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

BETWEEN:

UNITED PARCEL SERVICE OF AMERICA, INC.

Claimant/Investor

and

THE GOVERNMENT OF CANADA

Respondent/Party

I. STATEMENT OF DEFENCE

OF THE GOVERNMENT OF CANADA

Department of Foreign Affairs
and International Trade
Trade Law Bureau/JLT
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OF THE GOVERNMENT OF CANADA**

**PART I
OVERVIEW**

1. The NAFTA expressly recognizes that NAFTA Parties can establish monopolies and that these monopolies can compete in non-monopoly areas provided that do they not engage in anti-competitive conduct. As this Tribunal determined in its Award on Jurisdiction, only another NAFTA Party, not an investor, can bring a claim for anti-competitive conduct by a monopoly.
2. UPS of America (“UPS”) has ignored this Tribunal’s Award on Jurisdiction. UPS’ allegations remain essentially those of anti-competitive conduct including cross-subsidization and predatory conduct, which are covered by Article 1502(3)(d). The “new” allegations are mere reformulations or transparent re-labelling of the allegations already dismissed. The core of the UPS Claim remains outside the jurisdiction of this Tribunal.
3. To circumvent the Award, UPS has attempted to recast its allegations of anti-competitive conduct into breaches of the national treatment provisions in Article 1102. UPS’ efforts to advance its allegations of anti-competitive conduct under the cloak of a national treatment allegation do not change their true character. Moreover, even were this Tribunal to accept this strategy, the allegations cannot be characterized as breaches of a national treatment obligation. The expansive interpretation of Article 1102 advanced by UPS circumvents the clear expression of the intent of the Parties with respect to competition issues and the limitations on monopolies and state enterprises.

4. Canada's Statement of Defence is, therefore, with few limited exceptions, a pleading only in the alternative. In defending, Canada does not resile from its fundamental preliminary objections, as sustained by this Tribunal, to ensure that claims of anti-competitive conduct are not determined by a NAFTA Chapter 11 tribunal. Canada requests that its objections to this colourable attempt to circumvent the architecture of the NAFTA be addressed forthwith. To this end, Canada has, concurrent with this *Defence*, filed a *Notice of Motion* and supporting argument entitled *Memorial on Compliance with the Award on Jurisdiction*.

5. To bring a challenge against Canada under Chapter 11, UPS must satisfy a number of requirements. UPS must be an investor of another NAFTA Party. The conduct it complains of must involve: (i) measures; (ii) by Canada; (iii) that relate to UPS of America or its investments in Canada; and (iv) that are capable of breaching the substantive obligations in Chapter 11 or two specific obligations in Chapter 15. The complainant must also comply with the time periods for bringing a claim under Chapter 11 and with the procedural requirements for Canada's consent to arbitration.

6. The matters complained of and the facts alleged in the RASC fail to satisfy these requirements. Even if UPS could satisfy these requirements, which it cannot, its claim would still fail on the merits because the conduct it complains of is consistent with all of Canada's relevant obligations in the NAFTA.

7. The broadest jurisdictional problem with the RASC is that UPS lacks standing to bring its claim. UPS of America has not established, even on a *prima facie* basis that UPS is an investor with an investment in Canada. Canada puts the Claimant to the strict proof thereof. If UPS of America cannot establish that it is an investor that owns or controls an investment in Canada, the claim fails in its entirety and must be struck.

8. Even if UPS did have standing, much of its challenge would fail because the conduct complained of cannot give rise to a complaint by an investor under Chapter 11.

The NAFTA expressly allows NAFTA Parties to maintain monopolies and state enterprises. The NAFTA imposes obligations on each Party to ensure that its monopolies and state enterprises uphold certain standards of conduct. However, with one exception, a complaint that a NAFTA Party has failed to ensure the standards of conduct specified may only be brought by another NAFTA Party, and not by an investor, as the Tribunal found in its Award on Jurisdiction. The one exception is where the monopoly or state enterprise is exercising governmental authority delegated to it by the NAFTA Party.

9. Notwithstanding the Tribunal's Award on Jurisdiction, the allegations by UPS remain essentially allegations of anti-competitive conduct including cross-subsidization and predatory conduct by a monopoly or state enterprise. None of the conduct complained of involves the exercise by Canada Post of delegated governmental authority. For these reasons too, the core of the complainant's challenge remains outside the jurisdiction of this Tribunal.

10. As already noted, UPS has attempted to recast its allegations of anti-competitive conduct as breaches of the national treatment obligation in Article 1102. However, the conduct alleged cannot on its face constitute a breach of Article 1102 – or any other provision of Chapter 11 – because it does not involve a measure relating to UPS or any “treatment” of UPS. Even if it did, many of the claims in the RASC relate to tax measures, procurement, subsidies or cultural industries, all of which are expressly excluded from Canada's Chapter 11 obligations and therefore outside the jurisdiction of this Tribunal.

11. The claims in the RASC suffer from a number of other jurisdictional deficiencies. Many of the claims are time barred by Article 1116 because more than three years have elapsed from the date on which the claimant first acquired or should have acquired knowledge of the alleged breaches and knowledge that it has incurred loss or damage.

In addition, the claimant has failed to meet the requirements in Articles 1119 and 1120 for Canada's consent to the arbitration of some of its claims.

12. For all of these reasons, the complaint by UPS is not within the jurisdiction of this Tribunal.

13. If any claim in the RASC is within the jurisdiction of this Tribunal, which Canada denies, it fails on its merits. Canada has acted consistently with its obligations under Chapter 11 of the NAFTA and has ensured that Canada Post acts in a manner consistent with the obligations in Articles 1502(3)(a) and 1503(2).

14. If UPS of America is an investor with investments in Canada, which Canada denies, in no case has Canada accorded UPS or any of those alleged investments treatment any less favourable than that it accords, in like circumstances, to Canadian investors and their investments, as required by Article 1102 of the NAFTA.

15. If any of the entities described in the RASC are investments in Canada of UPS, which Canada denies, Canada has nevertheless complied with its obligation to accord them the minimum standard of treatment required by Article 1105. Canada regulates and administers Canada Post in a transparent manner consistent with applicable legislation and other instruments. In any event, neither lack of transparency in the administration of Canada Post nor any other conduct alleged in the RASC, including that alleged in respect of Fritz-Starber, amounts to a breach of Article 1105.

16. Canada denies that it has breached Articles 1502(3)(a) or 1503(2). None of the claims in the RASC pertain to the exercise by Canada Post of governmental authority. Even if they do, Canada has complied with its obligations in Articles 1502(3)(a) and 1503(2). Canada has ensured that Canada Post acts in a manner consistent with Canada's obligations under Chapter 11, including those in Article 1102, when Canada

Post exercises regulatory, administrative or other governmental authority delegated to it by Canada.

17. If UPS is an investor with investments in Canada, which Canada denies, Canada has not breached any obligation under Articles 1103 or 1104 of the NAFTA in respect of UPS or its alleged investments in Canada. The claims in the RASC pertaining to Articles 1103 and 1104 fail to identify any measures by Canada that accord treatment of any sort to UPS or its alleged investments. The claims further fail to identify any measures that accord to UPS or its alleged investments treatment that does not meet the requirements of Articles 1103 or 1104.

18. This *Defence* separately addresses the factual and legal issues arising from each of the three impugned programs. Part II sets forth the facts in respect of Canada Post, Parts III and IV address Canada Customs and Revenue Agency and the Publications Assistance Program. Canada's legal response in respect of each, together with its additional jurisdictional objections is set forth in Part V.

