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CONFIDENTIAL

STATEMENT OF CLAIM
UNDER THE ARBITRATION RULES
OF THE
UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW
AND
THE NORTH AMERICAN FREE TRADE AGREEMENT

BETWEEN:

UNITED PARCEL SERVICE OF AMERICA, INC. ("UPS")

Claimant/ Investor

- AND -

GOVERNMENT OF CANADA ("CANADA")

Respondent/ Party

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Pursuant to Article 18 of the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL) and Articles 1116 and 1120 of the North American Free Trade Agreement (NAFTA), the Claimant hereby submits its Statement of Claim.

A. NAMES AND ADDRESSES OF THE PARTIES

Claimant/ Investor	UNITED PARCEL SERVICE OF AMERICA, INC. 55 Glenlake Parkway N.E. Atlanta, Georgia 30328 USA
Respondent/ Party	GOVERNMENT OF CANADA Office of the Deputy Attorney General of Canada Justice Building 284 Wellington Street Ottawa, ON K1A OH8 CANADA

B. INTRODUCTION

This is a case about how the Government of Canada ("Canada") has provided its state-owned postal monopoly, the Canada Post Corporation ("Canada Post"), with special treatment and privileges it does not provide to its foreign-owned competitors in the courier industry. It is also about how Canada has failed to supervise Canada Post to prevent it from engaging in anti-competitive practices. Both of these actions by Canada are breaches of its international obligations under the NAFTA.

Canada has breached its national treatment obligations under NAFTA Chapter 11 by not providing the Investor or its Investments with the best treatment available to domestic courier operations in Canada. The best treatment in Canada for parcel importation and customs clearance services is being provided exclusively to Canada Post, not to the Investor or its Investment.

Under NAFTA Chapters 11 and 15, Canada is obligated to ensure that Canada Post does not abuse its privileged monopoly position by engaging in anti-competitive practices. Canada Post has abused this privileged position and Canada has failed to follow its NAFTA obligations by allowing Canada Post to do so.

Canada Post and the Investment, United Parcel Service Canada Ltd. ("UPS Canada") are direct competitors in the Canadian courier market. Canada Post has used its lettermail monopoly infrastructure, including its air and land transportation fleets, postal sorting and distribution facilities, retail postal outlets, network of mail storage containers and workforce of postal employees, to benefit its non-monopoly parcel and courier business. Canada is obligated under the NAFTA to ensure that such practices do not take place. The Investor and the Investment have suffered harm as a result of Canada's breach of its NAFTA Chapter 11 and 15 obligations. Canada is obligated to compensate the Investor for this harm.

Procedural History of Dispute

1. On January 19, 2000 United Parcel Service of America, Inc. ("UPS"), the Investor in this Claim, served upon Canada a Notice of Intent to Submit a Claim to Arbitration ("Notice of Intent") in accordance with Article 1119 of the NAFTA. The Notice of Intent was delivered to Canada by the Investor at least 90 days before the submission of this Claim.

2. This Claim is submitted less than three (3) years from the date the Investor first acquired, or should have first acquired, knowledge of the breach and knowledge that the Investor had incurred loss or damage, pursuant to Article 1116 of the NAFTA. Pursuant to Article 1120 of the NAFTA, the Investor submits this Claim on the basis that more than six (6) months have elapsed since the events giving rise to this Claim.

3. The Investor has fulfilled its obligations under Article 1118 of the NAFTA. Consultations between the parties were held on March 17, 2000 in Ottawa.

4. With the submission of this Claim on April 19, 2000, the Investor and the Investment have filed their waivers and the Investor has filed its consent to the extent required by NAFTA Article 1121(1).

Jurisdiction of this Tribunal

5. The Investor's Claim is within the jurisdiction of this Tribunal. The Claim meets the requirements set out in Section B of Chapter 11 of the NAFTA, including the application of the UNCITRAL Arbitration Rules as applicable, for seeking compensation from an Investor-State Dispute Settlement Tribunal for any harm caused by the breach of a Party's obligations under Section A of Chapter 11.

6. Sections A and B of NAFTA Chapter 11 contain the contract and the arbitration agreement between the disputing parties, pursuant to paragraph 1 of Article 18 of the UNCITRAL Arbitration Rules. A copy of NAFTA Chapters 11 and 15 are annexed to this Statement of Claim.

7. To bring a claim, a claimant must be an investor of a Party. The Investor, UPS, is a corporation incorporated under the laws of the State of Delaware in the United States of America. The Investor owns the Investment, United Parcel Service Canada Ltd. ("UPS

Canada"), a company organized under the laws of Ontario, Canada. UPS Canada provides courier delivery and associated services throughout Canada and with the Investor, worldwide. UPS Canada constitutes an "investment" as defined by NAFTA Article 1139.

8. The Investor has filed its Claim under NAFTA Article 1116(1) with respect to NAFTA Articles 1502(3) and 1503(2), with a Party to the NAFTA. Under NAFTA Chapter 15, the respondent must have designated or maintained a monopoly or state enterprise to which regulatory, administrative or other governmental authority is delegated. Canada Post is both a government monopoly and state enterprise maintained by Canada. Canada has delegated governmental authority to Canada Post with respect to its letter mail monopoly.

9. Under NAFTA Chapter 15, the respondent has the obligation to ensure that a government monopoly or state enterprise does not exercise its delegated authority in a manner that is inconsistent with other NAFTA obligations, in particular under NAFTA Chapter 11 and NAFTA Article 1502(3)(d). Accordingly, the actions of Canada Post which are inconsistent with the respondent's obligations under the NAFTA are subject to a claim under NAFTA Chapter 11 and NAFTA Chapter 15.

10. The Investor claims that Canada Post has used its delegated authority to act in a manner inconsistent with Canada's NAFTA obligations. Accordingly, if Canada has not fulfilled its obligation to control, supervise or apply other measures to ensure that Canada Post does not act inconsistently with Canada's NAFTA obligations, Canada will have breached its NAFTA obligations. The Investor claims as follows:

    (i) Canada Post is a government monopoly and state enterprise maintained by Canada.
    (ii) Canada has delegated governmental authority to Canada Post with respect to its letter mail monopoly.
    (iii) Canada Post has acted in a manner inconsistent with NAFTA Chapter 11, with respect to NAFTA Articles 1102 and 1105, and NAFTA Chapter 15.
    (iv) Canada has breached its NAFTA Chapters 11 and 15 obligations by failing to control and supervise Canada Post.
    (v) Canada has also breached its NAFTA Articles 1102 and 1105 obligations.
    (vi) The Investor has incurred damages by reason of, or arising out of, Canada's breaches of its NAFTA obligations.

C. SUMMARY OF NAFTA OBLIGATIONS BREACHED BY CANADA

11. The Investor claims that Canada has breached its NAFTA obligations under Section A of Chapters 11 and 15 of the NAFTA including, but not limited to, the following provisions:

    Article 1102 - National Treatment;
    Article 1105 - Treatment in Accordance with International Law;
    Article 1502(3)(a) - Regulation of Monopolies; and Monopolither
    Article 1503(2) - Regulation of State Enterprises.

12. The Investor alleges in its Notice of Intent to Submit a Claim and in this Statement of Claim that Canada has breached its NAFTA obligations contained in Section A of Chapter 11 and Articles 1503(2) and 1502(3)(a) of the NAFTA.

National Treatment

13. NAFTA Article 1102 sets out the NAFTA's national treatment obligation for investment. Under Article 1102(2) the investments of investors of other NAFTA Parties must be given the best in-jurisdiction treatment with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in like circumstances to the investments of Canadian investors. When read substantively, the national treatment obligation ensures that all investments in like circumstances whether domestic or foreign, are treated equally and without discrimination.

14. Canada Post and the Canadian Department of National Revenue entered into the *Postal Imports Agreement* on April 25, 1994. This Agreement outlines numerous specific areas of responsibility between Canada and Canada Post, which provides Canada Post with more favourable treatment in respect of customs matters than is accorded to like private sector courier companies such as the Investment. The existence of this Agreement was not made public by Canada, and the Investor therefore did not learn about it, and its losses arising from the execution of this Agreement, until 1999.

15. Canada has failed to provide national treatment to the Investor and its Investment regarding the importation of packages into Canada. These failures include, but are not limited to, the measures discussed in this Claim.

16. In addition, Canadian provincial governments, such as Ontario, have provided preferential treatment to Canada Post with respect to the payment of provincial taxes. This has resulted in a breach of national treatment obligations by Canada under NAFTA

Article 1102 since the Investor or its Investment have not been provided with treatment no less favourable than that provided to Canada Post.

Treatment in Accordance with International Law

17. NAFTA Article 1105 requires Canada to treat the Investment in accordance with international law, including fair and equitable treatment and full protection and security. Article 1105 requires NAFTA Parties to observe basic international legal norms, such as ensuring transparency and the observance of the international principle of good faith. It also requires NAFTA state Parties to ensure that NAFTA investors and investments are not subjected to unfair, discriminatory and otherwise inequitable treatment. One such example of inequitable treatment includes measures designed to specifically prejudice the interests of an investment, such as anti-competitive conduct.

18. Canada's failure to properly investigate and resolve allegations of anti-competitive behaviour by Canada Post, and its failure to make Canada Post's accounting records available for review by an impartial agency such as the Auditor General's Office, are examples of these breaches.

19. Canada has assisted Canada Post in camouflaging the real reason behind its anti-competitive and discriminatory practices. It has repeatedly refused to ensure that Canada Post complies with legitimate requests for information from supervising authorities, or even structure its accounting practices in such a way as to ensure transparency concerning its use of the monopoly infrastructure for non-monopoly business activities. These practices constitute a breach of Canada's obligation to function in a manner that is transparent, and free from discrimination or arbitrariness.

20. Thus, investments in Canadian parcel and courier businesses by US investors, such as UPS Canada, are not accorded treatment in accordance with international law as required by NAFTA Article 1105 and the Investor has suffered harm as a result of this breach of Canada's international treaty obligation.

Ensuring Designated Monopolies Act in Accordance with NAFTA Article 1502(3)(a)

21. NAFTA Article 1502(3)(a) requires Canada to ensure that a government monopoly does not act in a manner inconsistent with any of Canada's obligations under the NAFTA when it is exercising governmental authority delegated to it in connection with the monopoly service.

22. NAFTA Article 1505 defines "government monopoly" as "a monopoly that is owned, or controlled through ownership interests, by the federal government of a Party or by another such monopoly, "Monopoly" is defined as an entity "that in any relevant market in the territory of a Party is designated as the sole provider or purchaser of a

good or service". Canada Post is wholly owned by Canada and has been delegated the "sole and exclusive privilege" of operating letter mail collection and delivery service in Canada, under s. 14.1 of the *Canada Post Corporation Act* (Canada Post Act"). Accordingly, Canada Post constitutes a "government monopoly" for purposes of NAFTA Article 1502(3)(a).

23. For the purposes of NAFTA Article 1502(3)(a), any activity undertaken by the monopoly for which the government would be responsible if it were delivering the service designated for the monopoly to provide constitutes a delegation of government authority. This includes delegations made specifically through a legislative or regulatory instrument, such as s. 14.1 of the Canada Post Act, or an implicit delegation of authority (i.e. the authority to take actions necessary to provide the monopoly service designated for it to provide). Examples of this implicit authority include Canada Post's ability to manage its business, and to make purchases and expenditures as necessary to maintain the national postal infrastructure.

24. Under NAFTA Article 1502(3)(a), the primary issue is whether Canada has used regulatory control, administrative supervision or some other measure to ensure that a designated government monopoly does not exercise its delegated authority in a manner inconsistent with any other NAFTA provision. Evidence of Canada Post acting inconsistently with any provision of the NAFTA is therefore *prima facie* proof that Canada has failed to honour its obligations under NAFTA Article 1502(3)(a).

25. Under NAFTA Article 1116 an Investor must demonstrate, to seek compensation for Canada's failure to honour its obligations under NAFTA Article 1503(2)(a), that the monopoly has acted inconsistently with Canada's obligations under Section A of Chapter 11. NAFTA Article 1116 establishes a requirement that there be an underlying Part A of Chapter 11 breach before the remainder of a monopoly's behaviour can be examined with respect to breaches of other NAFTA obligations., NAFTA Article 1116(1) provides:

> *An investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under:*
>
> > *Section A or Article 1503(2) (State Enterprises), or*
> > *Article 1502(3)(a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A.*
> >
> > *and that the investor has incurred loss or damage by reason of, or arising out of, that breach.*

26. In this case, there is ample evidence that Canada Post has exercised the authority delegated to it to maintain a postal service in a manner that violates various NAFTA provisions. With its formal response to the Canada Post Mandate Review on April 23,

1997, Canada confirmed that it would not take the appropriate regulatory or administrative steps necessary to prevent Canada Post from continuing to take such action. Once it has been established that Canada Post has exercised its delegated authority in breach of a NAFTA Chapter 11 obligation, compensation may also be required for ways in which Canada Post's behaviour has also resulted in other breaches of the NAFTA.

27. Canada Post established and maintains a distribution infrastructure under government authority delegated to it in connection with its lettermail monopoly. This system includes, for example, air and land transportation fleets, postal sorting and distribution carriers, retail postal outlets, a network of mail storage containers and a workforce of postal carriers.

28. Canada Post provides full access to the benefits of this distribution system for its non-monopoly courier products. Access is not similarly provided to parcel and courier service investments of investors from other NAFTA Parties, such as UPS Canada. Under NAFTA Article 1102, UPS is entitled to receive the best treatment available in Canada with respect to the treatment of its investment. This treatment would include being provided with equal access to the postal distribution system currently provided exclusively to Xpresspost and Priority Courier by Canada Post.

29. For example, UPS customers cannot use letter mailboxes to send pre-paid packages as Xpresspost and Priority Courier customers can. UPS packages cannot be sent across Canada as part of domestic mail shipments, or delivered by letter carriers, as can Xpresspost or Priority Courier packages. UPS services cannot be purchased from Canada Post retail outlets, as can Xpresspost and Priority Courier products and services.

30. Other examples of Canada Post's acts that constitute a breach of Article 1102 include, but are not limited to those examples set out within this Claim relating to the use of monopoly infrastructure at Canada Post by non-monopoly competitive services and products.

31. In addition to constituting violations of NAFTA Article 1102 by Canada Post, these activities also constitute a breach of Canada's obligation to ensure that Canada Post does not engage in anti-competitive practices, under NAFTA Article 1502(3)(d). Such practices also constitute the kind of inequitable and discriminatory treatment that falls below the minimum standard of treatment required by NAFTA Article 1105.

32. The following actions by Canada Post are examples of the anti-competitive practices of the type prohibited under NAFTA Articles 1502(3)(d) and 1105:

(a) Subsidizing the development costs of its new e-commerce business with revenues earned from its letter mail monopoly.

(b) Pricing Xpresspost and Priority Courier services at predatory rates that are below the cost of providing such services as compared to other delivery products offered by private sector couriers in Canada.

33. Canada Post has also engaged in exercises of its delegated authority that violate the minimum standard of treatment in international law owed by Canada to UPS Canada. Canada Post's actions were arbitrarily imposed and designed to harm the businesses of its competitors in the private sector courier and parcel business, including UPS Canada.

Ensuring that state enterprises act in accordance with NAFTA Chapter 11 and NAFTA Article 1503(2).

34. NAFTA Article 1503(2) requires Canada to ensure that a state enterprise does not act in a manner inconsistent with Canada's obligations under Chapters 11 and 14 of the NAFTA when it is exercising any governmental authority delegated to it.

35. NAFTA Article 1505 defines "state enterprise" as "an enterprise owned, or controlled through ownership interests, by a Party". NAFTA Article 201(1) provides:

> *enterprise means any entity constituted or organized under applicable law, whether or not for profit, and whether privately-owned or governmentally-owned, including any corporation, trust, partnership, sole proprietorship, joint venture or other association.*

36. Canada Post is constituted under the Canada Post Act, and is wholly owned by Canada. Accordingly, Canada Post constitutes a "state enterprise" under NAFTA Article 1503(2).

37. For the purposes of NAFTA Article 1503(2), any activity undertaken by the state enterprise for which it was constituted represents a delegation of government authority to that state enterprise. It would be an activity undertaken by government if it were providing the service for which the state enterprise was constituted. This includes delegations made specifically through a legislative or regulatory instrument, such as section 12 of the Canada Post Act, or an implicit delegation of authority such as Canada Post's development and management of network of retail postal outlets.

38. Under NAFTA Article 1503(2), the primary issue is whether Canada has used regulatory control, administrative supervision or some other measure to ensure that a state enterprise does not exercise its delegated authority in a manner inconsistent with Chapters 11 or 14 of the NAFTA. Evidence of Canada Post acting inconsistently with any provision of Chapters 11 or 14 of the NAFTA is therefore *prima facie* proof that Canada has failed to honour its obligations under NAFTA Article 1503(2).

39. Canada is aware of the unfair and discriminatory activities that have taken place but it has established a practice of support for this behaviour, as described below in this Claim, that generates greater profits for its wholly-owned Crown Corporation and its business lines.

Harm to the Investor and the Investment

40. The courier and parcel services of Canada Post have benefited from special and preferential treatment from Canada Customs and Revenue Agency, which has provided special consideration to Canada Post. Canada does not provide such special privileges to Investments such as UPS Canada.

41. The NAFTA obligates its state Parties to supervise monopolies and to assure the fair treatment of investors and their investments. Under the NAFTA, Canada must ensure that Canada Post does not abuse its special position to engage in anti-competitive practices.

42. The special treatment provided to Canada Post's parcel and courier services is inconsistent with a number of Canada's NAFTA obligations, including:

i. The NAFTA obligation to ensure regulatory control and supervision over state enterprises (NAFTA Article 1503(2));

ii. The NAFTA prohibition against anti-competitive practices by a government monopoly (NAFTA Article 1502(3)(d) and 1502(3)(a));

iii. The national treatment obligations for investors and their investments (NAFTA Article 1102); and

iv. The obligation to treat investors and their investments consistently with international law (NAFTA Article 1105).

43. The Investor has been harmed, decreasing the value of the Investments, including UPS Internet Services, Inc., United Parcel Service, Inc (New York), United Parcel Service, Inc (Ohio), UPS Worldwide Forwarding, Inc, in the following ways:

i. Canada's breach of its NAFTA obligations has resulted in a significant loss of market share which has caused the Investor and the Investments to be less profitable;

ii. Canada's breach of its NAFTA obligations has resulted in the Investor and the Investments paying significantly higher costs than Canada Post and its subsidiaries. In some circumstances, these costs have resulted in the Investor and the Investments having to pass along cost increases to its customers, resulting in lost market share and decreased profitability;

iii. Canada's breach of its NAFTA obligations has resulted in Canada Post and its subsidiaries engaging in predatory pricing and other non-competitive activities which have hurt the market potential of the Investor and its Investments;

iv. Canada's breach of its NAFTA obligations has also resulted in the Investor and the Investments absorbing costs and expense, which have not been passed along to customers, reducing the profitability of the Investments and the Investor; and

v. Canada's breach of its NAFTA obligations has caused harm to intangible property of the Investor and the Investments, including goodwill.

44. Canada must compensate the Investor for these damages caused by its failure to act in a manner consistent with its NAFTA obligations.

D. BACKGROUND

The Operations of UPS Canada

45. UPS established its first operation outside of the United States in Ontario, Canada in 1975. UPS Canada is headquartered in Mississauga, Ontario overseeing 6,000 employees across Canada in 54 facilities. UPS Canada's delivery fleet includes 1,860 package cars, trailers, and tractors providing delivery service to every address in Canada, the US and more than 200 countries and territories worldwide. Over 40.2 million packages and documents were shipped by UPS Canada in 1998.[1]

46. UPS Canada is the third largest Canadian courier in terms of import express volume and delivers over 14% of Canada's express imports.[2] With respect to the domestic courier market in Canada, UPS Canada has a total market share of 7-8% in the small package and small package express markets, making it the third largest courier company operating in Canada, after Purolator Courier Ltd. and Canada Post.[3]

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1 "Oh Canada", *Inside UPS*, November/ December 1999, at 10.

2 "Oh Canada", *Inside UPS*, November/ December 1999, at 10.

3 Canada Post, Consolidation of Marketing Plans (1992) at 10, 19.

The Operations of Canada Post

47. Canada Post was established as a Crown Corporation on October 16, 1981 with the passage of the *Canada Post Corporation Act ("the Canada Post Act")*.[4] While Canada Post retains broad powers, it is "an agent of Her Majesty in right of Canada" for the purposes of the Canada Post Act.[5]

48. Under the Canada Post Act, Canada Post has been delegated the "exclusive privilege" (or monopoly) of collecting, transmitting and delivering letters in Canada.[6] Canada Post, subject to the approval of the Governor in Council (a committee of the federal Cabinet), also has the power to make regulations, *inter alia*, with respect to prescribing rates of postage and the definition of letters.[7]

49. Canada is entitled to delegate to Canada Post the authority to operate Canada□s postal monopoly under NAFTA and as a matter of international law.[8] Delegation can be understood to mean the transfer of governmental authority by means of an official act or undertaking. Under international law, a state is generally recognized as having the authority to control economic activity within its borders. Canada has delegated to Canada Post authority to run the postal monopoly under the Canada Post Act and Regulations.[9]

50. Accordingly, whenever Canada Post exercises its authority to maintain the postal service, it is exercising delegated government authority. As part of its monopoly, Canada delegated to Canada Post the authority to establish a postal distribution network comprised of air and ground transportation, post offices and a national system of sorting and transportation facilities.[10] Canada Post has been provided with the exclusive right in Canada to place its delivery boxes and red mail boxes throughout the public domain, including on any public roadway.[11]

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4 *Canada Post Corporation Act,* 1980-81-82-83, c. 54.

5 Canada Post Corporation Act, s.23.

6 Canada Post Corporation Act, s.14(1)

7 Canada Post Corporation Act, s.19(1)

8 This authority is clarified under NAFTA Article 1502(1), which states: "Nothing in this Agreement shall be construed to prevent a Party from designating a monopoly."

9 See section 14(1) of the Canada Post Act. For the purposes of NAFTA Article 1502(3), "delegation" is defined in NAFTA Note 45 as including "a legislative grant, and a government order, directive or other act transferring to the monopoly, or authorizing the exercise by the monopoly of, government authority".

10 See section 12 of the Canada Post Act whereby Canada has delegated authority to Canada Post to hire agents and employees to carry on its business.

11 See the *Mail Receptacles Regulations,* SOR/ 83-743 under the Canada Post Act.

51. In 1993, Canada Post acquired 75% of the shares of Canada's largest courier – Purolator. In late 1998, Canada Post increased its ownership of Purolator to 95.6 percent. Canada Post and Purolator combined have a total market share of about 47 percent compared to the Investment's 7-8 percent share.[12] Canada Post and Purolator's combined share of the small package delivery market in Canada is about four times as large as that of its next biggest rival.

52. Canada possesses extensive statutory authority to exert control over Canada Post. As a Crown Corporation, Canada Post is a creature of the federal government and is closely identified with the Government.[13] Postal policy is shaped by the Minister responsible for Canada Post in close consultation with the President of Canada Post.[14] Canada Post has increasingly been given extraordinary powers to regulate itself, which have resulted in the expansion of its monopoly and the deregulation of most of its products and services.

