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***EUROPEAN COMMUNITIES AND CERTAIN MEMBER STATES –  
MEASURES AFFECTING TRADE IN LARGE CIVIL AIRCRAFT***

***(WT/DS316)***

**ANSWERS OF THE UNITED STATES OF AMERICA  
TO THE PANEL'S QUESTIONS IN CONNECTION WITH  
THE FIRST SUBSTANTIVE MEETING**

**July 6, 2007**

## Table of Reports

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<i>Australia – Leather</i>	Panel Report, <i>Australia – Subsidies Provided to Producers and Exporters of Automotive Leather</i> , WT/DS126/R, adopted 16 June 1999
<i>Brazil – Aircraft (AB)</i>	Appellate Body Report, <i>Brazil – Export Financing Programme for Aircraft</i> , WT/DS46/AB/R, adopted 20 August 1999
<i>Canada – Aircraft (Panel)</i>	Panel Report, <i>Canada – Measures Affecting the Export of Civilian Aircraft</i> , WT/DS70/R, adopted 20 August 1999, as modified by the Appellate Body Report, WT/DS70/AB/R
<i>Canada – Aircraft (AB)</i>	Appellate Body Report, <i>Canada – Measures Affecting the Export of Civilian Aircraft</i> , WT/DS70/AB/R, adopted 20 August 1999
<i>Canada – Autos (AB)</i>	Appellate Body Report, <i>Canada – Certain Measures Affecting the Automotive Industry</i> , WT/DS139/AB/R, WT/DS142/AB/R, adopted 19 June 2000
<i>Dominican Republic – Cigarettes (AB)</i>	Appellate Body Report, <i>Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes</i> , WT/DS302/AB/R, adopted 19 May 2005
<i>EC – Bananas III (AB)</i>	Appellate Body Report, <i>European Communities – Regime for the Importation, Sale and Distribution of Bananas</i> , WT/DS27/AB/R, adopted 25 September 1997
<i>EC – Biotech</i>	Panel Report, <i>European Communities – Measures Affecting the Approval and Marketing of Biotech Products</i> , WT/DS291/R, WT/DS292/R, WT/DS293/R, circulated 29 September 2006
<i>EC – Computer Equipment (AB)</i>	Appellate Body Report, <i>European Communities – Customs Classification of Certain Computer Equipment</i> , WT/DS62/AB/R, WT/DS67/AB/R, WT/DS68/AB/R, adopted 22 June 1998
<i>EC – Customs Matters (AB)</i>	Appellate Body Report, <i>European Communities – Selected Customs Matters</i> , WT/DS315/AB/R, adopted 11 December 2006
<i>EC – Hormones (AB)</i>	Appellate Body Report, <i>EC Measures Concerning Meat and Meat Products (Hormones)</i> , WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998

<i>EC – Poultry (Panel)</i>	Panel Report, <i>European Communities – Measures Affecting the Importation of Certain Poultry Products</i> , WT/DS69/R, adopted 23 July 1998, as modified by the Appellate Body Report, WT/DS69/AB/R
<i>EC – Poultry (AB)</i>	Appellate Body Report, <i>European Communities – Measures Affecting the Importation of Certain Poultry Products</i> , WT/DS69/AB/R, adopted 23 July 1998
<i>EC – Sugar Exports (Australia)</i>	GATT Panel Report, <i>European Communities – Refunds on Exports of Sugar</i> , BISD 26S/290, adopted 6 November 1979
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<i>US – Cotton Subsidies (Panel)</i>	Panel Report, <i>United States – Subsidies on Upland Cotton</i> , WT/DS267/R, adopted 21 March 2005, as modified by the Appellate Body Report, WT/DS267/AB/R

<i>US – Cotton Subsidies (AB)</i>	Appellate Body Report, <i>United States – Subsidies on Upland Cotton</i> , WT/DS267/AB/R, adopted 21 March 2005
<i>US – Countervailing Measures (Panel)</i>	Panel Report, <i>United States – Countervailing Measures Concerning Certain Products from the European Communities</i> , WT/DS212/R, adopted 8 January 2003, as modified by the Appellate Body Report, WT/DS212/AB/R
<i>US – Countervailing Measures (AB)</i>	Appellate Body Report, <i>United States – Countervailing Measures Concerning Certain Products from the European Communities</i> , WT/DS212/AB/R, adopted 8 January 2003
<i>US – Countervailing Measures (21.5)</i>	Panel Report, <i>United States – Countervailing Measures Concerning Certain Products from the European Communities – Recourse to Article 21.5 of the DSU by the European Communities</i> , WT/DS212/RW, adopted 27 September 2005
<i>US – FSC (Article 21.5) (AB)</i>	Appellate Body Report, <i>United States – Tax Treatment for “Foreign Sales Corporations” – Recourse to Article 21.5 of the DSU by the European Communities</i> , WT/DS108/AB/RW, adopted 29 January 2002
<i>US – German Steel (AB)</i>	Appellate Body Report, <i>United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany</i> , WT/DS213/AB/R, adopted 19 December 2002
<i>US – Lead Bars (AB)</i>	Appellate Body Report, <i>United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom</i> , WT/DS138/AB/R, adopted 7 June 2000
<i>US – Shrimp (AB)</i>	Appellate Body Report, <i>United States – Import Prohibition of Certain Shrimp and Shrimp Products</i> , WT/DS58/AB/R, adopted 6 November 1998
<i>US – Softwood Lumber CVD Final (Panel)</i>	Panel Report, <i>United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada</i> , WT/DS257/R and Corr.1, adopted 17 February 2004, as modified by the Appellate Body Report, WT/DS257/AB/R
<i>US – Softwood Lumber CVD Final (AB)</i>	Appellate Body Report, <i>United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada</i> , WT/DS257/AB/R, adopted 17 February 2004
<i>US – Softwood Lumber Dumping (Panel)</i>	Panel Report, <i>United States – Final Dumping Determination on Softwood Lumber from Canada</i> , WT/DS264/R, adopted 31 August 2004, as modified by the Appellate Body Report, WT/DS264/AB/R

<i>US – Wool Shirts (AB)</i>	Appellate Body Report, <i>United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India</i> , WT/DS33/AB/R and Corr.1, adopted 23 May 1997
<i>US – Zeroing (EC) (Panel)</i>	Panel Report, <i>United States – Laws, Regulations and Methodology for Calculating Dumping Margins</i> , WT/DS294/R, adopted 9 May 2006, as modified by the Appellate Body Report, WT/DS294/AB/R
<i>US – Zeroing (EC) (AB)</i>	Appellate Body Report, <i>United States – Laws, Regulations and Methodology for Calculating Dumping Margins</i> , WT/DS294/AB/R, adopted 9 May 2006
<i>US – Zeroing (Japan) (Panel)</i>	Panel Report, <i>United States – Measures Relating to Zeroing and Sunset Reviews</i> , WT/DS322/R, adopted 23 January 2007, as modified by the Appellate Body Report, WT/DS322/AB/R
<i>US - Zeroing (Japan) (AB)</i>	Appellate Report, <i>United States – Measures Relating to Zeroing and Sunset Reviews</i> , WT/DS322/AB/R, adopted 23 January 2007

*European Communities and Certain Member States –  
Measures Affecting Trade in Large Civil Aircraft (DS316)*

**Answers of the United States to the Panel’s Questions in Connection  
with the First Substantive Meeting**

July 6, 2007

**I. QUESTIONS TO THE UNITED STATES**

**A. 1992 AGREEMENT**

**1. Please comment on the view expressed by the EC, at paragraphs 137, 139, 140, 143 and 144 of its FWS, that the Appellate Body’s findings in the *EC – Poultry*, *US – Shrimp*, *US – FSC (21.5)* and *EC – Computer Equipment* cases should be understood to mean that the term “parties” in Article 31(3)(c) of the VCLT refers to the parties to the particular dispute only, and not the entire Membership of the WTO.**

Response

1. The United States first refers the Panel to the U.S. discussion of Article 31(3)(c) of the VCLT in connection with the EC’s preliminary ruling request and updated preliminary ruling request. As explained there, the term “parties” in Article 31(3)(c) of the VCLT refers to all of the parties to a treaty (in the case of the WTO Agreement, all of the WTO Members), and not merely to the parties to a particular dispute. This is evident from the definition of “party” in Article 2.1(g) of the VCLT as well as from contrasting Article 31(3)(c) to other articles, in which the drafters of the VCLT expressly referred to parties to a dispute (*e.g.*, Article 66(a)-(b)).<sup>1</sup>

2. The only parties to the 1992 agreement are the United States and the EC. As none of the other parties to the WTO Agreement are parties to the 1992 agreement, it is not a “relevant rule” of international law applicable in the relations between the parties” within the meaning of Article 31(3)(c) of the VCLT. Therefore, the 1992 agreement is not relevant to interpretation of the SCM Agreement in resolving the present dispute.

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<sup>1</sup> See U.S. Response to EC Preliminary Ruling Request (“PRR”), para. 98 (Nov. 15, 2006); U.S. Comments on EC Answers to Panel’s Questions Concerning Temporal Scope of SCM Agreement, paras. 54-57 (Dec. 21, 2006).

3. The U.S. understanding of Article 31(3)(c) of the VCLT is confirmed by the explanation of the panel in *EC - Biotech*.<sup>2</sup> For the reasons discussed in the U.S. comments on the EC's answers to the Panel's questions concerning the temporal scope of the SCM Agreement, the EC's critique of the panel's reasoning in *EC - Biotech* is unfounded.<sup>3</sup>

4. The discussion of Article 31(3)(c) of the VCLT in the EC's first written submission largely repeats the EC's arguments in its preliminary ruling request and in its answers to the Panel's questions in connection with that request. Repetition does not make these arguments any more persuasive. In particular, the EC's view regarding Article 31(3)(c) is not supported by any of the four Appellate Body reports referred to in the Panel's question.

5. Preliminarily, it should be noted that none of the four Appellate Body reports actually discusses the rule of treaty interpretation reflected in Article 31(3)(c). Thus, it is, at a minimum, misleading for the EC to assert on the basis of these reports that the EC's approach to Article 31(3)(c) is "accepted in the WTO legal order."<sup>4</sup> Moreover, closer examination reveals that these reports do not even implicitly support the EC's view.

6. ***EC - Poultry***: In *EC - Poultry*, the Appellate Body expressly rejected the suggestion that the rules relevant to resolution of the dispute were to be found in the so-called Oilseeds Agreement between the EC and Brazil (negotiated pursuant to Article XXVIII of the GATT 1947).<sup>5</sup> The Appellate Body did not even entertain the possibility of the Oilseeds Agreement being relevant as a "rule {} of international law applicable in the relations between the parties," within the meaning of Article 31(3)(c) of the VCLT.

7. At issue was the relationship between the Oilseeds Agreement and the EC's Uruguay Round tariff schedule (Schedule LXXX). It was undisputed that the content of the Oilseeds Agreement (an agreement establishing a tariff rate quota for certain goods as compensation for

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<sup>2</sup> *EC - Biotech*, paras. 7.68-7.70.

<sup>3</sup> U.S. Comments on EC Answers to Panel's Questions Concerning Temporal Scope of SCM Agreement, paras. 54 and 56 (Dec. 21, 2006).

<sup>4</sup> EC First Written Submission ("FWS"), para. 137.

<sup>5</sup> *EC - Poultry (AB)*, para. 81 ("It is Schedule LXXX, rather than the Oilseeds Agreement, which contains the relevant obligations of the European Communities under the *WTO Agreement*. Therefore, it is Schedule LXXX, rather than the Oilseeds Agreement, which forms the legal basis for this dispute and which must be interpreted in accordance with 'customary rules of interpretation of public international law' under Article 3.2 of the DSU.").

the EC's modification of concessions with respect to other goods) had been incorporated into Schedule LXXX.<sup>6</sup>

8. As the provisions of the Oilseeds Agreement had been incorporated into the EC's schedule attached to a covered agreement (the GATT 1994), those provisions were not a rule applicable only between the disputing parties. Rather, they had been made applicable to all of the parties to the GATT 1994.<sup>7</sup> For this reason alone, *EC - Poultry* does not support the EC's position that a rule applicable only between the parties to a dispute and not between all of the parties to a treaty should be taken into account in interpreting the treaty.

9. To the extent the Oilseeds Agreement itself (as opposed to its substance as incorporated into Schedule LXXX) might have been relevant at all, the Appellate Body found that this would be only "as a *supplementary means* of interpretation of Schedule LXXX pursuant to Article 32 of the *Vienna Convention*, as it is part of the historical background of the concessions of the European Communities for frozen poultry meat."<sup>8</sup> In other words, the Appellate Body did not even entertain the possibility of the Oilseeds Agreement being relevant as a "rule of international law applicable in the relations between the parties," within the meaning of Article 31(3)(c) of the VCLT.

10. ***US - Shrimp***: Nor do the findings of the Appellate Body in *US - Shrimp* help the EC's position. Those findings have no relevance at all to a proper understanding of Article 31(3)(c) of the VCLT.<sup>9</sup> In that dispute, the Appellate Body did refer to various multilateral environmental agreements ("MEAs"). However, it did not rely on them as "relevant rules of international law applicable in relations between the parties." Indeed, even under the EC's theory, it hardly could have done so, given that at least one party to the dispute (the United States) was not party to the

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<sup>6</sup> *EC - Poultry (Panel)*, para. 201. Moreover, the *EC - Poultry* panel found that "the EC 'multilateralized' the result of the oilseeds compensation negotiations (including the Oilseeds Agreement between Brazil and the EC) through a communication to the TNC Chairman and that no GATT contracting party or any other participant of the Uruguay Round raised an objection to this communication at the time." *Id.*, para. 204.

<sup>7</sup> Unlike the 1992 agreement, which was undertaken "without prejudice to {the parties} rights and obligations under the GATT," the Oilseeds Agreement had been undertaken under the auspices of the GATT through a process expressly authorized by the Contracting Parties. See GATT 1947, art. XXVIII(4).

<sup>8</sup> *EC - Poultry (AB)*, para. 83 (emphasis in original).

<sup>9</sup> As the panel in *EC - Biotech* explained the report in *US - Shrimp*, "{T}he Appellate Body did not suggest that it was looking to other rules of international law because it was required to do so pursuant to the provisions of Article 31(3)(c) of the *Vienna Convention*. Indeed, the Appellate Body did not even mention Article 31(3)(c)." *EC - Biotech*, para. 7.94 & note 271.

MEAs at issue, as the Appellate Body itself recognized.<sup>10</sup> Rather, the Appellate Body referred to the MEAs as illustrations of how understanding of the concept “natural resources” had evolved and as confirmation of the factual point that certain species of sea turtles are “exhaustible natural resources.”

11. ***US - FSC (21.5)***: The Appellate Body’s findings in *US - FSC (21.5)* also have no relevance to a proper understanding of Article 31(3)(c) of the VCLT. There, the Appellate Body did not “appl{y} {the} methodology” the EC proposes – *i.e.*, the “methodology” of interpreting a covered agreement in light of non-covered-agreement rules applicable between the disputing parties but not other WTO Members.<sup>11</sup> Rather, the Appellate Body simply “observe{d} that many States have adopted bilateral or multilateral treaties to address double taxation.”<sup>12</sup> It then attached a footnote to this observation citing not to any rules applicable between the disputing parties, but to a U.S. Department of Treasury publication describing U.S. tax treaties addressing double taxation. This is far different from having recourse to “relevant rules of international law applicable in relations between the parties,” let alone rules applicable between the disputing parties only and not “the parties” to the covered agreement (in that case, as here, the SCM Agreement).

12. ***EC - Computer Equipment***: Nor do the Appellate Body’s findings in *EC - Computer Equipment* give any support to the EC’s argument. As explained in footnote 50 of the U.S. comments on the EC’s answers to the Panel’s questions concerning the temporal scope of the SCM Agreement, the Appellate Body in *EC - Computer Equipment* did not conclude that the Harmonized System, to which some but not all WTO Members are party, was a “relevant rule of international law” to be taken into account in a dispute over the interpretation of WTO tariff schedules between Members that are parties to the Harmonized System. Rather, the Appellate Body stated that the panel should have taken into account that the Uruguay Round tariff negotiations “were held on the basis of the *Harmonized System*’s nomenclature and that requests for, and offers of, concessions were normally made in terms of this nomenclature.”<sup>13</sup> While the Appellate Body did not elaborate on how the panel should have taken this fact into account, the Appellate Body’s statement indicates that its relevance may have been as a circumstance of the tariff negotiations’ conclusion (*i.e.*, a “supplementary means of interpretation” under Article 32

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<sup>10</sup> *US - Shrimp (AB)*, para. 130 & notes 110, 111, and 113. The United States is a party to the *Convention on International Trade in Endangered Species of Wild Fauna and Flora*. However, the Appellate Body referred to that agreement simply to confirm the proposition “conceded by all the participants and third participants in {that} case” that certain species of sea turtles are “exhaustible.” *Id.*, para. 132.

<sup>11</sup> EC FWS, para. 140.

<sup>12</sup> *US - FSC (21.5) (AB)*, para. 141.

<sup>13</sup> *EC - Computer Equipment (AB)*, para. 89.

of the VCLT), not as a “relevant rule of international law applicable in the relations between the parties.”

13. In sum, the view expressed at paragraphs 137, 139, 140, 143, and 144 of the EC’s first written submission is incorrect and misleading. None of the cited Appellate Body findings suggest that the term “parties” in Article 31(3)(c) of the VCLT refers to the parties to the particular dispute only, and not the entire Membership of the WTO. As discussed in the U.S. opposition to the EC’s preliminary ruling request, a “relevant rule of international law applicable in the relations between the parties” within the meaning of Article 31(3)(c) of the VCLT is a rule that applies to *all* of the parties to a treaty. Otherwise the EC’s proposed approach would mean that the exact same provisions of the SCM Agreement would have a different meaning for different Members. The 1992 agreement applies to only two of the parties to the WTO Agreement. Accordingly, it is not relevant to interpretation of any agreements covered by the WTO Agreement, including the SCM Agreement.

## B. LAUNCH AID / MEMBER STATE FINANCING (“LA/MSF”)

**2. At paragraph 843 of its FWS, the United States requests the Panel to find that the “Launch Aid ... measures at issue in this dispute are specific subsidies that cause or threaten to cause adverse effects to the United States and, thus, are inconsistent with Articles 5(a), 5(c), 6.3(a), 6.3(b) and 6.3(c) of the SCM Agreement.” Does the “Launch Aid” referred to by the United States in this paragraph include the alleged financing of the A350 described at paragraphs 299 to 320 of its FWS? In other words, does the United States request the Panel to make a finding that the alleged financing of the A350 is a specific subsidy that causes or threatens to cause adverse effects?**

### Response

14. Launch Aid for the A350 is relevant to this dispute in two respects. First, the legally binding commitment by the Airbus governments to provide Launch Aid for the A350 is a specific subsidy that causes or threatens to cause adverse effects to the interests of the United States. Accordingly, the Launch Aid referred to in paragraph 843 of the U.S. first written submission does include Launch Aid for the A350. Second, the Airbus governments’ legally binding commitment of Launch Aid for the A350 is relevant as evidence that the Launch Aid Program is a measure in its own right, distinct from each particular provision of Launch Aid.<sup>14</sup> It confirms the “systematic application”<sup>15</sup> of Launch Aid each time Airbus has undertaken to develop a new LCA model.

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<sup>14</sup> See *Airbus: Government aid pledges are ‘legally binding’*, Associated Press (Oct. 7, 2005) (Exhibit US-48).

<sup>15</sup> *US - Zeroing (EC) (AB)*, para. 198.

15. In light of the EC's contention that Launch Aid for the A350 is not within the Panel's terms of reference, these two points bear emphasis. In both its preliminary ruling request and its first written submission, the EC asserts that Launch Aid for the A350 cannot be challenged, because Launch Aid for the A350 allegedly did not exist at the time of panel establishment and does not exist today. In its first written submission, the EC relies in particular on the alleged absence of Launch Aid contracts for the A350.<sup>16</sup>

16. The EC simply ignores that prior to the date of panel establishment, the Airbus governments had made a legally binding commitment to provide Launch Aid for the A350, and that this commitment is a measure capable of being challenged in WTO dispute settlement; indeed, it was challenged by the United States. Thus, in an October 2005 interview, referring to letters Airbus previously had received from the Airbus governments committing to provide Launch Aid for the A350, Airbus CEO Gustav Humbert stated, "You can be assured that we and the governments made sure that the letters we got are legally binding."<sup>17</sup>

17. Further evidence of the Airbus governments' legally binding commitment of Launch Aid for the A350 is set forth in the U.S. response to the EC's preliminary ruling request and in the U.S. first written submission.<sup>18</sup> The evidence includes, among other documents, the 2005 financial statements of Airbus's parent company, EADS, confirming that "certain E.U. countries have already committed to fund the development of the A350 commercial aircraft program,"<sup>19</sup> and Germany's Federal Budget Plan for 2005, setting aside Euro 390,000,000 in Launch Aid for the A350.<sup>20</sup>

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<sup>16</sup> EC FWS, paras. 351-354; EC PRR, paras. 21-29.

<sup>17</sup> *Airbus says Government Aid Pledges are Legally Binding*, Associated Press (Oct. 7, 2005) (Exhibit US-48); see also U.S. Response to EC PRR, para. 31 (Nov. 15, 2006) (explaining that Airbus typically ensures that its Launch Aid subsidies are committed *before* it decides on an industrial launch of an aircraft, because the subsidies are an important part of the financing that makes the launch possible, and the October 7, 2005 industrial launch shows, therefore, that Launch Aid was committed prior to that date).

<sup>18</sup> U.S. Response to EC PRR, paras. 31-33 (Nov. 15, 2006); U.S. FWS, paras. 304-307.

<sup>19</sup> EADS Financial Statements and Corporate Governance (2005), Registration Document - Part 1, Risk Factors, Availability of Government Financing, at 11 (Exhibit US-77).

<sup>20</sup> Bundeshaushaltsplan (Federal Budget Plan) 2005, Budget Plan 09 (Economics Ministry), Chapter 02, Part 09, Item 870 93-634 ("Ausgaben für die Inanspruchnahme aus einer Verwaltungsvereinbarung mit dem ERP-Sondervermögen zur Förderung der Entwicklungskosten des Airbus A350") (Exhibit US-17MM). The 2006 and 2007 budgets no longer mention the A350 specifically but still refer to the same ERP program (the Launch Aid) for Airbus. Moreover, they show that the amount of the provision increased to EUR 820 million. See Excerpts from German Federal Budgets for 2006 and 2007 (Exhibit US-490).

18. A commitment to make a financial contribution is a subsidy within the meaning of Article 1 of the SCM Agreement and may be challenged in WTO dispute settlement. Thus, the definition of “subsidy” in Article 1.1 of the SCM Agreement includes “potential direct transfers of funds.” Indeed, the EC itself made precisely this point as a third party in the *Brazil - Aircraft* dispute, stating:

While in Canada’s analysis, {‘financial contribution’} is assumed to mean ‘payments,’ the European Communities submits that Article 1.1(a) of the SCM Agreement deliberately permits a much broader interpretation. For example a ‘financial contribution’ under Article 1.1(a)(1)(i) of the SCM Agreement may be not only a ‘transfer of funds’ but also a ‘potential direct transfer of funds or liabilities.’ Also, the other items in the List make clear that *payments need not be immediate but may be simply committed*. The European Communities argues that given the facts of the case, the Brazilian government makes a financial contribution when it issues, *or enters into a commitment to issue*, bonds in support of an export transaction.<sup>21</sup>

19. This view, as expressed by the EC, is entirely logical, as a commitment to make a financial contribution indeed confers a benefit. For example, from the very moment that the Airbus governments commit the Launch Aid, Airbus knows it will receive below-market financing for at least 33 percent of its development costs. The only remaining question is just how below-market the terms will be. Airbus can then take that knowledge into account in its pricing decisions, for example.

20. Furthermore, the commitments of Launch Aid can facilitate the recipient’s ability to obtain capital from the markets. It also can influence the perceptions of potential customers, persuading them that the project at issue has the support necessary for its realization. In the case of the A350, the Airbus governments’ legally binding commitment to provide Launch Aid demonstrates to customers that the Airbus product line will be further extended. And, as discussed below in response to Question 3, the commitment of subsidies affects the perceptions of credit rating agencies, assuring them that a source of financial support is readily available.

21. In fact, although the EC refused to provide the Annex V Facilitator with documents setting out the terms of the Airbus governments’ legally binding commitments to Airbus with regard to the A350,<sup>22</sup> publicly available information confirms that A350 Launch Aid will confer a benefit. As discussed in the U.S. first written submission, senior Airbus officials have stated,

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<sup>21</sup> *Brazil - Aircraft (Panel)*, para. 5.5 (emphasis added).

<sup>22</sup> See U.S. FWS, para. 306 and note 342.

for example, that Launch Aid would improve revenue projections for the A350 and that the profitability of the A350 would be “destroyed” without Launch Aid.<sup>23</sup>

22. Accordingly, the United States respectfully requests that the Panel find that the Airbus governments’ commitment to provide Launch Aid for the A350 is a specific subsidy that causes or threatens to cause adverse effects to the interests of the United States.

23. Separately, the Airbus governments’ commitment to provide Launch Aid for the A350 also is relevant as evidence that the Launch Aid Program is a measure in its own right, separate from each individual provision of Launch Aid.<sup>24</sup> This evidence confirms the Airbus governments’ consistent use of Launch Aid in pursuit of a “European industrial policy” that stretches back 38 years and continues to the present day. As then chief executive of Airbus Louis Gallois explained as recently as this past March in discussing the A350 XWB, “We are not putting away refundable launch investment.”<sup>25</sup>

24. Without exception, when Airbus has sought Launch Aid to support the development of a new model LCA, the Airbus governments have provided it according to the same essential terms: long-term unsecured loans at zero or below-market rates of interest, with back-loaded repayment schedules that allow Airbus to repay the loans, if at all, through a levy on each delivery of the financed aircraft.<sup>26</sup> The governments’ legally binding commitment of Launch Aid for the A350 confirms the “systematic application”<sup>27</sup> of Launch Aid and thus supports the U.S. contention that the Launch Aid Program is a measure distinct from and in addition to individual grants of Launch Aid.

**3. Is the Panel correct in understanding that the United States’ challenge of LA / MSF as a subsidy program with “normative value” is based on the allegation that each and every time a new Airbus aircraft is to be developed, the EC governments agree to support such development on the basis of the same general terms and conditions? If so, what conclusions may be drawn about:**

**(a) whether the alleged “launch aid program” has “general and prospective application” in the light of the fact that only the governments of France and**

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<sup>23</sup> U.S. FWS, para. 308.

<sup>24</sup> See U.S. FWS, paras. 85-106; U.S. First Oral Statement (“FOS”), paras. 19-26.

<sup>25</sup> AFP, *Airbus weighing up state-backed loans for A350: Gallois* (Mar. 9, 2007) (Exhibit US-449).

<sup>26</sup> See, e.g., U.S. FWS, paras. 91-106; U.S. FOS, paras. 19-26.

<sup>27</sup> *US - Zeroing (EC) (AB)*, para. 198.

**Spain supported the development of the A340-500/600, and only the government of France supported development of the A330-200; and**

- (b) whether the content of the alleged “launch aid program” is sufficiently precise given that the specific terms and conditions of LA / MSF contracts vary, to differing degrees (compare, e.g, the royalty terms of the French, German, Spanish and UK A380 contracts)?**

Response:

25. The U.S. challenge to the Launch Aid Program is based, but only in part, on the fact that the Airbus governments consistently agree to support the development of new Airbus aircraft models on the basis of the same general terms and conditions. However, this is not the only evidence demonstrating that the Launch Aid Program is a measure distinct from individual grants of Launch Aid. Other evidence includes statements by credit rating agencies and other market participants who consistently attribute financial value to the existence of the Launch Aid Program independent of specific provisions of Launch Aid, demonstrating their understanding that the Launch Aid Program is an established part of the financial landscape in which Airbus operates. The evidence also includes the institutional apparatus that exists to support the systematic application of Launch Aid, statements by officials of the Airbus governments expressing their commitment to the continuity of Launch Aid, and statements by executives of Airbus and EADS evidencing the companies’ reliance on Launch Aid.<sup>28</sup>

26. ***Evidence demonstrating that Launch Aid Program is a measure:*** In demonstrating that the Launch Aid Program is a measure in its own right, the United States has shown the precise content of the Launch Aid Program, that it is attributable to the four Airbus governments, and that it is generally and prospectively applicable in the sense that whenever Airbus seeks Launch Aid to support the development of a new model of LCA, the Airbus governments provide Launch Aid on the same core terms.<sup>29</sup>

27. In particular, the United States has shown that the precise content of the Launch Aid Program consists of the consistent, up-front provision by the Airbus governments of a significant portion of the capital that Airbus needs to develop each new LCA model through loans that are (a) unsecured, (b) repayable on a success-dependent basis (*i.e.*, through per sale levies), (c) with the levy amounts greater for later sales than for earlier sales (*i.e.*, back-loaded), and (d) with

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<sup>28</sup> See U.S. FWS, paras. 85-106; U.S. FOS, paras. 19-26.

<sup>29</sup> See U.S. FWS, paras. 85-106; U.S. FOS, paras. 19-26.

interest accruing at rates below what the market would demand for the assumption of similar risk.<sup>30</sup>

28. The Launch Aid Program is attributable to the governments of France, Germany, the UK, and Spain, and the EC does not contest this point.<sup>31</sup> In any event, the evidence discussed at paragraphs 91 to 106 of the U.S. first written submission, including evidence of intergovernmental institutions, bureaucracies dedicated to administering Launch Aid, and statements by heads of State confirming their governments' commitment to the Launch Aid Program, makes the point incontestable.

29. With respect to the general and prospective applicability of the Launch Aid Program, the evidence notably includes the consistent provision of Launch Aid with the same core characteristics described above each time Airbus has sought support for the development of a new LCA model. As discussed in the U.S. first written submission, a recent agreement between the ministers of the four principal Airbus countries and Airbus demonstrates the general and prospective applicability of the Launch Aid Program in that it requires Airbus to [“

obligation applies not only to [ ]<sup>32</sup> That  
]. Similarly, the Airbus governments and the European Commission have repeatedly affirmed the view that Launch Aid is an integral part of “European industrial policy” and “the commercial landscape of

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<sup>30</sup> The evidence of the precise content of the Launch Aid Program consists in part of the Launch Aid contracts themselves for post-1992 contracts. *See* U.S. FWS, paras. 234-297. For pre-1992 contracts, which the EC and member State governments refused to provide in response to the Annex V Facilitator's request (*see* U.S. FWS, para. 167), the United States relies on publicly available evidence, as detailed at paragraphs 169 to 233 of its first written submission. Similarly, as the EC refused to provide any information on financing for the A350, the United States relies on publicly available evidence to demonstrate the content of the Launch Aid Program with respect to that model. *See* U.S. FWS, paras. 306-320.

<sup>31</sup> *See* EC FWS, paras. 343-344 (arguing that United States has not shown precise content or general and prospective application of Launch Aid Program).

<sup>32</sup> A380 Launch Aid Agreement, Recitals, at 3, DS316-EC-BCI-00000597 (Exhibit US-122; *see* BCI Annex); *see* U.S. FWS, para. 101.

aircraft development.”<sup>33</sup> Or, as an Airbus spokesman put it in June 2006, “Launch aid is the only available system right now.”<sup>34</sup>

30. The markets have heard these statements and responded by taking account of the general and prospective applicability of the Launch Aid Program in their assessment of Airbus. For example, as the United States discussed in its first oral statement, the recent decision by Moody’s to maintain an A1 rating for Airbus’s parent (EADS) was based on “an entrenched inclination for state protection” of Airbus.<sup>35</sup> Likewise, Fitch Ratings recently recognized that the only obstacle to the provision of “additional launch aid for the A350XWB” is the present dispute.<sup>36</sup> In short, the Launch Aid Program has become such an established feature of the financial landscape that market analysts have put a value on it and rely on its availability in making their projections of Airbus’s financial health.

31. ***Development of the A340-500/600 and the A330-200:*** The facts surrounding the development of the A340-500/600 and the A330-200 (the focus of part (a) of the Panel’s question) are entirely consistent with the general and prospective nature of the Launch Aid Program. The fact that fewer than all of the Airbus governments provided Launch Aid for the A340-500/600 and the A330-200 does not undermine the U.S. showing that Launch Aid is a program of general application. It must be recalled that these two models are derivative models. As the EC describes it, the A330-200 is “a ‘shrink’ variant” of the A330-300.<sup>37</sup> The A340-500 and A340-600 are “ultra-long-range, high-capacity variants” of the basic A340-300.<sup>38</sup>

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<sup>33</sup> U.S. FWS, paras. 102-105 (collecting statements by Airbus governments and the European Commission evidencing the general and prospective nature of the Launch Aid Program). *See US - Zeroing (Japan) (Panel)*, para. 7.52 (relying on “statements by {U.S. Department of Commerce}, other United States’ agencies and courts” to support finding that “zeroing reflects a deliberate policy”) and *US - Zeroing (Japan) (AB)*, para. 86 (upholding Panel’s reliance on assorted statements).

<sup>34</sup> Katrin Bennhold, *Airbus looks likely to seek state assistance*, International Herald Tribune (June 19, 2006) (Exhibit US-62).

<sup>35</sup> *See* U.S. FOS, para. 24 and note 17; *see also* U.S. FWS, para. 104 and note 105 (citing statements by Moody’s explaining that ratings take into account “government support in the form of refundable advances”).

<sup>36</sup> Fitch Ratings, Special Report, *Diverging Flight Paths: Boeing and Airbus Large Commercial Aircraft Industry Update* (Nov. 15, 2006), at 6 (recognizing that, given financial difficulties, “Airbus may be forced to seek additional launch aid for the A350XWB,” a step that “{i}n a vacuum . . . would be viewed favorably from a credit perspective,” but that given the trade dispute, “additional launch aid to Airbus would only increase tensions and reduce the likelihood of a negotiated settlement”) (Exhibit US-451).

<sup>37</sup> EC FWS, para. 81.

<sup>38</sup> EC FWS, para. 83.

32. As a “shrink variant,” the A330-200 had substantially lower development costs than the original model from which it was derived. As explained in the French government’s critical project appraisal, [

]”<sup>39</sup> The A330-200 Launch Aid is thus better characterized as additional A330/340 Launch Aid than as Launch Aid for a separate model. Accordingly, the commitment of Launch Aid by fewer than all of the Airbus governments for this “shrink variant” does not contradict the general and prospective applicability of Launch Aid.

33. As for the apparent lack of German government Launch Aid for the A340-500/600, it should be noted that DASA outsourced key work on this model to Alenia Aerospazio of Italy. In particular, in February 1999, DASA awarded a Lira 150 billion (about Euro 77,469,000) contract to Alenia to supply rear fuselage sections for the A340-500/600.<sup>40</sup> Therefore, it would appear that work that otherwise would have been supported by German Launch Aid was performed by Alenia.

34. Also, it should be recalled that financing for development of the A340-500/600 was being put in place at precisely the time when the German government was working to relieve DASA of serious financial difficulties, ultimately resulting in the 1997 and 1998 debt settlements. It would seem anomalous for the German government to provide more Launch Aid to DASA at the very moment when it was arranging to eliminate all of DASA’s existing Launch Aid debt.<sup>41</sup>

35. In any event, each of the Airbus governments has provided Launch Aid for development of each of the major Airbus models (or committed to provide it, in the case of the A350).<sup>42</sup> More fundamentally, whenever an Airbus company seeks Launch Aid from an Airbus government for development of a new LCA model, it receives Launch Aid consisting of the same essential terms.

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<sup>39</sup> French Critical Project Appraisal for A330-200, DS316-EC-HSBI-0001199, at 3 (referring to [ use of [ ]; *see also id.* (referring to [ ]; *id.*, p. 7 ([ ])).

<sup>40</sup> Factiva, *Italy’s Alenia to Supply Airbus Fuselage Sections to Dasa* (Feb. 10, 1999) (Exhibit US-466).

<sup>41</sup> *See* U.S. FWS, paras. 515-536.

<sup>42</sup> *See* U.S. FWS, paras. 174-177 (describing French, German, and Spanish Launch Aid for A300/A310; note that the UK did not join the Airbus project until 1978); paras. 190-194 (describing French, German, Spanish, and UK Launch Aid for A320); paras. 214-218 (describing French, German, Spanish, and UK Launch Aid for A330/340); paras. 265, 273, 282, 290 (describing French, German, Spanish, and UK Launch Aid for A380); para. 305 (describing French, German, Spanish, and UK commitments to provide Launch Aid for A350).

36. Finally, it is not correct, as the EC asserted during the first Panel meeting, that only the governments of France and Spain supported the development of the A340-500/600. The government of the UK also supported the development of that model. In particular, on February 2, 1998, the UK Minister of Industry announced a commitment of £123,000,000 to support “the design and development of the wing for the new Airbus 340 *{i.e., the A340-500/600}*.”<sup>43</sup> The fact that British Aerospace ultimately declined to avail itself of the Launch Aid committed by the UK government does not change the fact that the government made the commitment.

37. **Differences in certain details of Launch Aid contracts do not affect the status of Launch Aid Program as a measure:** Regarding part (b) of the Panel’s question, each provision of Launch Aid consists of the same core elements that cause Launch Aid to confer a benefit on Airbus: Launch Aid loans are unsecured; they are provided at zero or below-market rates of interest; repayment is made through a levy on each delivery of the financed aircraft; and repayment is “back-loaded.” By this last element, it is meant, first, that Airbus receives the benefit of Launch Aid with no repayments due at all for a period of years, until deliveries are made; second, Airbus is allowed to make relatively small repayments on early deliveries and progressively larger repayments on later deliveries; third, in some cases, Airbus has no repayment obligation at all on an initial tranche of deliveries; and, finally, the benefits from each of the foregoing features are magnified as deliveries and hence repayment obligations are delayed.<sup>44</sup>

38. It is the foregoing elements that cause Launch Aid to confer a benefit on Airbus and thus make Launch Aid a subsidy. And, these elements have been a consistent part of each and every Launch Aid contract.<sup>45</sup>

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<sup>43</sup> House of Commons Hansard Written Answers (Feb. 2, 1998) (statement of Mrs. Beckett) (Exhibit US-467); *see also* House of Commons Hansard Written Answers (Dec. 15, 1998) (statement of Mr. Battle) (“{T}he Government agreed on 2 February 1998 to invest up to £ 123 million in a public-private partnership with British Aerospace on the development of the Airbus A340-500/600”) (Exhibit US-468); UK Department of Trade and Industry, *The Government’s Expenditure Plans 1999-2000 to 2001-2002* at para. 1.61 and Table 1.3 (showing £123.0 million for the A340-500/600 in column entitled “Launch investment committed/paid”); BAE Annual Report (1998) at 24 (confirming unchanged nature of the aid, which was provided on a “risk-sharing basis with repayments not due to start until 2003 by way of levy on aircraft sales”); Kevin O’Toole, “BAE Wins Launch Aid for Airbus A340-500/600,” *Flight International* (Feb. 11, 1998) (Exhibit US-469).

<sup>44</sup> *See* U.S. FWS, paras. 125-136.

<sup>45</sup> *See* U.S. FWS, paras. 178-185, 195-205, 219-228, 237-240, 245-250, 255-257, 267-270, 275-279, 284-287, 292-296, 306-311 (citing exhibits).

39. Differences in details from one Launch Aid contract to another do not prevent the Launch Aid Program from being sufficiently precise to constitute a measure in its own right.<sup>46</sup> These differences may have a marginal effect on the size of the benefit conferred by particular provisions of Launch Aid (though even that is doubtful, given the uncertainty that royalty payments ever will come due), but they do not change the fact that the Launch Aid Program confers a benefit and thus constitutes a subsidy within the meaning of Article 1 of the SCM Agreement.

40. Royalty terms in the French, German, Spanish, and UK A380 contracts (as identified in the Panel's question), for example: are marginal at most (ranging from [ ] to [ ] percent) and would still result in below-commercial rates of return to the Airbus governments; in certain cases are explicitly capped in terms of overall return to the governments or the number of years over which royalties would be due; and in each instance are payable only after Airbus has repaid the underlying Launch Aid amounts which – assuming it happens at all – will happen only far into the future and after significant numbers of deliveries, making the actual payment of any royalties highly uncertain (indeed, speculative).<sup>47</sup> Moreover, the royalties do not change the basic characteristics that all Launch Aid has in common: in each case repayment is based on deliveries and is success-dependent; in each case the amount repayable per delivery is back-loaded; and in each case interest is accruing on the Launch Aid principal at a rate lower than what the market would demand.<sup>48</sup> As a result of these features, Airbus receives a benefit from Launch Aid, and thus a subsidy, regardless of royalty payments, if any.

41. In sum, the Launch Aid Program (as distinct from individual provisions of Launch Aid) is a measure in its own right, and the nature and core content of the Launch Aid Program are and have been consistent in all essential respects from 1967 until today. Launch Aid as a measure, as well as each and every individual provision of Launch Aid, constitutes a subsidy and breaches the EC's obligations under Articles 5 and 6 of the SCM Agreement.

**4. In paragraph 266 of its FWS, the United States refers to LA / MSF as a “repayable advance” and as *either* a direct transfer of funds *or* a potential direct transfer. To what extent does the United States contend that each of the LA / MSF measures at issue demonstrates either one or the other (or both) of these characteristics?**

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<sup>46</sup> Cf. *US - Zeroing (EC) (Panel)*, para. 7.103 (finding content of measure to be sufficiently precise even though “what the European Communities refers to as standard computer programme has frequently been revised”).

<sup>47</sup> See French A380 Launch Aid Protocole, Arts. 7.1-7.3, DS316-EC-BCI-0000249 (Exhibit US-75; see BCI Annex); German A380 Launch Aid Contract, § 10, DS316-EC-BCI-0000345 (Exhibit US-72; see BCI Annex); UK A380 Launch Aid Contract at 25 & 29 (Schedule 3, paras. 3 and 5) DS316-EC-BCI-0000556 (Exhibit US-79; see BCI Annex); see also U.S. FWS HSBI Appendix, paras. 14-15.

<sup>48</sup> See U.S. FWS, paras. 178-185, 195-205, 219-228, 237-240, 245-250, 255-257, 267-270, 275-279, 284-287, 292-296, 306-311 (citing exhibits).

Response:

42. In paragraph 266 of its first written submission, as in a number of other paragraphs introducing particular provisions of Launch Aid, the United States established the basic proposition that the measure at issue comes within the definition of “subsidy” set forth in Article 1.1(a)(1)(i) of the SCM Agreement. In doing so, the United States paraphrased Article 1.1(a)(1)(i), which refers to “a direct transfer of funds . . . {or} potential direct transfers of funds.” The United States did not distinguish between direct transfers and potential direct transfers because, in either case, the measure meets the first prong of the definition of a subsidy (the second being conferral of a benefit).<sup>49</sup>

43. In the cases of Launch Aid for the A300/310, A320, A330/340, A330-200, and A340-500/600, the measures at issue demonstrate direct transfers of funds within the meaning of Article 1.1(a)(1)(i), inasmuch as the Launch Aid amounts have been disbursed.<sup>50</sup>

44. In the case of Launch Aid for the A380, the measures at issue demonstrate both direct transfers of funds and potential direct transfers of funds, inasmuch as certain amounts have been disbursed and other committed amounts have yet to be disbursed under the Launch Aid contracts.<sup>51</sup>

45. In the case of Launch Aid for the A350, the measures at issue demonstrate potential direct transfers of funds. The Airbus governments have made legally binding commitments to provide Launch Aid for the A350 but, as far as the United States is aware,<sup>52</sup> they have not to date made any Launch Aid disbursements for the A350.

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<sup>49</sup> See also U.S. FWS, paras. 173, 190, 214, 236, 244, 254, 274, 283, 291.

<sup>50</sup> See evidence cited in U.S. FWS, paras. 173-177 (A300/310), 190-194 (A320), 214-218 (A330/A340), 236 (A330-200), 244 (French Launch Aid for A340-500/600), 253 (Spanish Launch Aid for A340-500/600).

<sup>51</sup> The French A380 Launch Aid Protocole provides for disbursements to occur from [ ]. French A380 Launch Aid Protocole, Annex 3, DS316-EC-BCI-0000249, -259 (Exhibit US-75 (BCI)). Germany is disbursing Launch Aid for the A380 in annual installments between 2002 and 2013. See BT-Drs. 14/10002, at 3 (Exhibit US-124). The Spanish A380 Launch Aid contract provides for disbursements to occur from [ ]. Spanish A380 Launch Aid Contract, Article Tercera, DS316-EC-BCI-0000549 (Exhibit US-73 (BCI)). According the UK A380 Launch Aid contract [ ]. United Kingdom A380 Launch Aid Contract, Schedule 2, DS316-EC-BCI-0000556 (Exhibit US-79 (BCI)).

<sup>52</sup> See U.S. FWS, paras. 299-320. As discussed in the U.S. FWS, during the Annex V process, the EC refused to provide copies of the “legally binding” letters that the four Airbus governments provided to Airbus, and that Airbus CEO Enders described as legally binding on October 7, 2005. U.S. FWS, para. 306 note 342.

**5. In paragraph 634 of its FWS, the EC asserts that “... there is a distinction between the measure (the contract) and the alleged subsidy contained in the measure. The measure itself is not the subsidy. Nor is the amount advanced the subsidy. If there is any subsidy (quod no), it is the difference between the terms of the loan and the relevant benchmark ...”. How does the United States respond to this assertion?**

Response:

46. This assertion is incorrect, primarily because it confuses the distinction between a subsidy and the benefit conferred by a subsidy. According to Article 1.1 of the SCM Agreement, “a subsidy shall be deemed to exist if . . . there is a financial contribution by a government or any public body within the territory of a Member . . . and a benefit is thereby conferred.” The benefit conferred is not itself the subsidy. It is the result of a financial contribution. The financial contribution together with the benefit it confers constitutes a subsidy.<sup>53</sup>

47. The difference between the terms of the loan and the relevant benchmark constitutes a key benefit conferred by a loan provided on non-market terms. The recipient of the loan has use of the loan proceeds on terms more favorable than it would be able to obtain from the market and thereby receives a benefit.<sup>54</sup> The subsidy is the financial contribution – *i.e.*, the loan – that confers this benefit, not the benefit itself. In the case at hand, that subsidy is provided in Launch Aid contracts, in which the Airbus governments obligate themselves to provide financing to Airbus in consideration for an undertaking by Airbus to repay the financing under specified (non-market) terms.<sup>55</sup>

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<sup>53</sup> See generally *Brazil - Aircraft (AB)*, para. 157 (faulting panel for “import{ing} the notion of a ‘benefit’ into the definition of a ‘financial contribution’”).

<sup>54</sup> The difference between the terms of the loan and the relevant benchmark is not the only benefit conferred. If the loan recipient simply would not be able to obtain financing for the project at issue from the market, then the very existence of the government-provided loan is a benefit. For example, in considering the French government’s provision of Launch Aid to Aérospatiale for development of the A340-500/600, the European Commission found that “Aérospatiale could not finance the costs connected with the development of the Airbus A340-500/600 by itself or with the help of bank loans.” Letter from Karel Van Miert to Hubert Vedrine, *Reimbursable Advance to Aérospatiale for the Airbus A340-500/600 Program*, Aid No. N369/98, at 5 (translation at 7) (Jan. 26, 1999) (Exhibit US-3). In that instance, the very existence of Launch Aid constitutes a benefit.

<sup>55</sup> Provisions of Launch Aid contracts evidencing Airbus’s undertaking include, for example: French A380 Launch Aid Protocole, Art. 6.1, DS316-EC-BCI-0000249 (Exhibit US-75 (BCI)); German A380 Launch Aid Contract, § 1 (Basis of contract, item 4), DS316-EC-BCI-0000345 (Exhibit US-72 (BCI)); Spanish A380 Launch Aid Contract, Preamble (“Septimo”) and Article Primera, DS316-EC-BCI-0000549 (Exhibit US-73 (BCI)); United Kingdom A380 Launch Aid Contract, Article 8 and Schedule 3, DS316-EC-BCI-0000556 (Exhibit US-79 (BCI)); *Convention entre l’Etat et Aerospatiale concernant le développement des Airbus A340-500 et A340-600*, Art. 7 and Protocole (Annexe 5) (“A340-500/600 Convention”), DS316-EC-BCI-0000289 (Exhibit US-36 (BCI)); Spanish A340-500/600 Launch Aid Contract, Article Primera, DS316-EC-BCI-0000534 (Exhibit US-37 (BCI)); French

48. As for the supposed “distinction between the measure (the contract) and the alleged subsidy contained in the measure,” the United States refers the Panel to the panel report in *Australia - Leather*. In that dispute, the respondent sought to draw a similar distinction, which the panel dismissed as “artificial as regards the determination of what measures are before the Panel.”<sup>56</sup> This Panel should likewise reject the distinction the EC seeks to draw between the Launch Aid contracts and the subsidies provided in those contracts.

49. Finally, it is important to keep in mind the context in which the EC statement quoted by the Panel occurs. The EC confuses the concept of a subsidy with the concept of the benefit conferred by a subsidy in responding to the U.S. claim that certain grants of Launch Aid are export-contingent, in breach of the EC’s obligation under Article 3 of the SCM Agreement. The EC apparently seeks to portray the thing that is tied to anticipated exportation – *i.e.*, the provision of Launch Aid on non-market-based terms – as something other than the granting of a subsidy. However, for the reasons just discussed, the provision of Launch Aid on non-market-based terms is the granting of a subsidy; the difference between those non-market-based terms and a market-based benchmark is the benefit conferred by the subsidy.

50. Since the provision of Launch Aid on non-market-based terms is contractually tied to repayment of Launch Aid on a per sale basis over a number of sales that can be attained only by exporting, the provision of the subsidy is tied to anticipated exportation. Accordingly, the subsidy is contingent upon export performance within the meaning of Article 3.1(a) and footnote 4 of the SCM Agreement. The Panel should reject the EC’s attempt to obscure the tie between provision of the Launch Aid subsidy and anticipated exportation by misidentifying the subsidy.

**6. How does the United States respond to the EC’s contention at paragraph 445 of its FWS that “{a}s the 1979 Aircraft Agreement is still in force, WTO dispute settlement bodies are obliged to take account of the specificities of this sector” when considering which is the appropriate market benchmark for the LCA sector?**

Response:

51. The United States does not dispute that the 1979 Aircraft Agreement is still in force but disagrees with the suggestion that it is relevant to this dispute. This is so for several reasons.

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A330-200 Launch Aid Protocole, Arts. 6.1, 6.3, Annexe 5, DS316-EC-BCI-0000316 (Exhibit 78 (BCI)).

<sup>56</sup> *Australia - Leather*, paras. 9.38-9.39 (finding that “ordinary meaning of the term ‘grant’ . . . includes both the government’s commitment to make payments (that is, the grant contract), and the grant payments themselves, including all possible disbursements, whether past or future”).

52. First and foremost, the 1979 Aircraft Agreement is not a “covered agreement” within the meaning of Article 3.2 of the DSU. It is identified in Appendix 1 to the DSU as one of four plurilateral trade agreements that *could* be covered by the DSU. However, such coverage is made “subject to the adoption of a decision by the parties . . . setting out the terms for the application of the {DSU} to the {Agreement on Trade in Civil Aircraft}.” No such decision has been adopted.

53. Second, even if there were a basis for taking the 1979 Aircraft Agreement into account, that agreement would not shed any light on identifying the appropriate market benchmark for the LCA sector. The 1979 Agreement does not define the term “subsidy.” Nor does it suggest that the concept of “benefit” should be understood differently for the LCA sector than for other sectors.