PART II

CANADA POST CORPORATION

Mandate\Organization

19. Canada Post serves nearly 31 million Canadians and over one million businesses through one of the most sophisticated mail processing and distribution systems in the world. Canada Post and its subsidiaries annually collect, process and deliver nearly 10 billion messages and parcels to over 13 million addresses. Canada Post has over 24,000 retail points of purchase where customers can access their postal service, including almost 7,000 postal outlets. There are more than 950,000 locations where Canadians can deposit mail, 25 major plants where mail is processed and hundreds of local letter carrier depots and delivery hubs. To staff this operation Canada Post and its subsidiaries employ 66,000 people and retain thousands of independent contractors and suppliers.

20. At Confederation in 1867, authority and jurisdiction over postal matters was assigned exclusively to the Parliament of Canada under the *Constitution Act*, 1867. One of the first federal departments formed was the predecessor to Canada Post, the Post Office Department (the “POD”).

21. The Post Office was directed to assist in the economic and social development of Canada and took on a nation-building role. The POD was a driving force behind the development of Canada’s transportation infrastructure including road, rail and air. It established a federal presence in communities across the land. It was a key facilitator of commercial and financial transactions as well as political and social communication. To this day, it continues its vital role of ensuring that food and other necessities of life are available in the more remote northern regions of Canada. Throughout its history, Canada’s post office has delivered letters, parcels, newspapers, periodicals and

addressed and un-addressed advertising. It has offered a wide variety of services such as registered items, signature items, collect on delivery, money orders, insurance, special delivery and expedited service.

22. During the 1960's and 1970's, concerns about service, management, financial performance and labour relations of the Post Office led to consideration of a new model for the provision of postal services in Canada. That model was a Crown corporation featuring a broadly defined business, a decidedly commercial orientation and independent management charged with attaining financial self-sufficiency.

23. A Crown corporation like Canada Post is different from a department of government in that it has autonomy from government and is directed to attain efficiency, commercial, and profit goals. However, a Crown corporation is also different from a private corporation. The government is the sole shareholder and defines its mandate and public policy objectives.

24. In 1981, Canada Post was created as a Crown corporation by the Canada Post Corporation Act (the "CPCA") as the successor to the POD. International postal reform has since led many other countries to subsequently adopt this model. Under the *Financial Administration Act*, which prescribes the governance framework for Crown corporations, Canada Post is defined as a Schedule III, Part II Crown Corporation. As such it is accorded the highest degree of independence and autonomy from the Government of Canada in order that it might meet its commercial objectives.

25. Canada Post was created as a commercial vehicle for government to ensure that a critical public policy objective is achieved. Canada Post's fundamental public policy objective is the provision of universal letter and parcel service at affordable rates. Universal accessibility and affordability of basic postal service has been adopted as the cornerstone principal of postal services around the world. In postal parlance, this is

known as the Universal Service Obligation (the “USO”). The USO is Canada Post’s raison d’être.

26. International governance of postal services is conducted by the Universal Postal Union (the “UPU”), now a specialized agency of the United Nations. The UPU consists of 189 member states including Canada, Mexico and the United States. The UPU’s mission is to foster the sustainable development of quality universal, efficient, accessible postal services in order to facilitate communication among the people of the world by guaranteeing the free circulation of postal items through an interconnected single postal territory.

27. The USO is foundational to the UPU’s mission and is an obligation assumed by every UPU member state. This principle is enshrined in an international treaty made among all UPU member states, the Universal Postal Convention. The Universal Postal Convention requires that all member countries ensure that all users can enjoy the right to a universal postal services involving the permanent provision of quality basic postal services at all points in a country’s territory, at affordable prices. The Universal Postal Convention provides that postal administrations shall provide both a letter service and a service for parcels weighing less than 20 kilograms. The other principal features of the USO is the obligation to provide ubiquitous postal counter services and multiple points of access for induction of postal items.

28. Canada’s commitment to a public policy of universal accessibility and affordability with respect to letter delivery, and the discharge of its international obligations has been implemented in Canada through a uniform rate structure. A similar approach has been taken by all major postal administrations. As such, Canada’s postal administration has provided a universal letter service at uniform national rates without regard to the different relative costs of providing the services. Many countries such as Great Britain or Germany have adopted uniform rates for parcel delivery regardless of distance.

29. The difficulties posed by Canada's commitment to the USO are considerable. Canada is the world's second largest landmass, comprising almost 10 million square kilometres. Although 80% of its population lives within 150 kilometres of the United States border, Canada includes thousands of communities from coast to coast and into its northern reaches. Canada's immense geography and modest population create low density that challenges the efficiency and cost structure of distribution networks. Each year the requirements of the USO become more demanding as Canada grows by more than 200,000 new addresses. Additionally, Canada's rugged northern climate produces 6 months of weather, from November through April, which dramatically complicates delivery and transportation.

30. In order to ensure the viability of the USO, nearly all countries including Canada operate their domestic letter delivery services under a form of monopoly protection. Legislation in all but a few countries prohibits the collection, transmission and delivery of letters to addresses within the country by anyone other than the national postal administration. In order to enable postal administrations to provide a uniform letter rate that is affordable they must average high-cost and low-cost letter delivery service. The reality is that a uniform national rate for letters that is affordable is commercially sustainable only to the extent that the postal administration is the beneficiary of market protection in respect of the low cost markets. Otherwise, competitors would offer rates below the national uniform standard in low cost markets. This would decrease revenues from that market thereby compromising the financial ability to fund service in higher cost markets.

31. In 1981, the CPCA refined, and restricted, the monopoly on letter delivery that had been granted to the POD at Confederation. The CPCA grants Canada Post the exclusive privilege of collecting, transmitting and delivering letters to the addressees thereof within Canada. The CPCA not only establishes Canada Post's "exclusive privilege", it also created a series of explicit exceptions to it, which is further augmented

by a list of exceptions to the definition of a “letter” contained in the regulations to the CPCA. However, the CPCA and its regulations confine the scope of the exclusive privilege to letters not weighing more than 500 grams and for which a minimum charge of \$2.31 is incurred for delivery. By contrast, the POD had the exclusive privilege of all letter deliveries in Canada, without weight limit.

32. The CPCA created an exception to the exclusive privilege for “letters of an urgent nature that are transmitted by a messenger for a fee at least equal to an amount that is three times the regular rate of postage payable for delivery in Canada of similarly addressed letters weighing 50 grams or less.” The urgent letter for which more than \$2.31 is charged is the exception under which courier companies operate a substantial portion of their business today. Prior to 1981, the entire letter market, regardless of speed of delivery or rate, was reserved by law to the POD. This provision in the CPCA allowed courier companies access to a greater part of Canada Post’s traditional market.

33. In order to meet the USO, Canada Post requires an immense, sophisticated and integrated distribution network for the collection, processing, transportation and delivery of letters and parcels. The network capacity that the USO demands is not financially sustainable on the basis solely of the revenues derived from letters and parcels. As a result and, like all other postal administrations around the world, Canada Post uses its network to provide services in addition to letters and parcels. Competitive services generate revenues in excess of their incremental costs and their contributions make Canada Post’s network viable and the USO possible.

34. Canada Post is one of the very few Crown corporations established by Canada that is a commercial entity operating in a competitive environment. The competitive reality of Canada Post should not be underestimated; 49% or 2.9 billion dollars of the 5.9 billion dollar consolidated revenue of Canada Post are generated from services that face direct competition in the marketplace. The *Financial Administration Act* applies to all

Crown corporations but it recognizes Canada Post's unique commercial circumstances and the competitive environment in which it operates. As such, unlike most other Crown corporations, the FAA establishes financial expectations of Canada Post.

Correspondingly, based on the private-sector model, Canada Post's Board of Directors and its senior executive are provided with managerial autonomy to direct and control the affairs of the corporation.

35. The scope of monopoly protection afforded to a postal administration varies from country to country dependant upon local circumstances and domestic public policy choices. However, all postal administrations offer services in addition to those that they provide under their monopoly; including the postal administrations of the other NAFTA Parties. Outside North America, postal administrations typically offer a much wider variety of competitive services than does Canada Post including services such as banking, insurance and merchandise retailing. Generally, postal administrations around the world make full use of their networks in competitive environments. In doing so, they typically do not sell competitors' services or permit competitors to use their networks except under commercial conditions.