The Privileged Position of Canada Post

53. Canada Post has been provided with a privileged position by Canada that does not reflect the position of a private company. All of the privileges discussed here are examples of the benefits that Canada Post's non-monopoly courier products and services receive by virtue of the status that Canada Post has enjoyed as Canada's postal monopoly. Because of these privileges, Canada Post has been placed in an advantaged position to use its monopoly position to engage in anti-competitive practices to the detriment of competitor courier companies such as the Investment.

54. Examples of Canada Post's privileged monopoly position are contained throughout this Claim.[15]

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12 Canada Post, Consolidation of Marketing Plans (1992) at 18.

13 In the objects of the corporation under the Canada Post Act, at s. 5(1)(e), Canada Post is obliged to "maintain a corporate identity program approved by the Governor in Council that reflects the role of the Corporation as an institution of the Government of Canada."

14 See Professor Robert M. Campbell, *The Politics of the Post* (1994) at 358 (hereinafter "Campbell"). This book was written with the full cooperation of Canada Post: "Postal policy is shaped between the minister and the Canada Post president in a quiet way, behind the scenes, outside of the public and political spotlight."

15 Annex "B" provides additional items for the purpose only of explaining the complete context in which Canada Post operates in Canada.

The Canada Post Monopoly

55. In the late 1980's, Canada Post replaced the following traditional categories of mail with new names, which remain in use today:

i. "First class mail" is today called lettermail.[16] This is the most important source of postal revenue for Canada Post. As a result, the price of stamps or "rates" set for this class of mail is critical for Canada Post;

ii. "Publications mail" is today referred to as the mailing of newspapers and/or magazines. Canada Post's monopoly or "exclusive privilege" does not cover this class of mail;[17]

iii. "Third class mail" is today called "Admail" which includes unaddressed or addressed advertising materials. While unaddressed admail (often referred to as "junk mail") does not form part of Canada Post's monopoly service, Canada Post maintains that addressed admail under 500 grams in weight does form part of its exclusive privilege;

iv. "Fourth class mail" is today called Parcel Services through the mail. This class of mail is not part of Canada Post's monopoly service as long as the parcel weighs more than 500 grams.

56. Canada Post's annual financial reports set out that Canada Post serves four distinct markets, not all of which are actually part of its monopoly:

i. Communications - lettermail and hybrid lettermail (including e-commerce products);

ii. Advertising – admail (unaddressed and addressed);

iii. Physical Distribution - courier, expedited delivery and parcels;

iv. Publications - domestic and international newspapers.

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16 Canada Post has registered "Lettermail" as an official trademark which reflects its desire to maintain its exclusive privilege re "letters" within the communications market. Letter mail rates for some categories have been de-regulated and are established by the Corporation under contract.

17 World Trade Organisation, *Report of the Panel on Canada: Certain Measures Concerning Periodicals,* March 14, 1997, at para. 3.152.

57. Only first class mail (and perhaps addressed admail under 500 grams) comprises Canada Post's monopoly service. The remaining items (see above) represent services in which Canada Post is in direct competition with private sector companies.

58. It is apparent from Canada Post's annual financial reports that monopoly lettermail products and services are integrated with non-monopoly and e-commerce products and services and not accounted for separately. In addition, non-monopoly courier services are integrated with monopoly parcel services under 500 grams.[18]

59. Canada Post owns and operates the following non-monopoly services that compete with the Investor and the Investment under the following names:

i. Xpresspost;

ii. Priority Courier;

iii. Regular Parcel;

iv. Expedited Parcel; and

v. Skypak.[19]

60. Each of Xpresspost, Priority Courier, Regular Parcel and Expedited Parcel is not a separate company, but merely a product name utilized by Canada Post. In addition, Canada Post owns Purolator Courier Ltd., which competes directly with the Investor and the Investment in the parcel and courier business.

Canada Post and UPS Canada are Competitors in the Canadian Courier Industry

61. Canada Post, with its own courier products (Xpresspost and Priority Courier) and its ownership of Purolator, competes in 100 percent of UPS Canada's courier business; whereas UPS Canada competes in far less of Canada Post's business. UPS Canada and Canada Post's courier services and products compete in the same industry and for the same market. Both UPS and Canada Post offer a full range of similar parcel and courier services and products, whether for next business day, or for a second business day delivery.

62. Canada Post has admitted that it intends to be competitive with private sector courier companies, and that it is competitive with the products and services of those same companies.

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18 Canada Post Annual Report 1998-1999 at 42, para.16. Canada Post Annual Report 1997-98 at 42 para.15.

19 Under license with G.D. NET WORLDWIDE.

63. Further evidence that Canada Post believes it is directly competitive with private courier companies can be found in its Standard Dealership Agreement which sets out the legal relationship between Canada Post and its retail franchisees. In this Agreement, Canada Post admits that it is directly competitive with other courier products and services when it states in its non-competition clauses that Canada Post franchisees are prohibited from selling products which compete with Canada Post's own "courier or messenger services".[20] Canada Post's own marketing plans show that Canada Post considers itself to be in direct competition with other courier products and services, including the Investment.[21]

E. CANADA'S BREACH OF ITS NAFTA OBLIGATIONS

I. NATIONAL TREATMENT

64. This claim contains particular examples of the more favourable treatment provided by Canada to Canada Post than is provided to parcel and courier companies in like circumstances. These examples include:

(a) Special payments to Canada Post by Canada Customs;
(b) Preferential treatment and privileges afforded to Canada Post by Canada Customs;
(c) Unfair taxation practices; and
(d) Failing to provide UPS with treatment no less favourable than is provided to Skypak, Purolator, and Canada Post's own competitive products regarding access to Canada Post's monopoly network.

Points (a), (b) and (c) will now be dealt with in turn: Point (d) is referred to in Section III of this Claim.

CANADA CUSTOMS

65. Canada has provided preferential treatment to Canada Post when parcels are imported into Canada via the postal system. Canada has breached its national treatment obligations under NAFTA Chapter 11 by not providing the Investor or its Investment with treatment no less favourable than that provided to Canada Post.

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20 Canada Post, Standard Dealership Agreement, at para. 7.1(b) & 10.1 (non-competition clause).
21 Canada Post, Consolidation of Marketing Plans 1992 at 18.

66. The main source of this preferential treatment can be found in a secret contractual agreement between Canada Post and the Canadian Department of National Revenue (now the "Canada Customs and Revenue Agency") entered into on April 25, 1994 called the *Agreement Concerning Processing and Clearance of Postal Imports* (*"Postal Imports Agreement"*).[22] UPS only first acquired knowledge of the existence of this secret Agreement (but not of its contents) after it had requested confirmation that such a document existed through an official Access to Information request to Canada in 1999. The existence of this Agreement was not made public by Canada. UPS did not learn about it, and its losses arising from the preferential treatment provided under this Agreement, until it had received the Access to Information release and analyzed that Agreement with external experts in 1999. UPS then scrutinized the entire relationship between the Canada Customs and Revenue Agency and Canada Post and discovered additional items of concern (see below).

67. The *Postal Imports Agreement* outlines numerous specific areas of preferential and more favourable treatment provided by Canada to Canada Post in respect of customs clearance matters than it accords to like private sector courier competitors, such as the Investment.

68. The Canada Customs and Revenue Agency ("Canada Customs") – an agency of Canada - has three programs for processing parcels through Canada Customs: the mail program, the Courier/Low Value Shipments Program (LVS), and the regular cargo program. The mail program is used to process both mail and parcels that are presented to Customs by Canada Post for importation into Canada via the postal system. The current Courier/LVS program is used by UPS to import express parcels into Canada if they are valued at less than CDN $1,600.

69. Attached at Annex "A" is an excerpt from a recent study of the U.S. General Accounting Office (reviewed by Canada Customs), which compares the rules that apply to sending parcels into Canada via the mail process, and the courier process.

70. The reporting, accounting and payment obligations of both the mail program and the courier/LVS program have some similarities. However, the specific procedures apportioned between Canada Customs and Canada Post under the <u>mail program</u> convey

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22 Agreement Concerning Processing and Clearance of Postal Imports Between Canada Post Corporation and the Department of National Revenue, April 25, 1994. The Investor became aware of the existence of this Agreement in the late summer of 1999 and subsequently made an Access to Information Request pursuant to the Access to Information Act in that same year.

economic advantages to Canada Post that are not available to couriers such as UPS.

71. Notwithstanding that parcels sent via the post from outside Canada (which weigh more than 500 grams) are not part of Canada's monopoly service, such parcels are also handled in the mail program by Canada Customs.

72. The *Customs Act*[23] provides the applicable laws and regulations to which private express courier companies, such as UPS, must adhere. For example, importers must calculate duties and taxes owing, provide their own customs sufferance warehouses and pay fees for Canada Customs clearance services outside of regular business hours. Under the *Postal Imports Agreement*, the application of these obligations, amongst others under the Act, appear to have been waived for Canada Post in respect of its parcel importation businesses (but not for UPS Canada) and the Investor, resulting in unfair and discriminatory treatment.

73. The following are particular examples of the more favourable treatment provided by Canada to Canada Post than is provided to parcel and courier companies in competition with Canada Post.

Canada Customs Payments to Canada Post

74. Under the *Postal Imports Agreement,* Canada Customs makes a multi-million dollar, annual payment to Canada Post calculated on the basis of each package imported into Canada via the postal system. UPS, which competes with Canada Post in the business of importing packages into Canada, does not receive any such payments from Canada Customs.

75. The existence of this payment, from Canada Customs to Canada Post, has been kept secret from UPS. When Canada released a copy of the Postal Import Agreement to UPS pursuant to Access to Information, it deliberately deleted the portion of the Agreement that pertained to the secret payment. The official reason provided to UPS to justify the withholding of the relevant portion of the Agreement was that this was information "the disclosure of which could reasonably be expected to result in material financial loss or gain to, or could reasonably be expected to prejudice the competitive portion of, a third party (Canada Post)".[24]

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[23] *Customs Act,* R.S.C. 1985, c.C-52

[24] Section 20 (1)(c) *Access to Information Act* of Canada.

76. Of all the numerous companies that import packages into Canada, Canada Post is the only company competing in this business which receives such payment from Canada Customs. Therefore, while the disclosure of this secret payment might embarrass Canada Post and Canada Customs, it would certainly not "result in material financial loss" to Canada Post, or "prejudice the competitive position of Canada Post".

77. UPS has launched a formal appeal to the Access to Information Commissioner of Canada from Canada's refusal to disclose or release this document. To date, Canada continues to strenuously resist the release. Canada has instructed its civil servants employed at Canada Customs not to discuss the details of the payment with UPS.

78. Canada Customs suggests that it is paying Canada Post because the latter is assisting Canada Customs by providing certain data-entry services for packages imported into Canada via the postal system. This rational does not justify the payment. First, UPS also provides data-entry services when it imports packages into Canada. Yet Canada Customs does not pay UPS any similar payment, or at all.

79. Secondly, most of the work to enable the entry and assessment of Canadian import duties on packages sent into Canada via the mail is performed <u>for</u> Canada Post <u>by</u> Canada Customs officers who are permanently situated on Canada Post's premises. Therefore, it is ironic that Canada Customs is paying anything to Canada Post.[25]

80. In addition, if Canada Post withdrew the multi-million dollar payment, Canada Post employees would continue to provide the same data-entry services for free. This is because Canada Post has a day-to-day financial incentive to co-operate in every possible way with Canada Customs so as to ensure a speedy release of imported packages from Customs. UPS has the same incentive – that is why UPS provides similar data-entry and services, at no charge to Canada Customs. The difference is that UPS customers must pay for those services, while Canada Post customers do not.

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25 Canada Customs already allows Canada Post to retain for itself $5 fees that Canada Post collects from Canadian importers on packages where duties and taxes are assessed.

81. While UPS acknowledges the differences between the mail program pursuant to which Canada Post imports packages, and the courier program utilized by UPS, that does not in any way justify Canada Customs making multi-million dollar payments to Canada Post each year. [26]

82. Furthermore, Canada Post actually contracts out many of the "data-entry" services that it performs for Canada Customs. Since Canada Post can calculate the approximate amount of the payment that it will receive from Canada Customs each year, Canada Post can negotiate to pay a <u>lesser sum</u> to the firm with whom it actually contracts to do the work. This would allow Canada Post to "pocket" the difference.

Customs Staff and Facilities - Preferential services supplied to Canada Post only

83. The *Postal Imports Agreement* provides that Canada Customs staff and facilities are available on the premises of Canada Post on a permanent basis. Section 5 of the *Postal Imports Agreement* outlines the various areas of responsibilities of Canada Customs, which include all aspects of processing postal imports. That Agreement lists 14 separate duties that Canada Customs undertakes to perform for Canada Post. In effect, it is apparent from some of those duties on that list that Canada Customs is performing the functions of a customs broker for Canada Post by providing the appropriate tariff classification, origin of the value of the goods for duty purposes and amount of duties payable.[27]

84. Canada Customs and its staff do not provide such brokerage services for UPS. Rather, UPS Brokerage (or a separate private sector broker hired by the importer) provides such services, and charges the UPS customer accordingly. Canada Customs provides such services for free to Canada Post, so that Canada Post customers do not pay for the service. As a result, UPS is at a serious competitive disadvantage when it competes against Canada Post for the business of importing packages into Canada – a competitive disadvantage created by privileged treatment granted to Canada Post by Canada Customs.

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[26] Many of the Canada Post packages in question do not even form part of its monopoly services. Furthermore, UPS believes (but is not certain because Canada continues to withhold the details) that the formula (by which Canada Customs pays Canada Post) stipulates that the amount of the payment per package will <u>increase</u> if the volume of packages <u>decreases</u>. If it were true, as Canada Customs alleges, that it pays Canada Post for rendering data-entry "services", why would the amount of the payment per package increase when Canada Post processes fewer packages?

[27] See Section 5.1 of *Postal Imports Agreement*.

Preferential Treatment on Cost Recovery Fees

85. Canada Customs supplies Customs officers to Canada Post's major international mail sorting facilities in at least five cities in Canada. In particular, Canada Customs staff is provided to Canada Post during the evenings and weekends without any cost to Canada Post.[28]

86. In contrast, UPS has been obliged to sign service agreements with Canada Customs. During 1999, UPS paid $280,000 to Canada Customs as "cost recovery fees" for the relevant services. This increases UPS' costs of doing business in Canada as well as the price that UPS must charge to its customers. Canada Post, however, is not required to pay similar fees, or <u>any cost recovery fees</u>, to Canada Customs, thereby giving Canada Post better treatment than that provided to the Investment.

87. Canada Customs suggests that the reason UPS pays substantial "cost recovery fees" and Canada Post does not is because Canada Customs officers are provided to UPS Canada facilities (on an "as requested basis") during non-normal business hours, (eg. <u>before</u> 9:00 am, or <u>after</u> 5:00 pm). On the other hand, Canada Customs officers are permanently situated on the premises at Canada Post from 9:00 am to 5:00 pm – normal business hours.

88. In preparation for launching this NAFTA case, however, UPS has recently learned that in at least three of the five Canada Post facilities in question, Canada Customs officers work (a) from 9:00 am to 5:00 pm; <u>and</u> (b) a second shift of Canada Customs officers then comes in and works inside the Canada Post facilities from <u>5:00 pm until midnight</u>.

89. It is apparent that if UPS Canada requested the presence of Canada Customs officers from 5:00 pm until midnight, UPS would be charged "cost recovery" fees by Customs, calculated at $27 per hour for each Customs officer, plus mileage. The fact that Canada Customs is not charging any such fees whatsoever to Canada Post cannot be justified by the fact that Canada Post uses the mail program and UPS uses the courier program to import packages into Canada.

Duties and Taxes - Preferential Status re: payment, interest and penalties

90. The *Postal Imports Agreement* provides that Canada Post remains liable for all duties collected by it (from importers) on behalf of Canada Customs. The section dealing

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[28] Annex C2 of *Postal Imports Agreement*

specifically with these liabilities does not provide for any penalties or interest that must be paid by Canada Post in instances of late or non-payment. The Investment however is specifically obliged to pay interest and penalties on late remittances of duties and taxes.[29]

91. Although the Customs Act[30] stipulates that Canada Post will pay interest on late remittances of duties and taxes, there is no legal obligation on Canada Post to pay penalties for late remittances (as UPS is obliged to do by law). Therefore, Canada Post has no incentive to remit the funds on time. Furthermore, it is suspected that in practice, Canada Customs waives or fails to assess interest on late remittances by Canada Post, so that one agency of the Government (Canada Customs) is not charging interest to another "agency" (Crown Corporation).

Duties and Taxes - Failure to charge duties, taxes

92. Canada Customs has failed to ensure that its agent, Canada Post, actually charges any duties and taxes to Canadian importers on many packages, which are in fact dutiable or taxable. UPS is required to charge duty and taxes on each and every package imported into Canada where duties and taxes are payable.

93. Hundreds of thousands of packages imported into Canada via the postal system are in effect "dumped" on Customs officers who work at Canada Post facilities. There are far too few Customs officers present at these facilities to be able to assess the appropriate duties and taxes on all of these packages. As a result, packages are released from Customs as non taxable and non-dutiable when in fact the packages should have been assessed as dutiable and taxable.

94. In particular, UPS claims that Canada Customs and Canada Post are neglecting to charge multi-millions of dollars in Canadian customs duties and taxes on packages imported into Canada via the postal system. As a result, millions of dollars are slipping through the hands of the Canadian government each year, and the Canadian people are required to make up for these losses through the general taxation system. Furthermore, Canada Customs has shown no inclination whatsoever to remedy this serious situation.

95. By way of example, even if the goods imported into Canada are exempt from duties, Canada Post is still obliged by law to collect Canadian Goods and Services Tax

29 Customs Act of Canada
30 Section 147.1(8) of the Customs Act of Canada

("G.S.T.") – a 7% tax – on the Canadian dollar value of each such imported package. Canada Post is obliged by law to collect the G.S.T. from the person/company to whom Canada Post delivers in Canada, (if the sender valued the item at more than $20 Canadian). However, Canada Post is only collecting the G.S.T. from Canadian recipients on a sporadic basis. Canada has failed to enforce its G.S.T. collection laws against Canada Post. This is evident in part by the fact that the total amount of G.S.T. collected by Canada Post on the millions of packages (over $20) imported into Canada via the post, is far less than the volume of packages which exceeded $20.[31] As a result, Canada is losing millions of dollars in G.S.T. tax collection each year on packages imported into Canada via the postal system by businesses and individuals.

96. UPS Canada is obliged by that same law to collect the G.S.T. from Canadian recipients. UPS carries out its obligations in this regard. Isolated instances in which UPS has failed, or neglected to do so, or to calculate the G.S.T. correctly, have resulted in audits (and penalties) of UPS by Canada Customs and Revenue Agency – the same agency which has "turned a blind eye" towards Canada Post.[32]

97. As a result of this unjustified difference in treatment, UPS customers in Canada are charged the appropriate duties and taxes by UPS, whereas Canada Post customers are usually not.

Allowing Canada Post employees to support Customs officers' functions

98. Section 4.1 of the Postal Imports Agreement lists 17 separate duties that Canada Post employees will commit to perform to ensure that those imported packages clear Customs.

99. It is apparent from the list of 17 items that the *Postal Imports Agreement* has delegated to Canada Post employees some of the functions which Canada Customs officers and staff used to perform. For example, Canada Post employees are authorized to carry out initial screening so as to divert away from the inspection or scrutiny of the Canada Customs officers certain items that are then immediately released from the Customs

31 Canada Post charges a $5.00 fee to importers but only on packages where Canada Post collects duties or taxes. If one were to compare the number of times Canada Post charged its $5.00 fee, against the number of packages on which Canada Post should have collected the G.S.T. we would also find a large discrepancy

32 Effective June 1, 1999, Canada has agreed to collect the 8 percent Ontario provincial sales tax (P.S.T.) on non-commercial packages imported into Ontario. Once again, it is unlikely that Canada Post (and Canada Customs) are collecting this P.S.T. on all applicable imported packages sent into Ontario (and certain other provinces) via the postal system.

process, for delivery by Canada Post. In other words, for certain categories of items, Canada Post employees decide whether or not Customs officers will or will not see the item, or whether the item will be immediately released from Customs for delivery by Canada Post. This probably occurs because the relatively small number of the Canada Customs officers cannot possible cope on their own with the many thousands of items.

100. In fact, an internal Canada Post document helps illustrate the role played by Canada Post employees by referring to the place where this activity takes place as:

> *"The area at exchange offices (generally at the port of entry) where an initial segregation is made between non-dutiable and partially dutiable items before dispatch to destination or diversion to Customs."*[33]

101. It is highly improper for Canada Customs to have allowed Canada Post employees to play any such role because:

i. Canada Post employees have an incentive to push as many packages as possible through Customs, as quickly as possible. The pressure to do so intensifies, since Canada Post employees are confronted with hundreds of thousands of such packages. Therefore, those employees should not be given the task of deciding which items the Customs officers should or should not see;

ii. There are no monetary <u>penalties</u> applied by Canada Customs if Canada Post employees divert (from the Customs process) and release items that should have been dutiable and taxable;

iii. Canada Post employees are not qualified to serve as Customs officers; and

iv. There have been police complaints about how easy it is for drugs and other contraband to enter Canada in packages via the postal system.

102. The foregoing serves to illustrate only <u>one</u> of the reasons why Canada Customs and Canada Post are failing to collect the requisite duties and taxes on packages imported

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33 Definition of "Customs Primary Screening Center", from Canada Posts Terms of Reference document, (1998), at 12.

into Canada via the postal system. As a result of this non-arm's length arrangement between Customs officers and Canada Post employees under the Postal Imports Agreement, Customs officials are less stringent in their enforcement of Customs laws at Canada Post facilities, than at UPS facilities.

The $5.00 Handling Fee – Canada Post can retain it

103. On those occasions when it does decide to collect duties and taxes from the Canadian recipient of an imported package, the Customs Regulations [34]allows Customs to assess, and Canada Post to collect from the recipient, a $5.00 "handling fee".[35]

104. Canada Customs allows Canada Post to retain this fee each and every time it is collected. One of the apparent justifications is that this $5.00 per transaction compensates Canada Post for collecting the duties and taxes and remitting same to Canada Customs. In effect, Canada Post is being paid by Customs for collecting and remitting to Customs the duties and taxes collected from Canadians to which Canada Post delivers imported parcels.

105. In contrast, when UPS collects similar duties and taxes from its customers in Canada, and remits the money to Canada, Canada Customs makes no payment to UPS for so doing.

The $5.00 Handling Fee – regardless of value or complexity

106. The $5.00 "handling fee" does not change, regardless of the value or complexity of the clearance process for that particular package. In contrast, UPS must supply a broker and thereby incur significantly higher *ad valorem* or complexity-based costs.

107. By way of summary, (a) a multi-million dollar payment is made by Canada Customs to Canada Post each year, and (b) Canada Customs saves Canada Post from having to retain a full-service private sector customs broker. As a result, Canada Post can charge a lower fee of only $5.00[36] to the Canadian customer (importer) for a similar service to that offered by UPS to that same customer.

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[34] See Section 3 of the Fees in Respect of Mail Regulations, promulgated pursuant to subsection 147.1 (10) of the Customs Act.

[35] Priority Courier items are subject to an $8.00 handling fee

[36] The fee is only charged to a customer when Canada Post actually collects duties and taxes from the Canadian recipient of the package.

