

**FINAL NON-BCI VERSION  
U.S. AND EC BUSINESS CONFIDENTIAL INFORMATION REDACTED**

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

***(WT/DS316)***

**COMMENTS OF THE UNITED STATES OF AMERICA  
ON THE ANSWERS OF THE EUROPEAN COMMUNITIES  
TO THE PANEL'S QUESTIONS IN CONNECTION WITH  
THE SECOND SUBSTANTIVE MEETING  
AND ON THE ANSWERS OF THIRD PARTIES  
TO THE PANEL'S QUESTIONS**

**November 16, 2007**

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<i>Australia – Leather</i>	Panel Report, <i>Australia – Subsidies Provided to Producers and Exporters of Automotive Leather</i> , WT/DS126/R, adopted 16 June 1999
<i>Canada – Aircraft (Panel)</i>	Panel Report, <i>Canada – Measures Affecting the Export of Civilian Aircraft</i> , WT/DS70/R, adopted 20 August 1999, as modified by the Appellate Body Report, WT/DS70/AB/R
<i>Canada – Aircraft (AB)</i>	Appellate Body Report, <i>Canada – Measures Affecting the Export of Civilian Aircraft</i> , WT/DS70/AB/R, adopted 20 August 1999
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<i>EC – Biotech</i>	Panel Report, <i>European Communities – Measures Affecting the Approval and Marketing of Biotech Products</i> , WT/DS291/R, WT/DS292/R, WT/DS293/R, circulated 29 September 2006
<i>EC - Customs Matters (AB)</i>	Appellate Body Report, <i>European Communities – Selected Customs Matters</i> , WT/DS315/AB/R, adopted 11 December 2006
<i>EC - DRAMs</i>	Panel Report, <i>European Communities – Countervailing Measures on Dynamic Random Access Memory Chips from Korea</i> , WT/DS299/R, adopted 3 August 2005
<i>EEC - Airbus</i>	GATT Panel Report, <i>German Exchange Rate Scheme for Deutsche Airbus</i> , 4 March 1992, unadopted, SCM/142
<i>Japan - Alcohol (AB)</i>	Appellate Body Report, <i>Japan – Taxes on Alcoholic Beverages</i> , WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November, 1996
<i>Japan - DRAMs</i>	Panel Report, <i>Japan - Countervailing Duties on Dynamic Random Access Memories from Korea</i> , WT/DS336/R, notice of appeal filed 30 August 2007
<i>Korea – Commercial Vessels</i>	Panel Report, <i>Korea – Measures Affecting Trade in Commercial Vessels</i> , WT/DS273/R, adopted 11 April 2005
<i>US – Corrosion-Resistant Steel Sunset Review (AB)</i>	Appellate Body Report, <i>United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan</i> , WT/DS244/AB/R, adopted 9 January 2004

<i>US – Cotton Subsidies (Panel)</i>	Panel Report, <i>United States – Subsidies on Upland Cotton</i> , WT/DS267/R, adopted 21 March 2005, as modified by the Appellate Body Report, WT/DS267/AB/R
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<i>US – Gasoline (AB)</i>	Appellate Body Report, <i>United States – Standards for Reformulated and Conventional Gasoline</i> , WT/DS2/AB/R, adopted 20 May 1996
<i>US – Softwood Lumber CVD Final (AB)</i>	Appellate Body Report, <i>United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada</i> , WT/DS257/AB/R, adopted 17 February 2004
<i>US – Wool Shirts (AB)</i>	Appellate Body Report, <i>United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India</i> , WT/DS33/AB/R and Corr.1, adopted 23 May 1997
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*European Communities and Certain Member States –  
Measures Affecting Trade in Large Civil Aircraft (DS316)*

**Comments of the United States on the  
Answers of the European Communities  
to the Panel’s Questions in Connection with  
the Second Substantive Meeting  
and on the Answers of Third Parties  
to the Panel’s Questions**

November 16, 2007

1. In this submission, the United States comments on the answers of the European Communities (“EC”) to the Panel’s questions in connection with the second substantive meeting. In a number of its answers, the EC repeated arguments or assertions it made in previous submissions and statements. As the United States has already responded to those arguments and assertions, it has not repeated its responses in this submission. The lack of further comment does not indicate that the United States agrees with statements in the EC’s answers to the Panel’s questions.

2. Additionally, where appropriate, the United States has incorporated comments on the third parties’ answers to questions into its comments on the EC’s answers to questions.

**II. QUESTIONS TO THE EUROPEAN COMMUNITIES<sup>1</sup>**

**A. LAUNCH AID / MEMBER STATE FINANCING**

**170. In the ITR Report, the EC presents what it considers to be the rates of return that are implicit in the terms and conditions of each of the challenged LA / MSF contracts (apart from the contracts relating to the A300 and A310). In the Whitelaw Report, the EC presents the corresponding interest rates for what it considers to be comparable market financing. For all but one of the LA / MSF contracts covered by these two reports (i.e., French government financing for the A330-200), the proposed market interest rate benchmarks are higher than the implicit rates of return. In response to Panel Question 67, the EC states “*{i}*f the EC alternative benchmark rates are applied to the corrected anticipated returns, the amount of subsidy associated with MSF loans is small (with respect**

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<sup>1</sup> General note regarding citations: In the following comments on the answers of the EC to the Panel’s questions, all references to oral statements are to the “as delivered” versions of those statements. Additionally, references to the EC’s responses to questions from the Panel following the first substantive meeting with the parties (“EC Responses to First Panel Questions”) are to the revised version of those responses filed on July 6, 2007. The United States clarifies this point, because there is a discrepancy in paragraph numbering between the originally filed (April 30, 2007) version of the EC Responses to First Panel Questions and the revised (July 6, 2007) version of that document. Beginning with paragraph 60, the EC removed certain text which it placed in an HSBI appendix. The result is a five-paragraph numbering discrepancy, beginning with paragraph 60.

to [ ] zero”. Is the Panel, therefore, to understand that the EC acknowledges, in the context of its “alternative legal argument”, that all of the LA / MSF contracts pertaining to the A320, A330/A340 basic, A340-500/600 and the A380, confer a benefit?

- (a) If the EC accepts that these measures confer a benefit:
- (i) what is the relevance of the EC’s statement, made in response to Panel Question 73, that “should [the Panel] find that any MSF loans do not conform to ‘perfect’ market conditions, {it} would expect the Panel to take account of the specificities of the real situation of the LCA market”?
- (ii) what is the relevance of the EC’s suggestion that the Panel should take [ ] obligations contained in certain LA / MSF contracts into account in its assessment of whether these contracts conferred a benefit?

#### Comment

3. In light of the EC’s admission that even under its proposed benchmark the grants of Launch Aid at issue in this dispute confer a benefit,<sup>2</sup> the statements discussed in the EC’s response to this question are not relevant. The statements appear to focus on quantifying the amount of benefit conferred. However, as the United States has discussed previously, and as the Appellate Body found in *US – Cotton Subsidies*, no such quantification is required.<sup>3</sup> In this regard, the United States recalls the following finding of the panel in *Canada – Aircraft*:

In order to rebut the *prima facie* case of ‘benefit’, we consider that Canada must do more than simply demonstrate that the amounts of specific ‘benefit’ estimated by Brazil may be incorrect, or that TPC’s rate of return covers Canada’s cost of funds. Rather, Canada must demonstrate that no ‘benefit’ is conferred, in the sense that the terms of the contribution provide for a commercial rate of return.<sup>4</sup>

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<sup>2</sup> See EC Responses to Second Panel Questions, para. 6; see also U.S. Second Written Submission (“SWS”), paras. 72-78.

<sup>3</sup> See U.S. Responses to First Panel Questions, paras. 249, 342; U.S. SWS, paras. 600-604; *US - Cotton Subsidies (AB)*, para. 476.

<sup>4</sup> *Canada – Aircraft (Panel)*, para. 9.312 (emphasis added).

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4. The EC statements cited in the Panel’s question fail to “demonstrate that no ‘benefit’ is conferred” by Launch Aid. Nevertheless, in the interest of completeness, the United States offers the following additional comments on the EC’s response.

5. With respect to the first part of the question, the EC suggests that “the specificities of the real situation in the LCA market” favor use of its proposed risk-sharing supplier benchmark for analyzing the benefit conferred by grants of Launch Aid.<sup>5</sup> The EC does not explain which “specificities” it has in mind. Further, in response to Question 215, the EC acknowledges that “the critical question is whether a proffered benchmark captures the risk profile of these loans {i.e., Launch Aid}.”<sup>6</sup> In light of that acknowledgment, it is not clear what “specificities” – other than the extraordinarily high risk associated with the development of a new LCA model<sup>7</sup> – the EC believes must be captured. As for capturing the risk profile of Launch Aid, the United States previously has explained why the U.S.-proposed benchmark does that,<sup>8</sup> and why the EC-proposed benchmark does not.<sup>9</sup>

6. With respect to the second part of the Panel’s question, the United States refers the Panel to the U.S. response to Question 140.<sup>10</sup> As discussed there, the EC’s allusion to “‘public policy’ obligations” associated with Launch Aid is extremely vague. The EC has done nothing in its response to Question 170 to clarify its argument. Quite to the contrary, the EC simply states that it “has submitted all MSF contracts to the panel and all these obligations are set out there.”<sup>11</sup> Thus, the EC in effect invites the Panel to make the EC’s defense for it. It places the burden on the Panel to discern the relevant provisions in the various Launch Aid contracts and determine

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<sup>5</sup> EC Responses to Second Panel Questions, paras. 4, 5.

<sup>6</sup> EC Responses to Second Panel Questions, para. 518.

<sup>7</sup> See U.S. First Written Submission (“FWS”), paras. 112-115.

<sup>8</sup> See NERA, *Economic Assessment of the Benefits of Launch Aid*, pp. 19-22 (Nov. 20, 2006) (“Ellis Report”) (Exhibit US-80) (BCI); NERA Response to Whitelaw Report, pp. 2-6 (Exhibit US-534) (HSBI); see also U.S. FWS, paras. 112-147; U.S. SWS, paras. 82-112; U.S. Second Non-Confidential Oral Statement (“SNCOS”), paras. 54-60; U.S. Second Confidential Oral Statement (“SCOS”), paras. 13-44; U.S. Comments on EC SNCOS, paras. 27-32.

<sup>9</sup> See U.S. First Confidential Oral Statement (“FCOS”), paras. 20-27; U.S. SWS, paras. 113-119; U.S. SNCOS, paras. 57-59; U.S. SCOS, paras. 27-44; see also U.S. Comments on EC Responses to Questions 174 and 215, *infra*.

<sup>10</sup> See U.S. Responses to Second Panel Questions, paras. 26-28.

<sup>11</sup> EC Responses to Second Panel Questions, para. 8.

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how to account for those provisions.<sup>12</sup> However, as the party asserting that “‘public policy’ obligations” should be taken into account in a benefit analysis, it is incumbent upon the EC – not the Panel – to prove that assertion.<sup>13</sup> The EC has failed to do so. In place of proof, the EC simply asserts that any adjustment to the amount of benefit conferred by Launch Aid “must be significant.”<sup>14</sup>

7. Moreover, the EC continues to ignore obligations associated with commercial financing instruments that are not associated with Launch Aid. Even if there were a theoretical justification for the EC’s position (which there is not), it would not be appropriate to take account of supposed obligations associated with Launch Aid while ignoring other obligations associated with commercial financing.<sup>15</sup> For example, Boeing estimates that on a \$1 billion bond issuance it spends between \$10 and \$20 million (*i.e.*, between 1 and 2 percent) on investment bank fees, regulatory agency fees, and related fees alone. In addition, it incurs costs related to maintaining its credit rating (including rating agency fees) and maintaining compliance with securities regulations, as well as costs associated with employees engaged on an ongoing basis in activities related to borrowing, credit rating issues, and investment bank and investor relations.

8. Finally, the EC refers to the [ ]<sup>16</sup> Despite having discussed this [ ] earlier in this proceeding, the EC only now, in the very last stages, provides a copy of it.<sup>17</sup> The EC attempts to use it as an illustration of the “‘public policy’ obligations” allegedly associated with Launch Aid. However, the illustration does nothing to help the EC’s argument.

9. The EC offers no evidence as to why [ ]. Instead, it speculates as to where “part of the answer may lie” and what “may have tipped the balance,” basing its

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<sup>12</sup> See EC Responses to Second Panel Questions, para. 12 (“The exact amount of this adjustment {for public policy obligations} would be a matter for commercial negotiation or an independent assessment.”).

<sup>13</sup> See *US – Wool Shirts (AB)*, p. 14.

<sup>14</sup> EC Responses to Second Panel Questions, para. 12.

<sup>15</sup> See U.S. Responses to Second Panel Questions, para. 28.

<sup>16</sup> EC Responses to Second Panel Questions, para. 9.

<sup>17</sup> See EC SWS, para. 206; U.S. SCOS, para. 43.

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speculation on its understanding of the concerns of “businesses worldwide.”<sup>18</sup> As there is no evidentiary support for the EC’s speculation, the Panel should disregard it.

**171. At para. 85 of its SWS, the United States asserts that, unlike corporate bondholders, “[p]roviders of Launch Aid cannot pursue remedies for default in the event of non-repayment over the schedule forecast in the Launch Aid contract.” Does the EC agree with this assertion? If not, please explain the extent to which any remedies to recover funds that have been loaned pursuant to a LA / MSF contract exist for the lender government(s) in the event that the forecast number of sales are not achieved.**

Comment

10. The United States made the statement cited by the Panel in this question to illustrate that in addition to having certain debt-like features, Launch Aid also has certain equity-like features. Therefore, in identifying a market benchmark for purposes of analyzing the benefit conferred by Launch Aid, it is appropriate to consider Launch Aid as a hybrid form of financing (rather than as pure debt, as the EC has suggested).

11. In its response to Question 171, the EC agrees with the cited statement.<sup>19</sup> It then goes on to assert that risk-sharing supplier financing is comparable to Launch Aid inasmuch as it, too, is non-recourse. Whether or not this is true,<sup>20</sup> the risk-sharing supplier benchmark still is not an appropriate benchmark, for reasons the United States has discussed previously.<sup>21</sup>

12. Finally, the EC asserts that the non-recourse nature of Launch Aid “has to be seen in its full context.”<sup>22</sup> One element of that context, according to the EC, is the potential for the government providers of Launch Aid to earn royalties. However, not all of the Launch Aid contracts at issue provide for the payment of royalties. For those that do, the royalty rates are [

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<sup>18</sup> EC Responses to Second Panel Questions, para. 11 (emphases added).

<sup>19</sup> See EC Responses to Second Panel Questions, para. 13.

<sup>20</sup> Given the extremely limited evidence the EC has provided concerning risk-sharing suppliers, it is not possible to verify the EC’s assertion. See U.S. SCOS, para. 31.

<sup>21</sup> See U.S. FCOS, paras. 20-27; U.S. SWS, paras. 113-119; U.S. SNCOS, paras. 57-59; U.S. SCOS, paras. 27-44; see also U.S. Comments on EC Responses to Questions 174 and 215, *infra*.

<sup>22</sup> EC Responses to Second Panel Questions, para. 16.



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].<sup>23</sup> Moreover, the obligation to pay royalties is not triggered until the principal and below-market interest rates in the contracts have been repaid, which at best will be achieved only at the very end of the 17-year period identified by the EC as the life of a plane, but which – depending on the commercial viability of the plane after such a long period – may never be achieved at all.<sup>24</sup> And, in several cases, the obligation to pay royalties is [ ].<sup>25</sup>

13. In contrast to the very uncertain prospect of a provider of Launch Aid receiving the “high levels of royalties” to which the EC refers,<sup>26</sup> the non-recourse nature of Launch Aid is absolutely certain. Thus, the government providers of Launch Aid assume substantial downside risk with only the most remote prospect of eventually enjoying a limited upside reward.<sup>27</sup>

14. Another element the EC cites as context for considering the non-recourse nature of Launch Aid is Airbus’s “recent track record” which, according to the EC, shows “actual sales of Airbus models are well ahead of the forecast sales in {Launch Aid} contracts.”<sup>28</sup> To support this proposition, the EC refers to two paragraphs from its second confidential oral statement.<sup>29</sup> A careful review of those paragraphs reveals the highly misleading nature of the EC’s assertion.

15. Rather than compare actual sales with forecast sales for individual LCA models, the EC groups models together and asserts that combined actual sales have exceeded combined forecast sales.<sup>30</sup> What distorts this picture is the EC’s inclusion of sales of the A320, which have been exceptionally high. In effect, the EC is hiding the “track record” of other models behind the “track record” of the A320. Further distorting the picture is the EC’s focus on total deliveries without regard to the time that it took to achieve those totals – a significant oversight, given the back-loaded, per-delivery basis for repayment of Launch Aid. (The EC appears to ignore the

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<sup>23</sup> See U.S. Responses to Second Panel Questions, para. 32.

<sup>24</sup> See U.S. Responses to Second Panel Questions, paras. 33-34.

<sup>25</sup> See U.S. Responses to Second Panel Questions, para. 35.

<sup>26</sup> EC Responses to Second Panel Questions, para. 16.

<sup>27</sup> See U.S. SWS, paras. 121-123.

<sup>28</sup> EC Responses to Second Panel Questions, para. 16.

<sup>29</sup> See EC Responses to Second Panel Questions, para. 16. The EC cites paragraphs 45 and 46 of its second confidential oral statement. These correspond to paragraphs 47 and 48 of the as-delivered version of its statement.

<sup>30</sup> See EC SCOS, paras. 47-48.

fact that “time is money.”) Review of actual and forecast sales on a model-by-model basis shows that the track record is not nearly as robust as the EC suggests.

16. For example, by the end of 2006 – that is, 20 years after launch of the A330/340 – Airbus had delivered only 419 of these planes; 17 years after launch, it had sold only 356.<sup>31</sup> However, to repay the Launch Aid provided by the Government of France for this model, Airbus had to make 700 deliveries (*i.e.*, almost twice as many deliveries as it actually made 17 years after launch).<sup>32</sup> Similarly, almost a decade after it launched the A340-500/600, Airbus had delivered a mere 95 of these planes,<sup>33</sup> compared with a total of [ ] deliveries needed to repay the Launch Aid provided by the Government of France.<sup>34</sup>

17. Even in the case of the A320, much touted by the EC as the Airbus model that tops the delivery charts, only a little over half the deliveries occurred within 17 years of the model’s launch.<sup>35</sup> And, during the first ten years after launch, Airbus delivered only 433 A320s.<sup>36</sup> These numbers highlight that in evaluating Airbus’s track record, it is important to take into account not only how many planes have been delivered, but also when they were delivered.

**172. At paragraphs 95 - 101 of its FWS, the United States describes “intergovernmental institutions” and “dedicated bureaucracies at the national level”. The Panel understands the United States to argue that these bodies evidence the institutional framework for the alleged “launch aid programme”. Could the EC please clarify the role and functions of these bodies? Could the EC indicate whether these bodies and bureaucracies are still in existence? If not, are there successor bodies in existence today which perform the same functions?**

Comment

18. The United States calls the Panel’s attention to the EC’s careful choice of words in responding to this question. The EC acknowledges the existence and functions of the

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<sup>31</sup> Airclaims CASE database, data query on September 14, 2007.

<sup>32</sup> See U.S. FWS, para. 221 and footnote 235.

<sup>33</sup> Airclaims CASE database, data query on September 14, 2007.

<sup>34</sup> See U.S. FWS, para. 245.

<sup>35</sup> Airclaims CASE database, data query on September 14, 2007.

<sup>36</sup> Airclaims CASE database, data query on September 14, 2007.

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intergovernmental institutions and dedicated national bureaucracies identified by the United States as evidence of the Launch Aid Program,<sup>37</sup> but it repeatedly asserts that these entities do not “provide,” “fix the terms of,” or “require” the provision of Launch Aid.<sup>38</sup> In steadfastly denying that these entities are responsible for making the ultimate, formal decisions regarding the provision of Launch Aid – a proposition the United States has never asserted – the EC both explicitly and implicitly admits the vital role these entities play in enabling the officials who are responsible for making the ultimate, formal decisions to do their job.

19. For example, the EC acknowledges that the dedicated bureaucracies identified by the United States “conduct analyses and make recommendations.”<sup>39</sup> The EC also acknowledges that the various fora in which Airbus government officials meet with Airbus officials on a regular basis over the course of a year give the governments the opportunity to:

- “solicit information from Airbus officials regarding the company’s financial status, sales financing, or technical developments;”<sup>40</sup>
- “work with Airbus GIE/SAS to allocate development work (known as ‘workshare’) with respect to specific LCA programmes;”<sup>41</sup> and
- “discuss . . . the company’s financial condition, the status of existing LCA programmes, and plans for future Airbus LCA.”<sup>42</sup>

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<sup>37</sup> The EC states that “many” of these entities “have no nexus whatsoever” to Launch Aid. EC Responses to Second Panel Questions, para. 17. However, of the four intergovernmental bodies and four dedicated national bureaucracies discussed in the EC’s response to Question 172, the only one alleged by the EC to have no nexus to Launch Aid is the Permanent Working Group for Sales Financing. *See id.*, para. 26.

<sup>38</sup> EC Responses to Second Panel Questions, para. 20; *see also id.*, para. 17 (“entities neither provide nor fix the terms of MSF loans”), para. 18 (“existence of these entities does not compel the provision of *new* loans”), para. 21 (“Member States do *not* in {the Airbus Intergovernmental} Committee discuss whether to provide MSF loans, or the terms of those loans”), para. 25 (“ministers neither discuss nor coordinate the provision of MSF loans, much less set the terms of those loans”), para. 28 (“‘dedicated bureaucracies’ do not provide MSF loans”) (underscoring added).

<sup>39</sup> EC Responses to Second Panel Questions, para. 28.

<sup>40</sup> EC Responses to Second Panel Questions, para. 21.

<sup>41</sup> EC Responses to Second Panel Questions, footnote 11.

<sup>42</sup> EC Responses to Second Panel Questions, para. 25.

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20. All of these functions facilitate the ultimate decisions by the Airbus governments to provide Launch Aid and on what terms. The possibility that (according to the EC) the national and intergovernmental entities performing these functions do not make the decisions themselves is irrelevant. Even if the EC were correct in its assertion, that would not undermine the fact that – as established by the United States and now confirmed by the EC – these entities provide the support necessary for the responsible officials to make those decisions.

21. The EC repeatedly asserts that in the various intergovernmental fora concerning Airbus, the provision and terms of Launch Aid are never discussed.<sup>43</sup> However, it is implausible that the governments and Airbus meet at least three times each year<sup>44</sup> to discuss matters including “the company’s financial status” but never discuss the provision of billions of Euros of government financing representing one-third of the cost of developing an LCA model.

22. But, again, even if the EC’s assertion were true, it would be irrelevant. The topics that the EC admits are discussed in these meetings are fundamental to the decision of each government whether to provide Launch Aid and on what terms. A good example of this is the topic of “workshare” – that is, the allocation of LCA development work among Germany, France, the United Kingdom, and Spain. It strains credulity for the EC to assert that Airbus’s coordination with the governments on the allocation of “workshare” has “no connection” to Launch Aid.<sup>45</sup> Indeed, this assertion is contradicted by the EC’s own admission (in its response to the Panel’s Question 219) of “the link” between [

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23. With respect to the national bureaucracies that administer the Launch Aid Program, the EC does not dispute the descriptions of the entities’ functions provided by the United States based on national government documents.<sup>47</sup> It merely alleges that the national bureaucracies also

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<sup>43</sup> See EC Responses to Second Panel Questions, paras. 21, 25.

<sup>44</sup> The EC states that the Airbus Intergovernmental Committee meets twice per year and that the Airbus Ministers Conference meets at the annual aircraft shows. EC Responses to Second Panel Questions, paras. 21, 25.

<sup>45</sup> EC Responses to Second Panel Questions, para. 23.

<sup>46</sup> EC Responses to Second Panel Questions, para. 546.

<sup>47</sup> See U.S. FWS, paras. 96-101; U.S. SNCOS, paras. 44-45; see also U.S. Responses to Second Panel Questions, para. 12.

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carry out other functions and that the number of personnel responsible for Launch Aid provided to Airbus is (in its view) small.<sup>48</sup>

24. In the EC's view, "the role of these 'bureaucrats' is no different than that of the 'dedicated' loan officers at a bank."<sup>49</sup> The EC also states that the personnel whose job it is to advise on the provision, administration, and monitoring of Airbus Launch Aid devote between 30 and 50 percent of their time to this task.<sup>50</sup> Certainly if a bank were to commit this much loan officer time to financing for a single borrower, it would be reasonable to find that the bank had a program with respect to that borrower. Based on the EC's own admissions, that is the conclusion the Panel should reach with respect to the Launch Aid Program.

25. The United States has addressed elsewhere other assertions the EC makes in its response to Question 172 (such as its erroneous view that isolated instances of Airbus not requesting or a government not providing Launch Aid demonstrate the absence of a program)<sup>51</sup> and will not repeat that discussion here. However, the United States does wish to emphasize that the EC continues to misrepresent the U.S. claim regarding the Launch Aid Program as an "as such" claim.<sup>52</sup> As the United States explained in its second non-confidential oral statement:

{I}ts claim focuses on the breach resulting from the Launch Aid Program itself. It is not a claim that focuses on something about a measure that mandates or necessarily results in a breach each time the measure is applied, which is the essence of what is referred to in WTO dispute settlement as an 'as such' claim.<sup>53</sup>

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<sup>48</sup> See EC Responses to Second Panel Questions, paras. 27-42.

<sup>49</sup> EC Responses to Second Panel Questions, para. 33.

<sup>50</sup> See EC Responses to Second Panel Questions, paras. 36, 39, 40, 42. The EC does not indicate the time devoted by the UK personnel responsible for Launch Aid for Airbus in terms of a percentage. Rather, it states that "the equivalent time of 1.4 staff members is spent on MSF loans for Airbus." *Id.*, para. 40. This appears to mean, in effect, that Launch Aid for Airbus occupies 100 percent of one staff person's time and 40 percent of another's.

<sup>51</sup> See EC Responses to Second Panel Questions, para. 18; U.S. Responses to First Panel Questions, paras. 25-41.

<sup>52</sup> Thus, for example, the EC states that "the existence of these entities {i.e., intergovernmental institutions and national bureaucracies administering the Launch Aid Program} does not compel the provision of *new* loans with respect to future programmes – much less on subsidized terms." EC Responses to Second Panel Questions, para. 18. The United States has not made a claim with respect to what the Launch Aid Program may "compel" in the future. It has made a claim regarding a breach of the SCM Agreement that currently is occurring by virtue of the existence of the Launch Aid Program. See U.S. SNCOS, paras. 34-38.

<sup>53</sup> U.S. SNCOS, para. 37 (citing *US – Corrosion-Resistant Steel Sunset Review (AB)*, para. 82).