36. The economic and financial realities of the need for Canada Post to provide competitive services are recognized in the CPCA. The CPCA defines Canada Post's mandate not only as the operation of a postal service but also as providing products and services either incidental to it or capable of being conveniently provided along with postal services such as those in newer fields like electronic communications or traditional areas such as advertising distribution.

37. One of the competitive markets in which Canada Post engages is the courier or small parcel express market. There are over 2,000 private sector courier and small parcel express companies which provide effective services. However, without Canada Post, many Canadians would be without access to affordable expedited services. Unlike

any other company, Canada Post has the capability due to economies of scale and scope to provide these services through smaller centres in every region, both urban and rural. Many courier and parcel companies rely on Canada Post's network to complete deliveries in rural or remote areas or use Canada Post's services to complete a portion of their transportation. Canada Post has special access rates for companies that "interline" or use Canada Post as a part of their transportation or delivery network.

38. Many private-sector distribution companies, both domestic and multi-national, have established impressive delivery networks in Canada. These companies provide valuable services to their customers as is evident by their successes in the marketplace. However, in Canada only Canada Post is required to discharge the USO. While the scope of the other companies distribution networks often affords a wide span of coverage it is only Canada Post that is required to maintain the capacity to deliver to every Canadian address everyday, five days a week.

39. UPS alleges that Canada Post has expanded into its markets. The converse is true. Prior to 1981, the POD had a monopoly on all letter deliveries in Canada. Canada Post has provided parcel services since 1859 and the special delivery of documents since 1898. Canada Post has responded to developments in its markets over the years by giving brand names to its traditional products that position it better with consumers. Concurrently, as technology has permitted and customer demand evolved, Canada Post has added features to its services such as time guarantees or tracing capability.

40. Canada Post has, and has had for a considerable time, a number of distribution services that compete with services offered by UPS. Priority Courier was introduced in 1979 and is an overnight courier service. Canada Post introduced its Xpresspost brand in 1993 as a replacement for its traditional special delivery service as a lower-cost alternative to courier service that delivers locally the next day. Expedited Parcel is a

time-certain ground parcel service. Canada Post also offers Regular Parcel which is its economical non-guaranteed parcel service for relatively time-insensitive shipments.

41. In 1993, Canada Post acquired approximately 76% of Purolator Courier Ltd. ('Purolator'). In 1999, Canada Post was obliged to make an additional purchase of Purolator shares under shareholder put rights bringing its ownership to approximately 96%. Purolator is Canada's largest courier company and offers a range of courier services.

42. Purolator has always been managed separately from Canada Post on a self-sustaining basis. All transactions between Canada Post and Purolator have been (and are) on normal commercial prices and terms, comparable to those for transactions of Canada Post or Purolator with third-party customers and suppliers. Canada Post sells certain Purolator services as an authorized sales agent. These services include Purolator International Courier which in 2000 replaced the international courier service that Canada Post had offered to its customers since 1993. Since its acquisition, Purolator has made a positive contribution to Canada Post's net income.

Crown Corporation Governance and Accountability

43. Canada has recognized that a state enterprise with a monopoly that is engaged in providing competitive services requires government oversight. Governance is required to ensure that public policy purposes are achieved, shareholder value is realized, and competition is fair. There is a wide body of regulatory techniques that governments have employed to achieve these purposes and a broad spectrum of acceptable governance mechanisms are used in the international postal context. As a state enterprise and government monopoly, Canada Post operates under extensive regulatory control in respect of virtually all of its activities. It is governed by a complex matrix of laws of general application, laws which pertain to Crown corporations generally, and laws which pertain specifically to Canada Post.

44. As noted, Canada Post is subject to the provisions of the *Financial Administration Act* (the “FAA”). Under the FAA, Canada Post is obligated to submit annually to the Governor in Council, for approval, a five year Corporate Plan, which broadly describes the Corporation’s forward agenda in respect of major activities and strategic issues. Canada Post cannot act in a manner inconsistent with the plan, but otherwise has broad discretion consistent with its status as a state enterprise with a commercial mandate.

45. Canada Post is not dependant on appropriations of public money from the Consolidated Revenue Fund, namely the public treasury.

46. Canada Post’s Board of Directors and its role in the governance of the corporation are established by the statutory framework within which Canada Post operates. The Board is responsible for the direction and management of Canada Post’s business, activities and other affairs. It is responsible for overseeing Canada Post by holding its management accountable for performance, long-term viability and achievement of its objectives. To fulfill these responsibilities, the Board exercises judgment in establishing the strategic direction for Canada Post, safeguarding the

resources of Canada Post, and monitoring corporate performance. Under the FAA, the directors owe a duty to act in the best interests of the Corporation.

47. Under the CPCA Canada Post may propose regulations to the government for approval. This has traditionally been the mechanism by which Canada Post has sought increases in regulated rates of postage. There are *no* regulations made under the CPCA whereby Canada Post regulates the activities of others such as granting licenses, approving commercial transactions or imposing fees or quotas.

48. The *Competition Act* contains provisions which prohibit a broad range of anti-competitive conduct, including predatory pricing and abuses by corporations of dominant positions. Complaints of anti-competitive conduct are investigated by the Commissioner of Competition (the “Commissioner”) who is responsible for the administration and enforcement of the *Competition Act*. The Commissioner may commence civil proceedings in respect of anti-competitive conduct before the Competition Tribunal, comprised of judges of the Federal Court of Canada and lay experts such as economists. The Competition Tribunal is empowered to issue broad-based remedial orders. The Commissioner may also refer criminal violations to the Attorney General of Canada for prosecution.

49. As noted, Canada does not concede that there is any jurisdiction in a NAFTA Chapter 11 tribunal to review allegations of anti-competitive conduct or to review the administration or enforcement of domestic competition policy. In response, however, to the allegations that Canada lacks an adequate regulatory framework for the supervision of Crown corporations, and assuming that there is in fact jurisdiction to hear such a claim, and for this limited purpose only, Canada notes that Canada Post is subject to competition law.

50. In accordance with his mandate under the *Competition Act* to conduct a pre-merger review of certain transactions, the Commissioner examined the 1993 and 1999

acquisitions by Canada Post of Purolator shares. In doing so, the Bureau considered submissions made by Canada Post's competitors including organizations in which UPS was a member. In approving the transaction, the Competition Bureau concluded that Canada Post's Priority Courier was not being cross-subsidized and in 1999 concluded that the increased ownership of Purolator by Canada Post would not have a direct impact on the number of competitors in the market nor on the effectiveness of competition. In 1998, again as a result of the allegations by organizations in which UPS is a directing member, the Commissioner concluded that there was no evidence of cross-subsidization between the letter services of Canada Post and either its courier operations or the courier operations of Purolator, nor evidence of predatory pricing.

51. To the same effect, and subject to the same proviso noted in paragraph 49 above, since 1997 Canada has required that 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.

Response to Specific Allegations

52. As discussed below in paragraphs 118 *et seq.*, there is no legal merit to the allegations that Canada has breached the NAFTA by granting certain “privileges” or special treatment to Canada. In any event, UPS’ allegations as to “special privileges” are fraught with factual errors and omissions, or are otherwise selectively divorced from their context. For example;

- In paragraph 29, UPS asserts that Canada does not require a “market or commercial rate of return upon its investment in Canada Post”. This assertion is factually incorrect. The CPCA legislates that Canada is to conduct its operations on a self-sustaining financial basis. Canada Post is listed as a commercial Crown corporation under the FAA which recognizes that it operates in a competitive environment and that it is not dependant on appropriations from the Government for operating purposes. The FAA mandates Canada Post to earn a return on equity and pay dividends to the Government. Canada Post has paid \$367 million in dividends and returned capital. The Government has established a financial framework for Canada Post that sets its financial goals including an 11% return on equity target. Moreover, Canada Post is subject to federal income tax.
- Rural route contractors have always been excluded from collective bargaining. Section 13(5) of the CPCA simply continued the situation prior to the enactment of the CPCA.
- Contrary to UPS’ assertion, the costs associated with the *Public Service Superannuation Act* and the Canada Post pension plan have been and are borne by Canada Post.