The $5.00 Handling Fee - Goods and Services Tax ("G.S.T.") on the $5.00 fee

108. Canada exempts Canada Post from charging Canadian consumers the Goods and Services Tax (G.S.T.) on the $5.00 handling fee, while requiring the collection of the same tax on all similar handling charges imposed by UPS.[37] The fact that this $5.00 item may represent a "Government service", does not justify the fact that Canada Post customers do not pay the G.S.T., while UPS customers are obliged to do so.

Storage of Packages

109. When the Canada Post letter carrier finally arrives at the door of the Canadian recipient, to deliver the package sent from outside of Canada, nobody may be home at the recipient's address. In such a case (and this is very common) the Canada Post letter carrier leaves a card at the residence to inform the intended recipient to pick up the package at the local Canada Post retail outlet in his/her neighborhood. The retail outlet will store the package for a few weeks, at which time the intended recipient usually appears, pays the duties and taxes, if any have been assessed, and picks up the package.

110. If a UPS driver arrived at the home of the same recipient in Canada and found nobody at home, he would usually make a second and third visit on successive days – at considerable expense to UPS. It is apparent that UPS does not have access to leaving its packages at the local Canada Post retail outlet, for pick up by recipient.

111. The Canada Post retail outlet is part of the monopoly network. However, it is being used, in the above example, to store packages that do not form part of the monopoly. The non-monopoly Parcel service of Canada Post does not pay storage charges to the retail outlet.

UPS pays significant monthly charges to communicate electronically with Canada Customs

112. Section 12 of the Postal Imports Agreement makes it clear that it is Canada Customs (not Canada Post) which is responsible to maintain and upgrade the "PICS" computer system through which Canada Post communicates to Canada Customs, regarding packages imported into Canada via the postal system. Section 17 of the Postal Imports Agreement states further that it is Canada Customs (not Canada Post) that must

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[37] Pursuant to paragraph one of Part X of Schedule VI of the Excise Tax Act of Canada, and subsection 165(2) of that Act, "a supply made by Canada Post Corporation of a service under an agreement made with the Minister under subsection 147.1(3) of the Customs Act" is zero-rated (taxed at 0 per cent) for G.S.T. purposes.

construct, at its own expense an electronic data interchange (EDI) between Canada Customs and Canada Post. This system is designed, among other things to permit Canada Post to transmit to Canada Customs information about the duties and taxes assessed against imported packages.

113. On the other hand, effective October 1999, Canada Customs has required UPS to pay the costs of installing and the costs of operating "CADEX lines" through which UPS reports to Canada Customs the duties and taxes collected.

114. According to the *Postal Imports Agreement*, Canada Customs pays for and takes responsibility for operating all computer and processing equipment situated on the premises of Canada Post. Canada Post is not required to pay for the use of such equipment. UPS Canada is obliged, however, to pay for the use of similar computer equipment by Canada Customs officers who visit its premises.[38]

Canada Post Not Required to Post Bonds

115. UPS Canada is required to post a Release Prior to Payment Bond for storage facilities under the *Customs Sufferance Warehouse Regulations*, pursuant to Section 19 of the *Customs Act*. In addition, UPS is obliged by law to post six additional bonds, namely:
   (i) Customs Broker License Bond
   (ii) Temporary Importation Bond
   (iii) Bonded Air Carrier Operations
   (iv) Bonded Freight Forwarder Operations
   (v) Bonded Highway Carrier
   (vi) Sufferance Warehouse Bonds

As a result UPS incurs bonding fees each year. Canada Post is exempt from any similar bonding obligations. [39]

CANADA POST IS EXEMPTED FROM PAYMENT OF TAXES

116. In 1994, Canada announced that, for the first time, Canada Post would begin to pay federal income tax. The Government's rationale was that: "Canada Post operates on a

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[38] *Postal Imports Agreement*, at para. 12.0, 16.0 and 17.0.

[39] See Annex "A" attached hereto, being the General Accounting Office Report, US Postal Service Competitive Concerns about Global Package Link Service, June 1998 at 99. Revenue Canada officials reviewed and commented on this Report by a letter dated May 4, 1998 at 125 of the GAO Report, also attached at Annex "A".

commercial basis and competes with the other service providers for a significant share of its revenues. Making Canada Post taxable will place the corporation on a more even footing with private-sector competitors"[40]. Notwithstanding the fact that Canada gave the impression that Canada Post would now be operating on an "even footing" with private-sector competitors, this was not at all the case in the taxation field. UPS did not ascertain that Canada Post was exempt from the various taxes referred to hereunder until preparations for this Statement of Claim.

Canada Post is exempt from paying normal commercial municipal real property taxes on land and buildings owned by it in every part of Canada

117. Realty taxes are levied by each city or municipality in Canada against the owner of each piece of vacant land, and against the owner of any building situated in the municipality in question.

118. Canadian courts have established the principle that neither the provinces nor the cities or municipalities may tax the federal government or federal Crown corporations such as Canada Post.[41] However, the Canadian government has passed the *Municipal Grants Act* (renamed in 1999 as the *Payments in Lieu of Taxes Act*)[42] which obliges federal Crown corporations such as Canada Post to negotiate a payment of real property taxation for each piece of land or building owned by Canada Post anywhere in Canada.

119. This does not mean that Canada Post actually pays the specific amount of realty taxes that each municipality assesses against Canada Post's lands and buildings each year. Rather, the amount of realty taxes actually paid by Canada Post is the sum negotiated between Canada Post and the municipality. The Province in which the property is located may also be involved with the municipality in those negotiations. The sum that is eventually agreed to in those negotiations will invariably be less the realty tax assessed by the municipality – otherwise, there would be no point in Canada Post agreeing to negotiate.

120. In the event, however, that the parties are unable to agree upon an appropriate amount of realty tax for the Canada Post building in question, none of the Canadian municipalities has the power (under the Constitution of Canada or the *Payments in Lieu of Taxes Act*) to compel Canada Post to pay the assessed value of the tax, or to levy any lien or other charge against the property owned by Canada Post.

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40 Government of Canada, Regulatory Impact Statement, Canada Gazette, June 2 1994.

41 See the *Constitution Act of Canada, 1982.*

42 See Bill C-10: Act to Amend the Municipal Grants Act (1999). Unlike UPS, Canada Post may also be exempt from paying business occupancy taxes in some provinces.

121. In contrast, UPS Canada owns land and buildings that are situated in various municipalities across Canada. Unlike Canada Post, UPS has no legal right or ability to negotiate with the municipality to pay a lower sum of realty taxes than the amount of tax assessed by the municipality. If UPS objects to the amount of realty taxes, it is obliged to file a formal objection and appeal, which is then determined in a quasi-judicial process by a body which is independent of both the municipality and UPS.

122. Canada Post is a major owner of real estate across Canada. As a result, the favourable treatment afforded Canada Post in the payment of realty taxes saves Canada Post millions of dollars each and every year. The precise amount of such savings must be calculated by comparing the amount of realty taxes actually paid by Canada Post in the year, against the amount of realty taxes assessed against each of the thousands of properties owned by Canada Post across Canada.

123. The Canadian government could have amended the *Payments in Lieu of Taxes Act* to require Canada Post to pay the precise amount of realty taxes assessed against each of the Corporation's properties (subject to the normal right of appeal to a quasi-judicial body). UPS had anticipated that the Canadian government might do so when Canada introduced amendments to that Act in 1999, but the Government's amendments (now enacted into law) failed to do so. The 1999 amendments did create, however, by adding a new section 11.1, an advisory panel of at least 2 members from each Province. The advisory panel is to give advice to the Minister of Public Works and Government Services of Canada in the event a municipality disagrees with the amount of payment. It is noteworthy that the Minister who will make the decision on the complaint from the municipality, is the same Minister who is responsible for Canada Post.

124. Pursuant to the Reciprocal Taxation Agreement signed between the Government of Canada and Government of Ontario, (in force January 1,1994 until December 31, 1999 – currently being re-negotiated), Canada agreed that federal Crown corporations such as Canada Post would pay certain provincial government taxes listed therein, such as the Retail Sales Tax of Ontario, Gasoline Tax, and so on. The Reciprocal Taxation Agreement signed by Canada with each of the Provinces of Quebec and British Columbia are to the same effect. Therefore it is open to Canada during current negotiations with those provinces towards a renewal of the Reciprocal Taxation Agreements, to add realty taxes to the list of taxes that Canada Post will pay in full.

125. This preferential treatment provided to Canada Post represents the best treatment of a competitor in the courier industry in Canada. The Investment has not been provided with treatment no less favourable than that provided to Canada Post. Accordingly, this treatment is a breach of Canada's NAFTA Article 1102 national treatment obligation.

Canada Post does not pay land transfer taxes

126. In the course of preparing to commence this claim under NAFTA, UPS ascertained that Canada Post is also exempt from paying any land transfer taxes to the Province of Ontario[43] (and presumably to the other Provinces as well). UPS enjoys no such exemption.

127. As a major buyer/seller of real estate throughout Canada, this exemption saves Canada Post a considerable amount of money. For example, the purchase of a building worth $10 million dollars (Can) in Ontario by UPS today would require UPS to pay $148,475 in land transfer taxes to the Province.[44] Canada Post would pay nothing at all in land transfer taxes on the same transaction.

Ontario and Quebec fail to collect from Canada Post and Purolator the Ontario and Quebec provincial sales tax on excess value insurance

128. If a courier shipment originates in either the province of Ontario or Quebec, the provincial sales tax laws of each of those two provinces require that the respective rate of provincial sales tax ("P.S.T.") be charged on insurance premiums. In Ontario the P.S.T. rate of tax is 8%. In Quebec the rate is 9%.

129. As a result, when UPS Canada sells excess value insurance to a shipper, UPS charges either the Quebec or Ontario P.S.T., on the premium paid to it by the shipper. Canada Post and Purolator do not do so.

130. Consider the following example: A shipper contracts with UPS Canada to send a valuable package from Ontario to Quebec, and agrees to pay UPS shipping charges of $12.00. The shipper decides to insure the package against loss or damage. He takes out $3000 of "excess value insurance' with UPS, for which he pays UPS the additional sum of $16.50 as a premium. UPS charges the shipper Ontario P.S.T. of $1.35 on the excess value insurance portion only, calculated as: $16.50 x 8% = <u>$1.35.</u>

131. If, however, the same shipper sent that package via Canada Post's Xpresspost courier or via Priority Courier, he could also purchase excess value insurance from Canada Post. However, neither Xpresspost nor Priority Courier charge the shipper any sum

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43 This result follows from subsection 2(8) of the Land Transfer Tax of Ontario, together with subsection 29(1) of the Interpretation Act of Ontario

44 Land transfer tax is charged on the purchase price of the real estate. The higher the price, the more land transfer tax is payable. Canada Post has made purchases that would be exempt from this tax in some of the provinces during the last 3 years.

whatsoever for P.S.T.

132. If the shipper chose to send the same package via Canada Post's Expedited Parcel or Regular Parcel service, he could also purchase the same insurance through Canada Post. Once again, Canada Post fails to charge the shipper with any P.S.T.

133. If the shipper chose to send the same package via Purolator, he could purchase the same insurance through Purolator. However, Purolator fails to charge the shipper with any P.S.T.

134. UPS Canada has only recently[45] discovered that Canada Post and Purolator are failing to charge customers any P.S.T. on excess value insurance. UPS does not know how many years this practice has been taking place, but it is suspected that the practice has continued for decades.

135. The consequences are that:

i. Canada Post and Purolator owe multi-millions of dollars in (uncollected) P.S.T.

ii. The Ontario and Quebec Ministries of Revenue have been deprived of multi-millions of dollars in P.S.T. which Canada Post and Purolator have declined to collect and remit.

iii. UPS customers (shippers) are at a small financial disadvantage to customers who choose to ship non-monopoly packages through either Canada Post or Purolator.

136. A recent search of the Canada Post and Purolator websites discloses that in calculating the total charges payable by the shipper:

i. Purolator uses a separate line that is labeled "insurance"; no P.S.T. is calculated thereon;

ii. Xpresspost uses a separate line that is labeled "insurance"; no P.S.T. is calculated thereon;

iii. Priority Courier uses a separate line that is labeled

[45] When UPS ascertained in 1999 that another private sector courier company was being audited by the Ontario Ministry of Revenue regarding failure to charge P.S.T. on excess value insurance, UPS examined the conduct of Canada Post and Purolator and discovered that they were also deficient. Subsection 2.1(1) of the Ontario Retail Sales Tax Act imposes the tax on premiums payable, inter alia, a person resident in Ontario who enters into a contract of insurance with an insurer. None of the exemptions set out in subsection 2.1(8) are applicable.

"insurance"; no P.S.T. is calculated thereon;

iv. A Canada Post document entitled "Distribution Services-Domestic Rates" (October 1998) sets out that "additional insurance" of up to $5000 is available for Expedited Parcel, Regular Parcel, as well as Xpresspost and Priority Courier; and

v. Even Canada Post's monopoly service known as registered mail, which allows the sender to take out insurance through Canada Post on the contents of the letter, provides a price for "each additional $100 of *insurance* requested by the sender up to a maximum of $900 additional *insurance*".[46]

137. Canada Post, as a federal Crown corporation, is not exempt on Canadian constitutional grounds from the legal obligation to <u>charge</u> its customers the appropriate rate of P.S.T. on excess value insurance.

138. The Ontario Ministry of Revenue has audited another large courier company for failure to collect the Ontario P.S.T. on excess value insurance, in the same circumstances. The Ontario Ministry of Revenue and Quebec Ministry have elected not to demand payment from, or to audit Canada Post and Purolator for failing to collect similar and substantial arrears of P.S.T. out of deference to the federal Crown corporation status of Canada Post.

139. As result of the failure of the Ministries of Revenue of Ontario and Quebec to act against either Canada Post or Purolator, preferential treatment has been provided to Canada Post with respect to the payment of these provincial taxes. This results in a breach of national treatment obligations by Canada under NAFTA Article 1102 since neither the Investor nor its Investment have been provided with treatment no less favourable than that provided to Canada Post.

II MINIMUM STANDARD OF TREATMENT

140. This Claim contains particular examples of practices through which Canada has failed to meet is obligations to provide treatment in accordance with international law to the Investment. These examples include some of the items provided in the national treatment section above and also include the following:

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[46] Special Services and Fees Regulations, CRC, c.1296, column one, item 5.

(a) Failure to enforce Canadian laws,
(b) Failure to provide transparency, and
(c) Failure to properly supervise monopoly operations of Canada Post

(a) Failure to Enforce Canadian Laws

141. Canada has failed to enforce its own laws with respect to the operations of Canada Post in order to assist Canada Post in its anti-competitive campaign against its competitors in the private sector parcel and courier business. These failures include, but are not limited to, the apparent waiver of a number of customs rules and regulations under the *Postal Imports Agreement* and other failures set out in Section I above.

(b) Failure to Provide Transparency

142. Canada has an obligation under international law and the NAFTA to provide transparency to the investments of investors from other NAFTA Parties. Examples of Canada's failure to provide transparency with respect to the practices of Canada Post are set out in Section III below.

(c) Failure to Properly Supervisor Monopoly Operations

143. Canada has an obligation under international law and the NAFTA to properly supervise the operations of its government monopoly, Canada Post. Examples of Canada's failure to properly supervise the monopoly operations of Canada Post are set out in Sections I and III.

III VIOLATIONS OF NAFTA CHAPTER 15

This Claim contains particular examples of practices through which Canada has failed to meet its obligations under NAFTA Chapter 15. These examples include:

(a) Anti-competitive practices and predatory pricing by Canada Post.

(b) Cross-subsidization through the use of Canada Post's monopoly network for the benefit of its competitive products, and for the benefit of Purolator

(c) Contractors and pensions – shielding Canada Post from unions.

(d) Failure to use Canada's statutory authority over Canada Post.

(e) Allowing Canada Post to expand its monopoly and deregulate its products and services.

(f) Failure to exert regulatory control over Canada Post.

An analysis of each of points (a) to (f) will now follow:

(a) Anti-competitive practices of Canada Post

Canada Post Mandate Review

144. Many of the anti-competitive practices of Canada Post have been clearly and specifically documented. In 1995 Canada appointed a one person commission as the Canada Post Mandate Review ("the Mandate Review"). The Mandate Review dealt with some, but not all, of the anti-competitive practices of Canada Post. The Mandate Review conducted extensive public hearings about the activities of Canada Post. The Mandate Review was completed and submitted its report to the Government of Canada on July 31, 1996. The report was not released publicly until October 8, 1996.

145. The Mandate Review concluded that Canada Post is an unregulated public sector monopoly engaged in unrestrained competition with the private sector. The Mandate Review arrived at this conclusion by relying on the following findings:

i. Canada Post's practices raise serious concerns of fairness and appropriateness.

ii. The corporation is not subject to any effective accountability mechanisms and lacks the necessary supervision to ensure that its actions are fully consistent with the public interest.[47]

iii. Canada Post has resisted repeated calls to adopt a satisfactory accounting system that identifies actual costs and revenues for specific products and continues to carry out its competitive activities on the basis of cost-accounting processes that lack transparency.

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[47] Canada Post Mandate Review, Chapter 1.

iv. Canada Post has developed a reputation as a "vicious competitor" whose predatory practices have led corporations to refrain from criticism for fear of retaliation.[48]

146. On April 23, 1997, more than five months after the submission of the report of the Mandate Review, the Canadian Minister Responsible for Canada Post, the Hon. Diane Marleau provided the Government's final response to the findings of the Mandate Review. The April 23, 1997 news release stated the following:

> *Today's announcement by Minister Marleau 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...*
>
> *At the time of the release [Canada Post Mandate Review], the Minister gave a partial response to the Mandate Review ...*
>
> *The Minister also announced that the government needed to study the full ramifications of the recommendations in the Mandate Review report before it decided how to respond. The government retained TD Securities Inc as financial advisors to assess the impact of the recommendations on Canada Post's ability to remain financially self sustaining. In addition the Minister held consultations with various stakeholder groups, to gain a more in-depth understanding of their perspectives.*
>
> *The decisions announced today complete the Canada Post Mandate Review Process.*[49] [Emphasis added]

147. Attached to the news release was a background document prepared by Canada. This document stated:

> *Today, the government is presenting its final response to the report of the independent review of the mandate.*
>
> *Both of these studies on the "Mandate Review" were considered by the government during its deliberations on the appropriate mandate and role of Canada Post.*
>
> *The government has now made its decisions.*

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48 Canada Post Mandate Review, at 3.

49 Public Works and Government Services: News Release Communique: "Marleau Outlines Plan for Canada Post" (April 23, 1997)

> *This announcement <u>completes the review</u> of the mandate of Canada Post, taking into account the independent review and the work of financial advisers.*[50]
>
> [Emphasis added]

148. Canada has subsequently summarised the above process as follows: *"In 1995, the Government commissioned an independent review of Canada Post Mandate which examined the financial and policy issues related to the future of the Corporation. In April 1997, the Government confirmed the commercial mandate and directed the Corporation to operate on a basis that would ensure efficient, effective and quality postal services to Canadians..."51*

Predatory Pricing of Canada Post's Competitive Products

149. Canada Post has priced[52] its competitive products, namely, Xpresspost, Priority Courier, Regular Parcel and Expedited Parcel services at rates that are often below the cost of providing such services as compared to other private sector couriers in Canada, such as UPS. For example, consider a comparison between the next day letter delivery services from Calgary to Winnipeg by express courier for UPS, Xpresspost, and other competitors such as Purolator and FedEx. UPS' tariff rate to deliver such a letter – next day (end of day) is $12.52[53], compared with the Xpresspost rate of $4.25. <u>If the letter were delivered on a number of different routes across Canada, the price disparity would be similar.</u>

150. The key question is why is there such a significant price discrepancy between the UPS rate of $12.52 and the Xpresspost rate of only $4.25 for the same route. There are several possible reasons:

   i. Is the UPS product comparable to the Xpresspost product? Both UPS and Xpresspost will deliver the same item from Calgary to Winnipeg by the end of the next day. While it is true that UPS will provide the shipper with a version of the signature of the person who signs for the package in Winnipeg, and Xpresspost does not, Xpresspost will provide the signature of the receiver for an

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50 Speaking Notes for Hon. Diane Marleau: The Canada Post Mandate Review: Conclusion (April 23, 1997)

51 Regulatory Impact Analysis statement, Government of Canada, Canada Gazette, (January 29, 2000), at 311.

52 "The pricing of Canada Post's competitive products and other lettermail services will continue to reflect the marketplace and the Corporation's competitive strength". Canada Post Corporate Plan 1999/2000 to 2003/2004, at 9.

53 UPS "Expedited" product

additional fee of $1.00. The other major difference is that while the UPS shipper can track the status of his package at any time during the day or night, Xpresspost will only provide the shipper with confirmation once the package has been delivered. Both services provide guarantees for on-time delivery.

ii. Is it possible that UPS is charging more than the market rate? While UPS charges $12.52, Purolator – 96% owned by Canada Post – charges $14.43 to deliver that same letter from Calgary to Winnipeg by next day (end of day). In addition, FedEx charges $12.93 for next day delivery (earlier in the day). The rates charged by UPS, Purolator, and FedEx can be presumed to include recovery of the full costs that these firms incur in getting the package from Calgary to Winnipeg, in addition to a very small profit margin. In effect the rates charged by those three large competitors indicate that the market for delivery of comparable letters from Calgary to Winnipeg is in the rage of $12.52 to $14.43. It is noteworthy that these three large competitors are charging almost three times as much as Xpresspost. How can this be possible when Canada Post's labor costs are greater than or equal to UPS? The prevalence of such predatory pricing practices led the Canada Post Mandate Review, commissioned by Canada, to state in its 1996 Report that Canada Post has developed a reputation as an over-aggressive indeed "vicious competitor"[54].

iii. Cross-subsidization – The main reason Xpresspost's prices to the customer are far below the market price is due to "cross-subsidization": the reliance by Xpresspost on Canada Post's extensive network for carrying letter mail across the country. The customer can place the Xpresspost envelope (prepaid) directly into one of the many thousands of Canada Post letter mailboxes, (or the package will be picked up by a postal vehicle if the customer has a commercial account.)

Next, an authorized contractor retained by Canada Post, or an employee of Canada Post, will pick up the Xpresspost package at the same time as he/she picks up the volume of mail contained in that red letter mailbox. Then a van owned by Canada Post's letter mail monopoly picks up the Xpresspost package, together with the letter mail contained in that red letter mailbox, and conveys it to one of Canada Post's designated letter mail sorting facilities, which contains a dedicated processing area for time-sensitive items (such as this Xpresspost item). At that point, the Xpresspost item is segregated, scanned and identified and processed for expedited handling. The item is then tracked using a

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54 Canada Post Mandate Review (1996), at 3.

sophisticated bar coded system developed by Canada Post for its courier products[55]. All of the above sortation services are rendered by unionized Canada Post employees – Xpresspost has no employees of its own. The large batches of Xpresspost envelopes are then placed in a dedicated area for loading onto a Canada Post van or vehicle, for transportation to the Calgary Airport.

The next step in the process is that the Xpresspost containers are removed from the van, and are placed aboard a commercial air cargo jet for transportation to Winnipeg. The bulk of the space reserved by Canada Post on that aircraft is utilized for letter mail containers – only a small portion is allocated to Xpresspost. Upon arrival in Winnipeg, the containers are offloaded, and placed by Canada Post employees onto Canada Post vehicles for transportation to a postal delivery facility in Winnipeg – at which both letter mail and Xpresspost products are to be sorted for eventual delivery.

