UNDER THE UNCITRAL ARBITRATION RULES AND
THE NORTH AMERICAN FREE TRADE AGREEMENT

UNITED PARCEL SERVICE OF AMERICA INC.

Claimant / Investor

-AND-

GOVERNMENT OF CANADA

Respondent / Party

INVESTOR'S SUR- REPLY ON CANADA'S NON-COMPLIANCE WITH THE INVESTOR'S INFORMATION REQUEST

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Overview

1. The Investor makes the following Sur-reply to Canada's Reply to the Investor's Motion of June 9, 2004. That motion arose out of Canada's failure to answer, in whole or in part, over 100 of the Investor's interrogatories and document requests.

2. The essence of Canada's Reply is that Canada is free to disregard this Tribunal's procedural directions and that it cannot be sanctioned for so doing. Canada's position threatens the very integrity of this arbitral process. It has resulted in months of unnecessary delays that have prejudiced the Investor's ability to have its case heard on the merits. This Tribunal should direct Canada to answer the outstanding interrogatories and document requests forthwith and should declare that Canada's conduct will be sanctioned by an award of costs. The Tribunal should also declare that it will draw adverse inferences if Canada continues to ignore the Tribunal's procedural directions.

3. In its Motion, the Investor identified two categories of information requests that Canada had failed to answer by February 26, 2004:

   a. Questions that Canada refused to answer on the basis of untimely objections;
   b. Questions that Canada did not object to, but which it nonetheless failed to answer completely.

4. With respect to the first category, Canada acknowledges that it did not raise its objections to these questions within the time required by the Tribunal's *Procedural Directions* of April 4, 2003. Canada claims that this failure to comply with the Tribunal's directions has no consequences and maintains its spurious objections to the Investor's relevant and necessary information requests.

5. With respect to the second category, Canada acknowledges that it did not produce the documents within the time established by the Tribunal's *Procedural Directions* of August 1, 2003. Again, Canada claims that this breach has no consequences. It argues that its partial response to the Investor's Information Request excuses it from a full and complete response. It also raises further untimely objections that were not even made in its February 26, 2004 response.

Canada's Untimely Objections

6. Canada attempts to justify its non-compliance with the Tribunal's directions by making a series of statements, unsupported by any evidence, that purport to establish that Canada has undertaken extensive searches for documents. However, the fact that Canada has answered some questions does not excuse it from its obligation to answer the remaining

questions. Compliance cannot be assessed by considering only the number of pages produced, particularly in a complex arbitration such as this one.

7. Canada acknowledges that its searches did not cover any of the questions to which it made untimely refusals on February 26, 2004. Canada simply decided that these questions were not relevant when it was preparing its document production and it refused to answer them.[1]

8. Canada admits that it raised these objections late, but claims that it is excused from doing so due to the length of the Investor's Information Request and changes to its legal team in April 2003.[2] If Canada needed more time to state its objections, it should have sought an extension of the 14 day time period after it received the Investor's Information Request. It did not do so. On the contrary, Canada made numerous objections within the 14 day time limit set by the Tribunal. As a result, Canada was obligated to answer the remaining questions.

9. A party cannot be allowed to decide for itself that it will not follow the Tribunal's directions. If extraordinary circumstances require an adjournment, such relief should be sought from the Tribunal. Furthermore, the changes to Canada's legal team did not justify any extension. There have also been changes in the Investor's legal team since 2003, but the Investor has not sought any adjournment.

10. The length of the Investor's Information Request reflected the Investor's efforts to make the document requests precise, narrow and specific. These efforts made it easier for Canada to assess the relevancy of the requests in a timely manner and do not justify Canada's non-compliance.

11. Canada's absence of good faith is further demonstrated by the fact that it has raised new relevancy objections in its Reply. These latest objections purport to explain Canada's failure to answer in full the questions identified in Appendix B of the Investor's Motion.

12. To allow Canada to raise new objections at such a late date would violate the principle of equality of the parties contained in NAFTA Article 1115 and Article 15 of the UNCITRAL Arbitraton Rules. However, in the event that this Tribunal wishes to consider the merits of these objections, the Investor has demonstrated in Appendixes A and B of this Sur-reply that all of Canada's objections are meritless:

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[1] Canada's Reply, para.44. The questions are listed in Appendix A of the Investor's Motion.

[2] Canada's Reply at paras.46-47.

a. Appendix A of the Investor's Motion listed all of the untimely objections made by Canada on February 26, 2004. In Appendix A to this Sur-reply, the Investor has summarized Canada's position and has provided the Investor's response.

b. Appendix B of the Investor's Motion listed questions to which Canada had made no objection, but which it had not answered in full. That appendix identified the specific documents that were in Canada's possession that should have been produced. In Appendix B of this Sur-reply, the Investor has summarized Canada's position (including its latest relevance objections) and has provided the Investor's response.