54. Indeed, even though the EC purports to rely on the 1979 Agreement, it fails to explain what bearing that agreement should have on identifying a benchmark.<sup>57</sup> It follows its reference to the agreement with an oblique suggestion that there may be circumstances in which “‘fair’ market transactions” are not the appropriate benchmark. However, that suggestion is based on a misreading of the Appellate Body report in *US - Countervailing Measures*. The Appellate Body found that there may be situations in which “the ‘fair market price’ of a state-owned enterprise” is influenced by government action. It said nothing about using a benchmark other than commercial market transactions in determining whether a financial contribution confers a subsidy.<sup>58</sup> And, in any event, stating what the EC believes may *not* be the appropriate benchmark fails to impugn the benchmark used by the United States.

55. Finally, to the extent the EC believes the 1979 Aircraft Agreement is relevant in that it requires “the specificities in {the LCA} sector” to be taken into account, those specificities have been taken into account through the inclusion of footnotes 15, 16, and 24 in the SCM Agreement.

**7. What does the United States consider is the implication, in terms of assessing the existence of a benefit within the meaning of Article 1.1(b) of the SCM Agreement, of the analyses presented in Table 1 of the ITR Report (Exhibit EC-13-BCI) showing that, in NPV terms, there is a [ ] in the amount of repayments made by each recipient compared to total loan receipts?**

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<sup>57</sup> See EC FWS, para. 445.

<sup>58</sup> *US - Countervailing Measures (AB)*, paras. 123-124.

Response:

56. The methodology used in the ITR report has a number of serious flaws, some of which are noted in response to Question 42 below. Even with these flaws in the ITR methodology, there is a [ ] in the amount of repayments made by each recipient compared to total loan receipts, which confirms the existence of a benefit. In the case of a loan based on commercial terms, the present value of expected repayments would equal the present value of the amounts loaned. If a loan is provided at better than commercial terms, the present value of expected repayments is smaller than the present value of the amounts loaned.

57. For the sake of completeness, the United States also notes that neither the specific [ ] in the ITR report, nor the approach of stating the benefit in terms of present value in general is sufficient in itself to provide a full understanding of the amount of the benefit in any particular case. In the case of Launch Aid, the benefit accrues to Airbus every year that it does not have to pay a market rate on the loan. The benefit of each year's interest saving then compounds over time as future interest on that interest is also saved. The current value of the benefit (*i.e.*, the value today) shows the accumulated benefit of the subsidy, and as such this is a more meaningful measure of the benefit.

**8. Does the United States agree with the statement made at paragraph 11 of the Whitelaw Report (Exhibit EC-11-BCI) that “the KSS paper, the source of the project-specific risk premium, only examines the cost of equity of newly-public firms”?**

Response:

58. The EC has chosen its words carefully: The KSS paper<sup>59</sup> “examines” the cost of equity of newly-public firms. The examination that KSS conducts is for the explicit purpose of estimating the cost of capital for private venture capital investment (whatever form it takes). The results from the paper, therefore, apply to situations that involve forms of venture capital investment other than common equity.<sup>60</sup>

59. To elaborate, KSS used public equity investments in new U.S. companies as the “comparables” for estimating the returns on private venture capital investments. (Because of the private nature of venture capital investment, such public data necessarily is a proxy). As KSS

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<sup>59</sup> Frank Kerins, Janet Kiholm Smith, and Richard Smith, “Opportunity Cost of Capital for Venture Capital Investors and Entrepreneurs,” *Journal of Financial and Quantitative Analysis* 39 (2004) 385-405 (“KSS”) (Exhibit US-470).

<sup>60</sup> KSS, p. 386 (Exhibit US-470).

confirm, the conclusions apply to venture capital investment other than in the form of common equity in newly-public firms.<sup>61</sup>

We use a database of high tech IPOs to estimate opportunity cost of capital for venture capital investors and entrepreneurs.<sup>62</sup>

60. KSS go on to explain that they set out to “develop estimates of opportunity cost of capital for well-diversified limited partners of venture capital funds and for underdiversified entrepreneurs.”<sup>63</sup>

61. KSS’s work concludes that a 700 basis point premium is appropriate for a well-diversified portfolio of venture capital investments. (A much higher premium would apply to individual venture capital projects.) KSS’s conclusions are confirmed by other research on risks and returns on venture capital investing.<sup>64</sup>

**9. Does the United States accept that the “project-specific risk premium” used to derive the market rates of return for LA / MSF in the Ellis Report is essentially based on estimates of project-specific risk associated with equity investment? If so, how does the United States reconcile this approach with its view that LA / MSF contracts are “hybrid” instruments, comprising features of both debt and equity financing? In other words, given the alleged hybrid nature of LA / MSF, should any project-specific risk premium not also reflect the characteristics of a “hybrid” financing instrument, instead of a pure debt or pure equity investment?**

Response:

62. The United States does not accept that the project-specific risk premium used to derive the market rates of return for Launch Aid in the Ellis Report is based on estimates of project-specific risk associated with equity investments. The premium reflects a “hybrid” class of venture capital investments including both debt and equity instruments.

63. The Ellis Report finds that the appropriate project-specific risk premium for Launch Aid financing is 700 basis points (“bps”) over the corporate debt rate. This finding is confirmed in several ways. In particular, the Ellis Report finds that Launch Aid, given its project-specific and highly speculative nature, is comparable to venture capital financing. As discussed in response

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<sup>61</sup> KSS, p. 386 (Exhibit US-470).

<sup>62</sup> KSS, p. 385 (Exhibit US-470).

<sup>63</sup> KSS, p. 386 (Exhibit US-470).

<sup>64</sup> See, e.g., John H. Cochrane, “The Risk and Return of Venture Capital,” *Journal of Financial Economics* 75 (2005) 3-52 (“Cochrane”) (Exhibit US-471).

to Question 8, above, 700 bps is the risk premium that has been found to apply to a portfolio of venture capital financing. As the Ellis Report explains, venture capital financing includes a number of types of financing – *i.e.*, the premium itself, if anything, is hybrid.

64. Moreover, the Ellis Report further accounts for debt-like features of Launch Aid by applying this risk premium to the cost of debt of the Airbus entities. This is the most conservative approach NERA could take. Using either Airbus’s cost of equity or its weighted average cost of capital would have resulted in a higher benchmark. NERA’s commercial benchmark rate thus clearly reflects the characteristics of hybrid financing and, if anything, is biased towards debt and thus too conservative.

65. The conservative nature of the project-specific risk premium and the overall benchmark commercial borrowing rate that NERA calculates are further confirmed by the alternative bases for the conclusions put forward in the report. The EC’s own state aid practice, the analysis of one of the Airbus companies, and a method based on probability numbers found in one of the EC’s HSBI documents all confirm the benchmark commercial borrowing rate that the Ellis Report establishes.<sup>65</sup>

### C. PROHIBITED EXPORT SUBSIDIES

**10. Is the Panel correct in understanding that the United States is making allegations of both *de jure* and *de facto* export contingency in relation to LA / MSF? Does the United States rely on the same evidence in each case in order to do so?**

Response:

66. The Panel’s understanding is correct. The U.S. claim that provisions of Launch Aid for the A380, the A340-500/600, and the A330-200 are export contingent and therefore prohibited is principally a claim of *de facto* export contingency. However, the claim also can be approached as a claim of *de jure* export contingency. While the export contingency may not be set out explicitly in the Launch Aid contracts, it is implicit in those measures. That is, it can be “derived by necessary implication from the words actually used in the measure{s}.”<sup>66</sup>

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<sup>65</sup> See Ellis Report, including HSBI Appendix (Exhibit US-80 (BCI)).

<sup>66</sup> *Canada - Autos (AB)*, para. 100; see U.S. FWS, para. 328. The EC suggests that the United States does not make a claim of implied *de jure* export contingency because it “does not attempt to read provisions in the measure jointly.” EC FWS, para. 592. However, this assertion appears to be based on a misreading of the Appellate Body report in *Canada - Autos*. There, the Appellate Body recognized that *de jure* export contingency can be set out explicitly on the face of a measure, or it can be “derived by necessary implication from the words actually used in the measure.” *Canada - Autos (AB)*, para. 100. It did not purport to limit the ways in which an export contingency can be derived by necessary implication. One way might be through reading multiple provisions in conjunction with one another (although, contrary to the EC’s view, it is not clear that this was how the necessary

67. Whether the claim is viewed as one of *de facto* or *de jure* export contingency, the elements of the claim are the same: The Airbus governments provide subsidies in the form of financing for the development of LCA models on terms that are better than what Airbus could obtain in the market; the Launch Aid financing is provided in contracts in which it is tied to Airbus making repayments over a specified number of sales of the model being financed; and, in each case, the number of sales that must be made for Airbus to fulfill its repayment commitment cannot be reached without exporting.<sup>67</sup>

68. The evidence relied upon for the *de facto* and *de jure* claims is overlapping but not identical. Both claims rely upon the Launch Aid contracts themselves – in which the governments' commitments to provide Launch Aid are tied to Airbus's commitments to make repayments over specified numbers of sales – coupled with Airbus's Global Market Forecasts and project appraisals prepared by the Airbus governments. The Global Market Forecasts and project appraisals indicate the total number of sales worldwide that Airbus and the Airbus governments expect for each model at issue, as well as the portion of those sales expected to be made in Europe. When the Launch Aid contracts – in particular, the provisions setting out the numbers of sales over which Launch Aid is to be repaid – are read in conjunction with these forecasts they necessarily imply a tie to export performance.

69. For example, as discussed in the U.S. first written submission, Airbus's 2000 Global Market Forecast projected that orders for aircraft with more than 400 seats (a category that includes the Boeing 747 and 777-300 and the Airbus A340-600, as well as the A380) by European airlines would total only 247.<sup>68</sup> Yet, the UK A380 Launch Aid contract requires Airbus to repay Launch Aid over [ ] sales; the German contract requires Airbus to repay over [ ] sales; the French contract requires Airbus to repay over [ ] sales; and the Spanish contract requires Airbus to repay over [ ] sales.<sup>69</sup> Given a forecast of 247 European sales for *all* aircraft with more than 400 seats (not just the A380), these numbers translate into UK subsidies tied to at least [ ] export sales; German subsidies tied to at least [ ] export sales; French subsidies tied to at least [ ] export sales; and Spanish subsidies tied to at least [ ] export

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implication was derived in *Canada - Autos*). But there might be other ways as well. In the present dispute, the necessary implication of export contingency is derived by reading the words of the Launch Aid contracts against the backdrop of the understanding that Airbus and the Airbus governments had of the markets for the relevant LCA models.

<sup>67</sup> See U.S. FWS, paras. 343-386.

<sup>68</sup> Airbus, Global Market Forecast 2000, at 37 (Exhibit US-358); see also U.S. FWS, para. 346.

<sup>69</sup> See U.S. FWS, para. 353 (citing Launch Aid contracts).

sales.<sup>70</sup> Indeed, anticipated exports account for at least [ ] of the sales from which Airbus committed to repay A380 Launch Aid. The numbers for the A340-500/600 and the A330-200 tell a similar story.<sup>71</sup>

70. Reliance on the Global Market Forecasts and project appraisals to inform a reading of the Launch Aid contracts for purposes of a *de jure* export contingency analysis is supported by the Appellate Body report in *Canada - Autos*. In discussing the panel’s finding that the Canadian Value Added (CVA) rules were not inconsistent with Article 3.1(b) of the SCM Agreement (concerning the use of domestic over imported goods), the Appellate Body criticized the panel for considering those rules “*in the abstract* as opposed to the actual CVA requirements for the {particular automobile} manufacturer beneficiaries.”<sup>72</sup> It went on to state:

{T}he Panel did not make findings as to what the actual CVA requirements are and *how they operate for individual manufacturers*. Without this vital information, we do not believe the Panel knew enough about the measure to determine whether the CVA requirements were contingent ‘in law’ upon the use of domestic over imported goods.<sup>73</sup>

71. In the present dispute, evidence from Global Market Forecasts and project appraisals shows how the Launch Aid contracts operate and thus demonstrates that the provisions of Launch Aid are contingent in law on export performance. When read in light of an understanding of the number of sales both Airbus and the Airbus governments expect for Europe and for export, the “words actually used” in the Launch Aid contracts – in particular, the tie between the provision of the Launch Aid subsidy and repayment over specific numbers of sales – give rise to the “necessary implication” that the provision of Launch Aid is contingent on export performance.<sup>74</sup>

72. The Launch Aid contracts together with the Global Market Forecasts and project appraisals also support a finding of *de facto* export contingency. However, to support its claim of *de facto* export contingency, the United States relies not only on this evidence, but also other evidence such that the contingent relationship between the Launch Aid subsidy and export

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<sup>70</sup> See U.S. FWS, para. 354. Given the improbability that all 247 of the forecast European sales of aircraft with over 400 seats will go to the A380, the above numbers are conservative estimates of the degree of Launch Aid’s tie to export sales.

<sup>71</sup> See U.S. FWS, paras. 372-375, 383-386. As noted in the foregoing paragraphs, demonstration of the tie to anticipated export sales in the case of the French Launch Aid contracts is based on project appraisals that have been designated as HSBI. Accordingly, additional discussion of the tie is set forth in the HSBI appendix to the U.S. first written submission.

<sup>72</sup> Cf. *Canada - Autos (AB)*, para. 128 (emphasis in original).

<sup>73</sup> *Canada - Autos (AB)*, para. 131 (emphasis added).

<sup>74</sup> *Canada - Autos (AB)*, para. 100.

performance can be “inferred from the total configuration of the facts constituting and surrounding the granting of the subsidy.”<sup>75</sup>

73. The additional evidence supporting the U.S. claim of *de facto* export contingency includes, for example: public statements by Airbus and officials of the Airbus governments; historical data showing that Airbus is a highly export-oriented company; and remarks by the European Commission on reviewing under EC state aid rules France’s provision of Launch Aid for the A340-500/600.<sup>76</sup>

**11. Please articulate the United States’ views on the concept of “tied to anticipated exportation or export earnings” in cases of small or export dependent economies or a global market for the allegedly subsidized product?**

- (a) To what extent does the United States consider that a subsidy granted to an enterprise that is known to be highly export oriented (in the sense that it could not survive but for substantial exports) would be a prohibited export subsidy?**
- (b) What facts might demonstrate that a subsidy granted to an enterprise that is known to be highly export oriented is nonetheless *not* an export subsidy?**

Response:

74. The concept of “tied to anticipated exportation or export earnings” does not vary according to the size of an economy or its dependency on exports. Nor does it vary according to the degree to which the market for the allegedly subsidized product is globalized. The United States reads Article 3.1(a) and footnote 4 of the SCM Agreement as setting out a single standard for determining export contingency. The element of contingency, as the Appellate Body has found, is “at the very heart” of that standard.<sup>77</sup>

75. It is precisely the element of contingency that guards against a finding that a subsidy is prohibited simply because it is granted in a small or export dependent economy or with respect to a product with a global market. As the Appellate Body explained in *Canada - Aircraft*, “A subsidy may well be granted in the knowledge, or with the anticipation, that exports will result. Yet, that alone is not sufficient, because that alone is not proof that the granting of the subsidy is

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<sup>75</sup> *Canada - Aircraft (AB)*, para. 167.

<sup>76</sup> See U.S. FWS, paras. 346, 348-350, 367-370, 381.

<sup>77</sup> *Canada - Aircraft (AB)*, para. 171.

“*... tied to the anticipation of exportation.*”<sup>78</sup> In fact, the panel in that dispute expressly rejected Canada’s argument that “Brazil’s approach would ‘mean that there would be one law for larger economies that are not dependent on international trade and another for smaller economies that are.’”<sup>79</sup>

76. The United States shares the understanding of the panel and the Appellate Body expressed in their respective *Canada - Aircraft* reports. For this reason (with regard to part (a) of the Panel’s question), the United States does not consider that mere knowledge that the recipient of a subsidy is highly export oriented would render the subsidy prohibited. Rather, for the subsidy to be prohibited it must be tied to anticipated exports as, for example, through a contractual obligation to make repayments on a per sale basis over a level of sales that cannot be achieved without exports.

77. Facts that might demonstrate that a subsidy granted to an enterprise that is known to be highly export oriented is nonetheless *not* an export subsidy are well illustrated by the panel report in *Australia - Leather*. That dispute involved claims that financial contributions provided to an enterprise (Howe) that exported 90 percent of its sales were export contingent subsidies.<sup>80</sup> At issue were a grant contract and a loan contract. The grant contract was found to be export contingent while the loan contract was not. Factors that persuaded the panel to find the loan contract *not* export contingent despite Howe’s high export orientation included: the absence from the loan contract of any link between the loan and Howe’s production or sales; the fact that Howe’s parent (ALH) was ultimately liable for repayment under the contract, and ALH had “other businesses and produce {d} other products from which it could generate the funds to repay the loan;” and the fact that the loan was “secured by a lien on the assets and undertakings of ALH.”<sup>81</sup>

78. As discussed in the U.S. first written submission, these factors are in stark contrast to the factors that distinguish the Launch Aid contracts at issue in the present dispute. Unlike the Howe loan contract, the Launch Aid contracts *do* contain an explicit link to sales, in the form of Airbus’s express commitment to repay Launch Aid on a per sale basis over a specified number of deliveries that cannot be reached without exports. Unlike the Howe loan contract, the revenue source from which Airbus has to repay the governments does not include “other businesses” or “other products;” it is expressly limited to sales of the LCA model covered by the Launch Aid

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<sup>78</sup> *Canada - Aircraft (AB)*, para. 172.

<sup>79</sup> *Canada - Aircraft (Panel)*, paras. 9.333-9.336.

<sup>80</sup> *Australia - Leather*, paras. 9.58, 9.66 (“it is undisputed that . . . the overwhelming majority of Howe’s sales were for export”).

<sup>81</sup> *Australia - Leather*, paras. 9.74-9.75.

contract. Unlike the Howe loan contract, the Launch Aid contracts are not “secured by a lien on the assets and undertakings” of either Airbus or its parent (EADS).<sup>82</sup>

79. Conversely, the Launch Aid contracts contain features remarkably similar to those that caused the *Australia - Leather* panel to find the grant contract to Howe to be export contingent. These include, for example, express performance targets that could be met only by exporting and a conditioning of the provision of the financial contribution on the recipient’s “agreement to satisfy, on the basis of best endeavours, the aggregate performance targets.”<sup>83</sup>

#### D. EIB LOANS

**12. At footnote 481 of its FWS, the United States notes that it would not be necessary for the Panel to determine whether the 1997 loan to Aérospatiale for the Super Transporteurs was a subsidy if the EC was able to confirm that this loan was never drawn by Aérospatiale. The Panel notes that the EC has submitted a table with the title “Outstanding Airbus Loans – January 2007” (Exhibit EC-154-BCI) indicating that the loan at issue was apparently [ ]. Does the United States intend to pursue its claim in respect of this measure in the light of this information?**

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<sup>82</sup> See U.S. FWS, paras. 334-341, 358-359, 374, 385. At paragraph 672 of its FWS, the EC contends that Launch Aid contracts are like the loan contract in *Australia - Leather* in that “once the loan was advanced, it was immaterial whether or not the recipient actually exported.” This contention is linked to the EC’s view that a subsidy is export contingent only if it is received as a consequence of “actual{} export{},” a view that has no basis in the SCM Agreement and entirely ignores the reference in footnote 4 of the agreement to “anticipated exportation.” In the case of Launch Aid, exportation hardly is “immaterial,” given that Airbus’s only obligation to repay Launch Aid is tied to levels of sales that can be met only through exportation. See U.S. FWS, paras. 345-357, 364-373, 378-384. The possibility that Airbus might voluntarily opt to prepay its Launch Aid debt (see EC FWS, para. 673) does not sever this tie to exportation, as Airbus has no *obligation* to prepay. Nor does the inclusion of a “guarantee” in one particular contract (see *id.*) sever the tie, as the guarantor under that contract is not obligated to repay the loan under just any circumstances; it is obligated to repay on a per sale basis, just as is the case with the underlying debtor. See [

]; see also U.S. FOS, para. 73.

<sup>83</sup> *Australia - Leather*, paras. 9.67-9.71; see also U.S. FWS, paras. 335-337, 358, 374, 385. The EC’s attempt to distinguish the grant contract in *Australia - Leather* from Launch Aid contracts (EC FWS, paras. 668-671) is unavailing. Contrary to the EC’s suggestion (*id.* para. 668), the fact that Howe was the only Australian exporter of automotive leather was not a “necessary” or dispositive aspect of the panel’s finding of export contingency. It was one factor among others that “support{ed}” the panel’s finding. *Australia - Leather*, para. 9.69. Likewise, the fact that the grant contract followed Howe’s removal from an earlier subsidy program was relevant but not dispositive. See EC FWS, para. 670. Finally, the EC simply is incorrect to characterize the grant subsidy in *Australia - Leather* as a “consequence” of “actual sales performance”. *Id.*, para. 669. As the panel explained, “the pertinent consideration is the facts at the time the conditions for the grant payments were established, and not possible subsequent developments.” *Australia - Leather*, para. 9.70.

Response:

80. The United States does not intend to pursue its claim with respect to the 1997 EIB loan to Aérospatiale for the Super Transporteurs.

**13. Does the United States agree with the view expressed by the EC at paragraph 1043 of its FWS that the assessment of whether a particular subsidy is “disproportionately large”, within the meaning of Article 2.1(c) of the SCM Agreement, must take into account the extent of diversification of economic activities within the jurisdiction of the granting authority, as well as of the length of time during which the subsidy program has been in operation?**

- (a) If so, how should these factors be taken into account for the purpose of determining whether the particular loans at issue were “disproportionately large” within the meaning of Article 2.1(c) of the SCM Agreement?**
- (b) If not, please explain how the proportionality assessment in Article 2.1(c) should be carried out in determining whether a subsidy is *de facto* specific.**

Response:

81. The United States agrees that the elements referred to in the last sentence of Article 2.1(c) of the SCM Agreement – “diversification of economic activities within the jurisdiction of the granting authority” and “length of time during which the subsidy programme has been in operation” – must be taken into account in an analysis of *de facto* specificity (as indicated by the phrase “account shall be taken”). The United States does *not* agree, however, with the EC’s view as to *how* these elements must be taken into account. In particular, there is no basis in the text or context of Article 2.1(c) for the assertion that in considering the *de facto* specificity of EIB loans “the relevant period of consideration would have to be 1957 to the present, involving all EIB lending across all sectors.”<sup>84</sup>

82. The requirement to take economic diversification and length of time of a subsidy program’s operation into account must be considered in light of the relevant context. Those elements are to be taken into account “{i}n applying this subparagraph” (*i.e.*, subparagraph (c)). In other words, they are not factors that indicate specificity or non-specificity on their own. Rather, they are elements that inform the consideration of the “factors” set out in the immediately preceding sentence in subparagraph (c). Those factors are: “use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the

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<sup>84</sup> EC FWS, para. 1043.

manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy.”

83. ***Economic diversification***: The relevance of economic diversification or length of time of a subsidy program’s operation will depend on the facts and circumstances of each case. For example, the diversification of economic activities within the jurisdiction of the granting authority could bear upon a determination of whether a subsidy program is specific by virtue of being used by a limited number of certain enterprises. Use of the program by three industries could appear limited in the context of a diversified economy (thus supporting a finding of *de facto* specificity) but not limited in the context of an economy that has only three industries.

84. Similarly, relatively heavy use of a subsidy program by certain enterprises may be more likely to support a finding of predominant use or disproportionality in the case of a highly diversified economy than in the case of a less diversified economy. Thus, the EIB’s Euro 700,000,000 loan to EADS in 2002 for A380 research and development was the single largest loan to any one company under the EIB’s i2i program, representing one-third of its lending for research and development under i2i in 2002, and 18% of its lending for research and development under i2i since the program’s inception in 2000.<sup>85</sup> These facts take on particular significance in light of the relatively high degree of economic diversification within the EC (evidenced, for example, by the range of activities receiving financing under the i2i program),<sup>86</sup> supporting the conclusion that the 2002 loan is *de facto* specific under Article 2.1(c) of the SCM Agreement.

85. ***Length of time during which a subsidy program has been in operation***: As with diversification of economic activities, the relevance of the length of time during which a subsidy program has been in operation will depend on the facts and circumstances under consideration. A subsidy to certain enterprises that appears disproportionately large (thus supporting a finding of *de facto* specificity) in the context of a program that has been in place for only six months may not appear disproportionately large as the program continues to be carried out. Conversely, if a program has been in place for decades, many industries will have benefitted, and very few if any grants of subsidy may appear to be disproportionately large if viewed against the total amount of subsidies provided over the program’s entire history. In that case, taking account of “the length of time during which the subsidy programme has been in operation” means identifying a more meaningful temporal frame of reference.

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<sup>85</sup> See Overview of i2i loans (Exhibit US-474); European Investment Bank, Annual Press Conference 2003, Background Note No. 1: Innovation and Knowledge-Based Economy (Exhibit US-164); The EIB Group, Activity Report 2002, at 14 (stating that “in 2002, the EIB ploughed 2.1 billion into 15 R&D projects spanning 6 EU countries”) (Exhibit US-165).

<sup>86</sup> See Overview of i2i loans (Exhibit US-474).

86. This point bears emphasis, given the EC's view that the denominator in a disproportionality analysis of EIB loans to Airbus should cover the entire period from 1957 to the present.<sup>87</sup> If that view were correct (which it is not), it would lead to absurd consequences. Subsidies granted pursuant to programs operating for long periods of time could escape SCM Agreement disciplines even though the subsidies may have been disproportionately large relative to other subsidies granted during the same distinct periods.

87. The anomaly of the EC's view is especially apparent when one considers that subparagraph (c) of Article 2.1 operates as a check to determine whether a subsidy is in fact specific "notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b)." Subparagraph (c) expressly calls for a consideration of factors that could point to a finding of specificity where it might not otherwise be indicated. In this context, it makes no sense to read the last sentence in a manner that effectively would preclude a finding of specificity for subsidies granted pursuant to long-established programs.

88. Indeed, such a reading is contrary to the understanding of Article 2.1 of the SCM Agreement the EC has expressed elsewhere. For example, as a third party in *US - Softwood Lumber CVD Final*, the EC argued that Article 2.1 "requires an assessment of 'general availability', that is a determination of whether a subsidy selectively benefits certain industrial sectors or certain enterprises, or is rather a broad economic policy measure, such as the reduction of corporate taxes." It went on to explain that "{i}t is sufficient to show that the subsidy is made available or used only by a limited number of industries as opposed to the overall economy."<sup>88</sup>

89. The EC made a similar observation during negotiation of the SCM Agreement, noting that "a distinction should be drawn between general measures designed to stimulate economic activity as a whole and specific measures with identifiable beneficiaries whose competitive position is improved by the intervention. . . ."<sup>89</sup>

90. Yet, the EC's current position with respect to the last sentence of Article 2.1(c) would eliminate the foregoing distinction in the case of subsidies granted pursuant to programs that have been in existence for relatively long periods of time. Because such subsidies would not appear to be disproportionately large in comparison with the total subsidies granted over the long history of the program, they effectively would be grouped together with non-specific measures, such as "the reduction of corporate taxes" and other "general measures designed to stimulate

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<sup>87</sup> See, e.g., EC FWS, paras. 1040, 1043-1045, 1048.

<sup>88</sup> Third Party Oral Statement by the European Communities, *US - Softwood Lumber CVD Final (Panel)*, paras. 14, 15 (Feb. 12, 2003) (Exhibit US-476).

<sup>89</sup> Submission by the European Community, Negotiating Group on Subsidies and Countervailing Measures, Elements of the Negotiating Framework, MTN.GNG/NG10/W/31, p. 5 (Nov. 27, 1989).

economic activity as a whole.” That approach is contrary to the ordinary meaning of the last sentence of Article 2.1(c), in context and in light of the object and purpose of the SCM Agreement.

91. In view of the relatively long period during which EIB lending has been in operation, a *de facto* specificity analysis should establish relevant periods over which to examine the loans to Airbus.<sup>90</sup> In the case of the 2002 loan to EADS under the i2i program, the United States has therefore analyzed specificity both for the year in which the loan was granted (consistent with the EIB’s own approach to describing its lending activity) and for the period during which the program was in existence (2000 to 2003). In the case of the EIB loans provided from 1988 to 1993, the United States has looked at the five-year period over which those loans were provided. The appropriateness of using these time periods is discussed in greater detail in response to Questions 14 and 15, below.

**14. At paragraph 405 of its FWS, the United States argues that the 2002 EIB loan to EADS was “disproportionately large”, within the meaning of Article 2.1(c) of the SCM Agreement, when compared to total “R&D” funding under the “i2i program” “in 2002”. Please explain why the United States has chosen to assess the question of “disproportionality” in respect of this loan, with reference to this category of EIB funding.**

Response:

92. Analyzing whether the 2002 EIB loan to EADS for R&D related to the A380 was disproportionately large requires a comparison between the amount of the loan (the numerator) and an appropriate comparison group (the denominator). For the reasons discussed in response to Question 13, “EIB lending across all sectors” over the period from “1957 to the present”<sup>91</sup> is not an appropriate comparison group. It blends unrelated priorities over a period of decades, thus making the denominator so large as to render any disproportionality analysis meaningless. If the EC’s approach were correct (which it is not), a Member could circumvent SCM Agreement disciplines simply by collecting disparate subsidies provided over an extended period of time under a single umbrella. The result would be to effectively grandfather subsidy programs of long standing, a result plainly at odds with the ordinary meaning of Article 2.1 of

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<sup>90</sup> In this regard, it is notable that in the U.S. Department of Commerce (“DOC”) determinations cited favorably by the EC – in which the DOC found certain EIB loans not to be disproportionately large and, therefore, not specific – total EIB lending activity was examined over periods of three to four years, not 50 years. See EC FWS, para. 1014 (analysis based on loans made from 1987 to 1991); *id.*, para. 1015 (same). The DOC memorandum referred to at footnote 821 of the EC’s first written submission refers to an EIB program established in a 1994 decision, under which applications had to be made by the end of 1995 and payments were finalized by the end of 1997. In analyzing whether loans to the foodstuffs industry (at issue in that memorandum) were disproportionately large, the DOC considered the particular program, not all EIB lending, as its frame of reference.

<sup>91</sup> EC FWS, para. 1043.

the SCM Agreement read in context and in light of the object and purpose of the SCM Agreement.

93. In contrast to all EIB lending over a 50-year period, the i2i program is an appropriate comparison group, because it was under the auspices of this particular program that the 2002 loan to EADS was granted. While the EC asserts that “{t}he i2i is not a programme,”<sup>92</sup> the evidence tells a different story. For example, in the document unveiling i2i, the EIB calls it “a practical programme aimed at building a Europe based on knowledge and innovation.”<sup>93</sup> The EIB goes on to state that the program is intended to “target lending” towards specified objectives.<sup>94</sup> It later refers to i2i as a “dedicated EUR 12-15 billion lending programme,” which the EIB itself understood to be “mark{ing} a qualitative shift of emphasis in the EIB Group’s activities.”<sup>95</sup>

94. The EC also asserts that i2i should not be treated as a distinct program because “{t}here are no ring-fenced pools of funding available for specific objectives.”<sup>96</sup> But, it is not necessary to show that a subsidy is granted from a “ring-fenced pool” to demonstrate that it is granted as part of a program. Article 2.1(c) of the SCM Agreement makes no reference to “ring-fenced pools of funding.” Indeed, if the existence of such pools were required to establish *de facto* specificity, a Member might effectively circumvent SCM Agreement rules by refraining from explicitly dedicating funds to particular objectives *a priori*. What is important in a disproportionality analysis is not whether funds are expressly dedicated to particular objectives, but whether they are in fact targeted to “certain enterprises” as that term is defined in Article 2.1 of the SCM Agreement. As the EC argued as a third party in *US - Softwood Lumber CVD Final*,

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<sup>92</sup> EC FWS, para. 1037.

<sup>93</sup> *The Innovation 2000 Initiative, Actively promoting a European economy based on knowledge and innovation*, European Investment Bank, at 2 (Exhibit US-154).

<sup>94</sup> *The Innovation 2000 Initiative, Actively promoting a European economy based on knowledge and innovation*, European Investment Bank, at 2 (Exhibit US-154).

<sup>95</sup> *The Innovation 2000 Initiative, Actively promoting a European economy based on knowledge and innovation*, European Investment Bank, at 3 (Exhibit US-154). Confirming the fact that i2i represents a distinct program and thus an appropriate frame of reference against which to measure the EADS A380 loan is also the agreement between the European Commission and the EIB to cooperate “with the aim of optimising their action in the field of research and the exploitation of its results.” Joint Memorandum establishing a framework for co-operation between the community research framework programme and the “Innovation 2000 Initiative” between the European Community represented by the Commission of the European Communities and the European Investment Bank, para. 4 (Exhibit US-155). The principal tool the EIB committed to use to this end was the i2i program. This shows that the program represents a concerted effort to direct funds towards R&D-intensive projects.

<sup>96</sup> EC FWS, para. 1038.

“It is sufficient to show that the subsidy is made available or used only by a limited number of industries as opposed to the overall economy.”<sup>97</sup>

95. Put differently, while the existence of ring-fenced pools of funding certainly suggests the existence of a subsidy program, the absence of such pools does not by definition mean that there is no subsidy program.

96. Moreover, the EC’s characterization of i2i as something other than a program is at odds with the EIB’s announcement in February 2003 that by the end of 2002, it “had fully achieved its i2i objectives.”<sup>98</sup> Over that time, “the EIB Group approved some 300 operations totaling almost EUR 17 billion” (of which EUR 14.4 billion was provided by the EIB itself, and EUR 2.5 billion by the Group’s venture capital arm, the European Investment Fund).<sup>99</sup>

97. Thus, the EIB had established for itself the goal of lending EUR 12-15 billion for projects meeting a specified set of objectives and declared its mission accomplished when it had committed EUR 14.4 billion by the end of 2002. These facts support a disproportionality analysis that compares the EIB loan to EADS – which was provided pursuant to the i2i program – to other lending under the same program.

98. The EC also argues that if i2i is to be treated as a program, then it should encompass not only the i2i program itself – *i.e.*, the program put in place in 2000, the objectives of which the EIB declared “fully achieved” by the end of 2002 – but also lending that the EC characterizes as predecessors to i2i as well as lending undertaken pursuant to the Innovation 2010 Initiative, which was launched in 2002 and which also goes by the name “i2i.” However, including pre-i2i lending in the comparison group would ignore the express “qualitative shift of emphasis in the EIB Group’s activities” marked by the establishment of i2i.<sup>100</sup> And, including lending pursuant to the Innovation 2010 Initiative would ignore that the latter program was a “new initiative,” which followed “implementation of the first i2i.”<sup>101</sup> It also would ignore that since “implementation of the first i2i” the EC has added ten new member States.

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<sup>97</sup> Third Party Oral Statement by the European Communities, *US - Softwood Lumber CVD Final (Panel)*, paras. 14, 15 (Feb. 12, 2003) (Exhibit US-476).

<sup>98</sup> European Investment Bank, Annual Press Conference 2003, Background Note No. 1: Innovation and Knowledge-Based Economy, at 1 (Exhibit US-164).

<sup>99</sup> European Investment Bank, Annual Press Conference 2003, Background Note No. 1: Innovation and Knowledge-Based Economy, at 1 (Exhibit US-164).

<sup>100</sup> *The Innovation 2000 Initiative, Actively promoting a European economy based on knowledge and innovation*, European Investment Bank, at 3 (Exhibit US-154).

<sup>101</sup> Innovation 2010 Initiative, [www.eib.org/site/index.asp?designation=i2i](http://www.eib.org/site/index.asp?designation=i2i) (Exhibit US-477).

99. In short, the evidence clearly shows that the i2i program was a distinct EIB program with a beginning in 2000 and an end in 2003, pursuant to which the EIB targeted lending towards projects meeting specified objectives. Since the EIB's loan to EADS for A380 R&D was provided pursuant to this program, the question of whether the loan was disproportionately large should be evaluated by reference to that program.

100. Within the i2i program, the United States focused its analysis on lending under the "research and development" heading provided during 2002. It did so to be consistent with the way the EIB itself analyzes its lending activity. In its annual activity reports, the EIB describes i2i loans as having been made pursuant to one of five "economic sectors" (research and development; development of SMEs; technology networks; human capital formation; and the diffusion of innovation (including the audiovisual sector)). It discusses lending pursuant to each sector during the course of the calendar year. Thus, for example, in its 2002 report the EIB explained, "In 2002, the EIB ploughed {Euro} 2.1 billion into 15 R&D projects spanning 6 EU countries, with one pan-European international cooperation project partly located in Switzerland. . . ." <sup>102</sup> The Euro 700,000,000 loan to EADS accounted for one-third of that 2.1 billion.

101. While the loan is disproportionately large when measured against R&D lending under the i2i program in 2002, it also is disproportionately large when measured against other benchmarks. For example, it was the single largest loan to any one company under the i2i program as a whole. <sup>103</sup> It also represented 18% of the Euro 3.8 billion in EIB financing for R&D from 2000 through the end of 2002 (*i.e.*, when the EIB "had fully achieved its i2i objectives"). <sup>104</sup>

102. By any of these measures, the loan to EADS for A380 R&D was disproportionately large and therefore specific within the meaning of Article 2.1(c) of the SCM Agreement. Moreover, as noted in response to Question 13, above, these measures also support a finding of predominant use, which also leads to a finding of specificity.

**15. At paragraph 420 of its FWS, the United States argues that the 1988-1993 EIB loans at issue were "disproportionately large", within the meaning of Article 2.1(c) of the SCM Agreement, when compared to the EIB's lending in the years 1988-1993 to: (i) the "EIB's 'industry, services and agriculture' sector category"; and, (ii) the "international competitiveness and European integration of large firms' lending objective". Please explain why the United States has chosen to assess the question of "disproportionality" in respect of these loans with reference to this category of EIB funding.**

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<sup>102</sup> The EIB Group, Activity Report 2002, at 14 (Exhibit US-165).

<sup>103</sup> Overview of i2i loans (Exhibit US-474).

<sup>104</sup> European Investment Bank, Annual Press Conference 2003, Background Note No. 1: Innovation and Knowledge-Based Economy, at 2 (Exhibit US-164).

Response:

103. Assessing whether the EIB loans to Airbus from 1988 to 1993 were disproportionately large by comparing them to lending to (i) the EIB's industry, services and agriculture sector category, and (ii) the international competitiveness and European integration of large firms lending objective is consistent with the way the EIB itself classified its lending activity during this period.

104. During the period at issue, the EIB divided its lending between two broad categories: (1) "energy and infrastructure," which contains mostly state-owned-and-operated sectors like petroleum, electricity, railways, roads, telecom, water, and sewage; and (2) "industry, services, and agriculture", which includes, *inter alia*, "transport equipment" (the sector for aeronautical engineering). It also provided another perspective on its lending by identifying which of eight different objectives were met by particular loans.<sup>105</sup> Thus, the United States focused its analysis to mirror the way the EIB itself approaches and categorizes its lending activity.

105. As discussed in the U.S. first written submission, when looked at relative to overall EIB lending to the industry, services, and agriculture category, the 1988-1993 loans to Airbus are disproportionately large. Looking at those loans relative to overall lending under the EIB's international competitiveness objective offers useful confirmation of that conclusion.<sup>106</sup> The EC does not contest this point, but argues simply that "the relevant period of consideration would have to be 1957 to the present, involving all EIB lending across all sectors."<sup>107</sup> However, that frame of reference is inappropriate, for the reasons discussed above in response to Question 13.

106. In this regard, the United States would add several key observations to the demonstration in its first written submission of the disproportionality of the 1988 to 1993 loans to Airbus:

- Airbus was the largest private recipient of EIB individual loans between 1988 and 1993.<sup>108</sup>

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<sup>105</sup> See EIB, Annual Report 1988, Tbl. 24 (Exhibit US-176); EIB, Annual Report 1989, Tbl. E (Exhibit US-177); EIB Annual Report 1990, Tbl. E (Exhibit US-178); EIB, Annual Report 1991, Tbl. E (Exhibit US-179); EIB, Annual Report 1992, Tbl. E (Exhibit US-180); EIB, Annual Report 1993, Tbl. E (Exhibit US-181).

<sup>106</sup> U.S. FWS, para. 420.

<sup>107</sup> EC FWS, para. 1043.

<sup>108</sup> See Distribution of EIB loans (1988-1993), p. 1 (Exhibit US-475). Only public utilities and state-owned or government granted monopolies received more than Airbus. See EIB, Annual Report 1988 at 40-57 (Exhibit US-176); EIB, Annual Report 1989 at 72-92 (Exhibit US-177); EIB, Annual Report 1990 at 80-89 (Exhibit US-178); EIB, Annual Report 1991 at 80-90 (Exhibit US-179); EIB, Annual Report 1992 at 84-93 (Exhibit US-180); EIB, Annual Report 1993 at 87-97 (Exhibit US-181).

- Among private enterprises, the EIB loans to Airbus from 1988 to 1993 were approximately 44 percent more than to the next largest recipient (SEAT, the Spanish auto manufacturer).<sup>109</sup>
- The Euro 1,060,000,000 in loans that Airbus alone received from the EIB between 1988 and 1993 exceeded EIB lending to any entire industrial sector during this period, with the exception of chemicals and other transport equipment.<sup>110</sup>

107. These additional facts show that even looking at the EIB loans from perspectives other than those suggested in the U.S. first written submission, they still were disproportionately large.

**16. How does the United States respond to the EC’s request, at paragraphs 1057-1059 of its FWS, for the Panel to reject the United States’ claims in respect of the EIB loans from 1988-1993 because the United States has failed to demonstrate how such loans conferred a benefit on Airbus SAS?**

Response:

108. The EC’s request wrongly assumes that the United States has an obligation to demonstrate how EIB loans that unquestionably were provided to producers of Airbus LCA to support the development and production of particular Airbus LCA models continued to benefit a successor corporate entity – Airbus SAS. The SCM Agreement imposes no requirement on the United States to undertake this accounting exercise. Accordingly, the Panel should deny the EC’s request.

109. The EC’s discussion of the EIB loans is one of several places in which the EC asserts that the United States failed to make a *prima facie* case because it did not show that subsidies provided to the Airbus LCA operations of the four entities that formed Airbus GIE “passed through” when those entities restructured their relationship to one another and thereby established Airbus SAS. As the United States explains here and in its response to Question 122 below, this “pass-through” argument is flawed on several counts.<sup>111</sup>

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<sup>109</sup> Distribution of EIB loans (1988-1993), p. 1 (Exhibit US-475).

<sup>110</sup> Distribution of EIB loans (1988-1993), p. 2 (Exhibit US-475).

<sup>111</sup> Separate from the EC’s “pass-through” argument is its equally flawed argument that transactions related to the establishment of Airbus SAS resulted in the “extinction” or “extraction” of subsidies the Airbus governments previously provided for LCA development and production. The United States calls attention to this separate argument here, because the EC frequently discusses it in a way that confuses the distinct concepts of “pass-through,” on the one hand, and “extinction” and “extraction,” on the other. At the conclusion of this response and in response to Question 56, the United States will show that transactions related to the establishment of Airbus SAS did not “extinguish” or “extract” subsidies. The EC’s argument that they did is based on a comparison between those

110. “Pass-through” is a concept that applies in particular circumstances not at issue here. It applies, for example, in the countervailing duty (CVD) context, where the focus is on establishing the precise *ad valorem* rate of subsidy benefitting the recipient so that an offsetting or “countervailing” duty may be imposed on imports of the recipient’s products.<sup>112</sup> In that context, a “pass-through” analysis is typically required where a subsidy is bestowed on a producer of an input product and the question for an investigating authority is the extent to which “subsidies on inputs may be included in the determination of the total amount of subsidies bestowed upon processed products.”<sup>113</sup>

111. “Pass-through” also applies in the context of a claim under part III of the SCM Agreement involving a subsidy provided directly to a company that does not make (and is not related to a party that makes) the product alleged to be involved in the causing of adverse effects. In the latter case, it is necessary to show that the subsidy passed through to the producer of the product at issue, thus making that product a subsidized product.<sup>114</sup>

112. However, neither of these circumstances is at issue here. The EC has borrowed the term “pass-through” and applied it to a completely different set of circumstances – one not involving a CVD proceeding, and in which the subsidies were provided directly to producers of the product at issue (LCA). The only basis for this supposed “pass-through” requirement, following the EC’s reasoning, is a set of transactions that the European Commission called “a restructuring and rationalization of the existing legal relationship” among the producers of the subsidized product at issue resulting in the establishment of a new legal person producing the very same product.<sup>115</sup> Indeed, the European Commission noted:

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transactions and the transactions at issue in panel and Appellate Body reports that found (in the context of countervailing duty disputes under part V of the SCM Agreement) that certain subsidies were extinguished as the result of a full privatization of the subsidized entity. However, the EC fails to show that the findings in those disputes are relevant to disputes under parts II and III of the SCM Agreement. It also fails to show that the transactions leading to the establishment of Airbus SAS had the characteristics found to be essential in the disputes under part V of the SCM Agreement involving – notably, full privatizations involving a transfer of all or substantially all of the seller’s interest in an enterprise, in an arm’s-length, fair-market-value transaction, involving a relinquishment of control by the seller.

<sup>112</sup> SCM Agreement, Arts. 10, 19.4, and note 36; GATT 1994, Art. VI:3.

<sup>113</sup> *US – Softwood Lumber CVD Final (AB)*, para. 140.

<sup>114</sup> See SCM Agreement, Arts. 5(c) and 6.3 (describing “serious prejudice” as involving effects relating to a “like product” and a “subsidized product”).

<sup>115</sup> Commission of the European Communities, Merger Procedure Article 6(1)(b) Decision, Case No COMP/M.2061 – Airbus, para. 6 (Oct. 18, 2000) (Exhibit US-478).

Most of the parties' activities in commercial aircraft are already integrated through Airbus. . . . {T}here is no indication that the operation will affect the quality or nature of control of Airbus.<sup>116</sup>

113. And elsewhere the Commission stated:

The parties currently co-ordinate their Airbus activities through Airbus Industries, a 'European Interest Grouping' formed under French law in 1967. . . . The operation enables the parties to bring together their Airbus assets, activities and interests under a single unified management. The proposed transaction constitutes a restructuring and rationalisation of the existing legal partnership between the parties.<sup>117</sup>

114. However, the text of the SCM Agreement contains no requirement that a Member claiming a breach of Article 5 show that subsidies provided to producers of the product at issue (in this case, LCA) continue to benefit (or "pass through" to) a new corporate entity established if the subsidy recipients decide to undertake "a restructuring and rationalization of {their} existing legal relationship." The text (Article 1) does define the concept of "subsidy" to include a financial contribution that confers "a benefit;" and the Appellate Body has found that "{t}he term 'benefit' . . . implies that there must be a recipient;"<sup>118</sup> but, where a party making a claim under Article 5 has shown that a financial contribution confers a benefit within the meaning of Article 1 on producers of the product at issue (the recipients), the text does not require the party to make a further showing of continuity of that benefit with each change in the corporate relationship among the recipients; nor has the Appellate Body found a requirement to make such a showing. By misapplying the term "pass-through," the EC confuses the circumstances of this dispute with circumstances that really do require a demonstration of "pass-through."

115. As the Appellate Body clarified in *US - Cotton Subsidies*, in the case of an adverse effects assessment under part III of the SCM Agreement, there is no requirement to conduct a "pass-through" analysis to determine which company received the subsidy, such as required under part V.<sup>119</sup> For a serious prejudice analysis, it is necessary to establish that the product at

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<sup>116</sup> Commission of the European Communities, Merger Procedure, Case No. COMP/M.1745 - EADS, paras. 15-16 (May 11, 2000) (Exhibit US-479).

<sup>117</sup> European Commission, Press Release of 18 October 2000, "European Commission Clears the Creation of the Airbus Integrated Company" (Exhibit US-496).

<sup>118</sup> *Canada - Aircraft (AB)*, para. 154.

<sup>119</sup> *US - Cotton Subsidies (AB)*, para. 472 ("{T}he requirement in Article VI:3 of the GATT 1994 and Article 19.4 of the SCM Agreement that countervailing duties on a product be limited to the amount of the subsidy accruing to that product finds no parallel in the provisions on actionable subsidies and pertinent remedies under Part III of the SCM Agreement. Therefore, the need for a 'pass-through' analysis under Part V of the SCM Agreement is not critical for an assessment of significant price suppression under Article 6.3(c) in Part III of the SCM Agreement.").

issue is subsidized but not that the recipient of the subsidy is one enterprise rather than another. To establish that the product at issue is subsidized could require a pass-through analysis if the alleged subsidy is provided directly to an enterprise that does not make (and is not related to an enterprise that makes) the product at issue, but rather some other product (such as an input to the product at issue). In that case, a complainant would need to show that the subsidy in fact reached the product alleged to be involved in the causing of serious prejudice.

116. However, the latter circumstance is not present when companies are joined together in one legal relationship to collectively develop and produce the product at issue (such as “Airbus GIE”), receive subsidies for development and production of the product at issue, and then reorganize their relationship and place the same subsidized operations under a different corporate roof (such as “Airbus SAS”). In this regard, it is useful to recall how Airbus GIE became Airbus SAS.<sup>120</sup> Airbus GIE was established in 1970 as a consortium that by 1978 combined the LCA operations of Aérospatiale, BAE, DASA, and CASA. In 2000, Aérospatiale, DASA, and CASA merged to form EADS. In 2001, EADS and BAE transferred their Airbus-related assets to the newly incorporated enterprise known as Airbus SAS. The national Airbus units then were re-named Airbus France SAS, Airbus Deutschland GmbH, Airbus UK Limited, and Airbus España SL. Finally, in 2006, BAE exercised a put option, selling its 20 percent share in Airbus SAS to EADS, making EADS the 100 percent owner of Airbus SAS.

117. That this series of transactions amounted to nothing more than taking the subsidized LCA operations originally combined under Airbus GIE and re-grouping them under Airbus SAS is well illustrated by the schematic diagram at paragraph 68 of the EC’s first written submission. The point also is underscored by the European Commission’s observations on the creation of Airbus SAS and of EADS, as noted above.<sup>121</sup>

118. In sum, the re-grouping of four subsidized entities into a new corporate entity does not require a “pass-through” analysis. For purposes of identifying a subsidy within the meaning of Article 1 of the SCM Agreement, nothing changed as a result of the creation of Airbus SAS. The EC and the Airbus governments provided subsidies (including the EIB loans at issue in the present question) to the companies that formed part of the Airbus GIE consortium; those subsidies benefit the development and production of various Airbus LCA models; those Airbus LCA models continue to be produced and sold today by Airbus SAS, which combines in one corporation the subsidized Airbus LCA operations of the companies formerly grouped together in Airbus GIE.

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<sup>120</sup> See U.S. FWS, paras. 37-44; EC FWS, paras. 62-68.

<sup>121</sup> See Commission of the European Communities, Merger Procedure Article 6(1)(b) Decision, Case No COMP/M.2061 - Airbus, para. 6 (Oct. 18, 2000) (Exhibit US-478); European Commission, Merger Procedure Article 6(2) Decision, Case No COMP/M.1745 - EADS, para. 16 (May 11, 2000) (Exhibit US-479) (finding that creation of EADS did not affect “the quality or nature of control” of the LCA operations).