At that Winnipeg postal facility, the unionized postal clerks employed by Canada Post (and not by Xpresspost) segregate the time-sensitive courier products (such as the Xpresspost letter) from the non-time-sensitive letter mail, in order to ensure its rapid delivery dispatch. A fleet of Canada Post owned trucks moves both letter mail and the Xpresspost envelope directly from the processing plant's dock to various postal stations located in residential neighborhoods near the point of delivery. The Xpresspost envelope is then delivered by a unionized postal employee – whose salary is paid for totally by the Canada Post letter mail monopoly (and not by Xpresspost).

151. The entire process described above would be monitored at Canada Post's National Control Center in Ottawa, and regional centers across Canada. The National Control Center is a massive center, with 14 employees staffing the Center each shift, and 20 video screens allowing employees to view and update information locations in 25 centers in Canada.[56] Canada Post has described the National Control Center as follows: *"In the console room, contemporary telecommunication technology is the key to operational control...the new N.C.C. features an interactive computer system and satellite tracking for monitoring contracted highway services. With an eye to ever-changing technology, the center has special electronic features designed for flexibility, as new technologies become available."*[57] It is no wonder that Canada Post boasts that

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55 The bar-coded system was later expanded to other non-monopoly postal products such as bulk unaddressed admail. (The individual letter may not be tracked; rather a shipment of Xpresspost letters is tracked).

56 Canada Post's Performance Magazine (Sept/Oct 1993) at 22

57 Ibid.

visitors are "awed by [its] Star-Trek appearance".[58]

152. However, the National Control Center is used by Canada Post on a daily basis to perform sophisticated tracking and tracing of lettermail shipments as well as non-monopoly shipment such as Priority Courier.[59] The scope of the monitoring includes air and land transportation schedule changes, weather conditions, and other factors that may affect delivery schedules. The substantial costs of operating the National Control Center (and the Canada Post headquarters itself) are not believed to be allocated to the non-monopoly segment of Canada Post's business.

153. The predatory conduct of Canada Post with respect to its courier products and services is a breach of Canada's obligation under NAFTA Article 1502(3)(a) and 1502(3)(d) to ensure that Canada Post does not engage in anti-competitive practices.

(b) Cross-subsidization through use of Canada Post's monopoly network

154. The Government of Canada has transferred a substantial infrastructure worth approximately 3.1 billion dollars to Canada Post that was established for the provision of basic postal services pursuant to the Canada Post Act. From the red letter mailboxes, to the mail trucks that empty the red letter boxes, to the sorting and distribution facilities, to the letter carrier who delivers Canada Post products to the customers' door, this infrastructure or network has been built up over the past 100 years to support the letter mail monopoly service. The price of each stamp is intended to continue to support that service.

155. This long-established infrastructure is Canada Post's biggest advantage over courier industry competitors, such as UPS Canada. Canada Post has used this advantage to provide an integrated service with its monopoly and non-monopoly products and services. This integration is an example of the leveraging of Canada Post's monopoly infrastructure for the benefit of non-monopoly products and services.[60] Canada Post is in effect attempting to defray the fixed costs of its lettermail monopoly network through its entry into non-monopoly (competitive services).[61] Xpresspost and Priority Courier enable Canada Post to spread some of the (high) fixed costs of processing lettermail,

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[58] Ibid, at 21.

[59] Campbell, at 268.

[60] See Annex D for a more in-depth discussion and analysis of Canada Post's cross-subsidization of its non-monopoly courier products and services.

[61] Canada Post Mandate Review, (1996) at 58

over greater volumes that include those courier products.

156. On July 24, 1999, Canada Post announced that it had signed an agreement to form an alliance between the U.S. Postal Service and Canada Post[62] to develop, among other things, "new products" for customers in North America. Canada Post subsequently announced[63] that in the year 2000 Canadians may be able to send Xpresspost packages from Canada to the U.S. Xpresspost had previously only been available for delivery within Canada.

157. If Canada Post proceeds with its plans to allow Canadian customers to deposit Xpresspost in the red letter mail boxes for delivery to the lucrative American market, it will be a further serious example of conduct which is inconsistent with Canada's NAFTA obligations: use of Canada Post's extensive network (built to support lettermail) to transport courier products (Xpresspost), in concert with the network of the U.S. Postal Service. In return, it is anticipated that a comparable U.S. Postal Service product will be given access to the Canadian market through Canada Post's existing network.

158. One can understand why the conclusions of the Canada Post Mandate Review are as valid today as they were when the Mandate Review stated that: the "corporation, [Canada Post] exists, ultimately, to deliver the mail, and yet its most visible preoccupations in recent years has been with the establishment and expansion of various competitive actives."[64]

159. Canada has failed to ensure that Canada Post acts in a manner consistent with the NAFTA by allowing it to engage in anti-competitive practices. The following are particular examples of Canada Post's NAFTA inconsistent anti-competitive acts that include, but are not limited to, the following:

Use of Red Mailboxes by Xpresspost and Priority Courier

160. The red Canada Post mailbox is a traditional symbol of Canada Post's letter mail monopoly business. Pursuant to the *Mail Receptacles Regulations*[65], "Canada Post may install, erect or relocate or cause to be installed, erected or relocated in any public place,

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62 Canada Post, Press Release "Postal Leaders Sign Pact – Canada Post and U.S. Post Service Form Stronger Alliance" (July 24, 1999)

63 Canada Post's Performance Magazine, (October 1999), at 23.

64 Canada Post Mandate Review, (1996), at 59

65 SOR 83-743, sections 3 and 4.

including a public roadway," any such mail boxes. The Regulations also stipulate that no person shall relocate or remove any such receptacles without prior authorization from Canada Post under penalty of law.

161. Pursuant to the authority of the above *Mail Receptacles Regulations*, Canada Post claims the right to place mailboxes on any street corner in Canada, regardless of the municipality, UPS has no such right with respect to its drop boxes. Canada Post declines to pay any fee whatsoever to any municipality for such privilege.

162. Recently, Canada Post has also promoted its extensive network of red letter mailboxes as an important feature for its non-monopoly courier services. Canada Post courier customers are permitted to deposit Xpresspost (and Priority Courier) packages into any of the thousands of Canada Post letter mailboxes located across Canada[66]. In fact most red letter mailboxes in Canada have a sticker affixed thereon announcing that Xpresspost packages may be deposited therein. The customers of all other private sector courier companies, such as UPS, are not permitted to deposit any of their courier packages into these mailboxes. There are at least four primary benefits to Canada Post by virtue of this arrangement:

i. Convenient access from multiple points -- the Canada Post courier customer does not have to telephone the courier company to come and pick up his or her package; nor does the customer have to wait for the courier company to arrive at his or her door. Rather, the customer can go to one of approximately 936,000 mailboxes[67] on various street corners across Canada (or at Canada Post retail outlets) and deposit his or her own Xpresspost package, <u>day</u> or <u>night</u>. A Canada Post document[68] summarizes this situation as follows:

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

ii. Eliminates billing – since customers are depositing prepaid Xpresspost envelopes into the red letter mailboxes, this eliminates the need for Canada Post to invoice the customers accordingly.

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66 It is less common for customers to deposit Priority Courier packages into the mailbox because the delivery guarantee may not apply.

67 Canada Post, Annual Report 1998-99, at 47.

68 Canada Post Performance Magazine, March-April 1997, at 27

iii. Cost-effective pickup – the use of the red letter mailboxes for deposit of Xpresspost packages belonging to many different customers eliminates the need for Canada Post to pick up Xpresspost packages at individual residences or locations across Canada.

iv. Ease of use – Canada Post can introduce Xpresspost products to new customers, without the need for formal contracts, by encouraging those customers to buy prepaid Xpresspost packages (at their local franchise outlet or Canada Post retail outlet). Those customers can then deposit those Xpresspost envelopes (as and when required) into any one of the thousands of letter mailboxes across Canada.

v. Free Advertising – Canada Post affixes Xpresspost adhesive advertising banners to the red lettermail boxes to increase its brand awareness. In effect, the mailbox – long identified as a bastion of lettermail – is now being used as an advertising beacon for Xpresspost courier products.

163. The huge cost of purchase, installation and maintenance of these thousands of letter mail boxes across Canada is being charged to the general operation category of letter mail. No portion of this cost has been allocated or paid for by either Xpresspost, Priority Courier, or the commercial parcel business of Canada Post.

164. The irony is that while non-monopoly services such as Xpresspost are entitled to deposit their product into the letter mailboxes, addressed admail (which does form part of the monopoly) cannot be deposited into these same mailboxes; and letter mail items paid by postage meter or postage imprint are not supposed to be deposited into the mailboxes.

165. This integration of non-monopoly and monopoly infrastructure, and the non-allocation of the costs to courier products and services, are examples of how Canada Post acts in a manner inconsistent with Canada's obligations under the NAFTA. In particular, Canada Post has used its monopoly position to engage in anti-competitive practices by cross-subsidizing its (non-monopoly) courier products.

Collection of Canada Post's Non-Monopoly Products

166. Contractors or persons employed directly by Canada Post collect Xpresspost, Priority Courier and/or Parcels from these letter mailboxes. The cost of the salaries of the people doing the collection work are paid for by the letter mail monopoly and are not allocated to Canada Post competitive services.

167. Canada Post offers pickup at the residence or business address of the customer who has a contract with Canada Post. This pickup is either complimentary, or the customer is charged a very nominal fee. The costs of this pickup service are charged to the general operating expenses of the letter mail monopoly, and not to any of the competitive services (i.e. Xpresspost or Priority Courier).

168. One of the major concerns of UPS is that the huge Canada Post letter mail vehicle fleet is being used to carry not only letter mail (which is its lawful right) but also Xpresspost and other non-monopoly Parcels. In this regard, the cost of acquisition of these vehicles, including maintenance, fuel, insurance, licensing, and depreciation, are all being charged to the general operating expenses of the letter mail monopoly- and not to the competitive products whom they serve. UPS is not aware that Canada Post has any vehicles solely designated to Xpresspost.[69]

Processing of Non-Monopoly Products

169. Common mail processing facilities are used to process non-monopoly parcels, (Expedited Parcel and Regular Parcel), Xpresspost and Priority Courier. For example, a large Canada Post facility located in Toronto known as "Gateway", serves as the primary hub in Canada Post's distribution supply chain. This is a 1.2 million square foot, 25 acre site, and processes 300,000 pieces of products each day. The problem is that many of these 300,000 pieces are comprised of monopoly product, such as addressed admail, together with non-monopoly products such Priority Courier, Xpresspost and publications.[70] Canada Post claims to have 23 "major processing plants" across Canada.[71]

Transportation by Ground or Air of Non-Monopoly Products

170. Canada Post transports Xpresspost, non-monopoly packages, and Priority Courier packages across Canada on aircraft and trucks that are chartered, owned or leased by Canada Post's letter mail monopoly. Canada Post claims to have a fleet of 6,000 vehicles for this purpose.

Delivery of Non-Monopoly Products

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69 Some vehicles may be assigned to Priority Courier on an exclusive basis depending on the matter.

70 Canada Association of Logistics Management "Supply Chain e-Merchants" May 28-30, 2000 Conference Brochure, at Page 5.

71 Canada Post, Corporate Plan (1995-96 to 1999-2000), Capital Budget, at 2

171. If the parcel or Xpresspost item does not exceeds the size and weight limit[72] (1.3 kg, in weight), and is available in time for delivery by the Canada Post letter carrier on his/her regular route, then it will be delivered by the letter courier. The salary of that letter courier is borne by letter mail monopoly, and not by Canada Post's competitive services. Otherwise, Canada Post sends out its own vehicle and a driver to make the delivery.[73]

Use of Canada Post's Retail Outlets for Non-Monopoly Products

172. Canada Post maintains 18,608[74] retail points of access, namely, retail stores and Canada Post outlets that are often located in pharmacies across Canada. These retail points of access are either owned by Canada Post, or are operated as franchises by the owner of the local pharmacy who can bring in additional new customers by devoting space in the pharmacy to selling Canada Post products. The retail outlets make it easier for Canada Post customers to send items from thousands of different locations across Canada. However, non-monopoly products such as commercial Parcels, Priority Courier and Xpresspost are also being sold from these retail outlets, together with Canada Post's letter mail monopoly products and services. The costs of operating these outlets are charged against the general operating costs of the letter mail business, and are not allocated to the individual competitive services. The training, staff salaries, purchase of buildings and maintenance of facilities, are all charged back to the general operations of the letter mail monopoly business. As such, competitive products such as Xpresspost and Priority Courier get a "free ride" when they are sold at these thousands of retail outlets across Canada.

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72 Governed by terms of Canada Post's Collective Agreement with its unions.

73 "Combining different operations under one roof was just the first step in realizing savings…routes were restructured to accommodate a mobile (often carrier system in which a driver teams up with one or two partners to deliver mail, relays, oversized Priority Courier items": Canada Post Performance Magazine (1997) at 20-21.

74 Canada Post 1998-99 Annual Report at 47.

173. Canada Post uses these retail outlets as a selling opportunity to "upsell" or upgrade the customer to purchase a more expensive category of its services. The retail outlets allow Canada Post to display and market to the public specialized containers for Xpresspost and Priority Courier.

174. Canada Post maintains a large number of franchises in pharmacies and other choice locations in many towns and cities across Canada. Each of these franchisees is obliged to sign a lengthy contract with Canada Post which stipulates that the franchisee is precluded from selling the courier products of any competitor of Canada Post[75]. As a result, UPS is precluded from contracting with any of the thousands of Canada Post franchisees for the sale of UPS' courier products from any of those prime franchisee locations across Canada. Under the terms of the franchise agreement, each franchisee is obligated to carry a full range of Canada Post's courier products such as Xpresspost and Priority Courier, as well as the letter mail monopoly products.

175. It is also evident that UPS products are denied access from being sold to the public in any of these Canada Post retail outlets.

176. UPS has opened very few retail outlets across Canada, because they are not always cost effective as stand alone sites. The Canada Post retail outlets might not be cost effective either, except for the fact that Canada Post can utilize its retail outlets to sell both courier products and letter mail products to the public. For example, a Canada Post vice-president had recently been quoted as stating: "...There are 7400 post offices (in Canada). The vast majority of them where the total amount of stamps being sold doesn't even come close to covering employee wages. But you can go to the post office to pick up a package if you missed its delivery at home. Try this with UPS: they have only one pick-up location in Montreal."[76]

177. Canada Post has announced that by July 2000 it will introduce its Purolator international product for sale in its thousands of retail outlets across Canada. This would constitute a blatant violation of Canada's NAFTA obligations

[75] "The [Canada Post] Dealership Agreement also provides that dealers are not entitled to sell services that compete with Canada Post services." This quotation is taken from clause 14 of Canada Post's lawsuit against Mail Boxes Etc. Communications Inc. (April 27, 1995), pursuant to which Canada Post sought to block Mail Boxes Etc. from engaging in such activities.

[76] English translation of article published in French in La Presse newspaper, February 29, 2000 entitled "E-commerce Messengers", quoting Alain Guilbert, Vice President of Communications for Canada Post.

Use of Retail Outlets for Service Canada Access Centers

178. In January 2000, Canada and Canada Post announced the launch of a new program that is opening "Service Canada Access Centers" in Canada Post retail outlets. Customers of Canada Post will be able to pick up government of Canada forms and information brochures at the postal outlet, or use the public computer located there to access the Government website. According to Canada Post president Andre Ouellet, "our objective is to turn our postal outlets into multi-service centers where Canadians can obtain government services, financial services and commercial services all based on the new technologies available to us."[77]

179. The postal outlets were established to sell Canada Posts monopoly products. The misuse of postal outlets for extraneous purposes is an example of the NAFTA inconsistent conduct of Canada Post.

Storage of Products at Retail Outlets

180. Canada Post utilizes its retail outlets for storage purposes in the following manner:

i. Those customers who purchase Canada Post's competitive products (*i.e.* Xpresspost, Priority Courier, Commercial Parcels) at the retail outlet can deposit those products right then and there, from which location Canada Post vehicles will pick up the product at the end of the day. In the interim, products are stored at the retail locations in a secure temperature controlled environment.

ii. When customers are not at home or at their offices to accept delivery of Xpresspost or Priority Courier packages, the Canada Post letter carrier or postal employee will leave a notice or "card" at their door informing the customer that the package can be picked up at the local Canada Post retail outlet in the customer's neighborhood. On the other hand, if the UPS customer is not at his home when the UPS driver arrives, UPS makes a second (and a third) delivery attempt the very next day or days. This is costly for UPS. UPS is prohibited from leaving its courier packages at the Canada Post retail outlet in the customer's neighborhood.

iii. Canada Post explains its advantage with respect to Priority Courier products as

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77 Canada Post press release "Official Opening of Service Canada Access Centers in Bouctouche Post Office" (January 20, 2000)

follows: "a private courier's weakness is residential delivery", Richard Saint Laurent [Quebec City account executive of Canada Post] explains, "when there is no one at home, they have to go back. Our delivery force and our infrastructure allows us to leave a card telling the customer the item can be picked up at the nearest postal outlet"[78].

181. As a result, Canada Post's competitive products have a distinct cost advantage over that of UPS, in that no second or third delivery attempt need be made. Rather, the Canada Post customer can travel to the designated Canada Post retail outlet to pick up his or her own package. This gives Canada Post another opportunity to sell its courier products to that same customer while he/she is in the store. Canada Post is also able to drastically reduce its cost of delivery in this manner.

Marketing and Selling Of Canada Post Products

182. Canada Post employs hundreds of sales representatives to promote and market its services – all of its services, monopoly and non-monopoly. One of the main objectives of this sales force is to entice large volume users with special bulk lettermail rates. However, these Canada Post sales representatives have the authority to negotiate all forms of contracts, including bulk letter mail contracts, and competitive (courier and parcel) service contracts. In some cases, Canada Post offers master contracts to the customer which includes the sale of all of its various products, both monopoly and non-monopoly. In this respect, the sales force is able to use the monopoly service as leverage in order to gain entry to the customer's premises and sell other courier products.

183. Where the total volume of business is expected to be large enough, the Canada Post sales person is authorized to introduce a business account contract, which will allow the customer to be invoiced for services rendered. The sales representative can also provide complementary computerized shipping systems to customers, to enable the customer to reduce costs by utilizing the Canada Post network.

184. The salaries paid to the Canada Post sales force, and commissions, are charged to general operating expenses of the letter mail monopoly – even though many of the sales generated by the sales force will benefit Canada Post's competitive services products more directly.

185. Canada Post also fails to properly allocate to its various non-monopoly services the costs

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78 Canada Post's Performance Magazine (May 1998), at 29

of hiring, training and equipping the sales force with vehicles for mileage reimbursement.

186. Canada Post has spent multi-millions to build a "learning center" to train its sales and operational staff. It is believed that the cost of this facility has been charged to general operating expenses of the letter mail monopoly.

Advertising and Promotion

187. Canada Post spends millions of dollars each year on advertising and promotion. A significant portion of Canada Post's advertising budget is directed against the products offered by UPS. These expenditures are allocated against general advertising revenues of the letter mail monopoly, and are not charged to Canada Post competitive products. In addition, many of the advertising brochures and print media utilized by Canada Post[79] advertise not only the services of its competitive products, but also its letter mail monopoly services in one brochure. There is no indication that Canada Post is correctly allocating the costs of this advertising to its competitive products.

188. Xpresspost advertising has also been recently affixed to the exterior of many of Canada Post's thousands of lettermail vehicles across Canada.

189. Canada Post uses its addressed admail monopoly service, as well as its unaddressed admail service, to promote its own competitive products – to the disadvantages of other companies like UPS. In particular, Canada Post's own fleet of letter carriers can deliver unaddressed admail brochures that promote to every Canadian household the benefits of Canada Post's <u>courier products.</u>

190. Canada Post uses its website to advertise both monopoly and non-monopoly services. Whereas the costs of operating, designing and maintaining this website is not believed to be allocated to its competitive products.

191. Canada Post has also developed a sizeable Media Relations Office, to track media coverage and intervene to neutralize negative or misleading coverage. Major Canada Post events will usually have an approved communications plan before they are pursued or released[80]. Canada Post also has a Business and Community Affairs office. This office, and the Media Relations office, provide services to both the monopoly as well as the non-monopoly segments of Canada Post – with no attribution of costs to the non-

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79 UPS has copies of numerous examples of such print media.

80 Campbell, at 266.

monopoly segments.

Corporate security and investigation services

192. Canada Post employs a large security force to protect the mail, and its other corporate resources, so as to ensure that losses are minimized. This extensive security force is available to support all postal products (including products in which Canada Post does not enjoy a monopoly) and is charged against general operating expenses.

Invoicing and Accounts Receivable Collection Service

193. Canada Post maintains one accounts receivable collection department. This department is responsible for collecting any accounts receivable due to Canada Post from bulk letter mail users, as well as accounts due from Xpresspost, Priority Courier and Commercial Parcel users. The costs of operating this accounts receivable collection department are charged to the general operating revenues of letter mail, and not to the competitive services for whom they collect unpaid revenues.

194. Canada Post lists its accounts receivable as totalling $346 million dollars[81] - an unexpectedly high figure for a lettermail monopoly. This suggests that a good portion of the $346 million has been incurred in its competitive activities. If the accounts receivable department is unable to collect monies due to one of Canada Post's competitive products, UPS has no evidence to indicate that the bad debt is written off against the revenues of the competitive product itself.

195. When Canada Post's accounts receivable department sends out demand letters to customers, to the effect that the customers owe money for Xpresspost or Priority Courier, Canada Post does not pay for the price of stamps. Rather, a Canada Post imprint is used on the thousands of demand letters; thereby saving substantial costs of mailing in the collection of receivables due from the sale of competitive products. In addition, Canada Post's Accounts Receivable department "process more than one million invoices a year."[82]

196. On the other hand, UPS' accounts receivable department incurs thousands of dollars in postage each year to mail out <u>invoices</u> and <u>demand letters</u> about overdue accounts.

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81 Canada Post, Annual Report (1998-99) at 36

82 Canada Post's Performance Magazine (December/January 1998) at 33

197. In the event that Purolator and Canada Post should merge their accounts receivable operation, Purolator would then get the benefit of such free postage (for which Purolator claims to currently pay about $3,000,000 per year to Canada Post).[83]

Misuse of Postal Meters

198. Canada Post has an estimated 150,000 postage meter customers who are authorized to use postal meters (instead of stamps) to pay for their postal shipments. These customers have been authorized by Canada Post to use postal meter imprints to pay for their Canada Post courier products such as Xpresspost, Priority Post and Regular Parcel and Expedited Parcel. On the other hand, UPS customers (many of whom own postal meters) are not permitted to use postal meter imprints to pay for their UPS courier products.

199. The advantages of this arrangement to Canada Post are:

- Immediate and full payment of the price of the courier and parcel service.
- Convenience of payment for the customer who already owns a postal meter.
- Allows the customer, who wishes to mail or ship courier parcels of different weights, to adjust postal meter and pay variable rates according to geographic pricing.
- Eliminates the need for Canada Post to invoice the customer for this service. Only Canada Post is authorized to enact regulations governing the postal meter business.
- Postal meter manufacturers (such as Pitney Bowes) supply advertising brochures to their customers that extol the virtues of using postal meters to send out Canada Post products such as Xpresspost and Priority Courier.

