

United States – Measures Affecting Trade in Large Civil Aircraft
(Second Complaint)
(DS353)

RESPONSE OF THE UNITED STATES
TO THE FIRST SET OF QUESTIONS FROM THE PANEL TO THE PARTIES

December 5, 2007

TABLE OF REPORTS AND OTHER DOCUMENTS

Short Form	Full Citation
<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/DS139,142/AB/R, adopted 19 June 2000
<i>EC – Bed Linen 21.5 (AB)</i>	Appellate Body Report, <i>European Communities - Anti-Dumping Duties on Imports Of Cotton-Type Bed Linen from India, Recourse to Article 21.5 of the DSU by India</i> , WT/DS141/AB/RW, adopted 24 April 2003
<i>EC – Biotech</i>	<i>European Communities - Measures Affecting the Approval and Marketing of Biotech Products</i> , WT/DS291,292,293/R, adopted 29 September 2006
<i>EC – Pipe Fittings (AB)</i>	Appellate Body Report, <i>European Communities - Anti-Dumping Duties on Malleable Cast Iron Tube or Pipe Fittings from Brazil</i> , WT/DS219/AB/R, adopted 18 August 2003
EC FWS	First Written Submission of the European Communities, <i>United States – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)(DS 353)</i> (Feb. 9, 2007)
EC OS1	First Non-Confidential Oral Statement by the European Communities, <i>United States – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)(DS353)</i> (September 28, 2007)
EC OS1 (conf.)	Oral Statement by the European Communities to the First Meeting of the Panel – Confidential Session, <i>United States – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)(DS353)</i> (September 28, 2007)
EC SWS	Second Written Submission of the European Communities, <i>United States – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)(DS 353)</i> (Nov. 19, 2007)
<i>India – Patents (AB) (US)</i>	Appellate Body Report, <i>India - Patent Protection for Pharmaceutical and Agricultural Chemical Products (Complaint by U.S.)</i> , WT/DS50/AB/R, adopted 19 December 1997

U.S. AND EC BUSINESS CONFIDENTIAL INFORMATION REDACTED

<i>Korea – Commercial Vessels</i>	Panel Report, <i>Korea – Measures Affecting Trade in Commercial Vessels</i> , WT/DS273/R, adopted 11 April 2005
<i>Mexico – Taxes on Soft Drinks (AB)</i>	Appellate Body Report, <i>Mexico - Tax Measures on Soft Drinks and Other Beverages</i> , WT/DS308/AB/R, adopted 24 March 2006
<i>New Shorter Oxford English Dictionary</i>	<i>The New Shorter Oxford English Dictionary on Historical Principles</i> (Clarendon Press, Oxford) (1993)
<i>US – Gasoline (AB)</i>	Appellate Body Report, <i>United States - Standards for Reformulated and Conventional Gasoline</i> , WT/DS2/AB/R, adopted 29 April, 1996
<i>US – Upland Cotton (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 – Upland Cotton (AB)</i>	Appellate Body Report, <i>United States - Subsidies on Upland Cotton</i> , WT/DS267/AB/R, adopted 21 March 2005
<i>US – FSC (AB)</i>	Appellate Body Report, <i>United States – Tax Treatment for “Foreign Sales Corporations”</i> , WT/DS108/AB/R, adopted 20 March 2000
<i>US – FSC 21.5 (AB)</i>	Appellate Body Report, <i>United States – Tax Treatment for “Foreign Sales Corporations,” Recourse by the European Communities to Article 21.5 of the DSU</i> , WT/DS108/AB/RW, adopted 14 January 2002
US FWS	First Written Submission by the United States, <i>United States – Measures Affecting Trade in Large Civil Aircraft (Second Complaint) (DS353)</i> (July 6, 2007)
US OS1	Oral Statement of the United States at the First Substantive Meeting of the Panel with the Parties, <i>United States – Measures Affecting Trade in Large Civil Aircraft (Second Complaint) (DS353)</i> (September 26, 2007)
<i>US – Shrimp 21.5 (AB)</i>	Appellate Body Report, <i>United States - Import Prohibition of Certain Shrimp and Shrimp Products</i> , WT/DS58/AB/RW, adopted 21 November 2001
US SWS	Second Written Submission of the United States, <i>United States – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)(DS 353)</i> (Feb. 9, 2007)

I. ISSUES RELATING TO INFORMATION GATHERING AND THE AMOUNT OF THE ALLEGED SUBSIDIES

To both parties:

1. *In US – Upland Cotton, the panel stated that "the argument ... relating to the "amount" or "portion" of the subsidy ... is not germane to the inquiry that is to be conducted under Article 1 of the SCM Agreement. Here, we are asking whether a "financial contribution" exists, and whether a "benefit" is thereby conferred. We are not required precisely to establish, at this stage, the quantity of that benefit ...".¹ Do the parties consider this approach applicable to the present dispute?*

1. An analysis of whether a subsidy exists under Article 1 of the *Agreement on Subsidies and Countervailing Measures* (“SCM Agreement”)² requires a determination of whether a financial contribution exists that confers a benefit. In deciding whether a financial contribution confers a benefit, in that it provides something on terms that are more favorable than those available on the market, it is often necessary to compare the terms of the financial contribution with the terms “available to the recipient on the market.”³ For instance, with loans, the benefit analysis requires comparison of the terms of the government loan with the terms of a comparable “benchmark” loan. Government provision of equity capital requires comparison with the terms of the usual investment practice of private investors in the territory of the responding party. And the provision of goods and services – or the provision of goods – requires a comparison of the price charged by the government with a price that would provide adequate remuneration in relation to prevailing market conditions for the good or service in question. The comparison of the terms of the financial contribution to a commercial comparator often involves numbers and may involve some form of quantitative analysis. However, that exercise need not continue on to a precise quantification of the total. In other words, if the comparison establishes the existence of a benefit conferred by the financial contribution at issue, then a subsidy exists, and there is no need to precisely quantify the amount of the subsidy.

2. In the statement by the panel in *US-Upland Cotton* quoted above, the panel was not addressing the process of analyzing whether a benefit was conferred. In fact, in that case, the United States had not disputed that many of the measures at issue were subsidies.⁴ Rather, the panel’s statement in *US-Upland Cotton* pertains to the argument made by the United States regarding the need to apportion the benefit of the subsidy among various products to which it was relevant. In *US-Upland Cotton*, it was during this step, not during the examination whether an alleged financial contribution confers a benefit, that the panel found that precise quantification

¹ *US – Upland Cotton (Panel)*, para. 7.1119.

² In this submission, all citations to Articles are to the SCM Agreement unless otherwise indicated.

³ *Canada – Aircraft (AB)*, para. 157.

⁴ *US – Upland Cotton (Panel)*, para. 7.1114.

was not necessary.⁵ Nothing in that report suggests that the initial benefit determination may dispense completely with quantitative evidence or analysis.

To the European Communities:

2. *In its First Written Submission, the European Communities asks the Panel to adopt its estimates of subsidy amounts "as the best information available and, as appropriate, draw adverse inferences due to the United States' non-cooperation in the information-gathering process" (EC FWS, paras. 132, 154, 168, 182, 194, 203, 229, 245, 261, 277, 325, 336, 361, 385, 406, 431, 450, 525, 549, 573, 589, 604, 619, 632, 651, 763, 799, 848, 876, 913, 958.)*
 - (a) *Why does the Panel need to make a finding on whether the United States "cooperated" in the information gathering process envisaged in Annex V in order to adopt the European Communities' estimates? Does the Panel need to find that the United States failed to cooperate in the Annex V process in order to accept and rely upon the European Communities' estimates of the amount of the subsidies at issue?*
 - (b) *What is the legal and factual basis for finding that the United States failed to cooperate in information-gathering process? Please respond to the United States' assertions that "{t}he EC had multiple opportunities to request findings by the panel or the Annex V Facilitator that the United States failed to cooperate. It never made such a request and, in any event, neither the DS317 panel nor the DS317 Annex V Facilitator ever made such a finding." (US FWS, para. 25)*
 - (c) *Is the Panel correct in understanding that issues relating to "best information available", "adverse inferences", and "non-cooperation" in the information-gathering process arise only in connection with the European Communities' estimates of the amounts/values of the alleged subsidies?*
 - (d) *Does the European Communities still consider the estimates of the amounts of the alleged subsidies set forth in its First Written Submission to be the "best information available", or does the European Communities accept any of the figures provided by the United States in its First Written Submission?*
 - (e) *Does the European Communities mean the same thing when it asks the Panel to: (i) adopt its estimates as the "best information available"; and (ii) "as appropriate, draw adverse inferences"?*

⁵ US – Upland Cotton (Panel), paras. 7.1114-7.1119.

3. *At paragraph 72 of its Oral Statement, the European Communities argues that the United States "has offered absolutely no evidence in support of the unrealistically low figures presented in its First Written Submission. The United States cannot assert figures without any supporting evidence and expect them to be accepted at face value." At paragraph 74 of its Oral Statement, the European Communities argues that "only a complete disclosure by the United States of all NASA- and DOD-funded contracts and sub-contracts with Boeing and McDonnell Douglas under the programmes at issue will make an adequate bottom-up analysis possible".*
- (a) *Is the European Communities arguing that the only way that the United States can substantiate its assertions regarding the amount of the alleged subsidies would be for the United States to provide the European Communities and the Panel with copies of all of the relevant contracts?*
- (b) *Is the European Communities asking the Panel to find that payments made to Boeing under "sub-contracts" constitute "subsidies" within the meaning of Article 1? If so, what is the legal and factual basis for such a finding?*
4. *At paragraph 159 of its First Written Submission, the United States sets out the criteria that it used to identify the DOD contracts that the European Communities identified as its "primary area of concern". Does the European Communities accept the criteria used by the United States to identify relevant DOD contracts?*
5. *The European Communities estimates that through FY 2006, DOD granted \$2.4 billion in financial contributions to Boeing's LCA division through the RDT&E Program (EC FWS, para. 763). We understand this figure to comprise not only "direct R&D funding", but also "federal personnel and research facilities to support the RDT&E Program". What are the respective amounts of each?*

To the United States:

6. *How does the United States respond to paragraphs 72 and 74 of the European Communities' Oral Statement? Has the United States provided the Panel with any evidence to support its assertions regarding the actual amount of the payments made to Boeing under the NASA/DOD R&D programs at issue?*
3. The United States has provided the Panel with voluminous evidence to support its assertions with regard to the actual amount of payments made to Boeing under the NASA/DoD R&D programs at issue. With regard to NASA payments to Boeing under the programs challenged by the European Communities ("EC"), the United States has provided all of the contracts between NASA and Boeing identified in NASA's databases that related to the

programs identified by the EC that were available to the United States,⁶ and that had not already been submitted by the EC. The U.S. exhibits also contained the available modifications to all contracts subsequent to the ACT Program (including composites-related projects conducted under later programs, but defined as part of the ACT Program by the EC). The contracts and modifications allow tracking of the amounts of funding NASA allotted to each contract,⁷ and confirm that NASA's disbursement figures indicating that it paid less than \$750 million to Boeing under these programs are not, as the EC charges, "unrealistically low." Finally, the U.S. response to Panel Question 7 explains how NASA derived its disbursement figure, and demonstrates why that figure is reliable.

4. With regard to DoD payments to Boeing under the programs challenged by the EC, the United States submitted a "Contract List" indicating the 43 contracts that meet the criteria identified by the EC. This Contract List appeared as Exhibit US-41, and was properly labeled on the U.S. exhibit list. Through a clerical error, it was incorrectly identified (as Exhibit US-54) in the text of the first written submission. Along with the Contract List, the United States submitted copies of the contracts that met the criteria identified by the EC, along with subsequent modifications to those contracts. These appeared as exhibits US-599 – US-639 and US-641-US-704. The contracts and modifications allow tracking of the amounts of funding DoD allotted to each contract, and provide evidence for the figure reported in paragraph 161 of the U.S. submission.

5. In paragraph 74 of its first oral statement, the EC sets out the conditions that it views as necessary for a "bottom-up" analysis of the programs that it challenges:

{O}nly a complete disclosure by the United States of all NASA- and DoD-funded contracts and sub-contracts with Boeing and McDonnell Douglas under the programmes at issue will make an adequate bottom-up analysis possible.

As an initial point, the question is not whether "an adequate bottom-up analysis" is "possible." The question before the Panel is whether the EC's "top down" approach meets the EC's burden

⁶ Some of the older instruments were not available in NASA's files, and some of the newest instruments could not be reviewed for business confidential information in the time available for preparation of the U.S. first written submission.

⁷ Each contract indicates the funds that the agency allots to the contract at the outset. *E.g.*, NASA Contract NAS1-20220, section B.3 (Exhibit EC-347). That figure represents the amount of funds that the agency commits to make available for payment for work under the contract. As the work advances, NASA will periodically allot more funds to the contract, typically through a modification to the contract. *E.g.*, NASA Contract NAS1-20220, Modification 1, p. 2 (Exhibit US-550, page 2/352). The modifications allow a tracking of available funds over the life of a contract. However, the actual amount disbursed may be less than the funds allotted (if the contractor finishes the work before the funds run out) or may be more than the amount in the final modification if adjustments are necessary when the contract is closed out. Therefore, the funds allotted under the modifications allow an estimate of the maximum that NASA was authorized to spend under the contract.

of proof to establish the existence of an actionable subsidy – namely, that the programs in question were financial contributions, conferring a benefit, that were specific, and that caused adverse effects. The United States has shown that, even without reference to any evidence supplied by the United States, the EC’s assertions are flawed and unreliable.

6. Furthermore, the contracts do permit an adequate “bottom-up analysis” and demonstrate with certainty the flaws in the EC’s assertions. As noted above, the United States has submitted all of the contracts with Boeing identified in NASA’s databases that it could make available with its first written submission. The disbursements for which the United States has not submitted contracts account for \$21 million, less than 3 percent of the \$715 million that NASA’s records show it disbursed to Boeing for the supply of research and development services under the programs challenged by the EC. Therefore, there has been a substantially “complete disclosure” of the relevant NASA contracts. In addition, the United States reported the amount disbursed to Boeing and McDonnell Douglas pursuant to contracts under the programs challenged by the EC. This was a “bottom-up” analysis, in that it utilized NASA’s most detailed system of records to generate data on a contract-by-contract basis. These documents are plainly “adequate” for the Panel to reach conclusions regarding the nature of NASA’s R&D contracting, and the amount of money involved.

7. With regard to DoD RDT&E contracts, the EC formulated its allegation by reference both to the nature of the research (RDT&E into “dual use” technologies) and to the budgetary accounts used to fund the activity (the “program elements” cited in the EC submission). DoD does not maintain data that allow an identification of which contracts were funded under particular PE numbers.⁸ Except for two programs that explicitly seek to leverage civil knowledge for military purposes (Dual Use Science and Technology and ManTech), DoD has no knowledge as to what additional technology might meet the EC’s definition of “dual use.”⁹ Therefore, the United States attempted to identify relevant contracts using the criteria listed in paragraph 159 of the U.S. first written submission:

(1) funding by one of the budgetary program elements listed in paragraphs 676 and 677 of the EC first written submission;¹⁰ (2) absence of a purely military objective; (3) no relation to space; (4) no relation to missiles; and (5) no relation to engines {; and} . . . no relation to rotorcraft.

These criteria are likely to result in an over-inclusive set of contracts. That is, a contract involving a non-military (or non-space, non-missile, non-engine) technology with no application

⁸ Funding information is indicated on the paper copies of the contracts, but not in the relevant databases.

⁹ The United States notes that the “dual uses” for technologies studied under these programs, in most cases, were not relevant to large civil aircraft.

¹⁰ Based on manual review of contracts that met criteria (2), (3), (4), and (5).

(or applicability) to large civil aircraft would still be captured. (Paragraph 162 of the U.S. first written submission contains examples of such contracts.) In this way, the United States tried to ensure that the collection did not unintentionally exclude a contract that, while not explicitly having a dual use with civil aircraft, otherwise might meet the EC's definition of dual use. The EC should be familiar with these contracts, as most of them were submitted during the Annex V process in DS317.¹¹

8. Therefore, the contracts gathered and submitted by the United States are “adequate” for a bottom-up evaluation of the EC assertions in that the criteria only exclude RDT&E contracts with subject matters unlikely to produce technologies useful for large civil aircraft. They also include contracts that have no explicit link to large civil aircraft. This set of documents allows the Panel to examine and evaluate contracts that meet the EC's criteria. The United States is confident that the Panel will conclude that the EC's assertions regarding the volume of such contracts and their potential applicability to large civil aircraft are greatly exaggerated.

9. As the United States is rebutting assertions by the EC, the amount or nature of evidence that is “adequate” for the Panel's purposes will depend in part on what information the EC puts forward in support of those assertions. In this case, the information put forward by the EC consists of CRA's evaluation of the descriptions of work that *could* be funded under certain DoD budgetary program elements. For the reasons described in the U.S. first written submission, CRA's analysis is manifestly *inadequate*. Although the EC concedes that work carried out by DoD was for military objectives,¹² CRA assumes without explanation that references to generic terms always equate to applicability to large civil aircraft.¹³ Moreover, CRA ignored information indicating that its estimates of the value of such activities were vastly overstated.¹⁴ Thus, whatever issue the EC may raise in response to Panel Question 4, it is clear that the information submitted by the United States is better and more reliable than the information put forward by the EC.

10. The United States notes that the EC also proposes that “complete disclosure” of Boeing subcontracts is also necessary to an “adequate” analysis. The United States does not understand the relevance of subcontracts to the inquiry. The EC has stated quite explicitly that its claims with regard to NASA R&D and DoD RDT&E arise under Article 1.1(a)(1)(i) and relate to funds “directly transferred . . . to Boeing's LCA division” (or The Boeing Company, for DoD).¹⁵ Any

¹¹ For purposes of the first written submission, the United States gathered contracts that meet the criteria used to gather Annex V contracts but that were finalized afterward.

¹² EC SWS, para. 413.

¹³ US FWS, paras. 129-130.

¹⁴ US FWS, paras. 131-138.

¹⁵ EC FWS, paras. 524, 548, 572, 588, 603, 618, 631, and 638. The assertion with regard to DoD RDT&E contracts is that “DoD . . . directly transfers funds in the form of grants to Boeing.” EC FWS, para. 766.

payments that may have gone to Boeing as a subcontractor would have been paid to the prime contractor, who would then have been responsible for making any payments to subcontractors pursuant to the subcontracts.¹⁶ Therefore, such payments would not have fallen into the class of “funds directly transferred . . . to Boeing’s LCA division” that the EC asserts are subsidies to Boeing. This holds true for both NASA and DoD.

7. *At paragraph 212 of its First Written Submission, the United States indicates that NASA records show that less than \$750 million was paid to Boeing/MD under the NASA programs challenged by the European Communities. How did the United States arrive at that figure?*

11. NASA obtained the data used to generate the table in paragraph 212 of the U.S. first written submission from the Federal Procurement Data Base (“FPDS”) and from the NASA Procurement Management System (“NPMS”), a legacy NASA system that, prior to 2005, was used to accumulate agency data that was then input into FPDS.

12. Whenever any Federal agency awards a procurement action with an obligation greater than \$3,000, a prescribed data set for that action must be reported to the Office of Management and Budget in the Executive Office of the President via the FPDS. The data set includes such items as date of award, name of contractor, place of performance, etc. After award, the system is updated over its life with additional obligations as they occur. FPDS is the database of record for procurements for the U.S. Government and it is the only reliable and comprehensive source for data on NASA procurements.

13. Prior to 2004, all agencies had internal data collection systems which accumulated their data, performed checks, and then fed information into FPDS. As mentioned above, NASA’s system was known as NPMS. Since 2005, all agencies input their data directly into an updated version of FPDS, known as FPDS-NG (Federal Procurement Data Base – Next Generation).

14. NASA developed the data reported in the table in paragraph 212 of the U.S. first written submission by obtaining a listing from FPDS of all awards (whether contracts, cooperative agreements, or grants¹⁷) made to Boeing and McDonnell Douglas for the years 1989-2006. Awards that clearly did not pertain to any NASA Aeronautics programs, such as those related to manned space flight, the International Space Station or space science, were deleted. Information pertaining to each individual action was accumulated by the Program Groupings (ACEE, ACT+AST Composites), HSR, AST, HPCC, Safety, QAT, VSP, R&T Base) identified by the

¹⁶ DoD and NASA are not in privity of contract with subcontractors. That means that there is no contractual relationship between the agency and the subcontractor. If the subcontractor fails to perform its work, DoD or NASA cannot enforce the subcontract in court. If the subcontractors do not receive payment, they cannot sue DoD or NASA for payment.

¹⁷ Boeing did not receive any grants for aeronautics research.

EC. Note that NASA grouped ACT and AST composites together solely for purposes of comparison with the data presented by the EC. AST composite research was part of the AST Program, and not ACT.

15. Although FPDS does not record disbursement data, prior to 2005 NASA routinely accumulated disbursement data in the NPMS. Therefore, for each action identified for Boeing and McDonnell Douglas, NASA was able to accurately identify amounts obligated and disbursed for each contract, by year. For the years 2005 and 2006, since FPDS-NG does not record disbursement data, NASA was able to obtain disbursement data from its internal financial records. The ACEE Program is so old that there were no disbursement data available in either the NPMS or FPDS databases. As explained in the U.S. first written submission, NASA derived an estimate based on total budgeted funding for the ACEE program on Boeing and McDonnell Douglas's share of the NASA program budget for the next oldest program, ACT.¹⁸

16. Disbursements data for the HSR procurement instruments indicated a total spending of approximately \$395 million, and VSP Program instruments indicated disbursements of approximately \$26 million.¹⁹ These figures were higher than the amount of money allotted to the contracts for aeronautics research under those programs (\$325 million and \$12 million, respectively), indicating that some of the disbursements had gone for non-aeronautics purposes. NASA accordingly reduced the HSR and VSP disbursement amounts to reflect the amounts allotted for aeronautics research.

17. The amount disbursed under each contract for each program, as determined using this methodology, is listed in Payments to Boeing/McDonnell Douglas under NASA Aeronautics Programs Challenged by the EC (Exhibit US-1202).

8. *At footnote 219 of its First Written Submission, the United States indicates that the \$529 million figure referred to in paragraph 161 of its First Written Submission is an "estimate". Does this mean that the actual amount is greater than \$529 million?*

18. The U.S. response to Question 6 describes the method used to derive the \$529 million figure. In reviewing the materials submitted in support of the Contract List, the United States noted that Contract 33615-97-C-3219, for Composite Repair of Aircraft Structures (Exhibit US-642), was mistakenly omitted from the Contract List. The total value of that contract was \$5,611,891.²⁰ Therefore, the total estimate should be increased accordingly to \$534 million.

¹⁸ US FWS, para. 212, note 305.

¹⁹ The amount for the R&T Base Program is \$1 million less than reported in paragraph 212 of the U.S. first written submission because review of the data indicated that NASA Contract NAS1-00092 had mistakenly been counted twice.

²⁰ Contract 33615-97-C-3219, Modification 19, para. 3 (Exhibit US-642).

19. The actual amount – insofar as determination of an actual amount is possible in light of the subjective criteria used by the EC to identify the funding it is challenging – is likely to be lower than \$534 million for two reasons.

20. *First*, the EC defined the research subject to its allegations in vague, general terms. It acknowledged that all R&D purchased by DoD has a military purpose, but alleged that some also has a “dual use” applicable to large civil aircraft. To avoid excluding research that might meet the EC’s criteria, the United States crafted the criteria so as to be overly inclusive. As indicated in paragraph 162 of the U.S. first written submission, many of the contracts involved research with no conceivable relationship to large civil aircraft. The description in the EC second written submission of topics of interest to the EC was “research of *any kind* funded and supported by DoD through its RDT&E Program that gives rise to technology that could be (and/or was) applied to LCA.” Even under this broad standard, contracts for research with no conceivable relationship to civil aircraft did not involve research that “*also produces dual-use technology.*”²¹

21. *Second*, the United States based the value it ascribed to each contract on the amount of budgeted funds allotted to that contract. Contracts do not always make full use of allotted funds, which would make the budgeted amount high.

9. *In footnote 219 of its First Written Submission, the United States refers to "Contract List (Exhibit US-54)". Should this read "Exhibit US-41"?*

22. Yes. The reference to the Contract List should be to Exhibit US-41.

II. EXISTENCE OF SUBSIDIES

A. HORIZONTAL ISSUES

1. Measures at issue

To the European Communities:

10. *In its First Written Submission, the European Communities refers to "subsidies", "programmes", and "measures". Does the European Communities use these terms interchangeably?*

11. *At page 14 of its panel request, the European Communities claims that the measures at issue are inconsistent with the provisions of the covered agreements cited therein "as such and as applied".*

²¹ EC SWS, para. 461 (emphasis in original).

- (a) *Please specify: (i) which measures the European Communities is challenging "as such"; (ii) which measures the European Communities is challenging "as applied"; and (iii) which measures the European Communities is challenging both "as such" and "as applied".*
- (b) *Insofar as the European Communities is challenging certain measures "as such", please explain: (i) what the European Communities means when it states that it is challenging a measure "as such"; and (ii) how a measure can be inconsistent "as such" with the effects-based disciplines of Part III of the SCM Agreement.*

To both parties:

12. *In its First Written Submission, the United States suggests that the European Communities is challenging "future measures".*

- (a) *Can the parties explain what they consider to be a "future measure"?*

23. A future measure is one that is not in existence at the time that of panel establishment. Future measures are not properly within the Panel's terms of reference.

- (b) *Which measures in this dispute (if any) constitute "future measures"?*

24. The Industrial Revenue Bonds ("IRBs") that the City of Wichita, Kansas issued to Spirit Aerosystems, Inc. ("Spirit") are future measures that are outside the Panel's terms of reference. At the outset, it is important to clarify that the EC is not challenging the State of Kansas' IRB statute. Rather, it is challenging a series of actions taken by the Wichita City Council pursuant to the IRB statute. Although the City of Wichita issued one set of IRBs to Spirit in December 2005, before the request for panel establishment, it did not issue a second set of IRBs to Spirit until it passed another city ordinance in November 2006 – well after the Panel was established in this dispute.²² Accordingly, this second set of IRBs is a future measure. Moreover, any other IRBs that the Wichita City Council may choose to issue to Spirit in the future pursuant to new city ordinances that it may pass are also future measures that are outside the Panel's terms of reference.

25. As for the other measures that, in its First Written Submission, the United States suggested constitute future measures, specifically those taken by the State of Illinois, the United States considers it may have been more accurate to refer to "future benefit" rather than "future measures."

²² EC FWS, para. 296; Wichita City Council Ordinance No. 47-303 (Exhibit EC-177).

2. Issues in dispute

To the United States:

13. *Leaving aside the amount of the alleged subsidy, does the United States accept that all of the following constitute subsidies that are specific within the meaning of Articles 1 and 2 as argued by the European Communities: (i) the Washington State B&O tax credit for computer software and hardware; (ii) the Washington State sales and use tax exemption for computer hardware, peripherals and software; (iii) the Washington employment resource centre; and (iv) the retirement of a lease by the City of Chicago?*

26. The Washington State B&O tax credit for computer software and hardware allows a manufacturer of commercial airplanes to receive a tax credit for expenditures on “design and preproduction development computer software and hardware.”²³ Although this is a specific subsidy, the amount of the subsidy is only \$20 million.²⁴

27. Although the Washington State sales and use tax exemptions for computer hardware, peripherals, and software is a specific subsidy within the meaning of the SCM Agreement, the amount of this subsidy is only \$11.5 million through FY 2007, not all of which is attributable to Boeing.²⁵

28. In the opinion of the United States, the Washington employment resource center can be considered a specific subsidy under the SCM Agreement *only for the first five years* that it is in operation, because it is only during this period that Boeing is entitled to exclusive use of the facility.²⁶ Through December 2006, the amount of the subsidy was \$478,200 and will be only \$4.78 million over the full five years. After 2011, the employment resource center will revert to general public use, and, as such, can no longer be considered a specific subsidy. Accordingly, the EC has vastly overstated the amount of the financial contribution by the State of Washington from the employment resource center.²⁷

29. The retirement of the lease by the City of Chicago is a subsidy that is specific within the meaning of Articles 1 and 2 of the SCM Agreement. But the financial contribution from this

²³ HB 2294 s 8 (Exhibit EC-54); RCW 82.04.4462 (Exhibit US-193).

²⁴ Washington State Department of Revenue Final HB 2294 Fiscal Note – 20-Year Spreadsheet (Exhibit US-184) and US FWS, para. 488.

²⁵ Washington State Department of Revenue Final HB 2294 Fiscal Note – 20-Year Spreadsheet (Exhibit US-184)

²⁶ Employment Resource Center Lease, p. 3 (Aug. 2005) (Exhibit US-239).

²⁷ US FWS, paras. 582-585.

lease retirement that can be attributed to Boeing's large civil aircraft division is miniscule – only a half of a million dollars.²⁸

14. *Leaving aside the amount of the alleged subsidy, and the issue of specificity, does the United States accept that all of the following constitute subsidies within the meaning of Article 1 as argued by the European Communities: (i) so-called "direct R&D funding" under the DOC ATP program; (ii) the Washington State B&O tax credit for preproduction development; (iii) the Washington State B&O tax credit for property taxes; (iv) the Washington State workforce development program; (v) the State of Illinois reimbursement for relocation expenses; and (vi) the City of Chicago refund of certain property taxes paid on headquarters?*

30. Funding provided by the Department of Commerce's Advanced Technology Program ("ATP") can be considered a subsidy within the meaning of Article 1 of the SCM Agreement, but it is not an actionable subsidy because it is not specific under Article 2. In our answer to Question 48 below, the United States has provided a more detailed response to the EC's erroneous assertions that ATP is specific.

31. The Washington State B&O tax credit for preproduction development can be considered a subsidy under Article 1 of the SCM Agreement. This tax credit, however, is not specific, and is thus not actionable under the SCM Agreement. Washington has provided similar tax credits to a variety of other business activities in the State.

32. As with Washington's B&O tax credit for preproduction development, the tax credit for property taxes may also be considered a subsidy under Article 1 of the SCM Agreement. But this is also not specific, and is thus not actionable under the SCM Agreement. Washington has provided similar tax credits to a variety of other business activities in the State.

33. The Washington State workforce development program provides a subsidy within the meaning of Article 1 of the SCM Agreement. This program, however, has broad applicability beyond Boeing and its suppliers, and, accordingly, is not specific and not actionable under the SCM Agreement.

34. The reimbursement of certain relocation expenses by the State of Illinois pursuant to the Corporate Headquarters Relocation Act ("CHRA") constitutes a subsidy under Article 1 of the SCM Agreement. The relocation reimbursements are not actionable subsidies under the SCM Agreement because they are not specific to Boeing.

35. The property tax abatement provided by the City of Chicago to Boeing can be considered a subsidy within the meaning of Article 1 of the SCM Agreement, but it is not an actionable

²⁸ US FWS, para. 682.

subsidy because it is not specific. The City of Chicago is permitted by Illinois state law to abate the property taxes of numerous other enterprises outside the civil aircraft industry.