26. As the U.S. claim is not an “as such” claim, the EC errs in insisting that the relevant “test” is based on what the Appellate Body has identified as “the criteria for bringing an ‘as such’ challenge.”<sup>54</sup> As discussed in the U.S. response to Question 136:

{E}stablishing that the Program is a measure should be based on the ordinary meaning of the term “measure” in context and in light of the object and purpose of the WTO Agreement.<sup>55</sup> In applying that standard, the Panel should consider the relevant evidence and draw logical conclusions from that evidence.<sup>56</sup>

27. The relevant evidence – including evidence of the intergovernmental institutions and national bureaucracies that administer Launch Aid – strongly supports the conclusion that the Launch Aid Program is a measure distinct from individual provisions of Launch Aid. The evidence of intergovernmental institutions and national bureaucracies, in particular, shows the Airbus governments’ consistent use of Launch Aid to support Airbus and, indeed, their intent to do so.<sup>57</sup> Accordingly, the EC’s dismissal of this evidence is not well founded.

**173. Could the EC please respond to the argument made by the United States at paragraph 34 of its SNCOS that the alleged “launch aid programme” is similar to measures challenged in the *Japan – Apples* and *EC – Biotech* disputes?**

Comment

28. The EC misunderstands the relevance of the references in paragraph 34 of the U.S. second non-confidential oral statement to the reports in *Japan – Apples* and *EC – Biotech*. In previous submissions and statements, the EC had confused two distinct concepts: (1) the concept of “measure,” and (2) the concept of an “as such” claim.<sup>58</sup> In its statement at the second meeting with the Panel, the United States took the opportunity to clarify the distinction between these two concepts, as well as the nature of its claim regarding the Launch Aid Program. The United States explained that its claim is that the Launch Aid Program is a measure distinct from individual grants of Launch Aid and that this measure currently is causing adverse effects to the interests of the United States, in breach of the EC’s obligations under Articles 5

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<sup>54</sup> *US – Zeroing (EC)* (AB), para. 203.

<sup>55</sup> *See Vienna Convention on the Law of Treaties*, Art. 31(1).

<sup>56</sup> U.S. Responses to Second Panel Questions, para. 3.

<sup>57</sup> *See* U.S. Responses to Second Panel Questions, paras. 9-16.

<sup>58</sup> *See* U.S. SNCOS, para. 33 (citing EC FWS, para. 343; EC FCOS, para. 2; EC SWS, para. 110).

and 6 of the SCM Agreement.<sup>59</sup> The United States cited *Japan – Apples* and *EC – Biotech* as examples of other disputes in which the measure challenged happened to consist of individual components that could themselves be considered measures. Those disputes illustrate that a challenge to such a measure does not necessarily equate to an “as such” challenge.

29. The EC, therefore, is incorrect in asserting that a comparison to the measures challenged in *Japan – Apples* and *EC – Biotech* is “{t}he only justification” the United States has given for challenging the Launch Aid Program as a measure distinct from individual grants of Launch Aid.<sup>60</sup> The comparison to those prior disputes is not a “justification.” It is an illustration of a distinction that the EC evidently has misapprehended. The “justification” for the U.S. position is that the Launch Aid Program is a “measure” within the ordinary meaning of that term in context and in light of the object and purpose of the WTO Agreement; that this measure is itself a subsidy within the meaning of Article 1 of the SCM Agreement; and that it is causing adverse effects to the interests of the United States by enabling Airbus to launch new aircraft more quickly and simultaneously reduce prices to gain market share.<sup>61</sup>

30. The EC states that it has “accepted” the U.S. clarification of the nature of its claim.<sup>62</sup> Nevertheless, in identifying the factors it believes must be shown in order to establish that the Launch Aid Program is a measure, the EC reverts to what the Appellate Body called “the criteria for bringing an ‘as such’ challenge.”<sup>63</sup> As discussed in the U.S. response to the Panel’s Question 136 and in the U.S. comment on the EC’s response to Question 172, above, the EC simply has misidentified the relevant standard.

31. The EC’s assertion that “{t}he United States itself has acknowledged the need to satisfy these criteria”<sup>64</sup> is wrong. In particular, the EC ignores the introduction to the portion of the U.S. oral statement at issue, wherein the United States explained:

The EC contends that the United States has not shown the precise content of the Launch Aid Program or that the measure is one of general and prospective application. Even

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<sup>59</sup> See U.S. SNCOS, paras. 34-38.

<sup>60</sup> EC Responses to Second Panel Questions, para. 44.

<sup>61</sup> See U.S. SNCOS, paras. 36-37; U.S. Responses to Second Panel Questions, paras. 1-8.

<sup>62</sup> EC Responses to Second Panel Questions, para. 51.

<sup>63</sup> *US – Zeroing (EC)* (AB), para. 203; see EC Responses to Second Panel Questions, para. 49.

<sup>64</sup> EC Responses to Second Panel Questions, para. 50.

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assuming that we needed to show these elements to establish that the Launch Aid Program is a measure, the EC is wrong on both counts.<sup>65</sup>

32. In other words, in the discussion that followed, the United States plainly assumed, *arguendo*, that the standard for establishing that the Launch Aid Program is a measure is the standard as described by the EC. This was by no means a concession that the EC had identified the correct standard, as further explained in the U.S. response to the Panel’s Question 136.

33. Moreover, the EC deepens its obfuscation of the issue at hand by now trying to characterize the U.S. claim regarding the Launch Aid Program as an “as applied” claim.<sup>66</sup> The EC seems to assume that if the U.S. challenge to the Launch Aid Program is not an “as such” challenge it must be an “as applied” challenge. However, there is no basis for this assumption. There is no requirement in WTO dispute settlement that every claim be classified as either “as such” or “as applied.”<sup>67</sup> The *EC – Biotech* dispute, for example, involved a challenge to a moratorium that was not classified as either “as such” or “as applied.” In that dispute, as in this one, what is relevant is that a measure exists, and that the measure breaches covered agreement obligations.

34. Having erroneously labeled the U.S. claim an “as applied” claim, the EC then speculates as to the “potential remedies” if the Panel upholds this claim and as to the reasons of the United States for challenging the Launch Aid Program as a measure.<sup>68</sup> The EC appears to believe that finding the Launch Aid Program (as distinct from individual grants of Launch Aid) to be a measure in breach of the EC’s SCM Agreement obligations will not affect the “potential remedies.”<sup>69</sup> However, that is incorrect. As one option under Article 7.8 of the SCM Agreement is for the Member to “withdraw the subsidy,” the identity of the measures found to constitute specific subsidies that are causing adverse effects necessarily affects the range of options available to the Member.<sup>70</sup>

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<sup>65</sup> U.S. SNCOS, para. 39 (emphasis added).

<sup>66</sup> See EC Responses to Second Panel Questions, para. 52.

<sup>67</sup> See *EC – Customs Matters (AB)*, paras. 165-167.

<sup>68</sup> See EC Responses to Second Panel Questions, paras. 52-53.

<sup>69</sup> EC Responses to Second Panel Questions, para. 52.

<sup>70</sup> In any event, the question of what the EC refers to as “remedies” is premature. The United States would expect the EC to state its intentions on what to do in response to a panel report only after the report is adopted, pursuant to Article 21.3 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (“DSU”). The Panel should not be drawn into prejudging the EC’s response.



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35. Equally incorrect is the EC's speculation that the United States has challenged the Launch Aid Program in order "to link {individual grants of Launch Aid} together sufficiently as to claim that their alleged adverse effects can be considered globally."<sup>71</sup> First, the cumulative effect of individual grants of Launch Aid does not depend on the status of the Launch Aid Program as a measure.<sup>72</sup> Second, as explained in the U.S. response to the Panel's Question 138: "Given that the Airbus governments have in fact provided Launch Aid as part of a coordinated program, the United States believes that findings with respect to the Launch Aid Program, as well as individual grants of Launch Aid, would facilitate the resolution of this dispute."<sup>73</sup>

36. When it comes to discussing the panel reports in *Japan – Apples* and *EC – Biotech*, the EC focuses on factual differences that it believes distinguish the measures at issue in those disputes from the Launch Aid Program at issue in this dispute.<sup>74</sup> In so doing, the EC tries to read the reports as confirming what it believes to be the "test" for determining the existence of a measure. In fact, these reports confirm that in determining the existence of a measure, a panel should consider all of the evidence, draw logical conclusions from the evidence, and make findings based on the ordinary meaning of the term "measure" in context and in light of the object and purpose of the covered agreement.<sup>75</sup> In short, the Panel should apply the rules of treaty interpretation to which DSU Article 3.2 refers, and then should make an objective assessment of the question whether the measure exists, as Article 11 contemplates. Neither the DSU nor the panel reports in *Japan - Apples* and *EC - Biotech* support the existence of any other "test."

37. Moreover, the EC repeats assertions regarding characteristics of Launch Aid that, in its view, cause the Launch Aid Program to lack precise content and general and prospective application. The EC's response to Question 173 echoes the mantra it articulated in its oral statement at the first Panel meeting: that Launch Aid is not "monolithic."<sup>76</sup> In previous submissions and statements, the United States has shown this argument to be beside the point. The Panel need not find the provision of Launch Aid to be "monolithic" in order to find that the

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<sup>71</sup> EC Responses to Second Panel Questions, para. 53.

<sup>72</sup> See U.S. Responses to Second Panel Questions, para. 21.

<sup>73</sup> See U.S. Responses to Second Panel Questions, para. 17.

<sup>74</sup> See EC Responses to Second Panel Questions, paras. 55-63.

<sup>75</sup> See U.S. Responses to Second Panel Questions, para. 5 (discussing *EC – Biotech*, paras. 7.1271-7.1272).

<sup>76</sup> EC First Non-Confidential Oral Statement ("FNCOS"), para. 10.

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Launch Aid Program is a measure in breach of the EC's SCM Agreement obligations. The existence of the Launch Aid Program is not undermined by differences in particular terms from one Launch Aid contract to another or by the absence of a request for, or provision of, Launch Aid in an isolated instance.<sup>77</sup>

38. As the Panel is by now quite familiar with these arguments, the United States will not repeat them here. However, the United States will correct two particular assertions by the EC. First, the EC states that there is no "generally applicable decision" regarding the provision of Launch Aid comparable to the decision the panel found to exist in *EC – Biotech*.<sup>78</sup> That is incorrect. As the United States has demonstrated, the Airbus governments have consistently made clear that, in the words of former French Prime Minister de Villepin, "the State will fully play its part"<sup>79</sup> in the long-term success of EADS and Airbus.<sup>80</sup> The repeated affirmations by the Airbus governments of their commitment to support Airbus, primarily through the provision of Launch Aid, have given rise to an "expectation for continuing government support"<sup>81</sup> among market participants, corroborating the existence of a "generally applicable decision."<sup>82</sup>

39. Second, the EC misrepresents the United States as conceding that the "structural features" that make Launch Aid distinctive "are available in market financing instruments."<sup>83</sup> The United States has not and does not make any such concession. The EC's assertion to the contrary is based on paragraph 103 of the U.S. second written submission. There, the United States pointed out the EC's failure to address numerous distinctions between Launch Aid and the one and only market financing instrument the EC alleges to be comparable to Launch Aid – the

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<sup>77</sup> See U.S. Responses to First Panel Questions, paras. 25-41; U.S. SNCOS, paras. 39-52; U.S. SCOS, paras. 8-11; U.S. Responses to Second Panel Questions, paras. 9-16.

<sup>78</sup> EC Responses to Second Panel Questions, para. 61.

<sup>79</sup> Gil Bousquet and Jean-Pierre Bédéï, *Interview: de Villepin: "I will remain vigilant"*, La Dépêche du Midi (Nov. 14, 2006) (Exhibit US-638) (quoted at U.S. SNCOS, para. 48).

<sup>80</sup> See U.S. FWS, para. 102 (discussing statements by heads of state and government and cabinet officials consistently expressing commitment to support Airbus through Launch Aid).

<sup>81</sup> Press Release, *Moody's Assigns A3 Rating to New Euro Mtn Program of European Aeronautic Defence and Space Company EADS N.V.*, Moody's Investor Service (Feb. 6, 2003) (Exhibit US-56); see also Pierre de Bassuet, *EADS Aero-Notes* at 2 (Aug. 17, 2007) (EADS Head of Investor Relations and Financial Communication recognizing that Moody's "assumes an implicit support of EADS's home countries") (Exhibit US-662).

<sup>82</sup> See, e.g., U.S. Responses to Second Panel Questions, paras. 9-16; U.S. Comment on EC Response to Question 172, *supra*.

<sup>83</sup> EC Responses to Second Panel Questions, para. 61, fourth bullet point.

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contract between [ ]. In doing so, the United States corrected yet another EC mischaracterization of a U.S. argument. Specifically, the United States explained:

{The EC} asserts that [ ]<sup>84</sup> The EC provides no citation for this ‘US suggestion,’ which is not surprising, because the United States has not made that suggestion. The point the United States is making is not that success-dependent financing is inherently non-commercial but that, given the risks associated with Launch Aid, the one example of commercial, success-dependent financing the EC has called to the Panel’s attention is not ‘comparable’ to Launch Aid.<sup>85</sup>

40. In other words, the passage the EC cites did not deal with “structural features” of Launch Aid. It mentioned one such feature, success dependency, only for purposes of pointing out that the EC was addressing an argument the United States had not made. It did not mention other “structural features,” such as the unsecured or back-loaded nature of Launch Aid financing, at all. And, to the extent this passage mentioned success dependency, it did not concede success dependency of the Launch Aid variety to be “available in market financing instruments” or even in the one market financing instrument identified by the EC.

41. Quite the contrary. When the passage cited by the EC is read together with the immediately preceding paragraph, it is evident that under the [ ] contract, success dependency is qualified in a way that it is not under Launch Aid contracts. Notably, the [ ] contract contained a [ ] whereby [ ]<sup>86</sup> Also, the [ ] contract provides for a [ ]

<sup>87</sup> And, the [ ] contract was structured to reach full repayment by [ ] in [ ]

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<sup>84</sup> EC Responses to First Panel Questions, para. 67.

<sup>85</sup> U.S. SWS, para. 103.

<sup>86</sup> [ ] Loan Agreement, Art. 18.3(a) (Exhibit EC-113 (BCI)) (cited in U.S. SWS, para. 102, fifth bullet point).

<sup>87</sup> [ ] Loan Agreement, Art. 7.2(a) (Exhibit EC-113 (BCI)) (cited in U.S. SWS, para. 102, seventh bullet point).

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contrast to the French and Spanish Launch Aid contracts, which anticipated repayment over [ ]<sup>88</sup>

42. Thus, far from supporting the EC's contention that "the structural features of {Launch Aid} . . . are irrelevant"<sup>89</sup> to a demonstration that the Launch Aid Program is a measure, the passage from the U.S. second written submission cited by the EC, when read in context, highlights that these features are indeed distinctive. The EC's one attempt to show that the "structural features" of Launch Aid are commonplace in the market showed just the opposite. Accordingly, the consistent provision to Airbus of financing with Launch Aid's distinctive features demonstrates the precise content of the Launch Aid Program and thus supports the demonstration that the Launch Aid Program is a measure.<sup>90</sup>

**174. Could the EC please respond to the argument advanced by Brazil at para. 11 of its third party oral statement that subsidies for the underlying project distort the terms and conditions for risk sharing suppliers such that they cannot be considered appropriate as an element in determining a commercial benchmark for assessing the question of benefit with respect to LA / MSF?**

Comment

43. The EC's criticism of Brazil's argument concerning the unreliability of the EC's risk-sharing supplier ("RSS") benchmark is baseless.

44. First, the Panel should recall that the EC has provided only the most scant evidence to support its RSS benchmark. Specifically, it has provided only five pages from a single contract between one supplier and Airbus. It is, therefore, disingenuous for the EC to accuse Brazil and the United States of not adducing sufficient evidence to demonstrate the unreliability of the RSS benchmark.<sup>91</sup> As it is the EC that is asserting that the RSS benchmark is more appropriate than

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<sup>88</sup> [ ] Loan Agreement, Art. 1 (definition of "Margin") and Art. 10.1 (interest rate is aggregate of applicable Margin, LIBOR, and "Mandatory Cost, if applicable") (Exhibit EC-113 (BCI)); A340-500/600 Protocol, Art. 6.2, DS316-EC-BCI-0000276 (Exhibit US-35 (BCI)); Spanish A340-500/600 Agreement, DS316-EC-BCI-0000534, at 6 ("Quinta") (Exhibit US-37(BCI)) (cited in U.S. SWS, para. 102, eighth bullet point).

<sup>89</sup> EC Responses to Second Panel Questions, para. 61, fourth bullet point.

<sup>90</sup> See U.S. Responses to First Panel Questions, para. 27.

<sup>91</sup> See EC Responses to Second Panel Questions, para. 65.

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the U.S.-proposed benchmark for purposes of a benefit analysis, it is for the EC to substantiate that assertion,<sup>92</sup> which it has not done.

45. Second, there is no basis for the EC's assertion of evidentiary tests that must be met for Brazil's argument to succeed. The point of Brazil's argument (which the United States adopts for purposes of this dispute and with which Australia agrees<sup>93</sup>) is that there is reason to doubt the validity of the EC's proposed benchmark. This is because the return on financing that suppliers demand from Airbus will be influenced by Airbus's risk profile, which in turn is influenced by Airbus's consistent receipt of Launch Aid. This is a logical proposition which the Panel should take into account in its consideration of the RSS benchmark. Contrary to the EC's suggestion, the strength of that proposition does not depend on evidence of the internal decision-making processes of particular suppliers.

46. Third, and relatedly, whether suppliers knew the details of individual Launch Aid contracts for the A380 when they agreed to provide financing to Airbus is not relevant.<sup>94</sup> What is relevant is that suppliers knew that Airbus routinely receives Launch Aid to support the launch of LCA models and that Launch Aid helps reduce the risk associated with an LCA launch. As credit rating agency reports show, what matters in evaluating Airbus's risk profile is “{the} expectation for continuing government support, which is primarily in the form of refundable advances for up to 1/3 of the development cost of each new aircraft program at the Airbus level.”<sup>95</sup> Just as rating agencies' evaluations are influenced by “{the} expectation for continuing government support” without knowing the details of particular Launch Aid contracts,<sup>96</sup> so, too, Airbus's suppliers would be influenced by that expectation (an expectation that, indeed, Airbus itself readily acknowledges).<sup>97</sup>

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<sup>92</sup> See *US - Wool Shirts (AB)*, p. 14 (“the party who asserts a fact, whether the claimant or the respondent, is responsible for providing proof thereof”).

<sup>93</sup> See U.S. Comments on EC SNCOS, para. 27; Australia Responses to Panel Questions to Third Parties, p. 1.

<sup>94</sup> See EC Responses to Second Panel Questions, para. 66.

<sup>95</sup> Press Release, *Moody's Assigns A3 Rating to New Euro Mtn Program of European Aeronautic Defence and Space Company EADS N.V.*, Moody's Investor Service (Feb. 6, 2003) (Exhibit US-56); see also U.S. Responses to Second Panel Questions, para. 15.

<sup>96</sup> See U.S. SNCOS, para. 46.

<sup>97</sup> See Pierre de Bassuet, *EADS Aero-Notes* at 2 (Aug. 17, 2007) (EADS Head of Investor Relations and Financial Communication recognizing that Moody's “assumes an implicit support of EADS's home countries”) (Exhibit US-662).

47. In contrast, there is absolutely no basis for the EC's view that risk-sharing suppliers would have been influenced by an October 2004 Citigroup report opining on the amount of subsidy associated with Launch Aid.<sup>98</sup> Unlike credit rating agencies, Citigroup was not purporting to evaluate the effects of Launch Aid on Airbus's risk profile. Rather, Citigroup was opining on how the eventual removal of Launch Aid would affect the share price of EADS relative to the effects of other factors, such as "civil aircraft supply and demand."<sup>99</sup> To the extent Citigroup's financial analysts (with no apparent expertise in law or in the SCM Agreement) offered opinions about the present dispute, there is no reason risk-sharing suppliers would have credited those opinions.

48. Finally, the United States takes this opportunity to comment on Canada's response to the Panel's Question 1 to the third parties, which is similar to the Panel's Question 174 to the EC. Canada first asserts that "{t}he approach advanced by Brazil is not supported by the text of the SCM Agreement."<sup>100</sup> However, Brazil has not advanced an "approach" that must be "supported by the text of the SCM Agreement." Rather, it has advanced a legitimate criticism of the "approach" the EC has proposed for analyzing the benefit conferred by Launch Aid for purposes of Article 1.1(b) of the SCM Agreement. It is the EC that must demonstrate that its proposed approach is preferable to that proposed by the United States for analyzing the benefit conferred by Launch Aid. Brazil has identified an important reason why it is not.

49. Canada then asserts that "{i}f followed," what it calls Brazil's "approach" "would leave WTO Members with little, if any, guidance as to how they should benchmark public sector financing if they wish to ensure it does not provide a subsidy."<sup>101</sup> It is unclear why Canada believes that accepting Brazil's criticism of the EC's proposed benchmark for analyzing the benefit conferred by a financial contribution at issue in this dispute would somehow prejudice the ability of WTO Members to understand their rights and obligations under the SCM Agreement. In any event, to the extent Canada has identified a theoretical problem (a proposition the United States does not accept, as it views the SCM Agreement as clear), it is a problem that should be laid at the EC's door, not Brazil's; it is the EC that proposes flawed

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<sup>98</sup> See EC Responses to Second Panel Questions, para. 67. The EC asserts that the Citigroup report (Exhibit EC-875) represents "the commonly-held view" regarding the amount of subsidy provided by Launch Aid. However, the EC offers no evidence to support that assertion.

<sup>99</sup> See Citigroup, *EADS: Off we go to the WTO*, 6 October 2004, at 1 (Exhibit EC-875).

<sup>100</sup> Canada Responses to Panel Questions to Third Parties, para. 1.

<sup>101</sup> Canada Responses to Panel Questions to Third Parties, para. 1.

guidance, and Brazil is merely attempting to advance the analysis by pointing out why that guidance is not one that can or should be followed.

50. Canada seeks to support its disagreement with Brazil's argument by referring to the report of the Appellate Body in *US – Softwood Lumber CVD Final*.<sup>102</sup> However, the Appellate Body's findings in that dispute actually support Brazil's argument, inasmuch as they recognize that it may be inappropriate to use a particular benchmark for purposes of a benefit analysis where that benchmark is distorted by the very government actions that are in dispute.<sup>103</sup>

51. In conclusion, Brazil identified a further reason – in addition to those previously discussed by the United States – for rejecting the EC's RSS benchmark. The EC responds by asserting that Brazil's argument fails to meet certain alleged evidentiary tests and by citing an irrelevant financial analyst's report. However, the EC fails to address the straightforward and compelling logic of Brazil's point. Accordingly, for this further reason, the Panel should reject the EC's RSS benchmark as the basis for analyzing the benefit conferred by Launch Aid.

52. The United States also refers the Panel to its comment on the EC's response to Question 215 (including as set forth in the HSBI Appendix to this submission), which discusses additional reasons to reject the EC's proposed benchmark.

## **B. PROHIBITED EXPORT SUBSIDIES**

**175. Is it the EC's view that a subsidy which is *de jure* export contingent is not subject to the disciplines of the SCM Agreement if no qualifying exports ever occur? If not, could the EC explain the apparent contradiction with its view that "an export may be "actual or anticipated", that is, it may occur before or after the initial grant"? (EC SNCOS, heading between paragraphs 140 and 141).**

### Comment

53. The EC's response to this question highlights two fatal flaws in its understanding of Article 3.1(a) and footnote 4 of the SCM Agreement: (1) its view that exportation is "anticipated" only if it "will occur" (but not if it is "expected" to occur), and (2) its disregard of the term "tied to."

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<sup>102</sup> Canada Responses to Panel Questions to Third Parties, para. 2.

<sup>103</sup> See *US – Softwood Lumber CVD Final (AB)*, para. 103.

54. Preliminarily, the Panel should note that in answering this question, the EC obfuscates the issue by first focusing on “a measure providing for the grant of a subsidy contingent in law upon export performance”<sup>104</sup> and then shifting its focus to an actual subsidy contingent in law upon export performance. By “a measure providing for the grant of a subsidy contingent in law upon export performance,” the EC appears to have in mind a measure, such as a law, setting out conditions for the granting of a subsidy. It is this measure that the EC says is subject to SCM Agreement disciplines even if no export occurs. However, with respect to the subsidy itself, the EC maintains its unsupported view that a subsidy is contingent upon export performance only if exportation has occurred or will occur, but not if provision of the subsidy is tied to exportation expected to occur.

55. The United States previously has explained that the EC’s approach conflates the terms “actual” and “anticipated.” The ordinary meaning of “anticipated” (in Spanish, “previstos,” and in French, “prévues”) is “expected.” An event that is “anticipated” or “expected” may occur, but need not necessarily occur.<sup>105</sup> The EC’s insistence that exportation or export earnings must occur in order to be “anticipated” within the meaning of footnote 4 is contrary to the ordinary meaning of “anticipated” in context and in light of the object and purpose of the SCM Agreement. The EC’s acknowledgment that “a measure providing for the grant of a subsidy contingent upon export performance” – as distinct from the subsidy itself – is subject to the SCM Agreement even if no qualifying exports ever occur does not cure the EC’s fundamental misinterpretation of the term “anticipated exportation.”

56. In fact, the EC’s answer to Question 175 serves to underscore the fundamental problems with its analysis. In particular, the EC’s understanding of “anticipated exportation” as exportation that “will occur”<sup>106</sup> leads it to hypothesize a two-step approach to the granting of a subsidy that is tied to anticipated exportation. First, according to the EC, there is an “initial grant,” which occurs “{a}t the moment when the measure is enacted.”<sup>107</sup> This “initial grant” is then followed by a “completing {of} the grant” which, the EC asserts, occurs when “an export does take place.”<sup>108</sup> At that point, the EC contends, “the company obtains the right to

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<sup>104</sup> EC Responses to Second Panel Questions, para. 70 (emphasis added).

<sup>105</sup> See, e.g., U.S. SNCOS, paras. 14-17; Australia Third Party Oral Statement, paras. 18-19; Brazil Third Party Oral Statement, paras. 15-16.

<sup>106</sup> EC SWS, para. 238; see also *id.*, para. 245; EC SNCOS, para. 142.

<sup>107</sup> EC Responses to Second Panel Questions, para. 71.

<sup>108</sup> EC Responses to Second Panel Questions, para. 72.



*unconditionally* keep {the funds}.”<sup>109</sup> This understanding of what it means for the grant of a subsidy to be tied to anticipated exportation is deeply flawed for several reasons.

57. First, neither Article 3.1(a) nor footnote 4 of the SCM Agreement contemplates the granting of a subsidy being a two-step process. Footnote 4 refers to “the granting of a subsidy.” It does not refer to an “initial grant” followed by a “completing {of} the grant.” Nor does the ordinary meaning of “granting” imply a two-step process.<sup>110</sup> An “initial grant” followed by a “completing {of} the grant” is simply a concept the EC invents to explain its theory of what it means for the granting of a subsidy to be tied to anticipated exportation.