- The amount transferred out of the Public Service Superannuation into the Canada Post pension was not an “excessive payment”. The amount transferred was determined in accordance with actuarial principles and represented the actuarial value of accrued benefits.
- The placement of mail receptacles on public land is integral to the USO as it enables Canada to provide Canadians ubiquitous access to the postal network. Mail receptacles are not, and have never been, limited to monopoly services.

PART III

CANADA CUSTOMS AND REVENUE AGENCY

Mandate/Organization

53. Canada established the Canada Customs and Revenue Agency (“CCRA”) on November 1, 1999, replacing the Department of National Revenue (Revenue Canada) in an effort to provide better, more cost-effective and responsive tax, customs and trade administration services to Canadians.

54. The Minister of National Revenue is responsible for the CCRA and is accountable to Parliament for all its activities. Responsibility for overseeing the organization and management of the CCRA has been delegated to the Board of Management, which consists of 15 members appointed by the Governor-in-Council. The Commissioner of the CCRA, who is a member of the Board of Management, is responsible for the CCRA’s day-to-day operations.

55. The CCRA’s mandate flows from its enabling legislation – the *Customs and Revenue Agency Act* and from its various program statutes. As Canada’s national revenue administration, the CCRA is responsible for the administration, assessment and collection of federal customs duties, excise duties and taxes, income tax and the goods and services tax, and some taxes imposed by provincial and territorial governments, as well as for the administration of various social and economic benefit programs through the tax system.

Courier and postal import programs are administered by the Customs Branch of the CCRA (“Canada Customs”). Canada Customs is responsible for the administration of border and trade legislation including international agreements such as the World Trade Organization Agreement, the Canada-U.S. Free Trade Agreement and the NAFTA. In

providing customs services, Canada Customs has a mandate to facilitate the movement of legitimate goods, services, and admissible people into Canada, reducing compliance costs associated with crossing the border.

56. Upon Confederation in 1867, the Ministry of Customs and the Department of Inland Revenue were established with responsibility for assessing and collecting customs and excise duties, respectively. In 1927, the then amalgamated Customs and Excise Department assumed responsibility for the collection of income taxes. The Department was subsequently separated into the Department of National Revenue (Customs and Excise) and the Department of National Revenue (Taxation) and the two departments operated independently for a number of years, until they were administratively consolidated in 1992, and then reconstituted as the CCRA in 1999.

57. Customs officers originally only performed the traditional customs functions of border protection and revenue collection. In 1969 they also assumed responsibility for performing border control functions on behalf of various federal government departments. Today, in addition to administering the *Customs Act*, the *Customs Tariff*, the *Customs and Excise Offshore Application Act*, the *Special Import Measures Act* and the *Export and Import Permits Act*, Canada Customs administers more than 70 other federal acts involved in regulating, controlling or prohibiting the importation of goods or the movement of people into and out of Canada.

International Framework

58. Canada Customs programs are authorized by Canadian statutes and regulations. They also reflect Canada's international obligations. Canada's participation in international organizations such as the World Trade Organization ("WTO"), the World Customs Organization ("WCO") and the Asia-Pacific Economic Cooperation ("APEC") significantly shape the way in which Canada delivers its customs programs. Canada is a

member of a community of states bound by international conventions and driven by the need to harmonize and standardize processes in order to facilitate trade on a global scale. Canada's postal and courier import programs are examples of customs programs that were developed in this international environment.

59. Established in 1952, the WCO is an independent intergovernmental body whose 160 member governments are responsible for more than 97% of international trade. The mission of the WCO is to enhance the effectiveness of customs administrations around the world by studying customs processes and making recommendations to ensure, *inter alia*, the uniform interpretation and application of customs procedures.

60. In 1974 the WCO adopted the *International Convention on the Simplification and Harmonization of Customs Procedures* ("Kyoto Convention"). In 1999 the WCO also adopted the Protocol of Amendment to the Kyoto Convention ("Protocol of Amendment") in response to significant growth in international trade and the changing international business environment. Although the Protocol of Amendment is not yet in force, Canada is one of eleven contracting parties that has thus far ratified or acceded to it. The Protocol of Amendment will come into force three months after it has been ratified or acceded to by 40 contracting parties to the Kyoto Convention.

61. Annex F.4, one of 31 different Annexes to the Kyoto Convention, sets out recommendations concerning "*Customs formalities in respect of postal traffic*". It recognizes the inherently unique nature of postal imports and the special relationship that this requires between a country's postal administration and its customs authority. While member states are not obligated to adopt all the recommendations in Annex F.4, they are encouraged to do so and to meet or exceed the performance standards embodied in the recommendations. Canada's postal import program fully reflects these recommendations.

62. As regards courier shipments, the WCO has made submissions to the WTO with respect to trade facilitation in support of the principles set out in the Kyoto Convention. In 1999 it issued its “*Guidelines Which May Be Applied To Simplify and Harmonize Customs Formalities In Respect Of Consignments for Which Immediate Clearance Is Requested.*” These guidelines offer recommendations for facilitating the controlled release of small, low value goods across international borders. The Canadian courier import program reflects these guidelines.

63. Canada’s postal and courier import programs are therefore not unique to Canada. They are consistent with those of many other customs administrations in the world, reflecting both the best practices stipulated in the Kyoto Convention and the preferences expressed by the international customs, postal and courier communities.

64. Within this framework of international obligations, recommended standards and best practices, the courier import program further incorporates a customs clearance process that was developed in concert with, and subsequently endorsed by, key courier industry stakeholders, including UPS Canada.

Differences Between Postal and Courier Streams

65. A primary function of Canada Customs is to maintain and exercise control over the importation of goods and, where applicable, to assess and collect duties and taxes payable on imported goods. Customs procedures and legislation regulate the various reporting, release, accounting and verification activities for shipments of goods arriving by highway, air, rail, sea and post. The CCRA, in consultation with stakeholders, has developed numerous service options for customs processing. These processes are different depending on the modes of transport used, the value of the imported goods, and whether the goods are being imported for commercial or non-commercial use.

66. From a customs perspective, there is a fundamental difference between items entering Canada through the mail and items that arrive by courier. Mailed items are posted abroad with foreign postal administrations. The senders are unknown to Canada Post and no information is provided in advance to Canada Post by the foreign postal administration, or in turn to Canada Customs, about the items being sent. In contrast, courier shipments are sent pursuant to a contractual relationship between the courier and the customer. The customer's identity, together with information about what is being sent, are known to the courier and potentially available to Canada Customs from the outset.

67. In the postal stream, information regarding the sender and contents of mail can only be obtained by Canada Customs through physical inspection of the mail and its contents upon arrival in Canada. In contrast, the same information is available to Canada Customs from couriers in respect of their shipments, sometimes in advance of the arrival of the parcel, without inspection. All mail containing goods must therefore be presented to Canada Customs for potential inspection whereas only courier shipments selected by Canada Customs, on the basis of information disclosed to the courier by the sender or other risk indicators, are presented for inspection. As a result, the process of customs clearance is much longer for mail than for courier shipments. This distinction is one of the many reasons why the CCRA, as well as other Customs administrations, have developed different processes for dealing with mail and courier shipments.

68. The postal and courier import programs are specialized programs that have been developed to reflect the inherent differences between the two modes of importation.