B. US AERONAUTICS R&D PROGRAMMES

1. Issues relating to the "purchase of services"

To the European Communities:

15. *In its First Written Submission, the United States argues that the "purchase of services" falls outside of the scope of Article 1.1(a)(1). At paragraph 67 of its Oral Statement, the European Communities argues that "{t}he NASA and DOD R&D support at issue is in fact properly characterized as a direct transfer of funds pursuant to Article 1.1(a)(1)(i) of the SCM Agreement, not as a purchase of services."*
- (a) *Leaving aside the proper characterization of the NASA and DOD support at issue, does the European Communities agree or disagree with the proposition that any transaction properly characterized as the "purchase of a service" falls outside of the scope of Article 1.1(a)(1)? If the European Communities disagrees with that proposition, please respond to the United States' arguments that: (i) "services are explicitly mentioned with respect to government provisions but not purchases" (US FWS, paragraph 48); (ii) "the final version of the SCM Agreement eliminated an explicit reference to purchase of services contained in earlier drafts" (US FWS, paragraph 48); and (iii) interpreting Article 1.1(a)(1)(i) as covering purchases to the extent that they involve a direct transfer of funds would "would render Article 1.1(a)(1)(iii) inutile" (US FWS, paragraph 218).*
- (b) *Assuming that any transaction properly characterized as the "purchase of a service" does fall outside of the scope of Article 1.1(a)(1), when should a transaction be characterized as the "purchase of a service"? In other words, assuming that the "purchase of services" is excluded from the scope of the SCM Agreement, what types of transactions would in theory constitute the "purchase of a service"?*
- (c) *Please explain, on the basis of the European Communities' answers to questions (a) and (b) above, why the support at issue should not be characterized as the "purchase of a service".*
16. *At paragraph 457 of its First Written Submission, the European Communities asserts that "NASA and DOD generally provide funding for LCA-related R&D through what they call "contracts," but what are in reality "grants" to Boeing/MD for LCA-related R&D expenses." At paragraph 69 of its Oral Statement, the European Communities states that the United States' characterization of NASA R&D contracts as purchases of services "is*

in fact a sham". What does the European Communities mean by its assertion that the United States' characterization of NASA R&D contracts as purchases of services "is in fact a sham"?

To the United States:

17. *In its First Written Submission, the United States argues that transactions constituting the "purchase of services" are excluded from the scope of Article 1.1(a)(1). At paragraph 10 of its Third Party Submission, Brazil suggests that the United States' interpretation of Article 1.1(a)(1) would create an "enormous loophole". How does the United States respond?*

36. The United States has no interest in opening a loophole – enormous or otherwise – in the SCM Agreement, and our observation that purchases of services are not financial contributions does not create one. The United States has emphasized that the decision as to whether a transaction is a “financial contribution” depends on the substance of the transaction.²⁹ That is, the payment from the government must come with a requirement for the recipient to supply a service for the government.

37. Brazil’s concern stems from its belief that under the U.S. reasoning

Members could provide billions of dollars in payments directly to a manufacturer and shield this funding from WTO scrutiny by simply providing something of nominal value in return or by entering a “contract” declaring that the funding is in return for a nominal amount of research and development, consulting, or other services.”³⁰

The United States has demonstrated that this dispute presents no basis for Brazil’s concern, as the transactions challenged by the EC are purchases of valuable services and intellectual property rights. This is not a situation where the transaction would be a purchase of services in form only. For the same reason, a Member could not turn a grant into an excluded purchase of services simply by calling it a “contract.” An examination of the substance of the transaction would establish that it was not a purchase of services and, therefore, not entitled to treatment as such. Brazil would ignore the plain language of Article 1.1(a)(1) and instead write in “services” after “goods.” There is no basis for ignoring the text of the Agreement, particularly in a provision that refers to “services” in the clause immediately prior to “purchase of goods.” Clearly, the negotiators were capable of referring to services when they chose, and the fact that they agreed on the provision of goods or services in contrast with the purchase of goods but not services

²⁹ US SWS, para. 8

³⁰ Third Party Written Submission of Brazil, para. 10.

demonstrates that the purchase of services is not a financial contribution within the meaning of the SCM Agreement.³¹ Furthermore, Brazil's reliance on Article 8.2(a) is in error – there, the government is not purchasing services itself, but subsidizing a firm's acquisition of services.

38. The EC raises a concern similar to Brazil's repeatedly in its second written submission.³² It even argues that NASA's research contracts with Boeing are an elaborate "sham" to evade the WTO subsidies disciplines.³³ However, the United States has shown that this is not the case for NASA's purchase of R&D from Boeing.³⁴

18. Which of the alleged subsidies, according to the United States, constitute the "purchase of services" falling outside of the scope of the SCM Agreement? More specifically:

(a) At paragraph 235 of its First Written Submission, the United States indicates that

"non-reimbursable Space Act Agreements are most accurately classified as mechanisms for the government purchase of services in exchange for in-kind remuneration. As discussed above, the purchase of services is outside the scope of the SCM Agreement." Is the United States asking the Panel to find that NASA/DOD's alleged provision of goods or services constitutes, in whole or in part, the "purchase of a service"?

39. As with any transaction, the critical question in evaluating Space Act Agreements ("SAA") is the substance of the transaction, and whether it meets the definition of one of the financial contribution under Article 1.1(a)(1). A nonreimbursable SAA involves an exchange of valuable non-monetary items, which would represent a purchase by one party from the other. The critical question is whether NASA is purchasing a service or providing goods or services. The main thrust of the U.S. discussion of the SAAs was that the Boeing-NASA SAAs related to the programs challenged by the EC constitute the provision of a good or service. That is, in fact, the most accurate characterization. For example, where NASA provides wind tunnel services under a nonreimbursable Space Act Agreement, the transaction should be treated as a provision of services. Paragraphs 247 through 249 of the U.S. first written submission discuss three such agreements, and why they demonstrate that NASA did not receive less than adequate remuneration for Boeing's use of wind tunnels under those agreements.

³¹ In fact, as the United States noted in its first written submission, purchase of services was included within the concept of a subsidy (along with purchases of goods and provisions of goods or services) through many drafts of the text of the SCM Agreement, and were only deleted relatively late in the process. US FWS, para. 48. This sequence of events suggests that the deletion was a conscious decision of the negotiators.

³² E.g., paras. 349-350, 457-458.

³³ EC SWS, paras. 336, 343, 346, and 403.

³⁴ US FWS, paras. 213-217; US OS1, paras. 56-64; US SWS, paras. 62-64.

- (b) *At paragraph 270 of its First Written Submission, the United States argues that "IR&D and B&P are not distinct payments, but rather are one of a number of elements used in the calculation of how much the U.S. government pays for goods and services." Is the United States asking the Panel to find that NASA/DOD's reimbursement of IR&D and B&P costs constitutes, in whole or in part, the "purchase of a service"?*

40. IR&D and B&P are not a separate financial contribution at all. Each of them is factored into the price that an agency pays for a good or service. In fact, a review of the contracts submitted by the United States will show that there is no separate allowance in any of the contracts for reimbursement of IR&D or B&P. They are reimbursed, as are material, labor, and other costs, as part of the overall payment for work conducted in a particular period. Therefore, when any U.S. government agency (not just NASA or DoD) purchases a service, any IR&D or B&P costs allocated to that contract are part of payment for a service. When any government agency purchases a good, the IR&D or B&P are part of the adequate remuneration for the purchase of a good.

- (c) *At paragraph 326 of its First Written Submission, the United States argues that "the value of the patent rights is incorporated in the exchange of value that the government and contractor agree upon in negotiating the initial contract." Is the United States asking the Panel to find that the treatment of intellectual property rights by NASA/DOD constitutes, in whole or in part, the "purchase of a service"?*

41. Yes. The allocation of intellectual property rights is part of the overall package that a U.S. government agency buys when it purchases R&D or RDT&E services. In fact, since the intellectual property arises out of the performance of the services required under the contract, it is impossible to consider the provisions assigning rights in the intellectual property independently from the contract, as the EC tries to do.

To both parties:

19. *At paragraph 67 of its Oral Statement, the European Communities argues that the NASA and DOD R&D support at issue is in fact properly characterized as a "direct transfer of funds" and not as a purchase of services because "the true purpose of these programmes is to convey resources to Boeing to promote the development of LCA-related or dual-use technologies" (emphasis added). Should a determination of whether or not the NASA and DOD R&D support at issue is in fact properly characterized as a "direct transfer of funds", as opposed to the "purchase of services", be undertaken at the level of:*
- (a) *the purpose of the those programmes at issue;*
- (b) *the types of instruments through which payments and other funding were made;*
or

(c) *the terms of each individual contract?*

42. In this dispute, the EC has failed to provide evidence at *any* of the levels identified by the Panel that NASA and DoD R&D programs constitute actionable subsidies. The EC claims that NASA and DoD R&D programs are a direct transfer of funds, rather than a purchase of services, based on its interpretation of the purpose of these programs. But the EC's argument lacks merit.

43. Article 1.1(a)(1) defines a financial contribution in terms of the substance of the transaction. The purpose of the program will rarely indicate the type of transactions that are involved in the programs.³⁵ Only by examining the substance of the particular alleged subsidies at issue is it possible to determine whether they constitute the types of transactions that are a financial contribution under one of the subparagraphs of Article 1.1(a)(1). The purpose of a program may provide some useful context in determining whether the alleged subsidies under the program can be considered to provide financial contributions, but a program's purpose alone cannot be the basis for determining that a financial contribution exists.

44. Since the purpose of a program is insufficient to determine whether a financial contribution exists, it is necessary to examine the substance of a measure at a greater level of detail. The proper level at which to make this determination – either the types of instruments through which payments were made or the terms of individual contracts – is a more fact specific inquiry and depends on the degree of uniformity within the category of instruments. To the extent that there is sufficient uniformity in the types of payment instruments being used in a program, it is not necessary to go down to the level of each individual contract to decide if there is a financial contribution. For the RDT&E procurement contracts entered into by both NASA and DoD, there is a sufficient degree of uniformity in the payment instruments that it is possible to examine these instruments as a class and make a determination as to whether they provide a financial contribution, without examining the terms of each individual contract.

20. *At footnotes 75 and 100 of its First Written Submission, the United States makes reference to the differences between different types of instruments used US government procurement law, including "procurement contracts" and "cooperative agreements". 32 C.F.R. §22.205 (Exhibit US-22) reads in part:*

"§ 22.205 Distinguishing assistance from procurement.

³⁵ One program may involve a number of different types of transaction. Even if the purpose is explicitly to give, e.g., loans, the terms of the loans might make them in reality grants or equity infusions. In that case, the "purpose" of giving loans should not interfere with the substantive conclusion that the type of financial contribution is different, and the application of the measure of benefit indicated in Article 14 for loans is not appropriate.

Before using a grant or cooperative agreement, the grants officer shall make a positive judgment that an assistance instrument, rather than a procurement contract, is the appropriate instrument, based on the following:

(a) Purpose. (1) The grants officer must judge that the principal purpose of the activity to be carried out under the instrument is to stimulate or support a public purpose (i.e., to provide assistance), rather than acquisition (i.e., to acquire goods and services for the direct benefit of the United States Government). If the principal purpose is acquisition, then the grants officer shall judge that a procurement contract is the appropriate instrument, in accordance with 31 U.S.C. chapter 63 (“Using Procurement Contracts and Grant and Cooperative Agreements”). {...}” (emphasis added)

48 C.F.R. §35.005(a) (Exhibit US-23) provides, along the same lines, that:

“(a) Use of contracts. Contracts shall be used only when the principal purpose is the acquisition of supplies or services for the direct benefit or use of the Federal Government. Grants or cooperative agreements should be used when the principal purpose of the transaction is to stimulate or support research and development for another public purpose.” (emphasis added)

Finally, §1260.12(f)(1) of the NASA Grant and Cooperate Agreement Handbook (Exhibit US-94) provides, again along the same lines, that:

“(1) The decision whether to use a contract, grant or cooperative agreement as an award instrument must be based on the principal purpose of the relationship. When NASA, within its authority, enters into a transaction where the principal purpose is to accomplish a public purpose of support or stimulation authorized by Federal statute, a grant or a cooperative agreement is the appropriate instrument. Conversely, if the principal purpose of a transaction is to accomplish a NASA requirement, i.e., to produce something for NASA’s own use, a procurement contract is the appropriate instrument. Two essential questions must be asked to ensure that a grant or cooperative agreement is the appropriate instrument. The first question is: Will NASA be directly harmed in furthering a specific NASA mission requirement if the effort is not accomplished? The answer to this question must be “no.” The second question is: Is the work being performed by the recipient primarily for its own purposes, which NASA is merely supporting with financial or other assistance? The answer to this question must be “yes.” If these criteria are met, then the effort is not a NASA requirement, and can then be considered as to whether it supports or stimulates a public purpose.”³⁶ (emphasis added)

³⁶ See <http://ec.msfc.nasa.gov/hq/grcover.htm> [last visited 6 November 2007].

In light of the foregoing:

- (a) *To the United States: For the purpose of determining whether certain NASA/DOD R&D funding involved a purchase of services, what is the relevance, if any, of whether that funding was provided under a "procurement contract" as opposed to a "cooperative agreement"? Could the United States please explain how payments and other funding provided to Boeing under "cooperative agreements" or other "assistance instruments" constitute the "purchase of a service" for the purpose of Article 1.1(a)(1)?*

45. The relevance of the use of a cooperative agreement or Other Transaction – the two types of “assistance agreements”³⁷ present among the contractual vehicles submitted to the Panel – is that they are subject to a different set of regulations than procurement contracts. As the Panel notes, a procurement agreement is used when the principal purpose is acquisition of supplies for the direct benefit or use of the government.³⁸ A cooperative agreement is used when the benefit to the government is indirect. Unlike a grant, the government will have “substantial involvement” in the work done under a cooperative agreement, including collaboration, participation, or intervention.³⁹ Although cooperative agreements and Other Transaction Agreements (“OTAs”) are not “acquisitions” under U.S. government contracting law,⁴⁰ the substance of the cooperative agreements and OTAs at issue in this dispute demonstrates that they are purchases of services for purposes of Article 1.1(a)(1).

46. The question of cooperative agreements and OTAs is primarily a DoD issue. NASA rarely entered into cooperative agreements with Boeing under the programs challenged by the EC, and never provided grants. In fact, NASA entered into only one cooperative agreement with Boeing, NCC-1-287, calling for research to develop an Aviation Weather Information System, which we discuss further below. NASA also entered into cooperative agreement NCC-1-343 with an enterprise called Jeppesen-Sanderson, Inc., in June, 2000, to produce a Worldwide Terrain Database. Boeing bought Jeppesen-Sanderson in October, 2000, and with it the cooperative agreement. NASA allotted a total of \$4.8 million in funding to these two agreements.⁴¹ In contrast, the DoD Contract List discussed in response to Panel Question 8,

³⁷ U.S. regulations also provide for “technology investment agreements.” The contracts submitted to the Panel do not include any technology investment agreements.

³⁸ 32 C.F.R. § 35.005 (Exhibit US-95).

³⁹ 32 C.F.R. § 22.215(a)(2) (Exhibit US-1214).

⁴⁰ 32 C.F.R. § 22.205(a)(1) (“If the principal purpose is acquisition, then the grants officer shall judge that a procurement contract is the appropriate instrument. . . .”) (Exhibit US-22).

⁴¹ Cooperative Agreement NCC1-287, supplement 4, p. 1 (Exhibit US-589); Cooperative Agreement NCC-1-343, Supplement 10, p. 1 (Exhibit US-598).

contains 14 cooperative agreements and OTAs, worth \$49.4 million.⁴² Therefore, the following discussion focuses on the DoD cooperative agreement and OTA rules.

47. 10 U.S.C. § 2358(a) is the general authority for all research and development (R&D) in which DoD engages by contract, grant, or cooperative agreement. Section 2358 states:

The Secretary of Defense or the Secretary of a military department may engage in basic research, applied research, advanced research, and development projects that—

(1) are necessary to the responsibilities of such Secretary’s department in the field of research and development; and

(2) either—

(A) relate to weapon systems and other military needs; or

(B) are of potential interest to the Department of Defense.⁴³

10 U.S.C. § 2371 is the authority for R&D projects using “other transactions,” that is, transactions other than contracts, cooperative agreements, and grants. These statutes require that the research projects be “necessary to the responsibilities” of the department in the field of research and development and that they relate to weapons systems, other military needs, or areas of potential interest to DoD.⁴⁴ This necessarily results in a “purchase of services” as there is no authority for a “direct transfer of funds.”

48. There are important similarities, but also important differences between cooperative agreements and OTAs, on the one hand, and procurement contracts on the other. A procurement contract is subject to the highly detailed requirements of the Federal Acquisition Regulations (“FAR”). As we have noted elsewhere, the FAR provide detailed guidance on how to structure a transaction, including standardized contract clauses for use in particular situations. These rules allow a generalized evaluation of classes of contracts, such as RDT&E contracts. The regulations on DoD cooperative agreements, in contrast, offer more flexibility. Thus, it is difficult to generalize about cooperative agreements. An individualized evaluation of each instrument may be necessary to determine its treatment under Article 1.1(a)(1). However, if a group of cooperative agreements have similar characteristics – as is the case with the DoD

⁴² Contract List (Exhibit US-41).

⁴³ 10 U.S.C. § 2358(a) (Exhibit US-1205).

⁴⁴ 10 U.S.C. § 2371 (Exhibit US-1206).

cooperative agreements submitted by the United States – it is appropriate to analyze them collectively.

49. Another important difference is that using a cooperative agreement or OTA allows the government to require the private party (known as the “recipient”) to explicitly contribute to the costs of undertaking the program.⁴⁵ The recipient’s contribution is negotiated with the government as part of the initial agreement, although it may change over the life of the agreement. Under the cooperative agreements and OTAs currently before the Panel, the contribution often reflected the fact that the private party’s business obtained some advantage from the agreement.

50. Finally, a cooperative agreement “shall not . . . {p}rovide for payment of fee or profit to the recipient.”⁴⁶ That means that DoD may not pay any more than the expenses the private party incurs in performing the activities required under the agreement.

51. There are, however, important substantive similarities between a private party’s obligations under a cooperative agreement and under a procurement contract. The terms and conditions of a cooperative agreement are enforceable, including by actions in U.S. courts, in the same way as contracts. It commits the private party to perform a project defined in some detail in the agreement’s statement of work. The cooperative agreement is simply not a “procurement contract” subject to the rules and remedies under the FAR.

52. The individual cooperative agreements provide evidence that the transactions were purchases of services for purposes of Article 1.1(a)(1). This response uses Cooperative Agreement F33615-98-2-5113, concerning Structural Repair of Aging Aircraft, as an example (Exhibit US-636). The agreement sets out the following objective:

With forecast reductions in defense spending, there is an ever present need to increase the service life of aircraft currently in the Air Force inventory. This requirement has made the detection and characterization of corrosion and cracking major Air Force needs.⁴⁷

Thus, it is clear that DoD expects to receive a benefit (albeit an indirect one) from the work performed under the cooperative agreement – a technology that will allow it to inspect aircraft better and extend their service life.

⁴⁵ 32 C.F.R. § 34.13(a) (Exhibit US-1203).

⁴⁶ 32 C.F.R. § 34.18(a) (Exhibit US-1204).

⁴⁷ Cooperative Agreement F33615-98-2-5113, Attachment 2, para. 1.1 (Exhibit US-636).

53. The agreement specifies that the private party will achieve this result by performing research relevant to DoD needs – “to demonstrate and validate the production readiness of a nondestructive evaluation system by producing and demonstrating a full-scale prototype unit in a production environment and then validating the design through field testing.”⁴⁸ The subtasks also involve the performance of DoD-relevant tasks, requiring, for example: “definition” of requirements, “obtain” test articles, “inspect” prototype, “design and test” modifications, “develop” a process control plan and implementation plan, “develop” data fusion application, “validate” the prototype system, “produce” a video tape, “hold” reviews, “submit” data and final reports.⁴⁹

54. The terms of the agreement are binding on the parties, who “are bound to each other by a duty of good faith and best effort in achieving the goals of this agreement.”⁵⁰ The recipient commits to make the contributions provided under the agreement, which account for half of the total cost of the work.⁵¹ (This should eliminate any concern that there is some benefit to Boeing for which the company has not “paid.”) Payment is available to the private party only to the extent it submits requests for advance or reimbursement demonstrating that it has undertaken activities entitling it to payment.⁵² The private party is allowed to perform work only to the extent DoD has allotted funds to the agreement.⁵³

55. Thus, the agreement requires the private party to undertake activities that are services for the purposes of Article 1.1(a)(1), and requires DoD to reimburse the cost of those services. The services themselves go to develop a capability of interest to DoD, and result in DoD obtaining valuable patent and data rights with respect to that capability. In its first written submission, the United States noted that the ordinary meaning of “purchase” is “{a}cquisition by payment of money or some other valuable equivalent; the action or an act of buying.”⁵⁴ Therefore, the transaction under Cooperative Agreement 33615-98-2 is a “purchase” for purposes of Article 1.1(a)(1).

56. Rather than repeat this discussion for each of the 11 remaining DoD cooperative agreements, the United States has prepared Exhibit US-1207, which demonstrates that the remaining cooperative agreements have provisions equivalent to those outlined above. Therefore, they, too, are purchases of services for purposes of Article 1.1(a)(1).

⁴⁸ Cooperative Agreement F33615-98-2-5113, Attachment 2, para. 1.0 (Exhibit US-636).

⁴⁹ Cooperative Agreement F33615-98-2-5113, Attachment 2, paras. 3.1-3.4 (Exhibit US-636).

⁵⁰ Cooperative Agreement F33615-98-2-5113, art. 7A (Exhibit US-636).

⁵¹ Cooperative Agreement F33615-98-2-5113, art. 18A.(Exhibit US-636).

⁵² Cooperative Agreement F33615-98-2-5113, art. 16A (Exhibit US-636).

⁵³ Cooperative Agreement F33615-98-2-5113, art. 18A.(Exhibit US-636).

⁵⁴ *New Shorter Oxford English Dictionary*, p. 2418.

57. Although DoD has a great deal of flexibility in structuring cooperative agreements and Other Transactions, Exhibit US-1207 shows that the two at issue in this dispute have terms substantially identical to the cooperative agreements. Therefore, these agreements, too, are purchases of services for purposes of Article 1.1(a)(1)(iii).

58. The two NASA cooperative agreements were also purchases.⁵⁵ NASA describes the objective of NCC-287 as “the design of a system to improve weather information technology to allow better and more timely decisions by pilots and thereby decrease the probability of weather related incidents.”⁵⁶ It specifies that “the proposed aviation weather system is for a public purpose (national goal of reducing fatal airplane accidents).”⁵⁷ Payments were to be based on Boeing’s achievement of “performance-based, verifiable” milestones that were negotiated between Boeing and NASA.⁵⁸ Private enterprises such as Boeing, [***]⁵⁹ NASA’s technical monitor reviewed task labor hours and costs, and determined that the agreement offered “fair and reasonable price and terms.”⁶⁰ Since the agreement provided for a contribution of services by the private participants and money by NASA, it represented a purchase of services for purposes of Article 1.1(a)(1).

59. NASA negotiated Cooperative Agreement NCC-1-343 with Jeppesen Sanderson, Inc., prior to that company’s purchase by Boeing. The purpose was to “conduct a shared resource project that will lead to the development of a certifiable life-cycle process for the use of terrain, obstacle, and airport mapping databases in aviation.”⁶¹ The statement of work called for investigation and documentation of information regarding potential data sources, development of an acquisition strategy for data, recommendation for ways to integrate databases from a variety of sources, development of application programming interface, and development of test databases with regard to airfields in Juneau, Alaska, Reno, Nevada, and one site in South America to be named later.⁶² The statement of work also called for development of system requirements for a test flight and identification of requirements for users/airline partners

⁵⁵ NASA cooperative agreements are transactions distinct from Space Act Agreements, with different legislative and regulatory requirements.

⁵⁶ Prenegotiation Position Memorandum for Cooperative Agreement with the Boeing Company for the “Aviation Weather Information System (AWIN)” Implementation Team Proposal, Part A, **Procurement Objective** (Aug. 17, 1998) (“Agreement NCC-1-287 Memorandum”) (Exhibit US-588).

⁵⁷ NCC-1-287 Memorandum, Part B (Exhibit US-588).

⁵⁸ NCC-1-287 Memorandum, Part C, para. 5 (Exhibit US-588).

⁵⁹ NCC-1-287 Memorandum, Part C, para. 6 (Exhibit US-588).

⁶⁰ NCC-1-298 Memorandum, Part D (Exhibit US-588).

⁶¹ Cooperative Agreement NCC-1-343, p. 5 (Exhibit US-597).

⁶² Cooperative Agreement NCC-1-343, pp. 22-24 (Exhibit US-597).

American, Alaska Air, and Lufthansa.⁶³ Any equipment purchased with NASA funds was required to be returned to NASA at the end of the Agreement.⁶⁴ The focus on *aviation* and the fact that Boeing did not own the contractor at the time of the contract indicate that the purpose was not to assist Boeing, but to develop a database that would enable synthetic vision systems,⁶⁵ applications that allow safe flight in low- or no-visibility situations.

60. At the first Panel meeting, the Panel asked whether individual contracts were procurement contracts, cooperative agreements, other transactions, or technology investment agreements. All of the NASA contracts were procurement contracts, except for NCC-1-287 and NCC-1-343, which were cooperative agreements, and the Space Act Agreements listed in Exhibit US-71. For DoD the division is as follows:

Procurement Contracts:

FA8650-04-C-5001 (Exhibit US-599)
FA8650-05-C-3500 (Exhibit US-602)
F33615-00-D-3052 (Exhibit US-603)
F33615-02-C-5206 (Exhibit US-606)
N00019-95-C-0071 (Exhibit US-616)
N00019-01-C-0133 (Exhibit US-617)
F33615-96-C-1958 (Exhibit US-618)
F33615-94-C-3000 (Exhibit US-619)
F33615-92-C-3406 (Exhibit US-620)
F33615-94-C-2503 (Exhibit US-621)
F33615-94-C-3400 (Exhibit US-622)
F33615-94-C-3007 (Exhibit EC-827)
F33615-91-C-5716 (Exhibit US-625)
F33615-92-C-5971 (Exhibit US-626)
F33615-94-C-5009 (Exhibit US-627)
F33615-95-C-5225 (Exhibit US-628)
F33615-99-C-5019 (Exhibit US-629)
F33615-91-C-5720 (Exhibit US-630)
F33615-97-C-5270 (Exhibit US-631)
F33615-93-C-4334 (Exhibit US-633)
F33615-93-C-4302 (Exhibit US-634)
F33615-00-D-3052 (Exhibit US-639)
FA8650-05-C-3562 (Exhibit US-699)
FA8650-06-C-5210 (Exhibit US-698)

⁶³ Cooperative Agreement NCC-1-343, pp. 24-26 (Exhibit US-597).

⁶⁴ Cooperative Agreement NCC-1-343, p. 5 (Exhibit US-597)

⁶⁵ Cooperative Agreement NCC-1-343, p. 5 (Exhibit US-597).

FA8650-05-C-3563 (Exhibit US-697)
N00019-04-G-0007 (Exhibit US-700)
F33615-03-D-2358 (Exhibit US-696)
F33615-01-D-2000 (Exhibit US-640)
F33615-97-C-3219 (Exhibit US-642)
F33615-94-C-3001 (Exhibit EC-838)

Cooperative Agreements:

F33615-01-2-3110 (Exhibit US-600)
F33615-00-2-3002 (Exhibit US-604)
F33615-01-2-5206 (Exhibit US-605)
F33615-03-2-3300 (Exhibit US-607)
F33615-03-2-3304 (Exhibit US-608)
F33615-03-2-5201 (Exhibit US-609)
F33615-03-2-5202 (Exhibit US-610)
F33615-97-2-3220 (Exhibit US-611)
F33615-97-2-3400 (Exhibit US-612)
F33615-03-2-1403 (Exhibit US-613)
F33615-98-2-5113 (Exhibit US-636)
F33615-01-2-3103 (Exhibit US-638)
F33615-95-2-5019 (Exhibit EC-512)
F33615-96-2-5051 (Exhibit EC-513)

Other Transactions:

F33615-98-3-5104 (Exhibit US-614)
F33615-98-3-5103 (Exhibit US-624)
N00019-96-H-0118 (Exhibit EC-830)

For the sake of completeness, we have included the DoD contracts submitted by the EC in this list. The United States has done this to assist the Panel, and not because it believes these contracts meet the criteria set by the EC for inclusion in its claims.

- (b) *To the European Communities: For the purpose of determining whether certain NASA/DOD R&D funding involved a purchase of services, what is the relevance, if any, of whether that funding was provided under a "procurement contract" as opposed to a "cooperative agreement"? Could the European Communities please explain how payments to Boeing under "procurement contracts" constitute "grants" within the meaning of Article 1.1(a)(1)(i)?*

2. Issues relating to benefit

To both parties:

21. *Is there a market benchmark against which the terms of any financial contributions provided to Boeing under NASA/DOD R&D programs could be compared for the purpose of determining whether those financial contributions conferred a "benefit" within the meaning of Article 1.1(b)?*

61. The large majority of transactions with Boeing under the challenged DoD and NASA R&D were contracts for the purchase of research and development services. As we have explained elsewhere, purchases of services are not financial contributions under Article 1.1(a) and, therefore, the Panel need not proceed to an analysis of benefit under Article 1.1(b). Even aside from the fact that it is not necessary to evaluate whether there is a benefit under Article 1.1(b) with regard to the R&D contracts, there are market benchmarks for the NASA and DoD transactions challenged by the EC.

62. Before turning to those benchmarks, however, the United States notes that the EC has not alleged that NASA and DoD paid more than the commercial cost of the R&D services that Boeing provided under the challenged contracts. Rather, the EC argues that “{g}enerally, when private corporations fund other entities to carry out research on their behalf, they retain full rights to any intellectual property created.”⁶⁶ Although the United States has explained that the challenged NASA and DoD transactions are negotiated at arms length, and are concluded on commercially reasonable terms, the EC continues to insist that “this is not how a commercial actor would behave.”⁶⁷ In other words, the EC argues that the disposition of patent rights in NASA and DoD transactions is inherently noncommercial because it is different from what the EC asserts “generally” occurs.

63. The U.S. response to Panel Question 22 explains that “normal” or “typical” practice is not the sole way for identifying “commercial practice” for purposes of the Article 1.1(b) analysis for the simple reason that commercial practice differs from case to case. Commercial entities seek to buy the intellectual property rights they *need*, and do not operate from a single paradigm, as the EC suggests.⁶⁸ While certain commercial transactions may assign the buyer ownership of intellectual property generated in the performance of a contract, there are commercial entities that purchase R&D services in exchange for a limited license to use the resulting intellectual property. By way of example, the United States provides four contracts in which Boeing pays

⁶⁶ EC SWS, para. 553.

⁶⁷ EC SWS, para. 558.

⁶⁸ See Foley & Lardner, *Doing Business With Others Without Giving Away the IP Farm: Strategic Alliances and Other Joint Development Agreements*, Software & Information Industry Association Webcast Series (August 23, 2007) (Recognizing that the allocation of IP rights should align to the purpose of the development project and that the allocation of IP rights in newly developed IP ... depends on whether the purpose of the transaction is to control IP or to obtain use of IP.)

for major research universities to conduct R&D on its behalf, and receives in exchange a license – not ownership – of the intellectual property developed under the contract.⁶⁹

64. Specifically, in exchange for paying the costs of conducting R&D projects:

- **Contract A (Exhibit US-1208):** [***]
- **Contract B (Exhibit US-1209):** [***]
- **Contract C (Exhibit US-1210):** [***]
- **Contract D (Exhibit US-1211):** [***]

These contracts demonstrate several important points. *First*, there is no fixed rule in the marketplace as to the division of intellectual property rights when one entity funds research performed by another entity, as the EC would have the Panel believe. Purchasers may decide to allow for a variety of dispositions of intellectual property, as Boeing does, or they may in all instances insist on a standard disposition of intellectual property rights, as Airbus does.⁷⁰ *Second*, sellers of R&D services in the marketplace expect to receive more money if they convey greater intellectual property rights to the purchaser. They do not, as the EC intimates, expect to pay the same amount regardless of the extent to which the purchaser buys the intellectual property rights arising from performance of the service.⁷¹

65. Moreover, a comparison of these four examples with the challenged NASA/DoD transactions establish that NASA and DoD purchase R&D services on terms less favorable to the seller than the terms on which commercial entities may make similar purchases. For example, the U.S. Government reserves a right in certain circumstances to take title to inventions made under its contracts,⁷² but Boeing (as a commercial purchaser in the above situations) has no such

⁶⁹ The names of the universities are redacted in respect of the “use of names” confidentiality provisions contained in the contracts. Exhibits A, B and C are contracts with U.S. universities (transactions in the same market as the challenged measures); Exhibit D is a contract with a European university (a transaction outside the U.S. market, but provided for comparison and context).