58. The EC evidently recognizes that the reference in footnote 4 to “the granting of a subsidy . . . tied to . . . anticipated exportation” means that a subsidy covered by Article 3.1(a) and footnote 4 can be granted in advance of any exportation occurring. But, to reconcile this fact with its belief that “anticipated exportation” is exportation that “will occur,” the EC is forced to invent a second step to establish a consequence when exportation does or does not occur. As Australia put it, the EC’s approach “requires an analysis after the fact.”<sup>111</sup> In a vain attempt to characterize this second step as encompassed by the text of the SCM Agreement, the EC refers to it as “completing the grant.” However, what the EC calls “completing the grant” – *i.e.*, providing the subsidy after the occurrence of exportation, or transforming a previously provided but conditional subsidy into an unconditional subsidy upon the occurrence of exportation – really means granting a subsidy tied to actual exportation.<sup>112</sup>

59. Second, the EC’s description of the step that supposedly “complet{es} the grant” is quite telling. In the EC’s view, if the government provides funds to a company prior to an exportation taking place, there is an export contingent subsidy only if the occurrence of exportation triggers “the right to *unconditionally* keep {the} funds.”<sup>113</sup> Following this logic, if there is no exportation, then the company must not “obtain{} the right to *unconditionally* keep funds previously transferred.” In that case, according to the EC’s argument, the company presumably

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<sup>109</sup> EC Responses to Second Panel Questions, para. 72 (emphasis in original).

<sup>110</sup> See *New Shorter Oxford English Dictionary*, vol. 1, p. 1131 (1993) (defining “grant,” as relevant here, to mean, “Give or confer (a possession, a right, etc.) formally; transfer (property) legally”).

<sup>111</sup> Australia Third Party Oral Statement, para. 19.

<sup>112</sup> See Australia Third Party Oral Statement, para. 19 (“{EC’s interpretation} means that ‘anticipated exportation’ would in reality be ‘actual exportation.’”).

<sup>113</sup> EC Responses to Second Panel Questions, para. 72.

would be penalized by having to return the funds. But, this is precisely the argument the panel rejected in *Canada – Aircraft*. As that panel explained:

Canada argues that there are no penalties if export sales are not realised. While this argument may be relevant in determining whether a subsidy would not have been granted but for actual exportation or export earnings, we find this argument insufficient to rebut a *prima facie* case that a subsidy would not have been granted but for anticipated exportation or export earnings.<sup>114</sup>

60. Similarly, in *Australia – Leather*, the panel found subsidy grants to be tied to anticipated exportation even though the Howe company’s right to keep those grants was unconditional prior to exportation occurring. Thus, as the United States previously has explained, Australia’s first payment to Howe was made at contract signing, before any exportation had occurred, and its last payment was made in mid-1998, even though the grant contract set sales performance targets for Howe through the end of 2000.<sup>115</sup>

61. Third, the EC’s theory of the two steps involved in the granting of a subsidy tied to anticipated exportation amounts to a different legal standard for *de jure* export contingency and *de facto* export contingency, even though the EC previously has acknowledged (referring to the Appellate Body report in *Canada – Aircraft*) that “{t}he legal standard is the same for both in law and in fact claims, although the evidence may be different.”<sup>116</sup> The EC asserts that “if there is a subsidy contingent in law upon export, it is prohibited, and this already from the moment of initial grant.”<sup>117</sup> However, following the EC’s reasoning, a subsidy contingent in fact upon export performance – in particular, a subsidy tied to anticipated exportation or export earnings – would be prohibited only on the basis of the “completing {of} the grant.” This is because it would be impossible to determine, solely on the basis of what the EC calls the “initial grant,” whether any consequence will flow from the occurrence or non-occurrence of exportation; therefore, it would be impossible to determine whether the subsidy is, in fact, tied to exportation that “will occur.”

62. By contrast, an interpretation of “anticipated exportation” according to its ordinary meaning, in context, and in light of the object and purpose of the SCM Agreement is consistent

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<sup>114</sup> *Canada – Aircraft (Panel)*, para. 9.343 (first emphasis added; other emphases in original).

<sup>115</sup> See U.S. SNCOS, para. 24 (discussing *Australia – Leather*, para. 9.62).

<sup>116</sup> EC FWS, para. 606 (citing *Canada – Aircraft (AB)*, para. 167); see also EC Responses to Second Panel Questions, para. 521.

<sup>117</sup> EC Responses to Second Panel Questions, para. 71 (emphasis in original).

with a single legal standard for *de jure* and *de facto* export contingency. Following that interpretation, there simply is a “granting of a subsidy” – not an initial, conditional grant followed by a “completing” of the grant, whereby the grant is made unconditional. Based on the granting of a subsidy, the subsidy may be found to be contingent, either in law or in fact, upon export performance. At that point, it is possible to determine whether the granting of the subsidy is tied to “anticipated exportation” – *i.e.*, exportation that is “expected”<sup>118</sup> – whether as a matter of law or as a matter of fact. There is no need to wait for the subsequent occurrence or non-occurrence of exportation to determine whether the subsidy is in fact tied to exportation that “will occur.”

63. In short, the inconsistency of the EC’s two-step approach to the granting of a subsidy tied to anticipated exportation with the single legal standard for *de jure* and *de facto* export contingency is an additional reason for the Panel to reject that approach.

64. Finally, not only does the EC invent new, non-text based concepts in an effort to explain its understanding of “anticipated exportation,” it also does so in its attempt to justify its understanding of “contingent upon.” The text is quite clear in providing that a subsidy is contingent upon export performance if it is “tied to actual or anticipated exportation or export earnings.”<sup>119</sup> Nevertheless, the EC continues to develop new tests for determining whether a subsidy is contingent upon export performance. In its first submission, the EC stated that for a contingent relationship to exist, a subsidy must follow as a “consequence” of exportation.<sup>120</sup> In response, the United States explained that the SCM Agreement does not use the term “consequence,” and that equating “contingent upon” with “consequence of” would be inconsistent with the Agreement’s recognition that a subsidy contingent upon export performance may be tied to anticipated exportation.<sup>121</sup>

65. In its response to Question 175, the EC does not address these points or similar points raised by third parties.<sup>122</sup> Instead, it invents yet another concept with no basis in the SCM Agreement (or in the English language, for that matter). It asserts that for a subsidy to be contingent upon export performance, the granting of the subsidy must be connected to

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<sup>118</sup> *Canada – Aircraft (AB)*, para. 172.

<sup>119</sup> SCM Agreement, footnote 4 (emphasis added).

<sup>120</sup> *See* EC FWS, paras. 578-579.

<sup>121</sup> *See* U.S. SWS, paras. 151-160; U.S. Comments on EC SNCOS, para. 17.

<sup>122</sup> *See* Australia Third Party Submission, paras. 32-33; Australia Third Party Oral Statement, para. 15; Brazil Third Party Oral Statement, para. 15.

exportation by what it calls “ifness.”<sup>123</sup> However, like “consequence,” “ifness” is not a term used in Article 3.1(a) or footnote 4 of the SCM Agreement. As the EC’s understanding of the term “contingent upon” has no basis in the SCM Agreement, it must be rejected.

### C. EIB LOANS

**176. At paras 1081-1089, the EC identifies numerous “obligations” that it argues recipients of EIB financing may have to comply with that are not faced by recipients of financing from commercial lenders. Please identify the extent to which any such costs actually formed part of the loan contracts challenged by the United States.**

#### Comment

66. As in the case of Launch Aid, the EC seeks to minimize the benefit that EIB loans confer on Airbus by referring to various “costs/obligations” alleged to be associated with EIB financing but not with comparable market financing. Also as in the case of Launch Aid, the EC fails to meet its burden of proof. Once the United States established its *prima facie* case that EIB loans confer a benefit on Airbus, it became the EC’s burden to demonstrate that “no ‘benefit’ is conferred, in the sense that the terms of the contribution provide for a commercial rate of return.”<sup>124</sup> It is not enough for the EC simply to question the amount of benefit conferred by EIB loans.

67. Yet, questioning the amount of benefit conferred is all that the EC does with respect to the one category of “costs/obligations” that it seeks to quantify (*i.e.*, so-called “finance-related project costs/obligations”).<sup>125</sup> The EC asserts that due to the lower level of risk associated with the EIB’s project-specific loans as compared with corporate bonds, a bond-based benchmark should be reduced by 6.5 basis points. However, when it makes that adjustment to its proposed benchmarks, it still comes up with a benefit in two out of three cases.<sup>126</sup> Moreover, applying the

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<sup>123</sup> EC Responses to Second Panel Questions, para. 73.

<sup>124</sup> *Canada – Aircraft (Panel)*, para. 9.312.

<sup>125</sup> See EC Responses to Second Panel Questions, paras. 77-84.

<sup>126</sup> See EC Responses to Second Panel Questions, paras. 81-83. The EC’s approach of averaging the resulting benefits under each of its proposed benchmarks is not relevant, as the average derives from four random benchmarks that the EC itself has selected. The EC has not established that any of these four benchmarks is representative.

same adjustment to the benchmark established by NERA results in a benefit of at least [ ] basis points from the EIB loans.<sup>127</sup>

68. Evidently recognizing that it has not met its burden by referring to “finance-related project costs/obligations,” the EC asks the Panel to take account of certain other “costs/obligations.” The EC fails to substantiate the impact of these alleged “costs/obligations,” and for this reason alone, it has failed to meet its burden of proof.<sup>128</sup> But, even if the EC had tried to substantiate their impact, they would have no bearing on an analysis of the benefit conferred by the EIB loans.

69. In responding to a similar EC argument regarding alleged burdens associated with Launch Aid, the United States pointed out that taking account of unquantifiable “additional obligations” (such as reporting requirements and the tasks associated with applying for Launch Aid) would make a benefit analysis virtually impossible.<sup>129</sup> The same is true with respect to the EIB loans. How, for example, would one compare the burden associated with applying for EIB loans with the burden (including the efforts of lawyers, bankers, and others) associated with obtaining financing from the market? Or, to take another example, how would one compare project-specific “costs/obligations” identified by the EC with the “costs/obligations” of a borrower having dedicated personnel to maintain relations with investment banks for purposes of regular bond issuances? Engaging in the exercise that the EC proposes would be entirely speculative.

70. Furthermore, while the EC lists certain features of EIB loans that it refers to as “additional project costs/obligations,” it merely asserts that these features “would not normally be present” in the instruments referred to by the United States and the EC as market benchmarks. It bases this assertion on the supposition that “those instruments were made for ‘general corporate purposes’ and were not project specific.”<sup>130</sup> However, the EC does not undertake to compare actual “costs/obligations” under individual EIB loans to actual “costs/obligations” under comparable commercial financing. Therefore, once again, the EC has failed to meet its burden of proof.

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<sup>127</sup> For the 2002 EIB loan to EADS, NERA established a benchmark rate of 5.68 percent, as compared to a rate of [ ] percent on the loan. See NERA, *The EIB Loans to Airbus*, pp. 5-7 (Exhibit US-542 (BCI)). With the EC’s proposed 6.5 basis points adjustment, the benchmark rate would still be 5.615 percent.

<sup>128</sup> See U.S. SNCOS, para. 122.

<sup>129</sup> See U.S. Responses to Second Panel Questions, para. 28; see also U.S. Comment on EC Response to Question 170, *supra*.

<sup>130</sup> EC Responses to Second Panel Questions, para. 76.

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71. In fact, consideration of the costs a company incurs in issuing bonds or raising capital through other market channels undercuts the EC's unsubstantiated assertion that such costs must be lower than the "costs/obligations" particular to EIB loans (indeed, according to the EC, so much lower as to negate any benefit from such loans). For example, Boeing estimates that on a \$1 billion bond issuance it spends between \$10 and \$20 million (*i.e.*, between 1 and 2 percent) on investment bank fees, regulatory agency fees, and related fees alone. In addition, it incurs costs related to maintaining its credit rating (including rating agency fees) and maintaining compliance with securities regulations, as well as costs associated with employees engaged on an ongoing basis in activities related to borrowing, credit rating issues, and investment bank and investor relations. Also, as pointed out in NERA's EIB Loans to Airbus report, a 2003 study of several thousand issues showed total costs ranging from 0.475 percent to 1.75 percent for bond offerings and even higher for other types of commercial financing.<sup>131</sup>

72. Finally, the EC asserts that "{t}he main administrative cost faced by a borrower taking an EIB loan is time."<sup>132</sup> In particular, the EC contends that a long time elapsed from EADS's initial approach to the EIB for A380 financing to actual disbursement under the loan, and that this factor ought to be taken into account in a benefit analysis.<sup>133</sup> However, the EC ignores that the time from application to disbursement is a function of factors such as when the loan was requested (at the very beginning of the A380 development process, when Airbus was starting to incur high up-front development costs, and any lender would have had to carefully consider lending to the company); the substantial size of the loan (Euro 700,000,000); and the fact that the entire loan was provided by a single bank (in contrast to the commercial norm of syndicating large loans).

73. In conclusion, the EC has failed to rebut the U.S. demonstration that EIB loans confer a benefit on Airbus and thus constitute subsidies within the meaning of Article 1 of the SCM Agreement. At most, the EC has shown that there are various unquantifiable "costs/obligations" associated with EIB loans. But, it has not shown that these "costs/obligations" negate the benefit conferred by those loans. Nor has it shown that these "costs/obligations" are any more burdensome than corresponding "costs/obligations" incurred in connection with raising capital from the market. Therefore, the EC has not met its burden of rebutting the U.S. *prima facie* case by demonstrating that no benefit is conferred by the EIB loans.

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<sup>131</sup> See NERA, *The EIB Loans to Airbus*, p. 5 (citing Richard A. Brealey, Stewart C. Myers, and Franklin Allen, *Principles of Corporate Finance*, p. 399) (Exhibit US-542 (BCI)).

<sup>132</sup> EC Responses to Second Panel Questions, para. 85.

<sup>133</sup> See EC SWS, para. 497.

**177. At para. 1091 of its FWS, the EC refers to an amendment to the 2002 EIB loan contract with EADS. Please provide a copy of this amendment.**

Comment

74. The United States has no comment on the EC's response to this question.

**178. At para. 1092 of its FWS, the EC asserts that EADS drew half of the available loan facility provided in the 2002 [ ] denominated EIB loan in [ ]. Elsewhere in its FWS, the EC states that the remainder of the loan facility was cancelled. Are there any documents to demonstrate that (i) EADS drew down only half of the loan facility in [ ]; and (ii) that the remainder of the loan facility was cancelled? If so, please provide a copy of these documents.**

Comment

75. The United States has no comment on the EC's response to this question.

**179. In response to Panel Question 87, the EC suggests that it would be inappropriate to expect the EIB to charge “commitment fees” because the nature of its loans is such that “commitment fees” of the kind applied by commercial banks are not required. Moreover, in the answer to the same question, the EC asserts that “{a}s regards non-utilization fees, such fees are basis point charge on the amount undrawn”. Please elaborate on these assertions with reference to any evidence the EC considers may be relevant to the Panel's assessment of the challenged EIB loans.**

Comment

76. The EC's discussion of the absence of commitment fees from EIB loans makes a critical assumption that the EC does not substantiate. The assumption is that because the interest rates on the EIB's loans to Airbus are set at the time of disbursement rather than at the time of signature, Airbus does not receive “a valuable option” of the type described in the textbook discussion of commitment fees cited by the EC. Verifying that assumption would require information about “the methodology to be determined by EIB's board of directors at the time of disbursement.”<sup>134</sup> However, the EC has not provided that evidence. The EC invites a

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<sup>134</sup> EC Responses to Second Panel Questions, para. 94.

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comparison between guaranteed access to a bank's money at a fixed spread over the general level of interest rates (a situation it asserts warrants a commitment fee) and guaranteed access to a bank's money at a rate to be set at time of disbursement according to an undisclosed methodology (a situation it asserts does not warrant a commitment fee). But, it provides no information regarding the latter half of the comparison.

77. Without that information, it is impossible for the Panel to determine the degree to which interest rates may vary according to date of disbursement and, therefore, the degree of uncertainty a borrower from the EIB actually faces compared with a borrower from a commercial lender. The EC does not indicate, for example, which factors the EIB does not take into account when it sets interest rates at date of disbursement. In this regard, it is notable that in describing the variables that may affect the interest rate on an EIB loan set at date of disbursement the EC refers only to the EIB's cost of funds, its administrative expenses, and its reserve fund.<sup>135</sup> Absent from this list is any reference, for example, to a deterioration in the creditworthiness of the borrower.<sup>136</sup>

78. Moreover, the EC's suggestion that certainty about future interest rates is the only possible benefit a borrower can derive from a loan commitment is belied by recent events in world credit markets. As the past few weeks have made very clear, access to liquidity is itself a valuable benefit, whether or not the borrower knows the precise rates at which such liquidity will be provided.

79. Finally, the Panel should note that in its EIB Loans to Airbus report, NERA did not increase the benchmark rate to account for commitment fees. Rather NERA described the absence of commitment fees from the EIB loans as a separate, stand-alone benefit.<sup>137</sup> Thus, the [ ] and [ ] basis points benefits that the NERA report establishes for the 2002 and 1992 EIB loans to Airbus, respectively, do not reflect the absence of commitment fees.

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<sup>135</sup> EC Responses to Second Panel Questions, para. 94.

<sup>136</sup> In this regard, compare the EC's textbook citation at paragraph 90 of its response, which describes a fixed spread over the general level of interest rates regardless of change in creditworthiness as part of the "valuable option" warranting a commitment fee.

<sup>137</sup> See NERA, The EIB Loans to Airbus, p. 4 (Exhibit US-542 (BCI)).



**180. How does the EC respond to United States criticisms, set out at para. 279 of the United States SWS, of the methodology used to derive the benchmark interest rate the EC calculated for the 2002 EIB loan to EADS?**

Comment

80. The EC's response to Question 180 (like the EIB analysis in Exhibit EC-857 on which the response relies) errs in criticizing the United States for identifying a benchmark for the 2002 loan to EADS based on lending by non-U.S. lenders to non-U.S. borrowers (*i.e.*, "Eurodollar bonds" or "Eurobonds"). The EC wrongly reads into this basis for the benchmark "an assumption that EADS would have chosen the most expensive commercial market options."<sup>138</sup> The U.S. reference to Eurodollar bonds reflects no such assumption. Rather, it reflects the logical proposition that to achieve an apples-to-apples comparison with the EIB loan, a commercial benchmark should be a loan denominated in the same currency as the EIB loan and provided under comparable market circumstances in the same place where the EIB loan was issued.<sup>139</sup>

81. Accordingly, like the EIB loan to EADS, the U.S.-proposed benchmark is a [ ] loan provided by a non-U.S. lender to a non-U.S. borrower. By contrast, the EC would look to benchmarks that differ from the EIB loan, inasmuch as they involve U.S. lenders<sup>140</sup> or both U.S. lenders and U.S. borrowers.<sup>141</sup> A third EC-proposed benchmark, involving a hypothetical "swap" into [ ] bonds issued by EADS,<sup>142</sup> also bears no resemblance to the loan actually issued by the EIB.

82. In ignoring differences between its proposed benchmarks and the loan actually issued by the EIB to EADS, the EC neglects factors that cause Eurodollar bonds (*i.e.*, dollar denominated bonds issued outside the United States) to be priced differently from "Yankee" bonds (*i.e.*, dollar denominated bonds issued by non-U.S. companies in the United States). For example, Eurodollar bonds are not registered with the United States Securities and Exchange Commission, and new issues cannot be immediately sold in the United States. (That is, they are less liquid.)

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<sup>138</sup> EC Responses to Second Panel Questions, para. 102.

<sup>139</sup> See NERA, The EIB Loans to Airbus, p. 7 (Exhibit US-542 (BCI))

<sup>140</sup> See EC Responses to Second Panel Questions, para. 103; EIB, Analysis of the NERA report dated May 23, 2007, pp. 4-5 (Exhibit EC-857 (BCI)).

<sup>141</sup> See EC FWS, paras. 1097-1099.

<sup>142</sup> See EIB, Analysis of the NERA report dated May 23, 2007, pp. 5-6 (Exhibit EC-857 (BCI)).

Indeed, Yankee bonds are usually issued by high credit quality sovereign and sovereign-guaranteed issuers, while corporate issuers typically issue Eurodollar bonds. The differences between Yankee bonds and Eurodollar bonds translate into recognized yield differences.<sup>143</sup> Thus, the EC's failure to engage in an apples-to-apples comparison is not just matter of formal distinctions; it is a matter of distinctions with substantive impacts that the EC fails to take into account.

83. The EC's response to Question 180 also refers to the absence of a commitment fee in the EIB loan to EADS. In this regard, the United States refers the Panel to its comment on the EC's response to Question 179, above.

84. As for EADS's credit rating on the date when the interest rate on the EIB loan was set, making the adjustment the EC proposes (*i.e.*, an adjustment to account for an A rather than an A-rating from Standard & Poors coupled with an A3 rating from Moody's)<sup>144</sup> does not change the fact that the EIB loan confers a benefit. With that adjustment and no addition for commitment fees, the Eurodollar bond rate on [ ] (the date on which EADS drew from the 2002 EIB loan and the rate was set) would still be 5.6138 percent. Consequently, the EIB rate of [ ] percent would still be more than [ ] basis points below the appropriate benchmark.<sup>145</sup>

85. Even under its own flawed analysis, the EC admits that the 2002 EIB loan confers a benefit when compared with three of the four benchmarks it proposes.<sup>146</sup> Confronted with this fact, the EC reprises its argument that the benefit is *de minimis* and therefore should be ignored.<sup>147</sup> As the United States discussed in its response to the Panel's Question 149, the SCM Agreement does not provide for the *de minimis* exception the EC proposes.<sup>148</sup> The EC also asserts that the benefit conferred by the loan is negated by "additional obligations" associated with the loan. However, as the United States has discussed, these alleged "additional

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<sup>143</sup> See NERA, *The EIB Loans to Airbus*, pp. 3-4 and footnote 5; see also *The Handbook of Fixed Income Securities*, pp. 396-401 (Frank J. Fabozzi, ed.) (7<sup>th</sup> ed., 2005) (Exhibit US-673).

<sup>144</sup> See EIB, *Analysis of the NERA report dated May 23, 2007*, p. 4 (Exhibit EC-857 (BCI)).

<sup>145</sup> See NERA, *The EIB Loans to Airbus*, p. 7 (Exhibit US-542 (BCI)). Even reducing the benchmark by a further 6.5 basis points to account for "finance-related costs project costs/obligations," as the EC alleges should be done in its response to Question 176 (*see* EC Responses to Second Panel Questions, para. 83), the actual rate on the EIB loan would still be [ ] basis points below the appropriate benchmark.

<sup>146</sup> See EC Responses to Second Panel Questions, para. 103.

<sup>147</sup> See EC Responses to Second Panel Questions, para. 103.

<sup>148</sup> See U.S. Responses to Second Panel Questions, paras. 79-83.

obligations” have no bearing on a benefit analysis under the SCM Agreement and, in any event, have not been substantiated through any evidence.<sup>149</sup>

86. Finally, as the EC’s response to Question 180 relies on the EIB analysis submitted as Exhibit EC-857, the United States takes this opportunity to comment briefly on the discussion in that document of the EIB’s 1992 loan to Aérospatiale. The EIB criticizes the NERA benchmark for the 1992 loan, because it is higher than the rates on [ ]<sup>150</sup>. A comparison of the EIB loan to those [ ] is revealing.

87. According to the EIB, the rate on the [ ] was [ ] basis points over treasury, and the rate on the [ ] was [ ] basis points over treasury.<sup>151</sup> That means that these [ ] respectively. Applying the same spreads to the 1992 EIB loan would have resulted in a rate of either [ ]. By comparison, the actual rate on the EIB loan was only [ ], or [ ] basis points lower than [ ] to which the EC refers. Thus, even if these [ ] constituted the relevant benchmark, it still would be the case that the 1992 EIB loan to Aérospatiale confers a benefit.

**181. At para. 452 of its SWS, the EC reveals that all of the statistics used in following paragraphs “take into account the ‘signed’, i.e., committed amounts, (thus, the total €700 million commitment to EADS)”. Does the EC mean that all of the totals of the loan amounts presented in the relevant paragraphs are based on “committed amounts” to each individual recipient, as opposed to the amounts actually disbursed?**

#### Comment

88. In its response to Question 181, the EC suggests that for purposes of a specificity analysis of the EIB’s 2002 loan to EADS what is relevant is not the Euro 700,000,000 amount of the loan but the Euro 350,000,000 that ultimately was disbursed to EADS.<sup>152</sup> That is incorrect. The Euro 700,000,000 loan provided to EADS in 2002 is a subsidy in its own right, regardless of the portion of the loan EADS subsequently chose to use.

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<sup>149</sup> See U.S. Comment on EC Response to Question 176, *supra*; cf. U.S. Responses to Second Panel Questions, paras. 26-28 (discussing similar EC “additional obligations” argument in connection with benefit conferred by Launch Aid).

<sup>150</sup> See EIB, Analysis of the NERA report dated May 23, 2007, p. 7 (Exhibit EC-857 (BCI)).

<sup>151</sup> See EIB, Analysis of the NERA report dated May 23, 2007, p. 7 (Exhibit EC-857 (BCI)).

<sup>152</sup> EC Responses to Second Panel Questions, para. 108.

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89. Under Article 1 of the SCM Agreement, a subsidy is deemed to exist if there is a financial contribution and a benefit is thereby conferred. A financial contribution exists where, as relevant here, “a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees).” The Euro 700,000,000 loan the EIB provided to EADS meets that definition of “financial contribution,” and the EC has not contended otherwise.

90. Apart from the benefit EADS received from its eventual use of the loan, the very fact of the EIB providing the loan conferred a benefit on EADS. In particular, EADS’s ability to draw on a Euro 700,000,000 line of credit gave it valuable liquidity. Accordingly, the appropriate focus in a specificity analysis is the entire amount of the EIB’s Euro 700,000,000 loan to EADS.

91. The EC’s suggested approach of focusing only on the amount ultimately disbursed finds no support in the SCM Agreement. Under that approach, an analysis of whether a loan granted on below-market terms is a subsidy that is *de facto* specific (and, thus, whether it is potentially inconsistent with the SCM Agreement) could be undertaken only after the loan is drawn down, which (as the EC admits) could occur years after the loan is originally provided,<sup>153</sup> even though provision of the loan itself may confer an immediate benefit and cause adverse effects to the interests of other Members. This approach is contradicted by the SCM Agreement’s reference to “potential direct transfers of funds” as a category of “financial contribution” that may confer a “benefit” and thus constitute a subsidy.<sup>154</sup> A specificity analysis of a subsidy consisting of a potential direct transfer of funds necessarily occurs in advance of any knowledge as to how much of the funds (if any) actually will be disbursed.