Postal Stream

69. Canada's postal import process reflects its international obligations. As a member of the UPU, Canada has an obligation to receive, control and protect international mail until it is delivered to the Canadian addressee.

70. International mail arrives in Canada by various modes of transport and remains under the control and responsibility of the foreign postal service until control is accepted by Canada Post at International Mail Exchange Offices ("IMEOs"). Each IMEO is designated to process certain types of international mail. For example, non-US international parcel mail is directed to an IMEO in Toronto, Montreal or Vancouver. US parcel mail can be directed to one of these IMEOs or to the IMEO's located in Winnipeg or Calgary.

71. Once Canada Post assumes control of international mail, it is responsible for making it available to customs for processing. Customs Mail Centres ("CMC") have been established in each of the five designated IMEOs for this purpose.

72. At CMCs, only Canada Customs personnel perform the core customs functions of primary screening, secondary inspection, enforcement, duty assessment, invoicing, and customs release.

73. While letter mail, periodicals and newspapers are subject to selective primary screening by customs officials, all parcel mail is screened. Primary screening of mail involves the consideration of the physical characteristics of each item and the accompanying documentation or information. At this stage, items are either identified and segregated for further processing, known as secondary inspection, or stamped "Cleared Customs" and released to Canada Post for immediate delivery. Where mail is identified as requiring secondary inspection by Canada Customs, tracking information concerning the item is entered into the CCRA's automated Postal Import Control System

("PICS"). This clerical data entry function is performed under contract by Canada Post personnel.

74. Secondary customs inspectors review mail items identified as requiring further customs processing to determine whether they are subject to duties or importation controls such as permits or certificates, whether enforcement measures or inspection by another government department are required or, alternatively, whether mail items can be released to Canada Post for immediate delivery. If the information on the customs declaration attached to the mail item is insufficient, the customs inspector may open the mail item, retrieve the invoice information, or physically examine the mail item's contents.

75. In all cases, it is a customs inspector who determines tariff classification, origin and value of goods imported by mail, using information from the customs declaration, invoices attached to the item or physical examination. This information is entered into the PICS by Canada Customs personnel. The PICS automatically calculates the duties and taxes to be assessed and generates an invoice. The item is then returned to Canada Post for delivery and collection of duties and taxes owing.

76. The customs postal process applies to non-commercial (casual) importations of any value and to commercial goods valued at less than \$1600. Imported commercial goods with a value of \$1600 or more ("high value goods") are removed from the postal stream and processed by Canada Customs officials in the same way as commercial goods presented at any port of entry. As a result, the customs clearance process for high-value goods imported by mail can extend to several additional days.

Courier Stream

77. The import processes applicable to courier shipments in Canada reflect the nature and needs of the courier industry. These processes are applicable to all couriers, including Purolator and UPS. While couriers handle both high and low value importations, which can be either commercial or non-commercial (casual) in nature, their service differs from mail in that in all cases it is driven by strict delivery timelines and other self-imposed service requirements.

78. Couriers operate for customs purposes as common carriers in international service to Canada and, as such, they must satisfy all Canada Customs carrier and cargo reporting requirements upon a shipment's arrival in Canada. However the time constraints associated with the customs clearance process available to common carriers, even when aided by a customs broker, are incompatible with the service commitments made by couriers to their customers.

79. As a result, in 1992, the courier industry, with the participation of UPS Canada, sought and obtained a simplified and streamlined clearance process for courier shipments known as the Courier/Low Value Shipment ("Courier/LVS") program. Currently, 45 companies, including UPS and Purolator, participate in this program. To be eligible for the program, a courier must be a bonded carrier, report goods in accordance with the Customs Act; have entered into a Memorandum of Understanding with the Minister of National Revenue; and post appropriate financial security.

80. Under the Courier/LVS program, shipments of low value goods that are non-prohibited, non-controlled or non-regulated, are recorded on a consolidated list that is presented to Canada Customs for review and selection of items for inspection. Items requiring inspection are identified by Canada Customs and set aside for this purpose, while the remaining items are immediately released to the courier for delivery

81. The Canadian Courier/LVS program is strongly endorsed by couriers, who describe it as “one of the most progressive and business facilitative customs clearance systems in the world”. It offers participating couriers like UPS the following specific advantages over Canada Post in respect of international parcel importations:

- a. Courier shipments are currently processed at roughly 30 CCRA commercial offices across Canada and the Courier/LVS program is also available on request at most of the CCRA’s other 480 customs service locations. Couriers that carry appropriate surety bonds have even greater flexibility because they are entitled to move un-cleared shipments beyond the border to some 30 inland warehouse facilities serviced by customs commercial offices for further processing. International parcel mail, by contrast, may only be processed at one of the 5 designated CMC’s – in Vancouver, Calgary, Winnipeg, Toronto and Montreal - where Customs officers are located.
- b. Couriers have “release prior to payment” privileges. This means that they can gain clearance of both low value and high value goods for commercial and casual clients prior to payment of duty and taxes. Canada Post clients have no similar privileges and therefore Canada Post is required to collect duty and taxes upon delivery of international mail before releasing the goods to the purchaser or importer. This allows couriers faster clearance of their goods.
- c. Couriers are authorized to account for low-value casual goods in lieu of the individual importer. This allows couriers to obtain faster clearance without having to obtain a power of attorney from the recipient. Canada Post has no such authorization and therefore, cannot offer a similar level of service to its customers.
- d. Couriers present for inspection only those parcels selected by Customs

officers from the cargo list. Approximately 98% of courier shipments are released by the CCRA without any intervention or inspection, while the remaining 2% are normally inspected and released (if permitted) within 1 to 2 hours of arrival. In contrast, Canada Post must present 100% of all international mail items containing goods, for primary screening. Canada Customs service standards for processing international mail, are 24 hours for air mail, 24 hours for 80% of surface mail (highway and sea), and 48 hours for the balance, 6 days a week.

- e. Couriers are authorized to consolidate certain CCRA related paperwork, including release data and accounting entries, rather than having to report shipments to Customs on a transaction by transaction basis. This translates into significant savings for couriers as millions of individual clearance documents and accounting entries have been eliminated as well as related storage costs. Canada Post client enjoys no similar privileges.

Customs Brokerage Services

82. As noted above, for customs purposes, couriers are common carriers of international shipments. However they also frequently offer other value added services to their clients such as materials handling and customs brokerage.

83. A Customs broker is retained by an importer to act as its agent in completing some of the formalities associated with importing goods into Canada. Brokers deemed qualified by the CCRA to provide such services are licensed in accordance with the *Customs Act* and the *Customs Brokers Licensing Regulations*.

84. Where goods are imported via the courier program, or by any means other than the postal stream, the process is characterized as one of self assessment, under which

the importer is responsible for declaring goods to Canada Customs and proposing their appropriate tariff classification and value for duty. A Customs brokers can be retained by an importer to assist it in determining the goods' correct classification and value, and then completing the requisite paperwork. Like other courier companies, UPS offers brokerage services to its clients as part of the range of services it provides

85. By contrast, when a person uses the postal system to import goods, international postal rules require only that the exporter affix a postal declaration to the outside of the package, describing its contents and an approximate value. When the package arrives at a CMC, Canada Customs officials determine the classification and value for duty on the basis of the postal declaration or through an examination of the packages contents. There is no opportunity for the importer to classify the goods or establish a formal value for duty, nor is there an opportunity for the importer to be assisted in these decisions by a customs broker.

86. It is clear therefore, contrary to what UPS alleges, that Canada Customs does not act as a "customs broker" for Canada Post or for anyone else. The only functions that Canada Customs can and does perform are those mandated by the *Customs Act*, or the other border legislation for which it is responsible. Canada Customs is not mandated, under that legislation, to provide customs brokerage services.

Canada Post/CCRA Postal Import Agreement

87. Commencing in 1992, Canada introduced a series of changes to the legislative framework for postal and courier services, in order to deal with issues arising in respect

of cross-border shopping between Canada and the United States and to improve the efficiency of the customs clearance process.