⁷⁰ Declaration of Regina Dieu, para. 4 (Exhibit EC-1174).

⁷¹ EC SWS, para. 551 (“If NASA and DoD wished to keep all intellectual property rights for themselves . . . there is no support for the U.S. assertion that contractors would consequently demand higher rates for the R&D ‘contracts.’”).

⁷² EC FWS, para. 814, citing FAR 27.302(f) (providing that the government may “march-in”, i.e. take possession of title to any invention arising from U.S. government funded contracts, where it finds that the contractor has failed, or is expected to fail, to take appropriate steps to “achieve practical application” of the invention, health or safety needs are not adequately satisfied by the contractor, or to meet requirements for “public use”, as designated by U.S. federal law).

right.⁷³ Additionally, the U.S. government receives a royalty-free license for the government to use the inventions made under the contracts for government purposes or have them used on its behalf for government purposes throughout the world.⁷⁴ In contrast, Boeing (as a commercial purchaser in the above situations) pays royalties to the R&D seller for each non-internal use of the patented invention.

66. In short, there are commercial benchmarks for the NASA/DoD purchases of research services challenged by the EC, and they demonstrate that the terms on which NASA/DoD purchase R&D services are not more favorable than the terms on which commercial entities in the U.S. market are willing to purchase the same services.

67. With regard to the Space Act Agreements, the EC has not stated with any clarity its allegation concerning the provision of goods and services. It certainly has not proposed any benchmark of its own. Therefore, the United States is not in a position to suggest a general benchmark. However, we draw the Panel's attention to the discussion of SAAs for the use of wind tunnels at paragraphs 241 through 250 of the U.S. first written submission. In that section, the United States notes that each wind tunnel, whether privately or publicly owned, has unique qualities that prevents benchmarking one against the other. In addition, the available files for eight of the SAAs contained copies of the standard worksheets NASA uses to carefully measure the cost of whatever it provides under an SAA, pursuant to the requirement under NASA Policy Directive 1050.1H to obtain either full reimbursement or a "fair and reasonable contribution" from the other party in exchange for anything conveyed pursuant to an SAA.⁷⁵

22. *The European Communities asserts, at paragraphs 81 and 85 of its Oral Statement, that "in normal commercial practice {...} companies contracting for R&D with another company normally maintain full rights to the IP generated under these contracts", and that "relevant market benchmarks {...} indicate that a commercial entity funding R&D typically retains full rights to the IP that is developed".*

(a) *Could the European Communities please explain the basis for those assertions.*

(b) *How does the United States respond to those assertions?*

68. The EC's assertion that "normal commercial practice" is to insist on conveyance of all intellectual property rights from the R&D service supplier to the purchaser of services is

⁷³ E.g., Contract B, Art. 8.6 (Exhibit US-1209) (BCI).

⁷⁴ US FWS, para. 321, citing FAR 52.227-14.

⁷⁵ NASA Policy Directive 1050.1H, paras. 1(a) and 1(b) (Exhibit US-108). The United States notes that while it discussed NASA's estimate of the cost of its contribution under SAA1-508, Blended Wing Body Low Speed Vehicle Problem, in paragraph 255 of its first written submission, it mistakenly omitted that information from Exhibit US-71.

incorrect. Laws allow for the assignment of patent rights by the inventor to other persons, and allow the licensing of some or all patent rights, precisely because individuals and enterprises wish to take a variety of approaches to the disposition of intellectual property rights arising from contracts. Commercial practice reflects this variety of approaches. As the United States demonstrates in response to Panel Question 21, the allocation of intellectual property rights in commercial R&D contracts varies on a case-by-case basis, depending on the particular interests of the parties in each situation. The EC has provided assertions as to normal commercial practice, and one example of a contract between Boeing and a university, under which Boeing purchases R&D services and ownership of intellectual property rights developed under the contract. The United States provided four examples in which Boeing contracted with universities to perform R&D services and bought only a limited license in any resulting intellectual property. These examples demonstrate that, insofar as there is a “normal” practice, it encompasses a variety of outcomes, depending on the interests of the parties.

69. The United States also fails to see the relevance of the EC assertions in paragraphs 81 and 85. In paragraph 81, the EC, in its effort to establish that U.S. law does not grant ownership of any patent, in the first instance, to the inventor, asserts that a company contracting for another company to perform research would “normally maintain full rights to the IP generated under these contracts.” It then cites this supposed “normal” practice as support for the proposition that the purpose of the 1983 Presidential Memorandum was to give DoD the authority to dictate what intellectual property rights each party to a government contract would hold. The logic is deeply flawed. Even assuming, *arguendo*, that the EC had established the existence of a “normal” practice of researchers conveying patent rights to the enterprise that funded the research, that normal practice would not change the meaning of the with regard to who holds those rights in the first instance. Moreover, the EC provides no basis to conclude that the “rationale” it divines for this “normal practice” was the “rationale” for the 1983 Presidential Memorandum. In fact, the Memorandum provides a different result entirely – it instructs all heads of agencies that

{t}o the extent permitted by law, agency policy with respect to the disposition of any invention made in the performance of a federally-funded research and development contract, grant, or cooperative agreement award shall be substantially the same as applied to small business firms and nonprofit organizations under Chapter 38 of Title 35 of the United States Code.”⁷⁶

Thus, DoD does not decide who will own the patent to an invention made under a DoD contract. The policy set out in the 1983 Presidential Memorandum and effectuated through DoD’s regulations decides that question, and provides that the rights are split between the government

⁷⁶ 1983 Presidential Memorandum (Exhibit EC-560).

and the contractor in accordance with chapter 38 of title 35 of the U.S. Code – the Bayh-Dole rule.⁷⁷

70. In paragraph 85, the EC uses a similarly worded assertion (this time that the purchaser “typically” retains full rights to intellectual property) to support the further assertion that NASA and DoD provided advantages on nonmarket terms in allowing contractors to retain *some* intellectual property rights. But even if the EC had established that a purchaser of R&D services “typically” buys full patent rights, and it has not, the evidence shows that commercial purchasers may also buy less than full ownership rights.

71. In closing, we note that, while the EC would presumably label the Boeing research contracts we have submitted as “atypical,” that does not make them noncommercial. Commercial practice, in fact, is open to a wide variety of outcomes. Thus, the EC assertions are not relevant to the question of whether DoD and NASA research contracts are noncommercial.

23. *At paragraphs 462ff of its First Written Submission, the European Communities asserts, under the heading "benefits of R&D subsidies flow principally to Boeing", that NASA and DOD disseminate certain R&D results that have significant commercial potential to domestic entities about two years in advance of general release. What is the legal relevance of whether, and if so when, the results of research carried out under NASA and DOD R&D programmes are widely disseminated? Is this germane to the inquiry that is to be conducted under Article 1.1(b)? Or does this relate to the inquiries under Article 1.1(a)(1), or Articles 5 and 6?*

72. DoD does not generally disseminate the results of its research, as DoD’s objective is to develop technologies with military applications, and not to build foundational knowledge for the benefit of all. Therefore, the dissemination of the results of DoD research are not germane to the Panel’s inquiry.

73. With regard to NASA, it is important to note that the EC provided little support for the proposition advanced in paragraphs 464-466 of its first written submission that NASA routinely delays disseminating the results of its research. Moreover, the EC makes no allowance for the fact that it takes time to write up research on a large project, perform internal review, and when appropriate, obtain external review. For example, the EC cites the publication of the ATCAS

⁷⁷ In its second written submission, the EC notes that DoD may “in exceptional circumstances” remove the contractor’s right to retain title to patents for inventions made pursuant to government contracts. EC SWS, para. 540. DoD’s exercise of this authority would require the use of a different standard contract clause providing the non-Bayh-Dole division of patent rights, which appears in 48 C.F.R. 52.227-13 (Exhibit US-1212). DoD rarely makes such exceptions, and none of the many DoD contracts in evidence contain such exceptional clauses. In any event, such a revision to standard contract terms would have to be part of the contract negotiation, which would give the contractor the opportunity to seek greater compensation from DoD to offset its loss in rights, or to withdraw entirely from the contract.

reports in 1997, based on research conducted from 1992 to 1994, as an example of a “lag” in publication.⁷⁸ What the EC fails to note is that the project produced multiple reports collectively more than 600 pages long.⁷⁹ That it took time to digest this mass of data, compile the results, and ready them for review and publication is only to be expected. The EC also fails to note that published reports are not the only ways NASA disseminates its research results. NASA and Boeing scientists attend conferences to discuss their work, and interim results may form the basis of articles published in journals.⁸⁰ For example, NASA contracts NAS1-20267 and NAS1-20268 engaged Boeing and McDonnell Douglas to conduct research on Integrated Wing Design in September 1994.⁸¹ Even though work on the contracts continued into 1997 and beyond,⁸² papers and articles arising out of the work performed on that project began appearing in 1995.⁸³ These results appeared quickly even though both contracts had Limited Exclusive Rights (“LERD”) clauses, thus demonstrating that such clauses do not prevent significant results of NASA research from circulating to the public.⁸⁴

74. With these facts in mind, the wide dissemination of NASA results is germane to all of the inquiries identified by the Panel, but most particularly in the context of the Panel’s analysis under Articles 5 and 6. To begin, NASA’s wide dissemination of the results of the research it acquires means that Airbus has access to the results, thereby undermining the EC argument that Airbus is at a commercial disadvantage as a result of the NASA R&D measures it challenges because it has access to the results.

⁷⁸ EC FWS, para. 466.

⁷⁹ The EC attached one ten-page segment of one report to support its assertion that there is a lag in NASA’s release of research results. Exhibits US-1157 – US1163 and US-1185 provide all of the final available reports in their entirety.

⁸⁰ For example, two engineers at the University of Iowa cited an ATCAS technical progress report in a 1997 paper. Incidentally, the Boeing lead author of the technical progress report (along with two other Boeing composites experts) left the company and now work for NSE Composites. One of that company’s projects includes “Structural Analysis Support for a BAE Passenger-to-Freighter Conversion of an Airbus A300.”

⁸¹ Contract NAS1-20267, p. 1 (Exhibit US-553); Contract NAS 1-20268, p. 1 (Exhibit US-402).

⁸² Contract NAS 1-20267, Modification 86 (Exhibit US-554); Contract NAS 1-120268, Modification 38 (Exhibit US-556).

⁸³ *List of publications based on work performed in the Integrated Wing Design (IWD) Project* (Exhibit US-1140).

⁸⁴ Contract NAS 1-20267, p. 11 (Exhibit US-553); Contract NAS 1-20268, p. 11 (Exhibit US-402). As just one example, “pressure sensitive paint” was one technology explicitly subject to the LERD provision in Contract NAS 1-20268, p. 11. Even so, a paper on pressure sensitive paint was presented at the IEEE Aerospace Applications Conference in February 1996 and an article on pressure sensitive paint published in *Experiments in Fluids* 22 in January 1996, both based in part on IWD results. *List of publications based on work performed in the Integrated Wing Design (IWD) Project* (Exhibit US-1140).

75. The EC first written submission tries to minimize the significance of the wide dissemination of NASA results by asserting that LERD and FEDD (“for early domestic distribution”) clauses blocked circulation of the most important results.⁸⁵ Subsequently, the EC has narrowed the scope of its concerns to LERD restrictions alone.⁸⁶ In any event, the provisions that accorded LERD treatment to a subset of data involved in some NASA projects do not serve, as the EC alleges, to bottle up significant research results inside NASA. To the contrary, entering into contracts with LERD clauses make available to NASA – and thus to the public – information that, if funded solely by the producer, would never become public at all. Thus, any delay is a cost that NASA pays to ensure the eventual public availability of the data in question.

76. To put it another way, the EC and the United States agree in this dispute that the causation analysis under Article 6.3 is a but/for analysis. The EC and the United States agree that, in the absence of the alleged subsidies, Boeing would still have had to fully fund the product development research that led to the 787. In that case, Boeing would not have made the results of its research public. Thus, to the extent any technology once subject to the LERD clause was in the development path of the 787, any “lag” in the release of those particular data is not a “technology effect” (to use the EC terminology) of the alleged subsidy. Rather, it is the eventual availability of all of the information generated by NASA programs to the global aerospace community that is the technology effect of the subsidy.

77. Next, NASA’s dissemination of the results of the R&D it acquires has legal relevance in the Panel’s analysis of financial contribution because the purpose of a transaction does not determine the type of transaction. For example, a government may buy shares in a company because it seeks to invest public money (such as pension funds) to make a profit or because it seeks to invest in a strategic industry. Either way, the transaction is an equity infusion. Similarly, the use to which NASA puts the results of the R&D transactions challenged by the EC does not make them purchases. However, the dissemination of the results of NASA R&D is germane to evaluating the EC assertion that the transactions are a “sham” designed to confer funds to Boeing to help it develop aircraft faster and better than Airbus. The only rationale the EC provides for this conclusion is that NASA does not manufacture commercial aircraft, and therefore has no need for aeronautics R&D. However, the dissemination of the results, as well as their usefulness in other government activities, such as protection of public safety, demonstrates the fallacy of this argument. The fact that there may be a temporary delay in the widest dissemination of some information does not alter the fact that NASA acquired the entire body of information as a result of the purchase of services.

⁸⁵ EC FWS, para. 464.

⁸⁶ EC SWS, para. 545 (“To be clear, with respect to NASA, the European Communities is challenging as a subsidy the protection of government-funded data rights on behalf of Boeing only pursuant to the Limited Exclusive Rights Data (“LERD”) clauses of the ACT, HSR, AST, and R&T Base programs.”).

78. Finally, dissemination of NASA's results is germane to the evaluation of the benefit. Dissemination of research results to the broader community, which advances the Space Act objectives of "{t}he expansion of human knowledge of the Earth and of phenomena in the atmosphere and space" and "{t}he improvement of the usefulness, performance, speed, safety, and efficiency of aeronautical and space vehicles," is one element of the value that NASA gets from the research that it conducts. In achieving these objectives, unlimited rights to all the data produced would obviously have the greatest value to NASA. However, the extent of data rights is frequently a subject of negotiation between NASA and its contractors. Thus, the differing levels of data rights conferred to the government are evidence of the commercial nature of the transactions. Temporary restrictions on the scope of dissemination permitted under NASA's license is part of the price NASA paid for the contractor's financial contribution to the research effort.⁸⁷ Moreover, the commercial benchmarks that the United States provided in Contracts A, B, C and D demonstrate that commercial entities also purchase R&D in exchange for restricted royalty-free licenses (for example, for internal use only), and must pay additional royalties for additional non-internal uses of the resulting intellectual property. Thus, even where NASA's right to widely disseminate the research it acquires is temporarily restricted, the transaction still reflects commercial practice.

To the European Communities:

24. *At paragraph 155ff of its First Written Submission, the United States argues that "speculation as to the existence of theoretical "dual uses" for the technology Boeing develops for DoD is irrelevant to the Panel's analysis of whether DoD's contracts with Boeing confer a benefit". What is the legal relevance of whether or not some or all of the research carried out under DOD RDT&E projects had "dual use" applications to large civil aircraft? Is this germane to the inquiry that is to be conducted under Article 1.1(b)? Or does this relate to the inquiries under Article 1.1(a)(1), or Articles 5 and 6?*
25. *At paragraph 53 of its Oral Statement, the European Communities states that "it is the accumulated knowledge and experience from engaging in R&D at all levels and with respect to all forms of flight vehicles that provides benefit to an LCA manufacturer". Is the EC claiming that this "knowledge and experience" constitute a "benefit" within the meaning of Article 1.1(b)?*

3. Facilities, equipment and employees

To the European Communities:

26. *At paragraph 499 of its First Written Submission, the European Communities states that "institutional support" includes "costs for NASA employee salaries, benefits, travel*

⁸⁷ US FWS, para 352.

expenses, facilities, business management functions, and basic centre operations". At paragraph 502 of its First Written Submission, the European Communities indicates that it has calculated the "institutional support" costs associated with each of the NASA aeronautics R&D programmes that have provided benefit to Boeing's LCA division, and includes them in the overall subsidy figures discussed below for each programme. However, at paragraphs 524, 548, 572, 588, 603, 618, 631, and 650 of its First Written Submission, the European Communities alleges that in addition to providing "institutional support", NASA also "furnished government-owned property, {...} and dedicated federal scientists, engineers, and research facilities" to support the NASA R&D programmes at issue. Is all of this not covered by "institutional support"? Please clarify.

27. *At paragraph 798 of its First Written Submission, the European Communities asserts that "DOC provides ATP recipients with organizational and technical advice, and makes available federal equipment, facilities, and personnel. The provision of these goods and services by the US Government constitutes financial contributions within the meaning of Article I.1(a)(1)(iii) of the SCM Agreement."*

(a) *Are these measures identified in the European Communities' panel request?*

(b) *Does the European Communities include the value of these goods and services in its estimate that "through FY 2004, DOC granted \$4.6 million in financial contributions to Boeing's LCA division through the Advanced Technology Program"?*

4. Treatment of intellectual property rights

To the European Communities:

28. *The European Communities argues that the "direct R&D funding" and support that Boeing allegedly received under the NASA and DOD R&D programmes at issue constitute subsidies, on the basis that Boeing "is not required to pay anything in return" for those financial contributions. According to the European Communities, because Boeing is "not required to pay anything in return" for this funding and support, the entirety of those financial contributions to Boeing's LCA division can be considered to confer benefits. The European Communities also claims that Boeing's acquisition/retention of rights over the intellectual property that it develops under these NASA/DOD R&D programs constitutes an additional subsidy. Does this not amount to double-counting the subsidies provided to Boeing under the NASA/DOD R&D programmes at issue?*

5. Reimbursement of IR&D and B&P costs

To the European Communities:

29. *At paragraph 876 of its First Written Submission, the EC estimates that through FY 2006, NASA and DOD provided financial contributions worth \$3.1 billion to Boeing's LCA division through IR&D and B&P reimbursements.*

(a) *Is this estimate limited to the amount IR&D and B&P reimbursements to Boeing under the NASA and DOD R&D programmes at issue in this dispute, or does this estimate include all IR&D and B&P reimbursements to Boeing by NASA and DOD, i.e. including but not limited to reimbursements made under the R&D programmes at issue in this dispute, through FY 2006?*

(b) *On the basis of the figures provided in Exhibits EC-005 (Appendix B) and EC-018, it appears that DOD reimbursements of IR&D and B&P comprise approximately 99% of this amount. Please specify the respective amounts of: (i) NASA IR&D reimbursements; (ii) NASA B&P reimbursements; (iii) DOD IR&D reimbursements; and (iv) DOD B&P reimbursements.*

C. OTHER SUBSIDIES

1. FSC/ETI-related measures

To both parties:

30. *The European Communities asserts that Boeing will continue to receive financial contributions/benefits from FSC/ETI-related measures after 2006. However, we understand the European Communities to exclude any financial contributions/benefits from the FSC/ETI-related measures that Boeing will allegedly receive after 2006 from its estimate of the total financial contributions/benefits to Boeing from the FSC/ETI-related measures (EC FWS, para. 957). If this is correct, then please explain whether and if so why it is necessary for the Panel to reach a conclusion on whether Boeing will continue to receive financial contributions/benefits under FSC/ETI-related measures after 2006.*

79. The United States believes that in light of the fact that the EC excludes any such benefits from their calculations and of Boeing's statement that it will not receive such benefits after 2006, there is no need for a finding as to whether Boeing will continue to receive such benefits after 2006.

2. State of Washington and municipalities

(a) Tax Measures

To the United States:

31. *The United States argues (e.g. US FWS, para. 462) that the scope of Article 1.1(a)(1)(ii) is limited to revenue that was foregone in the past, and that revenue a government may potentially forego in the future does not constitute a financial contribution under Article 1.1(a)(1)(ii). Does this mean that measures mandating the foregoing of government revenue that is otherwise due cannot be successfully challenged "as such" in WTO dispute settlement proceedings?*

80. As the FSC dispute demonstrated, measures mandating the foregoing of revenue that is otherwise due can be challenged as such in WTO dispute settlement proceedings. However, it is important to consider whether that measure has resulted in revenue foregone. In other words, no financial contribution exists under Article 1.1(a)(1)(ii) unless the government has foregone revenue. This is based on an ordinary meaning of the terms in Article 1.1(a)(1) of the SCM Agreement as set forth in the U.S. first written submission.⁸⁸ And for a claim of “serious prejudice,” it may be important to examine whether it is appropriate or possible to consider any revenue not yet foregone.

32. *According to the United States, the proper "normative benchmark" for determining whether revenue foregone under State B&O Tax Rate Reduction for aerospace manufacturing was "otherwise due" is the "average effective rate" for all businesses in Washington's activities-based tax system.*

(a) *Does the United States consider that any rates that fall below the "average effective rate" constitute the foregoing of revenue "otherwise due"?*

81. First, it is important to clarify the argument of the United States with respect to the B&O tax adjustment. The United States has argued that the proper “normative benchmark” for analyzing revenue foregone under Washington State’s Business & Occupation (“B&O”) tax structure is the range of nominal B&O tax rates that the State applies to all categories of business activities subject to the B&O tax, not the average effective tax rate. The impact of the B&O tax adjustment on the effective tax rate for aerospace manufacturing provides further confirmation that the B&O tax adjustment does not result in revenue foregone to the State of Washington.

82. With respect to the specific question raised by the Panel, the United States was referring to the “average effective rate” simply to demonstrate that in the context of this dispute, the fact that the tax structure results in a tax rate at or above the average effective rate further demonstrates that the tax rate is not “revenue foregone.”⁸⁹ The United States was not making an *a contrario* argument – the question of whether a lower tax rate would be revenue foregone is

⁸⁸ US FWS, paras. 463-64.

⁸⁹ US FWS, paras. 455-61; US SWS, paras. 137-38.

not at issue in this proceeding and would need to be examined in light of all the relevant facts if the question were to present itself.

- (b) *Does the "average effective rate" refer to a rate written down or otherwise reflected in legislation or regulations that meets that description, or is this simply a mathematical calculation based on rates being applied at the time of calculation?*

83. The “average effective rate” does not refer to a rate written down in legislation or regulations. However, during the 2001 legislative session (Chapter 7, Section 138, Laws of 2001), the Washington State legislature commissioned a select 11-member Tax Study Committee as part of its effort to examine the advantages and disadvantages of the B&O tax structure.⁹⁰ As part of its mandated reporting to the legislature, the committee provided an analysis of the effective tax rates for various sectors and the “average effective rate” for all sectors – in particular the disadvantages to specific sectors as a result of “pyramiding.” The disadvantage of the effective tax rate on aerospace was identified in 2002, well before the enactment of HB 2294.

84. The EC attempts to minimize the importance of this report,⁹¹ despite the fact that the study reflects the State legislature’s policy objectives with respect to the State tax regime and lays the basis for the tax adjustment challenged by the EC. In this regard, the report specifically identifies the implications of pyramiding on the effective tax rates for various sectors including aerospace. The report also identifies the average effective tax rate for all sectors subject to the B&O tax.⁹²

85. The EC also argues that Washington State could have changed its system to eliminate pyramiding for all businesses, and asserts that the fact that the State did not, demonstrates that tax neutrality is not the goal of the B&O tax adjustment for aerospace.⁹³ The EC’s argument is without merit.

86. In designing its tax policy, Washington State must balance multiple policy objectives. The State recognizes that, despite certain advantages, the pyramiding that occurs under the B&O regime, especially its effects on complex, multi-step business activities, creates impediments to investment and unfairly discriminates against certain business activities. Rather than revamping its entire tax system, Washington State has chosen to address these disadvantages of the B&O tax through sectoral adjustments. An adjustment to tax rates that seeks to alleviate the

⁹⁰ Washington State Tax Structure Study (Exhibit US-180).

⁹¹ EC SWS, para. 39.

⁹² Washington State Tax Structure Study, pp. v, 24, 35-37, 39, 110-11, Table 9-7, 112, 134 (Exhibit US-180).

⁹³ EC SWS, paras. 39-40.

discriminatory effects of the B&O tax on certain sectors is consistent with the goal of achieving tax neutrality – a goal that was identified in the study commissioned by the State legislature.

87. The EC further states that “{r}ather, {Washington State} has selectively modified its B&O tax rate for manufacturers of commercial airplanes and commercial airplane components, resulting in revenue foregone that would otherwise be due.”⁹⁴ The EC’s statement in this regard is misleading because it fails to take into account the other sectors that are subject to an adjusted B&O tax rate in Washington State. Indeed, the U.S. second written submission explained that over 60% of the manufacturing income in Washington State is subject to an adjusted B&O tax rate.⁹⁵ Thus, the EC’s statement ignores the broader context in which the adjustment to the aerospace rate takes place. The Appellate Body has clarified that the analysis of revenue foregone should take place in light of this broader context.⁹⁶

To both parties:

33. *Must there always be a "generally applicable tax rate" within the meaning of Article 2.2? If so, what is the "generally applicable tax rate" under Washington State's B&O tax system?*

88. Article 2.2 of the SCM Agreement states that “{i}t is understood that the setting or change of generally applicable tax rates by all levels of government entitled to do so shall not be deemed to be a specific subsidy for the purposes of this Agreement.” Nothing in the text of the provision requires that there be a “generally applicable tax rate.” The provision merely provides guidance regarding the specificity analysis in cases where a government sets or changes a “generally applicable tax rate.”

89. In the case of Washington State, there is no generally applicable tax rate. As the United States has set forth in detail in prior submissions, the State of Washington has adopted a multi-rate taxation system that taxes different business activities at different rates. Specifically, the B&O tax regime distinguishes among four major activity classifications: manufacturing, wholesaling, retailing, and professional services. It then further subdivides those activities into over 40 different categories of business activities.⁹⁷ Each activity group is assigned its own rate,

⁹⁴ EC SWS, para. 40.

⁹⁵ US SWS, para. 136.

⁹⁶ *US – FSC 21.5 (AB)*, para. 87, citing *US – FSC (AB)*, para. 90.

⁹⁷ These activities include manufacturing of semiconductor materials, international investment management services, tour operators, manufacturing of biodiesel/alcohol fuel and raw seafood, and warehousing or reselling of prescription drugs, among others. US FWS, paras. 430-31.

and these rates can be and often are adjusted independently of one another. Thus, there is no generally applicable tax rate in Washington State.⁹⁸

90. The EC has the burden of demonstrating that the B&O tax adjustment for aerospace is specific. As noted above, the adjustment of the aerospace B&O tax rates fits into the State's overall multi-rate tax regime in which individual rates are adjusted independently of each other. Washington has provided such adjustments to several other business activities in the State, such as biofuels manufacturing, timber products manufacturing, nuclear fuel assembly manufacturing, wholesaling/retailing, flour and oil manufacturing, dried pea and meat processors, and stevedoring.⁹⁹ Thus, the B&O tax adjustment is not a subsidy, nor is it specific.

To the European Communities:

34. *At paragraph 28 of its Oral Statement, the European Communities argues that "the United States' specificity analysis with respect to the HB 2294 B&O tax rate reductions is flawed because it addresses the wrong measure. The measure at issue is HB 2294, not the entire Washington State B&O tax system." Is the EC arguing that a proper analysis of whether or not the subsidy allegedly granted under HB 2294 is specific would exclude consideration of any B&O tax rate reductions in other sectors?*

(b) Infrastructure-related and other measures

(i) *Interpretation of "general infrastructure"*

To both parties

35. *How does a determination of whether infrastructure is "general" for the purposes of Article I.1(a)(1)(iii) differ from the determination as to whether a subsidy is "specific" within the meaning of Article 2?*

91. The ordinary meaning of "general" is "{i}ncluding, involving, or affecting all or nearly all the parts of a (specified or implied) whole, as a territory, community, organization, etc.; completely or nearly universal; not partial, particular, local or sectional."¹⁰⁰ The ordinary meaning of "infrastructure" is "the installations and services (power stations, sewers, roads, housing, etc.) regarded as the economic foundation of a country."¹⁰¹ Used together, the terms

⁹⁸ In this regard, as the United States explained in the second written submission, the EC's attempt to characterize the aerospace B&O tax rate as an exception to a general rule is without merit. US SWS, paras. 123-28.

⁹⁹ US FWS, para. 483.

¹⁰⁰ *New Shorter Oxford English Dictionary*, p. 1073 (Exhibit US-14).

¹⁰¹ *New Shorter Oxford English Dictionary*, p. 1365 (Exhibit US-14).

refer to installations and services that are available to all or nearly all inhabitants or users of the relevant area.¹⁰² Thus, infrastructure is general if the infrastructure is universally available to all or nearly all inhabitants or users of the relevant area.

92. In this regard, it is important to address the EC's arguments with respect to the meaning of "general infrastructure." First, the EC contends that the fact that infrastructure may be usable by or accessible to the public is not sufficient to establish that the infrastructure is general. The EC claims that while use and access may be considerations, there could be other factors surrounding the infrastructure that suggests that it is "partial" or "particular" and thus not general.¹⁰³ Furthermore, the EC posits that infrastructure is not general if it alters the competitive nature of firms, even if that infrastructure may be useable by or accessible to the public."¹⁰⁴ The EC provides no textual support for this proposition. Instead, the EC asserts that this interpretation of general infrastructure is grounded in SCM Agreement negotiating history. In reality, the EC can only point to a single EC submission to the SCM Agreement negotiating group stating that general infrastructure should not be considered a subsidy because it "does not alter the competitive position of firms."¹⁰⁵

93. Article 32 of the Vienna Convention on the Law of Treaties ("VCLT") provides that in interpreting a treaty, the interpreter may have "recourse . . . to supplementary means of interpretation including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable." The United States has provided a definition of "general infrastructure" based on the ordinary meaning of the terms – infrastructure is general within the meaning of Article 1.1(a)(1)(iii) if the infrastructure is available to all or nearly all inhabitants of the relevant area. The EC has provided no reason to believe that this meaning is ambiguous, obscure, or manifestly absurd or unreasonable. Therefore, resort to supplemental means of interpretation is neither appropriate nor necessary.

94. Moreover, the EC has not provided any evidence that other Members agreed with the interpretation of "general infrastructure" proffered by the EC during negotiation of the SCM Agreement. Thus, the EC's submission to the negotiating group is of little value in

¹⁰² US FWS, para. 46.

¹⁰³ EC SWS, para. 132-138.

¹⁰⁴ EC SWS, para. 138.

¹⁰⁵ EC SWS, para. 138, citing Submission by the European Community, 27 November 1989, MTN.GNG/NG10/W/31, p. 6.