Canada's Failure to Provide Complete Answers

13. Pursuant to the terms of the Tribunal's *Procedural Directions* of August 1, 2003, Canada was required to provide complete answers to the questions in the Investor's Information Request by October 1, 2003. As of this date, Canada still has not fully complied with this direction.

14. In addition to raising new relevance objections, Canada purports to excuse its non-compliance by alleging that answering the deficiencies identified by UPS would be overly burdensome or that, in some cases, the questions have been answered in full. In a small number of cases, Canada has agreed to make further enquiries but even then it has not yet completed this task.

15. If Canada believed that answering the Investor's questions would be overly burdensome, it had the option to raise such an objection within the 14 day period provided to it after receiving the Investor's Information Request. Having agreed to answer the Investor's questions, Canada must provide a full and complete response rather than only a partial response.

16. Furthermore, by identifying with great precision the missing documents listed in Appendix B of its Motion, the Investor has spared Canada much of the burden of additional searches. For each missing document so identified, Canada must merely locate the document in its files and produce it. There is no judgment involved in such an exercise and it can be accomplished easily by clerical staff.

17. Where Canada maintains that no further responsive documents exist for a given question, it should do so clearly and explicitly. Instead, Canada has accompanied these responses with various relevance and burden objections. In most cases, it would be highly unusual if the documents did not exist. For example, documents have been produced in some years but not others. In other cases, the documents should be kept in the ordinary course of business. A clear and explicit claim that no such documents exist would be a damaging admission that could be used against Canada. In an effort to aviod such an admission,

Canada has shrouded its claims that the missing documents do not exist with various objections.

Canada's Failure to Abide By Its Undertaking

18. On April 23, 2004, Canada gave a clear and unequivocal undertaking to supply the outstanding information identified by the Investor. Canada now suggests that this was only an undertaking to state its position with respect to the outstanding information. This conduct is yet a further example of the absence of good faith and dilatory nature of Canada's tactics.

19. The full text of Canada's letter of April 23, 2004 was as follows:

> We have your letter of April 23, 2004. In your letter of April 15, 2004, you stated as follows:"We expect that you should produce the missing information within a reasonable period of time, but in any case you should not take more than thirty days from the date of this letter*to produce the outstanding documents and interrogatory answers.*"
> We would advise you that we are proceeding to work within the above-noted timeframe. *We will have our answers to you by that time.* [emphasis added]

20. This letter clearly stated that Canada would deliver its outstanding documents and interrogatory answers by May 15, 2004. There is no indication that Canada would only provide its position within 30 days.

The Example of the Annual Cost Study

21. Canada's strategy is best illustrated by its refusal to produce documents relating to its Annual Cost Study ("ACS"). The relevance of the documents relating to the ACS cannot be disputed.

22. The Investor's enquiries into the cost allocations made by Canada Post were upheld by this Tribunal in its Jurisdiction Award. Canada unsuccessfully attempted to strike the Investor's claims in this area in its jurisdictional objections. This Tribunal rejected Canada's attempt to restrict the Tribunal's inquiry into the issue of Canada Post's allocation of non-monopoly service costs into its postal monopoly budget at paragraphs 100 to 102 of the Award on Jurisdiction.[3]

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[3] The Tribunal ruled as follows:

> 102. The conclusion we have reached under the previous heading about anticompetitive measures not being subject to article 1105 is not relevant to these two paragraphs. Paragraph 29 should refer to Canada's breach of its obligations rather than to Canada Post's breach of Canada's obligations, but subject to that and its repositioning with the other alleged breaches of the obligation to accord national treatment, the pleading in the paragraph alleges facts which are capable of constituting a violation of article 1102. That is also the case with para 16(f).

23. In paragraph 27 of its Revised Amended Statement of Claim, the Investor expressly alleged that:

> Canada Post has failed to use appropriate accounting devices to properly allocate costs between the monopoly and competitive dimensions of its business. Because of these inappropriate practices, Canada Post has been able to understate, misstate or omit the appropriate costs to Canada Post of its activities in the competitive sector of the market. The Investor has been afforded less favorable treatment, since Canada Post's ability to avoid allocating the appropriate costs thereof to its competitive activities allows it to engage in forms of discriminatory and unfair behavior.

24. In paragraph 51 of its Statement of Defence, Canada attempted to justify Canada Post's actions by alleging that:

> since 1997 Canada has required Canada Post include each year in its annual report a statement from external auditors on cross-subsidization. Each year since the auditor has opined that Canada Post has not cross-subsidized its competitive services group or any market grouping of competitive services, using revenue protected by monopoly services

25. The annual audit opinion referred to in the Statement of Defence is included in Canada Post's Annual Reports under the title "Auditors' Report on Annual Cost Study Contribution Analysis". The Annual Reports repeatedly refer to the ACS and the auditors' reports relating to it as justification for Canada Post's position that it does not cross-subsidize.