92. Moreover, in its response to Question 181, the EC persists in its error of analyzing the 2002 loan to EADS not in the context of the program under which it was granted – the Innovation 2000 Initiative – but in the context of that program combined with a successor program – the Innovation 2010 Initiative.<sup>155</sup> As previously discussed, the Innovation 2000 Initiative was a “dedicated EUR 12-15 billion lending programme,” the objectives of which the EIB declared to have been “fully achieved” by the end of 2002.<sup>156</sup> Combining that program with

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<sup>153</sup> See EC Responses to Second Panel Questions, para. 107 (“{T}here is inevitably a time lag between signature and disbursement as a borrower usually has between 18 months and three years to request disbursement of the signed amount.”).

<sup>154</sup> SCM Agreement, Art. 1.1(a)(1)(i) (emphasis added).

<sup>155</sup> See EC Responses to Second Panel Questions, para. 109.

<sup>156</sup> U.S. Responses to First Panel Questions, paras. 93-99.

what the EIB described as a “new initiative” following “implementation of the first i2i”<sup>157</sup> distorts the picture. For purposes of a specificity analysis, the Panel should focus on the program under which the loan to EADS actually was granted.

93. The EC further distorts the picture by comparing the EIB’s loan to EADS with groups of loans given to other borrowers for projects that may or may not have been related to one another. As the United States discussed in its response to the Panel’s Question 151, the 2002 loan to EADS is one of only three listed in Exhibit EC-164 (which identifies all loans signed under both the Innovation 2000 Initiative and the Innovation 2010 Initiative through the end of 2006) in an amount of Euro 700,000,000 or more, and the only such loan under the R&D objective.<sup>158</sup>

94. Referring to Exhibit EC-715, the EC describes EADS as “the 11<sup>th</sup> largest recipient in terms of signed amounts” under the Innovation 2000 Initiative and the Innovation 2010 Initiative combined.<sup>159</sup> However, that exhibit reflects total lending to individual borrowers, usually through multiple loans involving what often appear (based on the project names) to be unrelated projects. Also, that exhibit includes lending to governments (*e.g.*, Poland) and inter-bank loans (involving, for example, HSH Nordbank AG and Norddeutsche Landesbank Girozentrale). Against this background, the loan to EADS still stands out as the single largest loan to any one company under the i2i program as a whole, in addition to being disproportionately large in the context of the i2i program’s research and development objective.<sup>160</sup>

95. Finally, the EC refers to the EIB’s exposure to EADS in comparison to its exposure to other borrowers.<sup>161</sup> However, this comparison has absolutely no relevance to a specificity analysis. Exposure of the subsidy provider is not one of the factors indicated in Article 2.1(c) for purposes of a *de facto* specificity analysis.

**182. In response to Panel Question 119, the United States suggests that a “subsidy granted to certain enterprises constitutes an appropriate share of the relevant baseline” when that subsidy’s “relationship to the baseline corresponds to the relationship of certain**

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<sup>157</sup> U.S. Responses to First Panel Questions, para. 98 (quoting Innovation 2010 Initiative, [www.eib.org/site/index.asp?designation=i2i](http://www.eib.org/site/index.asp?designation=i2i) (Exhibit US-477)).

<sup>158</sup> See U.S. Responses to Second Panel Questions, footnote 156.

<sup>159</sup> EC Responses to Second Panel Questions, para. 110.

<sup>160</sup> See U.S. Responses to First Panel Questions, paras. 100-102; U.S. Responses to Second Panel Questions, para. 104.

<sup>161</sup> EC Responses to Second Panel Questions, para. 111.

**enterprises to the entire group of enterprises covered by the baseline being examined”. In the case of the 2002 EIB loan to EADS, the United States argues that it represents “one-third” of EIB “lending for research and development under i2i in 2002, and 18% of {EIB} lending for research and development under i2i since the program’s inception”. The United States concludes that “{t}hese facts take on particular significance in light of the relatively high degree of economic diversification within the EC”. How does the EC respond to the United States’ statements, and in particular, the suggestion that the EIB loan to EADS “take{s} on particular significance in light of the relatively high degree of economic diversification within the EC”?**

Comment

96. The EC’s response to this question repeats the analytical errors the EC previously has made when arguing that Article 2.1(c) of the SCM Agreement requires a determination of whether a subsidy is specific to be based on a comparison of the subsidy to a particular “subsidy program.” The EC states that

the relevant test for the universe of the data which are to be examined in the disproportionality analysis is set forth in the second sentence of Article 2.1(c), which refers, as one of the factors designed to establish specificity in fact, to the ‘use of a *subsidy programme* by a limited number of certain enterprises.’<sup>162</sup>

97. The second sentence of Article 2.1(c) lists four factors to be considered in determining whether a subsidy is *de facto* specific. Only the first factor – “use of a subsidy programme by a limited number of certain enterprises” – refers directly to a subsidy program. The second factor – “predominant use by certain enterprises” – may be understood as referring indirectly to a subsidy program through repetition of the word “use.” However, neither the third factor – “the granting of disproportionately large amounts of subsidy to certain enterprises” – nor the fourth factor – “the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy” – refers to a subsidy program.

98. Nevertheless, because the first factor refers to a subsidy program, the EC argues that other factors – in particular, disproportionality – must be assessed in the context of a subsidy program. In effect, the EC reads a reference to a subsidy program into the descriptions of these other factors. That reading is contrary to customary rules of interpretation of public international law. As the Appellate Body has explained, “interpretation must give meaning and effect to all

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<sup>162</sup> EC Responses to Second Panel Questions, paras. 113 (emphasis added by EC).

the terms of a treaty.”<sup>163</sup> Following this rule of interpretation, significance must be attached to the absence of language in one provision when contrasted to the presence of that very language in another provision in the very same sentence. Therefore, the correct approach to reading the second sentence of Article 2.1(c) is not to read a reference to a subsidy program into the description of the disproportionality factor, as the EC would do. Rather, it is to understand the contrast between the language used to describe the disproportionality factor and the language used to describe the limited use factor as signifying that disproportionality need not be assessed relative to a subsidy program.<sup>164</sup>

99. Moreover, as in prior submissions, the EC makes an inexplicable leap from the assumption that disproportionality must be analyzed relative to a subsidy program to the conclusion that “the disproportionality of the EADS loan has to be determined with respect to the entirety of EIB lending.”<sup>165</sup> Absent from this chain of reasoning is any substantiation for the proposition that “the entirety of EIB lending” constitutes a subsidy program. The United States discusses this point further in its comment on the EC’s response to Question 218, below.

100. Finally, the EC persists in its refusal to recognize (even though the EIB itself did) that the Innovation 2000 Initiative was a distinct program (separate from its successor, the Innovation 2010 Initiative) and therefore an appropriate frame of reference (even under the EC’s proposed approach) for a specificity analysis of the EIB’s 2002 loan to EADS. For an explanation of why the EC’s characterization of the Innovation 2000 Initiative is contradicted by the EIB’s own description of that program, the United States refers the Panel to prior submissions and statements in which the United States has discussed this issue in detail.<sup>166</sup>

**183. In response to Panel Question 13, the United States suggests that the requirement in Article 2.1(c) to take into account “the length of time during which the subsidy program has been in operation”, when applying that subparagraph, “means identifying a more meaningful temporal frame of reference” than the entire lifetime of a long-standing**

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<sup>163</sup> *US – Gasoline (AB)*, p. 23; *see also Japan – Alcohol (AB)*, p. 12.

<sup>164</sup> This is not to say that it is impermissible to assess disproportionality relative to a subsidy program. However, it is not required to refer to a subsidy program. A different frame of reference may be used if it is appropriate given the facts and circumstances under consideration. *See* U.S. Responses to First Panel Questions, para. 366.

<sup>165</sup> EC Responses to Second Panel Questions, para. 113.

<sup>166</sup> *See* U.S. Responses to First Panel Questions, paras. 93-99; U.S. SNCOS, paras. 129-130; U.S. Responses to Second Panel Questions, paras. 99-104, 255-256; *see also* U.S. Comment on EC Response to Questions 181, *supra*.

**subsidy programme. Thus, the United States argues that “it makes no sense to read the last sentence {of Article 2.1(c)} in a manner that effectively would preclude a finding of specificity for subsidies granted pursuant to long-established programmes”. How does the EC respond to these statements, and in general, the United States response to Panel Question 13?**

Comment

101. In the first part of its response to this question, the EC simply ignores the last sentence in Article 2.1(c) of the SCM Agreement. This is exemplified by the EC’s statement that application of the four factors referred to in the second sentence of that article “enables the identification of a *de facto* {specific} subsidy irrespective of the length of the operation of the programme in question.”<sup>167</sup> That view is flatly contradicted by the text of Article 2.1(c), the last sentence of which makes clear that, in the context of a subsidy program, specificity cannot be determined “irrespective of the length of the operation of the programme in question.” To the contrary, the last sentence provides that “account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority, as well as of the length of time during which the subsidy programme has been in operation.” (Emphasis added.)

102. In the second part of its response, the EC acknowledges the last sentence of Article 2.1(c), but seems to consider its reference to “the length of time during which the subsidy programme has been in operation” as relevant only in the case of a program that “has been in operation for only a limited period of time.”<sup>168</sup> However, this narrow reading is not borne out by the text. Article 2.1(c) does not require account to be taken only of whether a program has been in operation for a short period of time. That may well be one scenario in which “the length of time during which the subsidy programme has been in operation” may bear upon consideration of the factors listed in the second sentence of the article. But, the last sentence is drafted in a way that applies to other scenarios as well, including when a program has been in operation for a very long period of time, such as five decades, as in the case of the EIB (assuming, *arguendo*, that the entire lending activity of the EIB is considered to be a single subsidy program).<sup>169</sup>

103. Although the EC accuses the United States of taking a “result-oriented” approach to *de facto* specificity analysis under Article 2.1(c),<sup>170</sup> it is the EC that takes such an approach, as

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<sup>167</sup> EC Responses to Second Panel Questions, para. 122 (emphasis added).

<sup>168</sup> EC Responses to Second Panel Questions, footnote 101.

<sup>169</sup> See U.S. Responses to First Panel Questions, paras. 85-91.

<sup>170</sup> EC Responses to Second Panel Questions, para. 119.



shown by its refusal to acknowledge the relevance of the last sentence of that article to a program that has been in operation for such an extended period.<sup>171</sup> Its approach ignores the text of the SCM Agreement in favor of an analytical framework that makes findings of *de facto* specificity virtually impossible for long-standing subsidy programs. This amounts to one standard for Members that have been providing subsidies for a long period of time and a different standard for Members that have fewer resources and have started providing subsidies only recently (*e.g.*, developing country Members).

104. Finally, the EC attempts to defend using the entirety of EIB lending over five decades as the basis for a specificity analysis by asserting that a longer data series leads to a more reliable analysis.<sup>172</sup> However, that position ignores the substantial changes that take place in an economy over a period of decades. It ignores that technologies change, sectors decline, new sectors emerge, and government priorities evolve. Subsidies targeted towards certain enterprises in an emerging sector might not appear to be disproportionate or otherwise specific when compared with an extremely broad universe that includes subsidies to enterprises in sectors that do not play as significant a role in the economy today as they did fifty years ago. Looked at in the context of the current economy, however, those very same subsidies may well stand out as disproportionate or otherwise specific. In short, the EC's approach would mask the very targeting of subsidies that an analysis under Article 2.1(c) is designed to identify and, therefore, should be rejected.<sup>173</sup>

#### D. INFRASTRUCTURE

**184. Does the EC consider that there may be circumstances where a government's knowledge about the first user of contemplated infrastructure, and intention to develop contemplated infrastructure specifically to meet the requirements of that first user, could transform what might, in a different context, be considered the provision of 'general infrastructure' into the provision of a financial contribution?**

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<sup>171</sup> The EC asks the Panel to "consider total EIB lending activity as one programme, whose length of duration should be taken into account as such, i.e. since 1957." EC Responses to Second Panel Questions, para. 123. But, that approach does not take account of the length of time during which EIB lending has been in operation, as required by Article 2.1(c) of the SCM Agreement; it merely identifies the length of time during which EIB lending has been in operation.

<sup>172</sup> See EC Responses to Second Panel Questions, para. 122.

<sup>173</sup> At the end of its response to Question 183, the EC compares lending to Airbus to total EIB lending during five-year periods. However, this comparison is of no relevance, as it still uses all EIB lending as the frame of reference, as opposed to lending covered by the program under which a loan was issued (such as the Innovation 2000 Initiative) or by the sector category or lending objective under which the EIB classified a loan.

Comment

105. The EC’s response to Question 184 advocates “a case by case” approach to the issue raised by the Panel. It also identifies factors to be considered in such an approach, including “the nature and detail of the user’s requirements” and “the usability of the required infrastructure for other potential users.”<sup>174</sup> However, the EC’s argument regarding the Airbus industrial site at the Mühlenberger Loch is remarkable precisely for its failure to take into account the particular facts at issue, including with respect to the factors the EC itself has identified. Instead, the EC has resorted to an abstract distinction between the creation of land through reclamation and the provision of that land to its first user.

106. This approach – the very opposite of a case-by-case analysis – is well illustrated by the EC’s unsupported assertion in its second confidential oral statement that “land reclamation is a public task that cannot be conducted by a private company.”<sup>175</sup> Similarly, in its response to the Panel’s Question 186, the EC makes the broad generalization that “reclaiming land and protecting against floods is a basic service to support the economic and social development of a country, fulfils an agreed public policy objective and is designated for public use.”<sup>176</sup>

107. There may well be circumstances in which the reclamation of land is “general infrastructure” within the meaning of Article 1 of the SCM Agreement. Examples cited by the EC – the creation of large parts of the northern and western regions of the Netherlands and of large parts of New Orleans – could indeed be such cases.<sup>177</sup> However, with respect to the Airbus industrial site at the Mühlenberger Loch, the EC’s proposed distinction between the creation of the land and its provision to Airbus is entirely artificial.

108. In contrast to the EC, the United States has undertaken an analysis on a “case by case basis, taking account of various factors”<sup>178</sup> relevant to the City of Hamburg’s provision to Airbus of an industrial site adjoining its existing site. That analysis demonstrates that the land in the Mühlenberger Loch was created exclusively for use by Airbus and that it cannot “be easily

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<sup>174</sup> EC Responses to Second Panel Questions, para. 130.

<sup>175</sup> EC SCOS, para. 19.

<sup>176</sup> EC Responses to Second Panel Questions, para. 149.

<sup>177</sup> See EC SNCOS, paras. 31-32.

<sup>178</sup> EC Responses to Second Panel Questions, para. 130.

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offered to other users” (as the EC continues to allege without support).<sup>179</sup> Therefore, in this particular case, the reclamation of land was not “general infrastructure.” Not only did the City of Hamburg have knowledge of the first user of the site; it created the site as infrastructure specifically for that user.

109. The Panel is by now quite familiar with the evidence surrounding this subsidy. However, to highlight the contrast between the EC’s abstract and artificial approach and the U.S. fact-specific approach, the United States summarizes certain key points. First, the City of Hamburg would not have undertaken the reclamation of land in the Mühlenberger Loch but for Airbus’s need for land at this precise location for the expansion of its existing site.<sup>180</sup> Most notably, the European Commission would not have granted permission for the land reclamation – which was required under EC law, because the Mühlenberger Loch was an internationally protected wetland – but for the specific needs of Airbus and but for the fact that [ ]<sup>181</sup>

110. The United States has demonstrated as false the EC’s assertion that Hamburg reclaimed land in the Mühlenberger Loch to remedy an alleged shortage of industrial land or, alternatively, to expand the harbor to the West.<sup>182</sup> The United States has shown that there is an “abundant supply of office space and commercial real estate” in Hamburg and that the creation of the land had nothing to do with the Hamburg port.<sup>183</sup> In fact, the United States has shown that the EC went so far as to misquote the Hamburg Port Development Act to support its assertion that the creation of land in the Mühlenberger Loch was harbor-related.<sup>184</sup>

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<sup>179</sup> EC Responses to Second Panel Questions, para. 135.

<sup>180</sup> See U.S. SWS, paras. 332-338 (citing evidence).

<sup>181</sup> European Commission, Stellungnahme vom 19. April 2000 zur Erweiterung des Betriebsgeländes von DaimlerChrysler Aerospace Airbus (DASA) in Hamburg Finkenwerder, K(2000)1079 endg., at p. 2 of the English version of the decision (Exhibit EC-547 (BCI)).

<sup>182</sup> The EC repeated this assertion in its response to Question 184. See EC Responses to Second Panel Questions, paras. 135-136. However, the EC still has not substantiated the assertion.

<sup>183</sup> See U.S. SWS, paras. 318-320 (availability of industrial land in Hamburg), and paras. 321-331 (creation of land in the Mühlenberger Loch was not harbor-related).

<sup>184</sup> See U.S. SWS, paras. 324-325. In fact, Hamburg had to amend the Port Development Act, because creation of the land for Airbus would have been illegal under the Act as it existed prior to the amendment. See *id.*, para. 326.

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111. Second, use of the newly created land in the Mühlenberger Loch has been limited by law to Airbus from the outset. According to the *Bebauungsplan Finkenwerder 37*, the newly created land was designated as “Special Area Aircraft Factory” (“*Sondergebiet Flugzeugwerk*”) and (to the extent needed for taxiways, aircraft parking space, and runways) “Area for Air Traffic” (“*Fläche für den Luftverkehr*”).<sup>185</sup> The City of Hamburg explained the reasons for these use limitations as follows:

This {i.e., the *Bebauungsplan Finkenwerder 37*} ensures that these areas {i.e., the newly created land} are made available exclusively for special use by the aircraft industry. The possibility of establishing other factories . . . is to be excluded at the Finkenwerder site.<sup>186</sup>

112. In this connection, the Panel should recall the EC’s view that infrastructure is presumed to be general and is removed from that status only if limitations on its use are “clearly specified” and “restricted by regulation.”<sup>187</sup> As the United States has explained, this view has no basis in the SCM Agreement.<sup>188</sup> However, even if the relevant test were as asserted by the EC, that test unmistakably would be met in the case of the Airbus industrial site at the Mühlenberger Loch. In this case, the land use restriction is indeed “clearly specified” in law.<sup>189</sup>

113. Third, use of the Mühlenberger Loch industrial site is limited in fact to Airbus. The newly created land is surrounded by the river Elbe and the remainder of the Mühlenberger Loch

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<sup>185</sup> See U.S. SWS, paras. 342-345; *Bebauungsplan Finkenwerder 37* (Exhibits US-567, US-568 and US-569).

<sup>186</sup> City of Hamburg, *Begründung zum Bebauungsplan Finkenwerder 37*, at 17-18 (emphases added) (Exhibit US-568).

<sup>187</sup> EC SWS, paras. 333, 336-339.

<sup>188</sup> See U.S. SNCOS, para. 80; U.S. Comment on EC Response to Question 221, *infra*.

<sup>189</sup> The EC’s only response is that the *Bebauungsplan* can be amended. See EC SNCOS, para. 206. However, the same observation could be made of virtually any measure. The Panel’s role is to make “an objective assessment of the facts” (DSU, Art. 11), not of potential modifications to the facts. Furthermore, the City of Hamburg itself has explained that “{b}inding decisions regarding the land construction are . . . only taken by means of the land construction plans. . . .” City of Hamburg, Erläuterungsbericht, Neubekanntmachung vom Oktober 1997, at 2.1.5 (Exhibit US-566). While the *Flächennutzungsplan* (cited by the EC at paragraph 206 of its second non-confidential oral statement) provides guidance for the *Bebauungsplan*, it is not a binding document. Quoting again from the City of Hamburg’s own explanation, in the *Flächennutzungsplan*, “{d}etails . . . are not depicted {and} land uses on a minor scale {such as the newly created plot in *Finkenwerder*} are not shown.” City of Hamburg, Erläuterungsbericht, Neubekanntmachung vom Oktober 1997, at 2.1.5 (Exhibit US-566).

at its northern, western, and southern borders and by Airbus's existing facilities at its eastern border. Users other than Airbus are not able to access the site, including via the dyke lane.<sup>190</sup>

114. Finally, further illustrating the EC's misrepresentation of the facts regarding the Airbus site at the Mühlenberger Loch is the EC's assertion that "the lease agreement . . . required Airbus Germany, upon expiry of the lease agreement or termination, to hand back the land to the city of Hamburg in the same state as in which it had been taken over, i.e. without any internal development."<sup>191</sup> That assertion is incorrect. In fact, under the terms of the lease agreement, [

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115. In sum, the EC falls far short of the standard it sets for itself in response to Question 184. Its argument regarding Hamburg's creation and provision to Airbus of an industrial site at the Mühlenberger Loch does not reflect a "case by case" analysis but, rather, an abstract approach that is at odds with the facts.

**185. For the purpose of assessing the benefit conferred on a recipient under Article 1.1(b) of the SCM Agreement, are there any circumstances in which the market value of the infrastructure should incorporate the costs of creating that infrastructure to the specifications of the particular recipient? Does the EC agree with the United States' argument (at para. 406 of its SWS) that a commercial owner of land would either sell land 'as is' to a specific recipient or would have asked for a commercial return on the owner's investment in turning the land into an industrial site, in addition to a price reflecting the value of the land?**

Comment

116. The EC's response to this question confirms that the EC agrees with the U.S. explanation (as set out in paragraph 406 of the U.S. second written submission and paraphrased in the Panel's question) of how the benefit conferred by a government's provision of land should be

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<sup>190</sup> See U.S. SWS, paras. 346-348.

<sup>191</sup> EC Responses to Second Panel Questions, para. 135.

<sup>192</sup> See Land lease agreement between Profi and Airbus Germany on the Mühlenberger Loch/ Rüsshalbinsel (Flächenmietvertrag zwischen Profi und Airbus Deutschland - Erweiterungsfläche Mühlenberger Loch/ Rüsshalbinsel), Sec. 16.2 (Exhibit EC-551 (BCI)); see also U.S. SWS, para. 340 and footnote 416.

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analyzed.<sup>193</sup> The EC's main difference with the United States is not over how to analyze benefit. Instead, the difference involves the identification of the provision of land as either "general infrastructure" or "other than general infrastructure" (and thus a "financial contribution" within the meaning of Article 1 of the SCM Agreement). Because the EC assumes that both the creation of land for the expansion of Airbus facilities in Hamburg and the improvement of industrial land for Airbus in Toulouse were "general infrastructure," it fails to take these elements into account in its benefit analysis. The EC's assumptions are erroneous.

117. In the case of Hamburg, the provision of pre-existing suitable land to Airbus is not the financial contribution at issue. Airbus did not want or need a plot of pre-existing land. It needed land at a very precise location – next to its existing facilities – so that it could expand those facilities to accommodate the A380 final assembly line. That location happened to consist of wetland. Therefore, the City of Hamburg turned the wetland into usable industrial land in the size and form required by Airbus,<sup>194</sup> reserved the newly created land for Airbus by law,<sup>195</sup> and leased the newly created land to Airbus for an indefinite period.<sup>196</sup> In light of the facts at issue here, the reclamation of land in the Mühlenberger Loch was not "general infrastructure" within the meaning of Article 1 of the SCM Agreement. Thus, the financial contribution at issue is the creation and provision of a particular plot of land to Airbus. It is the benefit conferred by this financial contribution – and not by a hypothetical provision of pre-existing land – that must be analyzed for purposes of Article 1.1(b) of the SCM Agreement.

118. A commercial investor in the same situation as the City of Hamburg would have had two options: (1) lease the property "as is" (*i.e.*, as a wetland area) to Airbus and leave it to Airbus to undertake the reclamation necessary to make usable land, or (2) reclaim the land and then lease it to Airbus. A commercial investor choosing the second option (as Hamburg in fact did) would have demanded a lease price generating a commercial return on the investment in the land reclamation (including building the dykes, taking environmental compensation measures, and

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<sup>193</sup> See EC Responses to Second Panel Questions, para. 138.

<sup>194</sup> See [ ] Study, [ ], Sec. 3 (April 30, 1998) (Exhibit EC-796 (BCI)); Letter [ ] to [ ] Partners [ ] (Exhibit EC-797 (BCI)).

<sup>195</sup> See U.S. Comment on EC Response to Question 184, *supra*; see also U.S. SWS, paras. 342-345; *Bauungsplan Finkenwerder 37* (Exhibits US-567, US-568, and US-569).

<sup>196</sup> See U.S. Comment on EC Response to Question 184, *supra*; see also U.S. SWS, para. 340 and footnote 416.

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establishing the special purpose facilities<sup>197</sup>) and on the market value of the property prior to the reclamation. In establishing a lease price that did not include its investment in the land reclamation, Hamburg thus conferred a benefit on Airbus.

119. This approach to analyzing the benefit conferred by Hamburg's creation and provision of the land to Airbus has nothing to do with a "cost-to-government" approach, as the EC continues to assert.<sup>198</sup> Rather, it is squarely in accordance with the ordinary meaning of the term "benefit" in Article 1.1(b) of the SCM Agreement in context (including Article 14(d))<sup>199</sup> and in light of the agreement's object and purpose. On this point, the United States refers the Panel to its responses to Questions 154 and 155.<sup>200</sup>

120. At the very end of its response to Question 185, the EC refers briefly to the terms and conditions under which land was provided to Airbus in the ZAC Aéroconstellation in Toulouse. In doing so, it addresses only the purchase of land and not the lease of the EIG facilities (such as taxiways and aircraft parking areas used for A380 testing) on the land.

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<sup>197</sup> The United States has shown that the dykes are not general infrastructure. See U.S. SWS, paras. 349-351. The EC has not addressed the facts presented by the United States, but instead merely asserts that the dykes are, by their very nature, general infrastructure. See EC SCOS, para. 24. The United States also has shown that the environmental compensation measures are not general infrastructure. They only became necessary because Hamburg turned the Mühlenberger Loch – an internationally protected wetland area – into industrial land for the benefit of Airbus. Finally, as regards the special-purpose facilities, the EC admits that they are not general infrastructure. See, e.g., EC Responses to Second Panel Questions, para. 131. Therefore, there is no reason to exclude the costs for these measures from the benefit analysis.

<sup>198</sup> EC Responses to Second Panel Questions, para. 143.

<sup>199</sup> See, e.g., U.S. FWS, para. 431; U.S. Responses to Second Panel Questions, para. 112; EC FWS, para. 821.