Canada Post's cost of capital and E-commerce business

200. Canada Post's own financial position would not enable it to qualify for prime lending rates on bank loans. In fact, 1988-89 was the first year that Canada Post had operated at a profit in thirty years. Yet Canada Post is able to borrow money from sophisticated private sector lending institutions at preferred rates[84] – even during recent years when Canada Post was incurring huge annual losses. Canada Post is even able to gain access to world capital markets. The reason is that since Canada Post's debt is ultimately a federal Government liability, Canada Post can borrow at preferential rates.

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83 Canada Post, Annual Report (1998-99), at 42

84 Canada Post borrowed $55 million, by way of non-redeemable bonds: Canada Post (1998-99) Annual Report, at.40.

201. In fact, section 31 of the Canada Post Act makes it abundantly clear to creditors that Canada provides financial backing to Canada Post.

202. Furthermore, sections 30 and 31 of the Canada Post Act authorize Canada Post to borrow up to $500 million dollars from the funds provided to Canada by Canadian taxpayers, "on such terms and conditions as are approved by the Governor in Council" (a Cabinet committee).

203. In effect, Canada has extended a $500 million line of credit to Canada Post on preferential terms.

204. As a result, Canada Post is able to finance and pursue its expansion plans and projects. These projects often include non-monopoly activities with which Canada Post competes with UPS, such as Xpresspost, Priority Courier, Regular Parcel and Expedited Parcel.

205. Effective November, 1993, a Canada Post subsidiary purchased a 75 percent ownership interest in P.C.L. Courier Holdings Inc. ("Purolator") for $55 million dollars, plus the assumption of Purolator's debt. The question is where did Canada Post, which was in the process of posting a $270 million dollar loss from its 1993-94 operations, obtain $55 million to complete the purchase of Purolator?

206. In late 1998, Canada Post paid additional millions to purchase a further 21.9 percent of Purolator. Once again the questions arises, where did Canada Post get the money? Was the money used to purchase Purolator (a non-monopoly service) taken from (or charged to) Canada Post's lettermail monopoly?[85]

207. In the fiscal year 1991-92, Canada Post paid $32 million to purchase an equity interest in GD Express Worldwide. This was the same fiscal year in which Canada Post recorded a large net loss of $128 million dollars from all of its operations. The question is, where did Canada Post find $32 million dollars to invest?

208. Throughout 1998, 1999 and 2000, Canada Post announced that it is entering the E-commerce business.[86] Once again, there is no shortage of competitors in this field. In particular Canada Post announced the launch of a "new global electronic courier service

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85 Furthermore, Canada Post is liable to pay out multi-millions of dollars to its female employees in a pay equity dispute. Where will Canada Post get the money?

86 See, for example, Canada Post press release "Canada Post Offers Free Trial to Demonstrate Security and Efficiency of Electronic Courier Service," (December 15, 1998).

known as Poste CS,"[87] that will enable customers to send <u>secure</u> transmission of documents via the Internet. The new product will apparently include document encryption technology, password protection, and track and trace features to enable to customer to ascertain if the document arrived at its destination.

209. It was no doubt extremely expensive for Canada Post to develop, launch and market the new Poste CS product. Once again, the question remains whether Canada Post obtained the capital to invest in this project from revenues generated by the lettermail monopoly. Poste CS competes directly with UPS' Document Exchange product. UPS can therefore estimate how costly it would have been for Canada Post to develop a competing product. UPS' Document Exchange program is owned by UPS Internet Services, Inc., a subsidiary of United Parcel Service of America, Inc.

210. In addition, in 1999 Canada Post launched its "E-Parcel" service. This enables merchants who are selling their products "on-line" to allow customers to select any one of Canada Post's competitive services (Xpresspost, Priority Courier, Expedited Parcel or Regular Parcel) to ship the purchased merchandise to the customer's residence. The E-parcel software shows the customer the price he/she will pay for delivery, including the number of days it will take to be delivered. In 1999, Canada Post also announced the launch of its "Electronic Post Office" – which allows customers to receive and pay bills electronically. Since Canada Post does not release the relevant accounting records, it is difficult to ascertain whether the development, launch and marketing of these E-commerce products were funded by the lettermail monopoly itself.

211. According to the Canada Post Mandate Review, Canada Post is "a Corporation carry[ing] out its competitive activities on the basis of cost-accounting processes that are neither publicly open, transparent, reliable nor in any way confidence – inspiring."[88]

212. In its 1999/2000 Corporate Plan, Canada Post has made it clear that it perceives its survival to rest on its ability to compete in the burgeoning electronic communications market. The Corporate Plan states:

> *The rapid progression of electronic means of communications, electronic commerce, and electronic banking are radically changing the competitive environment in which Canada Post operates...the impact of electronic substitution on Canada Post's business will be significant revenue loss by the end of the five-year planning period. Given the Corporation's largely fixed-cost*

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87 Ibid

88 Canada Post Mandate Review, (1996) at 22

> *structure, approximately three quarters of the revenue loss will flow through to the bottom line unless drastic cost-containment measures are implemented to mitigate the impact of electronic substitution.*[89]

213. Canada Post's approach to its survival as a commercial entity, while understandable for a non-government monopoly, does not accord with its statutory raison d'etre: to provide the monopoly service of lettermail delivery delegated to it by Canada. Because it perceives this exclusive privilege as nothing more than just another business line, and is not adequately supervised nor controlled by the government that delegated it these monopoly privileges, Canada Post fails to see the fundamental injustice in its using these powers to compete in non-monopoly areas. In short, Canada Post seems to have forgotten that it exists to deliver lettermail under a monopoly authority granted by Canada.

214. Nonetheless, Canada Post has stated that it "aims to be a major player in the fiercely competitive electronic communications market."[90] Canada Post has committed itself to "position itself to deploy electronic network services that will compliment and be integrated with its extensive physical network".[91] Canada Post further suggests in its new 1999 five- year action plan, under its second "guiding strategic priority", that:

> *Grow Competitive Business -Taking steps to generate more business in competitive sectors...the critical thrust is developing an e-commerce business that generates $400 million revenue annually within five years. Launching the Electronic Post Office is only the first step: deploying eParcel and promoting PosteCS are also important. For the retail network, the target is to generate 30 percent of retail sales from non-traditional products within five years.*[92]

Purolator Courier Ltd.

215. The purchase by Canada Post of 75% of the shares of Purolator Courier Ltd. from Onex Corporation, was described by the Canada Post Mandate Review as follows: "the Corporation (Canada Post) in effect nationalized Canada's largest private sector courier[93]". At that time the courier business was (and still is) highly competitive in Canada. According to Professor Gregory Sidak, there was no market failure in the courier business that necessitated Government involvement. There was no need for Government itself to provide courier services and thereby compete against private firms.[94]

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89 Canada Post Corporate Plan, at 3.

90 Ibid at 6.

91 Canada Post 1995-1996 to 1999-2000 Corporate Plan at 7.

92 Canada Post Performance magazine, (January 2000) at 19

93 Canada Post Mandate Review, (1996) at 36.

94 G. Sidak and D. Spulber, "Monopoly and the Mandate of Canada Post", 14 Yale Journal on

216. At the time of its purchase by Canada Post, Purolator was in serious financial difficulty, and its ability to finance its activities with sizeable bank loans was in doubt, without the personal guarantee of its parent corporation, Onex.

217. After the purchase by Canada Post, however, Purolator has had less difficulty in securing financing for its business from lending institutions, by reason of the fact that it can in effect borrow on the credit of Canada Post and of Canada itself.[95]

218. Under the ownership of Canada Post, it is apparent that Purolator has been able to expand its arsenal of expensive chartered aircraft and other facilities, notwithstanding that Purolator's net income and return on investment over the last five years has been dismal. The question remains as to how Purolator – operating in direct competition with UPS' courier business – could possibly have financed its business without the financial assistance of Canada Post. Today, Purolator claims to operate 44 aircraft, 3380 courier vehicles, and 810 highway trailers daily.[96]

219. In January 2000, Canada Post published its five strategic priorities as a part of its new five year action plan. This "new vision" statement was made by the Honourable Andre Ouellet, President, CEO and Chairman of the Board of Canada Post Corporation. Mr. Ouellet confirms that Canada Post is planning to use the massive buying power of Canada Post's monopoly infrastructure to benefit its subsidiary, Purolator.[97]

220. Specifically, this "new vision" includes the ongoing "Financial Transformation" and "Supply Advantage" programs which are designed to "capture savings by combining Canada Post and Purolator's purchasing clout". The stated objective is to "find procurement synergies with Purolator."[98]

221. In preparation for this NAFTA claim, UPS has also come across this statement from the 1994 Annual Report of Onex Corporation, which at that time still owned a piece of Purolator's equity: "Purolator and Canada Post are gradually developing synergies between their two systems. For example, Canada Post is using Purolator planes to airlift

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Regulation at 39,40.

95 Purolator's debt financing arrangements have not been provided to UPS.

96 See www.purolator.com/Routes/

97 Canada Post is seeking ways to reduce non-operating costs and plans to "get better mileage from the joint buying power between Canada Post and Purolator: "A Vision in Full Color", Performance Magazine, August/September 1999, at 3.

98 "Let's get Busy", Performance Magazine January 2000 at 15, 18 & 19.

Priority Post mail. This is expected to lead to productivity improvements at both companies".[99]

222. Canada Post claims to have paid Purolator $17 million for "air line haul" in 1999.[100] In other words, Purolator's aircraft (that were not full to capacity with Purolator's own courier packages) also carried Canada Post's lettermail containers. The Canada Post Mandate Review had this to say about such transactions:

> *"The difficulty is that, for instance, by using the same airline as Purolator for its lettermail shipments, Canada Post is causing the overall costs per piece of transporting both products to decline through volume discounts. The fact that the planes continue to be used primarily for Purolator packages, with Canada Post making up the remaining capacity, indicates that both volumes are necessary to obtain the lower costs per unit. Since Purolator could not have procured such discounts in any other manner, Purolator's costs are lower than they would otherwise be – as a direct result of Canada Post's exclusive privilege. To the extent that Purolator's competitors do not have access to the same volumes and resulting discounts, this constitutes unfair advantage."*[101]

223. UPS, a direct competitor of Purolator, does not have access to the same volumes of Canada Post's lettermail containers, because Canada Post does not allow UPS to bid for the cargo business.

224. There are other ominous signs that indicate that Purolator is using (or will soon be using) Canada Post's extensive lettermail network in a more extensive way. According to a Canada Post vice president, "Theoretically, Canada Post doesn't deliver Purolator packages, but we're doing some testing in rural areas. Our new collective agreement gives us more flexibility to experiment."[102]

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99 Onex Corporation Annual Report (1994), at 27.

100 Canada Post Annual Report (1998-99), at 42.

101 Canada Post Mandate Review, (1996), at 46-47.

102 English translation of article published in La Presse newspaper (Montreal), February 29, 2000, "E-commerce Messengers", quoting Canada Post's vice president of communication, Alain Guilbert.

Skypak

225. Canada Post has entered a commercial agreement with a company called Global Distribution Express ("GD Net") to market GD Net's international courier services under the "SkyPak" trademark in Canada. This agreement allows GD Net (a foreign-based corporation) exclusive access to the entire Canadian Post network for the sale, service, and distribution of its courier products.

226. As a result, if a person sends an item from Europe to Canada by courier via the European version of Skypak, for example, the package will be delivered to the Canadian recipient's address by Canada Post employees. This is clearly not part of Canada Post's monopoly service, but a business in which Canada Post competes with UPS. UPS operates in about 200 countries worldwide. UPS also competes for the business of delivering courier packages from Europe to Canada. Unlike GD Net, UPS does not have access to any portion of Canada Post's vast distribution and delivery network in Canada.

227. If a customer in Canada wishes to use Canada Post, and not UPS, to send an item by courier from Canada to the U.S. (or internationally), Canada Post's brochures announce that Skypak packages can be picked up, paid for and sent out:

> *"directly through the over 7000 Canada Post Retail Postal Outlets, or by calling 1-800-661-3434 for pick-up. You'll enjoy totally reliable delivery to over 200 countries worldwide, on time and on budget. We even deliver to a P.O. Box address in the U.S.A. We're so confident of our services, we guarantee on-time delivery to major cities in: USA, Europe, Asia Pacific or your money back"* [103]

228. The arrangement allows GD Net to unfairly market its "SkyPak" services which compete directly with UPS for the lucrative USA market and other global destinations. Furthermore GD Net is able to do so without capital investment in Canada.

229. Once Canada Post sold its equity in GD Net it was anticipated that this arrangement would cease. However, even after Canada Post sold its equity in GD Net in July 1996,[104] Canada Post continued the arrangement with GD Net and its Skypak product.

230. The exclusive access to the monopoly infrastructure provided by Canada Post to GD Net is an example of how Canada Post integrates courier products and services with its

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103 Canada Post brochure called "Skypak Delivering It All".

104 Since details of the sale of Canada Post's interest in GD Net did not appear until the public release of Canada Post's Annual Report (1996-97) in about May 1997, UPS would not have known of it prior to May 1997

monopoly lettermail network. Canada Post accordingly competes directly with similar international courier products of UPS in an unfair and anti-competitive manner which is inconsistent with Canada's NAFTA obligations.

Canada Post has recently announced, however, that:

> *"Commencing July 1, 2000, Canada Post intends to take advantage of this brand recognition by offering Purolator's delivered, time sensitive International Courier services through Canada Post's corporate and franchise outlets, as well as through the Commercial Sales force. The service will replace the existing Skypak"*[105]

231. In other words, when a customer walks into any of Canada Post's 7000 retail stores across Canada, the customer will now be able for the first time to purchase Purolator's international courier product for shipment to the US or overseas.

Anti-competitive practices on the sale of stamps

232. As a result of Canada Post's restrictive sales practices, companies such as Mail Boxes Etc. have been prohibited from selling stamps at various store-front locations, by sole reason of the fact they were also selling UPS courier and other competitor products. In fact, Canada Post sued Mail Boxes Etc. and blocked that firm for many years from selling stamps for this very reason.[106]

233. For similar reasons, UPS Canada is unable to sell stamps from its own retail outlets, because it competes directly with Canada Post courier products[107]. The standard Canada Post "Stamp Shop Contract" quoted by Canada Post in its lawsuit against Mail Boxes Etc., states: "It is a specific term of each such Stamp Shop Agreement that: (a) the stamp shop offer no special services competing with those of Canada Post, and (b) Canada Post is entitled to authorize the shop retailer."[108]

234. However, in the year 2000 Purolator has begun to sell stamps from its own retail outlets with the full authority of Canada Post. Canada Post has waived the normal rules in favour of Purolator, since Purolator is 96% owned by Canada Post.

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105 Canada Post Performance Magazine (February 2000), at 7.

106 This case was only recently settled in the year 2000.

107 Section 57 of the Canada Post Act provides that no person is entitled to sell postage stamps to the public without the consent of Canada Post.

108 Canada Post lawsuit, filed April 27, 1995, Federal Court of Canada file T-865-95

Apartment Mailboxes

235. Canada Post letter carriers have exclusive access to the locked mailboxes of those persons who reside in apartment buildings. If, however, an apartment dweller receives an Xpresspost, Priority Courier or small parcel delivery, in which proof of signature is not required, the Canada Post letter carrier is authorized by law to use a key to open the locked mailbox of the recipient in that apartment building, and put the package therein. If, however, UPS is delivering to an apartment building the UPS driver is prohibited from gaining access to the locked mailboxes of any of the apartment dwellers.[109]

236. Canada Post uses its exclusive control over apartment mailbox keys to achieve a sales/service advantage over competitors.

P.O. Boxes

237. Thousands of Canadians rent "P.O. boxes" at Canada Post retail or franchise locations across Canada. Canada Post employees, delivering non-monopoly products such as Xpresspost, Priority Courier and small packages, have exclusive access to deliver packages into these P. O. boxes. UPS drivers have no such access. Therefore, UPS has no choice but to prohibit its shippers from designating a P. O. box as an address; whereas it is believed that Canada Post courier products can be addressed to a P. O. box for these reasons as above.

Community Mailboxes ("Super Mailboxes")

238. These community mailboxes ("super mailboxes") are situated in newly constructed residential areas. There are 1.5 million addresses in Canada served by these community mailboxes.[110] In other words, Canada Post will not deliver mail to the front door of each such household. Rather, common community mailboxes have been built at central locations in the neighborhood, where residents are required to pick up their own mail by using a key to unlock their own locked box. Canada Post has specifically designed and installed these community mailboxes to accommodate small packages. However, only Canada Post employees have the key to open these locked boxes – UPS drivers do not. The design, expansion and maintenance of the super mailboxes are covered under the capital budgets and general operating expenses of the Corporation, and are not allocated to any particular service.

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109 See court decision of Justice Cullen, Federal Court of Canada, June 1995, file T-2075-93

110 Canada Post, Corporate Plan (1995-96 to 1999-2000), Capital Budget at 2

"Collect on Delivery" Service

239. The Xpresspost, Priority Courier and Canada Post's Parcel businesses offer a "collect on delivery" (COD) service. In other words, the Canada Post employee will only deliver the package to the recipient in return for payment for the goods at the same time. UPS has a COD service that competes with Canada Post's service. Canada Post has recently announced that in order to expedite payment to the shipper, all monies collected from the recipient may be sent back to the shipper by way of Priority Courier, rather than ordinary mail. Therefore, Canada Post's COD service is being used as a hybrid service of sorts to cross promote its courier products.

(c) Contractors and Pensions

Canada shields Canada Post from attempts to unionize Canadian rural postal route contractors

240. Both UPS and Canada Post are subject to federal legislation called the Canada Labor Code. That Code permits any non-management "employees" of UPS (or Canada Post) to be represented by a union and to bargain collectively if the majority of the employees in a particular bargaining unit wish to have the trade union represent them as their bargaining agent.[111] The word "employee" is defined in the Canada Labor Code, section 3(1) to include "dependant contractors", which would include the thousands of persons who work for Canada Post as rural route contractors.

241. However, the legislation enacted by Canada prohibits any such rural route contractors from forming a union in order to bargain collectively with Canada Post. Canada Post had strenuously and successfully resisted previous court challenges brought by these contractors to the enforceability of this prohibition. It was apparent that Canada Post could not continue its current practice of paying very low wages to those contractors if they were represented by a union.[112]

242. As a result, Canada Post currently has the ability (which it exercises) to dictate to the rural route contractors very low wages and commissions for the important delivery services that the contractors provide in rural communities across Canada. These rural

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111 Section 28, Canada Labour Code.

112 Canada Post did allow the Canadian Union of Postal Workers (CUPW) to bargain on behalf of the 10,000 person independent unaddressed admail workforce prior to their termination in 1997. Why the difference in treatment for the rural route contractors?

route contractors also deliver parcels, Xpresspost and Priority Courier, which are not part of the monopoly.

243. As a result of the reluctance of Canadian courts to overturn (on human rights grounds or otherwise) the prohibition against collective bargaining enacted by Canada with respect to the rural route contractors, labor groups in the US have had the US National Administrative Office review this issue pursuant to the North American Agreement on Labor Cooperation – a NAFTA side accord. UPS had awaited the results of that decision.

244. In February 1999 the U.S. National Administrative Office decided not to review the provision of the law of Canada which excludes Canada Post's rural route contractors as employees eligible to bargain collectively.

Canada Post's employees are part of the Government of Canada's pension plan

245. Canada Post employees are covered by the Public Service Superannuation Plan administered by Canada. The thousands of employees who work for Canada Post contribute from their regular pay cheques to that pension plan, as does Canada Post itself.

246. This pension plan is intended to cover virtually all of the federal civil servants that are employed by the Government of Canada. Canada Post employees are not civil servants. UPS has recently learned that other comparable large federal Crown corporations such as Canada Mortgage and Housing Corporation, Canadian Broadcasting Corporation, Business Development Bank of Canada, and Air Canada (while it was a Crown corporation) are obliged to operate their own employee pension plans, and do not come under the umbrella of Canada's civil servant pension plan.

247. Ordinarily, a large employer such as Canada Post would be liable under its employee pension plan for any actuarial deficiencies (including any unfunded pension liabilities) that might occur in the plan (just as UPS Canada is). However, the legislation enacted by Canada, expressly protected Canada Post from any such deficiencies or liabilities.

248. Although Canada Post's employees contribute about 1% of their salaries to obtain a generous inflation indexation provision in the pension (plus a further 7½ % of salary to the pension plan), the legislation enacted by Canada stipulates that Canada Post is not required to match the employees' indexation contributions to the pension plan. In fact, the legislation exempts Canada Post from making any indexation payments to the pension plan at all.

249. As a result of the above arrangement between Canada and Canada Post, UPS believes (but does not know for sure because the details are not shared with UPS) that Canada provides services to Canada Post that may include:

i. Record keeping for the 50,000 current Canada Post employees who are part of the pension plan, as well as for the thousands of Canada Post pensioners;

ii. Recording the relevant data (*i.e.*, starting salary, changes in salary, birth date, etc.) for each new Canada Post employee who joins the plan;

iii. Calculating retirement and death benefits payable under the plan;

iv. Providing the sophisticated actuarial calculations required to administer the pension plan; and

v. Issuing the thousands of pension cheques each month to Canada Post retirees.

250. In addition, UPS has recently learned in preparing for this Statement of Claim that Canada expressly prohibits the powerful unions (who represent thousands of Canada Post employees) from negotiating with Canada Post or with Canada about any of the terms of the pension plan. As a result, none of Canada Post's unions are permitted by law to bargain with Canada Post for higher benefits under the pension plan. <u>The pension plan is a non-negotiable item.</u> Therefore, these unions cannot call a labor strike if benefits under the pension plan have not been improved to the satisfaction of their members. In contrast, UPS Canada must bargain collectively with its union (Teamsters) about the terms of the UPS employees pension plan each time UPS' collective agreement is due for renewal; and the union has the ability to call a strike against UPS as a result of the pension plan.

251. In 1999, Canada amended its relevant legislation: see Bill C-78, assented to September 14, 1999. This new legislation obliges Canada Post to exit the government of Canada's pension plan, and to establish its own employee pension plans by October 1, 2000.

252. Section 46.3(7) of Bill C-78 stipulates that the current Government of Canada pension plan that covers Canada Post' employees cannot be the subject of collective bargaining by Canada Post's unions until at least October 1, 2000 – the latest date the new Canada Post plans come into effect.

253. The introduction of Bill C-78 gave Canada an opportunity to eliminate (for the first time) the legal provisions that made the terms and benefits of the new Canada Post pension

plans non-negotiable items for Canada Post's unions. However, section 46.5 of Bill C-78 provides that the terms of the new Canada Post pension plans and group life insurance plans "shall not be the subject of collective bargaining – and shall not be modified by a bargaining agent with the meaning of Part 1 of the Canada Labour Code – for any period that ends before October 1, 2001".

254. Therefore, notwithstanding that the new Canada Post pension plans must be in place by no later than October 1, 2000, Canada has chosen to extend Canada Post's protection for at least another full year, if not more, from having to negotiate the terms of its own employees' pension plans and group life insurance plan with the Canada Post unions.