119. Finally, the concept of “pass-through” of the benefit of a subsidy is distinct from both the concept of “extinction” of the benefit of a subsidy and the concept of “extraction,” (a concept the EC apparently has invented for purposes of this dispute). The United States stresses this point because the EC obscures this distinction in a way that suggests that the United States has the burden to prove “pass-through” (which, as discussed above, is false), when in fact it is the EC that has the burden to prove its assertions of “extinction” and “extraction.”

120. It is, of course, well established in WTO dispute settlement that “the party who asserts a fact, whether the claimant or the respondent, is responsible for providing proof thereof.”<sup>122</sup> Here, it is the EC that asserts that subsidies were extinguished or extracted as the result of transactions leading to the creation of Airbus SAS. Accordingly, it is the EC that must prove these assertions. It has not done so.

121. The EC’s “extinction” and “extraction” arguments are built on a flawed attempt to analogize the transactions leading to the creation of Airbus SAS to the transactions at issue in prior WTO disputes dealing with the effects of full privatizations on the countervailability of pre-privatization subsidies under part V of the SCM Agreement. As discussed in detail in response to Question 56, below, those disputes all involved transactions in which the seller sold all or substantially all of its interest in an enterprise to a buyer at arm’s length and for fair market value and relinquished control of the enterprise. By contrast, none of the transactions cited by the EC in support of its “extinction” and “extraction” arguments have these characteristics.

122. Moreover, the EC’s “extraction” theory – the proposition that the transfer of cash from a subsidized entity to its parent results in the disappearance of subsidy in the amount of the transfer – has no basis whatsoever in the text of the SCM Agreement, prior panel or Appellate Body findings clarifying that text, or “economic common sense.”<sup>123</sup>

123. For all of the foregoing reasons, the Panel should reject the EC’s argument that the U.S. claims in respect of the EIB loans from 1988-1993 should fail for lack of a showing of “pass-through” to Airbus SAS. The Panel also should reject the identical argument as advanced by the EC in the context of other U.S. claims concerning subsidies first granted prior to the creation of Airbus SAS.<sup>124</sup>

**17. What does the United States consider to be the relevance of the fact that [ ] “[**

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<sup>122</sup> See *US - Wool Shirts (AB)*, p. 14.

<sup>123</sup> EC FWS, para. 220; see U.S. FOS, paras. 115-125.

<sup>124</sup> See, e.g., U.S. Responses to Questions 25 and 33, *infra*.

**]”, to the Panel’s assessment of whether or not the alleged subsidy has caused adverse effects to the United States’ interests?**

Response:

124. First, it is difficult to know what relevance, if any, to attach to this assertion (set out at paragraph 1058 of the EC’s first written submission without citation to any evidence whatsoever), because the EC has refused to provide the Panel or the United States with the 1991 EIB loan agreement or any documents related thereto.<sup>125</sup> From publicly available sources, one learns that the loan was provided for the A330/340, and the EC does not dispute this.<sup>126</sup> Today, Airbus continues to produce and sell the A330/340. Therefore, if the EC’s assertion is correct, it merely shows that Airbus received the entire benefit of a subsidy provided for the A330/340, while [ ].

125. In any event, as discussed further in response to Questions 16 and 122, to assess whether the subsidy has caused adverse effects to the interests of the United States it suffices to show that the recipient of the loan enjoyed a benefit, thus conferring a subsidy, and that the subsidy was for the development and production of LCA. Once these facts have been established, it is not necessary to re-identify the recipient of the benefit of the EIB loan following a corporate reorganization. The EC does not dispute that the loan was specifically for the Airbus A330/A340. The A330/A340 was developed and produced with the money from the EIB loan and other European subsidies. For purposes of the Panel’s assessment of whether the loan contributed to the adverse effects, the relevant fact is that the A330/A340 was brought to market and is still on the market today, and that, through the use of the subsidy, the EC has therefore caused and is causing adverse effects to the interests of the United States.

126. Finally, even following the EC’s flawed theory that the benefit of the EIB loan subsidy must continue to reside with Airbus SAS in order to be actionable, and even assuming that [ ] it must be recalled that [ ]

[ ] Thus, whatever the current [ ] of the 1991 EIB loan, the loan is properly before the Panel; Airbus and the A330/A340 in particular have benefitted from below-market EIB borrowing rates for 15 years; and throughout that period, the loan’s beneficial terms have contributed to the causation of adverse effects to the interests of the United States.

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<sup>125</sup> See *Replies to Questions by the Facilitator under Annex V of the SCM Agreement by the European Communities* (Nov. 18, 2005), Q81(g) & Q82(b) (Exhibit US-5 (BCI)).

<sup>126</sup> See U.S. FWS, para. 407. [ ]

**18. At paragraph 1001 of its FWS, the EC argues that the United States has failed to establish a *prima facie* case because “it has not explained how loans that have long been repaid constitute existing measures that the Panel should examine ... “. How does the United States respond to this argument?**

Response:

127. The EC assumes without basis that the adverse effects to the interests of the United States caused by EIB loans provided to Airbus on non-market terms ceased when the face amounts of the loans were repaid. The United States claims that the EC is in breach of its obligation under Article 5 of the SCM Agreement because it is causing, through the use of subsidies (here, the EIB loans), adverse effects to the interests of the United States. To the extent the EC has not eliminated those adverse effects it remains in breach, even if the loans have been repaid.<sup>127</sup>

128. In this regard, the United States recalls that in *US - Cotton Subsidies*, the Appellate Body recognized that “there could be a time-lag between the payment of a subsidy and any consequential adverse effects.”<sup>128</sup> The panel in *Indonesia - Autos* took a similar view.<sup>129</sup> A subsidized loan may continue to provide a benefit or cause adverse effects after it is repaid, just as a subsidy grant may continue to provide a benefit or cause adverse effects after it is granted. In either case, the continued existence of a benefit or adverse effects is a factual question to be resolved on a case-by-case basis.

129. Indeed, the adverse effects caused by the EIB loans that the EC claims have been repaid continue. Those adverse effects cannot be viewed in isolation from the adverse effects caused by other subsidies the Airbus governments have provided to Airbus. The EIB loans, working together with subsidies including Launch Aid, equity infusions, grants of infrastructure, and R&D grants, have enabled Airbus to develop LCA products on a pace and scale that it would not otherwise have been able to accomplish and to price its LCA more aggressively than it could otherwise have done.<sup>130</sup>

**19. How does the United States respond to the EC’s contention, expressed at paragraph 1056 of its FWS, that in assessing the existence of a benefit, “the Panel should take into account the economic impact of obligations imposed by the EIB upon its borrowers that**

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<sup>127</sup> See U.S. Responses to Panel Questions Concerning Temporal Scope of the SCM Agreement, paras. 1-6 (Dec. 18, 2006); U.S. Comments on EC Answers to Panel Questions Concerning Temporal Scope of the SCM Agreement, paras. 6, 14 (Dec. 21, 2006).

<sup>128</sup> *US - Cotton Subsidies (AB)*, par. 273; see also *id.*, note 214.

<sup>129</sup> *Indonesia - Autos (Panel)*, para. 14.206.

<sup>130</sup> See U.S. FWS, paras. 821, 830-834; U.S. FOS, para. 129.

**are due to the policy driven nature of the EIB. These obligations represent a cost to EIB borrowers that would not be incurred in the market”?**

Response:

130. The Panel should reject the EC’s assertion for several reasons. First, as pointed out in the U.S. first written submission, the EIB itself repeatedly admits that its entire purpose is to subsidize companies and to pass on its triple A-rated capital market borrowing rates to its borrowers at cost.<sup>131</sup> Thus, like the *Technology Partnerships Canada* (“TPC”) program at issue in the *Canada - Aircraft* dispute, the EIB “neither seeks nor earns a commercial rate of return.”<sup>132</sup> The United States does not see how any administrative obligations could change this situation and make the EIB’s returns commercial, and the EC offers no evidence of how this could happen.

131. Indeed, while there is no merit to the EC’s apparent suggestion that the benefit borrowers derive from EIB lending is offset by any obligations imposed on the borrowers, the very fact that an enterprise borrows from the EIB confirms that EIB financing in fact confers a benefit and thus constitutes a subsidy. If the additional EIB obligations the EC describes are more onerous than obligations imposed by commercial lenders, then one must wonder why a borrower would ever seek financing from the EIB rather than a commercial lender.

132. Second, it is difficult to see how the EC can ask the Panel to take into account the cost to EIB borrowers of certain EIB-imposed obligations when the EC itself admits that the impact of these obligations “cannot be quantified with precision.”<sup>133</sup>

133. Third, the obligations to which the EC alludes at paragraph 1056 of its first written submission appear to be the ones it discusses in more detail at paragraphs 1081 to 1089 of that submission. The latter discussion is remarkable because it does not cite to a single shred of evidence. The entire discussion is nothing more than a series of assertions of what the EC evidently believes to be the “special nature of EIB lending” as contrasted to commercial lending.<sup>134</sup>

134. The EC introduces this discussion by stating that there are three categories of obligations imposed by the EIB but “not imposed by the market.” These are “(i) project-related additional obligations (ii) finance-related additional obligations and (iii) administrative additional

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<sup>131</sup> See, U.S. FWS, paras. 398, 399.

<sup>132</sup> *Canada - Aircraft (Panel)*, para. 9.134; *see also id.*, paras. 9.313-9.315.

<sup>133</sup> EC FWS, para. 1090.

<sup>134</sup> EC FWS, para. 1082.

obligations.”<sup>135</sup> The EC goes on to make assertions regarding the first two categories, but never explains what it means by the third category. It states that “{e}ach of these obligations is ‘priced’ by any potential borrower, and this price is added to the applicable interest rate for an EIB loan,” but then, as already mentioned, it admits that these factors “cannot be quantified with precision.”<sup>136</sup>

135. Moreover, it is unclear why the EC believes that the obligations the EIB imposes – obligations that include appraisal, maintenance and insurance of the financed project, and reporting on project progress and completion, as well as the EIB’s option to accelerate the loan in the event of failure by the borrower to comply with its obligations – are any different from obligations that would be imposed by a commercial lender.

#### E. INFRASTRUCTURE

**20. The United States has advanced an interpretation of the term “general infrastructure” that is found in Article 1.1(a)(iii) of the SCM Agreement that appears to imply that any facility “open to all or nearly all users on a universal, non-discriminatory basis, where there are no *de jure* or *de facto* limitations on use” should be properly characterised as “general infrastructure”. In this light how does the United States respond to the EC’s contentions that:**

- (a) “all users of the Bremen airport may benefit from the extensions” of the runway (paragraph 867 of the EC FWS)?
- (b) “the creation of {the Aéroconstellation site} benefits society as a whole and reflects legitimate economic development policies” (paragraph 909 of the EC FWS)?
- (c) “there is no restriction on {the} use {of Routes Départementales 901, 902 and 963} in law. Nor do the companies located in Aéroconstellation have any privileged access to them” (paragraph 940 of the EC FWS)?

#### Response:

136. Under Article 1.1(a)(1)(iii) of the SCM Agreement the provision of infrastructure that is not “general” constitutes a financial contribution. The ordinary meaning of the term “general” is:

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<sup>135</sup> EC FWS, para. 1082.

<sup>136</sup> EC FWS, paras. 1083, 1090.

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*Including, involving, or affecting all or nearly all the parts of a (specified or implied) whole, as a territory, community, organisation, etc.; completely or nearly universal; not partial, particular, local or sectional. . . . Not specifically limited in application. . . .*<sup>137</sup>

137. Thus, in order to be excluded from Article 1.1(a)(1)(iii) of the SCM Agreement, infrastructure must include, involve, or affect all or nearly all the parts of a whole territory or community; must be completely or nearly universal, as opposed to partial, particular, or local. Conversely, infrastructure that *includes, involves, or affects* only a certain enterprise or group of enterprises, or that is open only to a limited number of enterprises or group of enterprises (“*specifically limited in application*”) does not constitute “general” infrastructure.

138. As the United States noted previously, the mere fact that a government creates infrastructure for reasons of “public policy” or to “foster economic development” or to perform a “public task” does not make it “general.”<sup>138</sup> Governments always invoke some sort of public policy justification for a subsidy, and there would be little point to having an SCM Agreement if justification on public policy grounds rendered subsidies non-actionable.

139. None of the three examples referred to in the Panel’s question are consistent with the ordinary meaning of “general infrastructure.” Moreover, in several instances, the EC has relied on evidence that does not support its contentions; that is, the evidence demonstrates that, in fact, access to the infrastructure is limited to certain users. In the discussion below, the United States will first address the EC’s contention that the Aéroconstellation site does not constitute a subsidy because it “benefits society as a whole and reflects economic development policies.” The United States then will discuss the Routes Départementales 901, 902 and 963 and the Bremen Airport runway extensions.

140. **Aéroconstellation Site**: The motivation for a government measure is an inappropriate and inadministrable standard to distinguish between general and non-general infrastructure. “Economic development policies” might motivate general infrastructure measures, and such measures might serve “society as a whole.”<sup>139</sup> But, the same is true for most, if not all subsidies and other government measures, whether or not infrastructure-related. In fact, this is what all government action is about: to implement public policy objectives and to serve society as a whole. The EC itself notes as much when, in a footnote to its discussion of the access roads to the Aéroconstellation site, the EC acknowledges that “the status of a measure as ‘general infrastructure’ does not hinge on the subjective intent of public authorities (which is notoriously difficult to establish).”<sup>140</sup> The United States could not agree more.

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<sup>137</sup> *Shorter Oxford English Dictionary*, vol. 1, pp. 1082-1083 (5<sup>th</sup> ed.) (Emphases added).

<sup>138</sup> U.S. FOS, para. 79.

<sup>139</sup> EC FWS, paras. 909, 923.

<sup>140</sup> See EC FWS, para. 941, footnote 762.

141. Focusing on its “public policy objectives,” the EC fails entirely to address the specific situation of the Aéroconstellation site in its first written submission. The EC provides general, high-level comments on the French legal concept of “zones d’aménagement concertée” (“ZACs”) but fails to address the fact that the Aéroconstellation site is demonstrably *not* general infrastructure. As the United States demonstrated in its first written submission, the site has been “tailor-made”<sup>141</sup> for Airbus, its suppliers, and Air France by Grand Toulouse.<sup>142</sup>

142. For example, in an information memorandum about the Aéroconstellation site, the government of Grand Toulouse describes the history of its creation as follows:

AéroConstellation: A centre for the aeronautics industry with international dimensions. . . .  
History: *Mobilisation for the A380*. In September 1999, in light of the launch of the A380, the public partners (State, Region, Department, Grand Toulouse) concluded a protocol that obliges them to strengthen the aeronautics industry in providing the necessary development work, services and support.<sup>143</sup>

143. The president of Grand Toulouse, Philippe Douste-Blazy, also confirmed that the Aéroconstellation site had been designed and built specifically for Airbus and to its specifications:

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<sup>141</sup> U.S. FWS, para. 456 (citing Airbus, press release, *Airbus’ A380 Final Assembly Facility inaugurated by French President*, July 16, 2002 (Exhibit US-200)).

<sup>142</sup> As the government of Grand Toulouse described it: “[I]e plus grand site d’activités aéronautiques d’Europe sort de terre: 260 hectares aménagés et équipés autour de l’usine de l’Airbus A380.” Midi Presse Services MPS, June 18, 2004, mo. 1482, *Le Grand Toulouse: Maître d’Ouvrage d’Aéroconstellation* (Exhibit US-498).

<sup>143</sup> See [http://www.grandtoulouse.org/index.php?pagecode=125&modele\\_affi\\_dossier=](http://www.grandtoulouse.org/index.php?pagecode=125&modele_affi_dossier=) (Exhibit US-532) (emphases added) (“AéroConstellation: un pôle aéronautique de dimension internationale. . . . Historique: mobilisation pour l’A380. En septembre 1999, dans la perspective du lancement de l’A380, un protocole engage les partenaires publics (Etat, Région, Département, Grand Toulouse) pour renforcer le secteur aéronautique en apportant les aménagements, les services et les assistances nécessaires. Dès 2001, les travaux préparatoires au chantier débutent et le 7 janvier 2002, le permis de construire du premier bâtiment, le centre d’essais statiques a été accordé.”). Another publication by the city government of Toulouse also puts the creation of the Aéroconstellation site into the context of the decision by Airbus to build the A380 in Toulouse: “In order to sustain Airbus’ success, Europeans need a large capacity aircraft to compete with its American competitor. *In that light, the A380 program was launched. The first phase involves the construction of the facilities.* Thus, in the proximity of Blagnac, Colomiers and Toulouse, *AéroConstellation has become one of the largest development projects of Europe.*” Mairie de Toulouse, Capitole Infos, Été 2004 - Supplément du N°146: Un dessein pour Toulouse (Summer 2004), at 10 (emphases added) (Exhibit US-206).

Setomip, the Greater Toulouse development company, accepted an audacious technological wager to *build the Aeroconstellation project as premises for the gigantic Airbus plant and related business.*<sup>144</sup>

144. Moreover, the site is dedicated exclusively to the aeronautics industry, which, in fact, is the only industry using the site. As discussed in more detail in the United States first written submission, Airbus is also the predominant user of the Aéroconstellation site and the predominant or exclusive user of the EIG facilities, and all users on the site are engaged in aeronautics operations only.<sup>145</sup> For example, Airbus occupies the largest single individual space on the site. It alone accounts for 51 hectares (or more than half)<sup>146</sup> of the total 95 hectares available on the site for sale as industrial land. Air France, the second biggest occupant of the site, has described its facilities as “ten times smaller than those of EADS {Airbus}.”<sup>147</sup> Almost all other occupants are suppliers to Airbus.<sup>148</sup>

145. Most of the taxiways on the site exclusively connect Airbus’ assembly and testing facilities to the airport. The only other users of taxiways on the Aéroconstellation site are Air France and STTS, which use the taxiways to access their buildings. As is obvious from the official map of the site, these buildings are located right at the entrance to the site from Toulouse-Blagnac Airport at the very Southern end of the site. The taxiways (also) used by Air France and STTS do not even account for 10 percent of the total length of the taxiways.<sup>149</sup> Similarly, Airbus is exclusive user of most of the aircraft parking space available on the site. In fact, the large space in front of Airbus’s production hall labelled “infrastructure publique” and marked red on the map available from the website of Grand Toulouse is used exclusively by

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<sup>144</sup> See website of PromoToulouse Midi-Pyrénées, [http://www.promotoulouse.com/english/toulouse\\_mp/grandtoulouse.htm](http://www.promotoulouse.com/english/toulouse_mp/grandtoulouse.htm) (Exhibit US-207).

<sup>145</sup> See U.S. FWS, para. 459.

<sup>146</sup> See Atisreal study provided by the EC as Exhibit EC-18 (BCI) at p. 10.

<sup>147</sup> *Air France inaugure son nouveau centre industriel de Blagnac*, at 25 (April 2, 2004) (“... notre bâtiment étant dix fois plus petit que celui d’EADS.”) (Exhibit US-217).

<sup>148</sup> See the maps at <http://www.grandtoulouse.org/admin/upload/fichier/aeroconstellation.htm> (Carte interactive) (Exhibit US-218), in particular the descriptions of the activities of these companies in the maps entitled “La société Capelle”, “La centre technique” and “La station carburant”. See also the press releases published by ELYO (Exhibit US-221) and ExxonMobil (Exhibit US-222), describing the role of ELYO, ExxonMobil and Spie Batignolle.

<sup>149</sup> See the maps at <http://www.grandtoulouse.org/admin/upload/fichier/aeroconstellation.htm> (Carte interactive) that the United States submitted as Exhibit US-218. On the maps, the sites marked in blue are the private facilities (each marked with the name of the occupant; the areas marked in red are the “public” infrastructure: the roads, taxiways and airplane parking spaces on the site. See also the satellite photographs of the site at <http://maps.google.com> (Exhibit US-481)

Airbus as a testing site for the A380. Airbus only owns the land used for the actual testing facilities, marked blue on the map.<sup>150</sup>

146. Finally, the Aéroconstellation site (including EIG facilities) is open to access by the aeronautics industry only. As the EC itself acknowledges in its first written submission,<sup>151</sup> the Aéroconstellation site is a “zone d’activités à vocation aéronautique”<sup>152</sup> that has been entirely dedicated to aeronautics (“entièrement dédiée à l’aéronautique”).<sup>153</sup>

147. In 2001, when the development work for the Aéroconstellation site began, it was already agreed that Airbus would be the predominant user of, and owner of land at, the site; Airbus had committed to locate its A380 facilities at this site and had submitted a plan describing the exact location of its assembly, testing and delivery facilities on the site. Grand Toulouse developed the EIG facilities (taxiways, aircraft parking space, technical galleries etc.) around the Airbus facilities, as well as the facilities of Airbus’ suppliers (including, in particular, energy and water provider ELYO, fuel provider EXXON Mobil, and A380 transport company Capelle)<sup>154</sup> and Air France, making it effectively impossible for any other user to access the site and to locate, in particular, non-aeronautics-related facilities on the Aéroconstellation site.<sup>155</sup> Indeed, in 2001, the

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<sup>150</sup> See map at <http://perso.orange.fr/franceaero/plan/planaccueil.htm> (Exhibit US-219). See also the maps at <http://www.grandtoulouse.org/admin/upload/fichier/aeroconstellation.htm> (Carte interactive) (Exhibit US-218), in particular the maps entitled “Les aires industrielles” and “Les postes extérieures”. Finally, see the [ ] the Atisreal study provided by the EC as Exhibit EC-18 (BCI) at p. 11.

<sup>151</sup> See EC FWS, para. 911: “According to the protocol, this site was dedicated to aeronautical activities.” See also the Atisreal study provided by the EC as Exhibit EC-18 (BCI) at p. 13 (I

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See also U.S. FWS, para. 459.

<sup>152</sup> City of Blagnac, Les Parc d’Activités, available at <http://www.blagnac-eco.com> (Exhibit US-204); see also *Les élus toulousains réservent un site pour la chaîne d’assemblage de l’Airbus géant*, Les Echos No. 17994, at 13 (Sept. 28, 1999) (citing the protocol signed between various local, regional and central authorities in France on September 27, 1999, that documented the commitment of these entities to establish the site) (Exhibit US-205).

<sup>153</sup> See the description of the site available at <http://www.grandtoulouse.org/index.php?pagecode=20> (Exhibit US-216).

<sup>154</sup> See the maps at <http://www.grandtoulouse.org/admin/upload/fichier/aeroconstellation.htm> (Carte interactive) (Exhibit US-218), in particular the maps entitled “La société Capelle”, “La centre technique” and “La station carburant”.

<sup>155</sup> See Grand Toulouse, Flash AéroConstellation, Bulletin d’information des riverains, No. 1, July/August 2001, available at <http://www.grandtoulouse.org/index.php?pagecode=20> (Exhibit US-208). In this publication, Grand Toulouse describes how the planning and development of the site and the planning and construction of the A380 facilities were inextricably linked to each other: “L’aménagement des deux premières phases {de la ZAC AéroConstellation} doit respecter un calendrier serré pour permettre le début de la construction des premiers bâtiments en 2002. Les industriels d’E.A.D.S. {i.e., Airbus} ont annoncé leur dernier plan de localisation. Deux taxiways (routes utilisées pour déplacement des avions vers la piste) structurent la zone du nord au sud, les futurs

Council of Grand Toulouse changed the formal zoning designation for the relevant area to turn the site into an industrial park specifically for the aeronautics industry.<sup>156</sup>

148. For the foregoing reasons, as well as those set forth in the U.S. first written submission, the Aéroconstellation site cannot be characterized as “general infrastructure” within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement.

149. **Routes Départementales 901, 902 and 963:** The EC argues that the construction work on the Routes Départementales 901, 902 and 963 is “general” because the road construction measures challenged by the United States were not triggered by the Aéroconstellation site, but had been planned before, and that the “construction of the ZAC {only} prompted the Département to accelerate the timetable for these improvements.”<sup>157</sup> The facts, however, belie the EC’s claims.

150. Examination of the documents submitted by the EC reveals that the measures were not planned prior to the decision to locate Airbus’s A380 facilities at the Aéroconstellation site. Rather, all of these measures were either triggered exclusively by the use of the Aéroconstellation site for A380 assembly, testing, and delivery or were amended significantly for that purpose. The resulting infrastructure is open for access only or primarily for those uses. To be specific:

- First, the Département Haute-Garonne constructed two overpasses at the Route Départementale 901 (which runs along the Southern border of the

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*bâtiment industriels seront implantés de part et d’autre. L’assemblée de l’A380 devrait se faire dans la partie nord et les tests dans la partie sud, en continuité avec l’aéroport.*” (Emphasis added.) This publication also contains a map showing the location of the A380 facilities around which the AéroConstellation site was planned.

<sup>156</sup> See Conseil de Communauté d’Agglomération du Grand Toulouse du Jeudi 19 avril 2001, 4ième Modification de l’Acte de Création de la ZAC de Grand Noble II, p. 3, available at <http://publi.agglo-grandtoulouse.fr/> (Exhibit US-215) (“L’accueil d’importantes installations aéronautiques sur le site nécessite que la zone d’aménagement concerté Grand Noble II, initialement à vocation d’activités diverses, soit adaptée. La redéfinition de son économie générale suppose une modification du périmètre de cette Z.A.C., de son objet, ainsi que du programme global de construction associé. Le mode de réalisation sera également différent de celui la Z.A.C. Grand Noble II. A l’issue de cette modification, elle se nommera désormais ZAC “AéroConstellation.” (Emphases added.)). A few years later, the Council of Grand Toulouse described this decision to develop the AéroConstellation site as follows: “La Communauté d’Agglomération du Grand Toulouse a décidé par délibération du Conseil de Communauté, en date du 19 avril 2001, de réaliser sur les Communes de Blagnac et de Cornebarrieu, une ZAC dite: “ZAC AEROCONSTELLATION” ayant vocation à accueillir des activités industrielles aéronautiques et notamment les halls d’assemblage du futur gros porteur A380 ainsi que le transfert du centre de maintenance technique d’Air France de Montaudran.” Conseil de Communauté d’Agglomération du Grand Toulouse du 13 Décembre 2004, ZAC AéroConstellation - Bail Grand Toulouse / AFUL: Adoption de l’Avenant No. 1, p. 3, available at <http://publi.agglo-grandtoulouse.fr/> (Exhibit US-482).

<sup>157</sup> See EC FWS, paras. 921 and 944.

Aéroconstellation site) to allow the taxiways linking the Aéroconstellation site to Toulouse airport to cross this road.<sup>158</sup>

The overpasses would not have been necessary absent Airbus's decision to locate its A380 facilities at this place and absent the development of the Aéroconstellation site for that purpose by Grand Toulouse.<sup>159</sup> Not surprisingly, the overpasses for the taxiways, or, for that matter, any other work concerning the Route Départementale 901, are not mentioned in the documents submitted by the EC.<sup>160</sup>

Like all of the taxiways on the Aéroconstellation site, the taxiways crossing the Route Départementale using the overpasses are predominantly used by Airbus, to move its A380 aircraft for testing and delivery to Toulouse airport. (Air France and STTS will be the only other users of the taxiways for aircraft taxiing to their facilities located right after the Eastern overpass at the Southern end of the Aéroconstellation site.)

Thus, the overpasses for the Route Départementale 901, constructed at a cost of Euro 17,000,000,<sup>161</sup> are open for access only to the users of the Aéroconstellation

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<sup>158</sup> Prior to the construction of the site and the underpasses, there was only a taxiway linking the SIDMI facility (which existed already before the Aéroconstellation site was built for Airbus) at the road level (requiring traffic to stop each time an aircraft taxied from the airport to the SIDMI facility and back). *See* the photograph available at [http://www.grandtoulouse.org/index.php?pagecode=126&modele\\_affi\\_dossier=instit](http://www.grandtoulouse.org/index.php?pagecode=126&modele_affi_dossier=instit) (Exhibit US-480).

<sup>159</sup> *See* Grand Toulouse, Flash AéroConstellation, Bulletin d'information des riverains, No. 11, Novembre/Décembre 2002, available at <http://www.grandtoulouse.org/index.php?pagecode=20> (Exhibit US-208): "La future RD 901: Les entreprises travaillent à la réalisation des deux ouvrages d'art qui permettront le passage des automobiles sous les taxiways reliant l'aéroport et la ZAC AéroConstellation. Cette voirie, d'un coût de 17 million d'euros, est financée par le département de la Haute-Garonne." *See also* Grand Toulouse, Flash AéroConstellation, Bulletin d'information des riverains, No. 1, July/August 2001, available at <http://www.grandtoulouse.org/index.php?pagecode=20> (Exhibit US-208). Under the heading "Les voies de desserte", Grand Toulouse similarly described the purpose of the road construction work at the Route Départementale 901 (in that document called "RD1") to enable the uninterrupted passage of aircraft across this road: "Son encaissement et la réalisation de deux ouvrages de franchissement permettront le passage des avions à niveau entre l'aéroport et les deux taxiways de la ZAC." *See also* the satellite photographs of the site at <http://maps.google.com> (Exhibit US-481) for a view of the overpasses.

<sup>160</sup> The maps contained in the document submitted as Exhibit EC-126 that illustrate the measures planned in 1998 in the area of the future Aéroconstellation site show no measures whatsoever concerning the Route Départementale 901 (which is the route running from East to West towards Cornebarrieu directly north of the runways) (*see* the maps entitled "R.D.1: Déviation de Cornebarrieu", "R.D. 63: Déviation de Cornebarrieu", and "R.D. 902"; all other maps show road measures taken in other areas of Haute-Garonne). Similarly, the page cited by the EC in the document submitted as Exhibit EC-125, p. 216, does not even mention the Route Départementale 901.

<sup>161</sup> *See* U.S. FWS, para. 578, listing evidence supporting the cost information provided by the United States. The EC has not disputed the amounts in its first written submission.

site, including, most importantly, the site's single largest user, Airbus, and are only used by them.

- Second, while the EC suggests that some road construction work was planned in 1998 to improve the Route Départementale D 902 (which runs along the Eastern border of the Aéroconstellation site) and the Route Départementale D 963 (which runs along the Northern and Western border of the Aéroconstellation site), these plans were changed significantly to enable use of the Aéroconstellation site by Airbus.

In particular, the document provided by the EC as Exhibit EC-126 neither shows the traffic circle called "Diffuseur de Pinot" on the Route Départementale 902<sup>162</sup> nor the traffic circles on the Route Départementale 963 providing site access to the Airbus facilities at the Northern end of the Aéroconstellation site<sup>163</sup> (both of which, of course, were not needed, absent the decision to locate Airbus' A380 facilities). In fact, a comparison of the maps provided by the EC as Exhibit EC-126 with recent satellite photographs and maps available from "Google" shows that there are significant differences between the road improvements planned in 1998 and their implementation following the decision by Airbus to locate its A380 facilities at Aéroconstellation.<sup>164</sup>

The infrastructure created at the Routes Départementales D 902 and D 963 to access the Aéroconstellation site is, in fact, only open for use by Airbus and is only used by Airbus. Both the traffic circle called "Diffuseur de Pinot" and the traffic circles at the Northern border of the Aéroconstellation site are only used to access the facilities of Airbus (and its suppliers) on the site. It would not have been necessary to build this infrastructure for the through traffic on the Routes Départementales D 902 and D 963 (and it was thus not planned in 1998). Moreover, this infrastructure is also not needed for access to the Air France, STTS and SIDMI facilities at the Southern end of the Aéroconstellation site; these facilities are accessed from the Route Départementale D 901, through two traffic circles located at that road.<sup>165</sup>

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<sup>162</sup> See the map entitled "R.D. 902" at Exhibit EC-126.

<sup>163</sup> See the map entitled "R.D. 63: Déviation de Cornebarrieu" at Exhibit EC-126.

<sup>164</sup> See the satellite photographs and maps of the site at <http://maps.google.com> (Exhibit US-481). The Route Départementale 963 is called N 224 on these maps.

<sup>165</sup> See the satellite photographs and maps of the site at <http://maps.google.com> (Exhibit US-481). The Route Départementale 963 is called N 224 on these maps; the Route Départementale 901 is called D 1 on these maps. Air France itself, in a description of its facilities on the Aéroconstellation site, also confirms that it is using the South Eastern access to the site ("la porte sud-est de la ZAC Aéroconstellation") rather than the Diffuseur de

151. For the foregoing reasons, as well as those set forth in the U.S. first written submission, the Routes Départementales 901, 902 and 963 cannot be characterized as “general infrastructure” within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement.

152. **Runway Extension at Bremen Airport:** The EC argues in its first written submission that the extension of the runway at Bremen airport is general infrastructure because “all users of Bremen airport may benefit from the extensions.”<sup>166</sup> In the same paragraph, however, the EC acknowledges that the extension is only available for regular use by Airbus, while all other uses are exceptional (*e.g.*, emergency landings or interrupted take-offs).<sup>167</sup>

153. Moreover, documents submitted by the EC itself, as well as other, publicly available documents, demonstrate that the right to use the extension is limited to the transport by air of wings for the A330/340 manufactured by Airbus at its Bremen facilities:

- First, the EC explains, in its first written submission, that the Bremen government decided in 1973 to restore the runway to its original length of 2,040 meters (after it had previously been shortened to 1,740 meters). In May 1988, the EC goes on to explain, the Bremen government authorised an additional extension of the runway by 300 meters in each direction.<sup>168</sup> The EC provided the authorization decision, dated May 31, 1988, as Exhibit EC-577. This document confirms that this further extension of the runway to a total of 2,634 meters was “for the *exclusive use* of super guppy take-offs or take-offs by similarly quiet freight aircraft for *MBB intra-factory flights*.”

The authorization decision submitted by the EC also belies the EC’s assertion, in its first written submission, that the further extension of the runway by 600 meters was motivated by “security reasons” or any other general purpose.<sup>169</sup> To the contrary, the Bremen government noted in its authorization decision that “Bremen Airport, *after full availability of the existing 2,034m long runway has been restored, duly satisfies the requirements to be placed on it in the interest of ensuring the safety of flight operations and achieving optimum integration with*

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Pinot or the Northern access facilities. See *Air France, Air France inaugure son nouveau centre industriel e Blagnac*, 2 April 2004, at 25 (Exhibit US-217). As Grand Toulouse explained in 2001: “L’accès principal à la ZAC se fera par le futur diffuseur dit de ‘Pinot’ créé sur la RD 902. Un accès au nord sera destiné à l’arrivée des tronçons de l’A380.” See Grand Toulouse, Flash AéroConstellation, Bulletin d’information des riverains, No. 1, July/August 2001, available at <http://www.grandtoulouse.org/index.php?pagecode=20> (Exhibit US-208).

<sup>166</sup> EC FWS, para. 868.

<sup>167</sup> EC FWS, para. 868.

<sup>168</sup> See EC FWS, para. 863.

<sup>169</sup> See EC FWS, para. 868.

the domestic and European operations network.” The Bremen government explicitly rejected the notion that the extended runway could be used (or required) for general, non-Airbus related air transport. Thus, it noted in its decision to extend the runway that “the rejection of an extension to the existing runway for general air traffic remains the unchanged foundation of Bremen’s airport policy and the subject of Bremen Airport’s operating licence.”<sup>170</sup>

- Second, a judgment of December 20, 2001, issued by the Bremen Administrative Court further confirms that the use of the extended runway was limited, as a matter of law, to Airbus for the transport of wings for the A330/340 by air. The EC has submitted this judgment as Exhibit EC-578, but it has omitted the relevant pages from that document and ignores the facts described therein.

The Court considered a complaint by the owner of land neighboring Bremen airport. The complainant was concerned that the Bremen government did not strictly enforce the user restrictions.<sup>171</sup> In its judgment, the Court, as the EC acknowledges, upheld the complaint and reaffirmed the restrictions on the use of the runway extensions. However, in its description of the pertinent facts, the Court also recalled that the use of the extended runway was limited to Airbus, and only for the transport of wings for the A330/A340:

The operating restrictions set forth in the following nos. 1 to 4 provide, *inter alia*, that the special runway can only be operated for take-offs and solely for transporting airfreight consisting of the wings of Airbus

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<sup>170</sup> Senatsbeschluss of 31 May 1988, at paras. 1 and 3 (Exhibit EC-577) (Non-BCI). The translation into English has been provided by the EC: “{1.} The Senate hereby endorses its decision of 8 May 1973, that Bremen Airport, after full availability of the existing 2,034m long runway has been restored, duly satisfies the requirements to be placed on it in the interest of ensuring the safety of flight operations and achieving optimum integration with the domestic and European operations network through short and medium haul flights with the exception of minor restrictions on load capacity. The rejection of an extension to the existing runway for general air traffic remains the unchanged foundation of Bremen’s airport policy and the subject of Bremen Airport’s operating licence in its revised form of 7 February 1985. . . . {3.} The Senate resolves, for the purposes of safeguarding Airbus wing assembly operations in Bremen in the long-term and the 500 jobs which are dependent on such operations, to extend the paved runway to the west and east of the airport by 300m in each direction by Summer 1990 for the exclusive use of super guppy take-offs or take-offs by similarly quiet freight aircraft for MBB intra-factory flights.”

<sup>171</sup> Again, the EC omits relevant details and modifies the facts to suit its purposes. The EC suggests, at para. 867 of its first written submission, that the complainant had “complained that a Boeing 747 (!) had used the extended runway.” In fact, however, the complaint was triggered primarily by the use of the extended runway by Airbus for *six* test flights with an aircraft of the type VFW614-ATD. The complainant was concerned (and the Court agreed) that this regular use of the runway by Airbus for test (rather than transport) flights indicated that the restrictions on the use of the extension (*i.e.*, only wing transport flights) might not be fully enforced any longer. The one instance in which the extension of the runway was used by a Boeing 747 was irrelevant to the judgment. *See* pp. 9-13 of the judgment (Exhibit EC-578) and pp. 9-12 of the translation submitted by the EC.

*models A 330 and 340 as well as successive versions thereof and only using Aero Spacelines 377 Guppy/Super-Guppy or one with noise levels not exceeding those of such model. The implementation order of the Senator for Building Affairs, which conform with the settlement, was issued on January 14, 1992. Subsequently, the special runways were built, i.e. the main runway was extended by 300m at each end.*<sup>172</sup>

- Finally, the Bremen Parliament also reaffirmed that the runway extension was for use by Airbus only. In a motion submitted by the SPD in the Bremen Parliament on May 16, 1988, the SPD asked the Bremen Parliament to approve the runway extension, but also noted that “{t}he extension of the takeoff and landing runway as a *company runway* at the Bremen Airport is being done *exclusively for use in the industrial transport of MBB* {i.e., the corporate parent of Deutsche Airbus} *Bremen to transport the Airbus wings.*”<sup>173</sup> The Bremen Parliament adopted the motion on May 18, 1988.<sup>174</sup>

154. In sum, the EC is mistaken when it says, in its first written submission, that “all users of the Bremen airport can benefit from the extensions,”<sup>175</sup> and when it suggests that the infrastructure is general. The contrary is true: As confirmed by the EC’s own documents, by publicly available documents, and by Bremen’s own Administrative Court, use of the extended runway is limited to Airbus (and only for specific uses). The runway extension is therefore not general infrastructure, within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement.

**21. How does the United States respond to the EC’s assertion that the extension of the Bremen airport runway in 1989-1990 cost a total of DM [ ] (DM [ ] for noise reduction and DM [ ] for the runway extension), as opposed to the DM [ ] figure that is presented in the United States’ FWS?**

Response:

155. The United States notes that the EC has not provided any evidence to support its assertion that the extension of the runway cost a total of DM [ ].<sup>176</sup> In view of the EC’s refusal to respond to the Annex V Facilitator’s questions on the subject, the United States has

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<sup>172</sup> Verwaltungsgericht Bremen (Administrative Court) (Dec. 20, 2001), case no. 2K 2787/00, at 3 (Exhibit US-199) (emphases added).

<sup>173</sup> Bremische Bürgerschaft, Antrag (Entschließung der Fraktion der SPD), Drs. 12/194 (Exhibit US-195).

<sup>174</sup> Bremische Bürgerschaft, 18. Sitzung am Mittwoch, dem 18. Mai 1988, Plenarprotokoll, at p. 1032, paras. (B) and (C) (Exhibit US-196).

<sup>175</sup> EC FWS, para. 868.

<sup>176</sup> EC FWS, para. 864.

relied on the public information available to it. In particular, the United States notes that in a motion submitted by the SPD in the Bremen Parliament on May 16, 1988, the SPD asked the Bremen Parliament to set aside DM 40 million in construction costs for the runway extension, plus an additional DM 9 million for noise reduction measures.<sup>177</sup> The Bremen Parliament adopted this motion on May 18, 1988.<sup>178</sup> Similarly, when the Bremen government authorized the extension, it also thought it appropriate to set aside DM 9 million for noise reduction measures.<sup>179</sup> Finally, a contemporaneous statement by a Bremen Parliamentarian also confirms that the expected costs for the runway extension and the noise reduction measures were DM 40 million and DM 10 million, respectively.<sup>180</sup>

156. The United States notes that the Annex V Facilitator had asked the EC to provide information and documents concerning the cost for the runway extension and the noise reduction measures.<sup>181</sup> The EC chose not to respond to a single question in the relevant section of the Facilitator's questionnaire.<sup>182</sup> Even in its first written submission, the EC limits itself to assertions about the costs of the measures taken at Bremen airport for Airbus, without providing any evidence.<sup>183</sup>

157. The logical inference to be drawn from the EC's refusal to provide the information the Facilitator requested regarding the Bremen airport runway is that the information would have supported the U.S. claim regarding the relevant costs.<sup>184</sup> The United States suggests that the Panel draw such a logical inference. In addition, this would appear to be a situation in which, in accordance with paragraph 7 of Annex V, the Panel would be justified in drawing an adverse inference that the withheld information demonstrates that the measure is a specific subsidy, and the United States respectfully requests that the Panel so infer.

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<sup>177</sup> Bremische Bürgerschaft, Antrag (Entschließung der Fraktion der SPD), Drs. 12/194 (Exhibit US-195).

<sup>178</sup> Bremische Bürgerschaft, 18. Sitzung am Mittwoch, dem 18. Mai 1988, Plenarprotokoll, at p. 1032, paras. (B) and (C) (Exhibit US-196).

<sup>179</sup> Senatsbeschluss of 31 May 1988, at paras. 1 and 3 (Exhibit EC-577) (Non-BCI).

<sup>180</sup> Bremische Bürgerschaft, 18. Sitzung am Mittwoch, dem 18. Mai 1988, Plenarprotokoll, Exhibit US-196, at p. 1016, para. (B).

<sup>181</sup> See *Questions for the European Communities Pursuant to Annex V of the SCM Agreement* (Oct. 7, 2005), Q48(b) & (c) (Exhibit US-4; see BCI Annex).

<sup>182</sup> See *Replies to Questions by the Facilitator under Annex V of the SCM Agreement by the European Communities* (Nov. 18, 2005), introductory remarks to section II.A.3 (Exhibit US-5 (BCI)).

<sup>183</sup> EC FWS, para. 864.

<sup>184</sup> See *Canada - Aircraft (AB)*, paras. 197-203 (discussing panel's authority to draw inferences based on party's refusal to provide information).

**22. What evidence does the United States have to support its view that Airbus benefited, within the meaning of Article 1.1(b) of the SCM Agreement, from the noise reduction measures taken in respect of the Bremen airport runway, given that Airbus is not the only company that uses the Bremen airport?**

Response:

158. The noise reduction measures had become necessary only because of runway extensions built so Airbus could take-off and land planes dedicated to the transport of A330/A340 wings.

159. The SPD therefore noted, in its motion of 16 May 1988,<sup>185</sup> adopted by the Bremen Parliament two days later,<sup>186</sup> that, while additional noise reduction measures were not formally required, the extension of the runway (“making the takeoff and landing runway fully usable”) should be accompanied by an extended noise reduction area. A Bremen Parliamentarian therefore called the noise reduction cost “follow-up costs for noise reduction.”<sup>187</sup>

160. The nexus between the extension of the runway for the use by Airbus and the additional noise reduction measures is also confirmed by the Bremen government’s decision of May 31, 1988, to authorize the extension. In that decision, submitted by the EC as Exhibit EC-577, the Bremen government noted, after having authorized the extension and asked the Bremen airport to initiate the relevant approval procedures, that, “{w}ith a view to protecting the resident population living within the proximity of the airport from aircraft noise and to improving the general airport environment in its location near to the city, the Senate resolves, as a voluntary measure, to reimburse, on application, future expenditure on structural noise protection within the existing noise protection zone 2.”<sup>188</sup>

161. Against this background, the additional noise reduction measures adopted by the Bremen government cannot be seen as measures to protect the areas adjacent to the airport against noise from the airport generally (and its use by companies other than Airbus). Rather, these measures were prompted exclusively by the extension of the runway and are, as such, for the exclusive benefit of Airbus, facilitating the extension of the runway for Airbus as a “company runway.”<sup>189</sup>

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<sup>185</sup> Bremische Bürgerschaft, Antrag (Entschließung der Fraktion der SPD), Drs. 12/194 (Exhibit US-195).

<sup>186</sup> Bremische Bürgerschaft, 18. Sitzung am Mittwoch, dem 18. Mai 1988, Plenarprotokoll, at p. 1032, paras. (B) and (C) (Exhibit US-196).

<sup>187</sup> Bremische Bürgerschaft, 18. Sitzung am Mittwoch, dem 18. Mai 1988, Plenarprotokoll, at p. 1016, para. (B) (Exhibit US-196).

<sup>188</sup> Senatsbeschluss of 31 May 1988, at para. 5 (Exhibit EC-577) (Non-BCI).

<sup>189</sup> Bremische Bürgerschaft, Antrag (Entschließung der Fraktion der SPD), Drs. 12/194 (Exhibit US-195).

**23. By arguing, at paragraph 468 of its FWS, that a “commercial actor would have charged Airbus a significantly higher price, or it would not have created the AéroConstellation site at all”, does the United States contend that the French government should have sold the land on the Aéroconstellation site to Airbus at a price that covered the cost of developing that site? In other words, is the United States arguing that the sale of land on the Aéroconstellation site benefited Airbus because it was at a price that did not enable the government of France to recoup its cost of site development?**

Response:

162. The United States recalls that Grand Toulouse invested at least EUR 158 million into the development of the Aéroconstellation site and into the creation of certain facilities located on the site for use by the occupants, the so-called EIG (“Équipement d’Interêt Générale”) facilities (such as the taxiways, the aircraft parking space, the technical galleries used to provide water and energy from Airbus suppliers to the Airbus plants, etc.). Grand Toulouse sold the majority of the land in the Aéroconstellation site to Airbus (with smaller areas sold to Airbus suppliers and Air France). The EIG facilities have been leased to Airbus and the other occupants.

163. The United States, indeed, takes the position that Grand Toulouse should have sold the land, and should have leased the EIG facilities, at a price that would allow it to recoup its full investment, plus a return on that investment that a private investor would consider reasonable. As explained in response to Question 20, above, the Aéroconstellation site is not general infrastructure. Rather, Grand Toulouse created the site from agricultural land – *i.e.*, it bought, improved and sold the relevant land<sup>190</sup> – specifically for the aeronautics industry and, in particular, for Airbus as a location for its A380 facilities.

164. In such a case, the relevant benchmark is the value of the land plus the investment made in preparing the land according to the specifications imposed by the private companies for whom the site was created. A commercial owner of the land would not prepare the land for a specific purchaser at a loss; rather, such a commercial investor would sell the land as it is and leave the preparation to the purchaser or, in case the land is prepared before the sale according to specifications of the new owner, require compensation for the investment made in such preparation, whether through a lease/user agreement or through the purchase price, in addition to the value of the land prior to that investment.

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<sup>190</sup> The EC, in its first written submission, described a “Zone d’aménagement concertée” or “ZAC” as an “industrial park or zone” in which a public authority buys, improves, and sells land for economic development” (para. 923). In addition to selling certain plots, the public authorities retain a portion of the land to create and provide certain facilities within a ZAC needed by one or more of the companies located in the ZAC (para. 924).

165. The EC itself has accepted this test in principle. It suggested the same benchmark for the provision of non-general infrastructure in its first written submission, when discussing the creation of new, artificial land in Hamburg:

*In Scott Paper {an EC state aid case}, the French authorities . . . turned existing agricultural land into a tailor-made industrial site. French authorities not only conducted measures according to the specific plans of Scott, but even built a factory warehouse for the company. That enabled Scott to place a household paper factory on the prepared site.*

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*The city had agreed with Scott to finance the site-preparation costs up to a maximum amount of FRF 80 million, which turned out to be at FRF 92 million. Upon completion of the site, the city sold 48ha of the available 68ha to Scott {at} a pre-fixed price of FRF 31 million.*

*Accordingly, Scott Paper . . . analyses the sales conditions of a tailor-made site for a specific company. The Commission saw no public policy reason why the French authorities were spending money on the development of a site that was *ab initio* dedicated for sale to a private company.*

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*Rather than providing general infrastructure, the French authorities acted in favour of one specific company to whom ownership of the tailor-made industrial site including specific buildings for the factory was transferred with a sales price that did not cover the investment costs. No private investor would have acted in such a manner.<sup>191</sup>*

166. The United States agrees: The relevant benchmark is the cost of site development, including the value of the land plus a commercial return on the investment made.

**24. How does the United States respond to the EC's assertion, at paragraphs 772-774 of its FWS, that there was in fact no co-financing of the A380 assembly line in Hamburg? Does the United States wish to continue pursuing its claim in respect of this alleged measure?**

Response:

167. The United States has decided not to pursue its claim with respect to co-financing of the A380 assembly line in Hamburg.

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<sup>191</sup> EC FWS, paras. 789-790 (emphases added) (footnotes omitted).

**F. CAPITAL INVESTMENTS AND SHARE TRANSFERS**

**25. How does the United States respond to the EC’s argument, at paragraphs 1109, 1172 and 1203 of its FWS, that it has failed to make a *prima facie* case in respect of its claims relating to the French and German governments’ share transfers, equity infusions and debt settlement transactions, because it has not demonstrated how such transactions conferred a benefit on Airbus SAS?**

Response:

168. The EC’s argument in the cited paragraphs repeats the so-called “pass-through” argument it makes elsewhere with regard to subsidies that benefitted the development and production of Airbus LCA models and that were first provided prior to the creation of Airbus SAS. The United States refers the Panel to the U.S. response to Question 16, above. Question 16 concerns the same EC “pass-through” argument in connection with the 1988-1993 EIB loans, and in its response to the question the United States explains why the EC argument is incorrect. The United States also refers the Panel to the U.S. responses to Questions 56 and 122, which pertain to related points.

169. Additionally, the United States notes that at paragraph 1203 of its first written submission, the EC questions whether the 1992 transfer by the German state-owned KfW to Messerschmitt Bölkow Blom (MBB) of KfW’s 20% stake in Deutsche Airbus resulted in a benefit “pass{ing}” to Deutsche Airbus (in addition to questioning whether the benefit later “passed” to Airbus SAS). This is quite surprising, given that a mere 23 paragraphs earlier in its submission the EC described KfW as having purchased a 20% stake in Deutsche Airbus in 1989 as having been made on the understanding that the shares ultimately would be transferred back to Deutsche Airbus’s parent (MBB) as part of a “restructuring package” designed to achieve “a long-term solution for Deutsche Airbus.”<sup>192</sup> The United States fails to see how an element of “a long-term solution for Deutsche Airbus” would not confer a benefit on Deutsche Airbus.