“confirm{ing} the meaning resulting from the application of Article 31,” which must be based on an the “ordinary meaning” of the terms in the treaty.¹⁰⁶

95. The EC also invokes the “object and purpose” of the SCM Agreement and states that “{i}n this respect, the reason for the carve-out of general infrastructure from the WTO disciplines is evident.”¹⁰⁷ The EC divines this “evident” purpose from the fact that “{w}hile the SCM Agreement subjects the conduct of WTO Members to certain disciplines for granting subsidies to specific economic operators, it does not interfere with legitimate government choices to pursue public policies for the benefit of the population *as a whole*.”¹⁰⁸ The EC does not substantiate this assertion with any citation. Instead, the EC contends that this interpretation is “also reflected in the preamble to the WTO Agreement, according to which Members recognize that ‘their relations in the field of trade and economic endeavour should be conducted with a view to *raising standards of living*’.”¹⁰⁹

96. This attempt by the EC to override the text of the agreement is wholly without merit. First, the provision from the preamble to the WTO Agreement cited by the EC is completely unrelated to and provides no guidance with respect to whether the provision of a good is “other than general infrastructure.” That provision thus provides no helpful context. Nor does any “object and purpose” that might be derived from it alter the outcome of the textual analysis. Second, even if the provision from the preamble of the WTO Agreement cited by the EC did shed any light on the “object and purpose” of the SCM Agreement, the provision does not explain the meaning of “general infrastructure” in Article 1.1(a)(1)(iii). There are many policies that benefit the population “as a whole,” or that could be considered to be “raising the standards of living.” However, if those policies took the form of subsidies, they would not be exempt from the SCM Agreement as is “general infrastructure.”

¹⁰⁶ In fact, other negotiating documents show that the EC is wrong on two levels. The Notes for the Meeting of the Negotiating Group on Subsidies and Countervailing Measures state that “precise criteria should be developed with respect to certain subsidy practices (e.g. infrastructure, R&D, regional development) which, if met, would preclude the application of countervailing duties as these subsidies would be considered not to cause trade distortion.” In other words, “causing trade distortion” was not itself a criterion, but a concept defined by the specific criteria agreed upon by the parties, which, if met, would preclude action under the SCM Agreement. Meeting of 28-29 June 1988: Note by the Secretariat, MTN.GNG/NG10/8, para. 15 (11 July 1988). In addition, many Members considered that the key criterion for exclusion of “basic infrastructure” should be whether it was for “general public use.” Communication from Canada, MTN.GNG/NG10/W/25, section I(a) (28 June 1989); Submission by the United States, [MTN.GNG/NG10/W/29](#), section I (22 Nov. 1989); Submission by India, MTN.GNG/NG10/W/33, para. 7 (30 Nov. 1989). Korea argued for exclusion of “expenditures for establishing social overhead capital,” including “transportation systems.” Communication from the Republic of Korea, MNF.GNG/NG10/W/34, section III.1 (18 Jan. 1990).

¹⁰⁷ EC SWS, para. 137.

¹⁰⁸ EC SWS, para. 137 (emphasis in original).

¹⁰⁹ EC SWS, para. 137 (emphasis in original).

97. With respect to the specific question raised by the Panel, under Article 1.1(a)(i)(iii), a financial contribution exists where a “government provides goods or services other than general infrastructure.” In the case where a good or service is “general infrastructure,” the government’s provision of that good or service is not a financial contribution. If there is no financial contribution, there is no subsidy. However, if a subsidy exists, a panel still must determine whether that subsidy is specific. It is important that the object of the two inquiries is different. Under Article 1.1(a)(i)(iii), the inquiry is whether the infrastructure is “other than general,” while under Article 2, the inquiry is whether the subsidy is specific.

98. Article 2.1(a) of the SCM Agreement states that a subsidy is specific where “the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises.” Some of the factors relevant to determining whether infrastructure is other than general may be relevant to determining whether a subsidy is specific. However, it would not be appropriate to merely apply the same criteria to both inquiries. For example, while Article 2.1(c) of the SCM Agreement requires that certain factors – such as “diversification of economic activities within the jurisdiction of the granting authority” and “the manner in which discretion has been exercised by the granting authority” – be considered in a *de facto* specificity inquiry, there is no indication that such factors are relevant to a determination of whether infrastructure is general under Article 1.1(a)(1)(iii).

36. *If the Panel were to conclude that particular infrastructure constitutes "general infrastructure", would it follow that any improvements made to that infrastructure would constitute the provision of "general infrastructure" as well?*

99. The legal test for determining whether particular infrastructure constitutes “general infrastructure” is the same as determining whether an improvement to that infrastructure also constitutes “general infrastructure.” Thus, with respect to each improvement, the Panel must determine whether the particular improvement is universally available. Such a determination will depend on the facts of the particular improvement in question. We understand the Panel’s question to relate to the State of Washington improvements to the roads I-5 and SR-527, the rail barge transfer facility, and the South Terminal expansion. Consistent with the definition of general infrastructure set forth above, each of these infrastructure improvements challenged by the EC constitute general infrastructure because they are universally available to all or nearly all inhabitants or users of the relevant area.

100. In the case of I-5 and SR-527, these roads are public roads with no limitations on availability. Specifically, I-5 is part of the U.S. Interstate Highway System and is the major north-south highway on the West Coast of the United States, running from Canada to Mexico.¹¹⁰ As such, it is used by countless businesses, tourists, and citizens.¹¹¹ In addition, according to the

¹¹⁰ US FWS, para. 531.

¹¹¹ US FWS, para. 531.

Washington State Department of Transportation, SR-527 is a “principal arterial highway” affecting “residential and commercial” developments.¹¹² There were no limitations on the availability of these roads to the public before the improvements, and there were no such limitations after the improvements. Accordingly, the improvements to these roads constitute general infrastructure.

101. The EC contends that the projected increase in traffic along I-5 and SR-527 supports the proposition that the road improvements were not general infrastructure, because the traffic increase was a reflection of an increase in Boeing employment levels.¹¹³ The EC disregards the fact that Boeing is but one of innumerable businesses and residences accessible from I-5 and SR-527, in a dynamic and growing area of the United States. Under the EC’s logic, any improvement to a public road that is near a company with projected growth would be non-general infrastructure simply because it accommodates that company’s growth. The growth in employment or operations of commercial enterprises will often be a factor in a Member’s determination of whether public roads require improvements. The determinative question remains whether there are limitations on availability of those roads. In the case of I-5 and SR-527, the improvements created no limitations on the availability of the roads. They remain public roads and continue to be used by businesses, tourists, and citizens. Thus, the EC has failed to establish that the improvements are “other than general infrastructure.”

102. In the case of the rail barge transfer facility, the Port of Everett constructed the facility to allow direct off-loading of oversized containers from barges onto rail cars.¹¹⁴ Prior to the construction of the facility, when oversized containers delivered to the Port of Everett were transferred to rail cars, the authorities had to shut down the main rail line between the Port of Everett’s Marine Terminal and the Japanese Gulch spur for between one and two hours.¹¹⁵ Furthermore, the trains carrying oversized cargo are only permitted to travel during daylight hours, when rail traffic is heaviest.¹¹⁶ This traffic congestion affects all users of the rail corridor. The construction of the rail barge transfer facility was designed to ease this traffic congestion, which benefits all users of the rail corridor, not just Boeing. Moreover, the rail barge transfer facility is available to any business. Accordingly, the improvement of the Port of Everett with a rail barge transfer facility is general infrastructure.

¹¹² US FWS, para. 533.

¹¹³ EC SWS, paras. 145-146.

¹¹⁴ US FWS, paras. 544-45.

¹¹⁵ US FWS, para. 545.

¹¹⁶ US FWS, para. 545.

103. With respect to the South Terminal Expansion, as the United States has explained, no work has been done to expand South Terminal.¹¹⁷ Even if the South Terminal expansion were undertaken, the improvement would constitute general infrastructure. The Port of Everett has contemplated an expansion to the South Terminal to address the significant increase in traffic volume in recent years.¹¹⁸ The expanded South Terminal will be available to all users or potential users without any limitations. Accordingly, the improvement to the South Terminal, if it were to be undertaken, would constitute general infrastructure.

104. Thus, in the case of each of the infrastructure improvement measures referred to above, the specific facts at issue demonstrate that the improvements, like the infrastructure to which they are applied, constitute “general infrastructure” within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement.

37. *In determining whether improvements to particular infrastructure constitute "general" infrastructure within the meaning of Article 1.1(a)(1)(iii), what is the relevance of whether or not:*

- (a) *the government undertook the project as part of an agreement with a specific company; (see EC FWS, para. 235)*
- (b) *the government had rejected previous efforts to make the improvements in question prior to an enterprise committing to a large scale investment (see EC FWS, para. 227);*
- (c) *a single enterprise agreed to cover a significant portion of the costs incurred in making the improvements (see US FWS, para. 547);*
- (d) *the project is of the type that governments "often undertake" (US FWS, para. 550)?*

105. As an initial matter, it is noteworthy that Article 1.1 asks whether the infrastructure is general, not whether the infrastructure was motivated by a particular goal. In deciding whether improvements to particular infrastructure constitute “general” infrastructure within the meaning of Article 1.1(a)(1)(iii), the determining factor is whether the infrastructure is universally available. The relevance of the factors identified by the Panel in this question depends on the extent to which such factors can provide insight into whether the improvement at issue is available to all or nearly all inhabitants of the relevant area.

¹¹⁷ US FWS, para. 549.

¹¹⁸ US FWS, para. 550.

106. As a preliminary matter, it is important to clarify that Washington State did not undertake the I-5 and SR-527 improvements as part of an agreement with Boeing. The State developed its plans well before the Master Site Agreement (“MSA”).¹¹⁹ In any event, infrastructure does not lose its general availability simply because the government promised a particular constituent or constituents that it would undertake the project. With respect to the rail barge transfer facility, there are no limitations on the availability of the facility to the public. Accordingly, the rail barge transfer facility is general infrastructure and the MSA does not affect that conclusion.

107. In basing its challenge to these infrastructure measures on the MSA, the EC ignores the fact that companies will frequently decide that it is only feasible to locate their operations in a certain place if the necessary infrastructure – highway systems, railroads, water access, or port facilities – exists. The fact that a particular company has a strong interest in ensuring the availability of infrastructure necessary to conduct its operations does not make those infrastructure improvement projects non-general. The determinative question is whether the infrastructure and any improvements to it are available to all users.

108. With respect to question 37(b) from the Panel, as a general matter, spending requests often fail multiple times before acceptance. A significant event, such as hosting the Olympics, getting a major conference, or gaining (or losing) a major employer, may provide the final push for a government to take long-contemplated general measures to improve its infrastructure. As noted above, Article 1.1 asks whether the infrastructure is other than general, not whether the infrastructure was motivated by a particular goal. Therefore, rejection of an infrastructure improvement prior to the commitment of a large investment is not relevant to an evaluation of whether it is “general infrastructure.”

109. As a factual matter, Washington State’s inability to obtain funding for the I-5 and SR-527 improvements fails to establish that they are other than general infrastructure. First, I-5 and SR-527 had been identified for years as needing improvements, and they were among a multitude of infrastructure projects of recognized urgency for which the State of Washington was seeking funding.¹²⁰ The fact that the State sought funding for these projects, among many others, prior to the MSA and long before the conception of the 787 demonstrates that the State perceived these improvements as necessary for the State independent of Boeing’s actions.¹²¹ Additionally, the I-5 and SR-527 improvements were ultimately funded as part of a broad transportation package covering more than 150 other projects throughout the State.¹²² This treatment further

¹¹⁹ US FWS, paras. 524-28.

¹²⁰ US FWS, paras. 525-528.

¹²¹ US FWS, para. 542.

¹²² US FWS, para. 542.

demonstrates that the I-5 and SR-527 improvements were part of an overall upgrade to state transportation infrastructure, and not restricted to Boeing.

110. With respect to question 37(c), the government's ability to obtain contributions from private parties for the construction of infrastructure is irrelevant to a consideration of whether it is "general." This does not by itself establish that the infrastructure is not open to anyone wishing to use it, or that it is not available to all users or potential users.

111. Finally, the fact that the government often undertakes a certain type of project to improve conditions for all users is not a factor in determining whether particular infrastructure is "other than general." The South Terminal expansion, if the project were undertaken, constitutes general infrastructure because it will be available to all users or potential users without limitation.

To the United States:

38. *At paragraphs 521 and 546 of its First Written Submission, the United States makes a reference to "quintessential general infrastructure". Could the United States please clarify its understanding of what "quintessential general infrastructure" is, and whether "quintessential general infrastructure" is used in the same sense in both paragraphs?*

112. The United States used the word "quintessential" in the phrase "quintessential general infrastructure" to express the position that these measures are the purest, or most typical type of general infrastructure measures. In particular the United States considers these measures at issue to be "quintessential general" infrastructure because there are no limitations on the availability of the infrastructure at issue.

(ii) *Other issues*

To the European Communities:

39. *Is the European Communities requesting the Panel to make any findings in respect of the Master Site Agreement as a whole, or is the European Communities asking the Panel only to make findings in respect of those incentives referred to in paragraphs 163 and 164 of its First Written Submission? Is the European Communities requesting the Panel to consider each of those individual incentives as a "measure"?*

40. *With regard to utilities, how does the European Communities respond to the United States' assertion that Boeing pays the same rates as other industrial customers?*

41. *At paragraphs 194 and 203 of its First Written Submission, the European Communities asks the Panel to find that the value of the incentives at issue is "large". If the Panel were to accept that these incentives constitute subsidies, and that the amount of those subsidies is "large", how would this affect the Panel's findings, given that the European*

Communities has based its claims of serious prejudice on a quantification of the amount for all other subsidies at issue in this dispute?

To the United States:

42. *At paragraph 578 of its First Written Submission, the United States asserts that "{t}he State of Washington is not providing any special tax incentives to the 747 LCF, and is therefore not foregoing any revenue otherwise due." In the accompanying footnote, the United States explains that "{i}t is true that the 747 LCF is eligible for other tax measures that apply to Washington's aerospace sector more broadly, such as the B&O tax rate reduction for the manufacture of commercial airplanes and components. These tax measures are discussed in detail in Section X above, and as explained in that section, they do not constitute WTO-inconsistent subsidies to Boeing." Does the United States' assertion that the State of Washington is not providing special tax incentives to the 747 LCF, and is therefore not foregoing any revenue otherwise due, rest solely on the premise that the tax measures discussed in Section X of its First Written Submission do not constitute subsidies to Boeing? If the Panel found that the tax measures discussed in Section X of its First Written Submission do constitute subsidies to Boeing, would it follow that Washington is providing any special tax incentives to the 747 LCF, and is therefore foregoing revenue otherwise due within the meaning of Article 1.1(a)(1)(ii)?*

113. The Panel is correct that the U.S. argument rests on the premise that the tax measures discussed in Section X of the U.S. first written submission are not subsidies. Such measures are also applicable to the Boeing 747 LCF.

43. *Regarding the so-called "Make Whole" provision of the Master Site Agreement, how does the United States respond to paragraph 32 of the European Communities' Oral Statement?*

114. The EC argument mischaracterizes the meaning of Article 10.4.1 of the MSA. The EC asserts that Article 10.4.1 "is a *guarantee* that should something happen that lessens or removes one of the Public Parties' obligations or commitments, the Public Parties must provide Boeing with either an exemption from the change in law, or if that is not possible, the full economic value of the lost obligation or commitment."¹²³ In addition, the EC claims that its interpretation is based on a "plain reading" of Article 10.4.1. In fact, the EC's argument is inconsistent with a plain reading of Article 10.4.1 and therefore fails for several reasons.

115. Article 10.4.1 of the MSA states as follows:

¹²³ EC SWS, para. 205.

{I}n the event of a change in law, or any other act, event or circumstance, the result of which would be to materially diminish, impede, impair or prevent in connection with Project Olympus the full performance after the Effective Date of any or all of the obligations and Commitments made by the applicable Public Parties, all applicable Public Parties shall *exercise their best efforts to, and to the extent permitted by law* shall, provide Boeing either with and exemption from the law as so changed or otherwise with another obligation or commitments acceptable to Boeing and having economic effect equivalent to the Commitment so lessened or removed.¹²⁴

116. First, contrary to the EC’s assertions, the language of Article 10.4.1 provides no such “guarantee” to Boeing, nor does it impose such a “requirement” on the State of Washington or any other Public Party. The operative portion of Article 10.4.1 provides that the Public Parties “shall exercise their best efforts to, and to the extent permitted by law shall, provide Boeing {with an exemption or alternative having equivalent economic effect}.” Accordingly, the commitment by the Public Parties is subject to the “best efforts” and “to the extent permitted by law” conditions.

117. The EC contends that these limitations have no legal significance because “if a change in law triggers the guarantee and the modified law somehow makes it illegal for an exemption to be provided to Boeing, then the applicable Public Party must provide Boeing with another obligation or commitment of equivalent economic effect that *is* permitted by law.”¹²⁵ The EC goes on to say “given that the Public Parties have the power to make or change the state and local laws, the ‘to the extent permitted by law’ provision would appear to have little practical impact.”¹²⁶ In fact, the EC’s contentions are inconsistent with the legislative process in Washington State.

118. Those who contract with public governments or entities understand that the government’s ability to act is subject to the requirements and restrictions of the State’s democratic and constitutional processes. Contrary to the EC’s argument, the Public Parties in the MSA do not unilaterally have the power to enact changes to Washington State laws or, for that matter, to “guarantee” a “potential direct transfer of funds.” At most, Public Parties can promise to use best efforts to bring about changes in laws through the processes that produce such laws. They cannot and would not promise to do more.

¹²⁴ Emphasis added.

¹²⁵ EC SWS, para. 206 (emphasis in original).

¹²⁶ EC SWS, para. 206.

119. Article 10.4.1 contains a promise to use best efforts and an explicit recognition of constraints imposed by the law. The EC's interpretation of Article 10.4.1 reads the "best efforts" and "to the extent permitted by law" constraints out of the provision. Accordingly, the EC's argument is inconsistent with a "plain reading" of the relevant provision.

120. The EC has also incorrectly concluded from Article 10.4.1 that the indeterminate "obligation" or "Commitment" that might be made in the future is an actionable subsidy in the form of a guarantee. Specifically, the EC claims that the unspecified obligation or commitment is a "potential direct transfer of funds" under Article 1.1(a)(1)(i) of the SCM Agreement. However, as just discussed, the MSA does not provide with certainty that an alternative measure will be provided in the event of such change in circumstance.

121. Moreover, the MSA provides for efforts to replace the impaired obligation or Commitment with another "obligation" or "Commitment", *without specifying what that obligation or Commitment would be*. It is thus impossible to evaluate whether the potential new "obligation" or "Commitment" would be a potential direct transfer of funds that confers a benefit. That is, the EC asks the Panel to assume that the alternative measure would be an actionable subsidy – something the Panel, of course, cannot do. It is the EC's burden to establish the existence of a subsidy, and it has not done so.

3. State of Kansas and municipalities

To the European Communities:

44. *We understand the European Communities to be alleging that the benefit of the financial contributions provided to Spirit through IRBs and KDFAs passes through to Boeing exclusively via discounted prices of goods and services that Spirit supplies to Boeing under the long-term supply agreements in question, and not through any other elements of the price that Onex Corporation paid to Boeing for Boeing Wichita. Is our understanding correct?*

45. *At paragraphs 290-292 of its First Written Submission, the European Communities asserts that Boeing and Spirit have a "close" and "special" relationship. At paragraph 292 of its First Written Submission, the European Communities asserts that "{t}his situation is relevant to the legal analysis for both the City of Wichita and State of Kansas subsidies." Is the European Communities alleging that Spirit does not operate at "arm's length" from Boeing? If not, please explain how the relationship between Boeing and Spirit is "relevant to the legal analysis" to be undertaken by the Panel.*

To the United States:

46. *At paragraph 31 of its Oral Statement, the European Communities argues that "the general Kansas property tax exemption to which the United States refers applies only to*

commercial and industrial machinery and equipment acquired after 30 June 2006. It therefore does not affect the continuing property tax obligations with respect to such property acquired prior to that date; it also does not affect any property tax obligations with respect to other types of property. Indeed, the United States fails to explain why, if it is true that Boeing and Spirit no longer need IRBs to obtain tax breaks in Kansas, they both incurred the costs of applying for and receiving a combined \$272 million in IRBs as recently as November 2006." How does the United States respond?

122. The United States does not contest that the general property tax exemption on machinery and equipment applies only to commercial and industrial machinery and equipment acquired after June 30, 2006 and does not affect other types of property. However, while the change in Kansas law did not eliminate companies' incentive to apply for IRBs, Kansas' general property tax exemption on such property, combined with the fact that most of the property financed by Boeing with IRBs has been property subject to this general exemption means that Boeing and Spirit have less of an incentive to seek IRBs.

123. More fundamentally, as the United States explained in previous submissions, the EC has failed to establish that IRB benefits are specific.¹²⁷ As the United States has demonstrated in prior submissions, the IRBs are broadly available and have been widely used. The EC asserts that the IRBs are *de facto* specific on the basis that Boeing used the program more than other businesses in Wichita. However, the fact that a company with such a significant role in the local economy utilized a generally available program more than others does not establish specificity. Indeed, the SCM Agreement mandates that in evaluating a claim of *de facto* specificity account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority. Taking account of that factor here, Boeing's receipt of IRBs is not disproportionate.

124. In its second written submission, the EC attempts to bolster its claim of specificity by citing Spirit's employment levels at its Wichita facility in 2006 and noting that its employment represented a smaller proportion of total Wichita employment than Boeing and Spirit's share of total IRBs issued.¹²⁸ By looking at this one metric in isolation, however, the EC fails to conduct the fact-intensive inquiry required to determine whether the factors listed in Article 2.1(c) support a finding of specificity. The EC has pointed to nothing beyond lack of strict numerical correspondence between usage and Spirit's employment level to support its case.¹²⁹

¹²⁷ US SWS, paras. 146-47.

¹²⁸ EC SWS, para. 249.

¹²⁹ The EC also argued that because other IRBs have been issued for terms of five years, and not ten years, this is a sign of specificity. However, as the United States noted, the EC points to no substantive difference between these two arrangements, and fails to respond to the U.S. argument that the nominal difference reflects the fact that the IRBs were authorized before a November 2004 City of Wichita policy limiting tax abatements to 5-year terms.

This by itself does not establish that there was a granting of disproportionately large amounts of subsidy to certain enterprises within the meaning of Article 2.1(c).

125. In this case, the extent of usage is fully understandable given the role of Boeing, and now Spirit, in the Wichita economy. Aircraft production is the core industry of Wichita, and Boeing was the largest single company and private sector employer for the City of Wichita (indeed, for the entire State of Kansas) during the period at issue.¹³⁰ The EC thus fails to take account of the extent of diversification of economic activities within the City of Wichita, as required under Article 2.1(c) of the SCM Agreement. Even the single metric that the EC relies on is misleading; the EC cites Spirit's – and not Boeing's – recent employment level. In fact, Boeing's employment was more than double that of Spirit's during the period of time when many of the IRBs were issued. ¹³¹

47. *At paragraph 35 of its Oral Statement, the European Communities states that "the United States criticizes the European Communities for not pointing to anything in these agreements that proves that Spirit passes these tax benefits through to Boeing {...} since these agreements have been withheld by the United States, how can the European Communities point to a provision of an agreement that it does not have?" How does the United States respond?*

126. As a threshold matter, it is the EC's burden to show pass-through of the alleged benefits from Spirit to Boeing. The EC has failed to meet this burden.

127. The EC makes much of its contention that the United States has not provided supplier agreements between Spirit and Boeing, presumably on the hope that these will provide the evidence of pass-through that it has been lacking. In fact, these agreements are readily available to the EC. The EC has submitted Spirit's 2005 prospectus filed with the Securities and Exchange Commission ("SEC") as Exhibit EC-165 to its first written submission.¹³² The EC could have used the same source – the SEC's publicly available database – and retrieved the supplier agreements between Boeing and Spirit filed with the SEC as exhibits to Spirit's prospectus.¹³³ Accordingly, the EC's complaints regarding the lack of access to these documents are disingenuous. Moreover, there is nothing in these agreements that demonstrates that the anticipated future value of IRBs to Spirit was captured by Boeing, as alleged by the EC. The EC's pass-through claim must fail.

¹³⁰ US FWS, paras. 607, 613.

¹³¹ See, e.g., Exhibit EC-192, p. 9 (Boeing employment exceeded 21,000 people in 1997).

¹³² Spirit Prospectus (Exhibit EC-165).

¹³³ Special Business Provisions Between The Boeing Company and Spirit Aerosystems, Incorporated; General Terms Agreement Between The Boeing Company and Spirit Aerosystems, Incorporated (Exhibit US-1213). These agreements are available from the SEC website, www.sec.gov.

128. Whether on the basis of the supply contracts or otherwise, the EC has not established pass-through. The EC continues to argue that by the time the sale transaction between Boeing and Spirit was closed on June 16, 2005, the City was committed to providing IRBs to Spirit. The EC argues that the future benefits of these bonds would have been expected by Spirit at the time of the sale and therefore reflected in the terms and conditions of the transaction.¹³⁴ However, as the United States explained in the first written submission, even if this were enough to show pass-through, Boeing and Spirit signed their Asset Purchase Agreement on February 22, 2005, before the City issued its Letter of Intent to issue IRBs to Spirit. It was at the time of the signing of the agreement that the parties set the price for the transaction.¹³⁵ Thus, contrary to the EC's assertions, when the price for the transaction was set, the City had not yet committed to providing any IRBs to Spirit. There is accordingly no basis, even under the EC's own economic theory, to determine if and how the sale price would have reflected an anticipation of future benefits from IRBs to Spirit. The EC fails to adequately respond to these facts and instead merely repeats that the transaction was not closed until June 16, 2005. But the price for the transaction had been set four months earlier, at the time of the signing of the agreement, and thus the June closure date is irrelevant for determining whether the IRBs could play a role in the price.¹³⁶

129. In order to downplay these inconsistencies in its arguments, the EC asserts in its second written submission that "the precise timeline of events is not as important as the expectations that Boeing and Spirit had at the time they negotiated and finalized their deal."¹³⁷ The EC contends that the parties expected Spirit to receive future IRBs because the "City of Wichita, without fail, approved Boeing's IRB applications every year since 1979"¹³⁸ and the parties "surely had solid expectations of Spirit's future property needs" and "surely took those expectations into account in finalizing the terms and conditions of the transaction."¹³⁹ However, the EC fails to substantiate these assertions. There was no guarantee that Spirit would receive the IRBs for which it applied simply because Boeing's applications for IRBs were granted, and there is no evidence in any event that Spirit and Boeing considered the potential availability of IRBs to Spirit in the future in negotiating a price for the transaction.

130. Boeing and Spirit had no basis to calculate the amount of any future IRB benefits that would flow to Spirit. Accordingly, any possible future benefit to Spirit – let alone Boeing – from

¹³⁴ Paul Wachtel *Economic Analysis: Subsidy Pass-Through and Asset Pricing Issues Relevant to Subsidies to U.S. LCA Industry*, p. 4 (Dec. 2006)(Exhibit EC-16); EC SWS, para. 237.

¹³⁵ US FWS, paras. 628-29.

¹³⁶ EC SWS, para. 237.

¹³⁷ EC SWS, para. 238 (emphasis in original).

¹³⁸ EC SWS, para. 239.

¹³⁹ EC SWS, paras. 239-240 (emphasis added).

IRBs was indeterminate at the time of the sale to Spirit. Even if Boeing and Spirit had an expectation that Spirit would receive IRBs in the future, there is no basis to determine if and how such an expectation would have been reflected in the sale price.¹⁴⁰

III. SPECIFICITY

To both parties:

48. *At paragraph 16 of its Third Party Submission, Brazil submits that the Panel should not interpret the term "group of enterprises or industries" in Article 2.1 too narrowly in analyzing whether subsidies in the aircraft sector are specific. According to Brazil, "even if the group is large and diverse", the Panel should find that it constitutes a "group of enterprises or industries" within the plain meaning of Article 2.1. At paragraphs 31ff of its Third Party Submission, Canada argues that the European Communities' claim that the ATP Program is specific to a "group of enterprises or industries" fails because, inter alia, the universe of companies and industries that potentially fall within the limits identified by the EC is "highly indeterminate and extraordinarily diverse", and because the European Communities makes "no effort to establish any commonality" among the industries or groups of industries that are eligible for ATP funding "by reference to the products they produce". Could the parties please elaborate their views as to the meaning of "a group of enterprises or industries" in the chapeau of Article 2.1?*

131. At the outset, in defining the phrase “group of enterprises or industries,” it is important to remember the overall context of the SCM Agreement and the place of this phrase within that Agreement. The SCM Agreement does not capture every type of government action that may be considered a subsidy. Subsidies that are broadly available are not subject to the disciplines of the SCM Agreement. Rather, only those subsidies that are found to be specific within the meaning of Article 2.1 are actionable.

132. A determination of specificity under Article 2 is made in relation to “an enterprise or industry” or “group of enterprises or industries.” Thus, the phrase “group of enterprises or industries” places limits on those subsidies that may be deemed specific. As such, an overly broad definition of “group of enterprises or industries,” as advocated by the EC, particularly in relation to the Department of Commerce’s Advanced Technology Program, undermines the disciplines of Article 2 and the specificity requirement. Contrary to the EC’s approach, the phrase “group of enterprises or industries” serves as a limiting principle in determining specificity.

133. The SCM Agreement does not define the phrase “group of enterprises or industries” or the individual terms in this phrase. The words of a treaty “are to be given their ordinary meaning

¹⁴⁰ US SWS, para. 630.

in their context and in light of the treaty’s object and purpose.”¹⁴¹ The ordinary meaning of the term “group” is “{a} number of people or things regarded as forming a unity or whole on the grounds of some mutual or common relation or purpose, or classed together because of a degree of similarity.”¹⁴² The EC agrees with this definition.¹⁴³ The ordinary meaning of the term “enterprise” is “{a} business firm, a company.”¹⁴⁴ And the ordinary meaning of the term “industry” is “{a} particular form or branch of productive labour; a trade, a manufacture.”¹⁴⁵

134. The panel in *US – Upland Cotton* accepted the ordinary meaning of “industry,” stating that it “may be defined as ‘a particular form or branch of productive labour; a trade; a manufacture.’”¹⁴⁶ The panel also noted that Article 2.1 “does not offer any technical definition or additional, detailed indication about how broadly or narrowly we are to classify an industry.”¹⁴⁷ The panel, however, went on to explain:

We nevertheless believe that an industry, or group of “industries,” may be generally referred to by the type of product that they produce. To us, the concept of an “industry” relates to producers of certain products. The breadth of this concept of “industry” may depend on several factors in a given case. At some point that is not made precise in the text of the agreement, and which may modulate according to the particular circumstances of a given case, a subsidy would cease to be specific because it is sufficiently broadly available throughout an economy as not to benefit a particular limited group of producers of certain products.¹⁴⁸

135. Based on the ordinary definitions of the terms group, enterprise, and industry, as well as the *US – Upland Cotton* panel’s interpretation of the term “industry,” the phrase a “group of enterprises or industries,” in the chapeau of Article 2 means a number of business firms or companies, or a branch of productive labor or a trade or manufacture that form a unity or whole.

¹⁴¹ *US-Gasoline*, p. 17 (reasoning that Article 31 of the Vienna Convention on the Law of Treaties has attained the “status of a rule of customary or general international law” and thus applies in the interpretation of the provisions of the WTO Agreements.)

¹⁴² *New Shorter Oxford English Dictionary*, p. 1151.

¹⁴³ EC SWS, para. 525, n. 841 (citing *New Shorter Oxford English Dictionary*, p. 1151).

¹⁴⁴ *New Shorter Oxford English Dictionary*, p. 828.

¹⁴⁵ *New Shorter Oxford English Dictionary*, p. 1356.

¹⁴⁶ *US – Upland Cotton (Panel)*, para. 7.1140, citing *The New Shorter Oxford English Dictionary*, (1993). See also *US – Softwood Lumber IV (Panel)*, para. 7.120 (“The New Shorter Oxford English Dictionary defines an industry as ‘a particular form or branch of productive labour; a trade, a manufacture.’”)