26. As a result, the Investor's Information Request requested documents related to the ACS. However, rather than making a vague and broad request for all documents relating to cross-subsidization, the Investor identified with precision a series of documents or narrow categories of documents that were known or presumed to exist.

27. Canada then sought to avoid producing these documents on the grounds that they related to issues that were the subject of further jurisdictional objections. The Tribunal dismissed these objections in its *Procedural Directions* of August 1, 2003.

28. Canada did not object to the relevance or the burden of any of these requests until its Reply of last week. Only then did Canada allege that some of the Investor's requests were irrelevant or overly burdensome. It also alleged that it had satisfied the remaining requests by providing the complete methodology of the ACS, the financial numbers used to generate the ACS in the relevant years and the external audits conducted in each of these years.[4]

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[4] Canada's Reply, paras.53-67

29. Although Canada did provide the methodology of the ACS, it did not provide the full ACS reports or sufficient financial detail to allow the Investor's accounting experts to generate the ACS. Nor did Canada provide the specific audit information requested by the Investor. Canada only provided carefully edited extracts of certain ACS reports rather than complete copies.

30. Most of the Investor's specific requests relating to the ACS were simply ignored by Canada until it raised objections to them in its Reply. For example, Canada did not provide any documents relating to the following questions, amongst others:

> 82B. Provide all supporting documents prepared by or on behalf of Canada Post from 1997 to 2002 with respect to each of the studies, analysis or reports referred to in the immediately preceding document request [relating to the ACS] , including:
> (1)All special studies, statistical reports and transfer pricing studies used in preparing each [ACS]
>
> 89B. [Provide] for the years 1997-2002, the working papers of the auditors prepared for the purposes of providing the Auditors' Report on the [ACS].

31. Canada refused to search for these documents or, for question 89B, make a simple enquiry of its auditors.

32. In other cases, Canada provided only rudimentary financial data that is not fully responsive to the specific requests made by the Investor. For example, for question 82B(2), the Investor requested "all documents which define or explain the cost accounts, cost categories or cost pools used in the calculation of the incremental cost of each of Canada Post's products and services, *including financial and general ledger information...*" [emphasis added]. Canada responded by providing extracts of the ACS that did not have sufficient detail to answer this question. It did not provide the requested financial or general ledger information.

33. As a result, based on Canada's partial productions, the Investor identified specific data in Canada Post's possession that would satisfy request 82B(2). Canada has refused to search for this data, even though most of it is likely in electronic form and readily accessible by Canada Post's accounting department.

34. If, for some reason, the requested data does not exist or cannot be retrieved from Canada Post's computer records through reasonable efforts, then Canada should state clearly that this is the case. The Investor could then use this admission against Canada in its Memorial. For example, such an admission could demonstrate that Canada Post's auditors are unable to verify that Canada Post does not cross-subsidize as the necessary accounting records do not exist.

35. Instead of making a clear admission to this effect, Canada has claimed that the request is irrelevant or overly burdensome as well as maintaining that the information does not

exist. The Investor is entitled to know if documents truly do not exist or if Canada is simply refusing to search for them.

Relief Requested

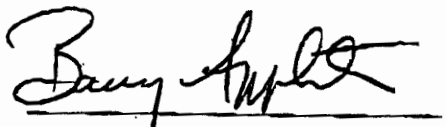
36. Canada's defiance of the Tribunal's previous procedural directions must be sanctioned in order to ensure future compliance. Declarations that Canada's conduct may result in adverse inferences or will be considered in the final award on costs are appropriate sanctions in this case.

37. In its Award on Final Costs, the *Pope & Talbot* NAFTA Tribunal made a "special mention" of Canada's decision not to comply with the directions of the Tribunal regarding certain document production matters.[5] This Tribunal should also declare that it will consider Canada's failure to comply with its directions in its award on costs.

38. Although the Investor is not asking for a specific adverse inference to be drawn at this time, it is requesting that the Tribunal put Canada on notice that these documents and interrogatory answers will be in issue at the merits phase and that appropriate inferences may be drawn at that time. This procedure was adopted by the NAFTA Tribunal in the document production stage of *Waste Management and Mexico*.[6] Otherwise, Canada may be led to believe that its non-compliance will not be sanctioned.

All of which is respectfully submitted.

Submitted this 6th day of July, 2004



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[5] *Pope & Talbot v Canada*, Award on Costs dated November 26, 2002 at para. 11. Copy attached as Appendix C to this Sur-reply.

[6] See Appendix L of the Investor's Motion of June 9, 2004.