**26. How does the United States respond to the EC’s assertion, at paragraph 1113 of its FWS, that “informed investors commit capital based on an assessment of future prospects, not past performance.”**

Response:

170. It is correct that investors commit capital based on their assessments of potential earnings in the years ahead. However, to assess future potential earnings, an investor will look at several objectively quantifiable representations of the current financial health of a company (*e.g.*, its

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<sup>192</sup> EC FWS, paras. 1178-1180.

balance sheet and financial ratios). Additionally, an investor will evaluate the company's future prospects based on information established and known at the time just prior to its decision to make the investment (*i.e.*, information contemporaneous with the decision). The panel in *Korea - Commercial Vessels* agreed that this is how investors assess a company's future prospects, thus finding that whether the terms of a debt-for-equity swap at issue in that dispute were commercially unreasonable "should not be analysed *ex post*," but rather, they "should be assessed in light of the facts before creditors at the time they decided upon them."<sup>193</sup>

171. Assessing the terms of various equity infusions in light of the contemporaneous facts is precisely the approach the United States took in its first written submission. Just as private investors would have done, the United States analyzed balance sheets and financial ratios of the Airbus companies in the year of and the years just prior to each equity infusion. The United States also analyzed contemporaneous expressions of what Airbus itself and its investors expected in terms of the company's future financial and commercial prospects. Thus, the United States evaluated the equity-worthiness of Airbus in the periods at issue consistent with the usual investment practice of private investors.<sup>194</sup> In doing so, the United States assessed the equity infusions on the basis of the same information that would have been relevant to a commercial investor when deciding whether to provide an equity infusion.

172. By contrast, the EC seems to suggest that in evaluating whether an equity infusion constituted a subsidy, one should take an *ex post* perspective, looking at actual returns on the equity years after the equity infusions were made. For example, to justify the French government's equity infusions in Aérospatiale, the EC makes repeated reference to the [ ] return the government allegedly earned on its investment a decade after the initial equity infusions.<sup>195</sup> However, any actual return on the equity that was eventually realized is irrelevant to the facts before investors at the time they make their investment decision.

**27. Please comment on the EC's assertion, at paragraph 1125 of its FWS, that there was "considerable evidence of {Aérospatiale's} positive future prospects, as well as an optimistic view of demand that was shared by Boeing".**

Response:

173. The United States disagrees that there was "considerable evidence" of Aérospatiale's positive future prospects or of an optimistic view of demand at the time of the French equity infusions to Aérospatiale. First, although the equity infusions to Aérospatiale all occurred between 1987/1988 and December 1993, the EC's main evidence post-dates this time period:

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<sup>193</sup> *Korea - Commercial Vessels (Panel)*, para. 7.491.

<sup>194</sup> See U.S. FWS, paras. 537-556, 557-620.

<sup>195</sup> See EC FWS, paras. 1122, 1130.

- The EC refers to a “contemporaneous” US National Research Council study that it suggests would reflect industry sentiment during the period in which the French government provided its equity infusions into Aérospatiale.<sup>196</sup> In reality, this “contemporaneous” study dates from 1994, whereas the last of the four equity infusions to Aérospatiale that the United States challenges was provided on December 31, 1993.<sup>197</sup> Moreover, the same report expressed “considerable pessimism concerning the next several years,” and projected that “{e}ven with cost reductions” there would be “lower profit levels within the industry relative to the past which could affect funds available for research and development on next-generation products.”<sup>198</sup>
- The EC continues by referring to the actual rate of return of [ ] that it claims the French government realized on its investment.<sup>199</sup> As the EC’s own chart calculating this return shows, it was based on the value of the company at the time of the EADS IPO in 2000/2001.<sup>200</sup> Thus, the EC tries to justify equity infusions made from 1987/1988 through 1993 on the basis of returns realized a decade later, during which time changes in the value of Aérospatiale reflected not just equity infusions, but also the receipt of other subsidies, such as Launch Aid, EIB loans, and various types of R&D support.
- In its discussion of Aérospatiale’s performance and prospects, the EC also emphasizes the company’s “return to profitability in 1996” and the fact that it remained profitable through the merger with MHT and the creation of EADS in 2000.<sup>201</sup> However, these observations are irrelevant to the question of whether the French government acted as a private investor would have acted in making infusions from 1987/1988 through 1993. Moreover, it was precisely the billions of dollars in equity infusions and Launch Aid provided in the late 1980s and early 1990s that helped make the company profitable again.

174. Second, the EC does not provide any evidence of contemporaneous studies or analyses by the French government on the investment prospects of Aérospatiale at the time of the investments. During the Annex V process, the Facilitator expressly asked the EC to provide

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<sup>196</sup> EC FWS, para. 1118.

<sup>197</sup> See U.S. FWS, para. 594.

<sup>198</sup> Exhibit EC-170, pp. 66-67.

<sup>199</sup> EC FWS, para. 1122.

<sup>200</sup> See Exhibit EC-171 (BCI).

<sup>201</sup> EC FWS, para. 1136.

such evidence. In particular, the Facilitator asked the EC to provide, among other things: (a) information on the French government’s expected rate of return and how it calculated that expected rate of return; (b) “any prior evaluation . . . of the equity infusion, the shares purchased, and/or the company (Aérospatiale) and/or its operations (including its Airbus operations) . . . including any government, Airbus/Aérospatiale, or third party reports, studies, analyses or other documents discussing the equity infusion and its terms, conditions and effects;” and (c) any other contemporaneous reports, studies, or valuations.<sup>202</sup> In response, the EC did not provide any contemporaneous reports, evaluations, or valuations. Contrary to the approach suggested by the panel in *Korea - Commercial Vessels* to evaluating a similar category of investment, the EC has failed to show that the French government assessed the equity infusions to Aérospatiale “in light of the facts before {it} at the time {it} decided upon them.”<sup>203</sup>

175. By contrast, the United States, in its first written submission, has demonstrated in detail that Aérospatiale’s financial ratios at the time of the French equity investments were objectively unappealing from an investor’s perspective and substantially worse than those of a peer group of companies. In such circumstances, a private investor would have had no basis for providing capital to Aérospatiale rather than to an alternative investment.<sup>204</sup>

**28. At paragraph 1112 of its FWS, the EC argues that although Aérospatiale “posted losses in the early 1990s when the industry was in recession, it was consistently profitable in the second half of the 1980s and returned to profitability in 1996”. The EC argues that this is “explicitly confirmed by the documents cited by the US”, e.g., Exhibit US-276, page 29. Does the United States agree with this characterisation of the industry situation and Aérospatiale’s performance over this period? How does the United States respond to the EC’s contention that Exhibit US-276 supports its view?**

Response:

176. The United States does not agree with the EC’s characterization of the industry situation and Aérospatiale’s performance over the cited period. That characterization is misleading for two reasons. First, it ignores the key indicators of Aérospatiale’s financial health at the time of the French government’s equity infusions. Second, it engages in *post hoc* rationalization, justifying equity infusions made from 1987/1988 through 1993 based on returns realized in 1996, which returns reflected not only the equity infusions themselves, but also Launch Aid, R&D grants, and other subsidies.

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<sup>202</sup> *Questions for the European Communities Pursuant to Annex V of the SCM Agreement* (Oct. 7, 2005), Q92(e), (h) and (i) (Exhibit US-4; see BCI Annex).

<sup>203</sup> *Korea - Commercial Vessels (Panel)*, para. 7.491.

<sup>204</sup> See U.S. FWS, paras. 557-620.

177. The EC's only acknowledgment of Aérospatiale's dismal financial health during the period at issue is a passing statement that "financial performance may not have been as robust as the company would have liked."<sup>205</sup> The EC glosses over the company's less-than-robust financial performance and points instead to its profitability in 1987, 1988, and 1991. It asserts that the company's financial performance "did not preclude the investment of new capital."<sup>206</sup> But, preclusion is not the issue. The issue is whether, consistent with usual investment practice, a private investor would, at the time of the infusion, have made the investment the French government in fact made, given the company's poor financial health.

178. The United States does not deny that Aérospatiale was profitable in these years (a fact due in no small part to government equity infusions in the 1970s and early 1980s, FF 4,100,000,00 in Launch Aid for the A320 in 1984, and another FF 7,800,000,000 in Launch Aid for the A330/340 beginning in 1987). But, its profitability must be put into perspective and examined the way a private investor would have examined it. Profitability, by itself, does not give an investor an adequate basis for comparing a potential investment to other alternative investments. More revealing is a ratio, such as return on equity, which tells an investor how a company's profitability relates to the money shareholders have invested in it. The mere fact that a company made a profit in a given year does not make an investment in that company reasonable, especially if the profit is spread over a relatively large equity base when compared with the company's peers.

179. In particular, Aérospatiale's profits must be considered in relation to its considerable debts. As discussed in the U.S. first written submission, Aérospatiale's debt-to-equity ratio was 10.9 in 1986 (compared to 6.2 for its peer group) and 8.2 in 1987 (compared to 4.9 for its peer group), the two years prior to the first and second equity infusions that the United States challenges.<sup>207</sup> Additionally, its return on equity in these years was substantially below that of its peer group: 9.8% versus 45.2% for its peer group in 1986; 4.0% versus 17.2% for its peer group in 1987; and negative 1.3% versus positive 15.4 percent for its peer group in 1988.<sup>208</sup>

180. In sum, the EC's reference to the profitability of Aérospatiale in 1987, 1988, and 1991 fails to accurately portray the considerations a private investor would have taken into account in deciding whether to invest in the company in the years at issue.

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<sup>205</sup> EC FWS, para. 1137.

<sup>206</sup> EC FWS, para. 1137.

<sup>207</sup> See U.S. FWS, para. 570.

<sup>208</sup> See U.S. FWS, para. 571.

181. The EC also points out that in the early 1990s, the industry was in recession.<sup>209</sup> This period was indeed a difficult period for the LCA industry. However, the EC's comparison of the steps that Aérospatiale and Boeing each took to deal with this situation actually highlights the benefit of non-commercial equity infusions and other subsidies as compared with market-based financing.

182. Both Boeing and Aérospatiale (along with the other Airbus companies) encountered slow demand in the early 1990s, and this was precisely the period in which McDonnell Douglas's MD11 failed to find sufficient customers and became a commercial failure.<sup>210</sup> Later, Boeing and McDonnell Douglas merged, in large part because of the difficult financial and commercial situation faced by McDonnell Douglas. What distinguishes the situation of Aérospatiale and the other Airbus companies are precisely the massive subsidies they received in that same time period. Throughout these difficult times, the Airbus companies had the luxury of receiving and knowing they would continue to receive massive amounts of government support in the form of Launch Aid, equity infusions and other subsidies. By contrast, Boeing had no choice but to go to the market and "assume {} significant additional debt."<sup>211</sup>

183. Moreover, it is notable that in discussing the situation in the early 1990s, the EC focuses on the perspective of "management," asserting that "{t}he managements of both Boeing and Aérospatiale know that for industries, such as LCA, with long and costly development cycles, it is imperative to invest even during periods of weak performance."<sup>212</sup> This may well be so, but it is entirely irrelevant to assessing whether the French government's investment in Aérospatiale conferred a benefit. What matters is not management's perceived need for investment but, rather, the market's perception of the worthiness of a particular investment.

184. Likewise, the EC's assertion that "{i}f the company had failed to invest in these new programmes {i.e., the A320 and the A330/340}, the dramatic improvement in its earnings in 1996, 1997 and 1998 would not have occurred" is also irrelevant.<sup>213</sup> The fact that an investment ultimately may pay off does not mean that, consistent with the usual investment practice of private investors, the investment would have been made in the first place. Indeed, acceptance of this proposition would mean that subsidies intended to improve earnings could be justified by the very improvement in those earnings that the subsidies were designed to bring about. Clearly

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<sup>209</sup> See EC FWS, paras. 1112, 1138-1143.

<sup>210</sup> See U.S. FWS, note 114.

<sup>211</sup> EC FWS, para. 1115; *see also id.*, para. 1142.

<sup>212</sup> EC FWS, para. 1139. Indeed, throughout its discussion of the French government equity infusions to Aérospatiale, the EC consistently focuses on the perspective of management. *See, e.g., id.*, paras. 1115, 1116, 1145-1147, 1153, 1155.

<sup>213</sup> EC FWS, para. 1139.

such a proposition amounts to “bootstrapping” and cannot be the proper way to determine whether a financial contribution confers a benefit and thus constitutes a subsidy within the meaning of Article 1 of the SCM Agreement.

185. In short, the EC’s assertion that Aérospatiale returned to profitability in 1996 – almost three years after the last of the challenged equity infusions had been made – has no bearing on the question at hand. If anything, it confirms precisely the role that the massive equity infusions and other subsidies that Aérospatiale received played in supporting the company’s key financial and commercial position.

186. Finally, as the question notes, the EC relies on Exhibit US-276 (a translation of an article from the journal *Air & Cosmos/Aviation International*) to support the proposition that Aérospatiale returned to profitability in 1996. However, its characterization of this document is misleading. The EC apparently relies on the article’s observation that Airbus sales were up and that Airbus operations had started to return to profitability. However, just a few paragraphs later, the article quotes Aérospatiale’s CEO as stating that ““{the company’s} current cash balance (at Fr 5 billion, or 10 percent of revenue) is extremely light,”” and that ““to inspire confidence in private investors, this ratio would have to average around one-third of revenue, calling for a balance of around Fr 15 billion.””<sup>214</sup> (Indeed, by 1998 the company received another equity infusion from the French government in the form of the Dassault share transfer.) In any event, as already discussed, information about Aérospatiale’s financial health in 1996 has no bearing on an assessment of the 1988 - 1993 equity infusions by the French government.

**29. How does the United States respond to the EC’s assertion, at paragraph 1123 of its FWS, that “{v}aluations undertaken by a number of investment banks in the context of the privatization of Aérospatiale included the value of Dassault shares in setting the price for the public offering, demonstrating that the French State received fair compensation for its stake in Dassault”?**

Response:

187. The EC’s assertion does not affect the U.S. *prima facie* case that the French government’s transfer of the Dassault shares to Aérospatiale is a financial contribution that confers a benefit and is therefore a subsidy within the meaning of Article 1 of the SCM Agreement. As discussed in the U.S. first written submission, in December 1998, the French government transferred its 45.76 percent share of Dassault’s capital to Aérospatiale. In return, the French government received additional Aérospatiale stock. Based upon Dassault’s share value at the time, the measure translated into a FF 5,280,000,000 equity infusion that increased

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<sup>214</sup> *Corporate Strategies, France: Aérospatiale Reveals Earnings/Losses by Sector*, Air & Cosmos / Aviation International, at 29 (Sept. 6, 1996) (Exhibit US-276).

Aérospatiale's total consolidated capital by about 20 percent and effectively created a corporate tie-up (partial merger) between Dassault and Aérospatiale.<sup>215</sup>

188. The test for determining whether the transfer of the Dassault shares constituted a subsidy is whether the transfer was consistent with the usual investment practice of private investors.<sup>216</sup> The possibility that “valuations undertaken by a number of investment banks in the context of the privatization of Aérospatiale included the value of Dassault shares in setting the price for the public offering” has nothing to do with whether a private investor would have transferred the Dassault shares in the first place. The value of the Dassault shares six months after the transfer might be relevant to measuring the longer term benefit that Aérospatiale derived from the transfer, but it does not address the issue of the consistency or inconsistency of the transfer with the usual investment practice of private investors.

189. Similarly, whether the French government ultimately (at the time of the Aérospatiale public offering) received “fair compensation” for its transfer of the Dassault shares has no bearing on whether the transfer conferred a benefit on Aérospatiale. The United States has presented extensive evidence of the dire financial state of Aérospatiale at the time of the share transfer.<sup>217</sup> The transfer to Aérospatiale of FF 5,280,000,000 of equity and the corporate tie-up to Dassault significantly improved this situation to the benefit of Aérospatiale.<sup>218</sup> Indeed, the measure had the clear objective of strengthening Aérospatiale's balance sheet and protecting French interests in the upcoming industry consolidations.<sup>219</sup> Even if one were to assume, *arguendo*, that “nothing of economic significance”<sup>220</sup> occurred from the perspective of the French government as the shareholder, from Aérospatiale's perspective the share transfer was clearly beneficial. The transaction was among the factors that allowed the company to integrate further into the Airbus consortium and, crucially, to continue to grow its LCA development and production activities.

190. Finally, the EC's statement in no way addresses the significant evidence that demonstrates that the Dassault share transfer occurred for political and industrial policy reasons and did not reflect commercial practice or happen at arm's length. The transaction was

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<sup>215</sup> See U.S. FWS, para. 607.

<sup>216</sup> See U.S. FWS, para. 561.

<sup>217</sup> See U.S. FWS, paras. 557-573; response to Question 28, *supra*.

<sup>218</sup> See U.S. FWS, para. 614; Collin (Yvon), Senate Report No. 89 (1999-2000), Commission des Finances, du Controle Budgetaire et des Comptes Economiques de la Nation sur le projet de loi de finances pour 2000, Tome III, Annexe No. 25, Equipement, Transport et Logement: III. - Transports: Transport Aerien et Meteorologie et Aviation Civile (“French Senate Report No. 89”), at 55 (Exhibit US-302).

<sup>219</sup> See U.S. FWS, paras. 610-615.

<sup>220</sup> EC FWS, para. 1167.

surrounded by politics, and it took considerable persuasion to get Dassault to agree to the share transfer.<sup>221</sup>

**30. Please comment on the EC’s assertion, at paragraph 1202 of its FWS, that under the 1998 debt settlement, Deutsche Airbus paid the German government “fair value of its claims”, and thus did not receive any advantage relative to that it would have been accorded “by a market-based creditor”.**

Response:

191. The EC’s assertion at paragraph 1202 of its FWS wrongly equates paying the government the “fair value of its claims” with not receiving any advantage relative to what would have been accorded by a market-based creditor. That equation ignores the non-market-based terms of the underlying claims. A “market-based creditor” would have had claims against Deutsche Airbus reflecting market-based terms. The fair value of those claims would have been higher than the fair value of the non-market-based claims that the German government had against Airbus. To settle those claims for fair value, Deutsche Airbus would have had to pay the market-based creditor more than it paid the German government. By paying the German government less, therefore, Deutsche Airbus received an advantage relative to what it would have been accorded by a market-based creditor – *i.e.*, a subsidy.

192. The EC does not dispute the facts that are the basis for the U.S. claim: In 1998, the German government agreed to settle outstanding debt of DM 9.4 billion owed by Deutsche Airbus for a payment of DM 1.7 billion. Deutsche Airbus could keep the remaining DM 7.7 billion.<sup>222</sup> The elements of the underlying debt and the settlement of that debt are set out at paragraphs 516 to 531 of the U.S. first written submission. The EC confirms these elements at paragraphs 1177 to 1184 of its first written submission.

193. In particular, the EC confirms that in 1989, the German government “assisted” Deutsche Airbus with a “one-time package of restructuring measures . . . designed . . . to allow Deutsche Airbus to gradually recuperate and regain . . . financial strength.”<sup>223</sup> The EC further confirms that this “package” (described at the time by the European Commission as an “aid package”<sup>224</sup>) consisted of: (i) the repayment by the German government of DM 2.326 billion in private debt,

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<sup>221</sup> See U.S. FWS, para. 616.

<sup>222</sup> The DM 7.7 billion that Deutsche Airbus was allowed to keep was equivalent to EUR 3.9 billion or USD 4.6 billion, based on the fixed Euro/DM exchange rate and the USD/DM exchange rate at December 31, 1998, respectively.

<sup>223</sup> EC FWS, paras. 1178-1179.

<sup>224</sup> European Commission, Press Release, *Commission Approves Aid to Restructure German Civil Aircraft Industry* (IP/89/148) (Mar. 8, 1989) (Exhibit US-258).

(ii) the payment by the German government to Airbus of DM 1.48 billion through an exchange rate insurance scheme, (iii) the provision of a DM 165 million loan to Airbus for A320 production; (iv) the deferral of Launch Aid repayment by Airbus for the A300, A310, A320 and A330/340, and (v) a DM 505 million capital injection by the German government-owned bank KfW into Deutsche Airbus in exchange for a 20 percent stake in the company (of which Airbus had to repay a maximum of DM 192 million).<sup>225</sup>

194. As a result of this “aid package,” Deutsche Airbus received financial contributions from the German government, which it was entitled to use free of interest, and which it would be required to repay only after attaining certain financial milestones and, in any event, not prior to 2000 or 2001. As Daimler-Benz, the investor that the government induced to take over Deutsche Airbus in 1989, explained in its 1997 annual report:

Such undertakings, advances and assistance were to be repaid on a contingent basis by Daimler-Benz Aerospace Airbus’ making annual payments equal to 40% of its pretax profits (as defined), if any, beginning with the fiscal year 2001 (subject to advance to the year 2000 under certain conditions). Each annual payment is contingent on Daimler-Benz Aerospace Airbus’ having earned pretax profits in the prior year. Pretax profits are subject to reduction by application of prior years’ cumulative loss carryforwards. . . . The amount of the annual 40% profit-sharing obligation, if any, will depend upon the profitability of Daimler-Benz Aerospace Airbus in 2001 and beyond, which will be subject to a variety of unpredictable factors. Accordingly, the Group is unable to predict with certainty how long Daimler-Benz Aerospace Airbus will remain subject to the contingent 40% profit-sharing obligations, *but it is likely to be a period of decades.*<sup>226</sup>

195. In 1997, the German government settled the repayment obligations for Launch Aid received by Deutsche Airbus for the A320 (a settlement that the United States does not challenge in this dispute). In 1998, the German government further agreed to settle the remaining debt,<sup>227</sup> amounting to a total of at least DM 9.4 billion,<sup>228</sup> for a final payment of DM 1.7 billion.<sup>229</sup> According to the EC, “The settlement, paid by Deutsche Airbus to the government as a lump sum, discharged *all* of the remaining obligations of the German government against Deutsche Airbus.”<sup>230</sup>

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<sup>225</sup> EC FWS, paras. 1181-1182.

<sup>226</sup> See Daimler-Benz, Annual Report 1997, pp. 96-97 (emphasis added) (Exhibit US-262).

<sup>227</sup> EC FWS, paras. 1183-1184

<sup>228</sup> See U.S. FWS, paras. 519-521. While the EC does not explicitly confirm this amount, it also does not dispute the facts as set out by the United States.

<sup>229</sup> EC FWS, para. 1193.

<sup>230</sup> EC FWS, para. 1194 (emphasis in the original).

196. The EC rejects the description of this settlement – in which Deutsche Airbus paid DM 1.7 billion to eradicate DM 9.4 billion of debt to the German government – as debt forgiveness. Rather, the EC would characterize it as a payment to the government of the “fair value of its claims.”<sup>231</sup> The United States does not accept that characterization.<sup>232</sup> But, more fundamentally, regardless of the characterization, Deutsche Airbus received a benefit as a result of the transaction.

197. By 1998, Deutsche Airbus had received DM 9.4 billion from the German government that it was able to use without obligation for many years up to and including 1998. During that period prior to 1999, Deutsche Airbus enjoyed a huge benefit from having received this money interest-free. In addition, under the terms of the debt, Airbus would only have had to repay the DM 9.4 billion over a “period of decades.”<sup>233</sup> Thus, it would have continued to benefit from a “considerable interest rate subsidy”<sup>234</sup> each year for many years into the future.

198. Instead, under the settlement agreement, that future, potential benefit that Airbus expected to enjoy over decades was moved forward to 1998, and paid out to Airbus in one lump sum. The economic result of the 1998 settlement was that Airbus could simply keep DM 7.7 billion of the DM 9.4 billion it still owed to the German government in 1998. Thus, through the debt settlement, the German government effectively turned benefits that Deutsche Airbus expected to enjoy in the future from interest-savings on debt provided interest-free by the German government into a current cash grant of DM 7.7 billion provided in 1998.

199. Put another way, the net present value of the settlement of debt originally granted on preferential (*i.e.*, non-commercial) terms converts the future benefit of these preferential terms into a present benefit. Rather than receiving an interest rate benefit for “a period of decades” from 1999,<sup>235</sup> Airbus received a one-time benefit of DM 7.7 billion in 1998. That is what happened here, even if one assumes, *arguendo*, that the DM 1.7 billion that Deutsche Airbus paid to the German government represented the “fair value of its claims.” By discounting the

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<sup>231</sup> EC FWS, paras. 1202.

<sup>232</sup> The ordinary meaning of “forgive,” as relevant here, is “remit (a debt).” *Shorter Oxford English Dictionary*, vol. 1, p. 1013 (5<sup>th</sup> ed.). The ordinary meaning of “remit” is “{r}efrain from exacting (a payment or service).” *Shorter Oxford English Dictionary*, vol. 2, p. 2527 (5<sup>th</sup> ed.). Therefore, if a government is entitled to payment of DM 9.4 billion and refrains from exacting payment of DM 7.7 billion of that amount, it has remitted or forgiven that debt.

<sup>233</sup> See Daimler-Benz, Annual Report 1997, p. 97 (Exhibit US-262).

<sup>234</sup> “Zusammenschlußvorhaben der Daimler-Benz AG mit der Messerschmitt-Bölkow-Blohm GmbH, Sondergutachten 18, Sondergutachten der Monopolkommission, gemäß § 24b Abs. 5 Satz 7 GWB” (“Monopolkommission”), para. 132 (Exhibit US-30).

<sup>235</sup> Daimler-Benz, Annual Report 1997, pp. 96-97 (Exhibit US-262).

preferential repayment obligations of Launch Aid and other outstanding debt effective January 1, 1999, the German government converted the loans/repayable grants, and the future benefit associated with them, into a net present repayment obligation (DM 1.7 billion) and a net present benefit (DM 7.7 billion)

200. Finally, Deutsche Airbus received an additional “intangible” benefit from the 1998 settlement. As Daimler-Benz noted in its 1997 Annual Report, there was a high level of uncertainty as to the period of time over which it could have enjoyed the benefit of an interest-free DM 9.4 billion debt (and thus also as to the total size of the benefit). It stated that the period (and the size) of the benefit “will depend upon the profitability of Daimler-Benz Aerospace Airbus in 2001 and beyond, which will be *subject to a variety of unpredictable factors*.”<sup>236</sup> The 1998 settlement removed that uncertainty. It ensured Deutsche Airbus the full benefit of DM 7.7 billion.

**31. At paragraph 97 of its Opening Oral Statement, the United States states that Deutsche Airbus received a benefit from the 1998 debt settlement “because the ‘fair value of {the German government’s} claims’ already embedded a substantial benefit to Deutsche Airbus in the form of an interest rate of zero”. At paragraph 108 of its Opening Oral Statement, and at paragraph 23 of its Closing Oral Statement, the EC argues that this constitutes a “new claim” – both legally and factually – by the United States. How does the United States respond?**

Response:

201. The EC is incorrect. The U.S. claim with respect to the 1998 Deutsche Airbus debt settlement as discussed at paragraph 97 of the U.S. Opening Statement is identical to the claim described in the U.S. first written submission,<sup>237</sup> which is identical to the claim described in the U.S. panel request.<sup>238</sup>

202. Factually, the U.S. claim with respect to the 1998 settlement remains exactly as described in the U.S. first written submission and in the response to Question 30. Legally, the claim also remains exactly as described in the first written submission. That is, the settlement constitutes a financial contribution to Deutsche Airbus within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement, which confers a benefit within the meaning of Article 1.1(b), and is specific within the meaning of Article 2.<sup>239</sup>

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<sup>236</sup> See Daimler-Benz, Annual Report 1997, pp. 96-97 (Exhibit US-262).

<sup>237</sup> U.S. FWS, paras. 515-536.

<sup>238</sup> WT/DS316/2, p. 3 (numbered para. (4)).

<sup>239</sup> U.S. FWS, paras. 532-536.

203. The point that the United States made at paragraph 97 of its Opening Statement was a response to the EC's characterization of the 1998 debt settlement as payment of the fair value of the government's claims rather than debt forgiveness. As discussed in response to Question 30, the characterization of the transaction does not matter. Whether it is called debt forgiveness or payment of fair value, it still is a financial contribution that confers a benefit to Airbus.<sup>240</sup>

204. The discussion at paragraph 97 of the U.S. Opening Statement based on the EC's characterization of the 1998 debt settlement is not a "claim," as the EC's statement suggests. Rather, it is an argument. The distinction between claims and arguments is well established and has been fully described in prior Appellate Body reports. As the Appellate Body explained in *Korea - Dairy Safeguard*, for example, the term "claim" "mean{s} a claim that the respondent party has violated, or nullified or impaired the benefits arising from, an identified provision of a particular agreement." Whereas a claim must be set forth in a panel request, "{a}rguments supporting a claim are set out and progressively clarified in the first written submissions, the rebuttal submissions and the first and second panel meetings with the parties."<sup>241</sup>

205. Logically, if a complaining party is to engage in the progressive clarification to which the Appellate Body has referred, it must be able to respond to arguments by the responding party that rely on alternative characterizations of the facts. One possible response may be to challenge that characterization. But, an equally valid response is to demonstrate that even if the alternative characterization were correct (*arguendo*), the responding party's argument must still fail. That method of argumentation does not amount to the assertion of a new claim.

**32. At paragraph 1209 of its FWS, the EC contends that "contrary to the United States' assertions, the {1992} transfer {of KfW's 20% stake in Deutsche Airbus} was not free of charge". How does the United States respond to this contention?**

Response:

206. First, the EC's contention referred to in the Panel's question is nothing more than unsubstantiated assertion. The United States notes that while the Annex V Facilitator asked the EC about the terms and conditions of the 1992 transfer of KfW's 20% stake in Deutsche Airbus

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<sup>240</sup> See U.S. Closing Statement, paras. 33-35.

<sup>241</sup> *Korea - Dairy Safeguard (AB)*, para. 139; see also *Dominican Republic - Cigarettes (AB)*, para. 121; *Korea - Beef (AB)*, para. 88; *EC - Hormones (AB)*, para. 156; *India - Patent Protection (US) (AB)*, para. 88; *EC - Bananas III (AB)*, para. 141. As noted above, in the present dispute, the U.S. "claim" is that the EC has violated Article 5 of the SCM Agreement through the 1998 settlement agreement, which amounted to a financial contribution that provided a benefit to Deutsche Airbus within the meaning of Article 1, that is specific within the meaning of Article 2, and that causes adverse effects to U.S. interests..

to DASA, the EC refused to respond to any questions concerning this transaction.<sup>242</sup> Nor has the EC provided evidence to support the argument laid out in its first written submission.

207. Second, the Panel should recall the background to the share transfer: The EC has acknowledged that KfW had injected DM 505 million in cash into Deutsche Airbus in 1989, in exchange for the 20% shareholding in Deutsche Airbus.<sup>243</sup> The EC also admits that, only three years later, the value of that stake was determined to be not more than **[[HSBI]]** of this initial DM 505 million capital injection.<sup>244</sup> Even including the [ ] in the analysis, the EC admits that the amount received by KfW for the transfer of its shareholding in Airbus to DASA does not even come close to the DM 505 million in cash initially contributed by KfW to Deutsche Airbus (not even considering the time value of money accruing to Airbus during the period following the initial investment).<sup>245</sup>

208. The United States will address the EC's defense of the initial injection by KfW of DM 505 million in cash in its rebuttal submission. As regards the conditions of the subsequent transfer of KfW's 20% shareholding in Airbus to DASA, the EC's failure to provide any evidence makes it impossible to test the accuracy of its assertion that the transfer was not free of charge.

209. Tellingly, the EC does not provide any explanation of why Daimler-Benz and the then-EC Director-General Peter Carl themselves described the transfer of the 20% shareholding as a "compensatory measure" (or an "equally satisfactory solution") to compensate Deutsche Airbus for the withdrawal of the exchange rate scheme, subsequent to a finding by a panel established under the Tokyo Round Subsidies Code that the exchange rate scheme constituted a prohibited export subsidy. The EC simply ignores this evidence.

210. The United States has provided the relevant quotes in its first written submission,<sup>246</sup> but reiterates them here, for the sake of completeness. Daimler-Benz described the transfer of the KfW shareholding in its 1992 interim financial report as follows:

Following the decision of the GATT panel directed against the currency equalization assistance provided by the German government to Deutsche Airbus, the Federal Republic

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<sup>242</sup> See *Questions 108-126 from the Facilitator to the European Communities and Germany* (Exhibit US-4; see BCI Annex); *EC Response to Questions 108-126 from the Facilitator* (Exhibit US-5 (BCI)).

<sup>243</sup> EC FWS, para. 1214.

<sup>244</sup> See EC FWS, Full HSBI Version Appendix, para. 1208 (Apr. 5, 2007), for the number the EC designated as HSBI.

<sup>245</sup> EC FWS, para. 1209.

<sup>246</sup> U.S. FWS, paras. 550-551.

of Germany and Daimler-Benz entered into negotiations *with a view to achieving an equally satisfactory solution when the present assistance ceases*. In the resulting agreement it was decided that, *as one of the compensatory measures, the shares held by the Reconstruction Loan Corporation will be transferred to Deutsche Aerospace at an earlier date than scheduled*.<sup>247</sup>

211. Similarly, Peter Carl described Germany's "compensation" of Daimler-Benz in the following way:

We lost the export subsidy case . . . . But it was settled immediately afterwards. We agreed with the Germans that they had to change their system. *But what happened in reality was the way the German government simply changed the way in which it handed out very substantial amounts of money to Deutsche Airbus*. Instead of going by route A, it went by route B.<sup>248</sup>

212. These statements indicate that either the terms of the transfer of the shareholding or the acceleration of the transfer to 1992 (from the initially agreed 1999),<sup>249</sup> or both constituted a benefit to Airbus. The logical inference to be drawn from the EC's refusal to provide the information the Facilitator requested regarding the 1992 share transfer is that the information would have supported the U.S. claim (as well as the contemporaneous statements made by Daimler-Benz and the EC) that the measure is a specific subsidy. The United States requests that the Panel draw such a logical inference. In addition, this would appear to be a situation in which, in accordance with paragraph 7 of Annex V, the Panel would be justified in drawing an adverse inference that the withheld information demonstrates that the measure is a specific subsidy and the United States respectfully requests that the Panel so infer.

## G. R&D AND TECHNOLOGY

**33. How does the United States respond to the EC's request, at paragraphs 1234, 1262, 1266 and 1272 of its FWS, for the Panel to disregard, in its determination of subsidization, the grants under the 2nd EC Framework Program, and parts or all of the grants made by the Bavarian, Hamburg and Bremen authorities, because the United States has failed to demonstrate how such grants conferred a benefit on Airbus SAS or its subsidiaries?**

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<sup>247</sup> See Daimler-Benz, Consolidated Interim Report, January 1-June 30, 1992, at 7 (Nov. 16, 1992) (emphasis added) (Exhibit US-272).

<sup>248</sup> Stephen Aris, *Close to the Sun*, at 166-67 (2004) (quoting Carl) (Exhibit US-23).

<sup>249</sup> The EC admits that the date for the transfer was moved forward from 1999 to 1992. EC FWS, paras. 1180 and 1207.

Response:

213. The EC's argument at paragraphs 1234 and 1262 repeats the so-called "pass-through" argument it makes elsewhere with regard to subsidies that benefitted the development and production of Airbus LCA models and were first provided prior to the creation of Airbus SAS. The United States refers the Panel to the U.S. response to Question 16 above. Question 16 concerns the same EC "pass-through" argument in connection with the 1988-1993 EIB loans, and in its response to the question, the United States explains why the EC argument is incorrect. The United States also refers the Panel to the U.S. responses to Questions 56 and 122, which pertain to related points.

214. Moreover, the United States has demonstrated, and the EC has acknowledged, that Airbus participated in most of the 28 research projects that the EC funded under the Second Framework Program.<sup>250</sup> In view of the EC's refusal to provide project-by-project breakdowns of the Second Framework Program budget, including a breakdown for projects in which Airbus participated, as specifically requested by the Annex V Facilitator, the United States has relied on the best available information to determine the amount of such Framework Program grants to Airbus.<sup>251</sup>

215. With respect to the EC's argument at paragraphs 1262, 1266, and 1272 of its first written submission, the United States has shown that Airbus received R&D funding from the governments of Bavaria, Hamburg, and Bremen of [ ], [ ], and Euro 11,000,000, respectively.<sup>252</sup> This funding was provided to EADS and Daimler-Benz (the Bavaria grants),<sup>253</sup> EADS Airbus GmbH and Airbus Deutschland GmbH (the Hamburg grants),<sup>254</sup> and Airbus Bremen<sup>255</sup> – all Airbus companies.<sup>256</sup> All of the money was for civil aeronautics. With regard to the Hamburg grants to EADS Airbus and Airbus Deutschland, as is evident from the identity of the recipients, and as the EC itself noted in response to one of the Annex V

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<sup>250</sup> See U.S. FWS, para. 628 and evidence cited therein; EC FWS, para. 1234.

<sup>251</sup> U.S. FWS, para. 629.

<sup>252</sup> See U.S. FWS, paras. 667-677.

<sup>253</sup> *Replies to Questions by the Facilitator under Annex V of the SCM Agreement by the European Communities* (Nov. 18, 2005), Q188(c) (Exhibit US-5 (BCI)); see also U.S. FWS, para. 669.

<sup>254</sup> See DS316-EC-BCI-0003268 (Exhibit US-332 (BCI)); U.S. FWS, para 672.

<sup>255</sup> See Freie Hansestadt Bremen, Wirtschaftssenator Dr. Peter Gloystein, "Luftfahrzeugbau eine der Schlüsselindustrien in Bremen," press release of October 8, 2004 (Exhibit US-335); U.S. FWS, para. 674.

<sup>256</sup> See U.S. FWS, para. 44 note 24 (defining "Airbus companies").

Facilitator's questions, the money was LCA-related.<sup>257</sup> Indeed, the project that Hamburg supported was the development, integration and testing of the cabin environment of the A380.<sup>258</sup>

**34. Does the United States accept that the EC has now disclosed the full amount of funding provided to Airbus under the R&D measures at issue?**

Response:

216. The United States does not consider that the EC has now disclosed the full amount of funding provided to Airbus under the R&D measures at issue. For EC Framework Programs ("FP") 3 to 6, the EC appears to have disclosed R&D funding solely to the legal entities Airbus Germany, Airbus France, Airbus Spain and Airbus UK.<sup>259</sup> For FP2, the EC has disclosed amounts that went to MBB-Transport Aircraft Group, Aerospatiale Division Avions, CASA Getafe, and British Aerospace Commercial Aircraft.<sup>260</sup> It has described other monies as going to companies that are "{not} relevant for this dispute" without giving any further explanation of why such companies are not "relevant."<sup>261</sup>

217. The EC still has not disclosed all monies that went to Aérospatiale Division Avions (which it included for FP2 but not for some of the other FPs), Deutsche Aerospace Airbus GmbH, Aérospatiale, and BAe Airbus. Also, it included funds to Airbus UK for some FP projects but not all. These are all Airbus companies, and the EC has not explained why monies to these companies are "not relevant." A list of these types of missing amounts based on information of which the United States is aware<sup>262</sup> is submitted herewith as Exhibit US-485.

218. Further, the EC has failed to disclose grants to EADS, EADS Deutschland, BAE Systems and other Airbus entities. Exhibit US-485 provides an overview of projects and their recipients based on information of which the United States is aware. The EC provides no rationale for excluding these grants from the subsidies that the Panel should consider. Indeed, all of the money was provided to Airbus entities (identified individually in Exhibit US-485), and all of it was provided under the aeronautics budgets of the EC Framework Programs which, by

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<sup>257</sup> In its response to a question posed by the Annex V Facilitator, the EC states that "Daimler Benz and EADS received funding for 9 projects (related to LCA)." *See Replies to Questions by the Facilitator under Annex V of the SCM Agreement by the European Communities* (Nov. 18, 2005), Q188(c) (Exhibit US-5 (BCI)).

<sup>258</sup> The project is called "CASIV" ("CABin System Integration and Verification testing"). *See* Werum Software & Systems, Pressemitteilung Messdatenmanagementsysteme, Testdatenmanagementsystem von Werum im Einsatz für Tests des A380. (Exhibits US-483 and US-483a).

<sup>259</sup> EC FWS, paras. 1236, 1238, 1240, 1242.

<sup>260</sup> EC FWS, para. 1234.

<sup>261</sup> EC FWS, para. 1224.

<sup>262</sup> *See* Exhibit US-318.

definition, directly relate to civil aeronautics research and development. Thus, the EC has not disclosed the full amount of the funding; it is entirely unclear how the subsidies identified in Exhibit US-485 are “not relevant” to this dispute.

219. With regard to R&D grants that the French government provided to the aeronautics industry between 1986 and 2005, the EC concedes that an amount of [ ] was provided to Airbus France between 1994 and 2005.<sup>263</sup> It alleges that the remaining part of the EUR 809 million budgeted under this program for 1994 to 2005 was provided to companies not relevant for the present dispute.<sup>264</sup> However, it is unclear from the EC’s summary argument on this issue which companies that received French R&D funding it considers “not relevant.” Moreover, the EC has still not disclosed any of the French R&D grants provided to Airbus between 1986 and 1993. The United States therefore cannot accept that the EC has disclosed the full amount of funding provided to Airbus under the French R&D measures.

220. Finally, the United States notes that the EC has not provided any information as to the amounts of R&D loans to Airbus provided by the Spanish government under the Programa de Fomento de Innovacion Tecnica (“PROFIT”) between 2000 and 2005.<sup>265</sup> The EC does not provide any reason for its refusal to provide such information other than its own view that these measures are not within the terms of reference of this Panel.

**35. Is the allegation, set out at paragraph 653 of the United States’ FWS, that the predominant users of the grants under the Framework Programmes were aeronautics companies, the sole basis for the United States’ contention that the R&D funding to Airbus under the Framework Programmes is *de facto* specific within the meaning of Article 2.1(c)?**

Response:

221. The Framework Program aeronautics funding is specific within the meaning of Article 2.1 of the SCM Agreement, first, because, as discussed in more detail in response to Question 36, the grants are *de jure* specific. Each Framework Program has a sub-budget specific to the aeronautics industry allocating funding for which only aeronautics-related proposals are eligible.<sup>266</sup>

222. Second, FP aeronautics funding is *de facto* specific because within each FP’s aeronautics sub-budget, Airbus is the predominant user of the grants. Indeed, the company received [ ]

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<sup>263</sup> EC FWS, para. 1276.

<sup>264</sup> EC FWS, para. 1276.

<sup>265</sup> EC FWS, paras. 1315-1318.

<sup>266</sup> See U.S. FWS, paras. 652-653.

[ ] under FP2,<sup>267</sup> constituting [ ] of the Euro 35 million budget reserved for aeronautics research under “BriteEuram Area 5, Specific Activities relating to Aeronautics.”<sup>268</sup> FP3 funding to Airbus amounted to [ ], which is [ ] of the Euro 56 million budget.<sup>269</sup> Under FP4, Airbus received [ ], which is [ ] of the Euro 245 million budget for aeronautics<sup>270</sup> and, with funding of [ ], [ ] of the Euro 700 million budget of FP5.<sup>271</sup> Finally, Airbus received [ ] of the Euro 840 million FP6 aeronautics budget.<sup>272</sup>

**36. The United States argues, at paragraph 652 of its FWS, that grants under the EC Framework Programmes are specific “in law” because each Framework Programme has a “sub-budget” that is specific to the aeronautics industry”. What are the aeronautics “sub-budgets” under the EC Framework Programmes, and how do they operate?**

Response:

223. Starting with the second Framework Program, each of the EC’s Framework Programs has been implemented through “specific programmes.” Thus, FP6, for example, was divided into a “Specific Programme Integrating and Strengthening the European Research Area,” a “Specific Programme Structuring the European Research Area,” and a “Specific Programme” for nuclear research.<sup>273</sup> Each “specific programme” has its own implementation rules and a separate, dedicated budget. The “specific programmes” are further broken down into separate budgets for particular research areas or industries. Thus, for example, the EC established dedicated subsidy programs for aeronautics R&D that are specially set aside (*i.e.*, “ring-fenced”) within the Framework Program’s overall funding system. These are what the United States has referred to as “sub-budgets.”

224. Similar aeronautics-specific sub-budgets exist under each Framework Program.<sup>274</sup>

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<sup>267</sup> This amount and the amounts of FP3, FP4, FP5 and FP6 funding to Airbus described in this paragraph can be found in the U.S. first written submission at paragraphs 630, 635, 640, 645, 650.

<sup>268</sup> U.S. FWS, para. 628.

<sup>269</sup> U.S. FWS, para. 631.

<sup>270</sup> U.S. FWS, para. 636.

<sup>271</sup> U.S. FWS, para. 641.

<sup>272</sup> U.S. FWS, para. 646.

<sup>273</sup> See, e.g., “FP6 in Brief”, [http://ec.europa.eu/research/fp6/pdf/fp6-in-brief\\_en.pdf](http://ec.europa.eu/research/fp6/pdf/fp6-in-brief_en.pdf), p. 4 (Exhibit US-497).

<sup>274</sup> The aeronautics sub-budgets for FP2 through FP6 are listed in the U.S. first written submission at paragraph 652.

- FP2: The EC established a specific program called “Industrial manufacturing technologies and advanced materials applications” (BRITE/EURAM). Within that specific program, it established a sub-budget for aeronautics research of Euro 35 million called “Area 5 - Specific Activities Relating to Aeronautics.”<sup>275</sup>
- FP3: The EC established a sub-budget of Euro 56 million for aeronautics research, called “Area 3, Aeronautics” within the BRITE/EURAM specific program.<sup>276</sup>
- FP4: The EC established a sub-budget for aeronautics research called “Area 3A, Aeronautics Technologies” within the BRITE/EURAM specific program, with dedicated funding of Euro 245 million.<sup>277</sup>
- FP5: FP5 contained eight specific programs, including one known as “competitive and sustainable growth.” A separate sub-budget within that specific program of EUR 700,000,000 was earmarked for “New perspectives for aeronautics.”<sup>278</sup>

225. The European Commission is in charge of operation of the sub-budgets. For areas under the FPs where a sub-budget has been made available, the Commission adopts a “work program.” In the case of the aeronautics sub-budgets, the “work program” sets out the technical content of funded areas of civil aeronautics R&D.<sup>279</sup> Budgeted funds are made accessible through calls for project proposals issued by the Commission in accordance with the aeronautics work program

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<sup>275</sup> See Council Decision of 14 March 1989 on a specific research and technological development programme in the field of industrial manufacturing technologies and advanced materials applications (Brite/Euram) (1989 to 1992) (89/237/EEC) OJ L 98/18 (April 11, 1989), stating Brite/Euram program funding of Euro 499 million, of which the aeronautics budget is 7 percent (*see* Annex IV) (Exhibit US-491).

<sup>276</sup> Council Decision of 9 September 1991 adopting a specific programme of research and technological development in the field of industrial and materials technologies (1990 to 1994) (91/506/EEC), OJ L 269/30 (September 25, 1991) (“Council Decision 91/506/EEC”), showing a budget of Euro 53 million at 37 (Annex II) (Exhibit US-492). This initial budget was later slightly increased.

<sup>277</sup> Initially, EUR230 million were specifically earmarked for aeronautics research and development, Annex II of Council Decision of 27 July 1994 adopting a specific programme for research and technological development, including demonstration, in the field of industrial and materials technologies (1994-1998) (94/571/EC), OJ L 222/19 (“Council Decision 94/571/EC”), at 31 (Exhibit US-493). Subsequent EC Commission documents indicate that the EC eventually spent EUR245 million on aeronautics technologies R&D under FP4.

<sup>278</sup> See Council Decision 1999/169/EC of January 25, 1999 adopting a specific program for research, technological development and demonstration on competitive and sustainable growth (1998-2002), OJ L 64/40, Annex I (March 12, 1999) (Exhibit US-487).

<sup>279</sup> For FP5, *see* New Perspectives in Aeronautics, at 34, in European Commission, Growth Workprogramme 1998-2002 (December 2000) (Exhibit US-488); *see also*, for FP6, Thematic Priority 1.4 Aeronautics and Space, Work Programme 2002-2006 (Exhibit US-489).

under each FP. Calls for aeronautics R&D projects establish specific criteria for the proposals to be submitted, including the type of project, criteria for the evaluation of proposals, the number of project participants, and, most notably, the area and specific topic of research as well as the budget for the call.<sup>280</sup> Only project proposals satisfying the requirements of the respective call are eligible for R&D grants.

**37. How does Exhibit US-342, referred to by the United States at footnote 844 of its FWS, support the United States’ assertion that Technology Programme grants “are awarded through calls for proposals that are limited to aeronautics related technologies”?**

Response:

226. The reference to Exhibit US-342 in footnote 844 of the U.S. first written submission was a clerical error. The evidence that the United States intended to refer to is contained in Exhibit US-495, attached to the present submission.<sup>281</sup>

**38. At footnote 990 of its FWS, the EC states that the figures the EC has provided concerning the total amount of R&D funding provided to Airbus “do not include the value of any loans since the US has not quantified what alleged benefit within the meaning of Article 1.1(b) of the SCM Agreement they confer.” Does the United States consider it necessary to quantify the amount of the benefit conferred by loans made under the PTA and PROFIT programmes?**

Response:

227. Loans provided by the Spanish government to Airbus under the PTA and the PROFIT programs confer a benefit to Airbus within the meaning of Article 1.1(b) of the SCM Agreement,

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<sup>280</sup> See, e.g., for the sixth Framework Program, European Commission, Calls for proposals for indirect RTD actions under the specific programme for research, technological development and demonstration: ‘Integrating and strengthening the European Research Area’, OJ C 315/1 (December 17, 2002), Annexe 7, which details the conditions for the aeronautics call identified as FP6-Aero-1. Research topics referenced in the call (at 8. “Areas called and instruments”) are selected in accordance with the Work Program established by the EC Commission for Aeronautics. For the sixth Framework Program, see European Commission, Thematic Priority 1.4, Aeronautics and Space, Work Programme (2002-2006), Version 2004 (“Work Program FP6”), pp. 1 - 16 (Exhibit US-489).

<sup>281</sup> DTI, Second Call of the Technology Programme (April 2004), Advanced Composite Materials and Structures, at 1 and 2; The Technology Programme, November 2004 Competition for Funding, Smart Materials and Related Structures, at 2, and The Technology Programme: Spring 2006 Competition for Funding, Design Engineering & Advanced Manufacturing: Management of complex fluid flow conditions, at 2 (Exhibit US-495).

because they are provided at [ ] interest.<sup>282</sup> It is not necessary to quantify the amount of the benefit received by Airbus from such [ ] loans.<sup>283</sup>

## H. ADVERSE EFFECTS

**39. The United States argues, with reference to page 9 of Exhibit 448, that LCA products, as a whole, are the subsidized product because of their commonality. Please clarify the facts underlying this view and explain how, if at all, any differences in the physical characteristics of LCA products should be taken into account in the Panel’s adverse effects analysis.**

### Response:

228. “Commonality” – that is, the existence of common elements among different Airbus models designed to provide cost advantages to customers that operate multiple types of Airbus LCA – is one, but only one, of the factors leading to the conclusion that the subsidized product in this dispute is Airbus LCA as a whole.

229. The commonality among all the Airbus LCA models is a central aspect of Airbus marketing, of which the Airbus advertisement reproduced on page 9 of Exhibit US-448<sup>284</sup> is only one example.

Airbus is sensitive to the way an airline’s profitability can stand or fall by how closely it matches capacity to demand and how quickly it can adapt its fleet. For this reason, Airbus aircraft offer the highest possible degree of commonality in airframes, on-board systems, cockpits and handling systems. This benefits pilots, crews and maintenance staff, while giving airlines lower training and maintenance costs as well as that all important flexibility. For example, pilots who hold a type rating on one Airbus aircraft type require minimal training to become qualified on another.<sup>285</sup>

{Fly-by-wire technology} enabled Airbus to introduce its commonality philosophy, creating a family of aircraft with near-identical cockpit design and handling features. The A320 Family, the A330/A340 Family, the A350 Family, and the A380 Family all share this unique commonality, so pilots need much shorter training times to transfer from one aircraft to another. ... By making it so simple and inexpensive for pilots to operate several aircraft types, Airbus also promotes the concept of mixed fleet flying, which gives

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<sup>282</sup> See U.S. FWS, paras. 693, 697.