¹⁴⁷ *US – Upland Cotton (Panel)*, para. 7.1141.

¹⁴⁸ *US – Upland Cotton (Panel)*, para. 7.1142 (citing *US – Softwood Lumber IV (Panel)*, para. 7.120).

136. The EC argues that the Advanced Technology Program is specific because it is “explicitly limited to *groups* of industries or enterprises that engage in ‘high risk, high pay-off, emerging and enabling technologies.’”¹⁴⁹ By focusing on the language, “high risk, high pay-off, emerging and enabling technologies,” the EC attempts to fabricate a “group” that is so artificial as to render the concept of “group” under Article 2.1 meaningless. Indeed, as the United States has noted, there is no limitation on industries that can participate,¹⁵⁰ and even the EC recognizes that ATP extends across a wide range industries and enterprises.¹⁵¹ Some of the many sectors that have ATP project participants include, among others, advanced materials and chemicals, biotechnology, electronics, computer hardware and communications, information technology, and manufacturing.¹⁵² Some of the many enterprises that have received ATP funding engage in technologies related to, among others, abrasives, adhesives, and ceramics, animal and plant biotechnology, automobile manufacturing, bioinformatics, catalysis and biocatalysis, computer systems and software applications, energy conversion, energy storage, environmental technologies, intelligent control, marine biology, materials handling, nanotechnology, optics and phototonics, polymer synthesis and polymer fabrication, semiconductors, and separation technology.¹⁵³ By arguing that such a broad array of sectors and enterprises, constitutes a “group of enterprises or industries,” the EC fails to understand the essential limiting principle of Article 2 of the SCM Agreement.

49. *At paragraphs 89, 305, 334, 516, 559, 591, 601, 604, and 670 of its First Written Submission, the United States argues that certain alleged subsidies were governed by "objective" conditions and criteria within the meaning of Article 2.1(b) and footnote 2. Could the parties please elaborate their views as to the meaning of "objective" criteria or conditions within the meaning of Article 2.1(b) and footnote 2?*

137. Pursuant to Article 2.1(b), a subsidy may be found to be *de jure* non-specific and therefore not an actionable subsidy under the SCM Agreement. A finding of *de jure* non-specificity depends on the existence of “objective criteria or conditions.” Thus it is important to understand what is meant by “objective” criteria or conditions.

138. Article 2.1(b) of the SCM Agreement provides:

¹⁴⁹ EC SWS, para. 520 (emphasis in original). It should be noted that the EC uses the word “groups” of industries or enterprises. The chapeau to Article 2, however, does not use the word “groups.” Rather, it uses the singular word “group.” The EC’s interpretation is inconsistent with the text of the Agreement.

¹⁵⁰ US SWS, para. 120.

¹⁵¹ EC SWS, para. 520.

¹⁵² ATP Awards Summary Data - Awards (Technology Area by Year), Factsheet 3.B1 (Sept. 2004) available at <http://www.atp.nist.gov/factsheets/3-b-1.pdf> (Exhibit US-151).

¹⁵³ ATP Funded Technologies, available at <<http://www.atp.nist.gov/atp/category.htm> (last visited May 8, 2007) (Exhibit US-152).

Where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions² governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and that such criteria and conditions are 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.

Footnote 2 states:

Objective criteria or conditions, as used herein, 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.

139. In the view of the United States, “objective” criteria or conditions mean those criteria or conditions that are observable and capable of being evaluated and applied without subjective judgment. In other words, the consequence of evaluating and applying the conditions or criteria should not vary according to the person that is engaged in the evaluation and application of the conditions or criteria. This interpretation of “objective” criteria or conditions is supported by the ordinary meaning of the word “objective,” which is “[d]ealing with or laying stress on what is external to the mind; concerned with outward things or events; presenting facts uncoloured by feelings, opinions, or personal bias; disinterested.”¹⁵⁴ The outcome of evaluating and applying criteria or conditions that are “uncoloured by feelings, opinions, or personal bias” or that are “disinterested” would not differ based on the person engaged in the analysis.

140. The examples of objective criteria found in footnote 2 to Article 2.1(b) support the United States’ interpretation of the meaning of “objective” criteria or conditions. Both the number of employees and the size of the enterprise are observable criteria, and an application of these criteria should not vary according to the person that is applying them.

141. The meaning of objective criteria that render a measure *de jure* non-specific is further illustrated by the utility rates charged by the City of Everett. The City of Everett’s utility rates are observable because they are set forth in city ordinances, and their application does not vary based on the person that is applying them.¹⁵⁵ For instance, Ordinance 2805-04 establishes the city’s water rates. This ordinance breaks water rates into two categories of users: 1) “domestic” or residential customers, and 2) “Commercial/Industrial/Governmental.” Depending on the

¹⁵⁴ *New Shorter Oxford English Dictionary*, p. 1965.

¹⁵⁵ The EC’s assertion that Boeing does not pay the utility rates found in these ordinances is incorrect. EC SWS, paras. 192-198. As the United States explained in its first written submission, the language in the Project Olympus Master Site Agreement referring to the “applicable regulated tariff rate” is the rate set by City Ordinance – not a special rate that Boeing received. US FWS, para. 555.

category into which a customer falls, the customer pays set rates based on the volume of water consumed.¹⁵⁶ Similarly, the City of Everett’s sewer rates are set forth in Ordinance 2804-04. This ordinance provides that a “{s}ingle family residence” pays \$38.40 per month for sewer charges, and users “other than single family residence{s} (multiple family residence, commercial, and industrial users, etc.)” pay a sewer service rate that is calculated based on a usage formula.¹⁵⁷ In short, these utility rates are clearly based on objective criteria.¹⁵⁸

50. *At paragraph 77 of its Oral Statement, the European Communities states, “it could be argued that what is at issue in this dispute are 23 particular RDT&E PEs, and an examination at the PE level confirms that each PE was explicitly limited to the group of enterprises capable of conducting RDT&E in the narrow areas defined by each PE” (emphasis added). At paragraph 79 of its Oral Statement, the European Communities likewise states that “it could be argued that what is at issue in this dispute are the eight ATP projects in which Boeing participated, and an examination at the project level confirms that each of these projects was explicitly limited to a group of enterprises. Thus, ATP, as well as each of the ATP projects at issue, is specific.”*

(a) *Could the European Communities please clarify whether it is arguing that the Panel should examine specificity at the PE/project level.*

(b) *Could the United States please respond to these statements.*

142. The EC’s arguments that specificity should be examined at the Program Element (“PE”) level for DoD RDT&E and at the project level for ATP lack merit. For both of these programs, the EC has failed to identify the appropriate level at which to analyze specificity.

143. The United States recognizes that it is not the case that specificity must always be examined at the highest level of aggregation of the activities of the granting authority, whether or not that is the level that the granting authority refers to as the “program” or some similar term. In some instances, it may be appropriate to analyze specificity at a lower level. But, this is a fact-specific inquiry. To the extent that a complaining party believes that specificity should be examined at a given level, such as the project level, the complaining party must provide a reasoned basis for performing the analysis at that level. This reasoned basis could, for example,

¹⁵⁶ City of Everett Water Ordinance 2805-04 (Exhibit US-227).

¹⁵⁷ City of Everett Sewer Ordinance 2804-04, section 3 (Exhibit US-228).

¹⁵⁸ The United States previously argued that the DoD RDT&E, IR&D and B&P, the treatment of patent rights under U.S. government research contracts, the Illinois EDGE tax credits, and the Kansas IRBS were *de jure* non-specific under Article 2.1(b). US FWS, paras. 89, 305, 334, 601, 604, and 670. Upon further reflection regarding the meaning of “objective” criteria, the United States believes that they are not *de jure* non-specific by virtue of Article 2.1(b). However, these transactions are not specific within the meaning of Article 2.1(a) or 2.1(c).

include a consideration of how the granting authority itself classifies activities under what it calls the “program” – for example, whether activities of the authority are subdivided in a way that supports a frame of reference other than the program. If a granting authority has chosen to subdivide what it calls a program according to common characteristics within each of several groups, it may be appropriate to examine specificity at the group level.

144. An analysis of specificity at a given level, however, does not have a reasoned basis and is not appropriate merely because it is a convenient way for the complaining party to frame its argument. But that is precisely what the EC has done in this dispute by arguing that DoD RDT&E may be examined at the PE level and ATP may be examined at the project level.

145. With regard to DoD RDT&E, the sole reason that the EC gives for assessing specificity at the PE level is that “what is at issue in this dispute are the 13 general aircraft RDT&E PEs and 10 military aircraft RDT&E PEs.”¹⁵⁹ That is merely another way of saying that the complaining party should be able to dictate the scope of the specificity analysis by sculpting its claims in a particular way.

146. In fact, a determination as to the specificity of DoD RDT&E cannot be made at the PE level, as the EC contends, because the PEs challenged by the EC are, for the most part, not themselves programs, or even groupings below the program level, and do not create a frame of reference. With the exception of a few PEs, such as Industrial Preparedness/Manufacturing Technology and Dual Use Science and Technology, the general aircraft RDT&E PEs challenged by the EC do not coincide with the various program offices within DoD. Instead, the funding that is authorized by a given PE can be used by a variety of DoD programs, so long as the given use by the program office coincides with one of the spending authorizations set out in the PE.

147. As for ATP, the EC has also failed to put forth a reasoned basis for examining specificity at the level of eight particular ATP projects in which Boeing participated.¹⁶⁰ The Department of Commerce has not grouped those particular projects together, nor is there any reason to do so. The only commonality among these eight projects is that Boeing participated in them. This is hardly the type of reasoned basis that warrants use of this subset as the group to be examined for purposes of a specificity analysis. Rather, it simply manipulates the data set before the Panel in a way to make the program appear specific when it is not.

148. To the extent that the EC is arguing that specificity must be analyzed on the level of each individual project, rather than the eight projects in which Boeing participated as a group, its argument is even less plausible. The EC, in essence, asks the Panel to treat each separate government disbursement as a “program” or “sub-program.” If that is the level of inquiry, every

¹⁵⁹ EC SWS, para. 490.

¹⁶⁰ EC OS1, para. 79 and EC SWS, para. 528.

government program would be specific, since particular disbursements by their nature go to a limited group of recipients. Since treaties are to be construed, if possible, so as to give meaning to each provision, such a result is disfavored under customary rules of interpretation of public international law.

149. Not only has the EC failed to provide a reasoned basis for focusing on the eight projects in which Boeing participated, the EC has failed to even demonstrate that the Department of Commerce makes sub-program distinctions when awarding ATP funding. In fact, it makes no such distinctions. ATP competitions are open to proposals from any area of technology, and ATP makes awards across numerous technology fields.¹⁶¹ Accordingly, for ATP, the appropriate level at which to examine specificity is the program level. And, as the United States has explained in detail in its previous submissions, ATP is not specific because it is broadly available to a wide range of technology sectors and industries.

To the European Communities:

51. *Could the European Communities please elaborate on its view that the relevant baseline for the purpose of determining whether "disproportionately large" amounts of subsidy have been granted to certain enterprises is "the jurisdiction of the granting authority" (Oral Statement, paras. 36, 77, 87). To what extent does this baseline differ from that proposed by the United States at paragraphs 64-67 of its First Written Submission?*
52. *At paragraph 76 of its First Written Submission, the European Communities argues that "consideration of specificity depends on whether the subsidy is limited to a certain number of industries that may be involved in different trades or manufacturing processes" (emphasis added). However, there are numerous instances in its First Written Submission where the European Communities advances its specificity arguments in terms of whether the alleged subsidy is specific to an enterprise, i.e. Boeing. With respect to each of the alleged subsidies, please clarify whether the European Communities is claiming that the alleged subsidy is (a) *de jure* and/or (b) *de facto* specific to: (i) an enterprise; (ii) an industry; (iii) a group of enterprises; and/or (iv) a group of industries.*
53. *At paragraphs 143, 188, 200, 209, 236-237, 251, 283, and 340 of its First Written Submission, the European Communities argues that certain subsidies are specific within the meaning of Article 2.1(c) because Boeing is or will be the "predominant beneficiary" of those subsidies. Does "predominant beneficiary" mean the same thing as "predominant use" in Article 2.1(c)?*

¹⁶¹ NIST, *Measuring ATP Impact: 2006 Report on Economic Progress*, p. 13 (March 2007) available at www.atp.nist.gov/eao/gcr06-99.pdf (last visited May 7, 2007) (Exhibit US-149).

IV. EXPORT SUBSIDIES

A. HB2294

To both parties:

54. *At paragraph 687 of its First Written Submission, the United States argues that "HB 2294 does not require the commercial airplane final assembly facility to actually produce 36 airplanes per year; it only requires that this facility have the capacity to produce that number of planes per year. The EC fails to understand this crucial distinction". Please explain why this distinction is or is not crucial for the purposes of Article 3.1(a), in light of the dynamics of LCA production and the LCA industry/market more generally.*

150. The distinction to which the Panel refers – the distinction between a requirement to establish a certain production capacity and a requirement to produce a certain number of superefficient airplanes – is crucial because what Article 3.1(a) prohibits is the granting of a subsidy tied to actual or anticipated exportation, not the granting of a subsidy tied to the establishment of a certain production capacity.

151. As the Appellate Body found 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 tied to the anticipation of exportation.”¹⁶² It is precisely this “tie to” exportation that is missing in the case of HB2294.

152. The fact that HB 2294 merely requires the establishment of a certain production capacity is crucial for purposes of a *de facto* export contingency analysis. As the United States set forth in our second written submission, the EC’s export contingency claim relies on two unsubstantiated assumptions: first, that the production capacity Boeing was required to establish to be eligible for the tax treatment under HB 2294 would be fully utilized; and second, that full utilization of this capacity would necessarily require exports because of the size of the U.S. market for superefficient airplanes.

153. As the United States explained in prior submissions, neither assumption is correct.¹⁶³ The EC has failed to establish its implicit assumption that a requirement to establish a certain production capacity equates to a tie to anticipated exports. The EC’s assertion of such an equation is based on unsubstantiated assumptions about the dynamics of the large civil aircraft

¹⁶² *Canada – Aircraft (AB)*, para. 172.

¹⁶³ US FWS, paras. 684-702; US SWS, paras. 155-58.

market, in particular assumptions about projected capacity utilization and demand in the U.S. market.¹⁶⁴

154. In addition, in its second written submission and in its first oral statement, the EC contends that the “United States’ propositions that Washington State would subsidise additional large civil aircraft capacity whilst anticipating or expecting or intending that it would stand idle and will absorb 36 787s per year, are highly implausible.”¹⁶⁵ The United States has never argued that the Boeing 787 facility would stand “idle,” and a finding that HB 2294 is not export contingent need not rest on such a proposition. Rather, the United States has argued that the requirement to establish production capacity is an insufficient basis on which to conclude that the State’s granting of the tax treatment in HB 2294 was tied to anticipated exports.

55. *Footnote 4 to Article 3.1(a) provides that the “contingent ... in fact ... upon export performance” standard in Article 3.1(a) is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, “is in fact tied to actual or anticipated exportation or export earnings.” Could the parties please elaborate their views on the concept of the granting of a subsidy being “in fact” tied to “anticipated” exportation?*

155. The United States understands the Panel’s question to be asking for the U.S. views in particular on the concept of an “in fact” tie to exportation or export earnings, and on the concept of “anticipated” exports.

156. In order to prevail in an export contingency claim concerning HB 2294, the EC would have to demonstrate three things: (1) the “granting” of a subsidy; (2) that is “tied to” (3) “actual or anticipated exportation or export earnings.” This demonstration can be in law, or it can be in fact.

157. The SCM Agreement provides that in fact export contingency exists when “the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings.” While footnote 4 addresses the evidentiary question of how contingency in fact is demonstrated, it also restates the legal standard for establishing export contingency. To put it differently, the distinction between an in law export contingency, and an in fact contingency is the evidence pursuant to which the contingency can be established; the legal standard is the same.¹⁶⁶

¹⁶⁴ US SWS, para. 155-56; US FWS, paras. 687, 702.

¹⁶⁵ EC SWS, para. 643; EC OS1, para. 105.

¹⁶⁶ *Canada – Autos (AB)*, para. 107 (internal citation to *Canada - Aircraft (AB)* omitted) (“As the legal standard is the same for de facto and de jure export contingency, we believe that a ‘tie’, amounting to the

158. In both cases the granting of the subsidy must be “tied to actual or anticipated exportation or export earnings.” However, in the case of in fact contingency, where the text of the measure does not establish the tie (either explicitly or by necessary implication in light of the relevant context), the facts surrounding the granting of the alleged subsidy must demonstrate that the granting was nevertheless contingent upon actual or anticipated exportation or export earnings.

159. Thus, in the case of HB 2294, the EC’s burden is to establish that while, as a legal matter, the provision of the tax treatment in HB 2294 is not tied to anything more than the establishment of a certain production capacity, in fact it is tied to anticipated exportation or export earnings. As the United States has set forth in detail above and in the first and second written submissions, the EC has not shown the existence of such a *de facto* tie.

160. With regard to the term “anticipated”, the United States refers first to the definition provided by the Appellate Body in *Canada – Aircraft*.¹⁶⁷ There, the Appellate Body pointed out that the dictionary meaning of “anticipated” is “expected”.¹⁶⁸ Thus, for the EC to meet its burden, it would have to show that Washington State’s granting of the alleged subsidy was tied to expected exports.

161. The only factor that the EC points to other than the capacity requirement is the general export orientation of Boeing. As indicated in response to Question 54, Footnote 4 to the SCM Agreement, as well as panels and the Appellate Body construing that provision, make quite clear that the general export orientation of a particular company is not sufficient for a finding of export contingency. What is more, the export orientation of a company does not equate to evidence that the granting authority tied the provision of a subsidy to expected exports.

162. Finally, the United States points out that the final, and critical element to be demonstrated for a successful export contingency claim, is that the granting of the subsidy is “tied to” any alleged anticipated exports. As we have pointed out above in response to Question 54, as well as in our first and second written submissions, the EC has not shown the existence of a “tie” of the granting of the alleged subsidy to any anticipated exports or export earnings.¹⁶⁹ Indeed, the only thing that the EC can point to is a requirement for Boeing to site a facility with a certain production capacity within the State of Washington.

To the European Communities:

relationship of contingency, between the granting of the subsidy and actual or anticipated exportation meets the legal standard of ‘contingent’ in Article 3.1(a) of the SCM Agreement.”)

¹⁶⁷ *Canada – Aircraft (AB)*, para. 172.

¹⁶⁸ *Canada – Aircraft (AB)*, para. 172 (citing *The New Shorter Oxford English Dictionary*, (Clarendon Press, 1993), Vol. I, p. 88).

¹⁶⁹ US FWS, paras. 695-701; US SWS, paras. 153-158.

56. *At paragraph 111 of its Oral Statement, the European Communities refers to its "primary argument" in connection with its claim that the subsidies allegedly provided through HB2294 are contingent in fact upon export performance. How many distinct legal arguments (including those made in the alternative) is the European Communities advancing in support of its claim that the subsidies allegedly provided through HB2294 are contingent in fact upon export performance?*
57. *Is the European Communities arguing that the grant of the subsidy was in fact tied to "anticipated" or "actual" exportation?*

B. FSC/ETI-RELATED MEASURES

To both parties:

58. *In its first written submission, the European Communities recalls that "WTO panels and the Appellate Body have repeatedly found these tax breaks to constitute WTO-incompatible export subsidies" (e.g. para. 964 and footnote 1684). In US – Shrimp (Article 21.5 – Malaysia), the Appellate Body clarified that Appellate Body Reports that are adopted by the DSB must be treated by the parties to a particular dispute "as a final resolution to that dispute".¹⁷⁰ In EC – Bed Linen (Article 21.5 – India), the Appellate Body clarified that an unappealed finding included in a panel report that is adopted by the DSB must likewise be treated "as a final resolution to a dispute between the parties in respect of the particular claim and the specific component of a measure that is the subject of that claim".¹⁷¹ On that basis, the Appellate Body concluded that a particular claim "was not properly before the Panel".¹⁷² Is the European Communities' claim, i.e. that "subsidies provided by the FSC/ETI measures and successor legislation are contingent in law upon export performance" (EC FWS, para. 964), properly before this Panel?*

163. The EC's claim that FSC/ETI measures and successor legislation is contingent in law on export performance is superfluous and provides no basis for the Panel to make a finding or render a recommendation. There is no dispute between the United States and the EC as to whether FSC or ETI benefits are subsidies prohibited by the SCM Agreement. They are export-contingent subsidies and, therefore, prohibited subsidies inconsistent with the SCM Agreement.

164. The DSB has ruled that this is the case, and has recommended that the United States bring those measures into compliance with the SCM Agreement. Another finding that they are

¹⁷⁰ US – Shrimp 21.5(AB), para. 97.

¹⁷¹ EC – Bed Linen 21.5(AB), para. 93 (emphasis in original)

¹⁷² EC – Bed Linen 21.5 (AB), para. 99.

export contingent or another recommendation that they be brought into compliance with the SCM Agreement will add nothing to the force or effect of the earlier rulings or recommendations. Therefore, making such a finding or recommendation would be superfluous.

165. The United States notes in this regard that Article 3.7 of the DSU provides that the “aim of the dispute settlement mechanism is to secure a positive solution to a dispute.” Given the existing rulings and recommendations, which (as the Panel’s question notes) constitutes a final resolution to the EC-U.S. *FSC/ETI* dispute, additional rulings and recommendations would not provide any additional assistance to “secure{ing} a positive solution.”

166. For these reasons, the Panel should decline to address the question whether FSC or ETI is a prohibited subsidy.

To the European Communities:

59. *We understood the European Communities to clarify, in response to a question from the Panel at the first meeting, that it is not claiming that the Tax Increase Prevention and Reconciliation Act of 2005 – nor any other FSC/ETI-related measure referred to in its First Written Submission – is inconsistent with Article 3.1(a) "as such"; rather, the scope of the European Communities' claim under Article 3.1(a) is limited to the financial contributions/benefits to Boeing under those measures – i.e., these FSC/ETI-related measures "as applied" to Boeing. Is our understanding correct?*

To the United States:

60. *At paragraph 25 of its Oral Statement, the United States indicated that it does not contest that "FSC/ETI" was an export subsidy. Does it follow that the United States does not contest that the financial contributions/benefits to Boeing under FSC/ETI-related measures (i.e., FSC/ETI-related measures "as applied" to Boeing) also constitute an export subsidy?*

167. That is correct.

V. SERIOUS PREJUDICE

A. CLAIM OF SERIOUS PREJUDICE RELATING TO THE 1992 AGREEMENT

To both parties:

61. *Can the concept of "serious prejudice to the interests of another Member" in Article 5(c) be interpreted as covering forms of serious prejudice not enumerated in Article 6.3?*

- (a) *Please indicate whether such an interpretation of Article 5(c) would be in accordance with the customary rules of interpretation of public international law as expressed in the Vienna Convention on the Law of Treaties.*

168. An interpretation of Article 5(c) that “serious prejudice to the interests of another Member” in that provision covers forms of serious prejudice not enumerated in Article 6.3 would not be in accordance with customary rules of interpretation of public international law reflected in the VCLT. Under Article 31 of the VCLT “[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.” The ordinary meaning of Article 5(c) and Article 6.3 of the SCM Agreement, the context, and the object and purpose of the SCM Agreement make clear that the list of effects enumerated in Article 6.3 is exhaustive and that effects not enumerated do not constitute “serious prejudice” under the SCM Agreement.

169. Article 5(c) of the SCM Agreement, which declares “serious prejudice” to be one of the types of adverse effects covered by Part III of the SCM Agreement, does not contain a definition of the words “serious prejudice”. Neither does paragraph 1 of Article XVI of the GATT 1994, to which Article 5(c) refers in footnote 13. Article 6 of the SCM Agreement, titled “Serious Prejudice” does, however, contain a more detailed explanation of the concept of “serious prejudice” as used in Article 5(c) of the SCM Agreement.

170. Specifically the chapeau of Article 6.3 states: “[s]erious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply.” Thus, serious prejudice may arise if one of the forms of serious prejudice enumerated in Article 6.3 is found to exist.

171. This interpretation of Article 6.3 is further confirmed by the language of paragraph 6.2: “Notwithstanding the provisions of paragraph 1, serious prejudice shall not be found if the subsidizing Member demonstrates that the subsidy in question has not resulted in any of the effects enumerated in paragraph 3.”¹⁷³ The use of the word “shall” clearly indicates that where none of the effects enumerated in paragraph 3 exists, serious prejudice does not exist.

172. Indeed, such an interpretation is also confirmed by the structure of Article 6. When read together, Articles 6.1¹⁷⁴, 6.2 and 6.3 originally created two ways for a complaining Member to show serious prejudice. First, under Article 6.1, prior to its lapsing, the complainant could demonstrate that one of the situations enumerated under Article 6.1(a) through (d) existed. If that was the case, a rebuttable presumption (“shall be deemed to exist”) of serious prejudice was

¹⁷³ Emphasis added.

¹⁷⁴ Although this provision has lapsed, the panel in *US – Upland Cotton (Panel)* at para. 7.1377, n. 1487) found that it could nevertheless provide relevant guidance as to the interpretation of Article 6.3.

established. Article 6.2 allowed the subsidizing Member to rebut that presumption by demonstrating that the effects enumerated in Article 6.3 did not exist. If the complaining Member was not able to demonstrate that one of the situations in Article 6.1 existed, its second option was to demonstrate that one of the situations in Article 6.3 exists, in which case “serious prejudice . . . may arise.” In other words, the structure of Article 6 confirms the interpretation following from the ordinary meaning of Article 6.3 and from the context provided to that provision by Article 6.2, namely that serious prejudice cannot be found to exist unless the complainant demonstrates that one of the effects enumerated in Article 6.3 exists.

- a. *Please explain whether prior panel and Appellate Body reports provide any guidance on this question of treaty interpretation. In this regard, please comment on the US – Upland Cotton panel’s finding that “demonstration that at least one of the four effects-based situations in Article 6.3 exists is a necessary basis to conclude that serious prejudice exists” (para. 7.1380).*

173. The finding of the panel in *US – Upland Cotton* that the Panel refers to is directly relevant. That panel stated that “Article 6.2 serves to clarify that a prerequisite for a finding of serious prejudice is that one of the four effects-based situations in Article 6.3 must be demonstrated. It indicates to us that demonstration that at least one of the four effects-based situations in Article 6.3 exists is a necessary basis to conclude that serious prejudice exists.”¹⁷⁵ Thus, the panel’s analysis confirms the analysis set out by the United States in response to subquestion (a) above.

- (c) *If the Panel were to conclude that the 1992 Agreement could in principle be taken into account (pursuant to Article 31(3)(c) of the Vienna Convention or otherwise) for the purpose of interpreting Article 5(c), please explain whether the 1992 Agreement provides any guidance on the question of whether the concept of “serious prejudice to the interests of another Member” in Article 5(c) could be interpreted as covering forms of serious prejudice not enumerated in Article 6.3.*

174. As a preliminary matter, the United States would like to emphasize that the 1992 Agreement cannot be taken into account either pursuant to Article 31(3)(c) of the VCLT or on any other basis. As the United States set forth in its first written submission, the 1992 Agreement does not constitute a “relevant rule{ } of international law applicable in the relations between the parties” to be taken into account pursuant to Article 31(3)(c) of the VCLT.¹⁷⁶ The relevant rules of international law for purposes of Article 31(3)(c) of the VCLT are those “applicable in the relations between all parties” to the SCM Agreement.¹⁷⁷ As the 1992

¹⁷⁵ *US – Upland Cotton (Panel)*, para. 7.1380.

¹⁷⁶ US FWS, paras. 1191-1197.

¹⁷⁷ US FWS, paras. 1191-97.

Agreement is not applicable in the relations between all the parties to the SCM 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), and thus is not relevant for interpreting the SCM Agreement.

175. Moreover, the 1992 Agreement provides no guidance on the question of whether the concept of “serious prejudice to the interests of another Member” in Article 5(c) could be interpreted as covering forms of serious prejudice not enumerated in Article 6.3.

176. The 1992 Agreement itself makes no reference at all to the concept of “serious prejudice.” Nothing in the agreement even suggests that it has any relation to the concept of “serious prejudice,” let alone that a finding of serious prejudice would result from a violation of the agreement. Indeed, even if the 1992 Agreement would have contained a provision that could have been interpreted in such a way, the United States and the EC cannot together agree to expand the scope of a provision in the SCM Agreement from an exhaustive to a non-exhaustive list.¹⁷⁸ What is more, the Preamble to the 1992 Agreement itself explicitly confirms that the 1992 Agreement’s terms are “without prejudice” to the rights and obligations of the United States and the EC “under the GATT and under other multilateral agreements negotiated under the auspices o the GATT,” which includes the SCM Agreement.

62. *If the Panel were to conclude that the concept of "serious prejudice to the interests of another Member" in Article 5(c) could in principle cover forms of serious prejudice not enumerated in Article 6.3, can the concept of "serious prejudice to the interests of another Member" in Article 5(c) be interpreted as covering serious prejudice to a Member's "interest to have international obligations respected" (EC Oral Statement, para. 117)?*

(a) *Please explain whether such an interpretation of Article 5(c) would be in accordance with the customary rules of interpretation of public international law as expressed in the Vienna Convention on the Law of Treaties.*

177. An interpretation of Article 5(c) that the concept of serious prejudice covers serious prejudice to a Member’s “interest to have international obligations respected” would not be in accordance with customary rules of interpretation of public international law.

178. To begin, even if the Panel were to conclude that the concept of “serious prejudice to the interests of another Member” in Article 5(c) could in principle cover forms of serious prejudice not enumerated in Article 6.3, there is nothing in those provisions or anywhere else in the SCM Agreement that would allow for those provisions to be interpreted as covering serious prejudice

¹⁷⁸ EC – Biotech, para. 7.72 (“Indeed, it is not apparent why a sovereign State would agree to a mandatory rule of treaty interpretation which could have as a consequence that the interpretation of a treaty to which that State is a party is affected by other rules of international law which that State has decided not to accept.”)

to a Member's "interest to have international obligations respected."¹⁷⁹ As there is no basis in paragraphs (a) to (d) for such an additional effect, adding it would essentially require the Panel to add a sub-paragraph (e) to Article 6.3(a) through (d). As explained above, this is expressly prohibited by the customary rules of interpretation of public international law, as panels and the Appellate Body have expressly recognized.¹⁸⁰

179. What is more, such an interpretation would expand the scope of the SCM Agreement such that it would cover virtually every international treaty to which two or more WTO Members are parties. Such an interpretation would go directly against the ordinary meaning of Article 5(c) of the SCM Agreement as read in its context and in light of the object and purpose of the SCM Agreement and the WTO agreements in general. Article 6.3, which provides essential context for any interpretation of Article 5(c), contains an enumeration of effects that the SCM Agreement considers constitute "serious prejudice". Even if, assuming *arguendo*, that the list in Article 6.3 were non-exhaustive, it certainly provides clear indications as to the types of effects that constitute "serious prejudice". To put it differently, even if one were to consider the list non-exhaustive, it is illustrative of what "serious prejudice" means, within the meaning of Article 6.3 and therefore within the meaning of Article 5(c).

180. The effects listed in Article 6.3 make it very clear that the concept of "serious prejudice" has to do with the economic effects of subsidies on the marketplace *i.e.*, displacement or impedance of imports; price undercutting; market share shifts. Accordingly, there is no basis for an interpretation that serious prejudice could consist simply of the alleged breach of another, non-covered agreement without a consideration of whether such a breach has the types of economic effects Article 6.3 enumerates.