88. The *Postal Imports and Remission Order* (“PIRO”) and the *Courier Import Remission Order* (“CIRO”) were amended to reduce the limit for duty and tax-free importation from \$40.00 to the current level of \$20.00. The changes made in both the mail and courier streams were designed to deal with concerns expressed by retail and mail order businesses in Canada about a perceived imbalance in the “playing field” for Canadian retailers in relation to the collection and remittance of taxes, caused by cross-border shopping between Canada and the United States.

89. The reduction in the duty and tax-free limit meant that Canada Customs officers would have had to process significantly more dutiable postal and courier shipments, resulting in a greater workload and therefore, a need for more resources. Fiscal concerns required that Canada consider various alternatives for dealing with the anticipated increased volume of dutiable postal and courier shipments.

90. For courier shipments, various changes were made to the Courier/LVS program. For the mail stream, Canada Customs officials considered ways in which the process could be streamlined.

91. The *Customs Act* was amended in 1992 to authorize the Minister of National Revenue to enter into agreements with Canada Post. In 1994, the Department of National Revenue, entered into the *Processing and Clearance of Postal Imports Agreement* (“the Postal Agreement”), pursuant to which certain non-core functions previously performed by Canada Customs were outsourced to Canada Post. These activities included data entry, material handling and collections of duties and taxes on international mail. The services were outsourced on a commercial fee-for service basis. CCRA directly pays Canada Post a volume-based fees calculated on the number of items assessed. Additionally, Canada Post collects a user fee from addressees and

importers when it collects duties and taxes upon delivery. The aggregate amounts that Canada Post receives from addressees and the CCRA allow it to provide the services to Canada Customs on a commercial basis.

92. The Postal Agreement and its central feature – Canada Post performing certain services on behalf of the CCRA, were made public under a process which began in 1992. Changes to the *Customs Act* and associated regulations were widely publicized through the federal legislative and regulatory processes and coverage in the mainstream media. There was also extensive consultation with stakeholders during the development of the proposed changes and throughout the implementation process.

PART IV

The Publications Assistance Program

Objectives

93. The objectives of the Publications Assistance program are:

1) To encourage the widespread and affordable dissemination of Canadian cultural products in the form of printed material by ensuring that Canadian publications are available to Canada's widely dispersed readers at comparable costs;

2) To recognize the important role played by small community weekly newspapers in rural communities by ensuring that they continue to be accessible to their readers;

3) To support the vitality of the English and French minority communities and of Canada's cultural diversity by providing distribution support to minority official language and ethnic weekly newspapers; and

4) to provide access to those readers who, due to their geographic location or physical limitation, do not have access to a public library by supporting the distribution of library books to such readers or for the purposes of interlibrary loans.

94. To this end, the Program supports the mailing of eligible Canadian small weekly newspapers serving ethnic, geographic and linguistic communities, and commercial

newsletters to addressees in Canada. In addition, the Program supports mailing of library books through the Library Book Rate.

Administration

95. The Program is administered jointly by the Department of Canadian Heritage (DCH) and Canada Post. Eligibility and contribution amounts are determined by DCH, which deposits funds directly into individual publisher accounts at Canada Post. This process was established in order to comply with the June 1997 ruling of the World Trade Organization Appellate Body in *Canada – Periodicals*. Eligible publishers then use these funds to cover a portion of their total mailing costs for eligible copies of their publications.

96. Funding levels for individual publications are calculated as the difference between a fixed reference tariff and total mailing costs. DCH provides up to \$46.4 million through the Program each year. Canada Post provides additional funding to the Program, based on volume distributed in the previous year. In addition the Library Book Rate provides reduced rates for the mailing of eligible library books.

97. Last year, the Program supported the distribution of 215 million copies of over 1200 publications to Canadian readers.

PART V

CANADA'S LEGAL POSITION

GENERAL OBJECTIONS TO JURISDICTION

UPS of America is not an investor that owns or controls an investment in Canada

98. Article 1101, entitled "scope and coverage", states in relevant part:

This Chapter applies to measures adopted or maintained by a Party relating to:

a) investors of another Party;

b) investments of investors of another Party in the territory of the Party;

[...]

99. The allegations of breach and alleged damages relating to UPS Canada, UPS Internet Services, Inc., United Parcel Services, Inc. (New York), United Parcel Service, Inc (Ohio), UPS Worldwide Forwarding, Inc. and to Fritz Starber are outside the Tribunal's jurisdiction because they are not investments of the investor UPS of America as required by Article 1101. "Investment of an investor of a Party" is defined in Article 1139 as "an investment owned or controlled directly or indirectly by an investor of such Party". The Revised Amended Statement of Claim does not establish that UPS directly or indirectly owns or controls UPS Canada, UPS Internet Services, Inc., United Parcel Services, Inc. (New York), United Parcel Service, Inc (Ohio), UPS Worldwide Forwarding, Inc. or Fritz Starber. In addition, in the Notice of Intent and in the Statement of Claim, UPS admits that it did not own or control Fritz Starber.

100. If UPS cannot establish that it is an investor that owns or controls an investment in Canada, the claim as a whole is outside the scope of Chapter 11 and must be struck in its entirety.

UPS America cannot claim breach or damages suffered by its U.S. subsidiaries

101. The allegations of breach and alleged damages relating to UPS Internet Services, Inc., United Parcel Services, Inc. (New York), United Parcel Service, Inc (Ohio) and UPS Worldwide Forwarding, Inc. are outside the Tribunal's jurisdiction because these enterprises are not investments of an investor in the territory of another Party as required by Articles 1139 and 1101. The allegations in the RASC establish that the U.S. subsidiaries of UPS are investments in the territory of the U.S, not investments in Canada. UPS has not alleged that they are investors with investments in Canada.

102. Given that Chapter 11 does not apply to the allegations regarding the four U.S. subsidiaries of UPS America, the allegations of breaches that relate to these four U.S. subsidiaries as well as any portion of the damage claim that relates to them are outside the Tribunal's jurisdiction.

UPS' failure to identify measures adopted or maintained by Canada

103. The UPS claim contains many allegations that do not identify and do not involve "measures adopted or maintained" by Canada as required by NAFTA Article 1101 and fall therefore outside the Tribunal's jurisdiction. Many of the actions complained of are not the sort contemplated in the definition of measure in Article 201. Many of the allegations are purely commercial conduct of Canada Post that do not meet the definition of measures and that have not been adopted or maintained by Canada.

104. The following allegations are outside the Tribunal's jurisdiction because of UPS' failure to identify clearly in the RASC the measure adopted or maintained by Canada with respect to the alleged breach:

- (a.) The allegations regarding customs treatment in paragraphs 25, 25(a)(ii)(iii)(iv)(v)(vi), and 25(c), and the allegations in paragraphs 25(g) and (h), in which UPS fails to identify the measure under which the alleged treatment is accorded;
- (b.) The allegations regarding Canada Post's anti-competitive conduct or commercial operations by Canada Post in paragraphs 26, 27, 28,29, 30, 37-39, 41, and 43, in which the alleged treatment does not arise as a result of measures adopted or maintained by Canada; and
- (c.) The allegations of breach of Article 1103 and 1104 at paragraphs 32-35, in which no measures or treatment whatsoever are identified.

105. With respect to the allegations in paragraphs 12, 13, 14, and 15, of the RASC, the opinions expressed by the author of the Radwanski Report were in fact opinions of the author, solicited by Canada as part of its on-going policy development. Canada declined to accept Mr. Radwanski's views. As such, the opinions, proffered as they were, had no legal or other status, nor was Canada obligated to accept or respond to them in any manner or in any forum.

The allegations do not relate to UPS America or UPS Canada

106. This Tribunal lacks jurisdiction over the majority of UPS claims because the subject measures do not “relate to” UPS or its alleged investments in Canada as required by of Article 1101(1).