<sup>283</sup> See U.S. response to Question 42, *infra*.

<sup>284</sup> Also previously submitted as Exhibit US-390.

<sup>285</sup> Airbus, *The Airbus Way*, at 4 (Jan. 2006) (Exhibit US-499).

airlines much greater flexibility in quickly adapting their fleet, cockpit and cabin crews, maintenance crews and schedules in response to changing demand.<sup>286</sup>

230. Indeed, EADS attributes the fact that “Airbus has continually increased its market share,” in significant part, to the commonality that it offers its customers:

This is because every Airbus aircraft belongs to a single family, sharing the same cockpit, flight deck and spare parts, thus saving time and money for operators in terms of pilot training and maintenance as well as in other areas.<sup>287</sup>

231. The product strategy of Airbus – supported at every key step by massive subsidies from the Airbus governments – has deliberately focused on developing this commonality among the Airbus LCA models.

Since Airbus was established for the precise purpose of becoming a viable, profitable, long term enterprise, it was necessary to plan for a family of aircraft. As early as 1973, Airbus Industrie proposed the development over time of five related aircraft types. With the recent launch of the A330 and A340 programs, these five types are now in place.<sup>288</sup>

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Elsewhere, Airbus publicly acknowledges its “product development policy focusing on commonality and innovation.”<sup>290</sup> And Airbus customers confirm that they include fleet commonality in their evaluation and purchase of Airbus LCA.<sup>291</sup>

232. That Airbus has developed and marketed a full fleet of LCA with common features demonstrates that the effects of Launch Aid and other subsidies are not limited to particular

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<sup>286</sup> Airbus, *The Airbus Way*, at 9 (Jan. 2006) (Exhibit US-499).

<sup>287</sup> EADS Annual Report 2000 at 22 (Exhibit US-389).

<sup>288</sup> Testimony of Alan Boyd, Chairman of Airbus Industrie of North America, Inc., to U.S. House of Representatives Subcommittee on Commerce, Consumer Protection, and Competitiveness, at 34 (June 23, 1987) (Exhibit US-386).

<sup>289</sup> Airbus North America Holdings Inc., *Key Determinants of Competitiveness in the Global Large Civil Aircraft Market: An Airbus Assessment* (Mar. 2005) at 4 (“Airbus, *Key Determinants*”) (Exhibit US-379; see BCI Annex).

<sup>290</sup> Airbus, *Key Determinants* at 7 (Exhibit US-379; see BCI Annex).

<sup>291</sup> Statements from a wide variety of Airbus customers that cite commonality as one reason for their purchase of multiple Airbus LCA models are included in the U.S. response to Question 131.

Airbus or Boeing models. Rather the effect of the subsidies extends across the Airbus LCA family. The subsidized product, therefore, is the Airbus LCA family as a whole, which competes with the like Boeing LCA family.

233. This is not to say that physical and other differences among the various LCA models cannot or should not be taken into account, as appropriate, in an adverse effects analysis. The United States recognized this in its first written submission. For example, the United States presented data on market share by both volume and value in the context of claims of displacement and impedance in the EC market,<sup>292</sup> displacement and impedance in selected and cumulative third-country markets,<sup>293</sup> and material injury from subsidized imports in the U.S. market.<sup>294</sup> That the market share trends are the same whether measured by volume or value shows that there have not been significant changes in the relative mix of larger and smaller (i.e., more and less costly) LCA models between Boeing and Airbus in the relevant period. In addition, the United States presented data on price depression and price suppression with respect to particular Boeing LCA models in the global market<sup>295</sup> and in the U.S. market,<sup>296</sup> and arguments with respect to lost sales and price undercutting were presented with respect to the particular LCA models at issue in the campaigns discussed.<sup>297</sup>

234. The EC approach, by contrast, assumes without demonstration that the effects of Launch Aid and other subsidies that facilitate the launch or development of a particular Airbus LCA model are limited to that Airbus model and the Boeing products, if any, that compete most directly with it. This assumption is not only unsupported by evidence, but is in fact contradicted by the product development and marketing strategy of Airbus itself. Thus, while the specifics of individual products may and should be given due consideration in the adverse effects analysis, the identification of the “subsidized product” cannot ignore that the subsidies have been given and used to develop, not simply individual LCA models, but an entire LCA family that is marketed to customers as an integrated whole.

**40. How does the United States respond to the statement of Boeing’s Vice President Marketing, quoted by the EC at paragraph 25 of its Closing Oral Statement, who declares that “{y}ou’ll probably see a lot of coverage in which the A380 is compared side-by-side with the Boeing 747-8. So, just to be clear, these two airplanes serve different markets – the 747-8 has about 100 fewer seats. We think there’s a market there for both airplanes.”**

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<sup>292</sup> U.S. FWS, para. 767.

<sup>293</sup> U.S. FWS, paras. 772-773.

<sup>294</sup> U.S. FWS, paras. 733-735.

<sup>295</sup> U.S. FWS, paras. 803-809.

<sup>296</sup> U.S. FWS, paras. 741-745.

<sup>297</sup> U.S. FWS, paras. 738-740, 778-796.

Response:

235. No two LCA models – including the Airbus A380 and the Boeing 747 – are identical to one another. Whether any two LCA models compete in different “markets” or in the same “market” depends on how the term “market” is being used. The EC quotes the statement of Mr. Baseler of Boeing, made on his “weblog,” but his use of the terms “market” and “markets” in that statement demonstrate that, in that context, he was using the terms colloquially rather than with precision.<sup>298</sup> If one wanted to understand the nature of the competition between the A380 and the 747 based on colloquial remarks, one might just as easily cite the recent statement of John Leahy, head of sales at Airbus, to a major industry conference: “I should get an award for reviving the 747. The backlog was declining until A380 delays.”<sup>299</sup>

236. The existence and nature of the competitive relationship between the A380 and the 747 is relevant for the purpose of this dispute within the context of determining the “effect of the subsidy.” That is, the issue here is whether the EC and Airbus government subsidies that are funding the development of the A380 have adverse effects on the production of the Boeing 747 and other U.S. LCA models. The answer to this question is “yes.”

237. First, the A380 was designed to compete with the 747 at the large end of the LCA market, as Airbus itself recognized from the beginning. “We have attacked {the Boeing 747} from below with the A340,” said Airbus technical director Bernhard Ziegler. “Now the idea is to come from over the shoulder with” the A380.<sup>300</sup> The United States has also identified confidential evidence demonstrating that the A340 and A380 were both developed to compete with the 747.<sup>301</sup>

238. The economic literature modeling the impact of the A380 confirms that competition from the A380 has a direct and negative impact on Boeing’s 747 sales. For example, one study cited

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<sup>298</sup> Notably, the comment cited by the EC from Mr. Baseler’s “weblog” – a compilation of his “thoughts and observations” on various topics – is itself imprecise as to the “market” or “markets” to which the A380 and 747 belong. Although he states that the A380 and 747 “serve different markets,” he immediately goes on to note that there is “a market” for both airplanes – in fact, “a very small one.” In the very next paragraph, he goes on to say that “747-and-larger-sized airplanes will only make up 3% of the airplane market over the next 20 years” – suggesting that there is one “airplane market” covering all LCA and that “747-and-larger-sized airplanes” (i.e., the 747 and A380) form a single segment of that market. *Randy’s Journal*, entry of Mar. 19, 2007, <http://boeingblogs.com/randy>. The terms “market” and “markets” in this weblog entry, therefore, should be understood in a colloquial, rather than an analytical, manner.

<sup>299</sup> Scott Hamilton, *Airbus’ Leahy makes little news, but is entertaining* at 3, available at <http://www.leechem.net/filelib/Leahy.pdf> (Mar. 13, 2007) (Exhibit US-500).

<sup>300</sup> Interview quoted in Matthew Lynn, *Birds of Prey* at 208 (1993) (Exhibit US-42).

<sup>301</sup> U.S. FOS (BCI/HSBI Session), para. 63.

by the EC found that the introduction of the A380 would cause Boeing's profit margin on the 747 to fall by half or more, and that "this reduction in margin translates to a loss of \$3.8 billion in present value or a 6% drop in Boeing's total market value .... Clearly, the anticipation of entry and subsequent price competition has large effects on the value of the 747 product ...."<sup>302</sup>

239. That the delivery delays Airbus has experienced for the A380 have positively affected Boeing's 747 sales is confirmed, not only by Mr. Leahy's statement, but by industry analysts. The credit rating agency Fitch, in a report already provided by the EC, advises:

Fitch believes that Airbus' biggest risk of {A380} cancellations, however, is for the five airlines that have six or fewer A380s on order and already operate the 747-400. These carriers may be able to take delivery of the 747-8 before the A380 and benefit from operational synergies with their existing 747 fleet while sacrificing only 10%-20% of capacity per aircraft. It is also possible that large order holders who operate the 747-400 may now split their existing orders between the A380 and the 747-8.<sup>303</sup>

Of course, the converse will equally be true – if the temporary lack of availability of the A380 benefits the 747, then the availability of the A380 adversely impacts it.

240. Indeed, Steven Udvar-Hazy, the chairman and CEO of International Lease Finance Corporation (ILFC), the world's largest LCA leasing company, recently "predicted a major battle is shaping up between the 747-8 Intercontinental and the A380."<sup>304</sup>

241. The existence of real, market-based competition between the A380 and the 747 – the size difference between them notwithstanding – demonstrates that Boeing is not insulated from the effects of Launch Aid and other subsidies intended to facilitate the launch of the A380, as the EC asserts. Of course, subsidies connected with the launch of the A380 would have effects on Boeing's entire LCA production even if there were no direct competitive impact on a particular Boeing product, in that (1) "bundled" (simultaneous or sequential) sales of the A380 and other Airbus LCA models compete with Boeing "bundled" LCA sales,<sup>305</sup> (2) Airbus investments in A380 technology have direct effects on the production of other Airbus LCA models,<sup>306</sup> and (3) the assumption of much of the risk and capital costs of A380 development by the Airbus

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<sup>302</sup> Benjamin Esty & Pankaj Ghemawat, "Airbus versus Boeing in Super Jumbos: A Case of Failed Preemption at 13-14 (Feb. 2002) (Exhibit EC-344).

<sup>303</sup> Fitch Ratings, *Diverging Flight Paths: Boeing and Airbus* at 6 (Nov. 15, 2006) (Exhibit EC-269).

<sup>304</sup> *Boeing, Airbus duel over BA*, Seattle Post-Intelligencer (Apr. 10, 2007) (Exhibit US-501).

<sup>305</sup> See response to Question 131, below. Thus, for example, Airbus is reported to be giving away other Airbus LCA models for free in order to compensate airlines for A380 delays. *Airbus knocks down prices to entice airlines to purchase A350*, Times (London) (Apr. 20, 2007) (Exhibit US-509).

<sup>306</sup> U.S. FWS, para. 722; U.S. FOS (BCI/HSBI Session), paras. 62, 64.

governments allows Airbus to invest more of its own resources in development and aggressive pricing of other models. The existence of direct competition between the A380 and the 747 is an additional reason supporting the U.S. approach to the subsidized and like product in this dispute.

242. As a final point, the United States would note that even if – wrongly – one were to treat the A380 as a separate “subsidized product,” it would be incorrect to conclude, as the EC argues, that there is no Boeing “like product” to the A380. Footnote 46 of the SCM Agreement provides that, in the absence of a product that is “identical, i.e. alike in all respects to the product under consideration,” the “like product” is “another product which, although not alike in all respects, has characteristics closely resembling the product under consideration.” The evidence just discussed demonstrates that the characteristics of the 747 sufficiently resemble those of the A380 for there to be direct competition between the two aircraft. Such resemblance is more than enough to demonstrate that, even under the EC’s flawed division of the LCA market into a number of sub-markets, there is a “like product” to a hypothetical A380 “subsidized product.”

**41. To what extent does the United States consider that differences in the magnitude, age and nature of subsidies associated with the different models of Airbus LCA should be taken into account in the Panel’s adverse effects analysis?**

Response:

243. With respect to the Launch Aid Program, the United States has demonstrated that the subsidy has operated as a single measure with the objective of promoting the development, production, and sale of a full family of related Airbus LCA that can supply the full range of airline customer needs. Separately, in response to several of the Panel’s questions, the United States has further developed the evidence establishing that the effects of each particular provision of Launch Aid, although nominally given for the development of a particular LCA model, in fact encompass the whole product line of Airbus because of the “commonality” of the Airbus fleet, the use of technology introduced on one aircraft in the production of other aircraft, and the benefits to the full product line that flow from multiple sales of different aircraft sizes to the same customers.<sup>307</sup>

244. Moreover, the “magnitude, age, and nature” of each particular provision of Launch Aid are essentially similar.

- The magnitude of the subsidy has, in every instance, been sufficient to permit Airbus to proceed with the launch of an aircraft model that it could not have launched without the subsidy.

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<sup>307</sup> See response to Question 43, below.

- The age of the subsidy is, in every instance, contemporaneous, because the benefit from an outstanding loan at zero or below-market interest rates is ongoing. Even the EC’s own expert acknowledges that the subsidy benefit of Launch Aid must be calculated with respect to the interest rate differential and the current outstanding loan balance:

{T}o the extent that loans are repaid, the effective size of any subsidy is limited to the interest rate reduction in the loan, not the size of the principal. In other words, if launch aid includes any subsidy element, it is a subsidized loan, not a give-away. The amount of subsidy depends on the difference between the market interest rate ( $r^M$ ) and the rate paid by Airbus to its lenders ( $r^P$ ). Thus, any amount of subsidy received by Airbus is  $(r^M - r^P) L$ , where  $L$  is the size of the outstanding balance of launch aid.<sup>308</sup>

- The nature of the subsidy, in each instance, is the same: to provide assistance for the launch of an aircraft model that is unsecured, backloaded, and success-dependent, in order to enable Airbus to broaden its LCA family and increase its share of the LCA market without bearing the full commercial risk of its launch decisions.

245. Thus, each particular provision of Launch Aid and the Launch Aid Program as a whole have the same twofold effects: (1) to shift a decisive share of the cost and, more importantly, the commercial risk of aircraft launch, to the Airbus governments; and (2) to alleviate the financial burden on Airbus of its rapid product development strategy and therefore to allow it to use pricing to buy market share while simultaneously funding new aircraft.

246. The effect of other subsidies is similar to, and cumulative with, Launch Aid. Subsidies provided through EIB loans, infrastructure, and research grants targeted to LCA development work together with Launch Aid to facilitate the launch of particular Airbus LCA models and shift additional risk of product launch to the EC and the Airbus governments. Subsidies provided through debt forgiveness and equity infusions further shift the financial burden of rapid product launches from Airbus to the EC and the Airbus governments. Because these subsidies work together and have cumulative effects, the Panel should consider these effects as a whole.<sup>309</sup>

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<sup>308</sup> Paul Wachtel, “Critique of ‘The Effect of Launch Aid on the Economics of Commercial Airplane Programs’ by Dr. Gary J. Dorman,” para. 13 (Jan. 31, 2007) (Exhibit EC-12).

<sup>309</sup> As the *Cotton* panel recognized, the SCM Agreement “permit{s} an integrated examination of effects of any subsidies with a sufficient nexus with the subsidized product and the particular effects-related variable under examination.” *US – Cotton Subsidies (Panel)*, para. 7.1192; see also *Korea – Commercial Vessels*, para. 7.616.

**42. How does the United States respond to the EC’s assertion that “under any reasonable allocation methodology, the magnitude of the alleged subsidies for the A300, A310, A320 and A340 families is *de minimis*” (Closing Oral Statement, paragraph 29)?**

Response:

247. The EC assertion is false. The magnitude of the subsidies provided by the EC and the Airbus governments is enormous.

248. The EC does not dispute that, without Launch Aid, Airbus could not have launched the A300, A310, A320, or A330/A340. In addition, public statements of Airbus government officials confirm that Airbus could not have launched the A380 without Launch Aid.<sup>310</sup> The magnitude and nature of the subsidy, then, is such as to have had a decisive effect on Airbus’s ability to build and market these aircraft. The EC creation of an artificial “allocation” methodology is a diversion intended to focus the Panel’s attention away from the actual, and largely undisputed, effects of the subsidies.

249. As a preliminary matter, the concept of subsidy “allocation” borrowed from methodologies developed in the context of countervailing duties (CVDs) or Annex IV of the SCM Agreement is not appropriate for assessing a claim of adverse effects under Part III of the SCM Agreement.<sup>311</sup> In the CVD context, it is necessary to allocate the subsidy to particular times and products in order to determine the amount of CVD that may be imposed on imports of those products at those times, but this concern is not present in the Part III context.<sup>312</sup> Here, the relevant measure of the magnitude of the subsidy is whether it is large enough to have the claimed effects – and here, the EC mostly does not dispute that it is.

250. The purported quantification and allocation of the subsidy benefit performed by the EC’s paid consultants at International Trade Resources (“ITR”)<sup>313</sup> is therefore not relevant to this

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<sup>310</sup> U.S. FWS, para. 833.

<sup>311</sup> In its submission to the Appellate Body in the *US – Cotton Subsidies* dispute, the EC recognized this principle: “{T}he EC agrees with the Panel that there is no basis for transposing directly the quantitative focus and more detailed methodological observations of Part V into the provisions of Part III of the *SCM Agreement*.” Third Party Submission of the European Communities, *US – Cotton Subsidies (AB)*, Nov. 16, 2004, para. 44.

<sup>312</sup> See SCM Agreement, article 19.4 (“No countervailing duty shall be levied on any imported product in excess of the amount of the subsidy found to exist, calculated in terms of subsidization per unit of the subsidized and exported product.”).

<sup>313</sup> ITR, *Calculating Magnitude of the Subsidy Provided to the Recipient Entities* (Exhibit EC-13) (BCI) (“ITR Report”). The EC tendentiously refers to the ITR approach as the “US/Boeing methodology,” e.g., EC FWS para. 1588-1590, although it is in fact no such thing. The United States does not endorse the erroneous benefit calculation and allocation methodologies developed by ITR; indeed, many of these errors are at direct variance with the CVD methodologies used by the EC and the United States. Further, Boeing’s 1997 comments on the U.S. CVD

dispute. Moreover, even if such a CVD-style benefit calculation and allocation had any relevance to this dispute, the ITR report contains numerous, systemic errors and flaws that would preclude its use for this purpose. Even a cursory review of the errors in the ITR methodology shows that the benefit that would be allocated under a CVD methodology is many times that asserted by the EC.

251. To demonstrate the flaws in the ITR approach, the United States takes the example of the French Launch Aid for the A340-500/600 – just one of the subsidy measures at issue in this dispute, and by no means the largest. According to ITR, the subsidy measure is the equivalent of a grant of [ ] million Euro in 1997, of which [ ] million Euro can be allocated to 2006.<sup>314</sup>

252. In order to produce this wildly understated calculated benefit, however, ITR must employ a host of methodologies that are legally and factually without foundation. These errors include:

- The subsidy is conceptualized as a *grant* in the year of launch, equal to the increase in the “net present value” of the program attributable to Launch Aid.<sup>315</sup> As the United States explained at the first panel meeting, the increase in the net present value of an aircraft program is only one of the effects of Launch Aid, and not even the most significant effect.<sup>316</sup>
- The subsidy is calculated based on the *projected* schedule (volume and timing) of deliveries at the time of launch, rather than the *actual* schedule of deliveries.<sup>317</sup> ITR therefore ignores any additional benefit deriving from delayed deliveries (which increase the benefit by allowing Airbus to delay repayments of loan principal at the below-market interest rate) or fewer than anticipated deliveries (which increase the benefit by forgiving repayment entirely).
- The subsidy is calculated net of the impact of taxation.<sup>318</sup> The generally accepted practice in calculating a subsidy benefit is to consider the *pre-tax* benefit, not to

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regulations submitted to the U.S. Department of Commerce, submitted by the EC as Exhibit EC-325, cannot plausibly be read to endorse the many errors in the ITR methodology.

<sup>314</sup> ITR Report, Table 4 (Exhibit EC-13) (BCI).

<sup>315</sup> EC FWS, para. 1627; *see also* ITR Report, para. 19 (Exhibit EC-13) (BCI).

<sup>316</sup> U.S. FOS, para. 141.

<sup>317</sup> EC FWS, para. 1627; *see also* ITR Report, para. 19 (BCI).

<sup>318</sup> EC FWS, paras. 542-547; *see also* ITR Report, para. 17 (BCI).

adjust the benefit for taxation.<sup>319</sup> In addition, ITR failed to carry out its stated methodology of reducing the amount of the Launch Aid disbursements and the amount of Launch Aid repayments [

].<sup>320</sup> Moreover, the EC provides no evidence to show that the taxes were actually paid at the nominal marginal corporate rate, or whether other factors in fact may have reduced the amount of taxes paid.

- The subsidy is calculated based on forecast repayments that include both [

].<sup>321</sup> According to the French A340-500/600 Launch Aid contract, Airbus was required [

].<sup>322</sup> [

].

- The subsidy is allocated to individual years based on [ ],<sup>323</sup> even though Launch Aid repayments are tied to deliveries rather than orders.

The ITR calculation therefore is not, in the words of the EC statement referenced by the Panel in its question, “a reasonable allocation methodology.”

253. To the extent that calculating and allocating the annual CVD-type benefit from Launch Aid has any relevance whatsoever to the Panel’s determination, the appropriate methodology would seem to be that set forth in Article 14(b) of the SCM Agreement, which provides that the benefit on a loan is the “difference between the amount that the firm receiving the loan pays on the government loan and the amount the firm would pay on a comparable commercial loan which the firm could actually obtain on the market.” As noted above, even Dr. Wachtel – the

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<sup>319</sup> See, e.g., European Communities, *Guidelines for the Calculation of the Amount of Subsidy in Countervailing Duty Investigations*, Document G/SCM/N/1/EEC/2/Suppl.2, section G, para. 2 (Jan. 8, 1999) (“No allowance can be made for any tax effects of subsidies ....”).

<sup>320</sup> ITR Report, Table 1 (BCI).

<sup>321</sup> ITR Report, Table 1 (BCI).

<sup>322</sup> *Protocole relatif au financement par l’Etat des programmes Airbus A340-500 et A340-600*, Annex A à la Convention No. 98 90 104, article 6.4 (Exhibit US-36) (BCI).

<sup>323</sup> ITR Report Tables 3-4 (BCI).

EC's expert on other matters – admits that this is the correct approach to valuing the subsidy benefit of Launch Aid.<sup>324</sup>

254. The United States applies this approach to the data used by ITR with respect to French Launch Aid for the A340-500/600 in the table in Exhibit US-502. This table shows that, had Airbus obtained commercial financing on the terms and conditions of the Launch Aid it received from the government of France for the A340-500/600, its interest expenditures for this loan in 2006 would have been at least [ ] million Euro greater than they actually were. Thus, the CVD-type benefit of this single provision Launch Aid allocable to 2006 is at least [ ] million Euro, not the [ ] million Euro calculated by ITR.

255. The calculation presented in Exhibit US-502 not only shows that the ITR report fails to account for the vast majority of the subsidy benefit that would be calculated under a CVD-style allocation, but also demonstrates at least two other points that are of greater relevance to the Panel's adverse effects analysis.

256. First, because annual repayments are much smaller than the interest payments that would be accruing at commercial rates, the subsidy benefit grows rapidly over time as the unpaid interest in each year is added to the outstanding principal and accumulates additional interest in future years.<sup>325</sup> Clearly Airbus could not sustain a debt burden that spiraled out of control in this fashion. But this is simply another way of saying that, if Airbus had to obtain Launch Aid for the A340-500/600 on commercial terms in the marketplace, it could not have economically launched that aircraft – a point that the EC does not dispute. Thus, the relevant counterfactual to the subsidy – what would have occurred “but for” the subsidy – is not a world in which Airbus launches the A340-500/600 in 1997 and owes an additional [ ] million Euro in interest payments on French A340-500/600 Launch Aid in 2006. Rather, the world that would exist “but for” the subsidy is one in which Airbus does not launch the A340-500/600 in the way and at the time it did, if indeed it would have launched the project at all.

257. Second, in the scenario in which deliveries and repayments occur according to the forecast schedule (the top half of the table in Exhibit US-502), the EC anticipated that [

]. However, when the actual delivery and repayment schedule is taken into account (the bottom half of the table in Exhibit US-502), [

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<sup>324</sup> Paul Wachtel, “Critique of ‘The Effect of Launch Aid on the Economics of Commercial Airplane Programs’ by Dr. Gary J. Dorman,” para. 13 (Jan. 31, 2007) (Exhibit EC-12).

<sup>325</sup> Note that this is true whether one uses the EC *forecast* delivery stream (in the top half of the table in Exhibit US-502) or the *actual* delivery stream (in the bottom half of the table).

]. Given that the introduction of the A350 is likely to severely reduce future A340-500/600 sales,<sup>326</sup> the calculation in Exhibit US-502 shows that [

]. This further demonstrates that the ITR methodology fails to capture the actual benefit or the actual effects of Launch Aid.

**43. How, if at all, is the concept of *de minimis* subsidization relevant to the Panel’s adverse effects analysis?**

Response:

258. As the United States showed in the response to Question 42, the magnitude of the subsidy provided by the EC and the Airbus governments is very large. Thus, even if there were a concept of *de minimis* subsidization relevant to an adverse effects claim under Part III of the SCM Agreement, it would not come into play in this case.

259. In any event, the EC’s reliance on Article 11.9 of the SCM Agreement<sup>327</sup> would be misplaced, even if the level of subsidization were *de minimis*. The Appellate Body has rejected the proposition that the *de minimis* threshold in Article 11.9 “was intended to create a special category of ‘*non-injurious*’ subsidization, or that it reflects a concept that subsidization at less than a *de minimis* threshold *can never* cause injury.”<sup>328</sup> Rather, the Appellate Body found that the provision in Article 11.9 applies only to original countervailing duty investigations and does not even apply in other countervailing duty contexts,<sup>329</sup> let alone with respect to claims under Part III of the SCM Agreement.

260. In this instance, the United States has demonstrated – and the EC largely does not contest – that the magnitude of Launch Aid alone is sufficient to have allowed Airbus to make launch decisions that it could not otherwise have made.<sup>330</sup> The United States has also demonstrated that the magnitude of the subsidy is more than sufficient to have significantly impacted Airbus’s cash flow and to have enabled Airbus to adopt a pricing strategy it could not have otherwise employed, and that the serious prejudice to U.S. interests described in the U.S. first written

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<sup>326</sup> E.g., Fitch Ratings, *Diverging Flight Paths: Boeing and Airbus* at 9 (Nov. 15, 2006) (“The A350XWB is primarily then a two-engine replacement for the A340, orders for which have nearly evaporated since fuel prices began climbing.”) (Exhibit EC-269).

<sup>327</sup> See EC FWS, paras. 1591 n.1438, 1796 n.1697, 2154, 2156.

<sup>328</sup> *US – German Steel (AB)*, para. 83 (emphasis original).

<sup>329</sup> *US – German Steel (AB)*, para. 86.

<sup>330</sup> U.S. FWS, paras. 813-817; U.S. FOS, para. 129.

submission flows directly from these actions that Airbus could not have taken, but for the subsidy.<sup>331</sup> Thus, the magnitude of the subsidy is sufficient to have caused the serious prejudice. This is all the SCM Agreement requires.

**44. By asking the Panel to conduct its adverse effects analysis on the basis of one subsidized product and one like product (LCA products as a whole) is it the United States' view that alleged subsidies connected with one specific model of LCA have "spill-over" effects for other LCA models? If so, please describe such "spill-over" effects and explain how the Panel may assess or measure their impact for the purpose of its adverse effects analysis.**

Response:

261. Subsidies provided to facilitate the launch of individual Airbus LCA models provide benefits to the entire Airbus LCA family and have adverse effects on the entire Boeing LCA family. These cross-model or "spill-over" effects take at least three major forms.

262. First, there are "supply-side" effects in which technologies or facilities developed as part of the launch of one Airbus LCA model are then used on other Airbus LCA models. The use by Airbus of cross-over technologies is well documented in the public and confidential records,<sup>332</sup> and the EC has not contested that such cross-over technologies exist.

263. Second, there are "demand-side" effects in which the presence of one Airbus model in the LCA market enhances the marketability and value of other Airbus models. The United States describes these effects in detail in its responses to several other questions posed by the Panel. The the response to Question 39 demonstrates that the commonality of the Airbus fleet – which itself is a function of the use of similar designs and technologies across the various Airbus models – has been designed and emphasized in order to take advantage of customer demand for a full fleet of LCA. Likewise, that cross-model considerations often lead customers to purchase multiple LCA models, either simultaneously or consecutively, is documented in detail in the response to Question 131. Further, as discussed in the response to Question 45, offering a full fleet of LCA aircraft is central to the long-term viability of an LCA producer as a whole. Thus, the structure of the LCA market is such that the launch of each of the various models of LCA provides synergistic benefits to the marketing and sale of all LCA models.

264. Third, there are "financial" effects of Launch Aid that enable Airbus to deploy its resources more broadly in order to grow its LCA family and overall LCA market share more rapidly. By assuming a large share of the financial risk of Airbus's aggressive product

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<sup>331</sup> U.S. FWS, paras. 818-819; U.S. FOS, para. 130; U.S. FOS (BCI/HSBI Session), paras. 56-57.

<sup>332</sup> U.S. FWS, para. 722; U.S. FOS (BCI/HSBI Session), paras. 62, 64.

development strategy, the Airbus governments improve Airbus's overall credit rating and lower its overall cost of capital, which facilitates Airbus's ability to reduce prices (and win sales) for all of its LCA family.<sup>333</sup> Further, by assuming a large share of the commercial risk of LCA launch, the Airbus governments enable Airbus to simultaneously invest in multiple LCA launches more quickly than it otherwise could *and* use its limited funds to reduce prices for already launched LCA models.<sup>334</sup> Without subsidies, Airbus would bear all of the commercial and financial risk of its launch decisions – and, of necessity, would have to launch fewer models, engage in less aggressive pricing practices in order to conserve limited resources to fund launches, or both.

265. These effects of the subsidies cannot be quantified and allocated among the different LCA models in any meaningful way. Rather, because all of the subsidies benefit the Airbus LCA family as a whole, the proper way for the Panel to assess and measure these effects is to consider the Airbus LCA family as the “subsidized product” that is supported through the use of all of the subsidies, and to assess the effects on this basis.

**45. At paragraph 724 of its FWS, the United States argues that subsidies provided to Airbus for each major model of LCA benefit the production and marketing of its full LCA family. How does the United States consider that such a benefit would manifest itself in respect of LCA tenders or sales that do not involve more than one model of LCA? How is the alleged benefit of alleged model-by-model subsidization to the Airbus LCA family relevant to the Panel's assessment of adverse effects in a situation when the customer is not looking to acquire a family of LCA but rather only an individual aircraft?**

Response:

266. As explained in the response to Question 131, airline customers that purchase multiple LCA models are more likely to purchase other models from the same manufacturer whether the orders occur simultaneously or over time. Indeed, the EC recognizes this very phenomenon when it quotes the president of Iberia Airlines as stating that its “selection of the A340-600 ... *is mainly driven by the high level of flexibility and commonality with our A340-300 and single-aisle A320 Family fleets.*”<sup>335</sup> Thus, even though Iberia purchased its A320, A340 “basic,” and A340-600 aircraft at different times, the common features between them – as the EC readily acknowledges – increased the value to Iberia of purchasing the whole fleet.

267. Because airlines tend to operate *fleets* of aircraft (whether purchased all at once or over time) rather than individual models in isolation from one another, aircraft manufacturers must

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<sup>333</sup> U.S. FWS, para. 818; U.S. FOS, para. 142.

<sup>334</sup> U.S. FOS (BCI/HSBI Session), paras. 56-57.

<sup>335</sup> EC FWS, para. 2096 (quoting Xabier de Irala) (emphasis added by the EC).

also design and market their LCA families as an integrated whole in order to compete in the market. As the EC submission observes, “no manufacturer of a single product or family of products, no matter how compelling, has survived in the LCA industry.”<sup>336</sup> Indeed, the EC itself describes how the failure of McDonnell Douglas to invest in a full fleet of LCA played an important role in that producer’s exit from the LCA industry:

In contrast to the broader and more modern families of aircraft offered by Boeing and Airbus, {McDonnell Douglas} currently offers only three types of narrow-body and one type of wide-body aircraft which do not provide, according to Boeing, significant commonality benefits and are all themselves derivatives of earlier Douglas models, rather than entirely new designs. It appears that these are the main reasons for the continuous decline of {McDonnell Douglas’s} market shares. ... Since the cancellation of the MDXX program in October 1996, {McDonnell Douglas} has virtually received no new firm orders. This reflects the perception of airlines that {McDonnell Douglas} is no longer committed to the commercial aircraft business and may leave the market over time.<sup>337</sup>

In other words, the EC recognized that when McDonnell Douglas cancelled the launch of one new aircraft model, airlines perceived that McDonnell Douglas was no longer committed to providing a full LCA family, and this adversely impacted the manufacturer’s ability to sell *any* of its aircraft models.

268. Airbus itself has always recognized the importance of its full LCA family to its continued success in the LCA market.

Since Airbus was established for the precise purpose of becoming a viable, profitable, long term enterprise, it was necessary to plan for a family of aircraft. As early as 1973, Airbus Industrie proposed the development over time of five related aircraft types. With the recent launch of the A330 and A340 programs, these five types are now in place.<sup>338</sup>

This strategy continues to the present day. A report of the EADS Board of Directors prepared for the EADS general shareholder meeting scheduled for May 4, 2007 states that the first of the “long-term strategic goals” of EADS is:

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**Target long-term leading position in commercial aircraft:** Despite the difficulties in 2006, EADS will continue to strive for leadership in the commercial aircraft market. Product innovation, customer satisfaction and further development of its international

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<sup>336</sup> EC FWS, para. 30.

<sup>337</sup> Commission Decision 97/816/EC (O.J. 1997 L336, at 16), para. 59 (Exhibit US-375).

<sup>338</sup> Testimony of Alan Boyd, Chairman of Airbus Industrie of North America, Inc., to U.S. House of Representatives Subcommittee on Commerce, Consumer Protection, and Competitiveness, at 34 (June 23, 1987) (Exhibit US-386); *see also* EC FWS, para. 1133 (explaining that Airbus needed government equity infusions to enable new LCA model development because it could not have succeeded by producing only the A300 and A310).

partnerships are key elements of the Group's strategy. *A complete product portfolio is seen as necessary to serve the customer base and to maintain overall competitiveness.*<sup>339</sup>

269. Thus, even if there are a handful of airlines that fly only LCA of one size and have no interest in ordering any other type of aircraft in the future, no LCA manufacturer could survive by serving only this limited group of customers. Certainly Airbus does not, and never has, taken this approach to its participation in the LCA market.

**46. Why does the United States consider that 2001-2005 is an appropriate reference period for the Panel? Should the Panel exclude from its analysis relevant, more recent, available data relating to 2006 (and, as it becomes available, data relating to 2007)? Is the Panel precluded from gathering more recent information?**

Response:

270. As the United States explains in response to Question 133, nothing in the SCM Agreement provides direct guidance as to the length of any "reference period" to be used in evaluating a claim of adverse effects. For example, although Article 6.4 of the SCM Agreement provides that the displacement or impedance of imports is demonstrated when there has been a change in market share "over an appropriately representative period sufficient to demonstrate clear trends in the development of the market for the product concerned, which, in normal circumstances, shall be at least one year," it does not provide further guidance as how long an "appropriately representative" period should be. Further, Article 6.4 is expressly limited to claims under Article 6.3(b) and is not directly applicable to other types of serious prejudice. Thus, an appropriate reference period is one that enables the Panel "to make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the other covered agreements, and make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements."<sup>340</sup>

271. The United States considers that the adverse effects to its interests have existed over a significant period of time and continue to exist today. Nonetheless, in making its prima facie case, the United States has focused on the period from 2001 to 2005. In doing so, the United States takes into account several aspects of the LCA industry.

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<sup>339</sup> EADS, Report of the Board of Directors, in Documentation for the Annual General Meeting on Friday, May 4, 2007, at 30, *available at* <http://www.eads.com/xml/content/OF00000000400004/1/50/41582501.pdf> (Exhibit US-503) (bold in original, italics added).

<sup>340</sup> DSU, Art. 11.

- The LCA industry is characterized by very long time horizons – the long period of time from aircraft launch to first delivery (typically four to five years);<sup>341</sup> the long period over which sales campaigns develop; and the long period between order and delivery (averaging two to three years, with considerable variation).<sup>342</sup> Thus, as the EC recognizes, “participants in the industry {must} engage in very long-term preparation and planning to meet the demand of the market.”<sup>343</sup>
- The outcomes of individual sales campaigns have market effects that continue for many years thereafter. Once an airline has chosen one LCA manufacturer over the other, it tends to make additional follow-on orders from that manufacturer.
- As the EC also recognizes, “the LCA industry has an exaggerated business cycle which is particularly sensitive to external events.”<sup>344</sup> Short-term trends are therefore not necessarily indicative of the underlying dynamics of the market and the effects of subsidies. Indeed, Airbus itself states: “No single year’s order intake and market share in an industry with such long-term horizons can be taken as an indication of market position.”<sup>345</sup>

272. The United States considers that a starting point of 2001 provides a long enough horizon to allow an objective analysis of trends in competition in the LCA market. In fact, an even longer reference period could also be justified, in that current market conditions are affected by sales campaigns that took place even earlier than 2001. For example, the U.S. first written submission discusses sales campaigns won by Airbus in 1999 at America West, JetBlue, and Frontier Airlines.<sup>346</sup> The United States explained that these three airlines – all of which are exclusive Airbus customers in the U.S. market – accounted for nearly 40 percent of Airbus’s deliveries in the U.S. market from 2001 to 2005,<sup>347</sup> and had scheduled orders for an additional 130 Airbus aircraft as of August 2006.<sup>348</sup> The EC also makes reference to sales campaigns that took place in 1999 and 2000 in discussing market trends in the 2001-2006 period.<sup>349</sup>

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<sup>341</sup> See, e.g., Declaration of Andrew Gordon, para. 7 (Exhibit EC-16).

<sup>342</sup> See response to Question 132, below.

<sup>343</sup> EC FWS, para. 30.

<sup>344</sup> EC FWS, para. 29.

<sup>345</sup> Airbus, *Key Determinants*, at 11 (Exhibit US-379, see BCI Annex).

<sup>346</sup> U.S. FWS, para. 739.

<sup>347</sup> U.S. FWS, para. 738.

<sup>348</sup> U.S. FWS, para. 758.

<sup>349</sup> E.g., Statement of Christian Scherer, para. 41 (Exhibit EC-14).

273. Nonetheless, the United States recognizes that there are practical limitations on gathering and analyzing data for earlier periods. In the Annex V process, the EC refused to answer the Facilitator’s questions with respect to adverse effects for the period prior to 2000, stating:

Because the adverse effects claims focus on the existence of present adverse effects (or threat thereof), only information concerning the period 2000-2005 is likely to be relevant.<sup>350</sup>

The United States considers, however, that in general sufficient data exists with respect to market trends beginning in 2001 to demonstrate the existence of adverse effects in this case.

274. With respect to the end of the reference period, as the United States has already explained, the Panel’s terms of reference are defined with reference to the U.S. claim that, at the time of panel establishment, adverse effects were being caused.<sup>351</sup> The use of a reference period that ends in the year of panel establishment allows the Panel and the parties to focus on the “matter” before the Panel. By focusing exclusively on a reference period that ends well after panel establishment, the EC fails to rebut that adverse effects existed during the period identified by the United States or that the adverse effects were continuing at the time of panel establishment. Instead, the EC argues only that the adverse effects ceased to exist at a later time. As a factual matter, the EC is wrong – the adverse effects caused by the subsidies continue to be significant today. However, that question is not the one that is before the Panel.

275. Where necessary, of course, the Panel may have reference to data from any time period – before, during, or after any “reference period” used to establish one or more claims in this dispute – where such data is relevant to the Panel’s inquiry. The parties have presented such evidence in their submissions.

**47. At paragraph 1472 of its FWS, the EC asserts:**

**“By the time the United States filed its first written submission, it had available at least 10 months worth of data for 2006. The United States does not explain or even refer to these significant developments.”**

**48. How does the United States respond to this assertion, particularly in light of the following statement by the Appellate Body in *EC - Selected Customs Matters*, that “{e}vidence in support of a claim challenging measures that are within a panel’s terms of reference may pre-date or post-date the establishment of the panel.”**

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<sup>350</sup> See EC Responses to Questions from the Facilitator (Nov. 18, 2005), answers to questions 288, 292, 297, 320, 321, 322, 326, 327 (Exhibit US-5).

<sup>351</sup> U.S. FWS, para. 733 & n.917; U.S. FOS, paras. 182-184.

Response:

276. The United States agrees that a panel may examine relevant evidence, including evidence that post-dates the establishment of the panel. Indeed, the adverse effects arguments of the U.S. first written submission frequently refer to evidence that post-dates the establishment of the Panel in this dispute,<sup>352</sup> and even more recent evidence was submitted and discussed by the United States at the first panel meeting. The United States therefore rejects completely the EC assertion that the U.S. view is that “the Panel should not consider evidence or facts post-dating its establishment on 20 July 2005, even if these facts are highly relevant.”<sup>353</sup>

277. In preparing its first written submission for presentation to the Panel on November 15, 2006, the United States made arguments with respect to recent trends in market share, pricing, and Boeing financial data relying primarily on data for the full calendar years 2001 through 2005. As the United States explained, the use of full calendar year data for 2005 was primarily due to the difficulty of gathering and presenting data for partial years.<sup>354</sup> Partial data for 2006 would have entailed similar practical difficulties. Moreover, full-year 2006 data – to the extent that it is now available – demonstrates that in 2006 Airbus maintained most or all of its market share gains over the 2001-2005 period.<sup>355</sup>

278. In *EC – Customs Matters*, the Appellate Body stated that the measures at issue were certain EC legal instruments identified in the panel request “as administered collectively or as a whole.”<sup>356</sup> Accordingly, the Appellate Body considered that the panel in that dispute should have focused its review “on those legal instruments as they existed and were administered at the time of the establishment of the Panel.”<sup>357</sup> Here, the measures at issue are the subsidies identified in the U.S. panel request. The Panel’s evaluation of the U.S. adverse effects claims

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<sup>352</sup> E.g., U.S. FWS, paras. 708-709 (latest plans for the A350), 711 n.876 (2006 campaign at Aeroflot), 712 n.880 (2006 follow-on Airbus orders at AirAsia), 713 n.884 (2006 pricing reductions on A340 to offset high fuel costs), 714 n.886 (market capitalization of EADS in 2006), 720 (2006 campaign at British Airways), 722 (shared technology between A380 and A350), 723 (2006 announcement of increase in A320 production), 728 (2006 usage of aircraft models on various flights), 756 (2006 status of A380 and A350 projects), 758 (unfilled Airbus orders from various airlines as of August 2006), 760 (2006 announcement of projected Airbus capacity increases), 777 (2006 Airbus explanation of relative importance of market share targets to pricing), 784 n.981 (2006 follow-on Airbus orders at easyJet announced one day before U.S. first submission was filed), 794 (effect of 2006 developments regarding A380 on EADS cash flow and loss-making sales of A380), 808 n.1017 (2006 announcement of cancellation of 2003 A340 orders by Emirates Airlines), 808 n.1019 (2006 pricing reductions on A340).

<sup>353</sup> EC FWS, para. 1473.

<sup>354</sup> U.S. FWS, para. 733 n.917.

<sup>355</sup> U.S. FOS, para. 171; Exhibit US-448 at 10.

<sup>356</sup> *EC – Customs Matters (AB)*, para. 187.

<sup>357</sup> *EC – Customs Matters (AB)*, para. 187.

with respect to those measures, therefore, should likewise focus on those subsidies and their effects at the time of the establishment of the Panel.

279. The Appellate Body went on, in *EC – Customs Matters*, to specify that “in order to determine whether the measures at issue have been administered at the time of the Panel’s establishment in a manner that is inconsistent with Article X:3(a) of the GATT 1994, the Panel was, however, entitled to rely on *evidence* of acts of administration,” including “evidence relating to acts of administration before and after the date of Panel establishment.”<sup>358</sup> The same principle applies here. This Panel is to determine whether the measures at issue have caused effects “at the time of the Panel’s establishment in a manner that is inconsistent with” Article 5 of the SCM Agreement. As in *EC – Customs Matters*, the Panel has the discretion to examine evidence of the effects of the subsidies that pre-date or post-date its establishment, to the extent this evidence is relevant to determining whether the effects of the subsidies have been inconsistent with the EC’s obligations under the SCM Agreement at the time of panel establishment.

280. The Appellate Body report in *EC – Customs Matters* confirms that the Panel should examine all relevant evidence, of any date, in order to determine whether the subsidies were causing adverse effects at the time of panel establishment. However, when the EC asserts that market events in 2006 are “significant developments” that should be taken into account in the Panel’s analysis,<sup>359</sup> it is *not* asserting that this evidence should be considered because it is relevant for determining the consistency of the subsidy measures with the SCM Agreement at the time of panel establishment. Rather, the EC is making a different argument – namely, that any adverse effects that may have existed in the past no longer existed in 2006 and therefore there is no breach of the SCM Agreement. This is *not* the type of relevant post-panel-establishment evidence that the Appellate Body referred to in *EC – Customs Matters*. Thus, the EC’s argument that the adverse effects of the subsidies ceased in 2006 is not only factually incorrect, but also legally irrelevant to the Panel’s task in this dispute.

**49. How does the United States respond to the EC assertions, respectively at paragraphs 1937, 1946 and 1976 of its FWS, that:**

- (a) “Orders are a far better indicator of present serious prejudice, because they reflect the conditions of competition and the effects of any subsidies in the most recent period of time.”**

Response:

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<sup>358</sup> *EC – Customs Matters (AB)*, para. 188 (emphasis original).

<sup>359</sup> EC FWS, para. 1472.

281. The United States sets forth a detailed explanation of the relative value of order and delivery data in response to Question 132. This specific assertion by the EC, however, is particularly illogical. If the “effect of the subsidy” is, for example, a lost sale in 2003 that results in the delivery of an Airbus LCA rather than a Boeing LCA in 2007 – and, therefore, in a displaced U.S. export in 2007, lost revenue to Boeing in 2007, and idled U.S. workers in 2007 – this *is* an “effect of the subsidy” in “the most recent period of time.” According to the EC, such an “effect of the subsidy” would not be recent at all, but rather an artifact of ancient history hardly worth examining.

282. Nothing in the text of the SCM Agreement or economic logic requires such a limited interpretation of when and how subsidies have adverse effects.

- (b) “Market share data regarding such deliveries provide little information about the present effect of subsidies. This is because there can be many reasons totally disconnected from the price of a particular product why a particular airline may want to receive deliveries either earlier or later.”**

Response:

283. This EC assertion is also misplaced. The EC again appears to consider that the *present* displacement of imports or exports, *present* lost revenues, and *present* lost jobs and other economic activity are not a “present effect of subsidies,” simply because the length of time between the granting of a subsidy and the final delivery of subsidized products is, in the LCA industry, relatively long and variable. The United States sees no legal or economic justification for this view, and the EC has offered none.

- (c) “...the effects of 9/11 have to be considered *force majeure*, within the meaning of Article 6.7(c), thereby rendering the period 2001-2003 unreliable for assessing adverse effects.”**

Response:

284. It is understandable that the EC would prefer the Panel to ignore the large gains in global LCA market share that Airbus achieved between 2001 and 2003. However, the EC’s reliance on Article 6.7(c) of the SCM Agreement to shield these facts from the Panel’s consideration is without legal or factual foundation. Moreover, the EC argument also fails to explain why, in the period after 2006, Airbus has been able to maintain most or all of the additional market share it gained during this period.

285. Airbus increased its global share of LCA deliveries from 38 percent in 2001 to 53 percent in 2003 and 2004.<sup>360</sup> Although total world LCA deliveries fell in this period from 842 in 2001 to 573 in 2003 and 599 in 2004, Airbus increased its market share because it was able to maintain its production levels, delivering 324 aircraft in 2001 and 319 in 2004, while Boeing's deliveries fell dramatically from 518 in 2001 to 280 in 2004.<sup>361</sup> In 2005, Airbus itself pointed out how the burden of the market downturn fell very disproportionately on Boeing:

Looking back in time just 4 years, Airbus delivered 320 aircraft in 2004 (down 1.5% compared to 2001 deliveries) while Boeing delivered 285 aircraft (down 46% compared to 2001 deliveries).<sup>362</sup>

286. As a result, the market share of Boeing decreased substantially in the U.S. market, the EC market, and in most major third country markets.<sup>363</sup> Accordingly, most of the harm of the market decline in 2001-2003 fell on Boeing – as Airbus CEO Noël Forgeard recognized early in the recession:

Airbus is entering the current recession in a more favourable situation than its American competitor because our market share is increasing strongly and that trend, to a great extent, compensates for the shrinking of the whole market. For our competitor, the effects of loss of market share and the contraction of the market itself are cumulative.<sup>364</sup>

Moreover, even with recovered demand in 2005 and 2006, Airbus has maintained most or all of the market share gains it achieved during the 2001-2004 period. After increasing its market share to 53 percent in 2003 and 2004, Airbus accounted for 57 percent of global LCA deliveries in 2005, 53 percent in 2006,<sup>365</sup> and 53 percent in the first quarter of 2007.<sup>366</sup>

287. According to the EC, none of these facts are relevant to the assessment of adverse effects because the period 2001-2003 was a period of relatively low LCA demand. The EC's claim is legally and factually without foundation.

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<sup>360</sup> See U.S. FWS, para. 705 & Table 1.

<sup>361</sup> U.S. FWS, para. 705 & Table 1.

<sup>362</sup> Airbus, *Key Determinants*, at 39 (Exhibit US-379, see BCI Annex) (underlining in original).

<sup>363</sup> U.S. FWS, paras. 733-735, 767, 772-773.

<sup>364</sup> EADS Aero-notes: Letter to Shareholders, No. 3 (Nov. 2001) at 5 (interview with Airbus CEO Noël Forgeard) (Exhibit US-404).

<sup>365</sup> Exhibit US-448 at 10.

<sup>366</sup> Airclaims data base, data query on April 27, 2007.

288. As a legal matter, the EC's claim that the market downturn in 2001-2003 constitutes *force majeure* within the meaning of Article 6.7(c) of the SCM Agreement is baseless. Article 6.7(c) provides:

Displacement or impedance resulting in serious prejudice shall not arise under paragraph 3 where any of the following circumstances exist during the relevant period: ...

- (c) natural disasters, strikes, transport disruptions or other *force majeure* substantially affecting production, qualities, quantities or prices of the product available for export from the complaining Member; ....<sup>367</sup>

A downturn in the LCA market does not affect the product *available for export* from the United States, but rather affects demand for LCA generally. The EC does not allege that any event occurred in 2001-2003 that affected Boeing's ability to make its LCA available for export. The provision of Article 6.7(c) therefore does not apply.

