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TRADE LAW MEMORANDUM

THE UPS CASE

IMPLICATIONS FOR NAFTA CHAPTER ELEVEN

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The Importance of the UPS Litigation

The UPS investment claim against the Government of Canada under NAFTA Chapter 11 is entering an important phase. The case should be watched closely. It has far-reaching implications for current and future disputes under these NAFTA provisions.

Supported by the U.S. and Mexican governments, Canada has applied to have a large part of the UPS claim thrown out by the NAFTA arbitration panel. If Canada succeeds, it will narrow the scope for these kinds of arbitrations in future.

If the panel rejects the Canadian motion, on the other hand, it could extend the ambit of Chapter 11 cases beyond traditional kinds of investment disputes, such as expropriation and nationalization and direct discriminatory actions, to a range of measures that indirectly impact on foreign investments.

The panel will decide by September.

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First, some background. For some time, NAFTA Chapter 11 has been a lightning rod for discontent in Canada, with interest groups vociferously asserting that it allows for ever-expanding arbitration claims by U.S. and Mexican private interests that threaten legitimate laws and other measures by governments and government agencies.

While it took longer for these issues to percolate through in the U.S., similar concerns about the investor-State dispute provisions have now been voiced in that country. The issue actually came to the fore in the recent Congressional debate over renewal of trade promotion authority or TPA for the U.S. President.

In the agreement hammered out between the Senate and House in early August allowing passage of TPA, there is language aimed at ensuring that any similar investment provisions resulting from the WTO negotiations do not weaken legitimate regulation or other government policies by allowing expansive investment-related claims.

The UPS case is relevant in this context. Given these concerns, the U.S. government is supporting Canada's efforts to have the UPS case halted in its tracks.

NAFTA Free Trade Commission Directive

Among concerns of public interest groups is the potentially broad scope of NAFTA Article 1105, in particular, which allows investment disputes to be filed on the basis of a failure of governments to provide "fair and equitable treatment" and "full protection and security" to NAFTA investors. Critics say the wording is as wide as a barn door.

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Because of this, the NAFTA Free Trade Commission issued an interpretive directive on 31 July 2001, seeking to narrow the application of Article 1105. The directive states that the Article was not intended to require treatment for foreign investors by governments beyond the recognized customary international law *minimum standard* of treatment.

Second, the directive states that a breach by a government of another provision of the NAFTA, outside of Chapter 11, does not establish that there has been a breach of Article 1105. In other words, the “fair and equitable treatment” provision in Chapter 11 cannot be used as a back-door claim by an investor alleging that a government has breached *other* parts of the NAFTA. The investment claim must be made squarely within the confines of Chapter Eleven.

The UPS arbitration has now brought the issue of the scope of Chapter 11 and Article 1105 to the fore.

The UPS Claim

In its claim, UPS alleges that Canada Post unfairly uses its monopoly powers to the detriment of commercial courier services. It says that Canada Post cross-subsidizes its in-house *Xpresspost* and *Priority Courier* services through a variety of mechanisms, giving them an unfair advantage over private sector operations.

UPS also claims that the selling of *Xpresspost* and *Priority Courier* services through Canada Post’s retail postal outlets is anti-competitive and in breach of the NAFTA “fair and equitable treatment” and non-discrimination provisions because the same services are not available to UPS. It argues that Canada Post’s distribution facilities, such as sorting

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stations and transportation services, are provided to *Xpresspost* and *Priority Courier* but these same service are not available to commercial carriers.

As a result of all of this, UPS asserts damages of not less than US\$160 million in compensation.

Canadian Government Seeks Dismissal of the Claim

In its motion to dismiss, the Canadian government (supported by the U.S. and Mexico) says that UPS has stretched the NAFTA beyond legal limits. Canada says that the allegations of anti-competitive conduct by a government monopoly, even if proven, are *outside of* Chapter Eleven. Canada's position is that the Tribunal has no jurisdiction to deal with the claim and it should be thrown out.

The Canadian motion argues that “breaches of obligations pleaded by UPS are clearly not subject not investor/state dispute settlement”, that “UPS seeks to render non-arbitrable claims arbitrable through an untenable and expansive interpretation of other NAFTA provisions” and, finally, that the NAFTA Parties “did not consent to arbitrate allegations of anti-competitive business conduct by a government monopoly”.

Obligations Regarding State Monopolies

With respect to monopolies such as Canada Post, NAFTA Chapter 11 allows investors to bring arbitration claims where a government fails to ensure that such monopolies act “consistent with” NAFTA obligations. Canada argues that this only applies where that

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monopoly exercises “regulatory, administrative or other governmental authority” and that Canada Post was not engaged in the exercise of any such functions in its operations.

Second, Canada says that, while there indeed is a separate and more general requirement in another part of the NAFTA (in Chapter 15) that monopolies such as Canada Post must not engage in anti-competitive practices, that obligation is specifically not listed as a matter within the scope of investor-state disputes in Chapter Eleven.

In short, Canada argues that, while anticompetitive action by Canada Post could be complained of by either the U.S. or Mexican *governments* as a State-to-State matter, it cannot be the basis of an investment dispute by a private *investor* under NAFTA Chapter Eleven. To allow the UPS claim to proceed would expand the scope of claims arbitrable under Chapter 11, offending both the text of the treaty and the intention of the NAFTA parties.

UPS responds that while these provisions are not specifically found in Chapter 11, the legal requirements for monopolies’ behavior have to be generously interpreted in light of the overall objectives and purposes of the NAFTA as set out in the preamble, to encourage and liberalize trade and investment.

Customary International Law

UPS also argues that, in authorizing Canada Post’s monopoly powers, the Government of Canada has failed to provide foreign investors the treatment required under the famous NAFTA Article 1105, that is, “treatment in accordance with international law, including fair and equitable treatment and full protection and security” for their investments.

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In its motion to dismiss, Canada argues that the NAFTA Commission's directive clearly provides that Article 1105 does not go beyond the *customary international law standard* for the treatment of aliens and since nothing in the UPS argument reveals a breach of such a specific customary international law obligation, Canada says that the UPS claim cannot proceed.

UPS argues that the Commission directive should not be applied, since it is effectively an amendment to the NAFTA, which can only be done by the Parties through the formal amendment process. As to whether Canada's actions are in accordance with international law, UPS says this can only be assessed after a full hearing on the merits. It argues that, having raised the issue in the context of its claim, the only fair and proper way for the Tribunal to deal with the issue is to assess the evidence and hear substantive arguments. UPS says that it has raised enough of a *prima facie* case to allow the claim to proceed.

Concluding Comments

It is obvious that the UPS case, a bit of a sleeper up to now, raises fundamental issues for the NAFTA investment dispute provisions, not only about the obligations on NAFTA governments regarding activities of State enterprises and monopolies but, equally important, on the relationship of specific treaty obligations in Chapter 11 to more general NAFTA obligations in other parts of the Treaty. The tribunal's decision on the Canadian motion in September will therefore be of critical importance to future Chapter 11 cases.

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