107. Article 1101 requires that there be a legally significant connection between the measure at issue and the investor or its investment. The term “relating to” requires a direct and substantial link between the measure and the investor or its investment. Save for the customs treatment complaint there is no measure at issue that purports to regulate UPS or its investments. Rather the allegations relate to Canada Post’s operations and activities. It is not sufficient for the measure to simply affect the investor or its investment.

Allegations of breaches not contained in the Notice of Intent

108. Allegations of breaches introduced for the first time in the Revised Amended Statement of Claim are outside the Tribunal’s jurisdiction. UPS failed to meet the requirement of Article 1119 that the Notice of Intent identify the issues and factual basis for the claim and the provisions of the NAFTA alleged to have been breached, with respect to:

- (a.) the new Article 1105 claim with respect to Fritz Starber (par. 36-39, par. 52(c)); and
- (b.) the claim that the sale of Purolator products by Canada Post in its retail outlets (par. 28 vi, par. 41) is contrary to national treatment
- (c.) the claim of “unfair treatment” under Article 1105 with respect of Xpresspost to the U.S. and Epost (par. 41); and

- (d.) the new allegations of breaches of NAFTA Articles 1103 and 1104 (par. 21, 32-35, par. 52(b) and 53).

109. UPS should not be allowed a *third* opportunity to introduce new issues. Compelling Canada to face a continuously changing case with entirely new legal and factual allegations would be both unfair and cause prejudice to Canada.

Articles 1116-1117

110. This claim was not properly brought by UPS America under Article 1116 as a “claim by an investor on its own behalf” because it does not disclose any treatment of UPS as an investor. Rather, UPS appears to be complaining of certain treatment to its alleged investments in their own right as would be the case for a claim brought under Article 1117 (“claim by an investor on behalf of an enterprise”). In the alternative, UPS is precluded from claiming any damages suffered directly by its alleged investments.

SPECIFIC OBJECTIONS TO JURISDICTION AND DEFENCES

Canada Post Corporation

111. Article 1102 requires each NAFTA Party to accord investors and investments of investors treatment no less favourable than accorded in like circumstances to domestic investors and investments. The purpose of the national treatment obligation is to ensure that there is no discrimination on the basis of nationality.

112. Pursuant to Articles 1502(3)(a) and 1503(2) Canada Post is only required to act in conformity with Chapter 11 obligations when it exercises regulatory, administrative or other governmental authority delegated to it. The UPS allegations of breaches of the national treatment obligation at paragraphs 26 to 30, do not involve the exercise of any such delegated authority. Instead they involve conduct by Canada Post in respect of its

own business operations or in the commercial market place. Canada Post is not subject to Chapter 11 obligations when it engages in these activities. In any event, there is no merit to UPS' allegation that Canada Post breached the national treatment obligation.

113. At paragraphs 26 to 30 of the RASC, UPS alleges that Canada breached its national treatment obligations under Article 1102 by virtue of Canada Post

- a. using its infrastructure to offer non-monopoly services,
- b. denying UPS access to Canada Post's infrastructure, and
- c. engaging in anti-competitive conduct including predatory pricing and cross-subsidization.

114. The latter allegation represents an attempt by UPS to transform an obligation not to engage in anti-competitive behaviour, which is not arbitrable under Chapter 11, into an obligation of national treatment under Article 1102. As Canada argues in its Notice of Motion and accompanying Memorial, this allegation, however it is cloaked, is outside the jurisdiction of this Tribunal.

115. Allegations concerning Canada Post's use of its infrastructure to provide competitive services cannot constitute a breach of Article 1102. There is no measure relating to UPS or treatment of UPS at issue, let alone less favourable treatment than that accorded to a domestic investor. Articles 1502(1) and 1503(2) recognize that NAFTA Parties can establish or maintain monopolies or state enterprises and Article 1502(3)(d) permits monopolies such as Canada Post to compete in non-monopolized markets subject to certain disciplines which the Tribunal has recognized are beyond its jurisdiction.

116. Allegations that UPS is being denied access to Canada Post's infrastructure also cannot constitute a breach of Article 1102. As already noted, the NAFTA recognizes that monopolies or state enterprises may compete in the commercial market place. Providing

other couriers with access to Canada Post's infrastructure, as demanded by UPS, is incompatible with such right of competition. As well, unlike Chapter 13, which applies to telecommunications networks and services, there is no access obligation for monopolies or state enterprises under Chapters 11 or 15. If the NAFTA Parties had intended to impose such an obligation they would have said so.

117. A number of UPS allegations (paragraphs 25(f),(g),(h), and 30) relate to certain treatment accorded to Canada Post either in its capacity as a crown corporation and state enterprise (such as allegations about the pension plan for Canada Post employees, granting Canada Post a borrowing guarantee or not requiring a return on capital) or directly relate to the USO (such as the non-application of the Canada Labour Code to Canada Post rural route contractors and rights for Canada Post to place mailboxes).

118. In these matters, Canada Post's status as a monopoly or state enterprise and the important public policy role it fulfills delivering universal postal service in Canada means that it is not in like circumstances with private couriers such as UPS. In any event, the treatment in issue neither involves UPS nor any discrimination on the basis of nationality. Canadian courier companies in like circumstances are not treated differently than UPS with respect to pension plans, unionization and receptacles on public land.

119. Article 1105 requires a NAFTA Party to accord investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security. Canada has acted in complete conformity with this obligation.

120. At paragraphs 40 and 42 of the RASC, UPS alleges that Canada breached the minimum standard of treatment obligation under Article 1105 by not providing sufficient regulatory oversight or transparency in regulating Canada Post. These allegations, which were previously pleaded as paragraphs 33 and 34 of the Amended Statement of Claim,

were rejected by the Tribunal and struck out pursuant to paragraph 134(a) of its Award. As Canada argues in its Notice of Motion and accompanying Memorial, the allegations in paragraphs 40 and 42 of the RASC remain outside the jurisdiction of the Tribunal.

121. As already noted, allegations that Canada breached its minimum standard of treatment obligation because of an alleged lack of transparency and accountability in the administration of Canada Post are incapable of constituting a breach of Article 1105. In any event, Canada regulates and administers Canada Post in a transparent and accountable manner consistent with applicable legislation and other instruments.

122. UPS' allegations that Canada Post breached Article 1105 relates to commercial dealings and activities by Canada Post and not the exercise of delegated regulated, administrative or other governmental authority. Canada Post is therefore not subject to the minimum standard of treatment obligations in respect of these activities.

123. In any event, UPS' allegations in paragraphs 36 to 39 and 52 (a) of the RASC, which are not admitted, regarding Canada Post's treatment of Fritz Starber, and in paragraph 41 regarding Canada Post's sale of Xpresspost (U.S.A.) services to the United States and the sale of Epost services, do not rise to the level of a breach of the minimum standard of treatment.

124. Other vague references in the RASC to alleged breaches of Article 1105 – as are found in paragraphs 43 and 51 – lack adequate particulars and do not disclose any facts capable of constituting a breach.

125. UPS alleges in paragraphs 32-35, 52(b) (and incidentally in paragraphs 21 and 53) that Canada breached its obligations under Articles 1103 and 1104. The allegations are not properly before the Tribunal and have no merit.

126. The allegations of breach of Articles 1103 and 1104 neither identify the measure or treatment that is the basis of UPS' complaint, nor the better treatment that is being

accorded to non-NAFTA investors. The allegations are therefore incapable of being responded to by Canada save for observing that the existence of a bilateral investment treaty with another country containing differently worded provisions than those in the NAFTA cannot, in itself, constitute a violation of Canada's obligations under Articles 1103 and 1104. In any event, Canada denies that any such treaties provide more favourable treatment to non-NAFTA investors than to NAFTA investors.