289. Moreover, it is clear that when Article 6.7(c) is placed in its appropriate context that it has no application in this dispute. Article 6.4 provides that displacement or impedance of exports in the sense of Article 6.3(b) "shall include any case in which, subject to the provisions of paragraph 7, it has been demonstrated that there has been a change in relative shares of the market to the disadvantage of the non-subsidized like product." Thus, *any* demonstrated change in market share may constitute displacement or impedance within the meaning of Article 6.3(b), *unless* one of the factors in Article 6.7 apply. The factors in Article 6.7 uniformly address situations in which some event or situation unrelated to subsidization results in the displacement or impedance of exports – such as other trade barriers, voluntary export restrictions, or failure to conform with the importing countries' regulatory standards. In context, then, Article 6.7(c) provides that when an event unrelated to subsidization prevents the complaining Member from exporting the like product – such as natural disasters, strikes, transport disruptions, or other *force majeure* – then a decrease in that Member's market share in an export market shall not be deemed to constitute serious prejudice.

290. However, the reason that Airbus increased its market share from 2001 to 2003 had nothing to do with any factor preventing Boeing from building, delivering, or exporting aircraft – other than the fact that an increasing share of potential customers chose to purchase subsidized Airbus LCA instead.

291. As a factual matter, there is no basis for excluding a period of market downturn from an adverse effects analysis. Subsidies have effects in periods of strong markets and in periods of weak markets. Indeed, subsidies may provide additional advantages in periods of slack demand

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<sup>367</sup> Footnote omitted.

– a “helping hand in times of financial difficulties.”<sup>368</sup> This is particularly true in the LCA industry, which the EC acknowledges is characterized by “an exaggerated business cycle which is particularly sensitive to external events” and that therefore requires “participants in the industry to engage in very long-term preparation and planning to meet the demand of the market.”<sup>369</sup>

292. Indeed, as LCA market downturns go, the low cycle in 2001-2003 was relatively mild by historical standards. As one industry commentator observed in October 2002:

Assuming total production in 2003 comes to 575-600 planes, this would equate to the mildest down cycle in jetliner industry history. The low point of the last down cycle was in 1995, when 379 planes were delivered. Both 1994 and 1996 were only slightly better, with 434 and 397 deliveries, respectively. And the low point of the down cycle before that, 1984, saw deliveries of a mere 244 planes.<sup>370</sup>

In fact, total LCA deliveries in 2003 amounted to 573.<sup>371</sup>

293. Accordingly, the EC has provided no reason to exclude the period 2001-2003 from the adverse effects analysis.

**50. How does the United States respond to the assertion, at paragraph 60 of the EC’s BCI Oral Statement, that “[**

**]”?** In responding to this assertion, please explain the extent to which Boeing “[ ]” for aircraft leasing business during the relevant period.

Response:<sup>372</sup>

294. The EC allegation that, beginning in the late 1990s, Boeing “[ ]” and therefore [ ]

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<sup>368</sup> Moody’s Investor Service, *Moody’s confirmation of EADS highlights government’s role as odd rescuers*, at 1 (Mar. 12, 2007) (Exhibit US-450).

<sup>369</sup> EC FWS, paras. 29-30.

<sup>370</sup> Richard Aboulafia, *Airbus and Boeing Race to the Bottom*, Aerospace America (Oct. 2002) (Exhibit US-504).

<sup>371</sup> U.S. FWS, para. 705 & Table 1.

<sup>372</sup> The United States has maintained the Panel’s bracketing with respect to this question, but notes that the EC has now decided that the original source material quoted in the Panel’s question, which is found in Exhibit EC-14, para. 40, is not in fact BCI.

other than the [ ] is supported by nothing  
evidence. ]<sup>373</sup> The allegation is contradicted by the actual

295. When Boeing first announced in 1999 that Boeing Capital Corporation (“BCC”) would play a larger role in financing LCA sales, the president of BCC made clear that:

Boeing Capital is not interested in speculative operating leasing, which involves buying and maintaining a fleet of aircraft types for possible leases.

That allays much of the fear for traditional aircraft-leasing companies, such as International Lease Finance Corp. of Los Angeles. ILFC, the world’s largest aircraft lessor, accepts Boeing’s word that it won’t compete directly with leasing companies, said John Plueger, ILFC’s chief operating officer.

Still, “it’s safe to say we’ll be watching this very closely.” Plueger said.<sup>374</sup>

296. Indeed, in May 2000, BCC worked with ILFC and another large LCA lessor to finance the acquisition of Boeing LCA by American Trans Air (“ATA”), demonstrating that BCC’s leasing operations would assist ordinary airline customers in financing their purchases of Boeing aircraft and would not purchase Boeing aircraft in order to compete directly with leasing companies in the LCA leasing business.

Leasing companies had been worried about Boeing Capital as it got into the leasing business. Would it help or compete against Boeing sales? Would it use its inside track to take business from the major leasing companies?

The ATA deal eased many of those fears.

“Boeing Capital does not seem to be in the business of making speculative buys of aircraft,” said Plueger, the ILFC executive.

Bouillioun’s Willingham agreed, saying Boeing appears to play the role of helping make a sale happen for the customer rather than competing with the leasing companies.<sup>375</sup>

The EC’s assertion that Boeing was actively competing with leasing companies, and not simply helping its direct airline customers finance their purchases, is simply mistaken.

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<sup>373</sup> EC FWS, paras. 1449-1450.

<sup>374</sup> *Boeing puts new emphasis on financing unit*, Seattle Times (Oct. 8, 1999) (Exhibit US-505).

<sup>375</sup> *Why buy aircraft when planes can be leased?*, Seattle Times (Aug. 20, 2000) (Exhibit US-506).

297. To the extent that Boeing experienced financial problems during the 2001-2003 downturn related to its leasing business, this has nothing to do with any harm to the U.S. LCA *producing* industry. As the EC recognizes, Boeing's leasing business operated within BCC, a "wholly owned subsidiary of The Boeing Company," and was entirely separate from Boeing's Commercial Airplanes Division.<sup>376</sup> The financial performance of the U.S. domestic LCA industry, as presented in paragraph 746 and Table 4 of the U.S. first written submission, relates solely to Boeing Commercial Airplanes, not to BCC. Losses that may have been incurred by Boeing businesses other than LCA production are not relevant to an examination of material injury or serious prejudice with respect to LCA, and the United States has never contended otherwise.

298. In addition, the displacement and impedance of Boeing sales into the global market over the 2001-2005 period are not attributable to the behavior of leasing companies during market downturns, as the market share gains by Airbus during this period continued after the market recovered, and indeed continue to this day. As noted in response to the previous question, Airbus increased its world share of LCA deliveries from 38 percent in 2001 to 53 percent in 2003 and 2004, 57 percent in 2005, 53 percent in 2006,<sup>377</sup> and 53 percent in the first quarter of 2007.<sup>378</sup> To the extent that Boeing deliveries decreased in the downturn, as the EC alleges, because its customer base was more heavily weighted towards airlines than to leasing companies and thus more vulnerable to a poor market, this does not explain why Airbus has been able to maintain its market share gains now that the market has been strongly improving for several years. This fact undermines the EC's argument that leasing companies rather than subsidies are the cause of Boeing's market share losses.

299. Moreover, the data presented by the EC do not support its theory that Boeing's alleged failed strategy with respect to leasing companies was the primary drivers of its market share loss. The EC claims that Airbus was able to [

] <sup>379</sup> According to the EC, Boeing could have done the same thing, if Boeing had pursued leasing customers prior to 2001 as aggressively as it pursued airline customers rather than allegedly trying to compete with the lessors. Even granting *arguendo* the EC's erroneous characterization of Boeing's leasing philosophy in this period, the EC's theory can be tested by asking what would have happened if Boeing had maintained the same market share of *leasing* company deliveries over the 2001-2005 period as it in fact had of *airline* deliveries in that

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<sup>376</sup> EC FWS, para. 1449.

<sup>377</sup> Exhibit US-448 at 10.

<sup>378</sup> Airclaims data base, data query on April 27, 2007.

<sup>379</sup> *E.g.*, Statement of Christian Scherer, para. 36 (Exhibit EC-14).

period. If Boeing had done so, it would have made 53 more net LCA deliveries to leasing companies than it actually did over the five years.<sup>380</sup>

300. This figure is plainly too small to account for the large shift in market share in favor of Airbus during this period. Adding these extra Boeing sales to the total global LCA market,<sup>381</sup> instead of Airbus increasing its market share from 38 percent in 2001 to 53 percent in 2003 and 2004, and 57 percent in 2005, Airbus would have increased its market share from 39 percent in 2001 to 51 percent in 2003, 52 percent in 2004, and 55 percent in 2005. In other words, the phenomenon described by the EC – *even if it were true* – could account for no more than two percentage points of global market share during the relevant period.<sup>382</sup>

301. The EC focus on alleged competition between Boeing and leasing companies thus completely fails to explain why Airbus achieved a long-term increase in its market share during the 2001-2003 downturn, let alone why Airbus has been able to maintain most of its market share increase as demand has recovered.

**51. In relation to the United States’ allegation of “threat of material injury”, the EC asserts, at paragraph 2238 of its FWS, that:**

**“the United States has not demonstrated a ‘clearly foreseen and imminent’ ‘change in circumstances which would create a situation in which’ the alleged subsidies would cause material injury to Boeing. Even if data show that Boeing experienced a downturn from 2002-2004, with Boeing’s improving financial strength and increasing market dominance in 2005-2006, the existence of a ‘change in circumstances’ that would create a threat of material injury is even more doubtful. The United States faces a heavy burden to demonstrate new or changed circumstance which could foreseeably stem, let alone reverse, these exceptionally strong trends in Boeing performance in the most recent two years.”**

**52. How does the United States respond to this statement, in particular, in terms of the “clearly foreseen and imminent” standard in Article 15.7 of the SCM Agreement?**

Response:

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<sup>380</sup> To be precise, the figures are minus 22 in 2001, 8 in 2002, 18 in 2003, 27 in 2004, and 22 in 2005.

<sup>381</sup> That is, assuming that [

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<sup>382</sup> For 2006, the counterfactual Airbus market share under the EC hypothesis would be 52 percent, instead of the 53 percent actually recorded.

302. The United States does not agree that the improvement in the financial position of Boeing in 2005 and 2006 precludes a finding of material injury or threat of material injury. In terms of orders and financial performance, Boeing has benefitted from the same market upturn as Airbus. Indeed, the large increase in world orders in 2005 led to record order levels for both Boeing and Airbus.<sup>383</sup> Boeing continued to benefit from high world demand in 2006, but it did not “dominate” Airbus. Rather, Airbus largely took itself out of the market in 2006 because of a two-year delay in delivering the A380 (due to production problems) and a delay of more than a year to redesign the A350, after the market rejected its previous design of that aircraft.<sup>384</sup>

303. Many of the orders that Boeing received in 2006 will not be filled for many years.<sup>385</sup> The orders that Airbus would have received in 2006 for the A380 and the A350 – and for other aircraft that will have an improved market position due to their commonality with these two models – may have been delayed by the self-inflicted problems at Airbus, but they have not been foregone. Indeed, the whole purpose of Launch Aid is to shift the risk of LCA development to the Airbus governments, so that the full negative impact of such adverse circumstances is mitigated – to be, as Moody’s recently observed, a “helping hand in times of financial difficulties.”<sup>386</sup> Indeed, Barry Eccleston, the president and CEO of Airbus North America, observed at the end of 2006: “Notwithstanding all that you read in the press, these are the best of times for Airbus.”<sup>387</sup>

304. Airbus has relied on subsidies to recover from its production problems in 2006 in multiple ways. First, it has offered massive discounts on the A380 to maintain customer loyalty, as well as discounts on other Airbus aircraft purchased by customers adversely impacted by the A380 production delays.<sup>388</sup> The extra subsidy benefit due to the delay in A380 production (and thus the delay in A380 Launch Aid repayment) facilitates these extra discounts. Second, to compensate for the market misjudgment that delayed the A350 and the A380, Airbus is

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<sup>383</sup> Airbus Press Release, *2005: Airbus continues to lead* (Jan. 17, 2006) (Exhibit US-507) (“2005 was a record year for Airbus in all terms, be it for deliveries, order intake and profitability. In terms of orders Airbus continued to outsell its competitor for the fifth consecutive year, while continuing to lead in terms of deliveries for the third year in a row.”); Exhibit EC-238 (Boeing).

<sup>384</sup> U.S. FOS, para. 186; Fitch Ratings, *Diverging Flight Paths: Boeing and Airbus* at 5 (Nov. 15, 2006) (Exhibit EC-269).

<sup>385</sup> See Exhibit EC-21 at 440-51, 456-58, 460-66 (Airclaims database shows 880 orders for Boeing 737, 747, 777, or 787 with delivery scheduled for 2010 or later).

<sup>386</sup> Moody’s Investor Service, *Moody’s confirmation of EADS highlights government’s role as odd rescuers*, at 1 (Mar. 12, 2007) (Exhibit US-450).

<sup>387</sup> *Airbus’ Eccleston: 1<sup>st</sup> A380 Will Be Delivered in Oct. ‘07*, Dow Jones News Service (Dec. 6, 2006) (Exhibit US-508).

<sup>388</sup> E.g., *Qantas asks Airbus for 8 more A380s*, Int’l Herald Tribune (Oct. 29, 2006) (Exhibit US-405) (order of more A380s and A330s to “help Qantas mitigate” impact of A380 delays).

reportedly offering customers aircraft at extraordinarily low prices to offset any gap in their fleet plans.<sup>389</sup> Recent combined A330/A350 orders by Finnair, for example, suggest this strategy is working.<sup>390</sup> The expected forgiveness of A330/A340 Launch Aid that will go unpaid when these aircraft are replaced by the A350, not to mention Launch Aid for the A350 itself, enables Airbus to pursue this strategy as well.

305. Thus, the improvement in Boeing's financial performance since the Panel was established has not eliminated or removed the injurious effects of the subsidy. To the contrary, Airbus has continued to use the subsidies to alleviate the worst consequences of its risky development decisions, while continuing to benefit from the broad product lineup it has built with the use of subsidies and to enjoy the financial freedom to maintain an aggressive pricing strategy.

**53. What does the United States consider would be the implication, for its “threat of material injury” claim, of using a 2001-2005 reference period, in the light of the evidence that the EC has advanced on Boeing’s allegedly strong economic performance in the year 2006?**

Response:

306. As the response to Question 52 makes clear, the financial health of Boeing improved in 2006 largely as a result of stronger-than-expected overall order demand levels and the virtual absence of Airbus from key market segments due to internal problems at Airbus. With demand now returning to more normal levels, and as Airbus recovers from its difficulties with the A380 and A350, the threat of material injury to the U.S. LCA industry that existed in 2005 continues to exist today. As Airbus head of sales John Leahy recently predicted, “This will be the year for A350XWB orders. We are a bit late, but a lot of airlines are saying this is an aircraft worth waiting for.”<sup>391</sup>

**54. In paragraph 1821 of its FWS, the EC asserts that the United States appears to have “chosen to attempt to establish lost sales by reason of significant price undercutting...”. Please confirm whether this is a correct interpretation of the United States’ argument, and,**

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<sup>389</sup> E.g., *Airbus knocks down prices to entice airlines to purchase A350*, Times (London) (Apr. 20, 2007) (Exhibit US-509) (describing recent Airbus price discounts and stating that “Airbus is thought to be giving {Emirates} extra {A350} aircraft free as compensation for the two-year delay to the A380”).

<sup>390</sup> Airbus Press Release, *Finnair, first airline to sign firm contract for the A350XWB* (Mar. 8, 2007) (Exhibit US-510) (quoting Finnair CEO M. Jukka Hienonen as stating that purchase of additional A330s and A340s would provide a “{s}eamless transition” from current Airbus fleet to A350).

<sup>391</sup> *Airbus was caught napping by 787: Leahy*, Flight Global (Apr. 27, 2007) (Exhibit US-531)

**if not, please clarify the nature of the United States’ argument, responding to the remainder of the EC assertions made in connection with paragraph 1821.**

Response:

307. The EC has not correctly characterized the U.S. argument. Rather, the United States makes two distinct claims – that “the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product ... in the same market” and that “the effect of the subsidy is ... significant ... lost sales in the same market” – within the meaning of Article 6.3(c) of the SCM Agreement, with respect to the world market. Although some of the same evidence is relevant to both claims, the claims are both legally and factually distinct.

308. As the United States has shown, the primary economic distortions caused by Launch Aid and the other challenged subsidies are (1) to enable Airbus to build a full family of LCA at a pace and scale that would have otherwise been impossible and (2) to enable Airbus to pursue a strategy of gaining market share through low pricing in a way that it could not have otherwise done, at least not while simultaneously pursuing a highly capital-intensive product development strategy, without subsidies.<sup>392</sup> These economic distortions lead directly both to significant lost sales and significant price undercutting, but in different ways.

309. With respect to *lost sales*, Airbus may win a sale over Boeing because it was able to offer a specific LCA model that it would not have had, but for the subsidies. For example, the EC does not contest that the A340-500/600 could not have been launched without Launch Aid. The sales Boeing lost to the A340-500/600 at South African Airways, Thai Airways, and Iberia Airlines were thus lost to Airbus aircraft that would not have existed at the time of the sale, but for the subsidies.<sup>393</sup> Likewise, Boeing lost sales at Singapore Airlines, Emirates Airlines, and Qantas to the A380<sup>394</sup> – another aircraft that would not have been launched without subsidies.

310. In other instances, Airbus may win a sale over Boeing primarily by offering a particular LCA at a lower overall net price than Boeing relative to the value of the competing aircraft on offer. The lower Airbus price may be a function of price discounting, value or performance guarantees, escalation caps, other price-related terms, or some combination of these. In order for Airbus, for example, to win sales such as easyJet, Air Berlin, and AirAsia – all airlines that had been exclusive Boeing customers – Airbus had to offer a price far enough below Boeing’s to interest the airline in incurring the cost of switching suppliers, and then to keep that price below

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<sup>392</sup> U.S. FWS, paras. 813-819; U.S. FOS, paras. 134-160.

<sup>393</sup> U.S. FWS paras. 788-792.

<sup>394</sup> U.S. FWS, paras. 793-794.

Boeing's throughout the competition in order to win the sale.<sup>395</sup> The pricing strategy of Airbus in these sales is also, as the United States has demonstrated, an effect of the subsidy, because (1) the subsidy lowers Airbus's costs<sup>396</sup> and increases its cash flow and (2) the availability of further Launch Aid as needed means that Airbus knows it does not have to fully fund future product development from profits on current sales. Indeed, it is clear that Airbus would not have had sufficient cash flow at the time of these sales campaigns (2001 to 2004) to pursue its ambitious development strategy (A340-500/600, A380, and A350) and use price discounts to gain market share at the same time, but for the EC and Airbus government subsidies.<sup>397</sup>

311. Where the evidence indicates significant lost sales through subsidy-fueled aggressive pricing, such evidence establishes not only lost sales within the meaning of Article 6.3(c) but also significant price undercutting within the meaning of Article 6.3(c). As the EC observes, whether price undercutting is “‘significant’ (i.e. important, notable, or consequential)” in a given case will depend “upon the factual circumstances, and may not solely depend upon a given level of numeric significance.”<sup>398</sup> When a large, multi-billion dollar transaction is decided for Airbus exclusively or primarily on the basis that Airbus offered a lower price than Boeing, then the degree of price undercutting involved is manifestly “significant.” Thus, the statement by the chairman of easyJet that the price “difference was so substantial we would have been in breach of our fiduciary duty; it would have been an offence to buy Boeing”<sup>399</sup> is evidence not only of a major lost sale (valued at \$5.28 billion at list prices in 2001 U.S. dollars<sup>400</sup>) but also of price undercutting that was significant – that is, “important, notable, or consequential” enough to affect the outcome of the sale.

312. In another dispute involving different subsidies and different products, price undercutting might be demonstrated using evidence other than evidence taken from individual sales campaigns. Nonetheless, even though the lost sales and price undercutting claims in this dispute rely in part on the same evidence, they remain legally distinct. Moreover, because the U.S. lost sales claims encompass sales lost because of subsidy-enabled price undercutting, subsidy-

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<sup>395</sup> U.S. FWS, paras. 779-787.

<sup>396</sup> As the United States has explained, [ ] U.S. FOS (BCI/HSBI Session), paras. 58-59.

<sup>397</sup> U.S. FOS, paras. 154-160; U.S. FOS (BCI/HSBI Session), paras. 56-57.

<sup>398</sup> EC FWS, paras. 1824-1825 (quoting *US – Cotton Subsidies (Panel)*, paras. 7.1328-7.1329). Although the *Cotton* panel was describing the legal standard for a claim of significant price depression or suppression, the United States can agree with the EC that the panel's statements also apply to a claim of significant price undercutting.

<sup>399</sup> U.S. FWS, para. 779 (quoting public statements of Stelios Haji-Ioannou).

<sup>400</sup> U.S. FWS, para. 781.

enabled product availability, or both, it is inaccurate to say that the United States has “chosen to attempt to establish lost sales by reason of significant price undercutting” alone.<sup>401</sup>

313. The EC asserts that the United States can only succeed on its lost sales claims if two facts can be demonstrated – (1) that Airbus’s winning price is significantly lower than Boeing’s final offer and (2) that the significantly lower price is caused by subsidies.<sup>402</sup> This assertion simply ignores half of the U.S. demonstration – that the effect of the subsidy is also lost sales through the impact of Launch Aid and other subsidies on the products that Airbus had to sell in these campaigns. The EC’s proposed test is inadequate for this reason alone.

314. With respect to the first prong of the EC’s proposed test, the United States used publicly available evidence in its first written submission to show that a lower price from Airbus was one of the decisive factors, if not the decisive factor, in Airbus winning certain sales. Based on certain confidential information, the EC claims that in “many” – although, the EC apparently concedes, not all – of the campaigns identified by the United States, Boeing’s “last offer” was lower than Airbus’s winning price, and that in some cases factors other than price may have played a role in the customer’s decision.<sup>403</sup> This claim is inaccurate at best and, in many instances, misleading. The United States will respond in detail to this confidential information on a campaign-specific basis in its second submission.

315. As to the second prong of its proposed test, the EC claims that the amount of the subsidy allocated to the Airbus LCA that won the sales identified by the United States was too small to have materially affected the outcome of the sale. As the United States has explained in response to other questions, the EC’s proposed calculation and allocation of the subsidy benefit grossly understates the actual benefit in this case. More importantly, the EC argument is based on a misrepresentation of the causal relationship between the subsidy and the price effects demonstrated by the United States. The primary effect of the subsidy on prices is that it enables Airbus to grow more rapidly than it otherwise could by *simultaneously* broadening and deepening its LCA family through rapid product development *and* purchasing market share through aggressive price discounting. A simplistic analysis of the amount of subsidy that can be allocated to particular aircraft under a CVD-type methodology – even if done correctly, which the EC manifestly has not done<sup>404</sup> – is not relevant to the actual effects of the subsidy in this case.

**55. At paragraph 743 of its FWS, the United States alleges that “Boeing has been unable to maintain its U.S. pricing for B737s in line with cost increases”, while also alluding, in**

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<sup>401</sup> EC FWS, para. 1821.

<sup>402</sup> EC FWS, para. 1821.

<sup>403</sup> EC FWS, paras. 1828-1829.

<sup>404</sup> See response to Question 42, above.

**paragraph 747 of its FWS, to “deep cuts in costs and steady gains in productivity”. How does the United States reconcile these statements?**

Response:

316. The statements are consistent. As demonstrated in paragraph 741 and Figure 1 of the U.S. First Written Submission, U.S. market prices for Boeing’s 737 series fell by [ ] from 2001 to 2005 in *absolute* terms, i.e., not accounting for inflation or any changes in costs. In the world market, as shown in paragraph 805 and Figure 4, prices for the 737 fell by [ ], again in nominal U.S. dollars. These decreases in the nominal price are evidence of price suppression, as they are the direct result of aggressive Airbus pricing in key campaigns in which Boeing competed with the 737 – a pricing strategy Airbus was able to pursue because of the subsidies.<sup>405</sup>

317. These price declines are particularly significant when viewed in light of *overall* pricing trends in the aircraft industry. The U.S. “producer price index” that is specific to the aircraft manufacturing industry, representing *average* costs for aircraft manufacturers in the United States generally, increased from 2001 to 2005 by 16.25 percent.<sup>406</sup> This index is the most reasonable publicly available index that could be used to measure aircraft pricing trends in real, rather than nominal, U.S. dollars.

318. In paragraph 743 of its first written submission, the United States was merely making the point that if 737 prices fell by [ ] in the U.S. market and [ ] in the world market in *nominal* dollars, the price decrease would have been even greater if measured in *real* dollars, i.e., adjusted for inflation. In fact, setting aside post-order price adjustments, prices for 2005 orders of 737s, indexed for cost inflation, would have fallen by [ ] percent in the U.S. market and by [ ] percent in the world market

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<sup>405</sup> U.S. FOS, paras. 154-160; U.S. FOS (BCI/HSBI Session), paras. 56-57. The United States takes note of the HSBI documents submitted by the EC with respect to certain significant 737-related campaigns and submits that these documents confirm that Airbus pricing practices have been the cause of price depression in the U.S. and world markets. The United States will return to this issue in an HSBI Annex to its second written submission.

<sup>406</sup> Exhibit US-402.

from 2001 to 2005.<sup>407</sup> This degree of price depression is significant in context of the LCA industry.<sup>408</sup>

319. In paragraph 747 of its first submission, the United States was addressing the “impact of the subsidized imports on the domestic industry” within the meaning of Article 15.4 of the SCM Agreement, in the context of its Article 5(a) claim. The United States was observing that the full impact of the (nominal and real) price declines for the 737 and other Boeing LCA was mitigated by Boeing’s decision to reduce its costs and increase its efficiency. These efforts to reduce costs thus explain why even though U.S. LCA production fell by 45 percent and total sales fell by 35 percent from 2001 and 2005, Boeing’s operating income fell by only 25 percent.<sup>409</sup> In other words, the injurious impact of the subsidized imports on the profitability of the U.S. LCA industry was significant, and would have been even more significant if Boeing had not attempted to survive in the subsidy-distorted market environment of suppressed LCA prices by taking steps to cut costs and improve efficiency.

320. That a competitor reacts to subsidized competition by cutting its costs does not, of course, mean that it is not injured by reason of that subsidized competition.<sup>410</sup> Nor can it be assumed that Boeing will be able to offset a portion of continuing price suppression in the future.

## I. EXTINCTION AND EXTRACTION OF ALLEGED SUBSIDIES

**56. To what extent does the United States agree or disagree with the EC’s characterisation of the findings made by the panels and the Appellate Body in the relevant WTO cases cited by the EC in support of its arguments in respect of the extinction and extraction of alleged subsidies?**

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<sup>407</sup> In the U.S. market, nominal 737 prices fell from an indexed value of 100.00 in 2001 to [ ] in 2005. U.S. FWS, para. 741 & Figure 1. If this figure is indexed for inflation using the producer price index (PPI) of 116.25 in 2005, it would be [ ] / 1.1625 = [ ]. Likewise, nominal 737 prices in the world market fell from an indexed value of 100.00 in 2001 to [ ] in 2005, *id.* para. 805 & Figure 4, or an indexed value of [ ] / 1.1625 = [ ].

<sup>408</sup> *Cf.* U.S. FOS (citing Gary J. Dorman, *The Effect of Launch Aid on the Economics of Commercial Airplane Programs* at 12 (Nov. 6, 2006) (showing effect of failure to achieve price targets on profitability of LCA programs)).

<sup>409</sup> U.S. FWS, para. 746 & Table 4.

<sup>410</sup> For example, Boeing reduced costs, in part, by dramatically reducing the number of its employees engaged in its U.S. LCA operations. U.S. FWS, para. 746 & Table 4. While this may have improved Boeing’s financial performance, the corresponding reduction in U.S. jobs and economic activity is still “material injury” to the U.S. domestic LCA industry.

Response:

321. The EC's characterization of the panel and Appellate Body findings in the reports discussed in connection with its "extinction" and "extraction" arguments<sup>411</sup> is highly misleading in two key respects. *First*, the EC ignores that an essential element of the privatization transactions at issue in those reports was the transfer of *all or substantially all of the state's interest* in an entity to a buyer at arm's length and for fair market value, including a *complete transfer of control*. The EC mistakenly tries to extrapolate from these reports a general principle that applies to any and all sales, regardless of whether they have these characteristics. In fact, each of the transactions to which the EC applies this supposed principle lacks some or all of the features that were essential to the findings regarding subsidy extinction in the prior dispute settlement reports.

322. *Second*, the EC fails to address the significance of the fact that the panel and Appellate Body reports on which it relies all involved reviews of countervailing duty (CVD) determinations by an investigating authority under part V of the SCM Agreement. The EC takes no account of the differences between the inquiry in a CVD dispute (*i.e.*, whether and to what extent it is permissible to impose countervailing duties on imports of goods made by a post-privatization producer) and the inquiry in an adverse effects dispute (*i.e.*, whether, through the use of a subsidy, a Member has caused adverse effects to the interests of other Members).

323. The United States will elaborate below on each of these serious flaws in the EC's analysis. It also should be noted that the EC ignores many important factual distinctions between the transactions that, in its view, caused subsidies to Airbus to disappear and the transactions at issue in the panel and Appellate Body reports on which it relies. The United States discussed some of these factual issues in its first oral statement<sup>412</sup> and will expand on that discussion in its second written submission.

Extinction

324. The EC's "extinction" argument rests on the principle that "{a}n arm's-length, fair market value sale presumptively precludes the passing through of a benefit to a new owner."<sup>413</sup> To support what it supposes to be a general rule applying to all "arm's-length, fair market value sale{s}" (regardless of whether they involve a change of control or transfer of all or substantially all of the seller's interest in the enterprise being sold), the EC relies on the panel and Appellate Body reports in *US - Lead Bars*, the panel and Appellate Body reports in *US - Countervailing Measures*, and the panel report in *US - Countervailing Measures (21.5)*. However, as already

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<sup>411</sup> EC FWS, paras. 198-225.

<sup>412</sup> See U.S. FOS, paras. 115-124.

<sup>413</sup> EC FWS, para. 201.

mentioned, each of these disputes involved transactions with essential characteristics that the EC leaves out of its analysis.

325. *US - Lead Bars* was the first WTO dispute to address the effect of privatization on pre-privatization subsidies. The EC challenged the U.S. imposition of countervailing duties on imports of leaded bars produced by United Engineering Steels (UES) (later renamed British Steel Engineering Steels (BSES)). The imposition of countervailing duties was based on a finding by the DOC that a portion of the subsidies the UK government had conferred on the state-owned British Steel Corporation (BSC) from 1977 to 1986 survived the privatization transactions that resulted in the creation of UES and then BSES.<sup>414</sup>

326. The EC contended that the privatization transactions effectively extinguished the subsidies conferred on BSC and that, therefore, there was no basis for the DOC to impose countervailing duties. The panel and Appellate Body agreed. In particular, the panel found:

BSC's leaded bar assets were *spun-off* to UES in 1986. The USDOC found that the transaction 'represented an arm's length transaction in which BSC acted consistently with commercial considerations'. The United States has not denied that the BSC spin-off was negotiated for fair market value. Furthermore, we recall that BSplc {the successor to BSC} was *fully privatized* in December 1988. The USDOC found that the privatization of BSplc 'was at arm's length, for fair market value and consistent with commercial considerations.' Thus, fair market value was paid for *all productive assets, goodwill etc.* employed by UES and BSplc/BSES in the production of leaded bars imported into the United States in 1994, 1995 and 1996. *In these circumstances*, we fail to see how pre-1985/86 'financial contributions' bestowed on BSC could subsequently be considered to confer a 'benefit' on UES and BSplc/BSES during the relevant periods of review.<sup>415</sup>

327. Recalling this very finding, the Appellate Body upheld the panel's conclusion of extinguishment of the underlying subsidies "in the specific circumstances of this case."<sup>416</sup> Those circumstances, crucial to the panel's conclusion that subsidies to BSC's leaded bar production had been extinguished, included the panel's findings that "fair market value was paid for *all productive assets, goodwill etc.* employed by UES and BSplc/BSES in the production of leaded bars imported into the United States in 1994, 1995 and 1996," that the company was "fully privatized," and that the transaction was at "arm's length."<sup>417</sup>

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<sup>414</sup> See *U.S. - Lead Bars (AB)*, para. 2.

<sup>415</sup> *U.S. - Lead Bars (Panel)*, para. 6.81 (emphases added) (internal citations omitted).

<sup>416</sup> *US - Lead Bars (AB)*, para. 68.

<sup>417</sup> *US - Lead Bars (Panel)*, para. 6.81 (emphasis added).

328. The EC simply glosses over the foregoing aspects of the earlier dispute. It misleadingly asserts that the reports in *US - Lead Bars* stand for the proposition that an arm's-length, fair market value sale of *any* portion of an enterprise results in the extinguishment of a corresponding portion of subsidies provided to the enterprise.<sup>418</sup>

329. The EC's discussion of the reports in *US - Countervailing Measures* is similarly misleading. Like the *US - Lead Bars* dispute, the *US - Countervailing Measures* dispute involved an EC challenge to DOC determinations that certain subsidies survived despite the full privatization of the subsidized entity. As the panel explained at the outset of its analysis in that dispute, the EC expressly "limited its argumentation to privatization, as the challenged determinations involved privatizations."<sup>419</sup>

330. Emphasizing the particular focus of the claims in *US - Countervailing Measures*, the panel explained that

{p}rivatization is a very particular and complex change in ownership. It involves a fundamental transformation of a government-owned and controlled entity into a privately-owned, market-oriented company. Following privatization and consistent with commercial principles, the owners of the privatized company should be profit-maximizers, set on obtaining a market return on the entirety of their investment in the privatized company.<sup>420</sup>

331. The panel then went on to explain how it was focusing its findings in light of the relevant facts:

The European Communities initially argued that any change in ownership would necessitate a reevaluation of the benefit. The United States argued that since ownership of publicly traded companies and their market value change every day, a re-evaluation at every change in ownership would be impracticable. *The European Communities responded that the change in ownership must be of a sufficient magnitude so as to change the control of the enterprise and thus trigger a re-evaluation of the conditions of application of the SCM Agreement. We have not considered it necessary to address all those situations, as we have before us 12 determinations where the relevant government had sold all, or substantially all, its ownership interest and clearly no longer had any controlling interest in the privatized producer.*<sup>421</sup>

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<sup>418</sup> EC FWS, para. 203.

<sup>419</sup> *US - Countervailing Measures (Panel)*, para. 7.2 and note 274.

<sup>420</sup> *US - Countervailing Measures (Panel)*, para. 7.60.

<sup>421</sup> *US - Countervailing Measures (Panel)*, para. 7.62 (emphases added); *see also id.*, paras. 7.39, 7.65.

332. The Appellate Body likewise stressed that the question at issue was whether a subsidy benefit “continues to exist following a transfer of ownership of a state-owned enterprise to a new private owner at arm’s length and for fair market value, *where the government retains ‘no controlling interest in the privatized producer’ and transfers all or substantially all the property.*”<sup>422</sup> Indeed, it expressly observed that “the Panel has not examined whether a ‘benefit’, within the meaning of the *SCM Agreement*, would be extinguished following a change in ownership under circumstances different from those in the 12 cases under consideration.”<sup>423</sup>

333. Yet, the EC’s discussion of the reports in *US - Countervailing Measures* is devoid of any mention of the circumstances that caused the panel and Appellate Body to limit their findings in that dispute. Reading the EC’s characterization of those reports, one might come away with the impression that the panel and Appellate Body had articulated a generic rule with respect to any and all arm’s-length, fair market value transactions.<sup>424</sup> For the reasons discussed above, that impression would be incorrect.

334. Moreover, the EC compounds its misleading characterization of the findings in *US - Countervailing Measures* by asserting that “{t}he Appellate Body also reasoned that this presumption {of extinction of subsidy benefits} would appear *irrebuttable* in private-to-private sales” and calling this a “per se rule.”<sup>425</sup> The Appellate Body statement on which the EC relies was *obiter dicta* and not a “per se rule.” As the Appellate Body itself acknowledged, “the very narrow set of facts and circumstances analyzed by the Panel” did not include private-to-private sales.<sup>426</sup> Accordingly, any statements regarding such sales were outside the scope of the dispute.

335. In any event, as the United States noted in the panel proceeding in *US - Countervailing Measures* (thus causing the EC to limit its argument, as noted above), if there were an irrebuttable presumption of subsidy extinguishment in the case of private-to-private sales, this would amount to a massive exception to *SCM Agreement* disciplines for publicly traded companies, because their ownership and market value change every day.<sup>427</sup>

336. The EC’s argument is not helped by the panel report from the compliance phase of the *US - Countervailing Measures* dispute. The EC purports to rely on that report to show that

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<sup>422</sup> *US - Countervailing Measures (AB)*, para. 85 (emphasis added).

<sup>423</sup> *US - Countervailing Measures (AB)*, para. 85 note 177; *see also id.*, para. 117 (finding that “{t}he Panel should have confined its findings to {the} specific circumstances {at issue in the dispute}”), para. 118 (again referring to “the very narrow set of facts and circumstances analyzed by the Panel”).

<sup>424</sup> *See EC FWS*, paras. 204-212.

<sup>425</sup> *EC FWS*, paras. 213 and 214.

<sup>426</sup> *US - Countervailing Measures (AB)*, para. 118.

<sup>427</sup> *US - Countervailing Measures (Panel)*, para. 7.62.

“subsidy benefits are extinguished in cases of the sale of a portion of an enterprise.”<sup>428</sup> However, the report simply confirms the principles established in the underlying dispute. In fact, the compliance panel expressly noted that the EC was *not* challenging a revised DOC methodology whereby, to show that a subsidy had been extinguished, a respondent must “prove that the government sold ‘all or substantially all’ of its assets during the allocation period; that the government retains no control over the privatized company or its assets; and that the sale was at arm’s length and for {fair market value}.”<sup>429</sup>

337. The EC did challenge a particular instance in which the DOC found that a small portion of subsidy had not been extinguished despite a French government sale of all of its interest in a subsidized enterprise (the steel manufacturer Usinor), of which 94.84 percent was sold at arm’s length and for fair market value.<sup>430</sup> However, the DOC’s finding (upheld by the panel) that under these circumstances 94.84 percent of the pre-privatization subsidy was extinguished while 5.16 percent survived does not support the EC’s present view that *any* “partial sale” leads to a partial extinguishment of subsidy. Rather, these circumstances merely confirm the principle that a finding of extinguishment could be justified (in the CVD context) when the state transfers all or substantially all of its interest in an enterprise through an arm’s-length, fair market value transaction and there is a relinquishment of control.<sup>431</sup>

338. Conversely, the panel report in *US - Countervailing Measures (21.5)* does not support the proposition that a sale of *less* than all or substantially all of the state’s interest in an enterprise requires a finding of extinguishment of a proportionate share of subsidies provided to the enterprise. If the circumstances had been the opposite of what they actually were – that is, if the French government had sold 5.16 percent of its interest in Usinor while retaining a 94.84 percent interest – there would have been no extinguishment under the methodology described at footnote 313 of the panel report, which the EC did not challenge. Nor would the SCM Agreement have required a finding of extinguishment. Accordingly, there is no basis for the EC’s over-broad assertion – for which it provides no citation – that “the panel concluded that failure to consider the partial nature of a privatisation – and to limit countervailing duties accordingly – was untenable. . . .”<sup>432</sup>

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<sup>428</sup> EC FWS, para. 216.

<sup>429</sup> *US - Countervailing Measures (21.5) (Panel)*, para. 7.89 & note 313.

<sup>430</sup> *See US - Countervailing Measures (21.5) (Panel)*, para. 7.92.

<sup>431</sup> *See US - Countervailing Measures (21.5) (Panel)*, para. 7.119 (finding DOC’s approach to the privatization at issue “not unreasonable” “given the conditions of the privatization”).

<sup>432</sup> EC FWS, para. 218. Further, the EC misleadingly states in the preceding paragraph (para. 217) that the panel found that DOC’s approach “precluded charging the buyer of {the 5.16 percent} with the entire amount of the original subsidy.” In fact, the panel recognized that the DOC determination at issue was made in the context of a “sunset review” in which “no recalculation of the rate of subsidization as found in the original investigation is made.” *US - Countervailing Measures (21.5)*, para. 7.174. The panel stated its *expectation* that, upon review,

339. The panel report in *US - Countervailing Measures (21.5)* also is notable for its acknowledgment that “{i}n a subsidies case . . . the government that is privatising its own company is best placed to provide specific information regarding the conditions of that privatization.”<sup>433</sup> This finding is directly contrary to the EC’s unsupported assertion that the burden of proof lies with “those challenging the claim of extinguishment.”<sup>434</sup> Indeed, it is well established that the party asserting a proposition, such as the proposition that various transactions have had the effect of extinguishing subsidies, has the burden of proving it.<sup>435</sup> Accordingly, it is the EC’s burden to establish that subsidies provided to Airbus have been extinguished (a burden it has not met), rather than the United States’s burden to establish that subsidies have not been extinguished.

340. As noted above, a second major flaw in the EC’s characterization of the panel and Appellate Body reports relied upon in its “extinction” argument is its disregard for distinctions between the context of those disputes (*i.e.*, review of CVD determinations under part V of the SCM Agreement) and the context of the present dispute (*i.e.*, claims under parts II and III of the SCM Agreement). In *US - Lead Bars* and in *US - Countervailing Measures*, the panels and the Appellate Body made clear that their findings rested on their understanding of provisions in part V of the SCM Agreement.<sup>436</sup>

341. As the panel in *US - Lead Bars* put it, “the imposition of a countervailing duty is only envisaged where it is necessary to ‘offset’ a (countervailable) subsidy.”<sup>437</sup> An investigating authority in a CVD proceeding is required to determine whether a countervailable subsidy exists and, if so, the amount of subsidy to be offset through countervailing duties.

342. A panel in a dispute under part III of the SCM Agreement is faced with a very different task. It is *not* required to quantify the amount of subsidy, as the Appellate Body’s statement in *US - Cotton Subsidies* quoted at paragraph 120 of the Panel’s questions recognizes. Rather, it is required to determine whether the respondent, through the use of subsidies, has caused adverse effects to the interests of other Members.

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DOC’s finding of a 5.16 percent pass-through of pre-privatization subsidies would be “reflected in the level of any countervailing duty actually imposed on Usinor.” *Id.*, para. 7.175. However, it did not make an actual finding on this point as the EC suggests.

<sup>433</sup> *US - Countervailing Measures (21.5)*, para. 7.154.

<sup>434</sup> EC FWS, para. 210.

<sup>435</sup> *US - Wool Shirts (AB)*, p. 14.

<sup>436</sup> See *US - Lead Bars (Panel)*, paras. 6.45 - 6.57; *US - Lead Bars (AB)*, paras. 53, 61-62, 72; *US - Countervailing Measures (Panel)*, paras. 7.42 - 7.43, 7.86, 7.94, 7.113; *US - Countervailing Measures (AB)*, paras. 78-82, 139; *US - Countervailing Measures (21.5)*, para. 7.96.

<sup>437</sup> *US - Lead Bars (Panel)*, para. 6.56.

343. It is not the case that a transaction that may (*arguendo*) render a previously provided subsidy no longer countervailable for purposes of part V of the SCM Agreement also precludes a finding of breach of an obligation under part III of the SCM Agreement. The EC provides no textual support for its argument that the privatization findings on which it relies – which turned on the obligations in part V of the SCM Agreement – are relevant at all to findings under part III of the SCM Agreement. For this additional reason, therefore, the EC’s characterization of panel and Appellate Body findings in support of its “extinction” argument is misleading.

#### Extraction

344. Finally, it should be noted that none of the panel and Appellate Body reports relied upon by the EC supports its so-called “extraction” theory. Relying instead on what it deems to be “economic common sense,” the EC simply asserts that “extractions” are “analogous in economic terms to arm’s-length, fair market value sales or direct repayment {of subsidies} to a government.”<sup>438</sup> However, as the United States discussed in its first opening statement, when one examines the transactions to which the EC applies its extraction theory, it is impossible to see how they can be viewed as analogous to arm’s-length, fair market values sales or direct repayment. To the contrary, it becomes evident that what the EC means by “extraction” is nothing more than an accounting device, which does not affect the subsidies provided.<sup>439</sup>

345. The two instances of “extraction” described by the EC each involved the movement of cash from one entity to a related entity (from CASA to the Spanish government and from DASA to DaimlerChrysler).<sup>440</sup> According to the EC, these transactions caused subsidies to be “removed from Airbus SAS’ reach.”<sup>441</sup> However, the simple movement of cash from the books of one entity to the books of a related entity cannot possibly make a subsidy disappear. The loophole this would create in the SCM Agreement would make subsidy disciplines meaningless.

346. In fact, by arguing that the movement of money from an enterprise to its owner causes subsidies to disappear, the EC effectively is asking the Panel to draw a distinction between owners and the enterprises they own. This position is diametrically opposed to the one the EC itself advanced, and the panels and Appellate Body adopted, in the disputes involving the effect (in the CVD context) of a full privatization on pre-privatization subsidies. Thus, for example, the panel in *US – Countervailing Measures* – agreeing with the EC’s position in that dispute – concluded that:

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<sup>438</sup> See EC FWS, paras. 224-225.

<sup>439</sup> U.S. FOS, paras. 122-124.

<sup>440</sup> EC FWS, paras. 253-255.

<sup>441</sup> EC Closing Statement at First Panel Meeting, para. 10.

for the purpose of the benefit determination under the SCM Agreement, no distinction should be made between a company and its shareholders, as together they constitute a producer, a natural or legal person that may be the ‘recipient’ of the benefit to be assessed.<sup>442</sup>

347. By the EC’s logic in this dispute, it would seem that if a publicly traded company is the recipient of a subsidy, it “extracts” some of that subsidy every time it pays a dividend to its shareholders or buys back stock. The EC offers absolutely no support for this theory.

348. Finally, compounding the fundamental flaw in its argument, the EC never explains why every dollar supposedly “extracted” from a subsidized entity should be considered a dollar of subsidy. Presumably at the time of the “extractions” from CASA and DASA the entities had both subsidized and non-subsidized capital. Yet, the EC seems to assume that all of the money extracted consisted only of subsidized capital. In any event, as already noted, the EC’s extraction theory finds no support in any of the panel and Appellate Body reports on which the EC relies.

## II. QUESTIONS TO THE EUROPEAN COMMUNITIES

### III. QUESTIONS TO BOTH PARTIES

#### A. SPECIFICITY

**117. What are the parties’ views on the extent to which a subsidy granted, through a contract including one or more unique terms and conditions, to an individual enterprise pursuant to a subsidy programme that does not explicitly limit access to subsidies to certain enterprises, may be specific within the meaning of Article 2.1(a) of the SCM Agreement?**

Response:

349. If the unique terms and conditions of a given subsidy contract are sufficiently different from the terms and conditions of other contracts granted under the same subsidy program, this effectively could cause the subsidy at issue to fall outside the parameters of the program. In that case, one reasonably could find that even though, as a formal matter, the subsidy has been

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<sup>442</sup> *US - Countervailing Measures (Panel)*, para. 7.54; *see also id.*, para. 7.50 (“SCM Agreement does not make any reference or any distinction between shareholders and the company when it discusses the need to establish the benefit”); *US - Countervailing Measures (AB)*, paras. 110-115; *US - Lead Bars (Panel)*, para. 6.82 (“In the context of privatizations negotiated at arm’s length, for fair market value, and consistent with commercial principles, the distinction between a company and its owners is redundant for the purpose of establishing ‘benefit.’”).

granted pursuant to a program that is not explicitly limited to certain enterprises, in fact the subsidy ought to be considered separately from the larger program for purposes of a *de jure* specificity analysis. This situation should be considered as one in which the granting authority, through the unique terms and conditions of the contract, “explicitly limits access to a subsidy to certain enterprises,” which subsidy therefore should be found to be specific under Article 2.1(a) of the SCM Agreement.

350. Even if unique terms and conditions do not lead to a finding of specificity under Article 2.1(a), they will be relevant to an analysis under Articles 2.1(b) and 2.1(c). In particular, they are likely to undermine a finding of non-specificity under Article 2.1(b). As discussed in response to Question 118, below, a finding of non-specificity under Article 2.1(b) requires the presence of several enumerated criteria, including “objective criteria or conditions . . . which do not favour certain enterprises over others,” and which are “clearly spelled out in law, regulation, or other official document, so as to be capable of verification.” Unless the unique terms and conditions of the subsidy contract at issue were the result of the application of “objective criteria or conditions governing the eligibility for, and the amount of, {the} subsidy,” the subsidy would fail the non-specificity test under Article 2.1(b).

351. Under Article 2.1(c), the unique terms and conditions of the subsidy contract would be relevant to evaluating “the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy.” If the unique terms and conditions indicate that discretion has been exercised in a manner that favors certain enterprises over others, that would support a finding of *de facto* specificity under Article 2.1(c).

352. Finally, to the extent this question relates to the U.S. claims regarding the EIB loans provided to Airbus, the United States notes that the EC has refused to provide the information that the Panel would need to evaluate the unique terms and conditions of those loans. Of the 12 EIB loans at issue, the EC provided information on the terms and conditions of only the 2002 loan to EADS for R&D related to the A380 and the 1992 loan to Aérospatiale related to the A330/A340. Moreover, the EC refused to provide information about other EIB lending that might allow for an analysis of the manner in which the EIB exercised its discretion in providing loans to Airbus as compared with other borrowers.<sup>443</sup>

**118. What is the consequence in terms of determining whether a subsidy is “specific” of finding that it is not “specific” within the meaning of Article 2.1(a) but equally not “non-specific” within the meaning of Article 2.1(b) of the SCM Agreement?**

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<sup>443</sup> Replies to Questions by the Facilitator under Annex V of the SCM Agreement by the European Communities (Nov. 18, 2005), Q80 and Q82 (Exhibit US-5 (BCI)).

Response:

353. A finding that a subsidy is not “specific” within the meaning of Article 2.1(a) of the SCM Agreement coupled with a finding that it is not “non-specific” within the meaning of Article 2.1(b) means that the *de jure* specificity analysis has been inconclusive and calls for the undertaking of a *de facto* specificity analysis under Article 2.1(c). Moreover, if the subsidy is “limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority” within the meaning of Article 2.2, then it is “specific” regardless of the outcome of the analysis under Article 2.1.

354. Article 2.1 contains three subparagraphs, the first two of which address (a) *de jure* specificity and (b) *de jure* non-specificity, and the third of which addresses (c) *de facto* specificity. As between (a) and (b) there is no hierarchy, notwithstanding the EC’s suggestions to the contrary.<sup>444</sup> The relationship between (a) and (b) is not one in which a finding of non-specificity under (b) cancels a finding of specificity under (a). That is, the principles laid out in (b) do not “override{” or “outweigh{” the principles laid out in (a).<sup>445</sup>

355. Rather, (a) and (b) deal with entirely different situations. Subparagraph (a) concerns the situation in which access to a subsidy is “explicitly limit{ed}” to “certain enterprises.” Subparagraph (b) concerns the situation in which “objective criteria or conditions govern{ the eligibility for, and the amount of, a subsidy.” As explained in footnote 2 to the SCM Agreement, “Objective criteria or conditions, as used {in the SCM Agreement}, mean criteria or conditions which are neutral, *which do not favour certain enterprises over others*, and which are economic in nature and horizontal in application, such as number of employees or size of enterprise.” (Emphasis added.)

356. If access to a subsidy is “explicitly limit{ed}” to “certain enterprises” (as contemplated in (a)), then it favors those certain enterprises. In other words, “objective criteria or conditions” (within the meaning of footnote 2) do not “govern{ the eligibility for” (let alone the amount of) the subsidy, and subparagraph (b), therefore, does not apply.