181. If the EC's suggestion that "serious prejudice" in the SCM Agreement could encompass prejudice to a country's "interest to have international obligations respected," WTO dispute settlement panels could be in a position of evaluating alleged breaches of provisions of territorial agreements, peace treaties, the UN charter, international, political, and cultural covenants, and many other kinds of international agreements. Indeed, that is precisely the possibility that the Appellate Body warned against in its report on *Mexico – Taxes on Soft Drinks*¹⁸¹ that we will discuss under (b) below.

(b) *Please explain whether prior panel and Appellate Body reports provide any guidance on this question of treaty interpretation. In this regard, please comment on the relevance of paragraph 78 of the Appellate Body Report in Mexico – Taxes on Soft Drinks.*

¹⁷⁹ EC OS1, para. 117.

¹⁸⁰ *See supra.* para. 193, n. 189.

¹⁸¹ *Mexico—Taxes on Soft Drinks (AB)*, para. 78.

182. As already mentioned in response to Question 62(a) above, the findings of the Appellate body in *Mexico – Taxes on Soft Drinks* are particularly relevant in dealing with the EC’s suggestion that breach of a non-WTO agreement could be considered serious prejudice under Articles 5(c) and 6.3 of the SCM Agreement. In paragraph 78 of its report in that case, the Appellate Body considered Mexico’s attempted justification of its measures on the basis that they were intended to secure compliance with the U.S. NAFTA obligations. The Panel noted that “Mexico’s interpretation would imply that, in order to resolve the case, WTO panels and the Appellate Body would have to assume that there is a violation of the relevant international agreement (such as the NAFTA) by the complaining party, or they would have to assess whether the relevant international agreement has been violated.” Thus, said the Appellate Body, “WTO panels and the Appellate Body would . . . become adjudicators of non-WTO disputes . . . {which} is not the function of panels and the Appellate Body as intended by the DSU.”¹⁸²

183. In the current dispute, the EC’s claim that serious prejudice exists because of an alleged violation of the 1992 Agreement would similarly require the Panel to assess whether a violation of this international agreement existed. Thus, in the words of the Appellate Body, the Panel would have to become an adjudicator of a non-WTO dispute, a function that the DSU does not intend for panels and the Appellate Body to fulfill.

(c) *If the Panel were to conclude that the 1992 Agreement could in principle be taken into account (pursuant to Article 31(3)(c) of the Vienna Convention or otherwise) for the purpose of interpreting Article 5(c), please explain whether the 1992 Agreement provides any guidance on the question of whether the concept of "serious prejudice to the interests of another Member" in Article 5(c) could be interpreted as covering serious prejudice to a Member's "interest to have international obligations respected".*

184. Even if the Panel were to conclude that the 1992 Agreement could in principle be taken into account, it would not provide any guidance on the question of whether the concept of “serious prejudice to the interests of another Member” in Article 5(c) could be interpreted as covering serious prejudice to a Member’s “interest to have international obligations respected.” As the United States has set out in more detail in response to Question 61(c) above, the 1992 Agreement makes no reference to the concept of “serious prejudice,” nor does it make any reference to a breach of its terms or of any other international obligation constituting such serious prejudice for purposes of Article 5(c) or Article 6.3 of the SCM Agreement. Indeed, the Preamble to the 1992 Agreement itself confirms that the 1992 Agreement’s terms are “without prejudice” to the provisions of multilateral agreements negotiated under the auspices of the GATT, which includes the SCM Agreement.

¹⁸² *Mexico – Taxes on Soft Drinks* (AB), para. 78.

B. CLAIMS OF SERIOUS PREJUDICE RELATING TO SIGNIFICANT PRICE SUPPRESSION, THREAT THEREOF, SIGNIFICANT LOST SALES, AND DISPLACEMENT AND IMPEDANCE OF EXPORTS/IMPORTS

1. Number and nature of adverse effects claims and serious prejudice findings involved in this dispute

To the European Communities:

63. *How many adverse effects claims does the European Communities make as part of its "second and independent complaint" described at paragraph 1000 of the European Communities' First Written Submission? In particular, please clarify whether the European Communities is making three adverse effects claims corresponding to the three identified LCA product markets (as suggested in paragraph 1154 of its First Written Submission), and if so, the extent to which these claims are or are not dependent on the European Communities' identification of three separate LCA product markets.*
64. *If the European Communities is making only one adverse effects claim, please explain: (i) whether it would be necessary for the Panel to "aggregate" its findings in respect of the effects of the challenged measures in the three identified LCA product markets; and if so, (ii) how the Panel would "aggregate" its findings in respect of the effects of the challenged measures in the three identified LCA product markets.*

2. Definitions of relevant market(s), subsidized products and like products

To both parties:

65. *Assuming that "the degree to which a market is limited by geography will depend on the product itself and its ability to be traded across distances", what are the relevant criteria for delimiting specific geographic markets for LCA for purposes of Article 6.3(c)?¹⁸³ Do the parties consider it possible that, given that LCA are sold and operated throughout the world under similar conditions of competition and that relative transportation costs of delivery are negligible, there is in fact only one geographic market for LCA, namely, the world market?*

185. The Appellate Body found in *US – Upland Cotton* that, for purposes of Article 6.3(c), the "same market" could include the "world market," or another geographic market, if the facts

¹⁸³ *US – Upland Cotton (Panel)*, para. 7.1237.

indicated that the subsidized and like products are “engaged in actual or potential competition in the market.”¹⁸⁴ The Appellate Body further explained that

It is for the complaining party to identify the market where it alleges significant price suppression and to establish that that market exists. In doing so, it is for the complaining party to establish that the subsidized product and its product are in actual or potential competition in that alleged market.¹⁸⁵

The EC has made Article 6.3(c) claims with regard to the world market. We do not dispute the EC’s definition of that market for purposes of its Article 6.3(c) claims.¹⁸⁶ The EC has also made claims of displacement and impedance for all third countries collectively under Article 6.3(b). The United States does not dispute the EC’s definition of that market, either, for purposes of the EC’s displacement or impedance claims. The United States does not contest the permissibility of making a displacement or impedance claim on this basis. (It does, however, believe that the EC has failed to meet its burden of proving such claims.)

186. The EC has also alleged displacement and impedance with regard to a number of individual third country markets. The EC has, however, done nothing to meet its burden to establish for each such third country that “that market exists” for purposes of Article 6.3(b). It has simply asserted that the term “third country market” in that Article requires the Panel to treat any third country as a “third country market.”¹⁸⁷ The United States has explained why this result is inconsistent with Article 6.4(a) and (b), and the EC has not addressed those arguments.¹⁸⁸ Therefore, the United States is not in a position to comment at this time on the relevant criteria for delimiting the specific geographic markets alleged by the EC.

187. The United States notes that, even if the EC were to establish that the third countries it identifies were discrete “markets” for large civil aircraft, the volume of aircraft sold in the like product groupings challenged by the EC in each of these countries did not provide enough data to reach any conclusion as to how the markets have developed.¹⁸⁹ There is, therefore, simply no basis for a conclusion that Airbus imports or exports have experienced displacement or impedance.

¹⁸⁴ *US – Upland Cotton (AB)*, para. 412.

¹⁸⁵ *US – Upland Cotton (AB)*, para. 409.

¹⁸⁶ The EC in its oral statement at the confidential session of the first panel meeting, stated that “our claims of significant price suppression and lost sales . . . are based on a *world market*” and the Panel accordingly “need not address the US argument” regarding individual country markets. EC OS1(Conf.), para. 91.

¹⁸⁷ EC OS1(Conf.), para. 91.

¹⁸⁸ US FWS, para. 908.

¹⁸⁹ US FWS, paras. 1005 (787), 1093 (737), and 1167-1168 (regarding the EC’s 777 displacement and impedance claims).

66. *In the context of assessing claims of displacement and impedance under Article 6.3(a) and 6.3(b), what are the criteria for determining whether an LCA constitutes an "import" or an "export" in relation to a particular market (for example, do factors such as the location from which an order is made, the "nationality" of the purchaser and the seller (however such nationality may be established) and/or the country from and to which the LCA is delivered, have any relevance to this determination)? How are imports and exports of LCA based on these criteria derived from data on "orders" and "deliveries"?*

188. The ordinary meanings of import and export are, respectively, “something imported or brought in” and “an article that is exported.”¹⁹⁰ Thus, these terms refer to articles that cross borders. In the large civil aircraft context, that can only mean deliveries, as an order does not involve an article crossing a border.

189. With regard to associating an import or export (that is, a delivery) with a third country market (or all third country markets) the only relevant factor is the country into which the aircraft is delivered, as the physical delivery of the article (the aircraft) is what makes an export or import. The nationality of the purchaser or seller has no relevance to the inquiry, as the country to which an aircraft is delivered may be completely different from the country of nationality of its purchaser. Similarly, the country *from* which the aircraft is delivered is also irrelevant, as that does not determine the country into which the article is imported or to which it is exported.

190. Both parties in this dispute have used the Airclaims database as their standard reference for aircraft orders and deliveries. Airclaims delivery data reflect the country to which an aircraft is physically delivered. Even when a middleman (such as a leasing company) takes title to an aircraft delivered to a third country, Airclaims reports the third country as the delivery country. Therefore, the Airclaims data supplied by both the United States and the EC allow a measurement of imports and exports within the meaning of Article 6.3(c).

67. *Do the parties agree with Brazil (at paragraph 33 of the Third Party Written Submission of Brazil) that the Panel should recognize that (i) subsidies benefiting certain individual aircraft types or families may have "spill-over" effects to other families, and (ii) consistent with conditions of competition in the aircraft industry, sales of aircraft in one family or market segment may affect sales in another family or market segment? If so, how should the Panel incorporate recognition of these factors into its adverse effects analysis, in light of the European Communities' contention (at paragraphs 1159-1161 of its First Written Submission) that there are five separate product markets for LCA?*

191. The EC has based its serious prejudice claims on the assertion that aircraft in the five like products it has identified do not compete with each other.¹⁹¹ It has not claimed that sales of

¹⁹⁰ *New Shorter Oxford English Dictionary*, pp. 889 and 1323.

¹⁹¹ EC FWS, paras. 1160-1161.

aircraft in one of its alleged market segments affect sales in any of the other alleged segments.¹⁹² The United States does not challenge this aspect of the EC argument. Therefore, as a factual matter, addressing Brazil's assertion with regard to sales in one segment affecting sales in another is neither appropriate nor necessary to a resolution of this dispute.

192. The EC has also not claimed that alleged subsidies to one aircraft type or family have “spill-over effects” effects on other types or families. In fact, it has taken the opposite position, stating that “subsidies that historically benefited the 717, 757, and 767” have “no such *present* effects in LCA markets. . . . Boeing’s 747-400 and 747-8 are marketed, but do not compete with any Airbus product in the 400-500 seat market. Therefore, none of these products can be found to cause *present* commercial harm to Airbus in the large civil aircraft markets.”¹⁹³ The EC, in structuring its serious prejudice claims according to discrete market segments, has rejected the possibility that the effects of alleged subsidies to one Boeing aircraft could have “spill-over” effects across the product markets segments it identifies that would result in serious prejudice. Therefore, addressing Brazil’s assertion in this regard is neither appropriate nor necessary to a resolution of this dispute. We do note, however, that although the United States has stipulated to the division of large civil aircraft into three “products” for purposes of the Panel’s analysis, and also to the EC assertion that there is no competition for sales between these groups of products, that does not mean that the products have no effect on each other. In fact, the United States has identified relevant cross-product effects, unrelated to head-to-head competition among aircraft models, that are relevant to the Panel’s analysis. The response to Panel Question 71 provides more detail on this point.

To the European Communities:

68. *Should the Panel understand that, as a result of its division of the LCA product market into five segments and its identification of three "subsidized products" and three corresponding groups of "like products" for purposes of demonstrating serious prejudice, the European Communities is requesting the Panel to confine itself to examining the causal relationships between the following groupings of alleged subsidies and effects of those alleged subsidies:*

- *alleged subsidies to the 737 and effects to the A320 (i.e. the European Communities does not request the Panel to examine any causal relationship between alleged subsidies to the 737 and effects to the A330, A340, A350 Original, A350 XWB or A380);*
- *alleged subsidies to the 787 and effects to the A330, A350 Original and A350 XWB-800 (i.e. the European Communities does not request the Panel to examine any causal*

¹⁹² EC FWS, paras. 1160-1161.

¹⁹³ EC OS1, para. 134 (emphasis in original).

relationship between alleged subsidies to the 787 and effects to the A320, A340, A350 XWB-900, A350 XWB-1000 and A380); and

- *alleged subsidies to the 777 and effects to the A340 and A350 XWB-900/-1000 (i.e. the European Communities does not request the Panel to examine any causal relationship between alleged subsidies to the 777 and effects to the A320, A330, A350 Original, A350 XWB-800 or A380)?*

69. *Does the European Communities agree that a product need not necessarily be a "like product", in the sense of footnote 46, in order to be considered to compete in the "same market" as the subsidized product for purposes of Article 6.3(c)?*

70. *How is the European Communities' contention (at paragraph 1159 of the European Communities' First Written Submission) that Boeing and Airbus compete in "five separate markets" reflected in the model presented in the Cabral Report (Exhibit EC-4)?*

To the United States:

71. *Please explain more fully the implications of the Panel adopting, for the purpose of evaluating the European Communities' claims of serious prejudice, the European Communities' division of the LCA product market into five discrete segments. In particular, please explain what the United States means by its statement at paragraph 800 of its First Written Submission that the "flexibility granted to a complaining party in framing its prima facie case does not extend to preventing the panel or the responding party from considering evidence that indicates the complaining party has failed to meet its burden of proof."*

193. The issue before the Panel is whether the evidence supports the allegations the EC has made. The United States has demonstrated that the evidence does not support those allegations. It is not for the United States or the Panel to consider whether there might be other evidence, or other ways of organizing the evidence, or other analyses, that might provide more support for the EC claims.

194. Thus, in line with the EC's argumentation, the Panel would conduct three separate analyses – one for each of the "products" identified by the EC as competing in distinct market segments. The EC has made no claim that Boeing aircraft in one market segment have effects on Airbus aircraft in another. It concedes that alleged subsidies related to Boeing aircraft in one of its market segments do not affect an Airbus aircraft in another.¹⁹⁴ The United States does not accept the EC argument that the facts establish the existence of separate market segments or that they demonstrate an absence of competition between the different product groupings put forward

¹⁹⁴ EC OS1, para. 134.

by the EC. However, we are willing to proceed on that basis, as a principle for organizing the Panel's analysis. The Panel should view this as a stipulation, or a simplifying assumption of the type that an economist might make in analyzing a market, and conduct its analysis on that basis. As an example, the EC has alleged that the 787 does not compete with the A350XWB-900,¹⁹⁵ so the Panel should accordingly conclude that any subsidies with regard to the 787 do not affect sales of the A350XWB-900.¹⁹⁶ A critical implication of the EC's presentation of its case is that if the evidence demonstrates that a Boeing aircraft has an effect on an Airbus aircraft in a different market segment, that effect cannot be attributed to the alleged subsidies because the EC has conceded that alleged subsidies on a Boeing aircraft in one particular market segment do not cause adverse effects to Airbus aircraft in another market segment.

195. Another important point is that the EC did not allege that any serious prejudice resulted from alleged subsidies related to the 717, 757, 767, 747, MD-80, MD-90, or MD-11. Nor has it alleged that these aircraft competed with the Airbus aircraft subject to the EC claims. Therefore, any subsidies affecting these Boeing aircraft – \$7.5 billion under the EC calculation, or 39 percent of the \$19.1 billion alleged subsidy value on which the EC relies so heavily – would have no effect on the Airbus aircraft subject to the EC claims.¹⁹⁷

196. The U.S. observation that the complaining party has considerable latitude in framing the arguments in support of its claims reflects that a complaining party that has followed the procedures of the DSU can raise its claims in any form it wishes. However, any evaluation of whether it has made a case can only be made on the basis of the arguments that the complaining party has actually made, and not on the basis of arguments that it might have made. The responding party has a similar latitude in formulating its rebuttal case. In attempting to show that the complaining party has failed to establish an inconsistency with one of the covered agreements, the responding party may show that the evidence does not support the arguments or that the arguments are internally inconsistent. It may also accept some of the arguments and reject others. As with the evaluation of the complaining party's case, the evaluation of whether the responding party has met its burden of rebuttal must be based on arguments that the responding party made, and not on arguments it might have made.¹⁹⁸

197. In observing that the complaining party's framing of its case did not prevent the Panel or the United States from considering any evidence, the United States meant that the United States

¹⁹⁵ EC FWS, para. 1160.

¹⁹⁶ Paragraph 802 of the U.S. first written submission sets out the implications of this principle with greater specificity. The EC appears to accept these conclusions. EC OS1, para. 134.

¹⁹⁷ EC OS1, para. 134; US SWS, para. 172.

¹⁹⁸ The United States is mindful that the question of whether a party has met its burden is distinct from the legal reasoning a panel may choose to pursue, and that panels are not limited to the legal approaches advocated by the parties.

retains the latitude to frame its own arguments, and the Panel to consider those arguments. For example, the United States has stipulated that aircraft in one market segment do not compete with aircraft in another. However, that does not preclude products from having other types of effects on each other. The United States has shown that the resource drain caused by the development of the A380 fully explains Airbus' difficulties in developing an aircraft competitive with the 787.¹⁹⁹ That is an effect across product, but it is not an effect arising from head-to-head competition in the market. (The EC recognizes a similar principle in arguing that the alleged subsidies affect all Boeing aircraft.) In another example, the United States has shown that some customers bought 777s and 787s in "bundled" transactions.²⁰⁰ That is clearly an "effect" across the products defined by the EC, even though it was not the result of competition between the 787 and A340. Put simply, the EC's position that the injurious effects of alleged subsidies are limited to certain competitive match-ups does not prevent the United States from pointing to evidence outside of those competitive match-ups to demonstrate that the EC's argument regarding adverse effects is incorrect or without support in the evidence.

3. Reference period for assessing adverse effects

To both parties:

72. *What is the relevance of the length of the LCA business cycle to determining the appropriateness of the reference period for purposes of examining adverse effects in the context of this dispute?*

198. This question is directed to the reference period used by *the Panel* to examine adverse effects. The EC has framed its allegations of serious prejudice in terms of a 2004-2006 "reference period." Accordingly, it has not alleged developments either before or after that period as representing serious prejudice. However, the EC cannot by its choice of a period for its allegations dictate how the Panel constructs its examination of the facts and the arguments of the parties.

199. The length of the business cycle is relevant to the choice of a reference period by the Panel because the Panel must be able to distinguish between economic developments that are properly attributable to the normal cyclical ups and downs of the market and those market phenomena not attributable to normal business cycle swings. For example, the differing reaction of the large civil aircraft producers to the downturn in demand in the 2001-2003 period affected delivery levels in the 2004-2006 period, as well as purchasers' pricing expectations. Failing to consider data outside the 2004-2006 period might lead to an incorrect conclusion about the significance of delivery and pricing trends within that period. Also, it is impossible to properly

¹⁹⁹ *E.g.*, US SWS, HSBI Appendix, paras. 10-18.

²⁰⁰ US SWS, HSBI Appendix, paras. 28 and 70.

assess the EC's technology effects argument without reviewing the EC's decision to concentrate on development of the A380, which occurred years before the beginning of the reference period proposed by the EC.

200. The EC has been inconsistent on this issue. It insists that only 2004-2006 is a reasonable reference period, and rejects the idea that 2001-2003 might have "value" to the Panel's evaluation of the EC's claims.²⁰¹ However, the EC also cites data from as early as 1989 in some of its arguments.²⁰²

201. In light of the business cycle in the large civil aircraft industry, which fell into a trough in 2001 and began to peak in 2005, an evaluation exclusively of 2004-2006 presents at best a partial, and distorted, view. To make the objective assessment of this matter required under Article 11 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes*, the Panel would need a reference period long enough to distinguish which developments were the result of the business cycle and which were related to other factors. The United States considers that 2001-2006 is the shortest period that would meet that objective.

202. Whatever the reference period chosen, it should not preclude the consideration of evidence from outside the period as relevant to evaluate the EC claims that the alleged subsidies caused serious prejudice in the 2004-2006 period. The EC itself recognizes that data outside the period may be relevant,²⁰³ as does the United States. The Panel should do the same.

73. *At paragraph 129 of the European Communities' Oral Statement, the European Communities argues that the conditions of competition in the LCA markets during 2001 through 2003 are so dissimilar from the prevailing conditions of competition in the LCA markets that an assessment of the effects of Boeing's subsidies in the former offers little insight into whether the alleged subsidies cause adverse effects under today's conditions of competition. If the Panel were to adopt a reference period of 2001 through 2006, explain how the data for 2001 through 2003 should be assessed to make due allowance for such dissimilar conditions of competition in this period.*

203. The only significant difference between the conditions of competition in 2001-2003 versus 2004-2006 is that demand was weaker in the 2001-2003 period. Most of the factors that the EC first written submission identified as conditions of competition – the competitive duopoly

²⁰¹ EC OS1, paras. 125-130.

²⁰² E.g., EC OS1, para. 148.

²⁰³ EC FWS, para. 1076 ("The European Communities also presents data for the period prior to 2004 as well as data in 2007 to demonstrate the existence of serious prejudice."); US FWS, para. 809 ("[T]he EC admits that it has freely used information preceding 2004 as it saw fit, and would freely use data for 2007. The United States, of course, should have the same opportunity." (citation omitted)).

between Airbus and Boeing, the price- and value-sensitive nature of many campaigns, the high cost of developing aircraft models, and the importance of order data in the evaluation of price suppression and lost sales²⁰⁴ – existed in 2004-2006, as they did in the 2001-2003 period. To be sure, the United States does not agree with the EC's evaluation of the significance of these factors or the EC's identification of certain transactions as non-competitive, as suppressed in price, or as lost sales. But all are clearly conditions of competition that existed in both periods. In fact, the only significant difference between 2001-2003 and 2004-2006 is that overall demand increased – from 674 aircraft ordered in 2001 to 2028 aircraft ordered in 2006.²⁰⁵ Even on this measure, 2004 evidences much more the depressed demand that was characteristic of 2001-2003 than it does like the level of demand in 2005 and 2006.²⁰⁶

204. If the panel adopts a 2001-2006 reference period, as the United States believes it should, developments from 2001-2003 are relevant to provide the context in which to analyze the EC's claim that adverse effects occurred in 2004-2006. For example, examining Airbus' use of price undercutting to seize market share from Boeing during the period 2001-2003 when demand was low, explains price levels and patterns of competition in 2004-2006.²⁰⁷ Considering Airbus' success in holding on to the accounts it captured in 2001-2003 is vital to evaluating the EC's claims of displacement or impedance in 2004-2006. A consideration of the effect of Airbus' pre-2004 decision to devote its engineering and other resources to the "super-jumbo" A380 is vital to understanding its difficulties in developing a true competitor to the 787. In light of these factors, and others, the EC cannot validly claim that the alleged subsidies had any adverse effects on the A320, A330, A340, A350 Original, or A350XWB.

To the European Communities:

74. *Does the European Communities agree with the statement by the United States, at paragraph 108 of its Oral Statement, that the period 2004 through 2006 represents an "up" portion of the LCA business cycle that can only be properly understood in the context of the "down" portion of the cycle which began in 2001? If the Panel were to take due account of the fact that 2001-2003 represented the "down" portion of the business cycle, are there any reasons why the Panel would be in error in examining the effects of the alleged subsidies over the longer 2001 through 2006 period in order to determine whether the alleged subsidies cause adverse effects to the interests of the European Communities?*

²⁰⁴ EC FWS, paras. 1194-1225

²⁰⁵ *Boeing and Airbus: Total Orders and Deliveries, 1990-2006* (Exhibit US-11).

²⁰⁶ Producers sold an average of 603 aircraft per year from 2001 to 2003, and then sold 667 in 2004. In contrast, more than 2000 aircraft were sold each year in 2005-2006. *Boeing and Airbus: Total Orders and Deliveries, 1990-2006* (Exhibit US-11).

²⁰⁷ *E.g.*, US FWS, paras. 1066-1070.

4. Amount and Magnitude of Alleged Subsidies

To the European Communities:

75. *Please describe: (i) the manner in which the various subsidy "amounts" were derived; (ii) the basis on which those subsidy "amounts" were allocated among the Boeing LCA identified as "subsidized products" in this dispute (i.e. the 787, 737NG and 777); and (iii) the manner in which those subsidy "amounts" were allocated over time.*
76. *What do the figures in Exhibit EC-17, identified by the items "sub-total for subsidies reducing marginal units costs" and "sub-total for subsidies increasing non-operating cash flow", respectively, represent and how were the numbers appearing in the "amount of subsidy" columns (past amount, future amount and total amount) derived? What is the significance, if any, of the amounts listed in the "future amount" column of Exhibit EC-17 to the Panel's determination of adverse effects of any alleged subsidies received by Boeing?*
77. *At paragraph 1293 of the European Communities' First Written Submission, the European Communities indicates that it presents per-LCA subsidies and subsidization rates in terms of orders, as opposed to deliveries, on the basis that a sale occurs at the time of the order and this is the point in time when harm is caused to Airbus. However, the Panel notes that the per-LCA allocation calculation conducted by International Trade Resources LLC (at paragraph 34 of Exhibit EC-13), is based on a more complex methodology which does not rely on order data because LCA orders "are frequently modified with respect to the timing of a delivery, the number of aircraft ordered and the aircraft models ordered." Can the European Communities please explain the apparent inconsistency?*
78. *The Panel understands the European Communities to use the term "magnitude" of subsidies to refer to the "benefits" of alleged subsidies allocated over time pursuant to a methodology described by International Trade Resources LLC in their report at Exhibit EC-13 (based on the European Communities' First Written Submission, paragraph 1284, footnote 2054). Is the European Communities arguing that the allocated "benefit" of the alleged subsidies is a relevant factor for the Panel to consider in assessing the effects of the alleged subsidies? What is the nature of the relationship between the amount of a financial contribution, the "benefit" conferred by that financial contribution, the "magnitude" of the subsidy (in the sense used by the European Communities in its First Written Submission) and the "effects" of the subsidy?*
79. *The Panel understands that the European Communities has allocated the benefit of alleged recurring subsidies that reduce marginal unit costs to the year that the LCA (on which the alleged subsidy will accrue) was sold, even though the alleged subsidy would not be received by Boeing until the year that the LCA was delivered (Exhibit EC-13,*

para. 5). Please explain how such an allocation methodology is consistent with the SCM Agreement.

To the United States:

80. *Aside from the criticisms of the European Communities' analysis of the "magnitude" of the alleged subsidies made by the United States in its First Written Submission (at paragraphs 813 through 816 thereof) does the United States make any specific criticisms of the methodologies adopted by International Trade Resources LLC to allocate the benefits of alleged subsidies over time and over the various aircraft programs as described in Exhibit EC-13, or the relevance of the "magnitude" of the alleged subsidies (derived in the manner described by the European Communities at paragraph 1284, footnote 2054 of its First Written Submission) to the Panel's assessment of the effects of the alleged subsidies?*

205. The United States notes at the outset that its second written submission identifies further errors with the methodology developed by the EC's consultants, International Trade Resources ("ITR"), for allocating subsidies to particular aircraft.²⁰⁸ These errors, along with those identified in the U.S. first written submission, point to several overarching problems. *First*, the ITR methodology accepts the EC subsidy allegations as true, along with the grossly exaggerated estimates as to the value of resources received by Boeing under the challenged programs.²⁰⁹ *Second*, the EC allocates the alleged subsidies away from transactions that the EC treats as "noncompetitive" without any evidence that the alleged subsidies would affect one sale any more than another.²¹⁰ Since the methodology allocates alleged subsidies away from so-called "noncompetitive" transactions, this has the effect of exaggerating the attribution of alleged subsidies to the transactions the EC identifies as "competitive."²¹¹ *Third*, ITR "ties" alleged subsidies to particular aircraft without any consistency except in directing the alleged subsidy amounts to the aircraft that the EC highlights in its arguments.²¹² *Fourth*, ITR allocates subsidies to aircraft based on "imputed" orders, a measurement entirely at odds with how Boeing and Airbus actually book orders and compete in the market.

206. For the reasons described above, the magnitude calculated in the manner described in paragraph 1284, footnote 2054 of the EC first written submission – both in absolute terms and on

²⁰⁸ US SWS, paras. 171-177.

²⁰⁹ ITR Magnitude Report, paras. 1-3 (Exhibit EC-13).

²¹⁰ EC FWS, para. 1296, note 2067.

²¹¹ For a discussion of the invalidity of the EC's distinction between supposedly "competitive" and "non-competitive" sales, see US FWS, paras. 817-822.

²¹² Compare ITR Magnitude Report, Table 7 (Exhibit EC-13) with US FWS, para. 816, first bullet.

a per-plane basis – contains numerous errors. Therefore, those magnitude calculations do not accurately reflect the value of the transactions challenged by the EC or their proper treatment under the SCM Agreement, making them irrelevant to the Panel’s assessment of the effects of the alleged subsidies.

207. The United States notes that a *correctly calculated* subsidy magnitude figure will be *one factor* in the analysis of adverse effects. As the Appellate Body stated in *US – Upland Cotton*:

in assessing whether “the effect of the subsidy is . . . significant price suppression”, and ultimately serious prejudice, a panel will need to consider the effects of the subsidy on prices. The magnitude of the subsidy is an important factor in this analysis. . . . However, the size of a subsidy is only one of the factors that may be relevant to the determination of the effects of a challenged subsidy. A panel needs to assess the effect of the subsidy taking into account all relevant factors.²¹³

The other factors addressed by the panel in that dispute were the size of U.S. production relative to the world market, the direct link of the price-contingent subsidies to world prices, the temporal coincidence between subsidies and price suppression, and the divergence between producers’ costs and revenues.²¹⁴

208. Thus, the EC assertion that “[t]he amount and magnitude of the US subsidies alone, whether or not precisely quantified, conclusively demonstrates that these subsidies cause adverse effects” evinces a serious misunderstanding of the analysis required under Articles 5 and 6.²¹⁵ It is not enough to simply point to the value of the alleged subsidies and assert that it is large. A finding that alleged subsidies caused price suppression (and, by extension, other forms of serious prejudice) requires a broader consideration of the evidence. In particular, the “relevant factors” considered by the *US – Upland Cotton* panel suggest that the nature of the subsidy and the temporal coincidence of alleged subsidies and the effects laid out in Article 6.3 are both also highly relevant.

209. In any event, an “objective assessment” must begin with the evidence. Although the Appellate Body stated that “a precise, definitive quantification of the subsidy is not required” in an analysis of the amount and magnitude of alleged subsidies,²¹⁶ it did not suggest that a Panel could overlook obvious and significant errors. Those are precisely what appear again and again in the EC calculations. The following table shows on a program-by-program basis the maximum

²¹³ *US – Upland Cotton (AB)*, para. 461.

²¹⁴ *US – Upland Cotton (AB)*, paras. 449-452.

²¹⁵ EC SWS, para. 732.