<sup>200</sup> See U.S. Responses to Second Panel Questions, paras. 110-119, 120-127. For the sake of completeness, the United States recalls that it also has demonstrated that the lease price the City of Hamburg charges Airbus is less than adequate remuneration (and that the provision of the infrastructure thus confers a benefit on Airbus) even if the basis for analysis is pre-existing land. See U.S. SWS, paras. 362-371. At paragraph 23 of its second confidential oral statement, the EC briefly addressed one of the U.S. arguments (*i.e.*, that a private investor would have demanded a premium from Airbus due to the fact that the Mühlenberger Loch site is adjacent to Airbus's existing site (*see* U.S. SWS, para. 371)). However, the EC did not address other evidence and arguments presented at paragraphs 362 to 371 of the U.S. second written submission. Regarding the aforementioned premium, the EC essentially argues that Airbus would have moved to Toulouse had it been charged a premium on the lease price. The United States has addressed a similar argument in its response to the Panel's Question 219 and in its comment on the EC's response to the same question. See U.S. Responses to Second Panel Questions, paras. 275-278; U.S. Comment on EC Response to Question 219, *infra*. In brief, this "inefficiency defence" has no basis in the SCM Agreement.

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121. Concerning the land purchase, the EC refers to the appraisal report by Atisreal and states that Airbus paid more than the value indicated in that report. Curiously, the EC states that the amount actually paid “is consistent with a situation in which a commercial investor sells land it owns and reflects in the purchase price a commercial return on prior investments in land improvements undertaken for the company taking over the land.”<sup>201</sup> The United States welcomes the EC’s acknowledgment that the government of Grand Toulouse should have charged Airbus a price that would have yielded a commercial return on the government’s investment in improvements made to the land (*i.e.*, in turning agricultural land into the Aéroconstellation site designed to meet Airbus’s needs). As discussed above, this approach to a benefit analysis is appropriate, because the creation of the ZAC Aéroconstellation as an industrial site for Airbus is not general infrastructure.

122. However, although it acknowledges the correct approach, the EC has misapplied that approach. The purchase price paid by Airbus did not reflect a commercial return on the investments made by the government of Grand Toulouse. The United States refers to its previous submissions for further discussion of this point.<sup>202</sup>

123. Finally, while the EC did not address Airbus’s lease of the EIG facilities at the ZAC Aéroconstellation in its response to Question 185, it did discuss this issue in its second confidential oral statement. Even the EC’s consultant (Mr. Miller) came to the conclusion that the lease agreement conferred a benefit as compared with a market benchmark. According to Mr. Miller, a commercial investor would have asked for a lease price of Euro 4.4 million per year for the EIG facilities plus an additional Euro 1.5 million for the land on which these facilities were built, for a total of Euro 5.9 million per year.<sup>203</sup> However, on average, Airbus pays an annual lease price of Euro 3.1 million.<sup>204</sup> By the EC’s own admission, therefore, on average, Airbus pays Euro 2.8 million less per year than what a commercial investor would have required it to pay. Moreover, the EC’s calculation does not even consider that the lease price is progressive (*i.e.*, it starts at far less than Euro 3.1 million per year and reaches 100 percent of the average price only around the year 2022) and is not [ ]. Both features further

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<sup>201</sup> EC Responses to Second Panel Questions, para. 146 (emphasis added).

<sup>202</sup> See, e.g., U.S. SWS, paras. 403-407 (non-commercial nature of purchase price); U.S. Responses to First Panel Questions, paras. 140-148 (ZAC Aéroconstellation is not general infrastructure).

<sup>203</sup> See EC SCOS, paras. 31, 32.

<sup>204</sup> See U.S. SWS, paras. 408-414.



increase the benefit to Airbus, even if assessed using the methodology proposed by the EC itself.<sup>205</sup>

**186. The EC argues that “land reclamation and flood protection is considered a public task, serving democratically agreed policies within certain societal goals.” (EC, SNCOS at paragraph 31). Is the Panel to understand that the EC considers that the nature of the activity in question is determinative of whether a particular infrastructure project is general or not?**

Comment

124. In its response to this question, the EC restates its erroneous understanding of the term “general infrastructure” in Article 1.1(a)(1)(iii) of the SCM Agreement. For a correct understanding of that term and an explanation of the EC’s error, the United States refers the Panel to previous U.S. submissions and statements.<sup>206</sup>

125. Furthermore, as noted in the U.S. comment on the EC’s response to Question 184, above, the EC’s response to Question 186 is at odds with its acknowledgment that the status of infrastructure as “general” or “other than general” should be evaluated “on a case by case basis.”<sup>207</sup> In its response to Question 186 (as in the statement from its second non-confidential oral statement quoted by the Panel), instead of taking a case-by-case approach, the EC resorts to broad generalizations.

**E. CAPITAL INVESTMENTS AND SHARE TRANSFERS**

**187. Does the EC consider that there is anything which would preclude the Panel from considering the 1989 German restructuring package (without making findings on the package itself) as relevant background for assessing the challenged measures that formed part of the 1989 German restructuring package?**

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<sup>205</sup> See U.S. SWS, paras. 408-414.

<sup>206</sup> See U.S. FNCOS, para. 79; U.S. Responses to First Panel Questions, paras. 136-139; U.S. SWS, paras. 303-310; U.S. SNCOS, paras. 79-82; U.S. Comments on EC SNCOS, para. 33; U.S. Responses to Second Panel Questions, paras. 105, 283-291; see also U.S. Comment on EC Response to Question 221, *infra*.

<sup>207</sup> See EC Responses to Second Panel Questions, para. 130.

### Comment

126. In its response to this question, the EC discusses both the 1989 KfW equity infusion to Deutsche Airbus and the 1998 settlement of Deutsche Airbus's debt to the German government and asserts that neither transaction can be assessed without a detailed analysis of the entire 1989 German government aid package provided to Deutsche Airbus. In addition, the EC contends that the 1989 aid package did not constitute a series of subsidy measures, but instead was a commercially reasonable restructuring in light of Deutsche Airbus's "imminent insolvency."<sup>208</sup> The United States addresses each of these points in turn.

127. **The KfW Equity Infusion.** First, the Panel should note the dramatic shift in the EC's view regarding the relationship between the KfW equity infusion and the broader aid package to Deutsche Airbus. Previously, the EC tried to characterize the equity infusion as separate from the broader aid package.<sup>209</sup> It portrayed the aid package as a transaction that occurred first, following which KfW made an investment that the EC alleges to have been "on exactly the same conditions" as an investment made by DaimlerBenz.<sup>210</sup> The United States pointed out that the KfW investment was in fact part of the aid package and that the EC's attempt to portray it as a subsequent step following the restructuring of Deutsche Airbus was highly misleading.<sup>211</sup>

128. Now, in response to Question 187, the EC acknowledges that the KfW equity infusion was indeed "part of" the broader aid package to Deutsche Airbus.<sup>212</sup> However, it errs in describing the relevance of that fact to an analysis of whether the equity infusion constitutes a subsidy. Contrary to the EC's contention, nowhere has the United States argued that the equity infusion is a subsidy "because it was part of the 1989 restructuring."<sup>213</sup>

129. As explained in the U.S. response to the Panel's Question 157, the relevance of the fact that the KfW equity infusion was part of the broader aid package to Deutsche Airbus is that it

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<sup>208</sup> EC Responses to Second Panel Questions, para. 164.

<sup>209</sup> See, e.g., EC Responses to First Panel Questions, paras. 266-271.

<sup>210</sup> EC Responses to First Panel Questions, para. 267; see also EC SWS, para. 608.

<sup>211</sup> See U.S. SWS, paras. 456-458; U.S. SNCOS, para. 110.

<sup>212</sup> EC Responses to Second Panel Questions, para. 151.

<sup>213</sup> EC Responses to Second Panel Questions, para. 152 (emphasis added); see also *id.*, para. 158 (incorrectly asserting that "according to the United States, the KfW investment constitutes a subsidy just because it is part of the 1989 restructuring").

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undermines the EC's attempt to use Daimler's investment in MBB (the parent company of Deutsche Airbus) as a market benchmark. Daimler would not have made its investment without the aid package that included the equity infusion at issue. Therefore, it is illogical for the EC to rely on Daimler's investment to show that the government's investment was consistent with the usual investment practice of private investors.<sup>214</sup>

130. Moreover, not only does the EC mistake the relevance of the aid package to the equity infusion of which it was a part, it also ignores the wealth of evidence adduced by the United States to demonstrate that the equity infusion was inconsistent with the usual investment practice of private investors. The United States refers the Panel to its summary of that evidence in the U.S. response to Question 157.<sup>215</sup>

131. Furthermore, the EC's shift in view regarding the equity infusion to Deutsche Airbus is not merely a matter of previously treating the infusion as a step that followed the aid package and now treating it as part of the aid package. The EC goes further and asserts that in challenging the equity infusion, the United States has a "burden" to show that the entirety of the 1989 package constitutes a subsidy.<sup>216</sup> The EC cites no basis for this burden, and, indeed, there is none. The measure at issue is the equity infusion. In establishing that the equity infusion constitutes a subsidy, the United States is under no obligation to demonstrate that other elements of the restructuring package also constitute subsidies. Indeed, as mentioned in the U.S. response to Question 157, the Tokyo Round Subsidy Code panel that examined another element of the 1989 restructuring package – the exchange rate guarantee scheme – did so without examining other elements of the restructuring package.<sup>217</sup>

132. **The 1998 Debt Settlement.** Just as the EC mistakes the relevance of the 1989 aid package to an analysis of the KfW equity infusion to Deutsche Airbus, it also mistakes the relevance of the aid package to the 1998 debt settlement between the German government and Deutsche Airbus. In particular, the EC errs in characterizing the U.S. challenge to the 1998 debt settlement as a disguised challenge to what it calls "the repayment terms in the 1989 restructuring agreement."<sup>218</sup>

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<sup>214</sup> See U.S. Responses to Second Panel Questions, paras. 140-141; *see also id.*, paras. 128-139.

<sup>215</sup> See U.S. Responses to Second Panel Questions, paras. 142-144.

<sup>216</sup> See EC Responses to Second Panel Questions, para. 162.

<sup>217</sup> See *EEC – Airbus*, paras. 5.1 *et seq.* (discussed in U.S. Responses to Second Panel Questions, para. 141 and footnote 193).

<sup>218</sup> EC Responses to Second Panel Questions, paras. 153-155.

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133. The United States is not challenging the 1989 aid package. What it is challenging is the 1998 transaction that led to the elimination of DM 9.4 billion in debt that Deutsche Airbus owed to the German government in exchange for a one-time payment of DM 1.7 billion. The 1998 transaction effectively constituted a write-off – and thus, economically speaking, a grant – of DM 7.7 billion.<sup>219</sup>

134. When the EC responded to the U.S. *prima facie* case by alleging that the DM 1.7 billion payment represented the fair market value of Deutsche Airbus's DM 9.4 billion debt, the United States demonstrated that, even characterized this way, the transaction still amounts to a subsidy. The 1998 debt settlement converted a future interest rate benefit that Deutsche Airbus expected to realize over a period of decades into a present benefit that it would realize immediately (and that, consequently, could cause adverse effects immediately).<sup>220</sup> The 1989 aid package is relevant context to understanding the benefit conferred by the 1998 transaction. But, treating the 1998 transaction as a settlement for present value rather than as debt forgiveness does not transform a challenge to the 1998 transaction into a challenge to the underlying aid package.<sup>221</sup>

135. **The 1989 Aid Package.** Given the EC's misunderstanding of the relevance of the 1989 aid package to the two claims at issue, its attempt to show that the terms of the package were not preferential is beside the point. However, in the interest of completeness, the United States will discuss the additional errors the EC makes in the latter part of its response to Question 187. Before doing so, it is useful to recall the elements of the aid package and evidence demonstrating their better-than-market terms:

- The deferral of repayment of Launch Aid until 2001 led, in the words of the German Monopolkommission, to “a considerable interest rate subsidy.”<sup>222</sup>
- The exchange rate guarantee scheme was a shield for Deutsche Airbus against fluctuations in the value of the U.S. dollar. The DM 1.48 billion paid to Deutsche Airbus under the scheme were provided in the form of interest-free “repayable

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<sup>219</sup> See U.S. SWS, para. 441; U.S. FWS, paras. 529-535.

<sup>220</sup> See U.S. Responses to First Panel Questions, paras. 196-199; U.S. SWS, paras. 439-441.

<sup>221</sup> While the United States refers to the 1989 aid package as relevant factual context and not as the measure at issue, if the Panel were to find that the aid package is in fact the measure at issue, that measure would be within the Panel's terms of reference, as explained in the U.S. second written submission. See U.S. SWS, paras. 436-438; see also U.S. Comment on EC Response to Question 189, *infra*.

<sup>222</sup> U.S. FWS, para. 525 (citing Monopolkommission, para. 132 (Exhibit US-30)).

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grants” that Deutsche Airbus was required to repay from profits, if any, beginning in 2001. A scheme like this, of course, would not have been available in the market, and a Tokyo Round Subsidy Code dispute settlement panel indeed found it to be a prohibited export subsidy.<sup>223</sup>

- The so-called “Altlastenhilfe” – the repayment of DM 2.33 billion of Deutsche Airbus’s private sector debt by the German government – was described by the European Commission as a “debt write-off” and was examined, along with the exchange rate scheme, as state aid under the EC state aid regime.<sup>224</sup>
- As for the DM 505 million equity infusion from KfW, the United States refers to its response to Question 157, summarizing the evidence showing this financial contribution to be inconsistent with the usual investment practice of private investors, thus conferring a benefit and constituting a subsidy.<sup>225</sup>

136. That the elements of the 1989 aid package were provided on better-than-market terms also is confirmed by the documents relating to the package that the EC has provided only at a late stage in this proceeding, in response to the Panel’s Question 190.<sup>226</sup>

137. In the EC’s attempt to show that elements of the 1989 aid package were not provided on better-than-market terms, its only argument is that these measures were provided with an aim to “minimize losses” to the government from the alleged “imminent insolvency” of Deutsche Airbus, and that this conduct was consistent with “the terms a commercial creditor in Deutsche

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<sup>223</sup> See U.S. FWS, para. 526.

<sup>224</sup> See U.S. FWS, paras. 527-528.

<sup>225</sup> See U.S. Responses to Second Panel Questions, paras. 140-144.

<sup>226</sup> The United States notes that during the Annex V process, the EC refused to provide information requested by the Facilitator regarding the 1989 aid package. See EC Responses to Questions from the Facilitator, Part IV (Nov. 18, 2005) (Exhibit US-5 (BCI)). It is surprising, therefore, that the EC asserts that the United States has “long had access to all relevant information with respect to the 1989 restructuring.” EC SNCOS, para. 260. It is more surprising still that in support of that assertion, the EC cites to the very requests by the Annex V Facilitator that the EC rejected. See *id.*, footnote 253. The fact that the Facilitator asked for information regarding the 1989 restructuring does not show that the United States “long had access” to that information; it shows just the opposite. The very reason for posing questions in the Annex V process is “to obtain such information from the government of the subsidizing Member as necessary to establish {*inter alia*} the existence and amount of subsidization.” SCM Agreement, Annex V, para. 2.

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Airbus would have agreed to in restructuring the company.”<sup>227</sup> However, the EC fails to substantiate this argument. It merely asserts that “the German government evaluated its options and decided to minimize its losses by financially restructuring the company and arranging for its takeover by a commercial investor – Daimler.”<sup>228</sup> It provides no evidence whatsoever of this “evaluat{ion}.”<sup>229</sup>

138. Referring to the report of the panel in *Korea – Commercial Vessels*, the EC contends that the burden lies with the complaining party to “demonstrate that a restructuring was commercially unreasonable.”<sup>230</sup> This is a mischaracterization of that panel report. In *Korea – Commercial Vessels*, Korea had adduced studies undertaken by independent accountants (Anjin and Rothschild) that demonstrated that the going concern value of the company concerned exceeded its liquidation value, thus substantiating Korea’s argument that the restructurings at issue were commercially reasonable. In light of these studies, the panel found that the burden was on the EC, as the complaining party, to show that the restructurings were nevertheless not commercially reasonable (a burden that the EC did not meet).<sup>231</sup> Conversely, the panel did not find that to make its *prima facie* case the EC had to provide its own studies showing that a company’s liquidation value exceeded its going concern value.

139. The situation at issue in this dispute – an unsupported assertion by a responding party that a restructuring was commercially reasonable and that the going concern value of the restructured company exceeded its liquidation value – was in fact addressed in *EC – DRAMs*. In that dispute, the EC investigating authority, in a countervailing duty proceeding concerning the Korean DRAM producer Hynix, found that a debt restructuring by six government-controlled banks was not on commercial terms.<sup>232</sup> In its WTO challenge to the EC determination, Korea argued that “the banks invested in Hynix because they believed the going concern value of Hynix was greater than its liquidation value. For that reason, their decision to provide further financing made commercial sense from an inside investor perspective.” However, Korea did not

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<sup>227</sup> See EC Responses to Second Panel Questions, paras. 159-165.

<sup>228</sup> EC Responses to Second Panel Questions, para. 161.

<sup>229</sup> As the United States discussed in its response to Question 224, in evaluating the commercial reasonableness of government participation in a restructuring, panels have focused on whether there were independent assessments demonstrating that the going concern value exceeded the liquidation value of the restructured company. See U.S. Responses to Second Panel Questions, paras. 309-319.

<sup>230</sup> EC Responses to Second Panel Questions, para. 159.

<sup>231</sup> See, e.g., *Korea – Commercial Vessels*, paras. 7.429-7.437, 7.483.

<sup>232</sup> See *EC – DRAMs*, paras. 7.206-7.207.

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substantiate this assertion. Therefore, the panel accepted the EC's argument that "the banks do not seem to have based this conclusion on independent assessment studies, as could be expected given the situation of Hynix." The panel concluded that Korea, as the party asserting that the EC investigating authority had erred in finding the restructuring was not commercially reasonable, had not proven that assertion.<sup>233</sup>

140. In sum, far from supporting the EC's position in this dispute, the findings of the panels in *Korea – Commercial Vessels* and *EC – DRAMs* support the proposition that a Member asserting that a restructuring was commercially reasonable has the burden to substantiate that assertion; only following such substantiation would the complainant have a burden to "demonstrate that a restructuring was commercially unreasonable."<sup>234</sup> As the EC itself noted in *Korea – Commercial Vessels*, "{T}here is no basis in the *SCM Agreement* to allow insolvency to be a loophole in the subsidy disciplines."<sup>235</sup> As the EC has failed to meet its initial burden of substantiating its position that the 1989 aid package to Deutsche Airbus was commercially reasonable, its argument regarding the aid package (even assuming, *arguendo*, that it is relevant) is meritless.

141. Finally, a review of the 1989 aid package to Deutsche Airbus shows that it cannot possibly have been provided to minimize the government's losses or maximize its profits, as the EC alleges.<sup>236</sup> Rather, the German government more than doubled its total risk exposure, raising it from a maximum of DM 6.7 billion by the end of 1988<sup>237</sup> to a total of DM 14.3 billion as a result of the 1989 aid package.<sup>238</sup> Also, the repayment conditions under the aid package were

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<sup>233</sup> *EC – DRAMs*, paras. 7.208-7.209.

<sup>234</sup> EC Responses to Second Panel Questions, para. 159.

<sup>235</sup> *Korea – Commercial Vessels*, p. D-20, para. 97 (EC response to Question 23 from the panel).

<sup>236</sup> See EC Responses to Second Panel Questions, para. 161.

<sup>237</sup> By the end of 1988, the German government had provided about DM 3.7 billion in Launch Aid to Deutsche Airbus. In addition, it had assumed DM 1.9 billion of Deutsche Airbus's DM 2.8 billion in private debt and may ultimately have been liable for the remaining DM 0.9 billion. Finally, the German government had provided a DM 0.165 billion loan to Deutsche Airbus to support the production of the A320. In the event of an eventual Deutsche Airbus bankruptcy, therefore, the German government could have lost as much as DM 6.665 billion. See Monopolkommission, para. 118, table 11 (Launch Aid paid out to Deutsche Airbus by the end of 1988), para. 121 and table 12 ("Altlastenhilfe" and additional secured private sector loans as well as A320 loan) (Exhibit US-30).

<sup>238</sup> As part of the 1989 aid package, the EC promised to make further payments to Deutsche Airbus, including under the German exchange rate guarantee scheme and the 1989 KfW investment. See EC FWS, para. 1180. According to the German *Monopolkommission*, the German government expected payments of up to DM 2.465 billion to Airbus under the exchange rate guarantee scheme until 1996 and a further DM 1.64 billion in the

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such that it was impossible for the government to recover its additional DM 7.6 billion investment. Effectively, the German government invested an additional DM 7.6 billion in Deutsche Airbus to recover a fraction of the DM 6.7 billion already invested (and that, only if all went well).<sup>239</sup>

142. Against this background, it is not surprising that the EC never substantiated its claim that the 1989 aid package (or any of its elements) was commercially reasonable. It is obvious that such a restructuring – in which the government more than doubled its initial exposure and agreed to repayment conditions that made it unlikely that it would be repaid the principal (and ensured that it would not be paid any interest) on either existing or future loans – would by no means have been acceptable to a commercial creditor.

143. In conclusion, even if the EC were correct (which it is not) that the 1989 KfW investment and the 1998 debt settlement must be examined in light of the entire 1989 aid package to Deutsche Airbus, that examination does not change the analysis: Both measures constitute subsidies to Airbus.

**188. Does the EC agree with the United States’ contentions at paragraph 452 of its SWS? If so, what are the legal and evidentiary bases for the EC’s contention, at paragraphs 259 of its SNCOS, that KfW invested in Deutsche Airbus “on the same terms” as Daimler-Benz, “via its subsidiary MBB”? Does the EC accept that the Panel should, for the purpose of determining whether the equity infusions at issue conferred a benefit within the meaning of Article 1.1(b), determine whether the investment decisions at issue were consistent with the “usual investment practice” of private investors within the meaning of Article 14(a)?**

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period from 1997 to 2000 (*i.e.*, a total expected exposure of DM 4.105 billion). (As the exchange rate guarantee scheme was terminated in 1992, only DM 1.48 billion was eventually provided to Deutsche Airbus under the scheme.) In addition, the German government (through KfW) invested a total of DM 505 million in Deutsche Airbus. Finally, the German government made further Launch Aid payments until 1996 in the amount of about DM 3 billion. *See* Monopolkommission, paras. 118 (including table 11), 130, and 131 (Exhibit US-30). This adds up to a total additional expected risk exposure of DM 7.610 billion on top of the DM 6.7 billion already at risk in 1988.

<sup>239</sup> In fact, the 1998 settlement of the remaining debt of DM 9.4 billion for a payment of DM 1.7 billion shows that, even after Deutsche Airbus had ten years of interest-free use of the government’s DM 9.4 billion, the government still could not recover the amount initially at risk prior to providing the aid package, let alone the additional money provided to Deutsche Airbus through the package.



Comment

144. Tellingly, the EC's response to this question does not deny the facts set out in paragraph 452 of the U.S. second written submission. Indeed, it avoids those facts altogether. The United States elaborated on those facts in its response to Question 156. There, the United States explained that Daimler-Benz did not make an investment in Deutsche Airbus, and that the investment it did make – in Deutsche Airbus's parent, MBB – was not on the same terms as KfW's direct investment in Deutsche Airbus. In fact, even MBB's additional investment in Deutsche Airbus (selectively described in the EC's response to Question 188) was not on the same terms as KfW's investment in Deutsche Airbus. Briefly, the key points are as follows.

145. Daimler-Benz acquired shares in MBB, rather than in Deutsche Airbus – even if MBB in turn used the capital it received from Daimler to provide additional capital to Deutsche Airbus; even if Daimler directed MBB to do so; and even if MBB and KfW both acquired newly issued shares of Deutsche Airbus at the same price per share.<sup>240</sup> This fact reflects a key difference between Daimler's investment and KfW's. Daimler became a shareholder in a company with a diverse portfolio of business activities, whereas KfW became a shareholder in Deutsche Airbus, a company with a single business activity. Regardless of how MBB used the capital it received from Daimler, the risks and opportunities associated with Daimler's direct shareholding in MBB are not comparable to the risks and opportunities associated with KfW's direct shareholding in Deutsche Airbus.<sup>241</sup>

146. Furthermore, KfW agreed to sell its shareholding in Deutsche Airbus to MBB by a pre-determined point in time, regardless of the share price at that time and regardless of the likelihood that KfW would incur a significant loss. Daimler-Benz, by contrast, undertook no such obligation; nor did MBB undertake an obligation to sell its shareholding in Deutsche Airbus at any time.<sup>242</sup>

147. KfW effectively forfeited profits for the entire duration of its investment so that Deutsche Airbus could build its capital base. Conversely, as a shareholder of MBB, Daimler-Benz was entitled to profits from MBB's activities. In this regard, it should be noted that at the time of

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<sup>240</sup> See EC Responses to Second Panel Questions, paras. 168-171.

<sup>241</sup> See U.S. Responses to Second Panel Questions, para. 129.

<sup>242</sup> See U.S. Responses to Second Panel Questions, para. 137.

Daimler's investment, MBB generated 75 percent of its total turnover and all of its profits through activities other than LCA manufacturing.<sup>243</sup>

148. In sum, despite the EC's continued insistence on this point in its response to Question 188, Daimler's investment is not a relevant benchmark for analyzing the benefit conferred by KfW's 1989 provision of an equity infusion to Deutsche Airbus.

**189. How does the EC respond to the United States' contention (at paragraphs 436-438 of its SWS) that the reference in the United States' Panel request to "the assumption ...of debt ... including debt accumulated by Deutsche Airbus," refers to the 1989 German government aid package to Deutsche Airbus?**

Comment

149. In considering the EC's response to Question 189, the Panel should recall the context in which the underlying U.S. argument was made. The EC contended that the U.S. challenge to the German government's 1998 debt settlement with Deutsche Airbus is really a challenge to the 1989 aid package to Deutsche Airbus.<sup>244</sup> That characterization of the U.S. claim is incorrect.<sup>245</sup> However, if the Panel were to agree with the EC's characterization, the Panel should not reject the U.S. claim on the ground that "{t}he US panel request does not include any reference to the 1989 restructuring measure."<sup>246</sup> For the reasons explained in the U.S. argument cited in the Panel's question, the EC's assertion to that effect is incorrect.

150. In particular, the United States pointed out that its panel request referred not only to the "forgiveness" of certain debt but also to the "assumption" of certain debt, and that the latter reference included the German government's assumption of Deutsche Airbus's debts as part of the 1989 aid package.<sup>247</sup> In its response to Question 189, the EC asserts that the reference to debt forgiveness pertains to debt owed by Deutsche Airbus, while the reference to debt assumption

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<sup>243</sup> See U.S. Responses to Second Panel Questions, paras. 136 and 138.

<sup>244</sup> See, e.g., EC Responses to First Panel Questions, para. 287.

<sup>245</sup> See, e.g., U.S. SWS, paras. 439-442.

<sup>246</sup> EC Responses to First Panel Questions, para. 288.

<sup>247</sup> See U.S. SWS, paras. 436-437.

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pertains to debt owed by CASA.<sup>248</sup> However, that assertion is not supported by the text of the panel request.