255. The new Bill also provides in section 46.4(6) that Canada shall transfer funds or assets into Canada Post's new employee pension plans, in accordance with any regulations made. There exists the potential for Canada to transfer funds or assets to which Canada Post is not entitled from an actuarial point of view, so as to a further benefit Canada Post's cost of labor.[113]

256. The fact that Canada has provided all of the above services, and legislative protections to Canada Post (which Canada does not provide to UPS) constitutes a substantial and important benefit to those monopoly employees engaged in providing services related to non-monopoly courier products and services. In particular, this is of direct benefit to Xpresspost, Priority Courier, and the parcel business which utilize the services of some of these same employees.

(d) Canada possesses significant statutory authority over Canada Post

257. Canada possesses extensive statutory authority to exert control over Canada Post. Despite this potential for Canada to supervise or exercise control over Canada Post, it appears that Canada has no interest in doing so. Accordingly, Canada's failure to ensure that Canada Post acts in a manner consistent with the NAFTA is not because of a lack of authority.

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113 The regulations that would govern this procedure do not yet appear to have been promulgated.

258. The ability of Parliament to supervise, receive information from, and to influence policy over Canada Post has been severely diminished in recent years.[114] In fact, Canada Post has increasingly been given by Canada extraordinary powers to regulate itself, which have resulted in the expansion of its monopoly and the deregulation of most of its products and services.

259. Canada nonetheless still possesses the following extensive powers to control the activities of Canada Post, if it so chooses:

(A) Senior Management and Directors

- To appoint and remove the chairman of the board of Canada Post: (section 7 of the Canada Post Act);
- To appoint and remove the president of Canada Post: (section 8 of the Canada Post Act);[115]
- To determine the salary of the president as well as the chairman of the board of Canada Post (sections 7(2) and 8(2) of the Canada Post Act);
- To appoint and remove each one of the 11 member Canada Post board of directors (section 6 of the Canada Post Act);
- To fix the fees paid to the members of the Canada Post board of directors (section 6(5) of the Canada Post Act);
- To approve the names of the vice-presidents appointed by the Board of Canada Post;

(B) Policy and Practices Control

- To approve or reject Canada Post's requests for changes to regulations that govern Canada Post's business (section 20 of the Canada Post Act);
- To issue directives that must be complied with by Canada Post "in the exercise of its powers and the performance of its duties" (section 22 of the Canada Post Act).[116] This

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114 See Campbell at 307-310: The Canada Post Act does not give the Parliament of Canada any direct role in postal pricing or changes to postal regulations. Reviews conducted periodically by committees of the House of Commons on Canada Post reports or financial statements have become unimportant and ineffective. The government has diminished Parliament's role in influencing postal policy. Currently, the minister's office sends calls and letters from Members of Parliament regarding Canada Post, directly to Canada Post so that its own Government Relations Branch may handle the problems.

115 It is noteworthy, that the Board of Governors at the US Postal Service hires and fires the Postmaster General. In contrast, only the Canadian Government has the authority to hire and fire the President, Chairman of the Board and each of the members of the Canada Post Board.

116 The Canadian government has acknowledged that: "Section 22 of the Canada Post Act provides that

authority could be used by Canada to subject Canada Post to its direct supervision and/ or control; and

- The government determines which types of mail in Canada must be delivered by Canada Post free of charge (section 36 of the Canada Post Act).

(C) Financial Control

- To reimburse Canada Post from public funds the amount of any deficit or financial loss sustained by Canada Post in each fiscal year (section 22(3) of the Canada Post Act). The government has paid for Canada Post's annual deficits for decades. In fact, the 1988-89 fiscal year was the first time that Canada Post did not seek appropriations from the government;
- The government is the sole shareholder of Canada Post (section 27.1(4) of the Canada Post Act);
- The government may lend money to Canada Post on such terms and conditions as are approved by Cabinet, which sums shall not exceed an aggregate of $500 million dollars (section 29 of the Canada Post Act); and
- The government appoints the auditors of Canada Post (section 33 of the Canada Post Act); The government has the power to determine the fiscal year end of Canada Post (section 34 of the Canada Post Act).

260. In addition, Canada's powers with respect to Canada Post increased in 1984 when amendments to the *Financial Administration Act of Canada* were passed. Most of these provisions apply to all Crown Corporations, including Canada Post.

261. As a result, Canada Post is currently obliged to:

i. Seek Federal Cabinet approval for the sale or purchase of subsidiaries;

ii. Submit an annual report to Parliament;

iii. Seek annual approval of capital budgets from a Canadian Government Cabinet body, the Treasury Board;

Canada Post is required to comply with directions issued by the Minister responsible for the corporation. That gives the Minister powers analogous to those exercisable by shareholders of other privately held corporations through unanimous shareholders agreements" World Trade Organization, *Report of the Panel on Canada: Certain Measures Concerning Periodicals*, March 14, 1997, para. 3.158.

iv. Submit five-year corporate plans and borrowing requirements for approval by the Treasury Board each year.

262. Despite this formal legal arrangement, the Financial Administrative Act process (known as "Treasury Board process") operates in a relatively informal manner. One expert has made the following comments on this Treasury Board Process:

> *On most operational and technical issues, Canada Post encounters very little resistance from government. As its autonomy increases, Canada Post increasingly finds the process to be a nuisance.*[117]

263. The checks and balances of the Treasury Board process have become "predictable and non-threatening" to Canada Post, and the Treasury Board brings limited resources and personnel to the process.[118] The Treasury Board process is one way in which the government oversees Canada Post "in an insubstantial and fragmented way".[119]

264. In the late 1980's, the government rescheduled Canada Post under the *Financial Administration Act* as a Schedule III(2) Crown Corporation. This is the category assigned to Crown Corporations that operate in a competitive market and that are not dependent on appropriations from the government. This rescheduling has confirmed Canada Post's status as the type of Crown Corporation that is financially independent of the government, yet is by no means outside of the government's statutory control.

265. The relationship of Canada with Canada Post can best be described as a mix of Canada Post autonomy and sporadic government control. In effect, Canada Post enjoys the "best of both worlds." Its monopoly powers are unregulated in a practical sense, freeing Canada Post to compete with the private sector in non-monopoly services. Yet, Canada protects and assists Canada Post whenever necessary. Canada could exercise its authority to ensure that Canada Post acts in a manner consistent with its NAFTA obligations, but has chosen not to do so. It is apparent that so long as Canada Post appears to be making a profit, Canada will permit it to act in any fashion it sees fit.

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117 Campbell at 302.
118 Campbell at 302
119 Campbell at 300

(e) Canada has given Canada Post the regulatory power to expand its own monopoly and deregulate its products and services

266. Section 14 of the Canada Post Act gives Canada Post an "exclusive privilege" in Canada (a monopoly) over certain types of "letters". Section 56 of the Act makes it an offence for anyone to violate that exclusive privilege relating to letters. Canada has given Canada Post the authority to propose its own regulations to amend the definition of "letter" under the Canada Post Act, thereby granting it the authority to further expand the size and breadth of its own monopoly.

267. Section 19(1)(a) of the Canada Post Act provides Canada Post with the following authority:

> *The Corporation may, with the approval of the Governor in Council, make regulations for the efficient operation of the business of the Corporation ... and may make regulations (a) prescribing, for the purposes of this Act and the regulations, what is a letter....*

268. Accordingly, Canada Post could possibly propose to the minister a new regulation that would amend the definition of the word "letter" to include the delivery of letters on a non-urgent basis by courier. Such a slight change in the definition of the word "letter" would not only have the effect of expanding Canada Post's monopoly, but would deprive private sector courier companies in Canada (such as the Investment) of some of their ability to do business in Canada. Such a fundamental change in Canada Post's monopoly would not require the introduction of any legislation whatsoever to be approved by Parliament.

269. This is not merely a hypothetical power granted to Canada Post. Canada Post amended the regulations in 1989 to expand the definition of "letter" from the then weight of 454 grams, to the current level of 500 grams.[120] Canada approved this regulatory change, which had the effect of expanding the breadth of Canada Post's monopoly. There is nothing in the Canada Post Act that would today prevent Canada Post from proposing an amendment to that regulation so as to increase the weight of a "letter" once again; thereby expanding Canada Post's monopoly at the expense of private sector competitors, including UPS Canada.

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120 Section 33(b) of the current *Letter Mail Regulations* enacted by Canada Post under the powers given to it by section 19(1)(a) of the Canada Post Act, restrict Canada Post's monopoly to lettersthat weigh under 500 grams: See SOR/90-13 dated December 14, 1989

270. In fact, during debate in Canada's Parliament on the Bill that created the Canada Post Corporation, the House of Commons Standing Committee on Regulations was *"seriously concerned by the powers given to the Corporation to define by regulation, the word 'letter', and hence the extent of its own monopoly"*.[121] That Committee of Parliament considered this authority to be *"inappropriate to a parliamentary democracy"*.[122] That Committee was also concerned that the Act (as it still does today) authorized Canada Post to amend its own regulations to define what is "mailable matter", notwithstanding that this term is already defined in the enabling Act itself (the Canada Post Act).

271. Section 15 of the Canada Post Act <u>excludes</u> certain types of "letters" from Canada Post's monopoly. Notwithstanding that those <u>exclusions</u> were passed and approved by Parliament and the Canadian Senate, Canada Post has enacted its own *Letter Definition Regulations*[123] in which Canada Post sets out a long list of items that are <u>included</u> in the term "letter". By so doing, Canada Post has, through regulation and not by way of legislation, (subtly) expanded the definition of its monopoly that is set forth is sections 14 (and 15) of the Canada Post Act itself.[124]

272. In fact, groups like the Canadian Community Newspaper Association have accused Canada Post of stealing admail revenues through manipulation of mail regulations.[125]

Deregulation by Canada Post of most of its products and services

273. Part of the on-going failure of Canada to supervise and regulate Canada Post can be best evidenced in the systematic deregulation by Canada of Canada Post products and services over the last 15 years. This deregulation has included not only non-monopoly products

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121 House Standing Committee on Regulation and Other Statutory Instruments, *Minutes of Proceedings and Evidence*, 1980, 17:3, 6.

122 House of Commons Standing Committee on Regulation and Other Statutory Instruments, *Minutes of Proceedings and Evidence*, December 16, 1980, at 2-7.

123 SOR/83-481

124 If the package is under 500 grams, but exceeds the dimensions of "a letter" (more than 2 centimeters), Canada Post denies the package the normal lettermail rates. In such a case, Canada Post forces the sender to pay "parcel rates" – the more expensive rates reserved for items that are more than 500 grams. It could therefore be argued that items that are less than 500 grams, but more than 2 centimeters in dimension, are not part of Canada Post's monopoly.

125 See the House of Commons Standing Committee of Consumer and Corporate Affairs, November 22, 1989, pp. 4-7.

and services, but also monopoly products and services.[126] Canada has continued to remove, or refrain from imposing any regulatory means through which to ensure that Canada Post does not abuse its monopoly powers.

274. Traditionally, virtually all of Canada Post's products and services were offered under regulations approved by the Governor in Council. In the last 15 years, however, Canada Post has successfully introduced its own regulations to the minister that have deregulated, (removed from regulation) certain classes of service that used to be subject to formal regulation under the Canada Post Act. Examples of such deregulation include: incentive lettermail, electronic mail, postal money orders, parcels, lockbox fees and all forms of "admail" (i.e. advertising literature delivered through the postal system).

275. When Canada Post succeeds in removing such a product or service from direct regulation, it is no longer required to observe transparency requirements such as publication of proposals in the Canada Gazette, or to submit proposals for cabinet approval when it wants to change rates or terms and conditions under which the service is offered. Canada Post is accordingly free to set whatever rate or price for that product that it desires.

276. Some of the Canada Post products and services which are today unregulated are those offered by Canada Post under its monopoly powers. Examples of monopoly products and services that have been deregulated by Canada Post include incentive lettermail and addressed admail (see below).

277. Incentive letter mail refers to discounts given by Canada Post for large volume mailings, which are pre-sorted by the sender.[127] Regulations governing this class of monopoly service have been revoked. The Postal Services Review Committee (PSRC) concluded that: "Incentive letter mail… is part of Canada Post's exclusive privilege. Under deregulation there would be no guarantee that users would enjoy, through the discount, a fair proportion of the costs savings they create for Canada Post. The customers would have no choice but to accept. This was a major concern expressed to the Committee by a large-volume user of Canada Post's services. Nor is there, under deregulation, a

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126 Canada has admitted in a recent WTO panel decision that … if the Canadian Government considers Canada Post's pricing policy to be inappropriate, it can instruct Canada Post to change the rates under its directive power based on Section 22 of the Canada Post Corporation Act. Thus, the Canadian Government can effectively regulate the rates charged on the delivery of periodicals. See: WTO, *Report of the Panel on Canada: Certain Measures Concerning Periodicals*, March 14, 1997, at para. 5.35.

127 The Postal Services Review Committee recommended in 1989 that this product not be deregulated since there was no private sector discipline to ensure that the discount off the regular rate offered to subscribers by Canada Post fairly reflects the savings to the Corporation. Nevertheless, Canada Post proceeded to deregulate this product.

guarantee that users would not receive too liberal a discount, so that discounted mailings could in effect be cross-subsidized by users of regular mail".[128] As a result, there is no longer any requirement for pre-notification to the public in the Canada Gazette; nor approval by Cabinet committee.

278. Canada Post maintains that addressed admail is part of its monopoly. The regulations which used to pertain to both addressed and unaddressed admail, have been revoked. As a result, Canada Post is free to set its own rates for admail,[129] unimpeded by any external body.

279. In 1989-90, Canada established the Postal Services Review Committee ("PSRC"). This was the first and only time in Canada Post's entire history as a Crown Corporation that Canada made it accountable to a third-party regulatory body. Canada eliminated and disbanded the PSRC about 1 year later. Legislation to create any body similar to the PSRC has never been introduced by any subsequent Canadian government.

280. The Postal Service Review Committee (PSRC) stated in its 1990 report that it was concerned about the deregulation of monopoly products and services as follows:

> *... the Committee is concerned that the Corporation currently offers products outside of regulation where it appears to be a monopolist. If the Corporation can in fact exert monopoly power over these products, the public cannot be assured that the Corporation is not abusing its exclusive privilege...The current situation, whereby some postal products for which Canada Post holds a monopoly are not regulated, is not in the public interest. Some current proposals for deregulation would exacerbate this situation.*[130]

281. In addition, the PSRC concluded that while certain other products offered by Canada Post, such as parcels and money orders, do not form part of Canada Post's monopoly, those items should also continue to be subject to regulations under the Act. The PSRC reasoned that because Canada Post did not face significant competition in many parts of Canada with its parcel delivery business, the competition was not sufficiently strong to

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128 PSRC, *Recommendations to Canada Post Regarding is Proposed January 1990 Changes to Regulations" at 36-37.*

129 In 1999, Canada Post re-defined eligibility standards to exclude identical printed matter from accessing these reduced admail rates unless they were utilized in conjunction with promotional or charitable/fundraising uses. Ineligible items were forced into lettermail or publications services. As a result, any federal, provincial or commercial government notices (such as Goods and Services Tax notices), that are not selling an item, will lose the benefit of admail rates, and will now be required to pay the higher lettermail rates.

130 PSRC Recommendations 1990, at 28.

ensure that Canada Post would set the proper rates for this particular service.

282. Notwithstanding that recommendation from the PSRC, Canada Post has proceeded to deregulate its parcel business, and to deregulate its money order business. Canada Post is free to charge the public whatever it chooses for money orders, notwithstanding that the PSRC found that private sector competition to Canada Post in this area may not be sufficiently strong to withstand any abusive practices.

283. In addition, Canada Post introduced its Xpresspost courier service as a non-regulated product. The price of Xpresspost products is set by Canada Post alone in accordance with Canada Post's own criteria with absolutely no requirement for approval by an independent regulator or even the Minister or federal Cabinet.

284. The Priority Courier service offered by Canada Post also operates in a non-regulated environment, and its price is also set by Canada Post alone. By way of contrast, the prices that the US Postal Service charges for its domestic courier products, as well as for lettermail, are regulated by the US Postal Rate Commission (a third-party regulatory body.)

285. The situation that exists today is one in which only lettermail itself (formerly known as first class mail) continues to be subject to any formal government regulations. The prices of virtually all other classes of mail or courier services, whether or not they form part of the monopoly, are set by Canada Post itself, and are not published in the Canada Gazette for comment, nor submitted to the Minister or Governor in Council for approval.

286. In fact, on January 29, 2000 Canada Post gave formal notice that it intended to seek the deregulation of the last remaining product that remained subject to ministerial "scrutiny", namely, lettermail itself. Canada Post will have the regulations that govern lettermail (the *Letter Mail Regulations*) amended to remove the only remaining control that the government has on Canada Post's ability to raise the price of lettermail. This is being done notwithstanding s. 19(2) of the Canada Post Act which states that postage rates "shall be fair and reasonable and consistent so far as possible with providing a revenue. ... sufficient to defray the costs incurred by [Canada Post] in the conduct of its operations under this Act."

287. Canada Post states that this change will "reduce regulatory complexity and costs".[131] What this actually means is that Canada Post will now no longer need to seek and receive

[131] Canada Post Corporation Regulatory Impact Statement (January 29, 2000) at 311.

Canada's approval for an increase in the price of stamps. It will not even have to provide the perfunctory notice in the Canada Gazette to the public, which at least provides the public with 60 days to write to the minister to object to the stamp price increase. The new regulation will allow Canada Post to automatically increase the price of lettermail on January 1st of each year by 2/3rds of the increase in the Consumer Price Index.

288. It should be noted that this new "2/3 of CPI" formula was approved by Canada in December 1998.[132]

289. Commentators have viewed this state of affairs as especially troubling since Canada Post earns a large portion of its revenues from lettermail. In fact, "only government subsidies and a heavy reliance upon rate increases for Canada Post's monopoly first class mail enable it to remain in business."[133]

290. If the current trend continues, Canada will essentially have divested itself of the remainder of the less-than-adequate regulatory mechanisms it once had in place to prevent Canada Post from abusing its delegated authority to operate a postal monopoly. Canada Post would accordingly be completely free to use new revenues generated from stamp price increases to cross-subsidize its non-monopoly services such as Xpresspost, Priority Courier, Regular and Expedited parcel.

291. While Canada is moving towards giving up the loose control which it has over Canada Post, the trend in Europe is in the opposite direction. In December 1999, the European Commission published a draft directive that would tighten the rules that require post offices to keep separate accounts for their monopoly and commercial operations: see European Unions' Official Journal of the European Communities, December 29, 1999. In contrast, Canada has no such rule that would require Canada Post to keep separate accounts for its monopoly and commercial activities.

292. Members of Parliament who serve in the Opposition parties are often able to find out about and scrutinize otherwise hidden activities of Government departments, agencies and Crown corporations by filing formal requests for information and documents under Canada's Access to Information Act. However, when it comes to the subject of Canada Post, neither Members of Parliament, nor UPS, can gain access to relevant documents and information - even if the information pertains to Canada Post's letter mail monopoly itself, or is not commercially sensitive. This is because Canada has expressly exempted

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132 Canada Post Regulatory Impact Statement, January 29, 2000, at 312.

133 Douglas Adie: The Mail Monopoly: Analyzing Canadian Postal Service, (1990) at 160.

Canada Post from that Act.

293. As a Crown Corporation with certain monopoly powers, Canada Post is ostensibly controlled by the government, but is for all practical purposes unregulated and left alone to compete with the private sector in non-monopoly type products and services. Canada's official response on April 23, 1997 to the Canada Post Mandate Review report made it clear that Canada would not make Canada Post subject to a third-party regulatory body. By choosing not to put in place a regulatory body, Canada generated an institutional vacuum allowing Canada Post to pursue its commercial course unencumbered by regulatory demands.

(f) Lack of regulatory control over Canada Post is unique

294. The United States Postal Service also has a monopoly over core lettermail services, and also allows competes in the courier business with the private sector. However, in the United States the Postal Rates Commission consistently exerts controls on the US Postal Service's rates and prices. The US Postal Service, similar to the British Post Office, also has a rigid structural separation between its monopoly and non-monopoly products and services.[134] By contrast, Canada Post is not subject to any sort of similar third-party regulatory control and does not separate its monopoly and non-monopoly products and services.

295. The following is a sample of some influential comments that have been made about that situation:

- Former Cabinet Minister Andre Ouellet, in his capacity as Minister responsible for Canada Post, explaining the need for a system of third-party regulation of Canada Post:

> *The Corporation will have [a] monopoly... this procedure is [necessary] to protect the interest of the people and to establish the necessary arm's length relationships.*[135]

Mr. Ouellet is currently the president and CEO of Canada Post. Canada Post (and presumably Mr. Ouellet) are now vehemently opposed to third-party regulation of the Corporation.

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134 Canada Post Mandate Review, at 20.

135 House of Commons, *Debates*, October 24, 1980: at 4077-8.

- Former Cabinet Minister Harve Andre, in his capacity as Minister for Canada Post:

> *Canada Post is unique among the major providers of major public services that enjoy a monopoly in this country, as it is not subject to any kind of outside review.*[136]

- A discussion paper prepared by Canada's Department of Consumer and Corporate Affairs, concluded that independent scrutiny of postal rates and services has worked well in the U.S., Britain and Australia. The discussion paper stated: "Introduction of a third party review agency in Canada could make a similarly significant contribution to the development of the nation's postal service. By providing a forum for public involvement and an official channel for complaints it would curb the growing problem of political involvement in the day to day operations of the postal service. It could also promote financial responsibility and market sensitivity in services and rates."[137]

- Don Boudria M.P. (currently a Minister in the Federal Cabinet):

> *I'm thinking of a CRTC for the Post Office. Every other western democracy has such an agency. You cannot have an unregulated monopoly, even if the government owns it".*[138]

- An author of a text on the Canada Post monopoly wrote:

> *"Canada Post was the only government monopoly supplying a necessary service that did not have independent external regulation".*[139]

- Professor Campbell, in his book about Canada Post concludes:

> *"This complete absence of third-party regulation of a public postal corporation is unique in the industrial world".* [140]

- "From a competitive perspective, the principal harm that regulatory oversight can prevent is the misallocation of costs by Canada Post from competitive classes of mail to lettermail…"[141]

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136 Department of Consumer and Corporate Affairs, *News Release*, June 27, 1988.
137 Ibid.
138 Masthead, March 1994, at 5.
139 Douglas K. Adie, The Mail Monopoly: Analyzing Canadian Postal Services (1990), at 69
140 Campbell at 352
141 G. Sidak et al, "Monopoly and the Mandate of Canada Post", 14 Yale Journal on Regulation (1997), at 51

- Professors Sidak and Spulber in the Yale Journal on Regulation wrote: "If Canada Post remains a government-owned corporation with a statutory monopoly over lettermail, then Parliament should create a regulatory commission with full powers to set rates, to order public disclosure of Canada Post's costing methodologies and to prescribe modification of those methodologies as needed. In other words, Parliament should establish a stricter watchdog to ensure that cross-subsidization of competitive businesses with a monopoly never occurs. That regulator must have the power to order whatever structural relief (such as divestiture of operating units, separate subsidiaries, accounting separation and so forth) it deems necessary to regulate Canada Post in a manner that advances the purposes of public provision of postal services."[142]

F. THE POINTS AT ISSUE

1. Has Canada taken measures inconsistent with its obligations under Section A of NAFTA Chapters 11 and 15, including but not limited to Articles 1102, 1105, 1502(3)(a), 502(3)(d) and 1503(2)?

2. If the answer to question 1 is yes, what is the quantum of compensation to be paid to the Investor as a result of the failure of Canada to comply with its obligations arising under Chapter 11 of the NAFTA?