127. UPS' allegations of breaches by Canada and Canada Post of their Chapter 11 obligations in any event fall outside the scope of Chapter 11 because they are time barred. Only alleged breaches that first occurred after April 19, 1997 (three years from the date of the original UPS Statement of Claim) are within the Tribunal's jurisdiction. Many of the allegations in the RSAC relate to alleged measures or treatment that first occurred prior to that date. In fact many of the allegations relate to conduct that predates the NAFTA by decades.

128. Canada Post's involvement in letter and parcel delivery service and in other competitive services such as Xpresspost (U.S.A.) and Priority Courier, and the use of its infrastructure to support these services, pre-date April 19, 1997. The historical mandate of Canada Post to offer competitive services in the CPCA has not been modified. Numerous allegations such as the ones concerning the Publications Assistance Program, the Public Service Pension Plan, rural route contractors, the Mail Receptacles Regulations, borrowing guarantees, inappropriate returns on capital or the regulation of Canada Post are concerned with factual or legal conditions that have existed since incorporation or earlier.

129. The allegations concerning Fritz Starber, the sale of Purolator products by Canada Post in its retail outlets and Xpresspost (U.S.A.) and Epost are outside the Tribunal's jurisdiction because, when the Statement of Claim was filed, six months had not elapsed since the events giving rise to the claim. As a result, there were no

consultations on these matters, and the requirements for Canada's consent to arbitration were not met.

Canada Customs and Revenue Agency

130. UPS is estopped from alleging that Canada breached its national treatment obligation by implementing a customs clearance process for courier shipments that was developed in Canada at the request of, and in collaboration with the courier industry.

131. UPS alleges in paragraphs 25 (a) to (e) that the treatment accorded to Canada Post under the *Processing and Clearance of Postal Imports Agreement*", and purported exemptions granted to Canada Post in respect of the application of the *Customs Sufferance Warehouse Regulations* and the requirement to post certain financial securities, result in a breach of national treatment. The facts alleged to breach Article 1102 occurred prior to April 19, 1997 – more than three years from the date of the original UPS Statement of Claim – and therefore are outside the Tribunal's jurisdiction. In any event, these allegations, like the alleged breaches of national treatment set out in paragraphs 25(c) and (e), are without merit.

132. As already noted, Article 1102 does not obligate Canada to treat all foreign and domestic investors or investments in the same manner. Only when it is in like circumstances must the treatment accorded foreign investors or investments be no less favourable than the treatment accorded domestic investors or investments. Canada does not treat UPS less favourably than any other Canadian investor in like circumstances.

133. First, while different custom streams are involved and different processes are applicable to Canada Post and to courier companies such as UPS, UPS does not receive less favourable treatment than Canada Post.

134. The words “no less favourable” do not mean that the CCRA’s treatment of UPS should be identical to that of domestic investments in like circumstances. Rather, it simply should not be “less favourable”. In this case, different customs processes apply in light of the different circumstances of incoming mail and courier. Both processes are legislated under the *Customs Act* and both are administered by the CCRA to ensure compliance with the respective legislative requirements.

135. Second, UPS cannot claim that it should receive the same treatment as Canada Post because Canada Post and UPS are not “in like circumstances” for customs purposes.

136. The operational distinction for customs purposes between items imported by mail and by courier is recognized in the Kyoto Convention. This international convention to which Canada and the United States are signatories confirms that mail and courier are not “in like circumstances” as different sets of obligations and processes apply to them.

137. Third, there is no allegation that UPS is being discriminated against on the basis of its nationality. In fact, UPS is being treated like all other American or Canadian courier companies, including Purolator, a subsidiary of Canada Post.

138. Fourth, UPS’ complaint in respect of the Postal Import Agreement in paragraph 25(a) relates to a “procurement by a Party” by which Canada Post performs certain non-core administrative services on behalf of CCRA. As such, the national treatment obligation does not apply pursuant to Article 1108(7)(a) which provides that Articles 1102, 1103 and 1107 do not apply to procurement by a Party or a state enterprise. To the extent that UPS’ complaint is that the “payments” by Canada to Canada Post under the Agreement are excessive, such payments, as subsidies, would be exempt from the national treatment obligation under article 1108(7)(b) which provides that Articles 1102,

1103 and 1107 do not apply to subsidies or grants provided by a Party or a state enterprise, including government supported loans, guarantees and insurance.

139. Fifth, and as already noted, allegations in paragraphs 32-35, 52(b) (and incidental references in paragraphs 21 and 53) that Canada breached its obligation under Articles 1103 and 1104 are not properly before the Tribunal and have no merit.

Publications Assistance Program

140. At paragraph 25(i) of the RASC, UPS alleges that Canada breached its National Treatment obligation under Article 1102 by “designing and implementing a Publications Assistance Program in such a way as to provide financial assistance to the Canadian magazine industry, but only on condition that any magazine benefiting from that financial assistance are distributed through Canada Post, and not through companies such as UPS Canada”.

141. UPS’ allegations are outside the Tribunal’s jurisdiction pursuant to the cultural industries exemption in Article 2106 and Annex 2106, and to the exemption in Article 1108(7)(b), which provides that Article 1102 is not applicable to subsidies by a NAFTA Party.

142. In any event, UPS’ allegations are without merit as there is no less favourable treatment being accorded.

143. First, the treatment accorded to UPS and Canada Post is not accorded in like circumstances. In support of Canadian cultural policy, one of the program’s objectives is the wide and affordable distribution of magazines. Canada Post delivers to every address in Canada on a daily basis. The inherent nature of Canada Post’s delivery system means that it is not in like circumstances to other companies. No Canadian or

U.S. courier company can perform affordable distribution of magazines required by the program on a national basis.

144. Second, there is no discrimination “on the basis of nationality”. It is not possible or cost efficient for courier companies, whether Canadian or American, to carry out the distribution of magazines under the Publications Assistance Program.

Taxation Exemption

145. The allegations in paragraph 25(c) of the RASC relate to taxes and taxation measures as defined in Article 2107. Article 2103, which exempts taxation measures from the scope of the NAFTA, is therefore applicable. Sub-paragraphs (b) and (d) of Article 2103(4) provide, *inter alia*, that certain taxation measures are nonetheless subject to Article 1102 national treatment obligations except for a non-conforming provision of any existing taxation measure. Given that such existing non-conforming provisions are at issue, they are not subject to the national treatment obligations. Accordingly, any allegations relating to these non-conforming provisions are outside the Tribunal's jurisdiction.

PART V

DAMAGES

146. The Claim fails to advance any facts or evidence that the allegations set forth in the RASC, even if established, have caused as a consequence any loss, damage or injury suffered by UPS. There is no evidence or pleading of a nexus, let alone a sufficient nexus between the allegations, the breach of the NAFTA and the bare assertion of loss as give rise to an award of damages.

147. Over the last 25 years, UPS operations have expanded steadily across the country. UPS has Canadian revenues of more than \$500 million CDN not including US based revenues gained in respect of deliveries in Canada. UPS Canada has grown dramatically to the point where it is now has a significant share of the Canadian courier market.

148. Canada denies that UPS assertion's that it has suffered "reduced profit" and puts UPS to the strict proof of such including a proper accounting of revenues and cost amongst the UPS group of companies.

PART VI
RELIEF CLAIMED

149. If this Claim is arbitrable, which is not conceded, Canada denies all those facts alleged in the Claim that are not expressly admitted and puts UPS America to the strict proof thereof.

150. For the foregoing reasons, Canada respectfully requests that this Tribunal

- a. dismiss this Claim in its entirety for all of the reasons set out above; and
- b. order UPS America to pay all costs, disbursements and expenses incurred by Canada for legal representation and assistance, as well as the costs of the Tribunal.

Submitted this 7th day of February, 2003 at Ottawa, Ontario, Canada.

of Counsel to the
Government of Canada