²¹⁶ *US – Upland Cotton (AB)*, para. 467.

extent of the value of the alleged financial contributions to Boeing, as shown by the evidence and the extent to which the EC has exaggerated those payments to bolster its causation claim:

Amount of Alleged Subsidies (US\$1 billion)				
Challenged Program	Alleged Amount of Subsidy	\$ Received by Boeing (1989-2007)	Amount of Actionable Subsidy	Comments
<u>Federal</u>				
NASA	\$10.4	\$0.750 ²¹⁷	\$0	Purchase of services and provision of services for adequate remuneration
DOD	\$2.4	\$0.534 ²¹⁸	\$0	Purchase of services
IR&D/B&P	\$3.1	\$0 ²¹⁹	\$0	Government does not reimburse Boeing for LCA-related IRAD/B&P
IP rights	\$0.726	\$0	\$0	Government provides nothing; it is an allocation of property rights in data and inventions made by Boeing

²¹⁷ Of the \$10.4 billion amount of subsidy alleged by the EC pursuant to NASA R&D programs, it estimated that \$3.2 billion was provided in the form of “institutional support”. It reached this estimate by (1) calculating Boeing’s share of total NASA aeronautics contract dollars based on its share of U.S. commercial aircraft sales, and then (2) applying that percentage to NASA’s total “institutional support” budget. Even if such expenditures were a provision of services under Article 1.1(a)(1)(iii) of the SCM Agreement (and they are not, see US FWS, paras 265-267), the EC’s ten-fold overstatement of the contract dollars received by Boeing undermines the validity of its calculation. The United States has responded to the few specific examples of provisions that the EC identifies in its first written submission. The United States cannot, however, correct the EC’s aggregate estimate of institutional support without greater specificity as to the particular transactions the EC is challenging.

²¹⁸ See U.S. response to Panel Question 8. As indicated in that response, however, the actual disbursements made to Boeing under these contracts are, in fact, likely to be less than \$534 million, because contracts do not always make full use of allotted funds.

²¹⁹ As explained in US SWS, paras. 80-81, IR&D or B&P costs attributable to Boeing’s commercial aircraft operations are not reimbursed by the U.S. government. Specifically, all of the IR&D and B&P that has a “beneficial and causal relationship” with the BCA business segment is allocated to it (including a share of the “common enterprise” IR&D and B&P costs). Because BCA has no cost-reimbursement contracts with the US government, it has no vehicle to seek reimbursement of these overhead costs. Accordingly, the full amount of reimbursed IR&D and B&P – including the \$3.1 billion alleged by the EC – is attributable to the business of other Boeing segments.

U.S. AND EC BUSINESS CONFIDENTIAL INFORMATION REDACTED

*United States – Measures Affecting Trade
in Large Civil Aircraft (Second Complaint) (DS353)*

Response of the United States to the First Set of
Questions from the Panel to the Parties
December 5, 2007 – Page 83

Challenged Program	Alleged Amount of Subsidy	\$ Received by Boeing (1989-2007)	Amount of Actionable Subsidy	Comments
DOL 787 Worker Training Grants	\$0.0015	\$0	\$0	Funding is provided to Everett Community College, and is part of broadly available worker training program
DOC Advanced Technology Program	\$0.0046	***] ²²⁰	\$0	ATP program is broadly available to and used by all segments of U.S. economy
<u>Washington State</u>				
H.B. 2294	\$3.5	\$0.1359 ²²¹	\$0.0315 ²²²	Adjustment eliminated a penalty against aerospace because of high effective tax rate; did not create benefit
Everett B&O Tax Rate Adjustment	\$0.0675	\$0.0055 ²²³	\$0	Adjustment available to all manufacturing entities meeting monetary threshold
Project Olympus Master Site Agreement Provisions (infrastructure, project coordinators, job training incentives, assumption of litigation costs)	\$0.3958	\$0.0015	\$0.0005 ²²⁴	Bulk of money alleged (\$0.342b) relates to general infrastructure, including improvements to two public highways and a port terminal; remainder of programs challenged also do not entail transfer of funds to Boeing and are not subsidies

²²⁰ US FWS para. 395.

²²¹ Based on Washington State estimate of the difference in revenue collected between October 1, 2005 (when HB 2294 entered into force) and end of FY2007. Exhibit US-184. Not all of this amount can be considered applicable to Boeing, because it includes all taxpayers eligible for the new rate. The remainder of the EC's alleged subsidy figure relates to future years.

²²² Washington State B&O tax credit for computer hardware and software (\$0.02b) and sales and use tax exemption for computer hardware, peripherals and software (\$0.0115b).

²²³ This is the State's estimate of the difference in revenue collected from FY2006 to FY2007 as a result of the new B&O rate. USFWS, n.690. The remainder of the EC's alleged subsidy figure relates to future years.

²²⁴ Employment resource center facility and workforce development program.

U.S. AND EC BUSINESS CONFIDENTIAL INFORMATION REDACTED

*United States – Measures Affecting Trade
in Large Civil Aircraft (Second Complaint) (DS353)*

Response of the United States to the First Set of
Questions from the Panel to the Parties
December 5, 2007 – Page 84

Challenged Program	Alleged Amount of Subsidy	\$ Received by Boeing (1989-2007)	Amount of Actionable Subsidy	Comments
<u>Kansas</u>				
Wichita IRB Tax	\$0.7837	\$0.391 ²²⁵	\$0	State bond program is broadly available and used by all segments of the Kansas economy
KDFA Bonds	\$0.122	\$0	\$0	Boeing never utilized bond program
<u>Illinois</u>				
Relocation Package (relocation expenses, EDGE tax credit, property tax)	\$0.0243	[***] ²²⁶	\$0	Payments are part of broader, non-specific programs to attract business activity to Illinois
Retirement of the Former Lease	\$0.0005	\$0.0005	\$0.0005	Boeing obligated to pay four-times as much as city for lease termination.
<u>Total</u>	\$23.675	\$1.836	\$0.0325	
<u>FSC/ETI</u>	\$2.2	\$2.2		Measure withdrawn based on prior recommendations and rulings of the Dispute Settlement Body

Thus, there is clearly no evidence to support the EC's contention that the magnitude of the alleged subsidies, as calculated by the EC, is "so large that these subsidies must affect Boeing's commercial behaviour in a manner that causes adverse effects to EC LCA-related interests."²²⁷

²²⁵ The United States does not accept that this is the amount of tax benefits to Boeing but is currently unable to calculate their true historical value. However, nearly half of the amount challenged by the EC consists of IRBs utilized by an independent and unrelated company and projected future usage of IRBs by Boeing and an independent and unrelated company. The remainder equals \$0.391 billion.

²²⁶ US FWS paras. 663, 669, 679 (respectively, relocation expenses ([***]); EDGE tax credit [***], and property tax abatements ([***])).

²²⁷ EC SWS, para. 706.

As we have discussed elsewhere, the nature of the subsidies²²⁸ and the lack of any temporal coincidence between the alleged subsidies and the adverse effects claimed by the EC²²⁹ demonstrate further that there is no causal relationship between the two.

5. Causation

To both parties:

81. *Please explain how the Panel should undertake a counterfactual evaluation of the effects of the alleged subsidies in a market in which customers translate the overall financial package offered by each of Boeing and Airbus into a Net Present Value (NPV). Specifically, please explain how the Panel should determine that prices are being suppressed, that specific sales were lost, or that imports or exports were displaced or impeded, due to the price or technological features of a Boeing LCA, in a market in which the outcome of a sales campaign is typically determined by the best overall NPV to an airline or leasing company customer?*

210. As the panel notes, airlines compare offers by Boeing and Airbus to supply large civil aircraft by reference to the net present value, or NPV, of each offer.²³⁰ The net present value calculation begins with price (which includes the price of future deliveries based on escalation formulae and caps, if any, on price escalation) and then factors in financing terms, concessions on spare parts if any, other price and non-price concessions, and a host of other factors including the performance characteristics of the competing aircraft, their maintenance costs, any performance and maintenance cost guarantees on offer and the provision of any training and other costs associated with introducing the aircraft into the airline's fleet.

211. The EC has argued that the alleged subsidies caused adverse effects because "but for" the alleged subsidies, Boeing would not have been able to (1) price its 737, 777 and 787 LCA as it did, and (2) would not have been able to develop its 787 when it did.²³¹ For each set of subsidized product/like product categories, these allegations have to be examined in light of the conditions of competition in the large civil aircraft market, including an airline's practice of comparing competition Boeing and Airbus offers on the basis of its assessment of the relative NPVs of the competing offers.

²²⁸ US FWS, paras. 728-762.

²²⁹ US FWS, paras. 1059-1060. The response to Panel Question 82 discusses the analysis of temporal coincidence in greater detail.

²³⁰ *E.g.*, US FWS, Campaign Annex, para. 168.

²³¹ EC FWS, para. 1004.

212. A “counterfactual evaluation” of the effects of the alleged subsidies in this context requires an evaluation of whether the NPV of Boeing’s overall financial package would have differed “but for” the alleged subsidies and, if so, in what way. Specifically, would Boeing’s prices have been higher, or its technology less advanced, to such an extent that the NPV of its offers would differ? A positive answer on this question requires a further evaluation of whether any differences were sufficient to result in *significant* price suppression or lost sales, or displacement or impedance that rises to the level of *serious* prejudice. As the complaining party, the EC bears the burden of showing that the considerations that led Boeing to price and develop its large civil aircraft as it did would have changed, or the resources that enabled Boeing’s pricing and development decisions, would not have existed in the absence of the alleged subsidies.

213. On this critical point, the EC has not made a credible case that “but for” the alleged subsidies, Boeing’s offers would have been any different than they were.

214. ***Boeing would not have priced its aircraft differently.*** After losing several major 737 and 777 sales campaigns to Airbus in the 2001-2004 period and several major 777 campaigns in the 2001-2003 period, [***].²³² [***]²³³ Given the economics of large civil aircraft production, especially the very substantial “up front” development costs, [***]

215. With regard to the 787, the entire point of the program was to produce a new mid-sized aircraft with new technology within the price range of existing mid-sized aircraft.²³⁴ Thus, Boeing would have faced the same demand-based necessity to price the 787 in the band of prices for existing mid-sized aircraft with or without the alleged subsidies.

216. ***Boeing would not have developed its aircraft differently.*** In 1999, Airbus was moving forward with the A380, Airbus’ A330 was making the 767 ever less viable in the market, and Boeing was convinced that the point-to-point routes for mid-sized aircraft represented the most promising future market.²³⁵ These factors led Boeing to develop a new, low-cost, highly efficient mid-sized aircraft.²³⁶ Boeing would have had the same economic incentive to update its product line with or without the alleged subsidies.

217. ***Boeing would have had the financial resources to pursue these objectives.*** In its second written submission, the EC argues that Boeing could not have engaged in these activities absent

²³² US SWS, HSBI Appendix, para. 6.

²³³ US SWS, HSBI Appendix, para. 6.

²³⁴ US SWS, HSBI Appendix, paras. 20-23.

²³⁵ US FWS, para. 92.

²³⁶ US FWS, para. 92.

the subsidies that the EC alleges the company received. As we have shown, the EC's figures have no validity. However, assuming *arguendo* that the EC's subsidy calculations were correct, its own data show that Boeing spent \$7.74 billion on stock repurchases between 2001 and 2006 and received \$6.31 billion in alleged subsidies.²³⁷ Focusing on the 2004-2006 period for which the EC alleges "aggressive pricing" on Boeing's part, the stock repurchases were \$5.33 billion compared to alleged subsidies of \$2.98 billion.²³⁸ Moreover, these data understate the degree by which the amounts of Boeing's stock buyback exceeded the alleged subsidies, as the stock buyback dollars are after tax and the alleged subsidy dollars are pre-tax. On these data, there can be no doubt that Boeing had all the funds it needed to operate as it did without regard for any alleged subsidies and without the need to assume additional debt.

218. The EC also offers a comparison of stock buybacks and alleged subsidies between 1989 and 2006 which purports to show that the latter (\$19.1 billion) exceeded the former (\$16.1 billion) by \$3 billion.²³⁹ However, taking account of the fact that the stock buyback expenditures are after-tax and the alleged subsidy amounts pre-tax dollars reveals the invalidity of the EC's assertions that the magnitude of the alleged subsidies over the full 18-year 1989-2006 period exceeded the value of Boeing's stock buybacks over the same period. In addition, this comparison is valid only if the EC prevails on every single one of its subsidy allegations, and every single one of its assertions regarding the value of the alleged subsidies. As the United States has shown in its response to Panel Question 80, these figures are completely without evidentiary support. In any event, even if one concludes that Boeing would have had to borrow \$3 billion to fully fund its pricing and technology decisions, its debt-to-equity ratios would increase, but only to a level that even the EC cannot bring itself to characterize as "high." In fact, the "ten fold" increase in the debt-to-equity ratio that the EC cites in 2006 resulted from a one-time equity adjustment based on a change in Boeing's accounting rules, and *not* the alleged subsidies.²⁴⁰

219. ***Boeing would have had the technological resources to pursue these objectives at the same time Airbus pursued its own technology objectives.*** Notwithstanding the EC's assertions, the state of widely available technology did not create any differences between the technology

²³⁷ ITR Alternative Assessment of the Effects of US Subsidies on the US LCA Industry's Profit and Debt, Table 5 (Exhibit EC-1180) ("ITR Alternative Assessment").

²³⁸ ITR Alternative Assessment, Table 5.

²³⁹ EC SWS, para. 724; ITR Alternative Assessment, Table 5 (Exhibit EC-1180).

²⁴⁰ Compare EC SWS, para. 726 with para. 728. In paragraph 728 the EC notes that Boeing's debt-to-equity ratio would increase "ten fold" without the alleged \$19 billion in subsidies in 2006. However, in an earlier footnote, the reveals that the 2006 figures are distorted by a one-time adjustment to reflect a change in Boeing's policies for accounting for pension and post-retirement liabilities. The adjustment reflects the accrued effect going back for a number of years, and so does not reflect true 2006 performance, either with or without the alleged subsidies.

available to Boeing and Airbus.²⁴¹ As with the development of any commercial aircraft, there is a foundation of fundamental aeronautics technology concepts, well known throughout the industry.²⁴² To the extent any of the work done under the challenged NASA R&D programs is part of the background knowledge relevant for 787 development, the results of that work have been widely disseminated, and accordingly are a part of that public knowledge pool, available to all engineers, including those working for Airbus.²⁴³ For the significant additional development work required, Boeing and its suppliers drew on their internally funded R&D and the collective experience and expertise gained on previous commercial aircraft programs.²⁴⁴ Therefore, Boeing’s technological capabilities in relation to Airbus would have been the same with or without the subsidies.

220. Therefore, there is no credible evidence to support the EC’s contention that Boeing’s pricing, its technology or any other element that goes into an airline’s assessment of the NPV of its offers to supply large civil aircraft were dependent on the alleged subsidies. The absence of any temporal coincidence between alleged subsidies and the indicia of serious prejudice claimed by the EC provide further evidence that there is no causal link between the two.²⁴⁵ And, finally, if alleged subsidies to Boeing were affecting competition between Boeing and Airbus, there should be price undercutting in the form of Boeing offering packages with NPVs *higher* than those offered by Airbus. [***]²⁴⁶

82. *The United States argues (at paragraphs 929-930, 1059-1060 and 1120-1122 of its First Written Submission) that there is no coincidence in time between the alleged subsidies and the alleged serious prejudice to the European Communities’ interests. What sort of temporal correlation between the level of subsidization and the adverse effects of such subsidization is it appropriate to expect in an industry such as the LCA industry?*

221. The EC’s causation theory, at least with regard to price effects, has been that most of the alleged subsidies resulted in “free cash” that increased Boeing’s *non*-operating cash flow, which in turn allowed it to “price aggressively” to gain market share.²⁴⁷ Whether or not there is a temporal coincidence between the level of the alleged subsidies and shifts in Boeing’s prices and

²⁴¹ US FWS, Part XV, Section C.4.

²⁴² US FWS, paras. 934-938.

²⁴³ US SWS, paras. 194-195.

²⁴⁴ US FWS, paras. 939-942.

²⁴⁵ *E.g.*, US FWS, paras. 1056-1060.

²⁴⁶ The Campaign Annex to the U.S. first written submission and the HSBI Appendix to the U.S. second written submission present extensive evidence on this point. The United States cannot provide citations to the precise parts of these submission containing the examples, because to do so might reveal HSBI.

²⁴⁷ EC FWS, para. 1228.

market share is a reasonable test of the EC's hypothesis, and one endorsed by the panel and the Appellate Body in *US – Upland Cotton*.²⁴⁸ In fact, the EC and the Cabral model assume that Boeing takes most of the alleged subsidies that it receives in any given year and directs them to price-reducing "investments." The EC is explicit on this point: "The pricing effect of subsidies that increase Boeing's non-operating cash flow is *immediate and direct*."²⁴⁹

222. The existence of other factors affecting the aircraft market means that the correlation between the level of the alleged subsidies at any point in time and Boeing's pricing is unlikely to be perfect. However, if the pricing portion of the EC's causation argument had any merit, there should at least be some relationship between the alleged subsidies and Boeing's performance in the market. To the contrary, Boeing suffered its greatest market share losses precisely when the alleged subsidies were at or near their peak. For example, in 2002, when Boeing lost major accounts to Airbus, the EC's economic consultants, ITR, claim that the alleged subsidies to Boeing's 737 family was, on average, 12.17 percent *ad valorem*. In 2005, by contrast, when Boeing [***], the alleged subsidies to Boeing's 737 family had, by ITR's calculation, dropped to 6.36 percent.²⁵⁰

223. By the same token, if the subsidies "fueled" aggressive pricing, Boeing should have used the advantage of the alleged subsidies in the early 2000s to maintain key customers (like easyJet or Air Berlin) by meeting Airbus' prices. The fact that Boeing lost substantial market share in terms of large civil aircraft orders when the subsidies that the EC alleges were near their peak is strong evidence that the EC's causation argument is unfounded.

To the European Communities:

83. *At paragraph 119 of its Oral Statement, the European Communities contends that, but for the billions of dollars in subsidies received by Boeing, Boeing would have been forced to charge higher prices, and as a result, Airbus would have won additional sales and its LCA prices would have been higher.*

- (a) *What specific support does the European Communities have for the above-referenced contention that in the absence of the alleged subsidies, Boeing would have charged higher prices for its LCA? Does the European Communities consider it possible that, given the nature of competition in the LCA markets, "but for" the alleged subsidies, Boeing would have priced its LCA as aggressively as it did, but would have earned narrower margins on its sales of LCA? If not, why not?*

²⁴⁸ *US – Upland Cotton (AB)*, para. 451; *US – Upland Cotton*, para. 7.1315.

²⁴⁹ EC FWS, para. 1322 (emphasis in original).

²⁵⁰ See also US FWS, paras. 1059-1060.

- (b) *What is the significance, in terms of the Panel’s assessment of the “price effects” and “technology effects” of the alleged subsidies, of the distinction drawn by the European Communities between “competitive sales campaigns” and “non-competitive sales campaigns”? What are the implications of this distinction for the Panel’s assessment of the various claims of serious prejudice in Article 6.3?*
- (c) *Is the Panel correct in understanding the European Communities’ causation argument (as described in paragraph 119 of its Oral Statement) essentially to involve two steps, both of which involve the application of a “but for” causation test through a counterfactual demonstration; namely, (i) but for the alleged subsidies, Boeing’s LCA prices would have been higher (and as regards the 787, Boeing would not have developed, launched and been able to promise to deliver the 787 within the time frame that it did); and (ii) but for the lower Boeing LCA prices (and the innovative technologies and manufacturing methods used on the 787), Airbus’ sales and LCA prices would have been higher? If not, please explain the basis on which the Panel should evaluate whether the “nature” of the alleged subsidies is such that they give rise to the “price effects” and “technology effects” for which the European Communities contends.*
84. *At paragraph 120 of its Oral Statement, the European Communities argues that one of the effects of the alleged subsidies to Boeing is that the additional cash flow from the alleged subsidies “enhances Boeing’s ability to price down its LCA in competitive sales campaigns.” Does the European Communities argue that, for purposes of Article 5(c) and 6.3, a sufficient causal link between the subsidy and the serious prejudice factor can be established by demonstrating that a subsidy enhances or facilitates an actor’s ability to act in a manner which gives rise to a serious prejudice factor?*
85. *At paragraph 180 of its Oral Statement, the European Communities argues that it is “inconceivable that an average of \$2.4 million per 737 in subsidies played no causal role in Boeing’s decision to change its pricing policy” for the 737 in 2004. Does the European Communities agree that, if the alleged annual level of subsidization of the 737 in 2001 through 2003 exceeded the alleged 2004 level (as is indicated in Table 11 to Exhibit EC-13), it is reasonable to conclude that Boeing’s “radical change” in pricing policy in 2004 was the result of factors other than the alleged subsidies?*
86. *At paragraph 53 of its Confidential First Oral Statement, the European Communities states that in 2004, Boeing “suddenly decided to use more of the cash available from the US subsidies to change its pricing strategy with respect to the 737NG.” How is this scenario consistent with the European Communities’ general arguments concerning the price effects of the alleged subsidies that reduce Boeing’s marginal unit costs of production (at paragraphs 1306 and 1308 of the European Communities’ First Written Submission) and those that increase non-operating cash flow (as detailed in the Cabral*

Report and at paragraph 1321 of the European Communities' First Written Submission). On what basis does the European Communities assert that in 2004, Boeing used "more of the cash available from the US subsidies" to lower the prices of its 737NG?

87. *At paragraph 174 of its Oral Statement, the European Communities contends that Airbus' Original A350 "was not able to match the subsidy-enhanced technological innovations on the 787" because Airbus did not have "access to the same R&D – in particular composite-related – subsidies as Boeing". To what extent was Airbus' design of the Original A350 affected by its inability to access specific R&D, particularly R&D related to composites technology, rather than by the strategy and resource constraints described by the United States at paragraphs 920 to 928 of its First Written Submission?*
88. *What is the appropriate methodology for this Panel to adopt in determining whether the effect of the subsidy is significant price suppression, significant lost sales, or displacement or impedance of imports and exports under Article 6.3, in light of the Appellate Body's statement in US – Upland Cotton²⁵¹ that it is necessary to ensure that the effects of other factors on prices (in the context of a significant price suppression claim) are not improperly attributed to the challenged subsidies? When the European Communities argues that the Panel should ignore United States' claims that Airbus is suffering losses due to non-subsidy factors (paragraph 191 of the European Communities' Oral Statement) does the European Communities mean that factors such as Airbus' strategic decisions on product development and pricing, resource constraints faced by Airbus, the increase in oil prices and the depreciation of the U.S. dollar relative to the Euro are not relevant to the non-attribution analysis to be conducted by the Panel in a serious prejudice claim under Article 5(c) and Article 6.3?*
89. *In light of the United States' criticisms (in Exhibits US-3 and US-8) of the assumption in the Cabral Report that Boeing's expenditure on dividends and investments cannot exceed net revenue from operations plus subsidies received (constraint 1), how would the results and estimates in the Cabral Report be affected if this assumption were replaced by the assumption that Boeing has the possibility to raise funds from imperfectly functioning capital markets?*

To the United States:

90. *At paragraphs 162-163 of the European Communities' Oral Statement, the European Communities argues that, based on the logic underlying the criticisms of Professor Cabral's report by the United States and NERA Consulting, "subsidies would essentially*

²⁵¹ US – Upland Cotton (AB), para. 437.

*never affect the pricing of any products in any markets supplied by profit-seeking firms”.
How does the United States respond?*

224. The U.S. critique of Prof. Cabral’s reasoning is grounded on the assumptions he has made and on the specific facts of this dispute. Specifically, the United States criticizes Prof. Cabral’s report based on (1) its reliance on the EC’s grossly overstated calculation of the magnitude of the subsidies,²⁵² (2) the structure of Professor Cabral’s model (it does not accurately reflect business decision-making by a company like Boeing),²⁵³ (3) the key theoretical assumption on which it is predicted (*e.g.*, that Boeing’s investment decisions depend on its cash flow, which is invalid in light of Boeing’s unconstrained access to capital markets),²⁵⁴ and (4) assumptions of fact that find no support by empirical evidence (*e.g.*, that Boeing’s reference period sales involved significant switching costs or that its reference period production involved significant learning curve gains;²⁵⁵ that Boeing’s only discretionary use of non-operating cash is payments to shareholders or “investment” in “aggressive pricing”²⁵⁶). That criticism is specific to the EC’s effort to prove causation in this case. It should not be read as an assertion that subsidies to profit-seeking firms will never affect market pricing. To the contrary, as discussed below, certain subsidies will affect the pricing of firms that receive them.

225. In assessing the impact of alleged subsidies on the recipient’s pricing, their nature is particularly important. In its second written submission, the EC observes (correctly) that pricing “results from the interaction of supply and demand.”²⁵⁷ It follows that subsidies that are instrumental in creating supply that would not otherwise exist, or in maintaining supply that would otherwise be uneconomic, will have an impact on pricing. Similarly, subsidies that are linked directly to the pricing or production of specific products are far more likely to have an impact on the pricing of those products than subsidies that do not have such a link.

226. The point that a serious prejudice claim requires a careful examination of the nature of alleged subsidies and how the recipient used them is one that the Appellate Body recognized in *US – Upland Cotton*. In that case, the Appellate Body upheld the Panel’s finding of a causal link between price contingent subsidies and price suppression because the Appellate Body believed that (1) U.S. supply influenced the world market for cotton,²⁵⁸ (2) the price contingent subsidies

²⁵² Compare US FWS, para. 841 with Cabral Report, paras. 85-86 (Exhibit EC-4).

²⁵³ US FWS, para. 842 and US SWS, para. 181, fifth bullet.

²⁵⁴ US FWS, paras. 832-839.

²⁵⁵ US FWS, paras. 846-857.

²⁵⁶ US FWS, paras. 844-845.

²⁵⁷ EC SWS, para. 655.

²⁵⁸ *US – Upland Cotton (AB)*, para. 449 (citing Panel Report, *US – Upland Cotton*, para. 7.1348).

in question were directly linked to world cotton prices,²⁵⁹ (3) there was discernible temporal coincidence in the subsidies and suppressed prices,²⁶⁰ (4) there was “credible evidence on the record”²⁶¹ to support the proposition that “U.S. upland cotton producers would not have been economically capable of remaining in the production of upland cotton had it not been for the . . . subsidies at issue,”²⁶² (5) there was credible evidence that the effect of the subsidies was to allow U.S. producers to sell at a price below that necessary to cover their total costs,²⁶³ and (6) “other factors” did not “attenuate the genuine and substantial causal link” between the price-contingent subsidies and significant price suppression.”²⁶⁴ Notably, the Panel in *US – Upland Cotton* found that the challenged non-price contingent subsidies increased cash flow and wealth,²⁶⁵ yet this was an insufficient basis for a finding of price suppression.²⁶⁶

227. Any actionable subsidies claim must rest on its own distinct facts, and an analysis related to a global agricultural commodity product will differ greatly from the analysis of a highly engineered manufactured product like large civil aircraft. Nonetheless, the differences between the facts in this case and the facts that dictated the panel’s and the Appellate Body’s affirmative causation finding in *US – Upland Cotton* are striking. In this case, the EC does not, and cannot, (1) show that the alleged subsidies are contingent on prices or enabling of supply, (2) show a temporal coincidence between the alleged subsidies and LCA pricing (in fact, the EC concedes that, prior to 2004, when the alleged subsidies were at their peak, prices were *not* suppressed), (3) point to any credible evidence to show that Boeing could not, or would not, have remained in business “but for” the alleged subsidies, or (4) point to any credible evidence that the alleged subsidies allowed Boeing to sell LCA below its costs, or (5) refute evidence showing that “other factors” such as Airbus’ pattern of price undercutting at key accounts, its decision to bring the A340 to market as a fuel-inefficient four-engined aircraft and its decision to devote its engineering and other resources to the A380 instead of an A350 to replace its A330, are, in fact, the causes of the adverse effects that the EC wants the panel to ascribe to the alleged subsidies.

91. *What is the relevance of the United States’ argument that Boeing’s prices are “market driven” to the Panel’s evaluation of a claim of significant price suppression in a market which operates as a competitive duopoly?*

²⁵⁹ *US – Upland Cotton (AB)*, para. 450 (citing *US – Upland Cotton (Panel)*, para. 7.1349).

²⁶⁰ *US – Upland Cotton (AB)*, para. 451 (citing *US – Upland Cotton (Panel)*, para. 7.1351).

²⁶¹ *US – Upland Cotton (AB)*, para. 420 (quoting *US – Upland Cotton (Panel)*, para. 7.1353).

²⁶² *US – Upland Cotton (AB)*, paras. 452-453 (quoting *US – Upland Cotton (Panel)*, para. 7.1353).

²⁶³ *US – Upland Cotton (AB)*, para. 453 (citing *US – Upland Cotton (Panel)*, para. 7.1353).

²⁶⁴ *US – Upland Cotton (AB)*, para. 457-458 (quoting *US – Upland Cotton (Panel)*, para. 7.1363).

²⁶⁵ *US – Upland Cotton (Panel)*, para. 7.1305 n. 1417.

²⁶⁶ *US – Upland Cotton (Panel)*, para. 8.1(g)(ii).

228. By “market driven,” the United States means that Boeing always sets its prices at the best level it believes the market will bear. In the large civil aircraft market, Boeing’s price is shaped by Airbus’ pricing of its competitive aircraft and the willingness of customers to buy new aircraft at a particular price point (instead of, for example, delaying the purchase decision or buying used aircraft).²⁶⁷ The fact that the large civil aircraft market is a duopoly means that Airbus prices with regard to Boeing and Boeing prices with regard to Airbus. However, the duopoly nature of supply does not mean that Boeing or Airbus can set market prices. Pricing depends also on demand – a fact that the EC ignores in its assertions that, absent the alleged subsidies, Boeing’s prices would rise by the amount of the alleged per-plane subsidy magnitude or price effects.²⁶⁸ Nor does the duopoly structure of supply allow an assumption that it is Boeing’s pricing decisions that suppress Airbus prices, and not the reverse. That is a question that requires evidence to answer. Because the market is a duopoly on the supply side and characterized by a limited number of large transactions, the panel has an unusually clear picture of the sequence of events behind any price suppression that might have occurred. And in this case, there is very clear evidence that [***].²⁶⁹ The evidence also shows very clearly that Airbus undercut Boeing’s prices in order to capture market share at Boeing’s expense.²⁷⁰ [***]²⁷¹

92. *In which circumstances, if any, would it be reasonable to conclude that a subsidy that has the effect of lowering a firm’s costs of production, will result in that firm lowering its prices?*

229. In an industry like the large civil aircraft industry, involved in the production of non-fungible goods, it would be reasonable to conclude that a subsidy that lowers a firm’s cost of production results in that firm lowering its prices where the evidence shows:

- (a) A temporal coincidence between the incidence of subsidies at issue and lower firm prices, and a pattern of aggressive pricing behavior by the beneficiary of the subsidies in order to expand its market share; or

²⁶⁷ Statement of Clay Richmond, para. 11 (Exhibit US-275) (HSBI).

²⁶⁸ EC FWS, para. 1396, Figure 31 (providing “counterfactual” A330 pricing by increasing prices by the alleged magnitude); ECFWS, Annex D, para. 117 (multiplying the number of Airbus aircraft ordered by the per-plane price effect calculated by Prof. Cabral).

²⁶⁹ The Campaign Annex to the U.S. first written submission and the HSBI Appendix to the U.S. second written submission present extensive evidence on this point. The United States cannot provide citations to the precise parts of these submission containing the examples, because to do so might reveal HSBI.

²⁷⁰ US FWS, paras. 1027-1037 (discussing a series of key 737 campaigns).

²⁷¹ The Campaign Annex to the U.S. first written submission and the HSBI Appendix to the U.S. second written submission present extensive evidence on this point. The United States cannot provide citations to the precise parts of these submission containing the examples, because to do so might reveal HSBI.

- (b) That a subsidy creates supply that would not otherwise be brought to market or allows a firm to maintain production that would otherwise be uneconomic.