G. RELIEF SOUGHT AND APPROXIMATE DAMAGES CLAIMED

The Investor claims damages for the following:

> Damages of not less than US $160 million as compensation for the damages caused by, or arising out of, Canada's measures that are inconsistent with its obligations contained in Part A of Chapter 11 and Chapter 15 of the North American Free Trade Agreement.
>
> Costs associated with these proceedings, including all professional fees and disbursements.
>
> Fees and expenses incurred to oppose the effect of the measure.

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142 Ibid.

Pre-award and post-award interest at a rate to be fixed by the Tribunal.

Tax consequences of the award to maintain the integrity of the award.

Such further relief that counsel may advise and that this Tribunal may deem appropriate.

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ANNEX A

United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on the Postal Service, Committee on Government Reform and Oversight House of Representatives

June 1998

U.S. POSTAL SERVICE

Competitive Concerns About Global Package Link Service

GAO/GGD-98-104

Legal Requirements for Importing Parcels Into Canada

We reviewed Canadian customs laws and regulations for importing postal and private express parcels into Canada. Revenue Canada informed us that it has three basic programs for processing parcels through Canadian Customs: the mail program, the Courier/Low-Value Shipments Program (LVS), and regular cargo program. The mail program is used to process parcels that are presented to Customs by Canada Post. The LVS program is used to process private express parcels if they are valued at less than $1,600 Canadian. GPL parcels, as well as comparable private express carrier parcels, are processed under LVS because GPL parcels are currently being delivered by a private express carrier. We included legal requirements under the mail program to provide a comparison of the two sets of requirements.

Our primary source was the Customs Act (Departmental Consolidation, November 1997). We also reviewed relevant regulations issued by Revenue Canada. Following our review, Revenue Canada officials reviewed and commented on a draft of our compilation of requirements, and we made changes where needed.

Customs requirements	Laws and regulations applicable to postal parcels	Laws and regulations applicable to private express carrier parcels
A. Import shipping documentation: A manifest or list of goods must be presented to foreign customs services for import clearance.	Not required Sec. 12 of the Customs Act provides that generally, imported goods are required to be reported to the customs office as prescribed by regulation. Mail items are required only to have a standard declaration form attached. Customs inspectors examine the declaration and, if necessary, open the item to examine any invoice enclosed or physically examine the contents and the parcel. See Memorandum D5-1-1 (April 21, 1997).	Required Sec. 12 of the Customs Act provides that generally, all imported goods are required to be reported to the customs office as prescribed by regulation. Memorandum D-17-4-0 (Jan. 20, 1997, concerning the Courier/Low Value Shipment (LVS) Program-Low Value Commercial Goods, provides that presentation of a cargo release list meets the reporting requirements under Section 12. The cargo/release list must include (1) a unique identifier number generated by the courier; (2) the consignee's name and address; (3) the importer's name and address; (4) the name of the shipper, exporter, or vendor; (5) the quantity; (6) the weight of the shipment; (7) the estimated value for duty in Canadian dollars; (8) a description of the goods; and (9) the country of origin. Also, the cargo/release list must contain the carrier code and name, U.S. port of exit, vehicle identification number, office of release, and date.

(continued)

Customs requirements	Laws and regulations applicable to postal parcels	Laws and regulations applicable to private express carrier parcels
B. Entering shipping data into foreign customs services' computers: Importer/broker must enter shipping data into foreign customs' computer systems for entry.	Not required Postal items are presented to Customs by Canada Post, and Customs inspectors enter data. See Memorandum D5-1-1.	Not required Under sec. 8.1 (3) of the Customs Act, persons may be authorized to file forms electronically but are not required to do so.
C. Use of licensed customs brokers: Importer must use licensed brokers to submit shipping data.	Not required Postal items are presented to Customs by Canada Post. See Memorandum D5-1-1.	Not required For commercial goods imported under the Courier/LVS program, importers must either clear the goods themselves or use a customs broker. If customs brokers are used, they must hold a license under Sec. 9 of the Customs Act. See Memorandum D17-4-0.
D. Calculation of duties and taxes: Importer/broker must calculate duties and taxes to be verified by foreign customs services.	Not required According to Sec. 24 of the Guidelines and General Information Part of D5-1-1, the customs inspector determines the tariff classification and value of goods sent by mail on the basis of information from the customs declaration or invoices attached and enters data into the postal Import Control System.	Required Memorandum D17-1-10 outlines how to complete the form, which requires importer/broker to calculate duties and taxes.
E. Timing of payment of duties and taxes: Duties and taxes must be paid or secured prior to Customs' release of shipment to delivery agent.	Not required Under the customs international mail processing system, Canada post collects the duties and taxes on behalf of Customs before releasing the parcels to the importer. Subsection 147.(1) and the Customs Act provide authority for this arrangement.	Required Sec. 33 of the Customs Act states that goods may be released prior to the payment of duties in such circumstances as may be prescribed and shall be paid thereon within a prescribed time. Memorandum D-17-1-0 allows for release before payment with security.
F. Customs service charges: Importer/broker must pay for customs clearance outside of normal business hours.	Not required	Required Regulations Respecting Special Customs Services (Jan. 1, 1996) require payment for clearance outside of regular business hours.
G. Posting of bonds or other security: Importer/broker must post a bond or provide other security for storage facilities.	Not required	Required The Customs Sufferance Warehouse Regulations, pursuant to Sec. 19 of the Customs Act, requires posting of security for such facilities.

(continued)

Customs requirements	Laws and regulations applicable to postal parcels	Laws and regulations applicable to private express carrier parcels
H. Shipping records retention: Importer/broker must maintain shipping records on parcels.	Not required	Required The records retention period for commercial goods imported under the Courier/LVS program is 6 years plus the current year. See Sec. 2 of the Importers Records Regulations (Memorandum D17-1-21) and subsection 17(2) of the Customs Brokers Licensing Regulations.
I. Liability for parcel contents: Importers/brokers are subject to liability for illegal contents contained in parcels.	Applicable Importers are responsible for complying with Canadian laws with regard to controlled, restricted, or prohibited goods.	Applicable Importers are responsible for complying with Canadian laws with regard to controlled, restricted, or prohibited goods. Such goods are not eligible for importation under the Courier/LVS program.
J. Fines for incorrect or missing declarations: Importers/brokers are subject to liabilities for fines for incorrect or missing customs declarations.	Not applicable However, under Sec. 12 of the Customs Act, the sender of a parcel could be subject to liability for failure to provide a customs declaration.	Applicable As specified in Sec. 3 of the Reporting of Imported Goods Regulations, pursuant to Sec. 12 of the Customs Act, failure to report goods to Customs is subject to a penalty of $400 per shipment. Under Sec. 33.1 of the Customs Act, every person who fails to account for imported goods in accordance with law or regulation is liable to a penalty of $100 for each failure.

Comments From Revenue Canada

Revenue Canada Revenu Canada

MAY 0 4 1998

Mr. Bernard L. Ungar
Director, Government Business
Operations Issues
United States General Accounting Office
441 G St., N.W.
Room 2A10
Washington, D.C. 20548
United States of America

Dear Mr. Ungar:

I am writing to thank you for inviting Revenue Canada to contribute to your agency's draft report U.S. Postal Service: Competitive Concerns About Global Package Link Service.

The report correctly describes the key features of the processing of Global Package Link (GPL) parcels by Revenue Canada. GPL parcels are transported to Canada by a private express carrier and are processed through Revenue Canada's Courier/Low Value Shipment (LVS) Program. This means that GPL parcels are subject to the same customs clearance requirements, and are processed in the same manner, as all other private express carrier shipments that are imported under the Courier/LVS Program.

Our technical remarks and clarifications on the report, including the missing legislative references for Appendix V, are included in the attachment. Canada Post Corporation also reviewed the report, but will not be providing comments.

Should you have further questions, please contact Jan Gahagan, Manager, Courier and LVS Program, at (613) 954-7099.

Yours sincerely,

Laurie Bratina
Director
Import Process Division
Customs and Trade Administration Branch

Attachment

Canada

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ANNEX B

The Privileged Position of Canada Post

Canada Post has been provided with a privileged position by Canada that does not reflect the position of a private company. All of the privileges discussed here are examples of the benefits that Canada Post's non-monopoly courier products and services receive by virtue of the status that Canada Post has enjoyed as Canada's postal monopoly. Because of these privileges, Canada Post has been placed in an advantaged position to use its monopoly position to engage in anti-competitive practices to the detriment of competitor courier companies such as the Investment.

Professors Sidak and Spulber, in their comprehensive article entitled "Monopoly and the Mandate of Canada Post",[143] concluded that: "More generally, Parliament should specify by statute that, for as long as Canada Post remains publicly owned, it shall be subject to all laws generally applicable to private firms and shall have no special privileges or immunities arising from its public ownership. Canada Post should not be permitted to benefit from its government – owned status in terms of tax privileges, reduced costs of borrowing, minimal accounting to shareholder, and a government – funded pension plan."

Examples of Canada Post's privileged monopoly position are set out below:

Corporate Tax Exemptions

1. Canada Post is exempt from paying provincial corporate income taxes

Corporations carrying on business in Canada (such as UPS Canada Ltd.) pay both federal and provincial corporate income tax each year. Prior to 1984, Canada Post was exempt from paying both federal and provincial corporate income tax. Since 1994, section 27(2) of Canada's *Income Tax Act* has stipulated, however, that Canada Post is subject to federal corporate income tax, and the Large Corporation Tax.

Canada Post is currently **not** subject to provincial corporate income tax levied by any of the ten Canadian provinces or Territories.

The chart below indicates that on average, Canada Post's corporate tax rate throughout Canada is about **5%** lower in all provinces (except Quebec), than for UPS Canada.

143 G.. Sidak and D. Spulber, "Monopoly and the Mandate of Canada Post" (1997) 14 Yale Journal on Regulation at 78

Province	Rate paid by Private Sector	Rate Paid by Canada Post
Newfoundland	43.12%	39.52%
Nova Scotia	45.12%	39.52%
Prince Edward Island	45.12%	39.52%
New Brunswick	46.12%	39.52%
Quebec	38.27%	39.52%
Ontario	44.62%	39.52%
Manitoba	46.12%	39.52%
Saskatchewan	46.12%	39.52%
Alberta	44.62%	39.52%
British Columbia	45.62%	39.52%
NWT	43.12%	39.52%
Nunavut	43.12%	39.52%
Yukon	44.12%	39.52%

2. Canada Post is exempt from paying provincial corporate capital tax

Pursuant to section 57(1) of the *Ontario Corporations Tax Act*, Canada Post is exempt from paying capital tax to the province of Ontario. This tax is levied whether or not the corporation is profitable.

Canada Post is also exempt from paying corporate capital tax (or the comparable tax) that is levied by the other provinces of Canada. In particular, all ten provinces of Canada, with the exception of Alberta, levy a corporation capital tax, and Canada Post is likely exempt from paying corporation capital tax in each of those provinces as well.

3. Canada allowed Canada Post a $270 million dollar tax loss carry-forward to which Canada Post was not entitled

Canada Post's Annual Report shows that it had a net loss of $270 million dollars in its 1993-94 fiscal year. According to Canada Post's own Annual Report, that fiscal year ended on **March 26, 1994.**

Canada Post's Annual Report for 1994-95 states that one day later - **March 27, 1994** - Canada Post became subject to income tax for the first time.[144] That same Annual Report also states that tax loss carry forwards of $320 million are available to Canada Post to reduce future income taxes.[145]

This $320 million tax loss carry-forward is comprised of (in part) the $270 million tax loss incurred by Canada Post for its previous fiscal year ending March 26, 1994. It follows that Canada Post cannot claim tax loss carry forwards of $270 million incurred in its fiscal year ending March 26, 1994 because it was not a tax-paying corporation at any time during the fiscal year ending March 26, 1994.

This result follows from paragraph 149(10)(c) of the *Income Tax Act of Canada* that deems Canada Post to be a new corporation for the purpose of section 111 of that Act, as at the date it became taxable, namely, March 27, 1994. Section 111 of the Act is the provision that permits a corporation such as Canada Post to carry forward losses realized in prior years, under appropriate circumstances. Since Canada Post ceased to be exempt from income tax on March 27, 1994, section 111 does not permit Canada Post to carry forward any tax losses from taxation years that ended before March 27th.

As a result, Canada Post should not have permitted Canada Post to utilize any portion of this $270 million tax loss to reduce Canada Post's taxable income for any taxation year.

Furthermore, if any other portion of the total tax loss of $320 million that Canada Post purports to carry forward is comprised of losses incurred by Canada Post prior to the date it became taxable (March 27 ,1994), those tax loss carry forwards should also have been denied.[146]

UPS only discovered this point during preparations to commence this NAFTA claim against Canada. Revenue Canada Taxation (the tax-collecting arm of the Government of Canada) has allowed Canada Post to claim this tax loss carry forward. As result, Canada Post has saved very considerable sums of money that it would otherwise have had to pay in income tax.

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144 Canada Post Annual Report (1994-95). at 31.

145 Canada Post Annual Report (1994-95). at 31.

146 For example, the Canada Post Annual Report (1993-94) at 29 indicates that Canada Post obtained a tax loss carry-forward of approximately $46 million as the result of the 1993 purchase of Purolator, which is available to reduce Canada Post's future income taxes until the year 2000.

Special arm's length contracts with Canada's Department of Public Works and Governments Services

Canada's Department of Public Works and Government Services provides professional building management and repair services to thousands of federal government buildings across Canada.

Notwithstanding that Canada Post owns its owns buildings and has not been a department of the federal government since 1981, Canada, through the Department of Public Works, continues to supply similar services to Canada Post – at less than fair market cost. In particular, it is believed that the Department manages certain Canada Post real properties and provides related technical and professional services.

The Cabinet minister in the Canadian government who serves as Minister of the Department of Public Works is also the Minister responsible for Canada Post. Furthermore, the federal civil servants that advise the Minister about Canada Post are also employed by the same Department of Public Works. Therefore, Canada Post is contracting for property management services with the very same department that has been tasked with the responsibility of advising the Minister about Canada Post.

The 1998-99 Canada Post Annual Report states that: "The Corporation has incurred net operating costs of $10 million (1998: $12 million) in respect of real property agreements with Public Works and Government Services Canada".[147] Other than that statement, Canada Post and that Department of the Canadian government sign confidentiality agreements that shield those agreements from the public's scrutiny.

Canada Post receives a direct annual subsidy from the Canadian government: the Northern Air Stage Freight Program

The Government of Canada pays Canada Post a specific subsidy of about $14 million per year in order to compensate Canada Post for revenue foregone from operating the Northern Air Stage Freight Service. This service is designed to carry out the objective of Canada to provide delivery of parcels of perishable objects and foods to communities in the far north of Canada which lack access to year round road transportation (due to their isolation and snow conditions). [148]

Under the Air Stage Freight Service, Regular Parcels destined for remote northern Canada communities are taken as far as possible by surface transportation, before being airlifted from

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147 Canada Post, Annual Report, at 42.

148 On March 22, 2000 Canada Post announced a small modification to the program that had the effect of deleting 9 communities from the program.

designated staging points to air stage offices in remote communities. This service is designed to keep the price of foods and other goods in the remote communities lower than would otherwise be the case.

Businesses or individuals (who wish to ship items for resale in the North i.e. food and clothing), or for commercial use, or shipping personal effects on a frequent basis, are required to have a signed Distribution Services Contract with Canada Post. This locks the customer into shipping with Canada Post. In order to use the service, those customers must ship in excess of five parcels a day, or more than a specific weight per month. Since the postage paid to Canada Post on the parcels is less than the true cost of shipping, the difference is made up by the subsidy paid by Canada to Canada Post.

Canada Post contracts with airlines (not owned by Canada Post) to deliver the goods. *"Deliveries do not typically pass through Canada Post's hands, but go from suppliers to air carriers to communities"*.[149]

UPS wishes to make it abundantly clear that it has no objection to the policy of Canada that seeks to make food and other goods more affordable for residents of remote northern Canadian communities. As a result, UPS does not seek the termination or reduction of the Air Stage Freight Service.

UPS maintains, however, that since the program includes delivery of heavier <u>non-monopoly</u> parcels, the $14 million annual subsidy should not be paid by Canada to Canada Post alone. Canada Post's role is not a pre-requisite to the continuation of an effective Northern program. Rather, the parcel component of the program should be opened up to public tender by Canada, and awarded to the lowest bidder who would be required to charge rates prescribed by Canada. Many private sector courier companies have access to chartered aircraft, which could perform this service as efficiently (or more efficiently) than Canada Post.[150]

Priority Courier packages that are delivered to these remote communities also benefit from the Government subsidy. Packages delivered through UPS do not. As a result of the multi-million dollar subsidy provided by Canada to Canada Post, UPS is in effect prevented from competing with Canada Post on the delivery of (non-monopoly) packages in northern Canada.

It is apparent that Canada controls the Northern Air Stage Parcel program. Canada Post *"is*

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149 Professor Robert M. Campbell, *The Politics of the Post* (1994), at 316. See also Price Waterhouse, A Strategic Review of Progressive Administrations (1995) at 14: "Canada Post contracts out much of that service to private carriers."

150 It has been written that: "In particular, in the absence of the statutory monopoly, it would be possible for the federal government to invite bids from private firms to provide mail service to a particular remote area and to assume the obligations of being the carriers of last resort. Postal customers in the region would continue to pay a nationally uniform price for mail, and private firms would submit competing bids to provide such a service for the lowest subsidy to be paid by the federal government. The process would not be fundamentally different from that by which the baker submitting the lowest bid is awarded the contract to supply bread to the military base:" G. Sidak et al, "Monopoly and the Mandate of Canada Post'. (1997) 14 Yale Journal of Regulation at 46-47.

simply following a direction given by the government." [151]

Subsidy payment from Canada to Canada Post struck down by the W.T.O.: the Publications Distribution Assistance Program

Pursuant to a three year Memorandum of Agreement effective in 1996 and continuing until 1999, between what is now Canada's Department of Canadian Heritage and Canada Post, the Department of Canada Heritage agreed to pay to Canada Post $58 million dollars (Can.) in year one (May 1, 1996 to March 31, 1997) of the Agreement, a further $57.9 million in year two, and $47.3 million in year three. In return, Canada Post undertook to deliver Canadian owned magazines and periodicals mailed in Canada to Canadian subscribers, at a substantial reduction to the normal cost of mailing. Those periodicals and magazine companies that wished to take advantage of the subsidy were obliged to send their materials through Canada Post only, and not through any other company such as UPS.

These magazines and periodicals do not form part of Canada Post's letter mail monopoly. [152]

Therefore, UPS competes with Canada Post for the right to distribute these magazines and periodicals. As a result of this direct subsidy paid by a department of the Canadian government (Department of Canadian Heritage) to Canada Post, UPS was effectively shut out of the market for distributing magazines and periodicals in Canada. All eligible Canadian magazines and periodicals gave their business to Canada Post exclusively.

In a subsequent case brought against Canada by the U.S. government at the World Trade Organization, Canada admitted that "the payment of the funds from the Canadian Heritage department to Canada Post is made based on negotiations between the two agencies, taking into account the fact that Canada Post gets an *exclusive* contract for the delivery of periodicals at subsidized rates". [153]

The same WTO panel report (page 50) quoted the U.S. government as stating that: "A publisher seeking to have Canada Post transport and distribute its magazines to subscribers in Canada – and virtually all subscription magazines sold in Canada were distributed in this manner – would have to pay the postal fees prescribed by Canada Post."

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151 The Honourable Harvey Andre, Minister responsible for Canada Post, House of Commons Standing Committee on Consumer and Corporate Affairs, October 31, 1989, at 20.

152 Canada Post Act, section 14(2); and the Letter Definition Regulations of Canada –SOR/83-481 which provides in section 2 (g): "For the purpose of the Canada Post Corporation Act and any regulation made thereunder, "letter" ... does not include (g) a newspaper, magazine, book, catalogue..."

153 Decision of the WTO panel on *Canada-Certain Measures Concerning Periodicals*, (1997), page 80.

At the WTO case, on appeal, both the Canadian and U.S. governments acknowledged that this Canadian government program involves "a payment of subsidies".[154]

As a result of the WTO ruling to the effect that Canada's Publications Assistance Distribution program was not justified under GATT, the Canadian government terminated the program effective October 28, 1998. The Canadian publishers now pay regular publication mail rates. The Canadian government now pays a direct monetary subsidy directly to each magazine publisher, who is now free to choose the distributor of its choice.

154 Decision of the World Trade Organization, Appellate Body, (1997), in *Canada –Certain Measures Concerning Periodicals,* page 35.

ANNEX C

Xpresspost is Covered by Canada Post's Letter Mail Monopoly

1. Canada Post suggests that Xpresspost is in fact part of Canada Post's monopoly. Canada Post suggests that when Xpresspost was introduced in late 1993 to early 1994, it replaced the "special letter". UPS submits, however, that Canada Post specifically trade marked, designed, marketed, priced, sold and offered guarantees and indemnities to customers of Xpresspost in such manner as to make it apparent that Xpresspost was not covered by the monopoly. The factors which demonstrate this conclusively include, but are not limited to:

- Xpresspost is marketed by Canada Post as <u>courier</u> product. This is evidenced by the fact that in the Canadian Trade Mark registration obtained by Canada Post on the service "Xpresspost", Canada Post described the service as only "parcel delivery and courier services".[155]

- Numerous official documents prepared by Canada Post specifically place Xpresspost in the category of its "Physical Distribution" products. This is the phrase used by Canada Post to describe its non-monopoly products that compete with the private sector, such as Priority Courier. For instance, Canada Post's Corporate Plan states: *"For fiscal 1999, Canada Post is repositioning its physical distribution services (Priority Courier,* ***Xpresspost****, Expedited Parcel and Regular Parcel) into an integrated family of services to meet a wide range of customer needs. The Xpresspost service is now the smart alternative to fully featured premium priced courier as a result of improvements made to the Xpresspost service to better meet the speed, reliability, security and ease of use needs of courier customers"156*

- Canada Post, using extensive market research, carefully chose to market Xpresspost against competition from express courier companies. In fact Canada Post has conducted an extensive print /magazine and television campaign in 1998, 1999 and continuing in the year 2000 which expressly markets Xpresspost as "The Smart Way to Save An Average of 33% on the Cost of Your Courier Service". That particular phrase, as well as the phrase: "Xpresspost –the smart alternative to costly couriers" has been widely published in recent advertisements by Canada Post. If Xpresspost

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155 Canadian Trade Mark registered June 10, 1994. By definition, the private sector is expressly prohibited from violating any portion of Canada Post's monopoly Section 56, Canada Post Act. Since the launch of Xpresspost over 6 years ago, Canada Post has failed to take legal steps to stop this private sector competition. The strong inference is that Canada Post has accepted the position that Xpresspost is not covered by its monopoly.

156 *Canada Post, Corporate Plan 1995-96 to 1999-2000, Capital Budget, page 5.*

was in fact covered by the monopoly, it would be improper for Canada Post to use monopoly revenues to advertise the product against private sector couriers.