151. Point 4 of the request treats “assumption and forgiveness” of debt together. It does not separate out the two concepts the way the EC suggests. The reference to CASA, for example, does not concern only the assumption of debt, as the EC asserts. It concerns “debt assumed by the government of Spain on behalf of CASA and not repaid”<sup>249</sup> – in other words, both the assumption of debt and the non-repayment (*i.e.*, forgiveness) of debt. Likewise, the reference to Deutsche Airbus concerns both the assumption and forgiveness of debt.<sup>250</sup>

152. The EC also asserts that the reference in point 5 of the panel request to KfW’s 1989 equity infusion to Deutsche Airbus shows that the request did not identify the 1989 aid package.<sup>251</sup> However, the fact that a different element of the aid package may have been identified in a different part of the panel request does not negate the reference in point 4 to the assumption of Deutsche Airbus’s debt by the German government (also a part of the aid package) as well as its forgiveness of that debt.

**190. At paragraph 1179 of its FWS, the EC refers to a *Besserungsschein* (translated as debtor warrant) which established the terms pursuant to which Deutsche Airbus’ obligations to the German government following the 1989 restructuring would be repayable to the German government. Please provide a copy of this debtor warrant and any subsequent amendments.**

Comment

153. The United States refers the Panel to the U.S. comments on the EC’s responses to Questions 187 and 192, which address the points the EC makes in its response to Question 190.

**191. Please provide copies of the instrument(s) which effected the 1998 settlement between the German government, and Daimler, MBB and Deutsche Airbus.**

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<sup>248</sup> See EC Responses to Second Panel Questions, para. 178.

<sup>249</sup> WT/DS316/2, p. 2 (point 4) (emphases added).

<sup>250</sup> See generally *US – FSC (Article 21.5 II) (AB)*, paras. 66-68 (finding passing reference to measure in background section of panel request sufficient to bring measure within panel’s terms of reference).

<sup>251</sup> See EC Responses to Second Panel Questions, para. 180.

Comment

154. The United States has no comment on the EC's response to this question.

**192. At paragraph 1209 of its FWS, the EC contends that, the German government, Daimler, MBB and Deutsche Airbus negotiated that an amount representing the agreed price for the purchase by MBB of KfW's 20% interest in Deutsche Airbus, along with an additional amount specified in the 1989 restructuring agreement, be paid by Deutsche Airbus under the terms of the debtor warrant. Please explain why or how Deutsche Airbus assumed obligations which would appear to have been MBB's as purchaser of the Deutsche Airbus shares from KfW.**

Comment

155. The EC's response to this question is remarkable, first, for the fact that it does not actually address the issue identified by the Panel – *i.e.*, the assumption by Deutsche Airbus of an obligation that would appear to have been MBB's. It also is remarkable for the EC's confirmation that “on balance, this transaction {*i.e.*, the acceleration of KfW's transfer of its shares in Deutsche Airbus to MBB} did not affect, either positively or negatively, the economic position of Deutsche Airbus,”<sup>252</sup> even though the transaction accompanied the earlier-than-expected cancellation of the exchange rate insurance scheme that the government previously provided to Deutsche Airbus.

156. When it adopted the exchange rate insurance scheme in 1989, the German government expected that it would pay approximately DM 4.105 billion to Deutsche Airbus through 2000.<sup>253</sup> By 1992, when the scheme was prematurely terminated, the German government had paid only DM 1.48 billion to Deutsche Airbus. If, as the EC now admits, the 1992 transaction “did not affect . . . the economic position of Deutsche Airbus,” then it must have ensured that the company's position was as good as it would have been if the government had paid the company the additional DM 2.6 billion it expected to pay had the exchange rate insurance scheme remained in place. Considered together with the evidence previously adduced by the United States,<sup>254</sup> the EC's new statement further confirms that either the terms of the transfer of KfW's

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<sup>252</sup> EC Responses to Second Panel Questions, para. 191.

<sup>253</sup> See Monopolkommission, para. 131 (referring to government expectation to pay DM 2.465 billion through 1996 and DM 1.64 billion from 1997 through 2000) (Exhibit US-30).

<sup>254</sup> See, *e.g.*, U.S. Responses to First Panel Questions, paras. 206-212.

shareholding, or the acceleration of the transfer to 1992, or both conferred a benefit on Airbus in the amount of about DM 2.6 billion.

157. Additionally, as discussed in the U.S. comment on the EC's response to Question 187, above, there is no basis in the SCM Agreement for the EC's assertion that a subsidy analysis of a particular measure – in this case, the 1992 share transfer from KfW to MBB – depends on a subsidy analysis of other measures to which it may have been related – in this case, “the entirety of the 1992 amendment to the 1989 restructuring agreement.”<sup>255</sup> The burden for the United States (which it has met) is to establish that the measures at issue are subsidies, not to establish that measures that are not at issue also are subsidies.

158. Finally, the United States notes with surprise the EC's accusation that “the United States has not provided any evidence nor argued that the 1992 amendment, as a whole, constitutes a subsidy to Deutsche Airbus.”<sup>256</sup> The Annex V Facilitator asked the EC for the 1992 amendment (as well as other information concerning the 1992 transaction), and the EC refused to provide it.<sup>257</sup> Only at the latest possible stage in this proceeding, in response to the Panel's Question 190, did the EC finally provide this information. However, this new information does not alter the conclusion that KfW's transfer of its Deutsche Airbus shares to MBB in 1992 conferred a benefit on Deutsche Airbus and thus constitutes a subsidy.

**193. The EC argues (at paragraph 552 of its SWS) that the French government's transfer of its interest in Dassault Aviation to Aérospatiale could not have conferred a 'benefit' on Aérospatiale because “nothing of economic significance occurred” and observes that the French government owned 100% of its 45.76% stake in Dassault both before and after the transfer of its interest in Dassault to Aérospatiale, and 100% of Aérospatiale both before and after the transfer of its interest in Dassault to Aérospatiale. Does the EC agree that before the transfer of its interest in Dassault to Aérospatiale, the French government exercised (through its double voting rights) majority control over Dassault, while after the transfer of its interest in Dassault to Aérospatiale, the French government, through Aérospatiale, no longer exercised majority control over Dassault? If so, does the EC consider that the loss of majority control over Dassault Aviation in the course of the transfer of its interest in Dassault Aviation to Aérospatiale was of no economic significance to the French government?**

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<sup>255</sup> EC Responses to Second Panel Questions, footnote 176.

<sup>256</sup> EC Responses to Second Panel Questions, para. 191.

<sup>257</sup> See EC Responses to Questions from the Facilitator, pp. 95-96 (Nov. 18, 2005) (Exhibit US-5 (BCI)).

Comment

159. The EC’s response to this question focuses on the wrong issue. It focuses on whether the French government’s controlling stake in Dassault Aviation was of economic significance to the market.<sup>258</sup> However, the relevant issue – as the Panel’s question indicates – is whether the French government’s controlling stake was of economic significance to the French government. If the answer is yes – as it indisputably is – then the French government’s uncompensated relinquishment of that stake upon transferring its Dassault shares to Aérospatiale bears upon the question of whether the government’s actions were inconsistent with the usual investment practice of private investors in France, which in turn bears upon the ultimate question of whether the transfer conferred a benefit on Aérospatiale, thus constituting a subsidy within the meaning of Article 1 of the SCM Agreement.<sup>259</sup>

160. Analyzing whether the French government’s contribution of its Dassault shares to Aérospatiale conferred a benefit on Aérospatiale depends in part (but only in part) on whether Aérospatiale paid a price for those shares reflecting their market value.<sup>260</sup> It also depends on whether the very fact of having access to the shares is an advantage that would not have been available to Aérospatiale in the market. To answer that question, the Panel must consider whether a private investor in possession of those shares would have made them available to Aérospatiale, even if doing so required the investor to give up something of value – its controlling stake in Dassault – without any compensation at all. The EC’s response to Question 193 ignores the latter issue entirely.

161. The EC states repeatedly that the French government could not sell its controlling stake in Dassault and that, accordingly, the market placed no value on that stake.<sup>261</sup> But this observation, even if true, is beside the point. Even assuming, *arguendo*, that the French government could not transfer its controlling stake in Dassault to anyone other than the Dassault

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<sup>258</sup> See, e.g., EC Responses to Second Panel Questions, para. 193 (“The relevant inquiry under Article 1.1(b) of the *SCM Agreement* is whether the market considered control over Dassault Aviation to command a premium, and therefore to be of ‘economic significance.’”).

<sup>259</sup> See U.S. Responses to Second Panel Questions, paras. 306-308 (United States and EC agree that “in determining whether a government equity infusion confers a benefit and thus constitutes a subsidy, it is appropriate for the Panel to consider whether providing the infusion was consistent with the usual investment practice of private investors in the territory of the Member at issue”); see also *id.*, paras. 145-151, 156-158, 326-329.

<sup>260</sup> See U.S. Responses to Second Panel Questions, para. 152.

<sup>261</sup> See EC Responses to Second Panel Questions, paras. 193-201.

family,<sup>262</sup> that does not mean that the stake was without value. The EC effectively admits this when it acknowledges that the Dassault family benefitted from the French government's relinquishment of control.<sup>263</sup> Likewise, the September 1998 legal opinion of the French Conseil d'Etat concerning the French government's controlling stake in Dassault (Exhibit EC-846) expressly recognizes the value of control to the French government and, conversely, the value to the Dassault family of the government's eventual relinquishment of control.<sup>264</sup> Nevertheless, when the French government did relinquish control upon transferring its Dassault shares to Aérospatiale, it obtained no compensation from the Dassault family.

162. As discussed in the U.S. response to Question 158, a private investor might knowingly incur such a loss if it had a reasonable basis for expecting an offsetting gain. However, the EC has identified no studies or other evidence demonstrating that the French government had a reasonable basis for expecting such a gain.<sup>265</sup> Therefore, in contributing its Dassault shares to Aérospatiale, the French government acted inconsistently with the usual investment practice of private investors. The very fact that Aérospatiale received the Dassault shares under these circumstances – *i.e.*, circumstances under which a private investor would not have transferred the shares – means that Aérospatiale received a benefit even if it paid a price for the shares that reflected their market value.

163. For the foregoing reasons, it is irrelevant that neither the *Commissaire aux Apports* nor the investment banks that valued Dassault in connection with the public float of Aérospatiale-Matra shares referred to the control premium associated with the French government's stake in Dassault.<sup>266</sup> There is no reason they would have made such a reference, as they were indifferent as to whether the French government's actions were consistent with the usual investment

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<sup>262</sup> A report by a committee of the French Sénat notes that the French Conseil d'Etat leaned towards the view that the government could transfer its stake in Dassault to Aérospatiale and still maintain its controlling interest in Dassault. See Collin (Yvon), Senate Report No. 89 Projet de Loi de Finances pour 2000, Tome III, Annexe No. 25, Équipement, Transport et Logement: III. - Transports: Transport Aérien et Météorologie et Aviation Civile, at 52 (“{L}e problème des droits de vote double s’est enrichi de la question de savoir si un transfert de la participation de l’Etat à Aérospatiale s’accompagnerait du maintien ou de la perte des droits liés à cette participation. Il semble que, saisi pour avis, le Conseil d’Etat ait penché pour le maintien de ces droits.”) (Exhibit US-302).

<sup>263</sup> See EC Responses to Second Panel Questions, para. 197; EC SNCOS, para. 275.

<sup>264</sup> See Avis do Conseil d’Etat, no. 362-610, pp. 3-4 (referring to “la valeur réelee actuelle du droit pour son bénéficiaire” as well as “l’intérêt financier actuel de l’actionnaire majoritaire de Dassault Aviation à l’extinction de ce droit”) (Exhibit EC-846).

<sup>265</sup> See U.S. Responses to Second Panel Questions, paras. 147-151.

<sup>266</sup> See EC Responses to Second Panel Questions, paras. 198-201.

practice of private investors. Their only concern was valuation of the Dassault shares as transferred. Factors bearing on the French government's decision to transfer the shares in the first place were not germane to their task.

**194. What is the EC's response to the opinion expressed by Lauren D. Fox in her report (Exhibit US-HSBI-595 and Exhibit US-BCI-595a, referred to at paragraph 484 of the United States' SWS) that the transfer of Dassault to Aérospatiale [**

**]?**

Comment

164. The core basis for Ms. Fox's conclusion referred to in this question is the French government's uncompensated relinquishment of its controlling interest in Dassault Aviation, as discussed in the U.S. comment on the EC's response to Question 193, above.<sup>267</sup> In response to Question 194, the EC does not address this basis for Ms. Fox's conclusion (relying instead on its response to Question 193).<sup>268</sup> Rather, the EC focuses on what it calls "the second reason for Ms. Fox's conclusion," by which it means Ms. Fox's discussion of the diminishment in value in the French government's investment following the flotation of Aérospatiale-Matra ("ASM") shares on the Paris Bourse.<sup>269</sup> However, to call this part of Ms. Fox's discussion a "reason" for her conclusion is highly misleading. As Ms. Fox makes clear, her discussion of events following the flotation of ASM shares concerns "additional value destruction."<sup>270</sup> Even if the EC's criticism of this part of Ms. Fox's discussion were valid (which it is not), it would not refute the core basis for Ms. Fox's findings.

165. Furthermore, in the course of its response to Question 194, the EC asserts that "the French State's transfer of its Dassault stake was justified by contemporaneous valuations of the companies," and that, therefore, the government's loss of commercial value was not foreseeable.<sup>271</sup> However, that assertion is demonstrably false. The government's transfer to Aérospatiale of Dassault shares in exchange for new Aérospatiale shares occurred on December

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<sup>267</sup> See Lauren D. Fox, 1998 Dassault Share Transfer Valuation Report, p. 2 ("Fox Report") (Exhibit US-595 (HSBI) and Exhibit US-595a (BCI)).

<sup>268</sup> See EC Responses to Second Panel Questions, para. 204.

<sup>269</sup> EC Responses to Second Panel Questions, para. 205 (emphasis in original).

<sup>270</sup> Fox Report, p. 2 (emphasis added) (Exhibit US-595 (HSBI) and Exhibit US-595a (BCI)); see also *id.*, p. 6.

<sup>271</sup> EC Responses to Second Panel Questions, para. 208 (emphasis added).



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30, 1998.<sup>272</sup> The investment banks engaged to conduct valuations of Aérospatiale and Matra in advance of their anticipated merger produced their studies in February and March 1999.<sup>273</sup> The report of the *Commissaire aux Apports* – on which the EC asserts that the exchange ratio between Dassault shares and Aérospatiale shares “was based,”<sup>274</sup> and which the EC has provided only belatedly, in response to the Panel’s Question 195 – is dated April 27, 1999.<sup>275</sup>

166. The EC’s assertion that a transaction taking place in December 1998 was “justified” and that any losses resulting from that transaction were not foreseeable in light of reports carried out from February through April 1999 obviously makes no sense. In fact, this circumstance serves only to reinforce the point that the French government’s transfer to Aérospatiale of its interest in Dassault was inconsistent with the usual investment practice of private investors. As explained in the U.S. response to Question 160, “{T}he usual investment practice of a private investor in this situation would have been to undertake a study of the anticipated combination and sale of assets to determine how much wealth it could expect to be created by these transactions.”<sup>276</sup> Here, however, the only studies to which the EC refers were undertaken after the fact, in connection with a different transaction (*i.e.*, the anticipated Aérospatiale-Matra merger).

167. Moreover, the investment bank studies suffer from additional flaws that the EC fails to address. In particular, the EC does not respond to Ms. Fox’s explanation that the studies appear to overvalue the Aérospatiale shares. They all are based on discounted cash flow (“DCF”) calculations alone, in contrast to the norm of basing a valuation on multiple valuation methodologies,<sup>277</sup> and they all are based entirely on unverified and subjective numbers.<sup>278</sup> Ms. Fox also observed that the DCF analyses resulted in valuations that are more than 25 percent higher than the average of the analyses using two other methodologies (*i.e.*, the comparable company and comparable transaction methodologies). She noted that this is a “significant”

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<sup>272</sup> See EC FWS, para. 1165.

<sup>273</sup> See Fox Report, p. 3 and footnotes 9 and 10 (Exhibit US-595 (HSBI) and Exhibit US-595a (BCI)).

<sup>274</sup> EC FWS, para. 1165.

<sup>275</sup> See Rapport des Commissaires aux Apports sur la rémunération de l’apport de titres DASSAULT AVIATION devant être effectué à AEROSPATIALE SOCIETE NATIONALE INDUSTRIELLE par L’ETAT FRANÇAIS, p. 18 (Exhibit EC-892).

<sup>276</sup> U.S. Responses to Second Panel Questions, para. 157 (citing *Korea – Commercial Vessels*, para. 7.437; *EC – DRAMs*, para. 7.208; *Japan – DRAMs*, para. 7.128 (quoting findings of Japan investigating authorities)).

<sup>277</sup> See Fox Report, pp. 3-4 (Exhibit US-595 (HSBI) and Exhibit US-595a (BCI)).

<sup>278</sup> See Fox Report, p. 5 (Exhibit US-595 (HSBI) and Exhibit US-595a (BCI)).

difference – one that a private investor likely would have considered the result of “over-optimistic” management forecasts, which would have led the investor to conduct “a critical review of the underlying assumptions driving future growth and profitability.”<sup>279</sup> The EC’s response to Question 194 relies on the investment bank studies related to the Aérospatiale-Matra merger, but addresses none of these flaws.

**195. At footnote 939 to paragraph 1165 of its FWS, the EC refers to a report issued by a panel of independent experts concerning the exchange ratio for the transfer of the French government’s shares in Dassault in exchange for new Aérospatiale shares. Please provide a copy of this report.**

Comment

168. In its response to this question, the EC notes (as in its response to Question 193) that the report of the *Commissaires aux Apports* does not mention the French government’s loss of value due to its relinquishment of control of Dassault Aviation.<sup>280</sup> However, as discussed in the U.S. comment on the EC’s response to Question 193, above, there is no reason that the report would have mentioned this factor. It was not germane to the task at hand. The *Commissaires* took the French government’s transfer of its Dassault shares as a given and considered the appropriate ratio between those shares and newly issued Aérospatiale shares. The loss of value associated with the government’s decision to transfer the shares in the first place simply was not relevant to the *Commissaires*’ evaluation. This does not mean, however, that the government’s loss of value is not relevant to an inquiry into whether that transfer conferred a “benefit” on Aérospatiale within the meaning of Article 1.1(b) of the SCM Agreement. In fact, it is essential to such an inquiry.

169. Furthermore, the EC’s response to Question 195 asserts once again that the French government’s transfer of its Dassault shares to Aérospatiale was “fully consistent with contemporaneous valuations of both Aérospatiale and Dassault Aviation.”<sup>281</sup> However, as discussed in the U.S. comment on the EC’s response to Question 194, above, the *Commissaires*’ report was issued four months after the transfer of the Dassault shares and was in no sense “contemporaneous” with the transfer. Nor were the investment bank valuations on which the EC relies – also conducted after the transfer – “contemporaneous” with the transfer.

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<sup>279</sup> Fox Report, p. 4 (Exhibit US-595 (HSBI) and Exhibit US-595a (BCI)).

<sup>280</sup> See EC Responses to Second Panel Questions, para. 215.

<sup>281</sup> EC Responses to Second Panel Questions, para. 216.

**196. In response to Panel Question 102, the EC explains (at paragraph 283) that one way in which a ‘benefit’ could have been conferred by the transfer of the French government’s interest in Dassault to Aérospatiale is if, in selling its interest in ASM to Lagardère and the public in 1999, the French government had failed to secure adequate compensation for its Dassault shares. Please explain how the price paid to the French government by Lagardère and the public for the French government’s shares in ASM is relevant to the question whether the transfer of the Dassault shares to Aérospatiale conferred a benefit on Aérospatiale.**

Comment

170. The EC’s response to Question 196 accuses the United States of failing to demonstrate something that the United States has not sought to demonstrate: “that it is inconsistent with the usual investment practice of a private owner to pool wholly-owned, complementary assets together in anticipation of a combined sale of those assets.”<sup>282</sup> The United States has not sought to demonstrate this abstract proposition, because it does not need to do so to establish that the French government’s contribution of its Dassault shares to Aérospatiale conferred a benefit on, and therefore constitutes a subsidy to, Aérospatiale.

171. As the United States explained in response to Question 160, “Consolidating holdings in two different entities in anticipation of a combined sale could be consistent with the usual investment practice of a private investor in France if any financial losses knowingly incurred as a result of the consolidation were offset by a reasonable expectation of financial gains.”<sup>283</sup> However, that is not what happened in the case of the French government’s transfer of its Dassault shares. The government knowingly incurred a loss in the form of its uncompensated relinquishment of control of Dassault without having established a reasonable expectation of offsetting financial gains. For this reason, the government’s transfer of its Dassault shares to Aérospatiale was inconsistent with the usual investment practice of private investors and thus conferred a benefit on Aérospatiale.<sup>284</sup>

172. The EC’s response to Question 196 also repeats erroneous statements the EC made in its responses to Question 193 through 195, which have been addressed in the above U.S. comments on those responses. In particular, the evaluation of the Dassault share transfer by the

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<sup>282</sup> EC Responses to Second Panel Questions, para. 217.

<sup>283</sup> U.S. Responses to Second Panel Questions, para. 156; *see also id.*, paras. 326-329 (U.S. response to Question 224(c)).

<sup>284</sup> *See* U.S. Responses to Second Panel Questions, paras. 145-151, 156-158, 326-329.

*Commissaire aux Apports* was not made “at the time of the transfer,”<sup>285</sup> but rather, four months later.<sup>286</sup> Also, the French government’s inability to transfer its control of Dassault to a third party does not mean that the government did not knowingly incur a loss of value when it ceded control to the Dassault family without receiving any compensation.<sup>287</sup>

#### F. EXTINCTION AND EXTRACTION OF ALLEGED SUBSIDIES

**197. Is the Panel correct in understanding that it is the EC’s view that whenever there is a sale of the shares of an entity that received a subsidy, or a corporate restructuring of such an entity, in effect, a new determination of subsidy must be made by determining whether any benefit remains? If so, would the EC explain the consequences of this view in the context of a company whose shares are publicly traded.**

#### Comment

173. The EC’s response to this question underscores several fatal flaws in its theory of subsidy “extinction.”

174. First, the EC repeats its mischaracterization of the findings in previous Appellate Body and panel reports. The United States has discussed these mischaracterizations extensively in previous submissions and statements<sup>288</sup> and will not repeat those discussions here, except to emphasize two key points: (1) in prior disputes – in particular, *US – Lead Bars* and *US – Countervailing Measures* – panels and the Appellate Body did not make findings regarding the effects of private-to-private sales, and (2) they did not find transactions involving less than all or substantially all of the subsidized entity to bring about subsidy extinction.

175. The EC’s assertion that “the Appellate Body’s findings {in *US – Countervailing Measures*} also extended this principle {of subsidy extinction} to private-to-private sales” is flatly contradicted by paragraph 117 of the report of the Appellate Body in that dispute, in which it stated:

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<sup>285</sup> EC Responses to Second Panel Questions, para. 218.

<sup>286</sup> See U.S. Comment on EC Response to Question 194, *supra*.

<sup>287</sup> See U.S. Comment on EC Response to Question 193, *supra*.

<sup>288</sup> See, e.g., U.S. Responses to First Panel Questions, paras. 321-348; U.S. SWS, paras. 521-525; U.S. SNCOS, paras. 134-135.

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{T}he ‘core legal question’ before the Panel was to determine whether a ‘benefit’, within the meaning of the *SCM Agreement*, continues to exist following privatization at arm’s length and for fair market value. In considering this core legal question, the Panel examined a very precise set of facts and circumstances, namely, a benefit resulting from a prior non-recurring financial contribution bestowed on a state-owned enterprise where, following a privatization at arm’s length and for fair market value, the government transfers all or substantially all the property and retains no ‘controlling interest in the privatized producer.’ The Panel did not examine other situations, for instance, situations where a ‘benefit’ is conferred through recurring financial contributions, or where the seller retains a controlling interest in the firm following its change in ownership. The Panel had to consider only one kind of change in ownership (that is, a privatization at arm’s length and for fair market value where the government transfers all or substantially all the property and retains no controlling interest in the firm) and only one kind of benefit (that is, a benefit originating from a non-recurring financial contribution bestowed to the state-owned enterprise before privatization). The Panel should have confined its findings to those specific circumstances.<sup>289</sup>

176. Similarly, the EC’s asserted “principle” of partial subsidy extinction finds no support in the report of the compliance panel in *US – Countervailing Measures*. As explained in the U.S. second written submission, all of the transactions at issue in that proceeding involved the sale of all or substantially all of the subsidized entity.<sup>290</sup> The fact that one of those transactions involved 94.84 percent (rather than 100 percent) of a subsidized entity does not mean that any transaction involving less than 100 percent of a subsidized entity extinguishes a proportionate amount of subsidy.

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<sup>289</sup> *US – Countervailing Measures (AB)*, para. 117 (emphases added; internal citations omitted). In asserting that the Appellate Body’s findings in this dispute “extended . . . to private-to-private sales” (EC Responses to Second Panel Questions, para. 223), the EC cites paragraph 124 of the Appellate Body Report. However, in that paragraph, the Appellate Body does not make a finding regarding private-to-private sales (an issue which, as quoted above, was not before it). That paragraph is part of an explanation of the panel’s error in finding the presumption of subsidy extinction to be irrebuttable in the case of an arm’s length, fair market value transaction, involving all or substantially all of the subsidized company and relinquishment of control by the seller. The Appellate Body simply stated that such an “absolute rule . . . may be defensible” in the case of private-to-private sales. *US – Countervailing Measures (AB)*, para. 124. That off-hand remark about a circumstance not before the Appellate Body obviously is not a “finding” on the subject.

<sup>290</sup> See U.S. SWS, paras. 336-338; see also U.S. Responses to Second Panel Questions, para. 212 (discussing EC’s decision in compliance phase of *US – Countervailing Measures* dispute not to challenge U.S. Department of Commerce revised methodology, whereby the benefit conferred by a subsidy may be found to be extinguished pursuant to “a privatization . . . in which the government sold its ownership of all or substantially all of a company or its assets, retaining no control of the company or its assets, and . . . the sale was an arm’s-length transaction for fair market value” (Exhibit US-648 (emphasis added))).

177. Second, the EC's response to Question 197 conspicuously avoids the main thrust of the question. That is, the EC never actually explains the consequences of its extinction theory in the context of a company whose shares are publicly traded. It asserts that an analysis of the effects on subsidies of sales of shares of publicly traded companies "will depend on the circumstances of the case."<sup>291</sup> However, the EC refuses to confront the straightforward situation of a subsidized company, the shares of which trade daily on public exchanges among what the EC calls "revenue seeking investors."<sup>292</sup> The EC's avoidance is understandable, given that the consequence of its approach would be the constant extinction of subsidies provided to such companies, opening a major loophole in the SCM Agreement that Members could not possibly have contemplated.