357. Accordingly, the EC is incorrect when it states that “{i}f a subsidy satisfies the criteria of Article 2.1(b) of the *SCM Agreement* it is non specific, even when limited to certain enterprises

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<sup>444</sup> See, e.g., EC FWS, paras. 728, 738.

<sup>445</sup> EC FWS, para. 728. Nor do the principles in Article 2.1(b) “override{” or “outweigh{” the principles in Article 2.2, as the EC proposes. *Id.* The United States discussed this point in its statement at the first Panel meeting. See U.S. FOS, paras. 91-94.

within the meaning of Articles 2.1(a) and 2.2 of the *SCM Agreement*.<sup>446</sup> To the contrary, if a subsidy satisfies the criteria of Article 2.1(a), then *de jure* specificity is conclusively established, and Article 2.1(b) is irrelevant.<sup>447</sup>

358. If a subsidy does *not* satisfy the criteria of Article 2.1(a) (as the hypothetical posed by the present question suggests) – that is, if a subsidy is *not* “explicitly limit{ed}” to “certain enterprises” – then it is not *de jure* specific, and one would proceed to an analysis under subparagraph (b).<sup>448</sup> To be found *de jure* non-specific under subparagraph (b), the subsidy must meet all of the following criteria:

- Eligibility for and the amount of the subsidy must be governed by objective criteria or conditions, meaning criteria or conditions that:
  - are neutral;
  - do not favor certain enterprises over others; and
  - are economic in nature and horizontal in application.
- Eligibility must be automatic.
- The criteria and conditions must be strictly adhered to.
- The criteria or conditions must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification.

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<sup>446</sup> EC FWS, para. 728. The EC’s assumption that a finding of *de jure* non-specificity under Article 2.1(b) precludes a finding of specificity under Article 2.2 finds no basis in the text. To the contrary, as is the case with a finding under Article 2.1(a) that a subsidy is “explicitly limit{ed}” to “certain enterprises,” a finding under Article 2.2 that a subsidy is limited by geographical region would preclude a finding under Article 2.1(b) that “objective criteria or conditions” within the meaning of footnote 2 govern eligibility for the subsidy.

<sup>447</sup> In this regard, the United States fails to see why, in the EC’s view, the wording of subparagraph (b) – “specificity shall not exist” – is any more “clear” than the wording of subparagraph (a) – “shall be specific.” In fact, the texts of the two subparagraphs are equally clear, and nothing in (b) suggests that it prevails over a finding of specificity under (a).

<sup>448</sup> The EC incorrectly suggests that a negative finding under subparagraph (a) means that a subsidy is conclusively “non-specific.” EC FWS, para. 731. There is absolutely no basis for the “hypothesis” that the EC calls “the principle of ‘unrestricted’ non-specificity.” *Id.* To the contrary, the EC’s hypothesis that a specificity analysis ends upon a negative finding under subparagraph (a) is disproved by the reference in footnote 2, attached to subparagraph (b), to “criteria or conditions . . . which do not favour certain enterprises over others.” That reference would be entirely meaningless if the presence of “criteria or conditions . . . which do not favour certain enterprises over others” precluded ever getting to an analysis under subparagraph (b) due to a finding of no *de jure* specificity under subparagraph (a).

359. If any of the foregoing qualifications are not met, then the subsidy is not *de jure* non-specific within the meaning of subparagraph (b). This then would lead to an analysis of *de facto* specificity under subparagraph (c).

360. Subparagraph (c) applies “{i}f, notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific.” The situation described above presents precisely this circumstance. In particular, the analysis under subparagraph (a) gave rise to an “appearance of non-specificity,” because access to the subsidy was not “explicitly limit{ed}” to “certain enterprises.” However, the analysis under subparagraph (b) indicated “reasons to believe that the subsidy may in fact be specific,” because the subsidy did not have certain criteria necessary to support a finding of *de jure* non-specificity.

361. Therefore, the inconclusive analysis under subparagraphs (a) and (b) in this hypothetical leads one to a consideration of the other factors under subparagraph (c) that may indicate *de facto* specificity. This approach is supported by the negotiating history of Article 2.1, which reflects the widely held view (including of the EC) that a subsidy should be treated as specific if it is not generally available. For example, during negotiation of the SCM Agreement the EC explained:

{A} distinction should be drawn between general measures designed to stimulate economic activity as a whole and specific measures with identifiable beneficiaries whose competitive position is improved by the intervention, and only the latter should be actionable.<sup>449</sup>

362. Other parties to the SCM Agreement negotiation similarly expressed the understanding that a subsidy should be considered specific within the meaning of the Agreement if it is not generally available.<sup>450</sup>

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<sup>449</sup> Submission by the European Community, Negotiating Group on Subsidies and Countervailing Measures, Elements of the Negotiating Framework, MTN.GNG/NG10/W/31 (Nov. 27, 1989). As noted in response to Question 13, above, the EC repeated this view as a third party in *US - Softwood Lumber CVD Final*, stating that Article 2.1 “requires an assessment of ‘general availability’, that is a determination of whether a subsidy selectively benefits certain industrial sectors or certain enterprises, or is rather a broad economic policy measure, such as the reduction of corporate taxes.” Third Party Oral Statement by the European Communities, *US - Softwood Lumber CVD Final (Panel)*, paras. 14, 15 (Feb. 12, 2003) (Exhibit US-476).

<sup>450</sup> See, e.g., Communication from Switzerland, Negotiating Group on Subsidies and Countervailing measures, Elements of the Negotiating Framework, MTN.GNG/NG10/W/26 (Sept. 13, 1989) (“Subsidies other than those listed above can only be deemed non-actionable if they are not specific, i.e. generally available.”); Communications from the Republic of Korea, Negotiating Group on Subsidies and Countervailing Measures, Elements of the Framework for Negotiations, MTN.GNG/NG10/W/34 (Jan. 18, 1990) (“The existence of neutral eligibility criteria in applying for a subsidy programme across industries would be sufficient counter-evidence to specificity.”); Submission by India, Negotiating Group on Subsidies and Countervailing Measures, Elements of the

363. Thus, the negotiating history supports the above understanding of the ordinary meaning of Article 2.1: An inability to find *de jure* non-specificity – that is, an inability to find that the subsidy at issue is, in the EC’s words, a “general measure {} designed to stimulate economic activity as a whole” – should lead to further analysis to determine whether this “reason to believe that the subsidy may in fact be specific” is confirmed by an examination of other factors.

364. Finally, a finding that a subsidy is neither *de jure* specific within the meaning of Article 2.1(a) of the SCM Agreement nor *de jure* non-specific within the meaning of Article 2.1(b) has no effect whatsoever on an analysis of whether it is specific within the meaning of Article 2.2 (pertaining to regional specificity).<sup>451</sup>

**119. Article 2.1(c) indicates that in assessing whether a particular subsidy is *de facto* specific, one factor that may be considered is “the granting of disproportionately large amounts of subsidy to certain enterprises”. In general terms, how should the question of “disproportionality” be assessed? What must the “amounts of subsidy to certain enterprises” be compared with in order to determine whether they are “disproportionately large”? To what extent do the parties consider that the last sentence of Article 2.1(c) has a role to play in this assessment?**

Response:

365. To determine whether the amounts of subsidy granted to certain enterprises are “disproportionately large” one first must establish a baseline against which to measure disproportionality. An amount is disproportionate if it is “{}acking proportion; poorly proportioned; out of proportion (*to*); relatively too large or too small.”<sup>452</sup> A baseline, therefore, must indicate when an amount has proportion or is in proportion. That occurs when the amount constitutes an appropriate share of a whole<sup>453</sup> – in this case, when the relationship between the subsidy to “certain enterprises” as defined in Article 2.1 of the SCM Agreement and subsidies to

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Framework for Negotiations, MTN.GNG/NG10/W/33 (Nov. 30, 1989) (suggesting as test for “specificity” should be that “the measure should not be generally available”); Submission by Australia, Negotiating Group on Subsidies and Countervailing Measures, Elements of the Framework for Negotiations, MTN.GNG/NG10/W/32 (Nov. 30, 1989) (“The principle basis for a measure being non-countervailable should be general availability.”).

<sup>451</sup> In its first written submission (*e.g.*, para. 733), the EC set out an argument about the relationship between Articles 2.2 and 2.1 that is incorrect, for reasons the United States discussed in its first oral statement (paras. 90-94). The United States does not understand the Panel in this question to be focused on the relationship between Articles 2.2 and 2.1 and, therefore, the United States will not address that issue in more detail here, but will do so in its second written submission.

<sup>452</sup> *Shorter Oxford English Dictionary*, vol. 1, p. 708 (5<sup>th</sup> ed.).

<sup>453</sup> See *Shorter Oxford English Dictionary*, vol. 2, pp. 2370 & 2371 (5<sup>th</sup> ed.) (definitions of “proportionate” and “proportion”).

all enterprises in the baseline group is comparable to the relationship between the certain enterprises and all enterprises in the group (measured by indicators that are appropriate in light of the circumstances, which could include economic output, employment, or other indicators).

366. With respect to identifying the appropriate baseline, the United States refers to its responses to Questions 13, 14, and 15, above. There, the United States notes that identifying a relevant baseline is fact-dependent. In the first instance, such identification should reflect the manner in which the authority providing the subsidy classifies its activities. If, for example, the context is a loan provided pursuant to a “dedicated ... lending programme” – as is the case with the 2002 loan the EIB provided to EADS for A380 development pursuant to the EIB’s i2i program<sup>454</sup> – a relevant baseline would be all lending under the program. Absent a discrete program, other ways in which the entity providing the subsidy classifies its provision of subsidies should be examined. For example, if the entity classifies subsidies by economic sector or by policy objective, it would be appropriate to consider the amount of subsidy at issue in relation to these categories, as the United States has done with respect to the EIB loans provided to Airbus from 1988 to 1993.

367. An additional element in identifying the relevant baseline is the element of time. This is indicated by the last sentence in Article 2.1(c) of the SCM Agreement, which calls for taking account of “the length of time during which the subsidy programme has been in operation.” As the United States indicated in its response to Question 13, above, this does not mean (as the EC argues) that one must compare the amount of subsidy at issue to all subsidies granted during the entire life of the program. Such an approach would render a disproportionality analysis meaningless in the case of subsidies granted under the auspices of programs that have been in place for decades. Reading the last sentence of Article 2.1(c) in a way that would make a finding of disproportionality – and, hence, specificity – virtually impossible would be contrary to the context provided by the rest of subparagraph (c), which sets out principles to be applied when “there are reasons to believe that the subsidy may in fact be specific” “notwithstanding any appearance of non-specificity resulting from the application of the principles {pertaining to *de jure* specificity}.”

368. Therefore, when a subsidy program has been in operation for a relatively long period of time, taking account of that fact means identifying a shorter period for analysis that will lead to a more meaningful assessment of disproportionality than an assessment based on all subsidies granted during the entire life of the program.

369. Having identified the baseline against which to compare the amount of subsidy at issue, the question is how the certain enterprises receiving the subsidy at issue compare to other

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<sup>454</sup> *The Innovation 2000 Initiative, Actively promoting a European economy based on knowledge and innovation*, European Investment Bank, at 3 (Exhibit US-154).

enterprises in the baseline being examined. As noted above, here one would look to indicators that are appropriate in light of the circumstances. This analysis should lead to a proportion representing the relation of the certain enterprises at issue to the entirety of enterprises covered by the baseline being examined. The subsidy granted to certain enterprises constitutes an appropriate share of the relevant baseline if its relationship to the baseline corresponds to the relationship of certain enterprises to the entire group of enterprises covered by the baseline being examined. If the subsidy granted to certain enterprises bears that relationship to the baseline, then it is proportionate; if it does not, then it is disproportionate.

370. Applying these principles, the 2002 EIB loan to EADS for A380 research and development, for example, was disproportionately large. As discussed in response to Questions 13 and 14, above, the Euro 700,000,000 loan was the single largest loan to any one company under the EIB's i2i program, representing one-third of its lending for research and development under i2i in 2002, and 18% of its lending for research and development under i2i since the program's inception in 2000.<sup>455</sup> These facts take on particular significance in light of the relatively high degree of economic diversification within the EC (evidenced, for example, by the range of activities receiving financing under the i2i program),<sup>456</sup> supporting the conclusion that the 2002 loan is *de facto* specific under Article 2.1(c) of the SCM Agreement.

## B. BENEFIT PASS-THROUGH

120. In *US - Upland Cotton* the Appellate Body made the following statement:

**“As we have already noted, the requirement in Article VI:3 of the GATT 1994 and Article 19.4 of the SCM Agreement that countervailing duties on a product be limited to the amount of the subsidy accruing to that product finds no parallel in the provisions on actionable subsidies and pertinent remedies under Part III of the SCM Agreement. Therefore, the need for a ‘pass-through’ analysis under Part V of the *SCM Agreement* is not critical for an assessment of significant price suppression under Article 6.3(c) in Part III of the *SCM Agreement*. Nevertheless, we acknowledge that the ‘subsidized product’ must be properly identified for purposes of significant price suppression under Article 6.3(c) of the SCM Agreement. And if the challenged payments do not, in fact, subsidize that product, this may undermine the conclusion that the effect of the subsidy is significant”**

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<sup>455</sup> See Overview of i2i loans (Exhibit US-474); European Investment Bank, Annual Press Conference 2003, Background Note No. 1: Innovation and Knowledge-Based Economy (Exhibit US-164); The EIB Group, Activity Report 2002, at 14 (stating that “{i}n 2002, the EIB ploughed 2.1 billion into 15 R&D projects spanning 6 EU countries”) (Exhibit US-165).

<sup>456</sup> See Overview of i2i loans (Exhibit US-474).

**suppression of prices of that product in the relevant market.”<sup>457</sup> (Underline added)**

**121. To what extent do the parties consider that the Appellate Body’s statement is equally relevant to demonstrating: (i) the existence of injury to the domestic industry of another Member, for the purpose of Article 5(a) of the SCM Agreement; and (ii) that the effect of the subsidy is to displace or impede the imports or exports of the like product, for the purpose of Article 6.3(a) and 6.3(b) of the SCM Agreement? In other words, to what extent is it necessary to ensure that the “challenged payments do ... , in fact, subsidize {the relevant} product” when demonstrating the existence of the “adverse effects” envisaged under Articles 5(a), 5(c), 6.3(a) and 6.3(b) of the SCM Agreement? If such a demonstration is necessary, how can it be done?**

Response:

371. The United States agrees that, in order to demonstrate adverse effects, it must be shown that a subsidy benefits a subsidized product. The United States considers that it has done so in this dispute.

372. In particular, the United States understands the referenced passage from the Appellate Body report in *US – Cotton Subsidies* to mean that the calculation of the amount of the benefit attributable to particular products or producers serves different functions in the countervailing duty and actionable subsidy contexts. With respect to countervailing duties, such a calculation may be required in some instances because of the requirement in Article 19.4 of the SCM Agreement not to levy a countervailing duty “in excess of the amount of the subsidy found to exist, calculated in terms of subsidization per unit of the subsidized and exported product.” No parallel to this requirement appears in Part III of the SCM Agreement.

373. Rather, the Appellate Body considered that in the adverse effects context, while the existence, magnitude, and nature of the benefit to the subsidized product is certainly relevant to determining whether “the effect of the subsidy is ... serious price suppression” within the meaning of Article 6.3(c), a precise allocation of the benefit to particular products or producers is not necessarily required for such a determination. As the Appellate Body’s reasoning is not limited to any one particular type of adverse effect described in Part III, this reasoning would appear to apply equally to all forms of adverse effects.

374. Moreover, as the Appellate Body pointed out, the factual situation in *US – Cotton Subsidies* was different from that in *US – Softwood Lumber CVD*.<sup>458</sup> In the latter case, the

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<sup>457</sup> *US – Cotton Subsidies (AB)*, para. 472.

<sup>458</sup> *US – Cotton Subsidies (AB)*, para. 471 & note 640.

Appellate Body had found that it was necessary to determine whether a portion of the subsidy benefit should be attributed to logs or lumber, because the United States had imposed countervailing duties on softwood lumber, but *not* softwood logs, from Canada.<sup>459</sup> In *US – Cotton Subsidies*, by contrast, the Appellate Body found that a precise analysis of the amount of subsidy attributable to various stages in the processing of upland cotton was of relevance only to the extent that it materially impacted the analysis of the effect of the subsidy with respect to the subsidized product (U.S. upland cotton lint) on prices for the like product (Brazilian upland cotton lint).<sup>460</sup>

375. In this dispute, all of the subsidies were provided to the Airbus companies to benefit the production of Airbus LCA. The reasoning of the Appellate Body in *Cotton* would indicate that the allocation of the subsidy among the various Airbus companies is not relevant, in that it does not materially impact the analysis of the effect of the subsidy with respect to the subsidized Airbus LCA on the like Boeing LCA.

**122. Under what circumstances do the parties consider that a subsidy granted to one company may or may not benefit the activities of a successor company that has taken over the predecessor company’s operations in precisely the same business segment?**

Response:

376. The United States understands the Panel’s question to address the issue of extinction of subsidies. The only context in which prior panels and the Appellate Body have considered the possible extinction of subsidies as a result of a transfer of operations from one owner to another is disputes under part V of the SCM Agreement – *i.e.*, in the countervailing duty (CVD) area. In that context, panels and the Appellate Body have found that a subsidy granted to one company might not benefit the activities of a successor company that has taken over the predecessor company’s operations in precisely the same business segment in only one very particular set of circumstances: when all or substantially all of the predecessor’s interest in the company is sold to the successor in an arm’s-length, fair-market-value transaction involving a relinquishment of control by the predecessor.<sup>461</sup> The present dispute does not relate to countervailing duties and, in any event, none of the transactions described by the EC in its “extinction” and “extraction” arguments meet the criteria found to result in extinction of subsidies in the CVD context.<sup>462</sup>

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<sup>459</sup> *US – Softwood Lumber CVD (AB)*, para. 147.

<sup>460</sup> *US – Cotton Subsidies (AB)*, para. 471 & note 640.

<sup>461</sup> See panel and Appellate Body reports discussed in response to Question 56, *supra*.

<sup>462</sup> See U.S. FOS, paras. 117-121.

377. In circumstances other than those just described, the United States believes that a subsidy granted to one company does benefit the activities of a successor company that has taken over the predecessor company's operations in precisely the same business segment. This is the case, for example, if the transfer of ownership was not at arm's length and for fair market value, if the original owner has transferred less than all or substantially all of its interest in the company, or if the original owner has retained a degree of control over the company's operations.

378. If establishment of the successor company represents nothing more than "a restructuring and rationalisation of the existing legal relationship"<sup>463</sup> between the subsidy recipients themselves, then there is no basis for finding that the subsidy does not benefit the successor company. The fact that as a formal matter the subsidized operations of several different companies whose productive activities already had been integrated at the time the subsidies were granted are regrouped under a single corporate roof does not cause the benefit of those subsidies to remain outside the new corporation (let alone disappear entirely). This certainly is the case if the regrouping does not affect "the quality or nature of control"<sup>464</sup> of the previously integrated, subsidized operations.

379. Of course, the latter circumstances are precisely the circumstances that led the Airbus LCA operations of DASA, Aérospatiale-Matra, CASA, and BAES – originally "integrated" through Airbus Industries GIE<sup>465</sup> – to be integrated through Airbus SAS.<sup>466</sup> Accordingly, the subsidies granted to the predecessor entities benefit Airbus SAS.

380. The United States understands the Panel's question to be related to the EC's repeated allegation that the United States has not shown that certain subsidies received by enterprises that were predecessors to Airbus SAS "passed through" to Airbus SAS. Accordingly, the United States takes this opportunity to explain why that argument is baseless.

381. The EC's "pass through" argument and its separate but related "extinguishment" argument are based on the false premise that in a dispute under part III of the SCM Agreement, where the complaining party has shown that subsidies within the meaning of Article 1 were provided to enterprises producing the merchandise at issue (here, LCA), and where those enterprises later undergo a restructuring of their relationship to one another, "it is necessary . . .

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<sup>463</sup> Commission of the European Communities, Merger Procedure Article 6(1)(b) Decision, Case No COMP/M.2061 - Airbus, para. 6 (Oct. 18, 2000) (Exhibit US-478).

<sup>464</sup> European Commission, Merger Procedure Article 6(2) Decision, Case No COMP/M.1745 - EADS, para. 16 (May 11, 2000) (Exhibit US-479).

<sup>465</sup> European Commission, Merger Procedure Article 6(2) Decision, Case No COMP/M.1745 - EADS, para. 15 (May 11, 2000) (Exhibit US-479).

<sup>466</sup> See U.S. FWS, paras. 39-43.

to identify the precise recipients” of the subsidies at issue.<sup>467</sup> In other words, in the EC’s view, even where a complaining party has shown that a subsidy was provided to an enterprise producing the merchandise at issue, the party must make an additional showing to account for continuity of the subsidy over time, following each change in the enterprise’s relationship to other subsidized enterprises. In fact, as discussed in response to Question 16, above, the SCM Agreement contains no such requirement.

382. The EC’s belief to the contrary evidently stems from its misreading of brief passages in the Appellate Body reports in *Canada - Aircraft* and *US - Lead Bars*.<sup>468</sup> Neither report supports the EC’s position. In *Canada - Aircraft*, the Appellate Body’s statement that “{t}he term ‘benefit’ . . . implies that there must be a recipient”<sup>469</sup> did not mean that there is an obligation on the part of either the complainant or the panel to account for the continuity of subsidies to enterprises producing the merchandise at issue and “to identify the precise recipients” of the subsidies over time, following each change in corporate organization. The statement was simply part of the Appellate Body’s explanation of its finding that in determining whether a subsidy within the meaning of Article 1 of the SCM Agreement had been provided, the panel was correct to consider the benefit to the recipient rather than the cost to the government.<sup>470</sup>

383. As for the Appellate Body report in *US - Lead Bars*, its inability to support the EC’s position is evident from the very excerpt the EC quotes at paragraph 160 of its first written submission. The reason the Appellate Body found it “necessary to determine whether there was any ‘benefit’” to particular companies in that dispute was “to determine whether any subsidy was bestowed on the production by {those companies} of leaded bars imported into the United States. . . .”<sup>471</sup> In other words, this was a countervailing duty (CVD) dispute under part V of the SCM Agreement, in which the relevant question was whether particular goods imported into the United States benefitted from subsidies and, if so, what amount of countervailing duty should be imposed on each entry of the good in order to offset those subsidies. It was *not* a dispute under part III, in which the relevant question would have been whether the EC was causing adverse effects to the interests of the United States through the use of subsidies.

384. While there may be a need for a “pass-through” analysis in other contexts – such as the CVD context (where there is a need to quantify the subsidy attributable to particular entries of a good from a particular producer), or the context of a claim involving a subsidy provided directly to a company that does not produce, and is not related to a producer of, the product at issue

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<sup>467</sup> EC FWS, para. 161. See U.S. Response to Question 16, *supra*.

<sup>468</sup> See EC FWS, paras. 159-160.

<sup>469</sup> *Canada - Aircraft (AB)*, para. 154 (quoted in EC FWS, para. 159).

<sup>470</sup> *Canada - Aircraft (AB)*, para. 156.

<sup>471</sup> *US - Lead Bars (AB)*, para. 58 (quoted in EC FWS, para. 160).

(where there is a need to establish that it is subsidies benefitting the merchandise at issue that are causing adverse effects) – there is no such need in the context of determining whether subsidies provided directly to the producers of the merchandise at issue are causing adverse effects to the interests of other Members.

385. In short, to resolve this dispute the Panel need not decide whether subsidies granted to one company “benefit the activities of a successor company that has taken over the predecessor company’s operations in precisely the same business segment.” The United States has demonstrated as a factual matter that the Airbus governments provide subsidies to Airbus LCA development and production, which activities previously were carried out by companies integrated through Airbus GIE and now are integrated through Airbus SAS.<sup>472</sup> What is relevant to addressing the U.S. claims is that these subsidies have caused and continue to cause adverse effects to the interests of the United States. The fact that the subsidized entities reorganized their relationship to one another has no bearing on the issue of adverse effects, because establishing that the EC is causing adverse effects to the interests of the United States through the use of subsidies to LCA development and production does not require identifying the particular enterprises in which those subsidies reside, as an accounting matter, at any given point in time.

### C. REMEDY

**123. Assuming that a subsidy that has been repaid or otherwise extinguished is found to cause “adverse effects”, what are the parties’ views on how the remedy foreseen in Article 7.8 of the SCM Agreement might be implemented?**

Response:

386. Preliminarily, the United States notes that this question assumes facts not presented by this dispute. For reasons discussed in the U.S. oral statement at the first Panel meeting<sup>473</sup> and in response to Questions 16, 56, and 122 above, the EC’s contention that subsidies to Airbus have been extinguished is baseless. Transactions that involved the sale of less than all or substantially all of a subsidized enterprise, did not result in a complete relinquishment of the seller’s control and/or did not occur at arm’s length and for fair market value did not cause subsidies to be extinguished. Nor were subsidies “extracted” as the result of the movement of cash from a subsidized entity to a related entity.

387. Furthermore, the question of how the remedy foreseen in Article 7.8 of the SCM Agreement might be implemented may be a question for an eventual compliance panel and need not be addressed in order to resolve the present dispute. Article 7.8 expressly contemplates two

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<sup>472</sup> See U.S. Response to Question 16, *supra*.

<sup>473</sup> U.S. FOS, paras. 115-125.

distinct steps. The first step is the adoption of a panel or Appellate Body report “in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member within the meaning of Article 5.” As the Appellate Body explained in *US - Cotton Subsidies*, “The use of the word ‘resulted’ suggests that there could be a time-lag between the payment of a subsidy and any consequential effects.”<sup>474</sup> For this very reason, it agreed with the panel that expired subsidy measures that continue to cause adverse effects could be challenged in WTO dispute settlement.<sup>475</sup>

388. The second step under Article 7.8 is for the Member granting or maintaining the subsidy at issue to “take appropriate steps to remove the adverse effects” or “withdraw the subsidy.” The first and second clauses are independent of one another. Article 7.8 does not contemplate a determination that a subsidy has resulted in adverse effects to the interests of another Member only when both of the potential remedies are still available.

389. Moreover, the EC is incorrect to suggest that in the situation envisioned by this question the Panel would be entitled to make findings but not recommendations.<sup>476</sup> That view is contradicted by the Appellate Body’s explanation in *US - Cotton Subsidies* that “{i}f expired measures underlying past payments could not be challenged in WTO dispute settlement proceedings, it would be difficult to seek a remedy for such adverse effects {i.e., adverse effects resulting from past payments}.”<sup>477</sup> The Appellate Body’s recognition that a Member may “seek a remedy” in this situation implies that a remedy may indeed be recommended when a Member successfully challenges a past payment causing adverse effects.

390. Finally, it must be recalled that the United States is challenging multiple EC subsidies to Airbus. These subsidies operate together to enable Airbus to develop LCA products it would not otherwise have been able to develop and to cause adverse effects to the interests of the United States. As the panel in *US - Cotton Subsidies* explained, “a serious prejudice analysis may be integrated to the extent appropriate in light of the facts and circumstances of a given case.”<sup>478</sup>

**124. To what extent is it possible for a panel to rule that a subsidy is prohibited under Article 3 of the SCM Agreement and, at the same time, recommend that the subsidy be withdrawn without delay under Article 4.7 of the SCM Agreement, when that subsidy has been repaid or otherwise extinguished?**

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<sup>474</sup> *US - Cotton Subsidies (AB)*, para. 273.

<sup>475</sup> *US - Cotton Subsidies (AB)*, para. 273.

<sup>476</sup> EC FWS, para. 288.

<sup>477</sup> *US - Cotton Subsidies (AB)*, para. 273.

<sup>478</sup> *US - Cotton Subsidies (Panel)*, para. 7.1192; see also *Korea - Commercial Vessels (Panel)*, para. 7.616 (panel finding that it is not “legally bound to separately determine the degree of price suppression or price depression that may be caused by each of these subsidies individually”).

Response:

391. First, as is the case with Question 123, the factual premise for this question is absent in this dispute. The EC has not demonstrated – and, indeed, cannot demonstrate – that any of its prohibited subsidies have been repaid or otherwise extinguished. As discussed in the U.S. responses to Questions 16, 56, and 122, and in the U.S. oral statement at the first Panel meeting,<sup>479</sup> the EC’s theory with respect to extinction lacks any support in the panel and Appellate Body reports on which it relies, not to mention the text of the SCM Agreement. The EC argues without any basis that subsidies are extinguished through sales transactions that involve less than all or substantially all of the seller’s interest in an enterprise, did not result in a complete relinquishment of the seller’s control, and/or did not occur at arm’s length and for fair market value.

392. Likewise, the EC offers no support for its theory that the movement of cash from a subsidized entity to its owner results in the elimination of subsidy equal to the amount of the transfer. It asserts without explanation that these transactions are analogous to the arm’s-length, fair-market-value transactions at issue in prior disputes involving privatizations. And, its theory ignores findings by the panels and the Appellate Body in those disputes (findings that the EC vigorously supported as complainant in those disputes) that in analyzing the benefit conferred by a subsidy no distinction should be made between a subsidized entity and the owner of that entity.<sup>480</sup>

393. Moreover, any suggestion that the EC’s prohibited subsidies to Airbus for development of the A380 have been repaid or otherwise extinguished is especially implausible, given that disbursements pursuant to Launch Aid contracts for the A380 are still being made; all or nearly all of those disbursements that have been made were made after the creation of EADS and Airbus SAS; and none of the Launch Aid for the A380 has been repaid (since repayments are tied to deliveries, none of which have yet occurred).<sup>481</sup>

<sup>479</sup> U.S. FOS, paras. 115-125.

<sup>480</sup> See *US - Lead Bars (Panel)*, para. 6.82 (“In the context of privatizations negotiated at arm’s length, for fair market value, and consistent with commercial principles, the distinction between a company and its owners is redundant for the purpose of establishing ‘benefit.’”); *US - Countervailing Measures (Panel)*, para. 7.50 (“SCM Agreement does not make any reference or any distinction between shareholders and the company when it discusses the need to establish the benefit”); *id.*, para. 7.54 (“We conclude that, for the purpose of the benefit determination under the SCM Agreement, no distinction should be made between a company and its shareholders, as together they constitute a producer, a natural or legal person that may be the ‘recipient’ of the benefit to be assessed”); *US - Countervailing Measures (AB)*, paras. 110-115.

<sup>481</sup> In particular, under the [ ] the government is obligated to make disbursements through [ ]. [ ] Under the [ ]

394. As a theoretical matter, if it were found that a prohibited subsidy had been repaid or otherwise extinguished, that would not affect the Panel’s duty, upon finding the subsidy to be prohibited under Article 3, to recommend that the EC withdraw the subsidy without delay. Article 4.7 of the SCM Agreement prescribes a particular recommendation that a panel “shall” make “{i}f the measure in question is found to be a prohibited subsidy.” The possibility that the prohibited subsidy may have been repaid or otherwise extinguished is a matter that the EC might raise with respect to implementation, but it has no bearing on the recommendation the Panel must make under Article 4.7.

**D. TEMPORAL SCOPE**

**125. Assuming, *arguendo*, that each of the challenged measures, that the EC contends lie outside of the temporal scope of the SCM Agreement, was indeed a specific subsidy within the meaning of Articles 1 and 2 of the SCM Agreement, what are the principles that should be taken into account and applied when determining the extent and duration of the benefit associated with each such measure?**

Response:

395. First, it must be noted that the benefit associated with a particular measure is different from the adverse effects caused by the EC through its use of that measure.<sup>482</sup> The key question under Article 5 of the SCM Agreement is whether the EC is causing adverse effects to the interests of the United States through the use of certain subsidies to Airbus. While the benefit conferred by a subsidy and the adverse effects the EC causes through its use of a subsidy may be related, they are separate factors. The Panel should not assume that the extent and duration of the adverse effects caused by a subsidy are identical to the extent and duration of the benefit associated with the subsidy. Since the Panel poses this question under the “Temporal Scope” heading, the United States notes that to find that the EC is in breach of its obligation under Article 5 at the relevant time, the Panel must find that the EC is causing adverse effects at that time through the use of a subsidy.<sup>483</sup>

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]. [ ] Under the [ ] the government is obligated to  
make disbursements through [ ]. [ ]

<sup>482</sup> *US - Cotton Subsidies (AB)*, para. 480 (“‘effect’ of a subsidy cannot be equated with the ‘benefit’ of a subsidy”).

<sup>483</sup> See U.S. Answers to Panel Questions Regarding Temporal Scope, paras. 1-6 (Dec. 18, 2006); *id.*, paras. 12-13.

396. The panel and Appellate Body underscored this point in *US - Cotton Subsidies*. In particular, the panel explained that the fact that subsidies had been provided before the establishment of the panel did not mean that the subsidies had “expired, but simply occurred in the past, which will be true of most subsidies challenged in a claim of actual serious prejudice.”<sup>484</sup> The panel observed that subsidies provided in the past could have “lasting adverse effects” beyond the immediate period in which they were provided and proceeded to assess the extent to which the payments challenged by Brazil in that dispute were having such effects.<sup>485</sup> The Appellate Body agreed with the panel’s reasoning and with the notion that there could be a “time-lag between the payment of a subsidy and any consequential adverse effects.”<sup>486</sup> At the same time, Article 5 is clear that the adverse effects must be caused by the “use of” the subsidy. Accordingly, the subsidy must still “exist” in order for its “use” to be causing adverse effects.

397. Later in its report, the Appellate Body contrasted the different rationales for parts III and V of the SCM Agreement and reasoned that because part III “targets the effects of the subsidy more generally” (as opposed to part V, which focuses on “individual companies”), “{a} precise, definitive quantification of the subsidy is not required.”<sup>487</sup>

398. The Appellate Body in *Cotton* did indicate that “a panel should have regard to the magnitude of the challenged subsidy and its relationship to prices of the product in the relevant market when analyzing whether the effect of a subsidy is significant price suppression.”<sup>488</sup> Accordingly, the United States has demonstrated the magnitude of the EC subsidies challenged in this dispute. However, the Panel need not determine the extent and duration of the benefit associated with each subsidy.

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<sup>484</sup> *US - Cotton Subsidies (Panel)*, para. 7.110. According to the panel in *US - Cotton Subsidies*: ““{A}t any given moment in time some payments of subsidies have occurred in the past while others have yet to occur in the future. If we were to consider that past subsidies were not relevant to our serious prejudice analysis as they were “expired measures” while future measures could not yet have caused actual serious prejudice, it is hard to imagine any situation where a panel would be able to determine the existence of actual serious prejudice.” *Id.* (quoting *Indonesia – Autos (Panel)*, para. 14.206).

<sup>485</sup> *US - Cotton Subsidies (Panel)*, paras. 7.1201 and 7.1107-7.1416.

<sup>486</sup> *US - Cotton Subsidies (AB)*, para. 273.

<sup>487</sup> *US - Cotton Subsidies (AB)*, paras. 464-467; *US - Cotton Subsidies (Panel)*, para. 7.1173 (rejecting notion of quantifying subsidy for purposes of serious prejudice analysis because “{b}roader considerations are at play in a serious prejudice analysis than those involved in a countervailing duty sense”).

<sup>488</sup> *US - Cotton Subsidies (AB)*, para. 467.

399. If the Panel determined, nevertheless, that as part of its analysis it should quantify the extent and duration of certain subsidies, it should apply the principles set forth in the U.S. comment on the EC's answer to the Panel's Question 3 on the EC's preliminary ruling request.<sup>489</sup>

**126. Assuming, *arguendo*, that any subsidy granted prior to the entry into force of the WTO Agreement could properly fall within the scope of Article 5 of the SCM Agreement when it continued to confer a benefit beyond 1 January 1995, should the full benefit pre- and post-1995 be taken into account for the purpose of determining the existence of adverse effects under Article 5 of the SCM Agreement, or should only the benefit that occurred post-1995 be taken into account for this purpose?**

Response:

400. Article 5 of the SCM Agreement imposes an obligation on Members not to “cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members.” This obligation undertaken by Members extends to the causing of adverse effects through the use of “any” specific subsidy as defined in the SCM Agreement. Further, as the Appellate Body stated in *US – Cotton Subsidies*, “the ‘effect’ of a subsidy cannot be equated with the ‘benefit’ of a subsidy.”<sup>490</sup>

401. These principles confirm that there is no legal rule that would insulate any portion of post-1995 adverse effects from the obligations of Part III simply because some portion of the subsidy benefit is allocated to a period before 1995.

**E. 1992 AGREEMENT**

**127. The fifth recital to the 1992 Agreement appears to note that the parties’ intention in entering and applying that Agreement was “to act without prejudice to their rights and obligations under the GATT and under other multilateral agreements negotiated under the auspices of the GATT”. Please explain how the Panel should understand this recital and its effect, if any, on the arguments in this case.**

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<sup>489</sup> U.S. Comments on EC Answers to Panel's Questions Concerning Temporal Scope of SCM Agreement, paras. 17-34 (Dec. 21, 2006).

<sup>490</sup> *US – Cotton Subsidies (AB)*, para. 480.

Response:

402. For the reasons the United States discussed in opposing the EC’s preliminary ruling requests, the 1992 agreement does not prescribe rules governing the present dispute. Nor does it provide relevant context for interpreting the applicable rules under the SCM Agreement.<sup>491</sup>

403. Further, even if the 1992 agreement were relevant (which it is not), the fifth recital makes it unmistakable that the agreement does not affect the actionability of EC subsidies under the SCM Agreement.<sup>492</sup> In expressing their intention “to act without prejudice to their rights and obligations under the GATT and under other multilateral agreements negotiated under the auspices of the GATT,” the United States and the EC expressly preserved their respective rights under the GATT and other multilateral agreements negotiated under its auspices, including the right to pursue dispute settlement under those agreements.<sup>493</sup>

404. The agreements negotiated in the Uruguay Round of Multilateral Trade Negotiations – including the SCM Agreement – are encompassed by the phrase “multilateral agreements negotiated under the auspices of the GATT.” Thus, the Ministerial Declaration launching the Uruguay Round stated that the Contracting Parties to the GATT 1947 “DECIDE to enter into Multilateral Trade Negotiations on trade in goods within the framework and under the aegis of the General Agreement on Tariffs and Trade.”<sup>494</sup> Accordingly, the fifth recital to the 1992 agreement confirms that the agreement does not prejudice the rights of the United States under the SCM Agreement.

405. In fact, the EC acknowledges that the fifth recital “may be read as preserving the right of either side to challenge even pre-1992 measures in the GATT context, including under the future dispute settlement system of the WTO.”<sup>495</sup> However, it then attempts to argue against that reading by making reference to Articles 2 and 10.1 of the 1992 agreement. Specifically, it contends that Article 10.1 “safeguarded a possibility to challenge post-1992 measures if this were unavoidable under the WTO dispute settlement system,” and this was what was contemplated by the “without prejudice” clause. The EC further contends that pre-1992

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<sup>491</sup> See U.S. Response to EC PRR, paras. 96-98 (Nov. 15, 2006); U.S. Response to Updated EC PRR, paras. 41-45 (Nov. 29, 2006); see also U.S. FOS, paras. 33-34.

<sup>492</sup> See U.S. Response to Updated EC PRR, para. 47 and note 44 (Nov. 29, 2006).

<sup>493</sup> See U.S. Response to Updated EC PRR, note 44 (discussing explanation by the panel in *US - FSC* of the “without prejudice” clause in footnote 59 to the SCM Agreement).

<sup>494</sup> Ministerial Declaration on the Uruguay Round, MIN.DEC, Part I, 6<sup>th</sup> recital (Sep. 20, 1986); see also *id.* at p. 7 (establishing negotiating group to deal with subsidies and countervailing measures).

<sup>495</sup> EC Updated PRR, para. 59 (Nov. 7, 2006).

measures were not covered by Article 10.1 (and hence by the “without prejudice” clause) because any claims regarding such measures had been settled under article 2.<sup>496</sup>

406. This understanding of the “without prejudice” clause read together with Articles 2 and 10.1 does not hold up under scrutiny. Contrary to the EC’s view, Article 2 did not “exempt {}” pre-1992 measures “from any further action of either side in the GATT/WTO context.”<sup>497</sup> It simply made such measures “not subject to the provisions of *this* Agreement” (*i.e.*, the 1992 agreement). And, Article 10.1 did not deal with WTO disputes but with disputes under national trade laws, as the subsequent paragraphs in Article 10 make clear.<sup>498</sup>

407. As the EC’s reading of Articles 2 and 10.1 is incorrect, its reading of the fifth recital’s “without prejudice” clause in light of those articles also is incorrect. The only logical reading of the clause – the only one consistent with its ordinary meaning – is the one that the EC acknowledges to exist “{a}t first sight.” That is, it “preserv {es} the right of either side to challenge even pre-1992 measures in the GATT context, including under the future dispute settlement system of the WTO.”<sup>499</sup>

#### **F. ADVERSE EFFECTS**

**128. What is the relevance of footnote 46 of the SCM Agreement to the question of how to define the “subsidized product” and the “like product” for the purpose of an adverse effects analysis under Articles 5(a) and 5(c) of the SCM Agreement?**

Response:

408. Footnote 46 of the SCM Agreement provides:

Throughout this Agreement the term “like product” (“produit similaire”) shall be interpreted to mean a product which is identical, *i.e.* alike in all respects to the product under consideration, or in the absence of such a product, another product which, although not alike in all respects, has characteristics closely resembling those of the product under consideration.

<sup>496</sup> EC Updated PRR, paras. 61-62. The EC repeated this argument at the Panel’s first substantive meeting with the parties.

<sup>497</sup> EC Updated PRR, para. 58.

<sup>498</sup> See U.S. Response to EC Updated PRR, paras. 48-51.

<sup>499</sup> EC Updated PRR, para. 59.

Footnote 46 thus defines the term “like product” with reference to the “product under consideration.” Neither footnote 46 nor any other provision of the SCM Agreement defines the term “product under consideration.”

409. A material injury analysis under Article 5(a) incorporates the concept of “injury to the domestic industry of another Member” as that term is used in Part V of the SCM Agreement.<sup>500</sup> It is clear from the definition of material injury in Article 15 (which is found in Part V) that the “like product” is to be defined with reference to the “subsidized imports.” For example, Article 15.1 provides for an objective examination of, *inter alia*, “the effect of *subsidized imports* on prices in the domestic market for *like products*.”<sup>501</sup> For purposes of Article 5(a), therefore, the “product under consideration” is the “subsidized imports,” and footnote 46 defines the “like product” with reference to the “subsidized imports.”

410. Likewise, a serious prejudice analysis under Article 5(c) that relies on the concept of “like product” does so with reference to a “subsidized product.” For example, Article 6.3(c) provides that serious prejudice may arise when “the effect of the subsidy is a significant price undercutting by the *subsidized product* as compared with the price of a *like product* of another Member in the same market.”<sup>502</sup> Even where the term “like product” is used without a direct referent, as for example in Article 6.3(a) or Article 6.3(b), the reference to the “effect of the subsidy” makes clear that the “like product” is to be defined with reference to the subsidized product – that is, the product of the subsidizing Member that is affected by the subsidies.

411. Footnote 46 therefore provides that the term “like product” is to be defined with reference to the “product under consideration,” which for purposes of Article 5(a) is the “subsidized imports” and for purposes of Article 5(c) is the “subsidized product.” However, footnote 46 in itself provides no guidance as to how the “subsidized imports” or “subsidized product” is to be defined. In particular, footnote 46 does not require that each item within the “subsidized product” must be a “like product” to each other item within the “subsidized product.” Indeed, the panel in *US – Softwood Lumber Dumping* specifically rejected the view that Article 2.6 of the Antidumping Agreement

requires that each individual item within the “like product” must be “like” each individual item within the “product under consideration.” This in effect {would mean} that there must be “likeness” within both the product under consideration and within the like product.<sup>503</sup>

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<sup>500</sup> SCM Agreement, note 11.

<sup>501</sup> Emphasis added.

<sup>502</sup> Emphasis added.

<sup>503</sup> *US – Softwood Lumber Dumping (Panel)*, para. 7.157.

As the text of footnote 46 is identical to that of Article 2.6 of the Antidumping Agreement, footnote 46 equally cannot be read to require that each and every item within the “product under consideration” must be a “like product” to every other such item.

**129. Do the parties consider that jurisprudence under the AD Agreement, and Article III of the GATT, concerning the product under consideration / like product is relevant to identifying the “subsidized product” and the “like product” for the purpose of an adverse effects analysis under Articles 5(a) and 5(c) of the SCM Agreement?**

Response:

412. The Appellate Body has explained that the identification of a “like product” in any given case must take into account the particular legal provision at issue as well as the specific facts of the case:

The concept of “likeness” is a relative one that evokes the image of an accordion. The accordion of “likeness” stretches and squeezes in different places as different provisions of the WTO Agreement are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term “like” is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply.<sup>504</sup>

Therefore, as a general matter, panel and Appellate Body reports interpreting the concept of “like product” in other agreements and for other purposes are, at most, of indirect relevance to identifying the “subsidized product” and “like product” for purposes of Part III of the SCM Agreement.

413. However, several factors suggest that interpretations of Article 2.6 of the Antidumping Agreement may have more direct relevance in determining the meaning of “like product” for an adverse effects analysis under the SCM Agreement. First, footnote 46 of the SCM Agreement provides that the definition of “like product” applies “{t}hroughout this Agreement” – that is, it applies equally to adverse effects claims under Part III and countervailing duty proceedings under Part V. Second, the text of Article 2.6 of the Antidumping Agreement is identical to that in footnote 46 of the SCM Agreement, which suggests that the drafters intended them to have the same meaning in both cases.<sup>505</sup> Third, in the *Declaration on Dispute Settlement Pursuant to the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 and Part V of the Agreement on Subsidies and Countervailing Measures*, Members recognized “the need for consistent resolution of disputes arising from anti-dumping and countervailing duty

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<sup>504</sup> *Japan – Alcohol (AB)* at 21.

<sup>505</sup> The panel in *Indonesia – Autos* drew particular attention to the parallels between the two provisions as well as their common history. *Indonesia – Autos*, paras. 14.170-14.171.

measures.” This further indicates the intent of Members that, to the extent practicable, the two provisions should be applied in the same way.

414. Thus, the interpretation of footnote 46 proposed by the EC in this dispute,<sup>506</sup> which would forbid the Panel from applying in the adverse effects context a definition of “subsidized product” in which every item within the “subsidized product” is not a “like product” to every other, would apply equally to Article 2.6 of the Antidumping Agreement – yet this interpretation was rejected by the *US – Softwood Lumber Dumping* panel.<sup>507</sup> Further, if the EC interpretation here were adopted, the EC’s own practice in antidumping and countervailing duty proceedings would also appear to be inconsistent with Article 2.6 of the Antidumping Agreement and footnote 46, respectively.<sup>508</sup>

**130. The parties have presented different views of the relevant “subsidized product” and “like product” for purposes of the Panel’s analysis in this dispute. Could the parties please explain the legal basis for their respective positions? In other words, what is the legal basis for the United States’ view that the “subsidized product” and the “like product” are all LCA products of Airbus and Boeing combined, and the EC view that the “subsidized product” and the “like product” must be assessed according to more discrete market segments?**

Response:

415. Like any other term in a covered agreement, the term “subsidized product” must be interpreted in accordance with its ordinary meaning in its context, and in light of the object and purpose of the SCM Agreement.<sup>509</sup> A “subsidized product” is indisputably a product “in respect of which a subsidy is directly or indirectly granted or maintained.”<sup>510</sup> Further, the term “subsidized product” is used in Article 6.3 of the SCM Agreement in the context of provisions that contemplate the examination of the “effect of the subsidy.” The identification of the “subsidized product” in a particular case must, therefore, be one that facilitates rather than hinders the an assessment of the effects of the subsidy.

416. To define the “subsidized product” in a way that facilitates the assessments of its effects for purposes of a serious prejudice analysis, one must consider the nature and effects of the

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<sup>506</sup> EC FWS, paras. 1519-1521.

<sup>507</sup> *US – Softwood Lumber Dumping (Panel)*, para. 7.157.

<sup>508</sup> U.S. FOS, para. 167.

<sup>509</sup> VCLT, Art. 31(1).

<sup>510</sup> *US – Cotton Subsidies (Panel)*, para. 7.1220.

challenged subsidies as well the characteristics of the various LCA models at issue.<sup>511</sup> The United States views the “subsidized product” in this dispute as all Airbus LCA precisely because it is the only definition of the subsidized product that captures the effects of the subsidies that have been given to Airbus. The subsidies at issue in this dispute, as demonstrated in detail in the response to Questions 39 and 131, have been granted and maintained in order to enable Airbus to produce and sell an entire family of LCA, not simply a collection of isolated individual LCA models. Each provision of Launch Aid, for example, has effects up and down Airbus’s product line, and is therefore provided with respect to the full Airbus LCA family. A proper analysis of the effects of the particular subsidies at issue in this dispute, therefore, must encompass the actual product that is being subsidized by these measures.

417. In *US – Cotton Subsidies*, the panel identified “upland cotton” as the relevant “subsidized product,” even as it acknowledged that some of the relevant payments were made to persons who did not produce upland cotton and that part of the subsidy benefit was captured by persons other than producers of upland cotton.<sup>512</sup> For that panel, such factors were part of the “particular structure, design and operation of the measures” that had to be taken into account when determining whether the effect of the subsidy was, in fact, price suppression, but they did not affect its conclusion that upland cotton production did, in fact, benefit from the subsidy.<sup>513</sup> Likewise, physical differences among various LCA models is appropriately taken into account in demonstrating the effect of the subsidy in this dispute, as the United States explained in response to Question 39. But such physical differences do not affect the reality that Launch Aid and the other subsidies in this dispute benefit Airbus LCA production as a whole.<sup>514</sup>

418. In addition, it is well established that the burden of demonstrating the existence of serious prejudice within the meaning of Articles 5(c) and 6.3 of the SCM Agreement rests on the complaining Member.<sup>515</sup> In demonstrating the existence serious prejudice under any of the provisions of Article 6.3 that require the identification of a “subsidized product,” the complaining Member must make a prima facie case that the “effect of the subsidy” is one of the types of serious prejudice enumerated in Article 6.3, including as appropriate an identification of a product in respect of which the subsidy is granted or maintained and a like product in respect of which the corresponding serious prejudice is experienced. Once the complaining Member has

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<sup>511</sup> The nature and effects of the subsidy are less relevant in defining the “subsidized imports” for purposes of a material injury analysis, to the extent that the focus of a material injury analysis is on the effects of subsidized imports in the market of the importing Member rather than on the effects of the subsidy as such. SCM Agreement, Art. 15.5 & note 47.

<sup>512</sup> *US – Cotton Subsidies (Panel)*, para. 7.1226.

<sup>513</sup> *US – Cotton Subsidies (Panel)*, para. 7.1226.

<sup>514</sup> See U.S. FWS, paras. 718-724.

<sup>515</sup> *US – Wool Shirts (AB)*, para. 337.

made its prima facie case, the burden shifts to the defending Member to rebut or defend against that prima facie case.<sup>516</sup>

419. Thus, as the EC correctly argued to the panel in *Korea – Commercial Vessels*:

As long as the complainant identifies markets or products that are reasonable and coherent, the Panel should accept that definition. The Panel should reject the complainant's proposed definition only if it would make a market analysis impossible.<sup>517</sup>

Because the complaining Member's proposed definition of the subsidized product is an integral part of its prima facie case, a panel should not lightly find that the subsidized product should be identified in a different way. Rather, a panel should evaluate the complaining Member's prima facie case, including its definition of the subsidized product, as it is presented, along with the rebuttal or defense, if any, presented by the responding Member.