- Canada Post's promotional materials quote one of its business customers as stating: "The other attraction to Xpresspost is how easy it is to use. The Advance Purchase product envelopes and labels are easy to use and we've arranged with Canada Post for daily pick-up of our packages. Our courier charges have dropped dramatically, and our clients are getting the same great delivery"[157]

- Canada Post described its own advertising campaign as follows: "Faster Xpresspost service was launched March 23 [1998], with a high energy television and print advertising campaign directed at small business and home office customers. The enhanced service offers customers an alternative to high-priced couriers, with new features to be introduced in July [1998] including a new signature option and on-time guarantee for prepaids delivered through street letter boxes:"[158] Therefore, Canada Post can hardly complain that Xpresspost is treated in the Canadian market as a courier product.

- Section 14 of the Canada Post Act restricts the scope of Canada Post's monopoly to that of "collecting, transmitting, and delivering **letters** to the addressee thereof within Canada." Some of the reasons why Xpresspost does not qualify as a "letter" within section 14 include:

(a) Section 33 of the Letter Mail Regulations of Canada[159], (enacted at the specific request of Canada Post itself) states that 500 grams "is the maximum weight for an item of <u>letter mail</u>".
(b) In April 1997, Xpresspost introduced a new line of three sizes of boxes labeled "Xpresspost". The largest box was advertised as handling up to 4.5 kilograms (9.9 pounds) of goods, and costing $20 to ship, at that time. These boxes hardly constitute a 500 gram (1.1 pound) "letter" within the above quoted Letter Mail Regulations of Canada.
(c) By contrast, the previous Special Letter came in two sizes –both of which were <u>envelope</u> sizes only – there were no box sizes in which items that were not document size could be sent.

- Xpresspost was specifically designed to compete with private sector courier products. As a result, Xpresspost offers the customer the following additional features which are normally not offered with "letters", but are in fact offered with virtually all

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157 Alan Ludlow, V.P. of Bruce Moore Russell, quoted in Canada Post's "Xpresspost –Right in the Middle", September 27, 1993, p. 2

158 Canada Post's *Performance Magazine* (May 1998, p.4)

159 SOR/88-430, as amended SOR/90-13

comparable UPS courier products:

(a) purchase contracts between Canada Post and big Xpresspost users that provide the big user with discounts off the normal posted price of Xpresspost;
(b) The ability to have Canada Post invoice the big user for the monthly costs of the Xpresspost service, rather than having to pay cash at time of use;
(c) Xpresspost may include free pick up service at the customer's business or residence, or pick- up for a small fee;
(d) A written guarantee of the date on which the Xpresspost package will be delivered, together with a full refund if not delivered on time. Xpresspost provides guaranteed next day delivery locally, and guaranteed two business day delivery between most major cities in Canada;
(e) Bar-coded labels attached to the Xpresspost package to allow Canada Post to track the package;
(f) A Canada-wide toll-free automated telephone number that allows the Xpresspost customer to call in and ascertain the delivery status of his/her package;
(g) An option that allows the Xpresspost customer to obtain a signature of the recipient upon delivery;
(h) An indemnity payment of up to $100 for packages that are damaged, lost or stolen prior to delivery; and
(i) There are multiple tariffs charged to a commercial customer for Xpresspost packages (exceeding 500 grams), depending upon which of the various Canadian postal codes the item is being sent to and from. Whereas, there were only two prices charged by Canada Post for the former "special letter" – one price for letters to be delivered regionally, and a separate price for letters to be delivered nationally.

2. In addition, it is not entirely true for Canada Post to suggest that Xpresspost replaced the Special Letter. According to Canada Post's own materials issued at the launch of this product: " Canada Post created Xpresspost by combining and enhancing three existing domestic products: Special Letter/Special Delivery, Expedited Counter parcels and some Commercial Air parcels", explains Chris Delayen, Product Manager, Special and Expedited Services"[160].

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160 Canada Post's Performance Magazine, September /October 1993, at 21.

ANNEX D

Cross-Subsidization – An Analysis

1. The Canada Post Mandate Review (1996), found that Canada Post appeared to be using its delegated monopoly and letter mail service to cross-subsidize its competitive (non-monopoly) services and products. The Mandate Review found:

> "In its competitive activities with regard to unaddressed admail, courier services, and mailing centers, Canada Post Corporation is an unfair competitor in ways detrimental to private sector companies. Further, the Corporation's misallocation of costs constitutes a form of cross-subsidization, whether intentional or otherwise. And its ability to leverage a network built up with public funds on the strength of a government granted monopoly gives it a pricing advantage over competitors that is seriously unfair".[161]

2. The manner in which Canada Post carries out this cross-subsidization is by leveraging the use of its letter mail delivery network or infrastructure. For example, this occurs when Canada Post mail trucks carry Xpresspost or Priority Courier products. "Canada Post openly admits that it does and will continue to leverage its existing network to achieve cost savings in the provisions of <u>all</u> (emphasis added) product lines. It argues that this is merely efficient use of resources and sound business practice."[162]

3. This long established infrastructure, handed over by Canada to Canada Post in 1981, is Canada Post's biggest advantage in relation to its competitors, such as UPS. A new entrant into the market would find it extremely expensive to set up such a comparable infrastructure, if not totally prohibitive. UPS Canada has had to incur the huge expense of establishing a similar network, (on a much smaller scale) without the benefit of an established government granted infrastructure. While it is true that a multi-product company like UPS regularly uses leveraging of its network to considerable efficiency, the difference is that UPS did not build its network with public funds – with a government granted monopoly.

4. The Canada Post strategy is to provide its letter mail, parcel and courier services as an <u>integrated service</u> to customers. This is evidenced in Canada Post's 1999/2000 five-year Corporate Plan, in which Canada Post states that in 1999 it repositioned "its physical distribution services (Priority Courier, Xpresspost, Expedited Parcel and Regular Parcel)

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161 Canada Post Mandate Review (1996) at 122.

162 Canada Post Mandate Review (1996) at 46

into an integrated family of services to meet a wide range of customer needs."[163]

5. The Corporate Plan further states:

> With respect to its retail customers, Canada Post's long-term vision is to evolve to a retail network of Canada Service Centers offering all Canadians access to postal, government, financial and Internet commerce services as well other retail products. Achieving this vision requires continued development of retail initiatives predicated on increased network utilization, **integrated service provision,** strategic alliances and modernization.[164]

6. Canada Post's general manager, distribution business, has stated that:

> *...the sheer size of our network brings economies of scale to our distribution business that nonę of our competitors enjoy. So it makes sense to take advantage of what we do best and profitably...the message we want to convey to customers is that Canada Post offers the low-cost advantage of the largest and most accessible distribution system in Canada...*[165].

Government of Canada's Response to Canada Post Mandate Review

7. It is the stated policy of Canada that Canada Post monopoly service should not cross-subsidize its competitive services. This is also the public policy of Canada Post. Unlike the United States, however, Canada has no law (with the exception of the provisions of NAFTA itself) which would prevent Canada Post from cross-subsidizing its competitive services.

8. With the announcement by Canada's Minister responsible for Canada Post on April 23, 1997, it was apparent that the Government had chosen not to implement the recommendations of the Canada Post Mandate Review (1996). That Canadian government appointed commission had concluded in 1996 that the Government should combat the problem of cross-subsidization by requiring that:

> *Canada Post Corporation withdraw from all competition with the private sector in areas of activity outside its core public policy responsibilities for providing postal services...and that the Government specifically direct Canada Post Corporation to divest itself of Purolator Courier at fair market value and to withdraw from all other courier services, which are defined as services involving pickup of the envelope or parcel from a*

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163 Canada Post Summaries: 1999/2000 to 2003/04 Corporate Plan.
164 Corporate Plan at 7.
165 Canada Post, Performance Magazine (April 1998), at 13.

business or residential address.[166]

9. In announcing Canada's decision on April 23, 1997, the Minister also made it clear that the reason that Canada Post would be allowed to remain in competitive services was to ensure the survival of the letter mail service. The Minister stated:

> *In order to maintain affordable letter mail, without subsidies, Canada Post will remain in competitive services.*[167]

10. In other words, the Minister was espousing the long held view of Canada Post that it could keep the price of a stamp for mailing a letter under control, by virtue of profits earned from Canada Post's competitive (courier) business.

11. With respect to the Minister's comment, Canada Post has little to gain, in a corporate strategy sense, from using any profits achieved in its competitive activities to subsidize its letter mail monopoly. Moving profits from the competitive sector to the monopoly sector would diminish the Corporation's ability to invest back into the competitive sector so as to compete more effectively with its rivals and prepare for future competitive challenges.

12. Further, since performance evaluation criteria for Canada Post have not yet been fully or finally developed, it is unclear why Canada Post managers would value the Corporation's performance in a monopoly segment more highly than the Corporation's performance in competitive activities. It seems much more likely that the Corporation's managers would prefer that any profits from the competitive arena should stay in the competitive segment where they can help prepare the Corporation for existing and future competition. These managers would recognize the need to invest in capacity and other infrastructure investments which deter entry or expansion by competitors.

Canada Post Has Incentive and Ability to Cross-Subsidize its Courier Business

13. Canada Post has both the incentive and ability to cross-subsidize its competitive services, from its letter mail monopoly revenues, for the following reasons. First, unlike private profit-oriented firms, there is <u>no</u> strong incentive to prevent Canada Post from engaging in harmful cross-subsidy. In particular, Canada Post can sustain losses in its competitive activities which can be funded from its monopoly revenues. Obviously, more severe penalties exist for a private sector firm which cannot draw on monopoly revenues or the strength of government financial assistance. Canada Post is shielded from the negative consequences which private competitive firms would suffer if they engaged in cross-subsidization.

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166 Canada Post Mandate Review (1996), at 124-125.

167 Canada's Department of Public Works and Government Services, News Release (April 23, 1997).

14. Second, since Canada Post professes to believe that its monopoly business may be at the first stages of an inevitable decline due to e-mail and other substitute products, its long-term survival will depend on building a presence in other businesses such as the courier business. Any activity (including cross-subsidy) which strengthens Canada Post relative to its competitors will improve the Corporation's future prospects as it moves more heavily into new businesses. Thus, at the most basic level (i.e. corporate survival), the company has an incentive to cross-subsidize.

15. Finally, to the extent that part of Canada Post monopoly infrastructure is becoming more important to its competitive activities, the Corporation has an incentive to continue to allocate such costs to traditional monopoly services. Such an allocation may have already gained acceptance (based on the historical belief that certain resources were needed at one time to provide monopoly services). There is no external or internal pressure to change the allocation process, since Canada Post is not regulated by an independent authority, or at all, according to an allowable rate of return on its capital base.

16. Not only does Canada Post have clear incentives to engage in cross-subsidization, it also has an obvious ability to use its monopoly position to unfairly compete against others.

> *"The more Canada Post is permitted to expand in, and into, competitive markets, the more such acquiescence will increase both the incentive and the opportunity for Canada Post to engage in anti-competitive cross-subsidization of it provisions of competitive services"*[168].

17. The foregoing examination of Canada Post incentives and ability to cross-subsidize, suggests that if a subsidy flows from one market segment to another, it is most likely that the subsidy flows from Canada Post's monopoly segment (letter mail) to the competitive segment (courier services).

The Auditor's Report is seriously deficient

18. In announcing Canada's response to the Canada Post Mandate Review on April 23, 1997, Canada declared that Canada Post would be required to provide annual certification from its auditors as to whether cross-subsidization existed. Since then, there have been a number of annual certifications from Canada Post auditors. Each of these certifications has concluded that "Canada Post did not cross-subsidize its competitive services group...., using revenues protected by exclusive privilege..."[169]

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[168] G. Sidak et al, at 74

[169] Canada Post, Annual Report 1998-1999, at 32.

19. Although Canada Post claims that its costing methodology adequately ensures that it does not have the ability to cross-subsidize, and that its own auditors have so certified, this section demonstrates that such costing safeguards, and the auditors certification in particular, are deficient.

20. An examination of the auditors' certification reports for Canada Post creates considerable unease about its specific methodology. To begin with, Canada Post has only provided a two-page description of its cost study approach in the Annual Report. The actual descriptions of methodology are contained in a mere three or four paragraphs.[170]

21. Canada Post claims to use a long run incremental cost methodology: long run incremental cost is the total annual cost caused by the provision of a service. Although Canada Post claims to use such a methodology, it is clear that a substantial amount of costs are not associated with a given service or group of services and can therefore not be included as part of a long run incremental cost exercise. In fact, the Canada Post Annual Cost Study of 1997-98 admits that Canada Post was unable to attribute about 40% of its total non-consolidated costs.[171] In its 1998-99 Annual Report, Canada Post was once again unable to attribute 40% of total non-consolidated costs to any particular service.[172]. How can 40 percent of total costs be joint and common costs – incurred jointly across multiple cost categories, rather than being incurred on a segment-specific basis.

22. **In other words, of the $4,196,000,000 in operating costs reported by Canada Post in 1997-98, $1,774,000,000 constituted common costs that could not be attributable by Canada Post to any particular services. Therefore, of the $4,196,000,000 in operating expenses reported by Canada Post in 1997-98, only $2,422,000,000 were long run incremental costs which could be attributed to a particular service.**

23. The extremely large level of costs which could not be attributed to any services ($1,774,000,000) is of particular concern since it is probably larger than the combined costs incurred by virtually all of Canada Post's next biggest courier company rivals put together.

24. In its 1997-98 Annual Cost Study, Canada Post reports two separate service categorizations:

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170 By comparison, the costing methodology employed by the Canadian Radio-Television and Telecommunications Commission (CRTC) to categorize and measure costs for Canadian telephone companies numbered in the dozens of volumes, all of which were publicly available and subject to on-going public proceedings to ensure that no harmful cross-subsidization was occurring.

171 Canada Post, Annual Report, 1997-98, at 30.

172 Canada Post, Annual Report, 1998-99, at 30.

(i) "Services by market", namely,

a) Communications,

b) Advertising,

c) Physical Distribution,

d) Publications, and

e) Other.

(ii) Four "broad service categories" (exclusive privilege, competitive, concessionary, and other).

25. It is important that any costing methodologies adopt service categories which logically align with the way in which costs are actually incurred. It is unclear how this principle has been achieved in Canada Post's categorizations of "services by market", or in its "broad service categories".

26. The difficulty with Canada Post's two service categorizations is that there is no clear link between Canada Post's categorization of "services by market" (see the four categories below Table I), and the four "broad service categories" which involve exclusive privilege, competitive services, etc. The problem is that no combination of revenues earned, or costs incurred by any of the four "services by market" categories actually adds up to any one of the four "broad service categories" such as exclusive privilege, or competitive services. Therefore, the relationship between the two types of categories is unknown.

TABLE 1
ANNUAL COST STUDY
(Canada Post Annual Report 1997-1998 (Page 30)

Services by Market (millions $)

	Communications	Advertising	Publications	Physical Distribution	Other
Revenue	2,262	631	153	749	422
Long-run Incremental Cost	1,136	352	92	670	172
Contribution	1,126	279	61	79	260

Broad Service Categories (millions $)

	Exclusive Privilege	Competitive	Concessionary	Other
Revenue	2,682	1,256	115	164
Long-run Incremental Cost	1,403	944	96	42
Contribution	1,279	312	19	122

If we presume (although it is not stated anywhere by Canada Post and may not be the case) that the "Competitive" category (see Table 1 above) includes all of "Physical Distribution" the problem is that the difference between Physical Distribution and Competitive revenues equals $507 million ($1,256,000,000 - $749 million =$507 million). The "Advertising" category (with revenues of $631 million), is clearly too large to account for that difference.

27. Furthermore, the failure of this Annual Cost Study to indicate individual categories of the "Competitive Services" prevents an outside observer from determining whether cross-subsidy is in fact occurring in individual competitive service categories such as Priority Courier, for example. This concern is heightened by the fact that no information is provided by Canada Post in the Annual Cost Study about which services comprise the

"Exclusive Privilege" category, and which services fall into the "Competitive" category.

28. As a consequence of the disconnect between these two categories, the information provided by Canada Post and each of the individual market categories (see Table 1) is completely unhelpful. It provides no useful information or assurances that the competitive services of Canada Post are in fact covering their appropriate costs.

29. In fact, what can be discerned from Table I is that "Exclusive Privilege" is providing a positive $1,279,000,000 by way of "contribution". In other words, revenues for "Exclusive Privilege" exceed the incremental costs of providing that exclusive privilege service by $1,279,000,000. This means that 74 percent of the total "contribution" made by all of Canada Posts products, comes from its exclusive privilege (lettermail) products. So the burden of carrying the Canada Post network is in fact being borne by lettermail.

30. Furthermore, in its 1997-98 Annual Cost Study, Canada Post reports a "contribution" (revenues exceeded long run incremental costs) of $79 million from its competitive activities know as Physical Distribution. It is to be noted, however, that this sum of $79 million is less than 5% of the non-attributable costs (which totaled $1,774,000,000). In other words, if a small portion of these non-attributable costs of $1,774,000,000 could in fact be causally related to Canada Post's competitive services (Physical Distribution services), then the market category for competitive services (Physical Distribution) would be reporting a loss; not a positive contribution of $79 million. The implication of this analysis is that a relatively small margin of error or correction in measurement could result in cross-subsidization being reported. This is especially troubling when the deficiencies of the audit report are considered.

31. The auditor is stating that its analysis is a fair presentation in accordance with the Cost Methodology which was developed and implemented by Canada Post. The auditor does not, however, provide an opinion on whether the Cost Methodology is itself satisfactory. In fact, it is critically important for an independent and objective,outside agency – and not Canada Post itself – to develop the Cost Methodology in the first instance. Only then can opinions of the results of using the methodology have any real value as a safeguard against cross-subsidy.

32. While the audit does presumably involve test examinations of financial information and some assessment of the underlying methodology, there is no account of how such examinations and assessments were conducted. Given the overwhelming reliance on Canada Post management's judgement in preparing the financial information as well as the means for attributing costs to various services, the statements provided by the Cost Analysis auditor provide little in the way of substantive assurances.

33. At a minimum, if outside review must be limited to audit by a chartered accounting firm, the audit should explicitly examine the service categories used to present the data on cross-subsidy, the techniques used for attributing costs to various services, the level and

definition of common costs, and should be conducted in accordance with sound economic principles in addition to accounting principles. In fact, the auditor may be quite capable of conducting this type of audit, but may not have been given the mandate to perform the necessary review.

34. As a result, the auditor's conclusion that no cross-subsidization exits does not provide the necessary assurances, since it is premised on accepting the Cost Methodology as developed and implemented by Canada Post. A much more detailed and comprehensive examination is warranted if the "independent review process" is to have any value.

Failure to Provide Detailed Cost Information

35. According to Canada Post's Annual Cost Study:

> *Under the methodology in the Annual Cost Study, a positive contribution for a market or competitive grouping of services establishes that the grouping of services has not been cross-subsidized using revenues from exclusive privilege services.*[173] [Emphasis added]

36. In other words, as a first test in determining the issue, Canada Post is attempting to ascertain whether the revenues derived from a group of services provides a fair contribution towards covering the overhead costs of that group of services.

37. In 1989-90, Canada Post provided a similar piece of analysis to the Postal Services Review Committee ("PSRC"), and was severely criticized for providing it in such a fashion. The PSRC wrote:

> *The Committee does not agree that such a test is sufficient, since it does not allow the Committee and the public to adequately assess whether or not specific Canada Post products are being cross-subsidized.*[174] [Emphasis added]

38. According to the PSRC, a second critical test is required, namely, whether specific product lines cover their incremental costs and provide a fair contribution to those costs. The PSRC stated that "the logical necessity for such a second test stems from the inter-dependence of product costs across regulated and unregulated products."[175] According to the PSRC: "clearly a test for fairness of competition cannot be performed at a level which groups together products which are not "alike"."[176]

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173 1998-1999, Annual Report, at 30.

174 Postal Services Review Committee: Recommendations to Canada Post Corporation Regarding its Proposed January 1990 changes to Regulations (November 1989) at 12.

175 Ibid at 11.

176 Ibid at 11.

39. Applying the PSRC critique to Canada Post's most recent Annual Cost Study attached to its Annual Report, one can ascertain that Canada Post has made the same mistake again.

40. A common theme for Canada Post since its creation has been its inability to provide the type of information that would be required for a third-party regulator. This was the case during the existence of the Postal Service Review Committee 1989-90 (PSRC) and during the 1996 Mandate Review process. This inability reflects the nature of how Canada Post operates and is a *prima facie* demonstration of the integration of all its products and services. Canada Post uses this inability as a shield to deny detailed information of its operations. In particular, this lack of information and failure to collect and provide information has made it more difficult for assessments to be made by various Government Committees and by UPS of the extent of the anti-competitive conduct of Canada Post concerning acts of cross-subsidization and predatory pricing.

41. The PSRC made numerous requests of Canada Post to provide more information in support of Canada Post's application to deregulate products and services.[177] Much of the information submitted by Canada Post to the PSRC was already in the public domain, and therefore, did not add substantially to the review process. Canada Post declined requests to provide further information.

As Professor Campbell notes:

> *"These requests were embarrassing to Canada Post, which did not have all the disaggregated cost, benefit, and price information the PSRC believed it needed to make informed judgments about the proposals.*[178]*"*

42. The PSCR surmised that since Canada Post had never been subject to this kind of third-party review before, "the Corporation still may not be in a position to provide the type and quality of information which could be expected in a mature review relationship."[179] Canada Post has not provided any public indication of what it actually can and cannot do regarding the accumulation of such data, since it simply refuses to provide it as a matter of course.

43. As a result of Canada Post's refusal to provide the necessary information on its revenues and costs, the PSRC concluded that: "It is not possible to conclude whether these

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177 Section 21 of Bill C-149, pursuant to which the PSRC had been formed, obliged Canada Post to provide the PSRC with documents requested for the purpose of allowing the PSRC to fulfill its regulatory duties.

178 Campbell, at 349.

179 Postal Services Review Committee, *Recommendation to Canada Post Regarding its Proposed January 1990 Changes to Regulations*, November 1989, at 9.

products are now or may in the future be cross-subsidized by revenues from products which would remain regulated."[180]

44. The PSRC had requested such information, in part, to provide answers to questions regarding the fairness and reasonableness of Canada Post's rates and possible cross-subsidization between products. The PSRC stated:

> *"Canada Post is unique in this regard among Canadian firms that have been granted an exclusive privilege. Regulators require these companies, at a minimum, to submit revenue/cost tests on a periodic basis to demonstrate that they are not pricing competitive products in a predatory manner by cross-subsidizing them with revenues from monopoly products.*[181]*"*

45. The existence of regulated products typically creates unique cost advantages for Canada Post's unregulated products because many of Canada Post's costs are interdependent. The PSRC stated that Canada Post had only supplied

> *"... volume, cost and revenue information for unregulated products - for an aggregate, which included products which Canada Post proposed to deregulate. As a result, critical test for cross-subsidization of currently unregulated products and of products proposed for deregulation cannot be performed.*[182]*"*

46. The United States Postal Service (USPS) also has a monopoly, or exclusive privilege, over core lettermail services, and also competes with the private sector in the courier and package businesses. However, in the United States the Postal Rates Commission consistently exerts pressure on the US Postal Service's to produce detailed records of its costs, on a product by product basis. The US Postal Service, similar to the British Post Office, also has a fairly rigid structural separation between its monopoly and non-monopoly products and services.[183] By contrast, Canada Post is not subject to any sort of similar third-party regulatory control and does not separate its monopoly and non-monopoly products and services.

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180 Postal Services Review Committee, at 10.
181 Postal Services Review Committee, at 28.
182 Postal Services Review Committee, at 11.
183 Canada Post Mandate Review, at 20.