230. Here, these criteria preclude a finding that the effect of the alleged subsidies is pricing by Boeing that is lower than it would otherwise be. The evidence shows:

- (a) No temporal coincidence between the incidence of the alleged subsidies and lower prices by Boeing;
- (b) A pattern of Airbus pricing its aircraft packages at a level that undercut Boeing's prices;
- (c) No basis to conclude that the alleged subsidies created Boeing supply that would not otherwise exist.
- (d) That Boeing had a compelling economic incentive to narrow the price gap with Airbus and stem its market share losses, and had the financial wherewithal to price and develop the 787 as it did, without regard to the alleged subsidies.

93. *Does the United States agree that the three subsidies discussed at paragraph 1234 of the European Communities' First Written Submission lower Boeing's marginal unit costs of production and sale of individual LCA by an amount equal to the benefit of the subsidy?*

231. No. The United States demonstrated in its second written submission that, regardless of the effect of those programs on Boeing's marginal unit costs of production, the EC has provided no credible evidence for the "dollar-to-dollar" price effect of alleged subsidies that supposedly lower Boeing's marginal unit costs. The evidence proffered by the EC on this point consists solely of a page from a textbook that does not support the EC's "dollar-to-dollar" assertion, and an invalid interpretation of GATT Article VI:5.²⁷²

232. A response to this question also warrants a program-by-program elaboration:

233. **Washington State B&O Tax Rate Reduction.** The reduction in Boeing's Washington State tax rate on its revenues is not, in any sense, a reduction in Boeing's marginal cost of production. It is a post-production charge on Boeing's sales. Moreover, the tax treatment in question is not a subsidy. In fact, Boeing pays a higher effective tax rate on its revenue than the average Washington State producer.

234. **FSC/ETI.** As this tax benefit (when it was in effect) exempted companies from taxation on certain income, it allowed Boeing to keep more of its profits by giving less of them to the

²⁷² US SWS, para. 183.

Federal Government. This benefit had nothing to do with Boeing's marginal costs of production. In any event, the DSB has already ruled that this measure was inconsistent with the SCM Agreement, as it provided a prohibited subsidy. The United States has terminated the measure. FSC/ETI is, therefore, not properly at issue in this case.

235. **Landing fees for the 747-LCF at Payne Field.** If Snohomish County actually "waived" landing fees, and such waiver were a subsidy, as the EC alleges, it would be a subsidy that reduces Boeing's marginal costs of large civil aircraft production (albeit insignificantly). As the United States has already demonstrated,²⁷³ however, there is no such "waiver" of fees and no subsidy, so the question is entirely academic.

236. Lastly, if any of these programs is to be considered a subsidy, it is very different from the other programs that the EC claims are actionable subsidies and does not bear a sufficient nexus with those other programs to warrant an aggregated analysis of their effects.

6. Price suppression, lost sales, displacement and impedance

To both parties:

94. *In US – Upland Cotton, the Panel noted that for a basic and widely traded commodity such as upland cotton, "a relatively small decrease or suppression of prices could be significant because, for example, profit margins may ordinarily be narrow, product homogeneity means that sales are price sensitive or because the sheer size of the market in terms of the amount of revenue involved in large volumes trade on the markets experiencing the price suppression."²⁷⁴ Do the parties consider that, for a product such as LCA, a relatively small decrease or suppression of prices could be "significant" for purposes of determining significant price suppression under Article 6.3(a)? Please explain why this is or is not so, and indicate the factors that the Panel should consider in determining whether the effect of an alleged subsidy to Boeing LCA is "significant" price suppression within Article 6.3(c).*

237. An evaluation of whether a relatively small suppression²⁷⁵ of prices can qualify as "significant" will involve several considerations – what price to evaluate, what comparison to

²⁷³ US FWS paras. 560-566

²⁷⁴ US – Upland Cotton (Panel), para. 7.1330.

²⁷⁵ The Appellate Body has recognized that price suppression and price depression are distinct concepts:

"price suppression" refers to the situation where "prices" – in terms of the "amount of money set for sale of upland cotton" or the "value or worth" of upland cotton – either are prevented or inhibited from rising (i.e. they do not increase when they otherwise would have) or they do actually increase, but the increase is less than it otherwise would have been. Price depression refers to the situation where "prices" are pressed down, or reduced.

make to determine if the suppression is “relatively” small, and what standard to use to determine significance. The United States finds the reasoning of the panel in *Korea – Shipbuilding* compelling guidance on these issues:

The main implication of our conclusion that the concept of “like product” does not apply in respect of price suppression/price depression analysis thus would seem to be that such a structured price-to-price comparison would not be required in terms of the SCM Agreement. In other words, given that the relevant text is that “the effect of the subsidy is . . . significant price suppression {or} price depression”, the basic analytical question would be how to demonstrate such a causal relationship between the subsidy or subsidies in question, on the one hand, and movements in the prices of the product of concern to the complaining Member in the relevant market, on the other hand. In our view, this means that a main focus of the analysis would be levels and trends in the price for the product in question, as a whole, in the relevant market (i.e., “the same market”), as a whole, and the various reasons behind them.²⁷⁶

238. Thus, the first step in a price suppression analysis is to identify the market within which the complaining party’s products compete with the allegedly subsidized products. The EC has alleged the existence of only one market – the world market – with respect to its Article 6.3(c) claims.²⁷⁷ Therefore, any analysis of its price suppression claims would require the examination of price levels and trends across the world market for each of the aircraft families subject to serious prejudice claims.

239. Most of the argumentation put forward by the EC simply does not address this question. Its standard price suppression analysis for each product consists of data on prices per seat for products in the family, a graph adding the subsidy magnitude calculated by ITR to the Airbus price per seat or [***] for the relevant product, a graph adding the “price effect” based on the Cabral model to the Airbus [***] for the relevant product, and a reference to information on the

US – Upland Cotton (AB), para. 424, quoting *US – Upland Cotton (Panel)*, para. 7.1277. The EC has asserted no price depression claims. EC FWS, paras. 1082 and 1390. Therefore, decreases in prices for Airbus aircraft are not an issue in this dispute.

²⁷⁶ *Korea – Shipbuilding*, para. 7.557.

²⁷⁷ In its first written submission, the EC asserted that there is a separate “country market” whenever a purchaser from a country buys an aircraft, and even a “sales campaign market” for each large civil aircraft sales campaign. EC FWS, paras. 1190-1193. The United States demonstrated in its first written submission that the EC had provided no evidence to support the existence of any of these discrete markets. US FWS, paras. 879-885. The EC has never even attempted to rebut the analysis presented by the United States.

development of prices in certain campaigns.²⁷⁸ For the most part, these factors are irrelevant to the question of price levels and trends in the world market for the products it has defined:

- Sales campaign information goes only to prices at individual campaigns, and indicates nothing about prices “for the product in question, as a whole, in the relevant market,” namely, the world market. Indeed, sales campaign price data present the type of “structured price-to-price comparison” that the *Korea – Ships* panel found was *not* relevant to price suppression that would exist in the absence of the alleged subsidies.
- The ITR subsidy magnitude or the Cabral price effect are, for the many reasons we have already described, thoroughly invalid measurements of the effect of the alleged subsidies. Therefore, adding them to the Airbus [***] indicates nothing about world market price levels or trends.
- The EC’s per-seat price data for 200-300 seat aircraft covers only the A330, rather than prices for the “product as a whole,” which, as defined by the EC, would include A350 Original and A350XWB.

Therefore, the only information that the EC presents that is even arguably relevant to evaluation of the level or trends in prices for “the product as a whole” are price per-seat data for the A320 and A340.

240. Having identified the price to consider, the next step is to determine what comparison to make to determine if the suppression is “relatively” small. As noted above, the United States considers the proper measure of suppression is the difference between the actual price and the price the producer would have charged in the absence of the alleged subsidies. As with the prices, most of the EC data is simply irrelevant to the question. The supposed magnitude of the subsidy indicates nothing about actual changes in prices. (In fact, the EC’s addition of the magnitude to the [***] is circular logic, as it assumes that the subsidy would make the price higher as part of an effort to demonstrate that the subsidy made the price higher.) The Cabral price effect calculation is invalid. The campaign information indicates nothing about world market price levels or trends.

241. Finally, determining significance requires a consideration of any price suppression found to exist in light of the conditions of competition in the marketplace. In this regard, it is important to note that the large civil aircraft market is *not* a commodity market. Products are not homogeneous. Customers are sophisticated, and typically evaluate each purchase using complicated formulas in which price, while an important factor, is one among many. Product

²⁷⁸ E.g., paras. 1389 (A330 price per seat), 1396 (A330 price per seat plus magnitude), 1398-99 (A330 [***] plus magnitude); 1401 ([***] plus price effect; and 1401-1406 (A330 sales campaigns).

features (such as fuel efficiency or cockpit commonality) or incumbent supplier advantages may prove more important than prices for some customers. For these reasons, a relatively small decrease in global prices would not constitute significant price suppression in this industry.

95. *Can both parties please explain how their respective contentions regarding the significance of switching costs on fleet purchase decisions relate to the assumption in EC-Exhibit 4 (at paragraph 65) that there is "only a 25% probability of switching across sellers (for a given aircraft model and generation)".*

242. Professor Cabral's assumption that there is "only a 25% probability of switching across sellers (for a given aircraft model and generation)" is the basis for his conclusion that LCA suppliers would be willing to offer 25 percent price discounts on *current* sales to "lock-in" new buyers,²⁷⁹ such that, in the *future*, the buyer would face "high" costs if it switched to the other supplier.²⁸⁰ However, the EC contradicts Professor Cabral when it asserts that switching costs are "not such a big deal."²⁸¹ If switching costs are "not such a big deal," then there would be no basis for asserting, as Professor Cabral does, that suppliers would offer significant discounts based on the prospect of future switching costs.

243. Regardless of which position the EC takes regarding switching costs, Prof. Cabral's conception of the incentives related to future switching costs is based on a linkage between the probability of future switching and current price discounts that does not exist in the large civil aircraft industry. Whether a customer switches in the future depends more than anything on whether, at that time, the challenging supplier offers a discount large enough to offset the customer's switching cost.²⁸² Historical data on the probability of switching across suppliers does not affect the challenging supplier's ability to offer such a discount. Accordingly, a supplier as no incentive to offer current discounts based on the probability figure Professor Cabral uses.

244. Professor Cabral's assumed 25 percent switching cost discount is but one key component of the equation Cabral uses to find what he calls "annual investment in aggressive pricing of planes sold to 'new' buyers,"²⁸³ which, in turn, serves as the basis for his conclusion that Boeing would use 47 cents of each alleged subsidy dollar to engage in aggressive pricing to "new"

²⁷⁹ Cabral Report, para. 65. Professor Cabral defines "new buyer" as a "an airline that has not bought aircraft of the same current generation and family before." Cabral Report, para. 67.

²⁸⁰ Cabral Report, para. 63.

²⁸¹ EC OS1 (conf.), para. 59.

²⁸² Statement of Clay Richmond, para. 6 (Exhibit US-275) ("In order to make the sale, the challenger at the account has to price its aircraft lower to compensate the airline for the added costs of switching from the incumbent."); *see also* US FWS, para. 855.

²⁸³ Cabral Report, para. 68.

customers.²⁸⁴ The other key component of that equation is the proportion of Boeing aircraft deliveries in the 2000-2006 period to “new” buyers, a proportion Cabral states is 37.4 percent, without showing which Boeing deliveries are to new buyers.²⁸⁵ In fact, the evidence contradicts Professor Cabral’s assertion regarding the proportion of Boeing sales to which his switching cost incentive would apply.

- Professor Cabral’s switching cost incentive would not apply to sales to airlines that were long-standing customers for a particular Boeing model and generation, or to leasing companies, which are not affected by switching costs, yet these customers accounted for a significant proportion of Boeing deliveries during the 2004-2006 period on which Professor Cabral focuses.²⁸⁶
- Professor Cabral’s switching cost incentive would apply where Boeing seeks to sell aircraft of a given model and generation to a “new buyer” that operates Airbus aircraft of the same generation. However, of the 2,644 Boeing deliveries during the 2000-2006 period from which Professor Cabral used Boeing delivery data,²⁸⁷ less than 5 percent were to an Airbus customer that had “switched” from Airbus to Boeing.²⁸⁸ Most importantly, the evidence shows that, where Boeing was the incumbent supplier, (e.g., at easyJet and Air Berlin), it *resisted* price concessions and, as a result, lost major sales campaigns to Airbus on price, despite the costs incurred by those airlines in switching their business from Boeing to Airbus.

245. Finally, the United States notes that the EC’s mistaken conception of switching costs is the *only* reason it provides to explain why Boeing would use the alleged subsidies to lower prices on “mature” aircraft – that is, the 737 and 777.²⁸⁹ Given the fundamental flaws in the EC’s assertions regarding switching costs, there is no basis for finding that the alleged subsidies would lead Boeing to lower 737 and 777 prices.

²⁸⁴ Cabral Report, para. 82.

²⁸⁵ Cabral Report, para. 68.

²⁸⁶ NERA Reply to Professor Cabral, p. 17 n. 14. Note also that a Professor Cabral’s switching cost incentive would not apply to a Boeing 737-700 operator that purchased a Boeing 737-800. *See* Statement of Clay Richmond, para. 6 (Exhibit US-275).

²⁸⁷ Cabral Report, para. 52 (Exhibit EC-4).

²⁸⁸ Statement of Clay Richmond, Vice President, Revenue Management, Boeing Commercial Airplanes, para. 8 (Exhibit US-275).

²⁸⁹ *See, e.g.*, EC OS1, para. 161 (“Learning curves and switching costs imply that current sales are a form of investment . . .”); EC FWS, para. 1318 (asserting that, after investment in R&D and pricing of new aircraft models, the only other “investment option available to Boeing is investment in aggressive pricing to new customers, who are purchasing either new and {sic} mature aircraft.”); Cabral Report, para. 28 (Exhibit EC-4).

96. *How, if at all, should the Panel's assessment of whether specific sales campaigns provide evidence of price suppression, lost sales or displacement or impedance of imports and exports, be affected by the consideration that Boeing was the incumbent supplier?*

246. As the incumbent supplier in the great majority of the sales campaigns cited by the EC, Boeing's position was defensive.²⁹⁰ It had no incentive to initiate a downward move in pricing, but a strong incentive to respond to Airbus' price undercutting. In addition, because of the switching costs associated with moving to a new supplier, in a number of 737 campaigns, Airbus needed to undercut Boeing on price, and systematically did so. It is noteworthy in this regard that in the 737 sales campaigns subject to the EC serious prejudice allegations, there are examples of Boeing customers switching to Airbus, but *no* examples of Airbus customers switching to Boeing.

247. It is true that as it had an established supply relationship, Boeing had a strong incentive to retain the customer and, therefore, Boeing reacted to Airbus' pricing, but for purposes of analyzing cause and effect, the facts show that Boeing did not undercut Airbus' prices or "lead" pricing down. Moreover, Boeing's incentive to keep its customers [***] was entirely independent of, and unaffected by, the alleged subsidies. Having lost key customers to Airbus in the 2001-2004 period, the economic considerations that drove Boeing to narrow the price gap with Airbus (*e.g.*, defending its position as a major supplier to European low cost carriers) were far more significant than the bottom line impact of a more forceful response to Airbus' pricing, an impact that would have been the same with or without the alleged subsidies.

To the European Communities:

²⁹⁰ The EC selected 28 sales campaigns, 25 involving airlines, three involving leasing companies. Of the 25 sales campaigns conducted by airlines, Boeing was the incumbent supplier in 17 instances, meaning that it sought to place (1) additional aircraft of the same generation with a customer and avoid a "switch" to Airbus, or (2) newer generation aircraft to replace older generation Boeing aircraft or to grow an all-Boeing fleet. The first category comprises the following campaigns: Ryanair, easyJet, Air Berlin, Hamburg International, and dba. These represent half of the 737 airline campaigns identified by the EC. The second category comprises 12 campaigns covering all three Boeing aircraft subject to the EC's claims. In the 11 787 airline campaigns cited by the EC, seven airlines either had all-Boeing large civil aircraft fleets or operated only Boeing 767s as their mid-size large civil aircraft: Continental (all-Boeing large civil aircraft fleet; 767s); Icelandair (all-Boeing large civil aircraft fleet; 757s); Ethiopian Airlines (all-Boeing large civil aircraft fleet; 767s); Kenya Airways (all-Boeing large civil aircraft fleet; 767s); JAL (all-Boeing large civil aircraft fleet except for A300-600s it inherited when it acquired Japan Air Systems; 767s); ANA (all-Boeing fleet except for A320s; 767s); and Royal Air Maroc (all-Boeing large civil aircraft fleet except for two A321s; 767s). In the ten 737 airline campaigns cited by the EC, four of the airlines operated "Classic" 737s and did not operate Airbus A320s going into the campaign: Lion Air; JAL; Aegean; and AirAsia. In the four 777 campaigns, one airline, Air New Zealand had an all-Boeing long-range fleet. In addition, Singapore Airlines and Cathay Pacific had large 777 fleets alongside a far smaller number of A340s. Lufthansa was the only airline without 777s.

97. *Please explain how the counterfactual illustrations of the pricing of the various Airbus LCA (Figures 31, 32, 47, 48, 62 and 63 of the European Communities' First Written Submission) demonstrate the prices of Airbus LCA "but for" the alleged subsidies to Boeing. Is the European Communities asserting that, in the absence of the alleged subsidies to Boeing, Airbus' LCA prices would have increased by the magnitude of alleged subsidy to the corresponding Boeing LCA (and therefore that Airbus' LCA prices have effectively been suppressed by an amount equivalent to the magnitude of alleged subsidization to the corresponding Boeing LCA)? If not, please explain what the European Communities is seeking to demonstrate in the above-mentioned graphs.*
98. *What are the asymptotic characteristics of the Cabral model with respect to switching costs, i.e. how is a dollar of development subsidies allocated if • in the equation presented in paragraph 64 of Exhibit EC-4 tends to zero?*

To the United States:

99. *Does the United States agree with the European Communities (at paragraph 1098 of the European Communities' First Written Statement) that the "significance" of the price suppression, as contemplated by Article 6.3(c), can be demonstrated by showing the revenue losses alleged to have resulted therefrom, and the difference between Airbus' actual prices and the prices which the European Communities anticipates Airbus would have received in sales campaigns in the absence of the effects of the alleged subsidies?*

248. As we noted in the response to Panel Question 94, price suppression relates to levels and trends in prices for the product in question "as a whole" in the market in which the complainant's product and an allegedly subsidized product compete. The comparison between "actual" prices and "anticipated prices" that the EC describes in paragraph 1098 of its first written submission relates to the EC's expectations in individual sales campaigns. As this information does not indicate either the level of prices for the product as a whole, or trends in those prices, it is not relevant to the Panel's analysis. The United States also notes that the EC's assertions regarding lost revenue resulting from price suppression depend on the flawed price effects calculations conducted by Professor Cabral

249. At a more general level, alleged revenue losses are not an appropriate way to evaluate the significance of price suppression. The response to Panel Question 94 describes the factors that the United States considers relevant.

100. *How does the United States respond to the European Communities' contention (at paragraph 1400 of the European Communities' First Written Submission) that a substantial portion of the gap between competitive and non-competitive pricing for A330 family LCA can be explained by the magnitude of US subsidies and its observations on the differences in price movements for the A330 family LCA in competitive and non-competitive campaigns during 2004 through 2006?*

250. To begin with, the EC's distinction between "competitive" and "non-competitive" campaigns is based on the faulty premise that a campaign is "non-competitive" – and thus less appropriate for inclusion in the number of orders over which the alleged magnitude is allocated²⁹¹ – if "an airline or leasing company ordered Boeing aircraft without Airbus providing the customer with a firm offer."²⁹² As explained in the U.S. first written submission, the EC's definition of "non-competitive" campaigns includes the "firming up" of options that were priced in campaigns, such as the 2004 Air Asia campaign, that the EC would describe as competitive.²⁹³ The EC's "non-competitive" category also includes Boeing orders, such as the 2005 orders from Ryanair, that were heavily influenced by the effects of Airbus' price undercutting.²⁹⁴ Accordingly, it is incorrect for the EC to assert that the effects of the alleged subsidies should be assessed by focusing on campaigns that the EC describes as "competitive."

251. Even assuming, *arguendo*, that the EC's distinction between "competitive" and "non-competitive" campaigns is supportable, the A330 price trends do not support the conclusion that the EC asks the Panel to draw. The EC concedes that, under normal market conditions, it is "not surprising" that prices resulting from "competitive" A330 campaigns are lower prices than prices resulting from "non-competitive" campaigns.²⁹⁵ The EC then leaps to the conclusion that "the entire gap is not the result of normal competition" but, rather, is the result of a mixture of normal competition and the magnitude of the alleged subsidies.²⁹⁶ However, the EC provides no credible reason why only some, but not all, of the gap is the result of normal competition. Indeed, the differences in the A330 "competitive" and "non-competitive" price and [***] referred to by the EC reflect a basic feature of "normal competition" unrelated to whether the campaign was "competitive" according to the EC: order size. Generally, a customer can obtain better pricing from an aircraft manufacturer by increasing the number of aircraft ordered. The order volumes of "competitive" A330 campaigns during 2000 – 2006 are, on average, 60 percent higher than for campaigns the EC labels as "non-competitive."²⁹⁷

252. Nor can support for the EC's assertion be found in movements in A330 prices (and A330 [***]). Figure 33 in paragraph 1401 of the EC first written submission compares the A330 [***] for competitive and non-competitive campaigns. The [***] for both [***], and as the EC would

²⁹¹ EC FWS, para. 1297.

²⁹² Scherer Declaration, para. 37 (Exhibit EC-11).

²⁹³ US FWS, para. 818-820.

²⁹⁴ Compare USFWS, para. 1037, with Scherer Declaration, Annex II, p. 4.

²⁹⁵ EC FWS, para. 1400.

²⁹⁶ EC FWS, para. 1400 (emphasis in original).

²⁹⁷ The EC identifies 40 "non-competitive" campaigns, involving a total of 160 orders, which yields an average order size of 4 aircraft. The EC identifies 44 "competitive" campaigns, involving a total of 281 orders, which yields an average order size of 6.39 aircraft. See Scherer Aff., Annex I, pp. 7-8, 10 (Exhibit EC-11).

expect under normal competition, [***]. There is no basis for attributing [***] The United States also observes that A330 [***] in 2006,²⁹⁸ the year in which Airbus recorded the most A330 orders in its history,²⁹⁹ in part by placing them with unhappy A380 customers to help mitigate the impact of A380 delays.³⁰⁰

101. Please comment on whether the United States agrees that, if the European Communities establishes that Boeing obtained an order for an LCA for either of the reasons set forth in the third sentence of paragraph 1105 of the European Communities' First Written Statement, it has made out a *prima facie* case of "lost sales" for purposes of Article 6.3(c).

253. The United States disagrees that EC could make out a *prima facie* case of "lost sales" according to either reason set forth in the cited sentence of the EC First Written Submission.

254. **First reason: Boeing obtained an order "due to its subsidy-fuelled heavily discounted prices" in a situation where the customer considered Airbus' directly competing LCA to be capable of meeting its technical requirements.** This articulation of the test misstates the standard that the EC has conceded is required to establish "that the effect of subsidies is . . . significant . . . lost sales," namely, that "but for" the alleged subsidization, Airbus would have gotten the sale.³⁰¹ In other words, in the scenario outlined by the EC, the complaining party must show that in the absence of the alleged subsidies, the price charged for the allegedly subsidized product would have risen to such an extent that the complaining party's comparable product would have gotten the sale. Thus, it would not be enough to show that the allegedly subsidized product won the sale because of its price, or that the price was affected by subsidies (or, as the EC puts it, "subsidy-fuelled"). The complaining party must show that the effect of the subsidies was sufficient to change the result of the transaction.

255. The EC has not presented evidence that satisfies the correct standard. First, if there is no evidence establishing that, absent the alleged subsidies, Airbus would have won the sale in question, then there is no basis for considering the sale to have been "lost" by Airbus for purposes of the SCM Agreement. This issue is particularly significant in three 787 campaigns. In these campaigns, the customer had an existing fleet of Boeing 767s or 757s, and there is no evidence that it would have ordered Airbus A330s.³⁰² As for the other 787 campaigns identified

²⁹⁸ EC FWS, paras. 1398 (Figure 32), 1401 (Figure 33).

²⁹⁹ Airclaims CASE database.

³⁰⁰ See, e.g., *Qantas asks Airbus for more A380s*, Int'l Herald Tribune (Oct. 29, 2006) (DS316 Exhibit US-405) (order of A330s and additional A380s to "help Qantas mitigate" the impact of A380 delays).

³⁰¹ EC FWS, para. 1107.

³⁰² EC FWS, Ann. D, paras. 15-41-47, 72-75. By contrast, if the huge Airbus A380 did not exist, customers seeking a very large civil aircraft would have turned to the Boeing 747.

by the EC, publicly available evidence, some of it the EC's own, shows that Airbus' ability to offer a competitive A350 was compromised by its focus on, and commitment of resources to, the A380.³⁰³

256. Second, the EC has also failed to account for the fact that economic imperatives also guided Boeing's pricing policy. If Boeing had the incentive and the resources to price at the level it did without the alleged subsidies, then there is no reason to conclude that the alleged subsidies were sufficient to change the result of the transaction. The United States has, in fact, shown that sound economics are behind [***]. The alleged subsidies did not create the incentive Boeing had to stem its market share losses and did not enable Boeing to price in a way that would have otherwise been impossible.³⁰⁴

257. **Second reason: Boeing obtained an order "based in part on the technological advancements of its LCA resulting from US R&D subsidies."** Again, this standard fails to reflect the EC's *but for* causation burden. It is not enough to establish that Boeing won an order "based in part" on its technology. Rather, to prevail on its technology effects causation theory, the EC must establish that, but for the alleged subsidies to the 787, Boeing would not have been able to offer the 787 (and its technological advancements) in the campaigns cited by the EC, and, as a result, Airbus would not have won the sales. The evidence, however, shows that Boeing could have, and would have, developed the 787 as it did with or without the alleged subsidies.³⁰⁵

258. Finally, the United States notes that the lost sales standards articulated in paragraph 1105 of the EC first written submission fail to acknowledge that the EC must show that the lost sales it identifies are "significant" within the meaning of Article 6.3(c).³⁰⁶ This is an independent reason why the EC reasons set out in paragraph 1105 are not sufficient to make out a *prima facie* case of "lost sales" for purposes of Article 6.3(c).

102. *Does the United States agree with the European Communities (at paragraph 1112 of the European Communities' First Written Submission) that, in determining whether, for purposes of Article 6.3(c), the effect of the alleged subsidies was "significant lost sales" in the same market, the threshold of "significant" would be reached even if only a few LCA sales were lost as a result of the alleged subsidies?*

259. Whether the loss of "only a few LCA sales" reaches the threshold of "significant lost sales" within the meaning of Article 6.3(c) must be determined, as the EC acknowledges, "on a case-by-case basis, taking into account the relevant industry and value of the products at

³⁰³ See US SWS, HSBI Appendix, paras. 11-13.

³⁰⁴ See, *supra*, U.S. Response to Question 96.

³⁰⁵ See US FWS, Part XV, Section C.1.

³⁰⁶ See, *infra*, U.S. Response to Question 102.

stake.”³⁰⁷ The significance of any lost sales caused by the alleged subsidies depends on whether they are “important, notable, or consequential” in the context of the EC LCA industry.³⁰⁸ If, as a result of the alleged subsidies, Airbus lost “only a few” LCA sales that, even considered in the aggregate, are not “important, notable, or consequential” in the context of the EC LCA industry, then there is no basis for a lost sales claim under Article 6.3(c). As the United States has shown, none of the lost sales cited by the EC – not even a few – were caused by the alleged subsidies.

7. Threat of serious prejudice

To the European Communities:

103. *At paragraph 1148 of the European Communities' First Written Submission, the European Communities argues that, having established the existence of serious prejudice from the alleged actionable subsidies, demonstrating the existence of threat of serious prejudice from the effects of the same subsidies is a relatively straight-forward exercise. Is the Panel correct in understanding the European Communities' claims of threat of serious prejudice based on future LCA orders (demonstrated by the same types of evidence that support the European Communities' present serious prejudice claims) to be dependent on the European Communities demonstrating present serious prejudice? In other words, if the Panel were to find that the evidence presented by the European Communities did not support its present serious prejudice claims, would it follow that such evidence equally does not support its threat of serious prejudice claims based on future LCA orders?*
104. *The Panel notes that the European Communities' makes a second set of threat of serious prejudice claims (based on future LCA deliveries) in the alternative and conditional on the Panel disagreeing with the European Communities' focus on orders (as opposed to deliveries) for purposes of its present serious prejudice claims (paragraphs 1446, 1541 and 1631 of the European Communities' First Written Submission). Please explain whether (and the basis on which) the European Communities would make its alternative claims of threat of serious prejudice if the Panel were to assess the serious prejudice claims on the basis of orders of LCA, but to a more limited extent than is suggested by the European Communities (e.g. if the Panel were to agree with the United States that claims of displacement or impedance of imports or exports in Article 6.3(a) and 6.3(b) should not be assessed on the basis of orders of LCA)?*

To the United States:

³⁰⁷ EC FWS, para. 1111.

³⁰⁸ Cf., *US – Upland Cotton (Panel)*, para. 7.1326 (construing “significant” in the context of “significant price suppression” in Article 6.3(c) mean “important, notable, or consequential,” based on the word’s ordinary meaning set forth in *The New Shorter Oxford English Dictionary* (1993)).

105. *At paragraph 912 of its First Written Submission, the United States argues that the context provided by Article 15.7, along with the ordinary meaning of the term "threat" in both English and Spanish, "indicate that a threat of serious prejudice exists only where the complaining party has established the existence of a clearly foreseen change in circumstance that will lead to the imminent occurrence of one of the factors of serious prejudice." Does the United States consider that its contention that a threat of serious prejudice requires the demonstration of a change in circumstance is consistent with the characterization of serious prejudice as a continuum that ascends from a "threat of serious prejudice" up to "serious prejudice" as described by the Panel in US – Upland Cotton (at paragraph 7.1495)? In other words, does the United States consider it is possible for a situation which does not rise to the level of present serious prejudice, to nonetheless constitute a "threat of serious prejudice" absent a clearly foreseen change in circumstance?*

260. A clearly foreseen change in circumstances can arise in one of two ways. The first is that serious prejudice does not exist at the time of the evaluation, but the evidence establishes trends in existing conditions for the products of the complaining party that are likely to mature into serious prejudice in the imminent future. This situation is reflected in the continuum identified by the Panel in *US – Upland Cotton*. The worsening trends are the foreseen change in circumstance that will lead to serious prejudice.

261. The second situation is that the facts do not establish the existence of worsening trends with regard to the products of the complaining party. Perhaps they evince a state of “vulnerability.” However, if there is a clearly foreseen change in circumstances that will create a tipping point, plunging those products into serious prejudice, there would be a threat of serious prejudice.

262. The EC, in the first set of threat of serious prejudice claims (*i.e.*, those based on future large civil aircraft orders and not argued in the alternative), provides no basis for finding that a threat of serious prejudice exists in the absence of present serious prejudice. Rather, the EC premises its threat claims on the existence of present serious prejudice, and the continuation of that serious prejudice into the future.³⁰⁹ It does not suggest that there are worsening trends, or that some imminent change in circumstances will lead to serious prejudice. That is not enough to establish a “threat” of serious prejudice. Further support for the observation that circumstances are unlikely to change for the worse comes from Airbus’ projections that, in 2007, it will deliver more aircraft than Boeing for the fifth straight year and break its 2005 record for aircraft orders.³¹⁰

³⁰⁹ See EC FWS, para. 1148.

³¹⁰ Andrea Rothman and Massoud Derhally, Mideast puts Airbus far ahead of Boeing, *Seattle Times* (Nov. 13, 2007) (Exhibit US-1199).