420. A mere allegation by a responding Member that the prima facie case could have been presented differently, however, does not amount to a rebuttal of the prima facie case that in fact was presented. Rather, the responding Member would have to show something more, such as that the alleged subsidized product does not in fact benefit from the subsidy or that the proposed definition of the subsidized product prevents the analysis of the subsidy's effects. This the EC has not done. To the contrary, the EC's argument for five separate LCA products based on seating capacity both ignores the way in which LCA are designed, produced, and sold and the way in which the subsidies benefit the full Airbus LCA family.

421. Once the "subsidized product" has been identified, the identity of the "like product" of the complaining Member follows directly by an application of footnote 46 of the SCM Agreement.

**131. Please explain the extent to which LCA are sold in bundles comprising different models of aircraft? How prevalent are such bundled sales in the LCA business and what might such sales imply about how the Panel should conduct its serious prejudice analysis under Articles 6.3(a), 6.3(b) and 6.3(c) of the SCM Agreement?**

Response:

422. LCA are frequently sold in "bundles" in which an airline purchases aircraft of more than one size from the same manufacturer. In some cases, airlines will order more than one type of

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<sup>516</sup> *US – Wool Shirts (AB)*, para. 337.

<sup>517</sup> *Korea – Commercial Vessels*, Annex F-1, para. 33 (Oral Statement of the European Communities at the Second Panel Meeting).

aircraft at the same time. The United States has already mentioned the example of British Airways, which is currently evaluating proposals from Airbus for a mix of A330, A350, and A380 aircraft and from Boeing for a mix of 747, 777, and 787 aircraft.<sup>518</sup> The United States provided additional examples from the EC confidential documents at the BCI/HSBI session of the first meeting of the Panel.<sup>519</sup> Even when airlines do not purchase multiple aircraft types in a single campaign, their prior purchase decisions influence their subsequent decisions. As a result, the importance of a full family of LCA to meet the full range of customer needs is equally important, whether purchases of multiple models are bundled or sequenced.

423. The Airclaims database includes numerous instances of “bundled” Airbus LCA purchases, in which a single airline placed an order for Airbus LCA of more than one type on the same day. Examples from the Airclaims order database in Exhibit EC-21 include the following:

- ***Afriqiyah Airways*** ordered three A319s, six A320s, and three A330s on November 2, 2006.<sup>520</sup> In announcing the order, Captain Sabri, CEO of the airline, noted “the full advantage of commonality” between the several aircraft models being ordered from Airbus.<sup>521</sup>
- ***Etihad Airways*** ordered 12 A330-300s, four A340-500s, four A340-600s, and four A380s on December 20, 2004.<sup>522</sup> According to the chairman of Etihad Airways, Dr. Ahmed Bin Saif al Nahyan, the airline’s “fleet strategy” was best met by “the Airbus range of aircraft,” and Airbus touted that Etihad is “well placed to benefit from savings in training for pilots, maintenance engineers, and cabin crew” by the commonality between the A330, A340, and A380.<sup>523</sup>
- ***Lufthansa*** ordered five A319s, ten A320s, 15 A321s, and five A330-200s on October 13, 2006.<sup>524</sup> Airbus observed, in announcing the order, that Lufthansa

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<sup>518</sup> U.S. FWS, para. 720 (citing Exhibit US-443).

<sup>519</sup> U.S. FOS (BCI/HSBI Session), paras. 65-67.

<sup>520</sup> Exhibit EC-21 at 4, 9, 16.

<sup>521</sup> Airbus Press Release, *Afriqiyah Airways orders up to six A330s and 14 Airbus A320 Family aircraft* (July 18, 2006) (Exhibit US-511).

<sup>522</sup> Exhibit EC-21 at 1, 2, 5.

<sup>523</sup> Airbus Press Release, *ETIHAD selects Airbus A380 and A330/A340 family aircraft* (July 20, 2004) (Exhibit US-512).

<sup>524</sup> Exhibit EC-21 at 7, 14, 23, 29.

already operated nearly 150 Airbus aircraft, including the A300-600, A320 family, A330, and A340 and had ordered the A380 as well.<sup>525</sup>

- **Middle East Airlines** ordered four A319s and four A330-200s on December 11, 2006.<sup>526</sup>
- **South African Airways** ordered 11 A319s, 15 A320s, six A340-300s, and six A340-600s on May 24, 2002.<sup>527</sup> The United States has already discussed this sale with respect to both public information and the confidential information provided by the EC.<sup>528</sup>
- **Turkish Airlines** ordered 19 A320s, 12 A321s, and five A330-200s on September 15, 2004.<sup>529</sup> These aircraft complemented the A310s and A340s that Turkish Airlines already operated. As Airbus president and CEO Noël Forgeard explained, “The advantages of using a mixed Airbus fleet are enormous and we are sure that Turkish Airlines crew and passengers will benefit from these.”<sup>530</sup>

Examples involving “bundled” purchases of Boeing aircraft include Air India (777-200LR, 777-300ER, 787, and (through its wholly owned Air India Express subsidiary), 737) on December 30, 2005;<sup>531</sup> Air New Zealand (777 and 787) on August 25, 2004;<sup>532</sup> Ethiopian Airlines (737 and 767) on November 28, 2002;<sup>533</sup> and TAAG – Angola Airlines (737 and 777) on July 20, 2005.<sup>534</sup>

424. Even more numerous are instances in which airlines ordered multiple LCA models from the same manufacturer relatively close together in time. Even if the sales campaigns were nominally separate, the availability of a fleet of aircraft models of different sizes has appeal to airlines that fly a variety of routes and require aircraft of more than one size. To take just one of

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<sup>525</sup> Airbus Press Release, *Lufthansa places repeat order for Airbus A320 and A330-300 aircraft* (Oct. 13, 2006) (Exhibit US-513).

<sup>526</sup> Exhibit EC-21 at 7, 14.

<sup>527</sup> Exhibit EC-21 at 4, 15, 25.

<sup>528</sup> U.S. FWS, para. 791; U.S. FOS (BCI/HSBI Session), para. 67.

<sup>529</sup> Exhibit EC-21 at 8, 26, 30.

<sup>530</sup> Airbus Press Release, *Turkish national carrier chooses Airbus for fleet increase* (July 21, 2004) (Exhibit US-514).

<sup>531</sup> Exhibit EC-21 at 57, 58, 87.

<sup>532</sup> Exhibit EC-21 at 57-58.

<sup>533</sup> Exhibit EC-21 at 65, 92.

<sup>534</sup> Exhibit EC-21 at 62, 100.

many possible examples in the Airclaims database, *Qatar Airways* ordered two A321s on June 23, 2003; eight A330-200s and six A330-300s on July 17, 2003; two A340-600s and two A380s on December 8, 2003; one A330-300 on January 21, 2004; one A319 on February 10, 2004; and two more A330-300s on February 23, 2004 and March 30, 2004.<sup>535</sup>

425. Although these orders were formalized and reported in the Airclaims database at different times, Qatar Airways placed these orders as part of a single decision to operate the Airbus LCA family. Akbar Al-Baker, the CEO of the airline, explained in announcing Qatar's decision with respect to several of these orders: "We are also building on a long-standing partnership with Airbus, and are looking forward to benefitting from the unrivalled commonality among its aircraft family." Airbus CEO Noël Forgeard added: "This deal also confirms the value and standing of our product range in the market."<sup>536</sup>

426. As a final example of the importance of having a full family of LCA in marketing each individual LCA model, consider the airlines that have placed orders for the Airbus A350. According to the EC database, orders for 67 A350s have been placed by seven airlines (Air Europa (10), Eurofly (3), Finnair (9), Kingfisher Airlines (5), TAM Linhas Aereas (10), TAP Portugal (10), and US Airways (20)).<sup>537</sup> The database shows that each of these airlines already operates Airbus LCA of other model types and that some are exclusive Airbus customers:

- *Air Europa* operates three A330-200s purchased through the leasing companies ILFC and GECAS and is scheduled to receive one more A330-200 in 2007.<sup>538</sup>
- *Eurofly* has received one A319 on its own account and operates five A320s and two A330-200s ordered through the leasing companies ILFC, GECAS, GATX, and CIT Aerospace, and is scheduled to receive one more A330-200 in 2007.<sup>539</sup>
- *Finnair*, which was once an exclusive customer of McDonnell Douglas – having ordered 38 DC-8s, DC-9s, DC-10s, MD-80s, and MD-11s from 1966 to 1989 – has become an exclusive Airbus customer, ordering two A300s in 1986 and 21 A319s, A320s, A321s, and A340s from 1997 to 2006.<sup>540</sup>

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<sup>535</sup> Exhibit EC-21 at 1, 3, 8, 29.

<sup>536</sup> Airbus Press Release, *Qatar Airways to expand with an all-Airbus fleet* (June 19, 2003) (Exhibit US-515).

<sup>537</sup> Exhibit EC-21 at 1. In addition, 35 more orders had been placed by four leasing companies – ALAFCO, CIT Aerospace, ILFC, and Pegasus Aviation. *Id.*

<sup>538</sup> Exhibit EC-21 at 211-12, 409.

<sup>539</sup> Exhibit EC-21 at 159, 185-86, 210-, 212, 409.

<sup>540</sup> Exhibit EC-21 at 2, 11, 19, 28, 33, 39, 42, 45, 50, 54.

- **Kingfisher Airlines**, a new Indian airline, ordered its first 60 LCA in 2005 and 2006, all from Airbus. In addition to the five A350s, Kingfisher ordered the A319, A320, A321, A330-200, A340-500, and A380.<sup>541</sup>
- **TAM Linhas Aereas** also has never ordered LCA from any manufacturer other than Airbus, having placed orders for 105 A319, A320, A321, and A330-200 from 1997 to 2006.<sup>542</sup>
- **TAP Portugal** placed its last Boeing order in 1982, and since then has ordered 35 LCA, exclusively from Airbus, including the A310, A319, A320, A321, A330-200, and A340.<sup>543</sup>
- **US Airways** placed its last Boeing order in 1993, and since then has ordered 164 LCA, exclusively from Airbus, including the A319, A320, A321, A330-200, and A330-300 (“basic”).<sup>544</sup>

Even if these seven airlines did not order the A350 as part of a “bundled” sale with other Airbus LCA, these airlines have all plainly based their fleets on the use of multiple Airbus LCA models.

427. Moreover, each of these airlines stressed its existing history of operating all or mostly Airbus aircraft in announcing its A350 orders.

- **Air Europa**, according to an Airbus press release, is leasing A330s and A340s in addition to its A350 purchases, enabling the airline to “profit from valuable savings in operation, maintenance, and training.”<sup>545</sup>
- The Airbus press release announcing the **Eurofly** A350 order also announced that the airline would simultaneously lease two additional A330-200s, in addition to its existing A319, A320, and A330-200 fleet. The press release explains that “with the A350, Eurofly will also be able to continue operating ‘mixed fleet flying’ with the rest of its Airbus aircraft family.”<sup>546</sup> A Eurofly investor presentation explains that the concept of “mixed fleet flying” means that “Eurofly

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<sup>541</sup> Exhibit EC-21 at 1, 3, 7, 14, 23, 29.

<sup>542</sup> Exhibit EC-21 at 8, 15, 25-26, 29.

<sup>543</sup> Exhibit EC-21 at 4, 8, 15, 26, 29-30, 32, 118.

<sup>544</sup> Exhibit EC-21 at 8-9, 16, 26, 30, 69, 73.

<sup>545</sup> Airbus Press Release, *Air Europa orders 10 A350s with two more on option* (Jan. 25, 2006) (Exhibit US-516).

<sup>546</sup> Airbus Press Release, *Eurofly orders new Airbus A350* (Jan. 3, 2006) (Exhibit US-517).

is the only Italian flight carrier currently enabled to use its pilots on each of its aircrafts, therefore increasing productivity and flexibility.”<sup>547</sup> “Airbus President and CEO Gustav Humbert stated that the A350 order “reinforces the successful co-operation that Airbus has had with Eurofly since 2001, and opens the door to a long-term partnership.”<sup>548</sup>

- **Finnair** CEO Jukka Hienonen stated that “{c}ommonality with our Airbus A320 single-aisle fleet was one of the key drivers of our decision making” in its recent confirmation of its A350 orders.<sup>549</sup> At the time of the original Finnair order of A350s (bundled together with A340 orders), Mr. Humbert of Airbus underlined the same point:

By delivering a true Family of products, Airbus responds to the market’s needs in terms of technology, reliability, economics and passenger appeal. Therefore we are confident of a successful integration of the new A340s and A350s in Finnair’s existing A320 Family fleet.<sup>550</sup>

- When **Kingfisher Airlines** simultaneously announced its orders for the A330, A350, and A380, the chairman of its parent company, Dr. Vijay Mallya, stated that “these new Airbus aircraft, with their unmatched passenger appeal, economy and commonality, will give us the lead in competing” in the Indian market.<sup>551</sup> When Kingfisher ordered the A340-500 several months later, Mr. Humbert of Airbus cited “the confidence that an increasingly successful airline, such as Kingfisher Airlines shows in our modern family of aircraft.”<sup>552</sup>
- **TAM Linhas Aereas** made a simultaneous announcement of a purchase agreement for twenty A319s, A320s, and A321s and a memorandum of

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<sup>547</sup> Eurofly, *Road Show* at 26 (Dec. 2005) (Exhibit US-518), <http://www.eurofly.it/EN/doc/Road%20show%20presentation.pdf>; see also *id.* at 24 (stating that the existing Eurofly A320 and A330 fleet is “Young and Homogeneous”).

<sup>548</sup> Airbus Press Release, *Eurofly orders new Airbus A350* (Jan. 3, 2006) (Exhibit US-517).

<sup>549</sup> Airbus Press Release, *Finnair, first airline to sign firm contract for the A350XWB* (Mar. 8, 2007) (Exhibit US-510).

<sup>550</sup> Airbus Press Release, *Finnair orders A350s and A340s for future long-haul fleet* (Mar. 30, 2006) (Exhibit US-519).

<sup>551</sup> Airbus Press Release, *Kingfisher becomes first Indian customer for A380, A350, & A330* (June 15, 2005) (Exhibit US-520).

<sup>552</sup> Airbus Press Release, *Kingfisher grows its Airbus fleet with purchase of five A340-500* (Apr. 24, 2006) (Exhibit US-521).

understanding for eight A350s.<sup>553</sup> The announcement several months later of the actual A350 sales contract noted that the A350 would make use of technologies originally developed for the A380 and that it “will retain full operational commonality with the current Airbus wide-body long-range fleet, allowing this new aircraft to benefit from the ‘Family effect.’”<sup>554</sup> Less than a year later, the same airline announced an order for 37 more new Airbus LCA (and 12 options), including the A319, A320, A321, and A330.<sup>555</sup>

- **TAP Portugal** also made a simultaneous announcement that it would acquire A350s and A330s. Mr. Humbert stated that the airline “is guaranteed a smooth integration of these new aircraft into their successful all Airbus fleet,” and the press statement further explained:

Being an A330 and an A350 customer, TAP optimises costs related to operation, maintenance, and training. Both aircraft benefit from the Airbus “family effect,” notably the same pilot type rating, allowing pilots to fly both aircraft without additional training. The A350 also complements TAP’s A320 family thanks to the benefits of Airbus’ operational commonality between all fly-by-wire models.<sup>556</sup>

- The announcement that **US Airways** had signed a contract for A350s noted that US Airways and America West, its recent merger partner, together fly about 200 A320s and nine A330s and quoted CEO Doug Parker: “As both halves of our heritage include Airbus fleets, we have great confidence in the brand, and look forward to an airplane that meets our needs for range, economy, and comfort, while offering our crews technology with which they are already experienced.”<sup>557</sup> Mr. Humbert of Airbus added: “The A350 will be an ideal complement to the existing US Airways fleet.”<sup>558</sup>

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<sup>553</sup> Airbus Press Release, *Brazilian TAM increases A320 fleet and selects A350* (June 16, 2005) (Exhibit US-522).

<sup>554</sup> Airbus Press Release, *Brazilian TAM becomes A350 launch customer in Latin America* (Dec. 21, 2005) (Exhibit US-523).

<sup>555</sup> Airbus Press Release, *TAM signs contract for the acquisition of 37 additional Airbus aircraft* (Nov. 16, 2006) (Exhibit US-524). The same press release notes the increase of Airbus’s market share in Latin America in terms of Airbus LCA as a whole. *Id.* (“The Airbus presence in Latin America has steadily grown over the last ten years to reach 66 per cent of all new sales in the region today and with a total of 236 aircraft in operation with 12 airlines.”).

<sup>556</sup> Airbus Press Release, *TAP to acquire 10 Airbus A350 and 7 A330 aircraft* (Nov. 21, 2005) (Exhibit US-525).

<sup>557</sup> Airbus Press Release, *US Airways firms up order for 20 A350s* (Nov. 29, 2005) (Exhibit US-526).

<sup>558</sup> Airbus Press Release, *US Airways firms up order for 20 A350s* (Nov. 29, 2005) (Exhibit US-526).

428. These facts demonstrate one – but only one – of the ways in which subsidies nominally provided for the development of one Airbus LCA model are in fact used to enhance Airbus’s ability to sell other LCA models. When the Airbus governments provide Launch Aid for one aircraft model and thus enable Airbus to offer an aircraft model that it could not otherwise have developed, the entire Airbus LCA family becomes more competitive. Therefore, the Panel’s analysis of the effects of the subsidy properly focuses on the effects of the subsidies on competition in the LCA market as a whole.

**132. The parties have argued about whether the Panel should consider orders or deliveries or both in its analysis of adverse effects. Do the parties see any limits on the Panel’s ability, as a legal matter, to consider both in this case? Do the parties have any views about which is appropriate to be considered in respect of certain kinds of injury and/or serious prejudice, and if so, why?**

Response:

429. Data with respect to orders and deliveries are both relevant to an analysis of the LCA market, but in different ways. Each provides a different type of information about the state of the LCA market, and each can and should be taken into account in the Panel’s analysis as appropriate.<sup>559</sup> The relevance of each type of information will depend on both the *legal* requirements necessary to establish the several types of adverse effects at issue and the *factual* aspects of data regarding orders and deliveries, respectively, in the LCA industry and how each bears on those legal requirements.

430. As a *factual* matter, several points about the nature of the order and delivery process in the LCA industry must be kept in mind:

- Deliveries represent “what’s going out the factory door this afternoon.”<sup>560</sup> Orders are arrangements or contracts for delivery in the future and, as such, are subject to delay, renegotiation, or even cancellation. Indeed, the EC makes multiple references to cancellations or deferrals of orders in its submission.<sup>561</sup>

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<sup>559</sup> Boeing and Airbus likewise use various measures of orders and deliveries for different purposes. For example, the EADS 2006 annual investor presentation provides information about Airbus orders, deliveries, and total delivery backlog. EADS, *Annual Results 2006*, slide 15 (Exhibit US-527).

<sup>560</sup> *Airbus Chief Scoffs at Rival’s 7E7*, Seattle Post-Intelligencer, June 18, 2003 (Exhibit EC-288) (quoting Airbus head of sales John Leahy).

<sup>561</sup> EC FWS, paras. 1440-1441, 1446, 1451, 1453, 1460, 1495-1496, 1742, 1880, 1882, 1944. *See also* ITR Report, para. 31 (Exhibit EC-13): “Historical delivery data is readily available and firm. By contrast, while data on aircraft orders is available, it is not as firm. In other words, aircraft orders are frequently modified with respect to the timing of a delivery, and also with regard to the quantity and models ordered.”

- The date of delivery is generally easy to determine, but the complexity and duration of the process by which order agreements are finalized gives manufacturers and airlines some flexibility in determining the date on which orders are reported. Thus, for example, “Boeing doesn’t book orders in China until the airline signs the contract; Airbus elected to book the order upon signing the contract with the government.”<sup>562</sup>
- Leasing companies frequently order aircraft and arrange for a customer after placing the order but before delivery. In this case, the Airclaims database – which both the EC and the United States use as a source for statistics on orders and deliveries – records the order from the leasing company and the delivery to the airline.<sup>563</sup> When the leasing company and airline are in different countries, the order and delivery data by country will differ.
- The price of LCA and the other “terms and conditions of the purchase are set at the time of order.”<sup>564</sup> However, prices can be – and have been – adjusted between the time of order and delivery to account for changing market conditions, as the United States has already shown.<sup>565</sup>
- Most of the revenue from LCA is received at the time of delivery.<sup>566</sup> According to Airbus, [
 

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<sup>562</sup> Scott Hamilton, *The numbers game and Airbus*, Commercial Aviation Report, Aug. 1, 2006 (Exhibit US-528).

<sup>563</sup> Exhibit EC-21.

<sup>564</sup> Statement of Christian Scherer, para. 27 (Exhibit EC-14).

<sup>565</sup> U.S. FWS, paras. 742, 805-806.

<sup>566</sup> Compare the statement of the EC in the *Korea – Commercial Vessels* dispute: “It should be kept in mind that the economic consequences of taking an order will be felt in two or three years time when production takes place, not at the time of taking the order.” *Korea – Commercial Vessels*, Annex D, at D-35 para. 180.

<sup>567</sup> Statement of Christian Scherer, para. 28 (Exhibit EC-14).

<sup>568</sup> Statement of Rod Muddle, para. 58 (Exhibit EC-19).

<sup>569</sup> Statement of Rod Muddle, para. 58 (Exhibit EC-19).

sales is tied to delivery, not orders. Moreover, for accounting purposes both Boeing and Airbus report sales revenue, including pre-delivery payments, as income only at the time of delivery.

- The EC asserts that the “there is an approximate 3-year gap between an order and a delivery.”<sup>570</sup> However, this is only an average; the actual time between order and delivery varies greatly. For example, the Airclaims database provided by the EC, current as of January 2007, includes contracted deliveries that extend through 2015.<sup>571</sup> A single order can also include deliveries over an extended period. For example, the Airclaims database reports that AirAsia ordered 60 A320s on March 25, 2005 and an additional 40 A320s on July 19, 2006.<sup>572</sup> Of these, two were delivered in 2005 (i.e., in the same year as order) and 12 more in 2006, and more A320 deliveries to AirAsia are scheduled in each year from 2007 to 2015.<sup>573</sup>
- There is a certain amount of flexibility built in to the delivery timetables in orders. As Airbus CEO Louis Gallois recently explained, Airbus “could accept to have a certain margin {of overbooking} because we know that some airplanes are slipping . . . and shifting on the right because airlines are asking every year to do that.”<sup>574</sup>

431. These factual considerations impact the relative value of order and delivery data to the *legal* requirements of each type of adverse effects analysis before the Panel.

432. ***Displacement or impedance / volume of imports.*** In assessing claims of displacement or impedance of imports or exports under Article 6.3(a) or 6.3(b), or in measuring the volume of subsidized imports under Article 15.2, the terms “imports” and “exports” refer to actual deliveries rather than orders.<sup>575</sup> The ordinary meaning of the terms “imports” and “exports” includes actual *articles* or *things* that cross international borders – that is, deliveries.<sup>576</sup> Orders are, at most, contracts for future imports and exports. Thus, while orders may be relevant for an analysis of threat of displacement or impedance, as they provide information about likely future

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<sup>570</sup> EC FWS, para. 1403.

<sup>571</sup> Exhibit EC-21 at 381, 402-03, 414, 417, 451, 458.

<sup>572</sup> Exhibit EC-21 at 17.

<sup>573</sup> Exhibit EC-21 at 192-96, 381-403.

<sup>574</sup> EADS Presentation, Annual Earnings 2006, Analysts’ Conference Call (Mar. 9, 2007), at 1:06:47 (Exhibit US-529).

<sup>575</sup> U.S. FOS, para. 172.

<sup>576</sup> See *New Shorter Oxford English Dictionary* at 889 (export defined as “an article that is exported”), 1323 (import defined as “something imported or brought in”).

levels of imports or exports, they do not provide any information about imports and exports that have actually occurred.

433. **Lost sales.** The ordinary meaning of the term “sale,” in contrast to the terms “imports” and “exports,” includes the concept of an agreement to exchange a good for money in the future as well as in the present.<sup>577</sup> In the LCA industry, a sale is “lost” at the time when the customer makes a definitive decision to purchase a competitor’s aircraft – that is, at the time of order. Lost sales, therefore, are properly measured at the time of orders.

434. **Significant price undercutting, price suppression, and price depression / price effects of subsidized imports.** The text of Article 6.3(c) requires a showing of significant price undercutting, price suppression, or price depression “in the same market,” which implies that the effect of the subsidy must be demonstrated with respect to actual or potential price competition in a given market between the subsidized product and the like or affected product of the complaining Member.<sup>578</sup> The price competition between Boeing and Airbus LCA mostly occurs in the sales campaigns that end with a decision to order LCA from Airbus or Boeing. Moreover, as discussed above, LCA price is generally determined at the time of order. Therefore, to analyze the effect of the subsidy on price competition between Boeing and Airbus, price trends are appropriately examined on the basis of the time at which prices were determined – that is, at order.

435. At the same time, as also discussed above, LCA prices can be and have been subject to revision or renegotiation after delivery to account for changes in market conditions. Indeed, an important aspect of the U.S. demonstration of serious prejudice under Article 6.3(c) is the retroactive reduction in the price of already ordered Boeing LCA that was caused directly by lower prices in the overall LCA market resulting from aggressive subsidy-enabled Airbus price undercutting.<sup>579</sup> Thus, post-order pricing adjustments must also be included in any analysis of the price effects of the subsidies.

436. **Impact on the domestic industry.** Both orders and deliveries of subsidized imports can have injurious effects on a domestic industry. The factors enumerated in Article 15.4 include “actual and potential declines in output” and “actual and potential negative effects on cash flow, inventories, employment, wages, growth, {and} ability to raise capital or investments.” To the extent that deliveries of subsidized imports supplant current production for the domestic market,

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<sup>577</sup> See *New Shorter Oxford English Dictionary* at 2671 (sale defined as: “The action or an act of giving or agreeing to give something to a person in exchange for money ....” (emphasis added)).

<sup>578</sup> *US – Cotton Subsidies (AB)*, para. 408 (“{I}t seems reasonable to conclude that two products would be in the same market if they are engaged in actual or potential competition in that market.”).

<sup>579</sup> U.S. FWS, paras. 742, 805-806.

there is an *actual* impact on the domestic industry. Orders for future deliveries of subsidized imports can also have a similar *potential* impact on future output, revenues, and employment.

**133. What provisions in the SCM Agreement, DSU (including Article 11) or any other covered agreement, address or govern the selection of the “reference period” that a panel should or must take into account when considering: (i) a claim of material injury (and threat) under Article 5(a); and (ii) claims of serious prejudice (and threat) under Article 5(c)?**

Response:

437. The term “reference period” does not appear anywhere in the SCM Agreement. There are, however, several provisions relevant to determining the temporal scope of the evidence relevant to evaluating the U.S. claims in this dispute. These include:

- Article 6.4 of the SCM Agreement provides that, for purposes of claims under Article 6.3(b), displacement or impedance of exports includes cases in which

it has been demonstrated that there has been a change in relative shares of the market to the disadvantage of the non-subsidized like product (over an appropriately representative period sufficient to demonstrate clear trends in the development of the market for the product concerned, which, in normal circumstances, shall be at least one year).

Thus, at least for claims under Article 6.3(b), a showing of displacement or impedance of imports that relies on changes in relative market share must demonstrate the existence of such changes over a period sufficient to demonstrate clear trends in the market.

- Article 11 of the DSU provides that “a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements.” Thus, a panel must examine the market over a period of time sufficient to permit an objective assessment of the “matter before it.”
- The terms of reference for the Panel, which provide for it to examine “the *matter* referred to the DSB by the United States” in its request for panel establishment.<sup>580</sup>

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<sup>580</sup> Document WT/DS316/4, para. 2 (Oct. 25, 2005) (emphasis added).

This “matter” includes both the measures and the claims identified in the request for panel establishment.<sup>581</sup>

Taken together, these provisions contemplate that an adverse effects analysis should include an analysis of the relevant effects of the subsidy over a period of time sufficient to make an objective assessment of the measures and claims in the panel’s terms of reference.

438. In addition, the complaining Member has the burden of making a prima facie case in support of its claims.<sup>582</sup> In setting forth its prima facie case, the complaining Member will set forth the facts and arguments necessary to demonstrate the validity of its claims. These facts and arguments will, in the context of a claim of adverse effects within the meaning of Article 5 of the SCM Agreement, necessarily involve the presentation of facts and arguments relating to adverse effects that occurred over a particular period of time.<sup>583</sup> It is for the complaining Member, as part of meeting its burden of proof, to identify the period over which it considers the adverse effects of the challenged subsidies to have manifested themselves. Likewise, it is for the responding Member to identify facts and arguments that rebut the prima facie case established by the complaining Member. The responding Member may, of course, choose to identify facts and arguments pertaining to a different period of time, if it considers that these facts and arguments serve to rebut the prima facie case made by the complaining Member.

439. All of this suggests that it is, in the first instance, for the complaining Member to define the appropriate “reference period” over which it will demonstrate the adverse effects existing at the time of panel establishment. The panel then determines whether the complaining Member has set forth a prima facie case of adverse effects. This determination will, of necessity, involve an evaluation of whether the facts and arguments of the complaining Member are sufficient to demonstrate the existence of adverse effects as claimed in the panel request. If a panel finds that it has, it will then determine whether the responding Member has rebutted that prima facie case, and in doing so it will examine whether the facts and arguments of the responding Member are sufficient to rebut the complaining Member’s demonstration of those adverse effects. In making all of these determinations, a panel will examine whether the reference periods, if any, identified by the parties are adequate for the parties to meet their respective burdens of proof.

**(a) Does the Panel have limited (or unlimited) discretion in the selection of a “reference period” for consideration of adverse effects claims?**

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<sup>581</sup> *Guatemala – Cement I (AB)*, para. 72.

<sup>582</sup> *E.g., US – Wool Shirts (AB)*, para. 337.

<sup>583</sup> A Member may even use different periods to demonstrate the existence (or non-existence) of adverse effects in the same dispute. For example, the EC chose to make certain arguments in *Korea – Commercial Vessels* with respect to a six-year reference period, *Korea – Commercial Vessels*, paras. 7.648-7.649, and other arguments with respect to a ten-year reference period, *id.* para. 7.658.

Response:

440. As discussed above, the Panel should not select a particular “reference period” for consideration of the adverse effects claims in this dispute. Rather, the Panel should determine whether the United States has met its burden with respect to its claim of adverse effects by demonstrating, with reference to market data largely from the period 2001 through 2005, that the challenged subsidies were causing adverse effects to the interests of the United States at the time of the panel request in this dispute. If the Panel finds, as it should, that the United States has met this burden, it should then determine whether the EC has met its burden to rebut this *prima facie* case.

**(b) What, if any, relevance has the concept of “current” material injury to the selection of an appropriate “reference period”?**

Response:

441. Material injury for purposes of the adverse effects provisions in Article 5(a) of the *SCM Agreement* is defined with reference to the definition of material injury for purposes of a countervailing duty investigation in Part V, but the two inquiries are not identical in all respects. The Appellate Body has stated in the antidumping context that “the determination of whether injury exists should be based on data that provides indications of the situation prevailing when the *investigation* takes place,” but grounds this observation in the requirements that must be met “to impose an anti-dumping duty” consistently with the *Antidumping Agreement* and Article VI of GATT 1994.<sup>584</sup> By contrast, no duty is imposed in the event of a finding of adverse effects under Article 5. Thus, the requirement that “current” material injury (or threat thereof) be determined at the time that a duty is imposed does not have a direct parallel in the adverse effects context.

442. The task of a panel under Part III of the *SCM Agreement* therefore differs from that of an investigating authority under Part V. Before imposing a countervailing duty, a Member’s competent investigating authorities must determine, *inter alia*, that “through the effects of the subsidy, the subsidized imports are causing injury.”<sup>585</sup> The duty therefore is used to offset the subsidy, provided that the subsidized imports are causing injury (including threat of injury) at the time the duty is imposed. However, when a subsidy has been found to cause adverse effects, “the Member granting or maintaining such subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy.”<sup>586</sup> Only if the subsidizing Member fails to take

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<sup>584</sup> *Mexico – Rice (AB)*, para. 165 (emphasis added).

<sup>585</sup> *SCM Agreement*, Art. 19.1.

<sup>586</sup> *SCM Agreement*, Art. 7.8.

such appropriate steps may countermeasures be authorized.<sup>587</sup> Thus, under Part III the task of the initial panel is to determine whether or not the alleged violations of the subsidizing Member's obligation under Article 5 have occurred. The issue of whether adverse effects continue to exist such that countermeasures may be taken arises, if at all, only at a later stage.

- (c) Does the fact that this Panel remained inactive, at the parties' request, have any relevance to the identification of an appropriate "reference period" for the Panel's adverse effects analysis?**

Response:

443. That the parties jointly requested the Panel to set aside its timetable for a period of time in this dispute has no bearing on the "matter" as defined in the Panel's terms of reference. Thus, this period of inactivity does not, as a legal matter, bear on the definition of an appropriate "reference period" in this dispute. Moreover, as a factual matter, the effects of the challenged subsidies are not substantially different today from what they were when the United States requested the establishment of a panel in 2005. Thus, the 2001-2005 period used by the United States in its first written submission is perfectly appropriate for the Panel to use in its review.

- (d) Is the date of the consultation and/or panel request in this dispute relevant to the identification of an appropriate "reference period" for the Panel's adverse effects analysis? What about the dates involved in the Annex V process of information-gathering for serious prejudice cases?**

Response:

444. The "matter" that the Panel has been charged with examining is defined, both in content and in temporal scope, by the U.S. request for the establishment of a panel in this dispute. As discussed in the U.S. response to Question 134, the practice of panels in prior serious prejudice disputes has been to examine market data up to and including the year in which the panel was established, but not market data for subsequent years, except insofar as such data was relevant to determining the market situation when the panel was established. This is consistent with the mandate of panels with standard terms of reference to evaluate the "matter before it,"<sup>588</sup> including the claim of serious prejudice existing at the time of panel request and establishment.

445. To be clear, the United States believes that the adverse effects to its interests caused by Launch Aid and the other EC and Airbus government subsidies have continued to exist after the establishment of the Panel and continue to the present day. Thus, the United States disagrees, as

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<sup>587</sup> SCM Agreement, Art. 7.9.

<sup>588</sup> DSU, Art. 7.1.

a factual matter, with the EC assertion that any adverse effects ceased to exist in 2006, after the establishment of the Panel. But even if the EC assertion were correct, it would not constitute a *rebuttal* of the U.S. prima facie case that the challenged subsidies were causing adverse effects at the time of panel establishment, in breach of the obligations of the EC and the member States under Article 5 of the SCM Agreement. The use of a “reference period” that ends in the year of panel establishment is, in the U.S. view, a useful analytical tool that keeps the focus of these proceedings where it belongs – on the “matter” before the Panel.

446. With respect to the dates of consultations, it is well established that a matter must be the subject of consultations before it can be made the subject of a request for panel establishment.<sup>589</sup> Thus, a complaining Member in an adverse effects dispute must include the challenged subsidies in its consultations request. It would therefore be surprising if a complaining Member failed to include the date of consultations in its proposed reference period. This situation, however, does not arise here.

447. The dates involved in the Annex V process, by contrast, do not define the “matter” before the Panel. Nor do they define the relevant evidence before the Panel. Rather, the Annex V process allows the parties to gather data for the relevant period; it cannot affect the Panel’s terms of reference or define the relevant period for conducting the objective assessment. Thus, these dates are not relevant to determining an appropriate “reference period” for purposes of this dispute.

**134. What relevance, if any, does the following statement of the panel in *US – Upland Cotton* have for the Panel’s identification of an appropriate reference period for the serious prejudice and material injury analyses that it must perform under Articles 5(a) and 5(c) of the SCM Agreement?**

**“We believe, however, that it is important for the establishment of ‘current’ serious prejudice that such prejudice would be established to exist up to, and including, a recent point in time”. (Panel Report, *US – Upland Cotton*, para. 1198.)**

Response:

448. In the *US – Cotton Subsidies* dispute, the panel examined subsidies alleged to be provided with respect to U.S. upland cotton producers for marketing years 1999 to 2002 that were alleged to have caused serious prejudice during that same period.<sup>590</sup> The panel was

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<sup>589</sup> DSU, Art. 6.2; SCM Agreement, Art. 7.4; *Brazil – Aircraft (AB)*, paras. 127-133.

<sup>590</sup> *US – Cotton Subsidies (Panel)*, para. 3.1(vi).

established on March 18, 2003 – that is, during marketing year 2002, which ran from August 1, 2002 through July 31, 2003.

449. The parties in *US – Cotton Subsidies* agreed that, in order to determine whether “current” serious prejudice<sup>591</sup> existed, the panel should examine data for marketing year 2002, the year in which that panel was established. The parties disagreed, however, as to whether marketing years earlier than 2002 should be included in the reference period. The panel ultimately agreed with Brazil that marketing years 1999 through 2001 should be included in its analysis, as legal provisions for payments with respect to those years “may have had adverse effects at the time they were in effect, and may still have lasting adverse effects.”<sup>592</sup>

450. In other disputes involving Article 5 of the SCM Agreement, panels have also not extended their examination beyond the year in which the panel was established. For example, in *Korea – Commercial Vessels*, the panel was established on July 21, 2003, and the EC submitted market data for a period of six years (1997 to 2002) or ten years (1993 to 2002) prior to panel establishment.<sup>593</sup> Likewise, in *Indonesia – Autos*, the panel was established on June 12, 1997 (with respect to the complaints of the EC and Japan) and July 30, 1997 (with respect to the U.S. complaint), and the panel examined market data for 1996 (the first year in which the subsidized product was marketed) and partial-year data through May 1997.<sup>594</sup> Pre-WTO disputes involving claims of serious prejudice under Article XVI of GATT 1947 likewise limited their examination to the period up to the year in which panels were established.<sup>595</sup>

451. Here, as in *Cotton* and other adverse effects disputes, the existence of adverse effects “up to, and including, a recent point in time” is appropriately measured with respect to a period of several years up to, and including, the full year in which the panel was established. As noted above, 2005 is a “recent point in time” and market conditions in that year and the period immediately prior to it demonstrate that the EC and Airbus governments have, through the use of

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<sup>591</sup> The United States notes that the term “current” serious prejudice appears nowhere in the SCM Agreement. Indeed, the *US – Cotton Subsidies* panel may have used quotation marks to indicate that it recognized that “current” serious prejudice is a colloquial, rather than a legal, term.

<sup>592</sup> *US – Cotton Subsidies (Panel)*, para. 7.1201.

<sup>593</sup> *Korea – Commercial Vessels*, paras. 7.648-7.649, 7.658. The EC also submitted order backlog data as of January 2004 – that is, at the end of the year of panel establishment. *Id.* paras. 7.681, 7.686, 7.691.

<sup>594</sup> *Indonesia – Autos*, para. 14.212.

<sup>595</sup> For example, in *EC – Sugar Exports (Australia)*, the panel was established on November 6, 1978 and considered data through 1978, explaining (in paragraph 4.13 of its report) that 1978 data was a “special case,” in part because “at the time when Australia presented its complaint, the year 1978 had not ended.” Only in *EC – Sugar Exports (Brazil)* did the panel include more recent data in its analysis, but it did so on the grounds that the EC subsidy measures “had remained the same as in previous years and the effects of the application of the system may have been even more significant than previously.” *EC – Sugar Exports (Brazil)*, para. 4.8.

subsidies to Airbus, caused adverse effects to the interests of the United States in breach of their obligations under Article 5 of the SCM Agreement.

**135. In the trade remedy context, there may be potential difficulties with the reliability and probative value of data relating to the period *after* initiation of a trade remedy investigation, because that data may be affected by the very existence of the investigation. Would such considerations have any relevance in the context of a WTO panel conducting an injury examination, for the purpose of Article 5(a) of the SCM Agreement?**

Response:

452. Any injury examination, whether conducted by a national investigating authority in the context of an antidumping or countervailing duty determination or a panel evaluating a claim under Article 5(a) of the SCM Agreement, must consider the reliability and probative value of *all* evidence. Any factor that diminishes the reliability and probative value of particular evidence is therefore appropriately taken into account in both contexts.

453. In the antidumping or countervailing duty context, the anticipated or actual imposition of provisional duties can affect market data for the period after the initiation of an investigation. Provisional duties, however, are not directly relevant in the Article 5(a) context. Nonetheless, the general principle still holds that data regarding a period after litigation begins should be discounted to the extent that the evidence appears to reflect the effects of the case rather than the effects of the subsidy.

454. In this regard, that the Airbus governments have, while this dispute has been pending, not yet disbursed the Launch Aid that they have committed for the A350, this should not be interpreted as in any way diminishing the continued policy of the Airbus governments to provide significant, trade-distorting support to Airbus. As previously noted, Airbus CEO Louis Gallois recently stated that Airbus is “not putting away refundable launch investment” for the A350,<sup>596</sup> and even more recently the managing director of Airbus UK, Iain Gray, testified to a committee of the British Parliament that additional A350-related investments need to be made at the Airbus facility at Filton, “a move that Airbus would not be able to afford without Government assistance.”<sup>597</sup> To the extent that the Airbus governments have moderated their public statements with regard to these requests, this should be seen as an effect of this dispute. As Moody’s has observed, the demonstrated hesitancy of the Airbus governments to “risk escalating WTO-

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<sup>596</sup> *Airbus weighing up state-backed loans for A350: Gallois*, AFP (Mar. 9, 2007) (Exhibit US-449).

<sup>597</sup> *Airbus Demands More Government Funding*, Times Online (Mar. 27, 2007) (Exhibit US-530).

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arbitrated frictions” is outweighed by their demonstrated “entrenched inclination for state protection” of Airbus.<sup>598</sup>

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<sup>598</sup> Moody’s Investor Service, *Moody’s confirmation of EADS highlights government’s role as odd rescuers*, at 1 (Mar. 12, 2007) (Exhibit US-450).

## LIST OF ADDITIONAL U.S. EXHIBITS

### *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft*

<u>U.S. Exhibit</u>	<u>Description</u>
466.	Factiva, <i>Italy's Alenia to Supply Airbus Fuselage Sections to Dasa</i> (Feb. 10, 1999)
467.	House of Commons Hansard Written Answers (Feb. 2, 1998) (statement of Mrs. Beckett)
468.	House of Commons Hansard Written Answers (Dec. 15, 1998) (statement of Mr. Battle)
469.	Kevin O'Toole, "BAE Wins Launch Aid for Airbus A340-500/600," <i>Flight International</i> (Feb. 11, 1998)
470.	Frank Kerins, Janet Kiholm Smith, and Richard Smith, "Opportunity Cost of Capital for Venture Capital Investors and Entrepreneurs," <i>Journal of Financial and Quantitative Analysis</i> 39 (2004) 385-405 ("KSS")
471.	John H. Cochrane, "The Risk and Return of Venture Capital," <i>Journal of Financial Economics</i> 75 (2005) 3-52 ("Cochrane")
472.	Steven N. Kaplan and Per Stromberg, "Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts," <i>Review of Economic Studies</i> 70 (2003) 281-315
473.	Douglas J. Cumming: "Capital structure in venture capital finance," <i>Journal of Corporate Finance</i> 11 (2005) 550-585
474.	Overview of i2i loans
475.	Distribution of EIB loans (1988-1993)
476.	Third Party Oral Statement by the European Communities, <i>US - Softwood Lumber CVD Final (Panel)</i> , paras. 14, 15 (Feb. 12, 2003)
477.	Innovation 2010 Initiative, <a href="http://www.eib.org/site/index.asp?designation=i2i">www.eib.org/site/index.asp?designation=i2i</a>
478.	Commission of the European Communities, Merger Procedure Article 6(1)(b) Decision, Case No COMP/M.2061 - Airbus (Oct. 18, 2000)
479.	European Commission, Merger Procedure Article 6(2) Decision, Case No COMP/M.1745 - EADS (May 11, 2000)
480.	Screen shot from <a href="http://www.grandtoulouse.org/index.php?pagecode=125&amp;modele_affi_dossier=">http://www.grandtoulouse.org/index.php?pagecode=125&amp;modele_affi_dossier=</a>
481.	Satellite photographs of Aeroconstellation site

482. Conseil de Communauté d'Agglomération du Grand Toulouse du 13 Décembre 2004, ZAC AéroConstellation - Bail Grand Toulouse / AFUL: Adoption de l'Avenant No. 1, available at <http://publi.agglo-grandtoulouse.fr/>
483. Werum Software & Systems, Pressemitteilung Messdatenmanagementsysteme, Testdatenmanagementsystem von Werum im Einsatz für Tests des A380
- 483a. Werum Software & Systems, Pressemitteilung Messdatenmanagementsysteme, Testdatenmanagementsystem von Werum im Einsatz für Tests des A380 (English excerpt)
484. Airbus, CASIV, Vorhaben Verifikationstechnologie für Bordsysteme, Realisierungsphase (Phase 2), Schlußbericht
- 484a. Excerpt in English from Airbus, CASIV, Vorhaben Verifikationstechnologie für Bordsysteme, Realisierungsphase (Phase 2), Schlußbericht
485. List of R&D amounts EC has not disclosed
486. Decision No 182/1999/EC of the European Parliament and of the Council of 22 December 1998 concerning the fifth framework programme of the European Community for research, technological development and demonstration activities (1998 to 2002), OJ L26/1 (February 1, 1999) ("Decision 182/1999/EC")
487. Council Decision 1999/169/EC of January 25, 1999 adopting a specific program for research, technological development and demonstration on competitive and sustainable growth (1998 - 2002), OJ L 64/40 (March 12, 1999)
488. New Perspectives in Aeronautics, pp. 34-36, in European Commission, Growth Workprogramme 1998-2002 (December 2000)
489. Aeronautics and Space, Work Programme 2002-2006
490. Excerpts from German Federal Budgets for 2006 and 2007
491. Council Decision of 14 March 1989 on a specific research and technological development programme in the field of industrial manufacturing technologies and advanced materials applications (Brite/Euram) (1989 to 1992) (89/237/EEC) OJ L 98/18 (April 11, 1989)
492. Council Decision of 9 September 1991 adopting a specific programme of research and technological development in the field of industrial and materials technologies (1990 to 1994) (91/506/EEC), OJ L 269/30 (September 25, 1991) ("Council Decision 91/506/EEC")
493. Council Decision of 27 July 1994 adopting a specific programme for research and technological development, including demonstration, in the field of industrial and materials technologies (1994-1998) (94/571/EC), OJ L 222/19 ("Council Decision 94/571/EC")

494. Decision No 1513/2002/EC of the European Parliament and of the Council of 27 June 2002 concerning the sixth framework programme of the European Community for research, technological development and demonstration activities, contributing to the creation of the European Research Area and to innovation (2002 to 2006), OJ L 232/1 (August 29, 2002) (“Decision 1513/2002/EC”)
495. DTI, Second Call of the Technology Programme (April 2004), Advanced Composite Materials and Structures; The Technology Programme, November 2004 Competition for Funding, Smart Materials and Related Structures; and The Technology Programme: Spring 2006 Competition for Funding, Design Engineering & Advanced Manufacturing: Management of complex fluid flow conditions
496. European Commission, Press Release of 18 October 2000, “European Commission Clears the Creation of the Airbus Integrated Company”
497. “FP6 in Brief”, [http://ec.europa.eu/research/fp6/pdf/fp6-in-brief\\_en.pdf](http://ec.europa.eu/research/fp6/pdf/fp6-in-brief_en.pdf), p. 4
498. Midi Presse Services MPS, June 18, 2004, no. 1482, Le Grand Toulouse: Maitre d’Ouvrage d’Aéroconstellation
499. Airbus, *The Airbus Way* (Jan. 2006)
500. Scott Hamilton, *Airbus’ Leahy makes little news, but is entertaining at 3*, available at <http://www.leeham.net/filelib/Leahy.pdf> (Mar. 13, 2007)
501. *Boeing, Airbus duel over BA*, Seattle Post-Intelligencer (Apr. 10, 2007)
502. Calculation of annual subsidy benefit from French A340-500/600 Launch Aid (BCI)
503. EADS, Report of the Board of Directors, in Documentation for the Annual General Meeting on Friday, May 4, 2007, at 30, available at <http://www.eads.com/xml/content/OF00000000400004/1/50/41582501.pdf>
504. Richard Aboulafia, *Airbus and Boeing Race to the Bottom*, Aerospace America (Oct. 2002)
505. *Boeing puts new emphasis on financing unit*, Seattle Times (Oct. 8, 1999)
506. *Why buy aircraft when planes can be leased?*, Seattle Times (Aug. 20, 2000)
507. Airbus Press Release, *2005: Airbus continues to lead* (Jan. 17, 2006)
508. *Airbus’ Eccleston: 1<sup>st</sup> A380 Will Be Delivered in Oct. ‘07*, Dow Jones News Service (Dec. 6, 2006)
509. *Airbus knocks down prices to entice airlines to purchase A350*, Times (London) (Apr. 20, 2007)
510. Airbus Press Release, *Finnair, first airline to sign firm contract for the A350XWB* (Mar. 8, 2007)

511. Airbus Press Release, *Afriqiyah Airways orders up to six A330s and 14 Airbus A320 Family aircraft* (July 18, 2006)
512. Airbus Press Release, *ETIHAD selects Airbus A380 and A330/A340 family aircraft* (July 20, 2004)
513. Airbus Press Release, *Lufthansa places repeat order for Airbus A320 and A330-300 aircraft* (Oct. 13, 2006)
514. Airbus Press Release, *Turkish national carrier chooses Airbus for fleet increase* (July 21, 2004)
515. Airbus Press Release, *Qatar Airways to expand with an all-Airbus fleet* (June 19, 2003)
516. Airbus Press Release, *Air Europa orders 10 A350s with two more on option* (Jan. 25, 2006)
517. Airbus Press Release, *Eurofly orders new Airbus A350* (Jan. 3, 2006)
518. Eurofly, *Road Show* (Dec. 2005)
519. Airbus Press Release, *Finnair orders A350s and A340s for future long-haul fleet* (Mar. 30, 2006)
520. Airbus Press Release, *Kingfisher becomes first Indian customer for A380, A350, & A330* (June 15, 2005)
521. Airbus Press Release, *Kingfisher grows its Airbus fleet with purchase of five A340-500* (Apr. 24, 2006)
522. Airbus Press Release, *Brazilian TAM increases A320 fleet and selects A350* (June 16, 2005)
523. Airbus Press Release, *Brazilian TAM becomes A350 launch customer in Latin America* (Dec. 21, 2005)
524. Airbus Press Release, *TAM signs contract for the acquisition of 37 additional Airbus aircraft* (Nov. 16, 2006)
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526. Airbus Press Release, *US Airways firms up order for 20 A350s* (Nov. 29, 2005)
527. EADS, *Annual Results 2006*
528. Scott Hamilton, *The numbers game and Airbus*, Commercial Aviation Report, Aug. 1, 2006

529. EADS Presentation, Annual Earnings 2006, Analysts' Conference Call (Mar. 9, 2007), at 1:06:47
530. *Airbus Demands More Government Funding*, Times Online (Mar. 27, 2007)
531. *Airbus was caught napping by 787: Leahy*, Flight Global (Apr. 27, 2007)
532. Page from Grand Toulouse webiste  
([http://www.grandtoulouse.org/index.php?pagecode=125&modele\\_affi\\_dossier=](http://www.grandtoulouse.org/index.php?pagecode=125&modele_affi_dossier=))
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