178. Evidently aware of this problem with its approach, the EC states that "{t}he Panel is not called upon to solve all possible problems or to promulgate general rules on these matters."<sup>293</sup> The United States agrees that the Panel's role is not "to solve all possible problems or to promulgate . . . rules" (whether general or specific). It is to clarify rights and obligations set out in covered agreements.<sup>294</sup> However, that is not a reason to ignore the issue raised by the Panel's Question 197, or the obvious flaw in the EC's theory.

179. It is entirely appropriate for the Panel to consider the logical consequences of the finding the EC is asking it to make. The EC is asking the Panel to make a finding regarding interpretation of the term "benefit" in Article 1.1(b) of the SCM Agreement. Under customary rules of interpretation of public international law, it is appropriate for the Panel to consider whether that interpretation would "lead to a result which is manifestly absurd or unreasonable,"<sup>295</sup> as indeed it would.

180. Moreover, the EC's own argumentation demonstrates precisely why the Panel should consider the logical consequences of the finding the EC is asking it to make. The EC itself is asking this Panel to "extend" the reasoning used by panels and the Appellate Body in prior disputes,<sup>296</sup> (although, as discussed previously, what the EC actually is seeking is not an "extension" of prior reasoning but a major departure from that reasoning). It can be expected

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<sup>291</sup> EC Responses to Second Panel Questions, para. 225.

<sup>292</sup> EC Responses to Second Panel Questions, para. 225.

<sup>293</sup> EC Responses to Second Panel Questions, para. 225.

<sup>294</sup> See U.S. Responses to Second Panel Questions, paras. 200-201.

<sup>295</sup> *Vienna Convention on the Law of Treaties*, Art. 32(b).

<sup>296</sup> See EC Responses to Second Panel Questions, para. 223.

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that in future disputes, Members and panels will look to the reasoning of this Panel.<sup>297</sup> Accordingly, the Panel should reject the EC's attempt to avoid the issue raised by Question 197.

181. Third, the EC's response to the Panel's Question 197 is notable in that it asserts without basis that a presumption in favor of subsidy extinction has been established, giving rise to a burden on the part of the United States to rebut that presumption. Specifically, the EC states that “{a}ny intervening event that may have affected the present availability of a benefit from a financial contribution must be examined in establishing that there is a benefit.”<sup>298</sup> That statement leaves open the question of what constitutes an “intervening event that may have affected the present availability of a benefit from a financial contribution.” The EC answers that question by referring to “a series of transactions that it {that is, the EC} considers must have affected the availability or amount of any benefit.”<sup>299</sup> In other words, the test, according to the EC, is the EC's own consideration; an “intervening event that may have affected the present availability of a benefit from a financial contribution” is whatever the EC “considers” to be such an event, following the EC's reasoning.

182. However, the SCM Agreement provides no such test. It provides simply that a subsidy exists where there is a “financial contribution” and a “benefit” is thereby conferred. In prior disputes, panels and the Appellate Body have clarified that a privatization of a subsidized entity in an arm's length, fair market value transaction involving all or substantially all of the entity and a relinquishment of any controlling interest by the seller may result in extinction of subsidy. However, they have not found a presumption of subsidy extinction to arise simply because a Member “considers” it to have arisen.

183. Fourth, as previously discussed, several of the transactions the EC cites as the basis for its “extinction” theory occurred after the Panel in this dispute was established. Therefore, they have no bearing on the resolution of this dispute.<sup>300</sup> The EC asserted that the Panel should

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<sup>297</sup> See U.S. Responses to Second Panel Questions, para. 201 (noting that “the clarification of covered agreement provisions by a panel or the Appellate Body in the context of one dispute may be relevant to the consideration of a subsequent dispute to the extent that the reasoning underlying the clarification is persuasive and aids in the interpretation of covered agreement provisions in the subsequent dispute” (citing *Japan – Alcohol (AB)*, p. 14).

<sup>298</sup> EC Responses to Second Panel Questions, para. 224; *see also id.*, para. 226.

<sup>299</sup> EC Responses to Second Panel Questions, para. 224.

<sup>300</sup> See U.S. SWS, paras. 529-530.

consider the transactions anyway, citing the Appellate Body report in *EC – Customs Matters*.<sup>301</sup> However, as discussed in the U.S. comments on the EC’s second non-confidential oral statement, the EC misreads that report.<sup>302</sup> The point the Appellate Body made in *EC – Customs Matters* was that it is permissible to refer to facts post-dating panel establishment as evidence to confirm the existence of facts alleged to exist at the time of panel establishment.<sup>303</sup> That is not how the EC is attempting to use the transactions post-dating panel establishment in this dispute. It is citing those transactions in order to show the existence of facts alleged to exist after panel establishment. The EC has not responded to the U.S. rebuttal of its reliance on these transactions.

184. Fifth, even to the extent transactions cited by the EC pre-date panel establishment, the United States has shown that they are not “intervening event{s} that may have affected the present availability of a benefit from a financial contribution”<sup>304</sup> as that concept has been clarified in prior panel and Appellate Body reports.<sup>305</sup> The EC asserts that the transactions it cites are “significant” and “analogous to the kinds of sales which have already been found to extinguish or reduce benefit from past financial contributions.”<sup>306</sup> However, it cites no basis for the proposition that the relevant question is whether a transaction is “significant.” Nor does it offer a metric for determining whether a transaction is “significant.” Nor does it explain the basis on which it deems a transaction involving as little as 0.93 percent of the shares of EADS,<sup>307</sup> for example, to be either “significant” or “analogous” to the transactions found to result in subsidy extinction in prior disputes which, as already discussed, dealt with transactions that involved all or substantially all of the subsidized entity.<sup>308</sup>

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<sup>301</sup> See EC SNCOS, para. 62.

<sup>302</sup> See U.S. Comments on EC SNCOS, para. 9.

<sup>303</sup> See *EC – Customs Matters (AB)*, para. 188.

<sup>304</sup> EC Responses to Second Panel Questions, para. 224.

<sup>305</sup> See, e.g., U.S. SWS, paras. 520-555.

<sup>306</sup> EC Responses to Second Panel Questions, para. 225.

<sup>307</sup> See U.S. Responses to Second Panel Questions, para. 204 and footnote 282.

<sup>308</sup> The EC also fails to substantiate its characterization of certain of the transactions at issue as “sales.” For example, it does not address the fact that DaimlerChrysler itself explained that its April 2006 hedge/forward deal concerning a 7.5 percent stake in EADS “does not meet the criteria of a sale.” DaimlerChrysler, AG, Interim Report Q2 2006 at 21 (Exhibit EC-64) (discussed in U.S. SWS, para. 531). Nor does the EC address Daimler’s own characterization of a similar transaction in 2004 as a “securities lending agreement” rather than a “sale.” *Id.*



185. The EC alleges that “{c}ollectively” the transactions it cites (including those that post-date panel establishment) “resulted in the transfer to private buyers of 79.26 percent of EADS and Airbus SAS” and that this amounts to “all or substantially all” of the subsidized entity.<sup>309</sup> However, the EC offers no basis for analyzing the various transactions (which occurred over a period of seven years) collectively. Nor does it explain how “79.26 percent of EADS and Airbus SAS” would meet the “all or substantially all” standard, even if that number were accurate and relevant. And, the EC fails to mention that the “private buyers” to which it refers include Lagardère and DaimlerChrysler, which together hold 30.43 percent of the 79.26 percent at issue.<sup>310</sup> However, the EC does not even allege that these companies’ acquisition of their 30.43 stake extinguished any subsidies. Quite the contrary, it alleges that subsidy extinction occurred when these companies sold shares (*i.e.*, shares other than the 30.43 stake they retained).<sup>311</sup> Therefore, even if the Panel were to analyze the transactions cited by the EC collectively, and even if it were to include transactions occurring after panel establishment, the relevant percentage of EADS and Airbus SAS transferred to private buyers would have to exclude shares held by Lagardère and DaimlerChrysler, and thus would be 48.83 percent rather than 79.26 percent – a percentage that hardly can be considered to meet the “all or substantially all” standard.

186. Finally, the EC continues to ignore the fact that none of the transactions it cites resulted in the seller “no longer {having} any controlling interest.”<sup>312</sup> In its second written submission, the United States discussed the means by which controlling interests were retained in the transactions cited by the EC.<sup>313</sup> The EC did not address this issue in its response to Question 197. However, the EC did state that in considering whether a sale of shares in a publicly traded company extinguished subsidies to that company one would have to consider, among other factors, “whether the sellers completely exit or continue to share ownership of the economic unit.”<sup>314</sup> The implication of that statement is that if the sellers “continue to share ownership of the economic unit,” then the sale does not extinguish subsidies. Applying this observation to the transactions cited by the EC, none of the transactions extinguished subsidies. Not only did the

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<sup>309</sup> EC Responses to Second Panel Questions, para. 225.

<sup>310</sup> See EC FWS, para. 279.

<sup>311</sup> See EC Responses to First Panel Questions, para. 311.

<sup>312</sup> *US - Countervailing Measures (Panel)*, para. 7.62.

<sup>313</sup> See U.S. SWS, paras. 533-535.

<sup>314</sup> EC Responses to Second Panel Questions, para. 225.

sellers “continue to share ownership of the economic unit,” they continued to have a controlling interest in the economic unit. For this additional reason, therefore, none of the transactions cited by the EC are “analogous” to those found to result in subsidy extinction in previous disputes and should not be found to have extinguished any of the subsidies at issue in this dispute.

**198. At paragraph 75 of its SNCOS, the EC asserts that “a prior subsidy need not necessarily be “repaid” to the granting government in order for it to be “withdrawn” from the beneficiary...” Could the EC explain this statement. For instance, does the EC consider that a distribution of cash by a corporation to its shareholders can be considered “repayment” of a subsidy? If so, would this always be the case, and if not, in what circumstances would the EC consider that it would be the case.**

Comment

187. In the paragraph from the EC’s second non-confidential oral statement referred to in this question, in the sentence immediately preceding the one quoted by the Panel, the EC asserted that “any prior subsidies have already been ‘withdrawn’, within the meaning of Articles 4.7 and 7.8 of the SCM Agreement.”<sup>315</sup> The United States calls attention to this statement, because in its response to Question 198, the EC fails to address Articles 4.7 and 7.8. It discusses an Appellate Body finding regarding the meaning of the term “withdraw,” but it does not discuss the SCM Agreement context in which that term is used.<sup>316</sup>

188. In contrast, the United States refers the Panel to the U.S. response to Question 222. There, the United States explains that both Article 4.7 and Article 7.8 are drafted in the active voice. They require that the subsidizing Member do something particular – “withdraw the subsidy” – as opposed to merely requiring a particular result (*e.g.*, that the subsidy be withdrawn).<sup>317</sup> This context makes clear that a mere transfer of assets to a third party – such as a

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<sup>315</sup> EC SNCOS, para. 76 (corresponding to paragraph 75 of the check-against-delivery version of the EC’s SNCOS) (emphasis added).

<sup>316</sup> The United States notes that the EC is not arguing that Articles 4.7 and 7.8 as such are presently at issue. Indeed, these articles would become relevant only upon the Panel finding the EC to be in breach of Articles 3 and 5, respectively. Rather, the EC is attempting to draw an analogy between certain actions that have occurred – including actions post-dating panel establishment which, as previously discussed, are not properly before this Panel (*see* U.S. SWS, paras. 529-530; U.S. Comments on EC SNCOS, para. 9; U.S. Comment on EC Response to Question 197, *supra*) – and actions contemplated by Article 4.7 and 7.8. Because the EC misunderstands those articles, as discussed in this comment, its analogy is erroneous.

<sup>317</sup> *See* U.S. Responses to Second Panel Questions, para. 292.

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charity, in the EC’s example<sup>318</sup> – does not accomplish the withdrawal provided for in Articles 4.7 and 7.8.

189. The Panel’s question focuses on the implications of the EC’s theory of subsidy “extraction” in the context of a corporation’s distribution of cash to its shareholders. The EC’s response states that “{t}he Panel is not called upon to resolve all possible cases” and “caution{s}” the Panel “that it is dangerous to lay down universal rules on extractions.”<sup>319</sup> In this regard, the United States refers the Panel to its comment, above, on the similar point the EC made in response to Question 197.

190. Additionally, the United States notes that despite the EC’s call for “caution,” “lay{ing} down universal rules on extractions” is precisely what the EC is asking the Panel to do. Thus, from its first submission, the EC has based its “extraction” theory on what it deems to be “economic common sense” and asserts that “cash extraction from a recipient such that it no longer enjoys prior advantage, is necessarily a form of elimination of benefit within the meaning of the *SCM Agreement*.”<sup>320</sup> Likewise, the EC’s reliance on financial accounting standards that have nothing to do with “the facts before {the Panel}”<sup>321</sup> shows that it indeed is asking the Panel to “lay down universal rules on extractions.”<sup>322</sup>

191. Finally, the United States calls attention to the EC’s assertion that withdrawal of a subsidy can be accomplished by “simply removing the money from the hands of the entity alleged to be using it to cause adverse effects.”<sup>323</sup> Following this theory, it would seem that any cash transfer from a company to its shareholders – whether through a dividend, a stock buyback, or otherwise – would eliminate subsidies. As previously discussed, this would enable significant circumvention of SCM Agreement disciplines.<sup>324</sup>

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<sup>318</sup> See EC Responses to Second Panel Questions, para. 235. Indeed, it is highly questionable as a practical matter whether a cash transfer from a subsidized entity to a charity would accomplish elimination of a subsidy. Such a transfer could well yield tax benefits to the subsidized entity, as well as other, intangible benefits (such as an improved image among consumers), thus compensating for the ostensible removal of the subsidy.

<sup>319</sup> EC Responses to Second Panel Questions, para. 238.

<sup>320</sup> EC FWS, para. 225 (emphasis added).

<sup>321</sup> EC Responses to Second Panel Questions, para. 238.

<sup>322</sup> See U.S. Responses to Second Panel Questions, paras. 302-305.

<sup>323</sup> EC Responses to Second Panel Questions, para. 235.

<sup>324</sup> See U.S. SWS, paras. 547-550.

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192. The EC identifies an exception to its “extraction” theory in “the case where the distribution would have occurred in the absence of the subsidy.”<sup>325</sup> Like the theory itself, it is unclear what the basis for this exception is. Nor is it clear how a panel is supposed to determine whether a distribution “would have occurred in the absence of the subsidy.” Such an inquiry would require speculation. Companies pay dividends or buy back stock for any number of reasons. For example, a company might receive a subsidy in the form of a research and development grant and subsequently pay a dividend to its shareholders following an extended period of better-than-expected returns. It is not clear, under the EC’s proposed test, how a panel would determine whether this distribution “would have occurred in the absence of the subsidy” and thus whether or not it should be treated as removing a subsidy.<sup>326</sup>

193. In any event, even following the EC’s reasoning, it would not be the burden of the party challenging a subsidy to demonstrate that a “distribution would have occurred in the absence of the subsidy.” Rather, the burden would lie with the party alleging that a cash distribution from the subsidized company to its shareholders had “extracted” a subsidy to demonstrate that the distribution would not have occurred in the absence of the subsidy.<sup>327</sup> Likewise, in this dispute, even assuming (*arguendo*) the relevance of the EC’s “extraction” theory, it would be the EC’s burden to show that the transactions it characterizes as “extractions” of subsidies would not have occurred in the absence of those subsidies. The EC has not even tried to meet that burden, instead relying on mere assertion that this “‘but for’ test” has been met.<sup>328</sup>

194. Moreover, the EC contrasts “the case where the distribution would have occurred in the absence of the subsidy” with “the case where the company considers the receipt {of a subsidy} as a kind of lottery win and immediately distributed the whole amount to its multiple

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<sup>325</sup> EC Responses to Second Panel Questions, para. 236.

<sup>326</sup> In this regard, the EC’s asserted exception to its “extraction” theory resembles what it previously described as the “‘but for’ test” for subsidy extraction. *See* EC Responses to First Panel Questions, paras. 313-315. As the United States has explained, this “test” has no basis in the SCM Agreement. *See* U.S. SWS, paras. 539-540. It also provides no rationale for distinguishing subsidies from non-subsidized contributions to a company’s capital; just as one could ask whether a cash transfer would have been made “but for” the existence of subsidies, one could ask whether it would have been made but for an earlier contribution to capital from the company’s owner, but for better-than-expected returns, *et cetera*. *See id.*, paras. 541-542.

<sup>327</sup> *See US – Wool Shirts (AB)*, p. 14 (“the party who asserts a fact, whether the claimant or the respondent, is responsible for providing proof thereof”).

<sup>328</sup> *See, e.g.*, EC Responses to First Panel Questions, para. 315; EC Responses to Second Panel Questions, paras. 247, 253.

shareholders to spend.”<sup>329</sup> While the EC considers that subsidies would not be eliminated in the former case, it considers that subsidies would be eliminated in the latter. This contrast sheds additional light on the fallacy of the EC’s “extraction” theory. As between these two cases, the EC evidently believes the retention of cash by DaimlerChrysler and the Government of Spain in connection with their contributions to EADS of DASA and CASA, respectively, to be analogous to “the case where the company considers the receipt {of a subsidy} as a kind of lottery win and immediately distributed the whole amount to its multiple shareholders to spend.” However, the facts belie that analogy.

195. The subsidies at issue were not simply received by Deutsche Airbus and CASA and then immediately distributed to their respective shareholders. (Indeed, such a transaction would have been absurd in the case of CASA, given that its main shareholder, the Government of Spain, was also a provider of subsidies.) Rather, the subsidies were invested in productive assets and used to benefit Deutsche Airbus’s and CASA’s LCA production, which productive assets were then contributed to EADS. Therefore, if (as the EC suggests) the relevant point of reference for determining whether a cash transfer from a subsidized company to its shareholders “extracts” subsidies is “the case where the company considers the receipt {of a subsidy} as a kind of lottery win and immediately distributed the whole amount to its multiple shareholders to spend,” then the retention of cash by the shareholders of DASA and CASA upon contributing those companies to EADS cannot be considered as having “extracted” subsidies. For this additional reason, the Panel should reject the EC’s “extraction” theory.

**199. Please comment on the United States’ contention (at para. 546 of its SWS), that the EC’s argument that funds transferred from CASA to the government of Spain and from DASA to DaimlerChrysler resulted in an ‘extraction’ of subsidies previously provided to CASA and DASA, respectively, entirely contradicts the reasoning of the panel and the Appellate Body in *United States – Certain EC Products* that, for purposes of the benefit determination under the SCM Agreement, no distinction should be made between a company and its shareholders. What is the EC’s response to the United States’ argument (at paragraph 547 of its SWS) that money that is simply moved from the company to the owner’s pocket has not really left the company-shareholder unit, which together constitute a producer?**

Comment

196. Prior to the creation of EADS, DASA and CASA received Launch Aid and a variety of other, substantial subsidies benefiting their production of large civil aircraft. In 2001, these

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<sup>329</sup> EC Responses to Second Panel Questions, para. 236.

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entities were combined in EADS in non-arm's-length transactions, with the original owners (DaimlerChrysler and the Government of Spain, respectively) maintaining controlling interests through a pooling of "indirect shares" in an entity called EADS Participations B.V.<sup>330</sup> These transactions by themselves did not extinguish any previously granted subsidies, and the EC does not contend that they did. The fact that DaimlerChrysler and the Government of Spain each retained cash previously attributable to the Daimler-DASA and Spain-CASA shareholder-company units does not affect this analysis. The EC's assertion that it does is inconsistent with the proposition that a company and its shareholders should be treated as a single economic unit for purposes of a subsidy analysis.<sup>331</sup>

197. The very fact that the EC views these retentions of cash as "extractions" shows that it is treating each shareholder as separate and distinct from the company it owns. If Daimler "extracted" cash from DASA, for example, the implication is that the cash was attributable to DASA exclusively in the first place, and not to the Daimler-DASA shareholder-company unit. While, as an accounting matter, the cash may indeed have appeared on DASA's books immediately prior to the contribution of DASA to EADS, that does not mean that for purposes of a subsidy analysis the cash should be treated as belonging to DASA, such that its retention by Daimler might be viewed as an "extraction."

198. It is not at all uncommon for cash to move back and forth between a parent and a wholly-owned subsidiary. As the EC itself acknowledged in its response to the previous question (Question 198), the owner of a wholly-owned subsidiary "will shift cash resources as needed."<sup>332</sup> Those resources are attributable to the shareholder-company unit. Accordingly, there is no basis for the EC's assertion that when the company is sold and cash resources are retained by the shareholder, something is taken away or "extracted" from the company.

199. If it were otherwise, then it would be a simple matter to artificially "extract" subsidies in connection with a non-arm's-length sale of a subsidized company, in which the seller maintains a controlling interest. The more cash the owner attributed to the company and then retained upon selling the company, the more subsidy it could claim had been "extracted." The Panel should reject the EC's request for a finding that would lead to this manifestly absurd result.

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<sup>330</sup> See U.S. SWS, paras. 533-534.

<sup>331</sup> See U.S. SWS, paras. 544-550.

<sup>332</sup> EC Responses to Second Panel Questions, para. 237; *see also id.*, para. 239 ("money that is simply moved from the company to the shareholder's pocket has not really left the company-shareholder unit").

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200. Looked at another way, the EC’s view that LCA-related subsidies were “extracted” in the exact amount of the cash retained by Daimler and the Government of Spain upon their contributions of DASA and CASA, respectively, to EADS assumes an accounting rule for which the EC offers no basis. Under this supposed accounting rule, every Euro of cash retained is assumed to eliminate a Euro’s worth of LCA subsidy, even though the value of DASA and CASA before the contributions to EADS included components other than the subsidies they had received (components such as retained earnings, non-subsidized contributions to capital, appreciated assets, *et cetera*).<sup>333</sup>

201. This latter point relates to the issue of burden of proof. As discussed in the U.S. comment on the EC’s response to Question 198, above, as the party asserting that but for their receipt of subsidies DASA and CASA would not have had incremental value to “extract,” the EC had the burden to provide proof of that assertion. It has not done so.

202. In this regard, it also is notable that the EC offers no explanation as to why cash that Daimler retained from the Daimler-DASA shareholder-company unit should be treated as an “extraction” from only one of DASA’s five divisions (*i.e.*, DaimlerChrysler Aerospace Airbus GmbH). The United States discusses this point in more detail in its comment on the EC’s response to Question 200.

203. In its response to Question 199, the EC focuses on the fact that “{f}ollowing the transfer {of DASA and CASA}, the Spanish State and Daimler were minority owners of CASA’s and DASA’s assets.”<sup>334</sup> In the EC’s view, the attaining of minority shareholder status means that the cash retained by Daimler and the Government of Spain upon contributing DASA and CASA, respectively, has been put “beyond the reach of the ‘company-shareholder unit.’”<sup>335</sup> That view assumes that the mere attaining of minority shareholder status – even when the owner maintains a controlling interest in the assets at issue – is sufficient to break the shareholder-company unit for purposes of a subsidy analysis. The only basis the EC offers for that assumption is the unsubstantiated assertion that “{t}he Spanish State and Daimler . . . had a strong disincentive to re-inject the extracted cash into EADS.”<sup>336</sup>

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<sup>333</sup> See U.S. SWS, paras. 541-543.

<sup>334</sup> EC Responses to Second Panel Questions, para. 242.

<sup>335</sup> EC Responses to Second Panel Questions, para. 241.

<sup>336</sup> EC Responses to Second Panel Questions, para. 243.

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204. According to the EC, this “disincentive” stems from the fact that any returns from cash that Daimler or the Government of Spain might have “re-inject{ed} . . . into EADS” would have been shared proportionately with its fellow shareholders.<sup>337</sup> However, the same was true even before the contributions of DASA and CASA. Any returns on cash that Daimler or the Government of Spain provided to DASA or CASA, respectively, for LCA production would not have gone to Daimler or the Government of Spain exclusively, but would have been shared proportionately among the partners in Airbus GIE.<sup>338</sup> As the United States previously has discussed, the transformation from Airbus GIE to Airbus SAS was merely, in the words of the European Commission, “a restructuring and rationalisation of the existing legal relationship.”<sup>339</sup> It did not affect “the quality or nature of control”<sup>340</sup> of the previously integrated, subsidized LCA operations. Therefore, the EC has failed to demonstrate that the contributions of DASA and CASA to EADS changed the incentives of Daimler and the Government of Spain, respectively, in a way that would warrant (under the EC’s theory) treating their retentions of cash as “extractions.”

205. However, even accepting (*arguendo*) the EC’s assumption that the incentives of Daimler and the Government of Spain did change upon the contributions of DASA and CASA, the EC focuses on the wrong corporate relationships. As discussed above, the relevant relationships are the Daimler-DASA and Spain-CASA relationships, not the Daimler-EADS and Spain-EADS relationships. The EC admits that prior to the contributions to EADS, it was appropriate to treat Daimler-DASA as a single shareholder-company unit and Spain-CASA as a single shareholder-company unit.<sup>341</sup> However, in attributing the cash solely to the company half of each unit and then treating the shareholder’s retention of the cash as a subsidy-eliminating “extraction,” the EC ignores the unit and treats the company as separate and distinct from the shareholder. These cash retentions had no bearing on the fact that the entirety of DASA and CASA were contributed to EADS in non-arm’s-length transactions, with Daimler and Spain each retaining a controlling interest. Accordingly, the EC’s contention that these transactions eliminated subsidies should be rejected.

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<sup>337</sup> EC Responses to Second Panel Questions, para. 243.

<sup>338</sup> See U.S. FWS, para. 40 (describing relative shareholdings in Airbus GIE).

<sup>339</sup> Commission of the European Communities, Merger Procedure Article 6(1)(b) Decision, Case No COMP/M.2061 - Airbus, para. 6 (Oct. 18, 2000) (Exhibit US-478) (cited in U.S. Responses to First Panel Questions, para. 378).

<sup>340</sup> European Commission, Merger Procedure Article 6(2) Decision, Case No COMP/M.1745 - EADS, para. 16 (May 11, 2000) (Exhibit US-479) (cited in U.S. Responses to First Panel Questions, para. 378).

<sup>341</sup> See EC Responses to Second Panel Questions, para. 239.



**200. Please explain how DASA’s payment of €[ ] to DaimlerChrysler in connection with the creation of EADS constituted a repayment of subsidies that had been provided to DASA by the Federal government of Germany.**

Comment

206. The United States refers the Panel to its comment on the EC’s response to Question 199, above. As explained there, it is misleading to characterize DaimlerChrysler’s retention of cash as either a “payment” or “repayment” to DaimlerChrysler. That characterization inappropriately splits the shareholder-company unit, inasmuch as it attributes a fungible asset – cash – exclusively to the company rather than to the unit.<sup>342</sup> Even the EADS Offering Memorandum does not refer to a “payment” or “repayment” to Daimler. It refers to certain cash and cash equivalents being “retained by DaimlerChrysler.”<sup>343</sup> As the cash belonged to the Daimler-DASA shareholder-company unit prior to the contribution of DASA to EADS, its retention by Daimler cannot be considered a “payment,” “repayment,” or “extraction” from DASA.

207. Moreover, the EC’s reference to the amount of Euro 3,133 million is highly misleading. That reference comes from a summary in the EADS Offering Memorandum of exclusions from the assets and liabilities of DASA AG that were contributed to EADS Deutschland GmbH in preparation for the contribution of DASA to EADS.<sup>344</sup> However, later in the Offering Memorandum, it is explained that “{a}s part of the implementation of the agreements {regarding the creation of EADS}, Dasa cash and cash equivalents of €1,749 {million} shall be retained by DaimlerChrysler.”<sup>345</sup>

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<sup>342</sup> Equally misleading is the EC’s assertion that Daimler’s retention of the cash “represent{s} value drawn away from DASA before it was contributed to EADS.” EC Responses to Second Panel Questions, para. 247. That assertion, too, assumes that the value was uniquely attributable to DASA, rather than the Daimler-DASA shareholder-company unit, in the first place.

<sup>343</sup> See EADS Offering Memorandum, p. F-79 (July 9, 2000) (Exhibit EC-24); *id.*, p. F-12, Note G.

<sup>344</sup> See EADS Offering Memorandum, p. 142 (Exhibit EC-24).

<sup>345</sup> EADS Offering Memorandum, p. F-79 (Exhibit EC-24); see also *id.*, p. F-12, Note G. The EC’s reference to Euro 3,133 million appears to be based on the cash and cash equivalents shown on DASA’s balance sheet as of December 31, 1998, as opposed to December 31, 1999 (the year end immediately preceding the EADS share offering in July 2000). It also appears to include what the Offering Memorandum describes as the assumption by EADS of “financial liabilities of DaimlerChrysler amounting to €280 {million}.” *Id.*, p. F-12, Note G. According to the Offering Memorandum, the cash and cash equivalents on DASA’s balance sheet were Euro 5,065 million at year-end 1998, compared with Euro 3,958 million at year-end 1999. *Id.*, pp. F-4 and F-5. This difference of Euro 1,107 million, plus the Euro 1,749 million in cash actually retained by DaimlerChrysler, plus the Euro 280

208. Furthermore, the EC's response to Question 200 repeats the EC's alleged "'but for' test" for subsidy extraction.<sup>346</sup> Thus, the EC characterizes the cash retained by Daimler as "incremental value that would not have been there to extract in the absence of the alleged subsidies."<sup>347</sup> As the United States previously has explained, this "'but for' test" has no basis in the SCM Agreement.<sup>348</sup> Nor can it be reconciled with the supposed "economic common sense" that the EC cites as the basis for its "extraction" theory.<sup>349</sup> Nor has the EC satisfied its burden of proof even if one were to assume (*arguendo*) its "'but for' test" to be relevant.<sup>350</sup>

209. Any number of factors could explain the incremental value recorded on DASA's balance sheet and then retained by Daimler upon DASA's contribution to EADS. Such incremental value could have been the result of revenues, appreciated assets, or capital contributions from Daimler, for example. LCA-related subsidies also may have added to DASA's incremental value. But, that is not a reason to label cash retained by Daimler as incremental value in DASA attributable to LCA subsidies previously provided to DASA. In the absence of any of the aforementioned factors, it could be argued that there would have been no incremental value to extract. In that case, following the EC's reasoning, no subsidies would have been eliminated. However, in the presence of such factors, the EC asserts that all of the incremental value retained by Daimler constitutes the elimination of LCA-related subsidies.

210. This theory simply is illogical. As discussed in the U.S. comment on the EC response to Question 199, if the EC's theory were correct, it would be a simple matter to artificially "extract" subsidies. In the Daimler-DASA situation, the more cash the parent attributed to its wholly-owned subsidiary, the more the parent might retain in an eventual sale of the subsidiary – even a non-arm's-length sale in which the seller maintained a controlling interest – the more subsidy would be eliminated.

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million Daimler financial liability assumed by EADS equals Euro 3,136 million, which approximates the Euro 3,133 million to which the EC refers.

<sup>346</sup> See EC Responses to First Panel Questions, paras. 313-315.

<sup>347</sup> EC Responses to Second Panel Questions, para. 247.

<sup>348</sup> See U.S. SWS, paras. 540-543.

<sup>349</sup> See EC FWS, para. 225.

<sup>350</sup> See U.S. comment on EC response to Question 198, *supra*.

211. In any event, as discussed in the above U.S. comment on the EC’s response to Question 198, even if the relevant “test” were the “but for” test proposed by the EC, it would be the EC’s burden to prove that but for the subsidies to DASA, the cash retained by Daimler upon its contribution of DASA would not have been retained. The EC has failed to meet that burden.

212. An additional point to note in this regard is that DASA consisted of more than just DaimlerChrysler Aerospace Airbus GmbH (*i.e.*, the German participant in Airbus). It also included an aeronautics division, a space infrastructure division, a satellites division, and a defense and civil systems division, all of which were contributed to EADS together with DaimlerChrysler Aerospace Airbus GmbH.<sup>351</sup> Indeed, the notes to DASA’s combined financial statements attached to the EADS Offering Memorandum indicate that prior to 1999, these other divisions contributed more to DASA’s operating profit than DaimlerChrysler Aerospace Airbus GmbH.<sup>352</sup> Nevertheless, the EC alleges that the entirety of the cash amount retained by Daimler eliminated subsidies benefitting the commercial aircraft division of DASA. Even under the EC’s own reasoning, it is not clear why Daimler’s retention of cash should be treated as an “extraction” from only one of DASA’s five divisions.

213. In response to the U.S. demonstration of the fallacy in the EC’s “‘but for’ test,” the EC states that “{its} point is simply that the United States needs to establish that the benefit of old subsidies continues to benefit LCA production.”<sup>353</sup> But, in order for the United States to bear any such burden, the EC first must establish a presumption that the subsidies have been eliminated.<sup>354</sup> It has not done that. It has shown that an amount of cash originally belonging to the Daimler-DASA shareholder-company unit was retained by Daimler upon DASA’s contribution to EADS in a non-arm’s-length transaction in which Daimler maintained a controlling interest. However, this showing does not equate to establishment of a presumption of subsidy elimination. Accordingly, the EC has failed in its attempt to shift to the United States the burden of showing continuity of benefit.

214. Finally, with respect to the EC’s assertions regarding alleged “extraction” and cash flow relief, the United States refers the Panel to its response to Question 169, in which it explains the

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<sup>351</sup> See EADS Offering Memorandum, p. F-95 (Exhibit EC-24).

<sup>352</sup> See EADS Offering Memorandum, p. F-96 (Exhibit EC-24).

<sup>353</sup> EC Responses to Second Panel Questions, para. 250.

<sup>354</sup> See *US – Countervailing Measures (AB)*, para. 126.

EC's utter mischaracterization of the U.S. demonstration of the causal link between Launch Aid and adverse effects to the interests of the United States.<sup>355</sup>

**201. Please identify any specific evidence to show that CASA's payment of €[ ] to the Spanish government in connection with the creation of EADS was actually made to the Spanish government in its capacity as grantor of a subsidy in order to repay the subsidy, rather than as a shareholder of CASA.**

Comment

215. Much of the EC's response to this question repeats points the EC made in connection with its responses to Questions 199 and 200. Therefore, the United States refers the Panel to the U.S. comments on those responses, above.

216. As in the case of DaimlerChrysler's retention of cash upon the contribution of DASA to EADS, it is misleading for the EC to characterize the Government of Spain's retention of cash upon the contribution of CASA as a "payment" or "repayment" by CASA.<sup>356</sup> The attribution of a cash amount exclusively to CASA capable of being "paid" or "repaid" to CASA's main shareholder is inconsistent with the EC's own admission that prior to CASA's contribution to EADS, the Government of Spain and CASA should be considered as a single shareholder-company unit.<sup>357</sup> Also, as in the case of Daimler-DASA, the EC fails to substantiate the "but for" test that it believes applicable in determining whether a cash transfer from company to shareholder eliminates subsidies, and the EC fails to meet its burden of proof even if the "test" it identifies were the relevant test. Three additional points are notable.

217. First, the EC asserts that in retaining Euro 340 million upon its contribution of CASA, "the Spanish State was acting principally in its capacity as grantor of those subsidies, and only in part in its capacity as a shareholder." It bases that assertion on a reference in the EADS Offering Memorandum to a Euro 60 million dividend paid by CASA, which it alleges to be part of the

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<sup>355</sup> See U.S. Responses to Second Panel Questions, paras. 221-225.

<sup>356</sup> See EADS Offering Memorandum, p. F-12, Note G (referring to cash and cash equivalents being "retained . . . by . . . Sociedad Estatal de Participaciones Industriales").

<sup>357</sup> See EC Responses to Second Panel Questions, para. 239. Also, just as DASA included divisions in addition to the German participant in Airbus, so CASA included divisions in addition to the Spanish participant in Airbus. It is not clear why, even under the EC's own reasoning, the Spanish government's retention of cash should be treated as an "extraction" from only one of CASA's divisions.

*FINAL NON-BCI VERSION*

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

U.S. Comments on Answers of EC  
to 2d Panel Questions and on  
Answers of Third Parties to Panel Questions  
November 16, 2007 – Page 82

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Euro 340 million retained by the Government of Spain.<sup>358</sup> However, the Offering Memorandum indicates that the Euro 60 million dividend has nothing to do with the Euro 340 million retention of cash. The dividend is part of a “distribution of 1999 income” proposed by CASA’s directors. The entire distribution is 13,454 million Pesetas (equal to approximately Euro 80.86 million).<sup>359</sup> By contrast, the Euro 340 million retention of cash by the government is described as “{a} distribution of reserves and reduction of capital.”<sup>360</sup> Accordingly, the Offering Memorandum does not support the EC’s assertion that in retaining cash, the government was acting primarily in its capacity as grantor of subsidies.

218. Second, and relatedly, the Panel should recall that in addition to the Government of Spain retaining Euro 340 million, a payment of Euro 2,447,535.12 was made to CASA’s other shareholders, primarily DaimlerChrysler.<sup>361</sup> One must question why, if Spain was acting primarily in its capacity as grantor of subsidies, any money at all was paid to Daimler and other minority shareholders, which were not the grantors of any subsidies in the first place. If the government’s retention of cash were properly characterized as a repayment of subsidies by CASA, then the entire sum at issue should have gone to Spain. Instead, however, the cash went to Spain and Daimler and other minority shareholders in proportion to their respective stakes in CASA, which is what one would expect in a routine dividend.

219. Finally, in response to the U.S. demonstration of the fallacy in the EC’s “but for” test for subsidy “extraction,” the EC contends that a rejection of that test “must also impact the burden placed on the United States in these proceedings.”<sup>362</sup> In so arguing, the EC confuses the respective burdens of the United States and the EC.

220. The United States has established the existence of numerous subsidies benefiting Airbus’s LCA production. As the United States made its *prima facie* case, the burden shifted to the EC to try to rebut that case.<sup>363</sup> The United States had no additional burden to show that

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<sup>358</sup> EC Responses to Second Panel Questions, para. 252.

<sup>359</sup> EADS Offering Memorandum, p. F-105, Note 3 (Exhibit EC-24)

<sup>360</sup> EADS Offering Memorandum, p. 143 (Exhibit EC-24).

<sup>361</sup> See EADS Offering Memorandum, p. 143 (Exhibit EC-24).

<sup>362</sup> EC Responses to Second Panel Questions, para. 254.

<sup>363</sup> With respect to “benefit,” in particular, the EC’s burden is not “simply {to} demonstrate that the amounts of specific ‘benefit’ . . . may be incorrect,” but “{to} demonstrate that no ‘benefit’ is conferred” by the financial contributions at issue. *Canada – Aircraft (Panel)*, para. 9.312 (emphasis added). Cf. Brazil Responses to Questions to Third Parties, para. 7 (“{E}ven assuming, *arguendo*, that partial share transfers may extinguish a

subsidies to Airbus survived particular corporate events unless the EC first established a presumption that such events gave rise to subsidy extinction.<sup>364</sup>

221. The EC attempted to meet its burden by arguing that when a shareholder retained cash in connection with a non-arm's-length sale of a company in which it maintained a controlling interest, benefits from previously provided subsidies were "extracted" in the amount of the cash retained. The EC contended that this theory is justified by the proposition that "but for" the existence of subsidies, there would have been no incremental value for the shareholder to retain when it sold the company – ignoring numerous other circumstances (*e.g.*, revenues, capital contributions) "but for" which there would have been no incremental value for the shareholder to retain, and ignoring its burden of proof under its asserted "test."

222. If the Panel rejects the EC's "extraction" theory – as it should – this would have absolutely no impact on the burden of the United States. Quite simply, it would mean that the EC has failed to establish a presumption that the subsidy benefit originally demonstrated by the United States in its *prima facie* case has been eliminated. In the absence of such a presumption, the burden would not have shifted to the United States. Therefore, the U.S. *prima facie* case stands un rebutted.

#### G. ADVERSE EFFECTS

**202. Could the EC explain on what basis a panel may consider and determine whether the competing like product of the complaining Member is or is not a "non-subsidized product", such that, in the EC's view, the complaining Member may assert a claim of serious prejudice? Is it the EC's view that the mere allegation that the competing like product is subsidized precludes a finding of serious prejudice? If not, in what circumstances would the EC consider that the competing like product of the complaining Member may not be considered a "non-subsidized product"? In this regard, the EC referred to the Panel and Appellate Body findings in *United States – FSC*. Does the EC consider that these decisions constitute definitive determinations as to subsidization of specific products, including Boeing LCA?**

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portion of the benefit to the recipient in certain circumstances, such a finding should not affect the Panel's finding regarding the existence of a benefit.").

<sup>364</sup> See *US – Countervailing Measures (AB)*, para. 126.

Comment

223. The EC’s attempt to define the evidentiary requirements for the application of its interpretation of the term “non-subsidized like product” in Articles 6.4 and 6.5 of the SCM Agreement merely further demonstrates the incoherence of that interpretation.

224. The United States recalls its view that Article 6.3 as a whole, including the further specification of particular aspects of Article 6.3(b) and Article 6.3(c) in Article 6.4 and Article 6.5, respectively, provides detailed guidance with respect to particular ways in which a Member can demonstrate a breach of the obligation in Article 5(c) not to “cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, . . . serious prejudice to the interests of another Member.” As the chapeau of Article 6.3 makes clear, the ways of demonstrating serious prejudice set forth therein are not exhaustive.<sup>365</sup> Moreover, Articles 6.4 and 6.5 provide that displacement or impedance under Article 6.3(b) and significant price undercutting under Article 6.3(c), respectively, “shall include” the more particular market conditions described therein. Thus, Articles 6.4 and 6.5 provide further guidance for the application of Article 6.3(b) and Article 6.3(c), respectively, but do not necessarily set forth the only possible ways in which serious prejudice can be demonstrated.

225. However, the EC interprets the term “non-subsidized like product” as used in Article 6.4 and 6.5 to mean that, if the like product of the complaining Member benefits from *any* specific subsidy – no matter how small or indirect – that Member is affirmatively prevented from showing that the effect of another Member’s subsidy – no matter how large or direct – has caused displacement or impedance of its exports to a third country under Article 6.3(b) or significant price undercutting under Article 6.3(c). The EC does not propose any weighing of the relative effects of the subsidies to the products of different Members.<sup>366</sup> For the EC, even if the like product of the complaining Member receives, for example, a single dollar of benefit that is passed through from a specific subsidy to an upstream supplier, that Member’s complaint of displacement or impedance in a third country market or of significant price undercutting must necessarily fail, no matter how compelling the evidence that the challenged subsidy caused these significant effects.

226. Thus, the EC’s interpretation therefore does not comport with the role of Articles 6.3, 6.4, and 6.5 within Part III of the SCM Agreement. For the EC, the term “non-subsidized like

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<sup>365</sup> SCM Agreement art. 6.3 (“Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply . . . .” (emphasis added)).

<sup>366</sup> Nor, if the EC were correct that the term “non-subsidized” refers to subsidies other than the challenged subsidies in a particular matter, would there be any legal basis to introduce any such inquiry.

product” does not provide guidance as to how one might determine whether the challenged subsidies cause serious prejudice. Rather, it defines a situation in which one supposedly can *never* find – no matter what other evidence may be put forward – that serious prejudice exists, based on a condition having nothing to do with the challenged subsidy or its effects. Nothing in Articles 6.3, 6.4, or 6.5 suggests that these provisions are intended to deal with subsidies *other* than the challenged subsidies – whether those other subsidies are provided by the responding Member, the complaining Member, or other Members.

227. In an apparent attempt to mitigate the absurdity of its interpretation, the EC argues that only the receipt of a *specific* subsidy would place a product outside the scope of the “non-subsidized like product” in Articles 6.4 and 6.5. However, the EC cannot point to anything about the term “non-subsidized like product” that, in itself, constitutes a reference to the concept of specificity. Rather, the EC relies upon the placement of Articles 6.4 and 6.5 in Part III of the SCM Agreement and the provision in Article 1.2 that a subsidy “shall be subject to the provisions of Part III or V only if such a subsidy is specific.” However, Article 1.2 merely provides that a subsidy is “subject to” the provisions of Part III – that is, is actionable under Part III – only if it is specific, a requirement mirrored in the chapeau of Article 5 that obliges Members not to cause adverse effects “through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1.”<sup>367</sup> It does not state or imply that any use of the term “subsidized” in Part III for a purpose other than defining the scope of Article 5 is also to be understood as referring only to specific subsidies. Therefore, if the EC were correct that the term “non-subsidized like product” should be interpreted along the lines that the EC suggests, there would be no basis not to conclude that it is also limited to products that do not receive even a non-specific subsidy. And, as the United States has explained, because virtually any product can be said to benefit in some way from subsidies that are non-specific, indirect, or de minimis, the EC interpretation would virtually foreclose any claim of displacement or impedance under Article 6.3(b) or of significant price undercutting under Article 6.3(c).<sup>368</sup>

228. As the United States has explained, the term “non-subsidized like product” in Articles 6.4 and 6.5 should be understood simply as providing that the effect of the subsidy is determined by a comparison of the relevant market share or price, respectively, of the product that benefits from *that* subsidy (i.e., the “subsidized product”) with the market share or price, respectively, of the like product that does not benefit from *that* subsidy (i.e., the “non-subsidized like product”). This is consistent with the text of the provisions in Article 6.3 that Articles 6.4 and 6.5 interpret.

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<sup>367</sup> Emphasis added.

<sup>368</sup> U.S. SNCOS, para. 192.



229. For example, Article 6.3(b) concerns situations in which “the effect of the subsidy” (emphasis added) (i.e., the challenged subsidy) is the displacement or impedance of exports of “the like product,” without any qualification as to whether this “like product” is subsidized or not. Article 6.4 then goes on to define circumstances in which “displacement or impedance” exists for purposes of Article 6.3(b). Article 6.5 has a similar relationship to Article 6.3(c). Article 6.3(c) refers only to “significant price undercutting of the subsidized product as compared with the price of a like product,” and Article 6.5 goes on to define when “price undercutting” may be found to exist. In both cases, it is “displacement or impedance” or “price undercutting” that is in need of further definition, not the term “like product.” By contrast, the EC interpretation would introduce an entirely different matter into Article 6.3 – an alleged threshold condition having nothing to do with the effect of the subsidy at issue but that must be fulfilled before some, but not all, types of serious prejudice can be found to exist.

230. The EC complains that the interpretation advanced by the United States collapses the term “non-subsidized like product” into the “‘like product’ of the complaining Member,” thus allegedly failing to give meaning to the term “non-subsidized.”<sup>369</sup> It is true that, in the exceptional circumstances of this dispute in which there are only two LCA producers in the world, the “non-subsidized like product” is identical to the “like product of the complaining Member.” However, in most cases, like products from countries other than the subsidizing and complaining Member are likely to be present in the relevant markets. In these cases, Article 6.4 provides that serious prejudice may arise if there is a change in the market share in favor of the product benefitting from the subsidy at the expense of like products that do not benefit from the subsidy, whether of the complaining Member or another Member or even a non-Member.<sup>370</sup> The terms “subsidized product” and “non-subsidized like product” are the proper terms to cover all possible eventualities in such cases with precision. Thus, the U.S. interpretation does not render the term “non-subsidized” superfluous or inutile.

231. Indeed, in the majority of cases where more than two countries’ products are present in the market, under the EC interpretation the complaining Member would have to demonstrate with positive evidence, not only that its own like products do not benefit from any (specific)

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<sup>369</sup> EC Responses to Second Panel Questions, para. 265.

<sup>370</sup> To take a simple example, suppose that in a given market there are like products of three Members, including the subsidizing and the complaining Members. Suppose that the market share of the subsidizing Member increases, while the market share of the complaining Member is stable and the market share of a third Member decreases. If the decline in the market share of the third Member is due to external factors (drought, economic difficulties, etc.), the complaining Member may be able to show that, but for the subsidy, its like products would have gained some of the extra market share that in fact went to the subsidizing Member. In this case, the “effect of the subsidy” would be the displacement or impedance of the like product of the complaining Member in the relevant market, even though the loss of market share is entirely experienced by the third Member’s products.

subsidy, but also that the like products of other Members – and even non-Members – do not benefit from any (specific) subsidy. The impossibility of proving such a negative further underscores the absurdity of the EC interpretation.<sup>371</sup>

232. Accordingly, the Panel need not reach the question of whether Boeing LCA are subsidized, as this question is irrelevant to the resolution of this dispute. Whether Boeing LCA are subsidized and if so, with what effect, is a matter currently before another panel, and the United States has rebutted – and will continue to rebut – the EC allegations in the appropriate forum.

**203. Could the EC please explain how, in its view, the definition of like product in footnote 46 of the SCM Agreement is relevant in the determination of the subsidized product for purposes of an adverse effects analysis, in light of the fact that the definition of like product requires a comparison of the products produced in the complaining Member to the subsidized product, the scope of which must, as a matter of logic, already be determined in order to allow a comparison to take place.**

Comment

233. The United States welcomes the EC’s statement that footnote 46 of the SCM Agreement applies directly only to the definition of the “like product,” and is of no direct relevance to the identification or grouping of one or more subsidized products.<sup>372</sup> The United States can also agree with the EC that the identification or grouping of the subsidized product or products must be based on an objective assessment of “the evidence to determine whether it is appropriate to group any subsidized products into a single product – or multiple products – for purposes of assessing the adverse effects claims.”<sup>373</sup>

234. Where the United States parts ways with the EC is in the EC’s exclusive reliance on footnote 46 as providing context for this objective assessment. Because, as the EC itself explains, the identification and grouping of a subsidized product or products is done “for the

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<sup>371</sup> Although Article 6.6 and paragraph 3 of Annex V contemplate that, where there is a claim of displacement or impedance in the market of a third-country Member, that third-country Member should cooperate in the development of any information necessary to evaluate that claim, there is no parallel provision that would enable the gathering of information necessary to disprove the existence of (specific) subsidies that benefit the products of third country Members, let alone of non-Members.

<sup>372</sup> EC Responses to Second Panel Questions, para. 277.

<sup>373</sup> EC Responses to Second Panel Questions, para. 272.

purposes of assessing the adverse effects claims,<sup>374</sup> it is Articles 5 and 6 that provide the primary context for identifying the subsidized product. How the complaining Member has shown the subsidies to operate in the relevant market or markets is highly relevant in determining whether any of the conditions set forth in Article 6.3, including those that require the definition of a “subsidized product,” are in fact the “effect of the subsidy.” These provisions, not footnote 46, give the most important context for conducting the assessment described by the EC.

235. The United States also notes with interest the EC’s assertion that 100-200 seat and 550-seat LCA are distinct products in the same way that refrigerators and microwaves are distinct products.<sup>375</sup> The EC assertion is incorrect, as it compares products with different *uses* – refrigerators and microwaves – with products of different *sizes* – such as different models of LCA. An airline can choose to operate a 200-seat LCA or a 550-seat LCA to carry passengers on a given route; the choice between them ultimately depends on the economics of the several options.<sup>376</sup> A microwave, however, cannot be used to cool food, nor can a refrigerator be used to heat food, no matter what the price. The choice between a microwave and a refrigerator, therefore, is not influenced by their relative pricing, nor do sales of one enhance the ability to sell the other. Indeed, the United States has shown that LCA of various sizes are related to one another in multiple ways, none of which apply to microwaves and refrigerators.<sup>377</sup> The markets for microwaves and refrigerators are thus quite dissimilar in ways that the different segments of the LCA market are not.

**204. Does the EC consider that the Panel is legally precluded from considering information from the period 2001 to 2003 in its assessment of the adverse effects claims in this dispute?**

Comment

236. In its response to this question from the Panel, the EC does not contend that the Panel is, in general, legally precluded from considering evidence from the period 2001-2003 or any other period. The United States agrees that panels are not legally precluded from considering any

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<sup>374</sup> EC Responses to Second Panel Questions, para. 272.

<sup>375</sup> EC Responses to Second Panel Questions, paras. 272-273.

<sup>376</sup> See U.S. FWS, para. 728 (giving examples of different sizes of LCA operated by the same or different airlines on the same passenger routes).

<sup>377</sup> U.S. SWS, paras. 632-640.

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relevant evidence, and indeed are obligated to consider all relevant evidence under Article 11 of the DSU.<sup>378</sup>

237. The EC does, however, assert one exception to this general rule, which is its fallacious argument that consideration of data from this period to evaluate the U.S. claims under Articles 6.3(a) and 6.3(b) is precluded by Article 6.7(c). The United States has already refuted this EC argument and demonstrated the inapplicability of Article 6.7(c) to this dispute.<sup>379</sup> As the EC has seen fit not to respond to the U.S. showing in this regard, we simply refer the Panel to our earlier submissions on this point.

238. Rather, the primary argument of the EC is that, as a factual matter, data relative to the period 2001-2003 is not relevant to an assessment of whether adverse effects exist “today.”<sup>380</sup> The United States disagrees. Events that occurred during this period – when Boeing experienced greater market share and higher prices than it does “today” – are highly relevant to an assessment of whether adverse effects exist “today.” Moreover, this is true independently of whether “today” means, as it normally does in WTO dispute settlement, at the time of panel establishment, or some later date during the panel proceeding.

239. It is uncontested that Airbus increased its share of global LCA deliveries from 38 percent in 2001 to 53 percent in 2003, and that it maintained this increased share at 57 percent in 2005, 53 percent in 2006, and 53 percent in the first half of 2007.<sup>381</sup> It is uncontested that this shift in market share is reflected in the U.S., EC, and third country markets.<sup>382</sup> It is uncontested that LCA prices [ ] in 2002 and [ ] by 2005 and [ ] by 2007.<sup>383</sup> It is uncontested that Boeing lost numerous significant, competitive sales to Airbus in 2001 and thereafter, and that those sales were continuing to result in Airbus deliveries in 2005 and 2007 and will continue to do so in the future.<sup>384</sup> It is uncontested that Boeing has not recaptured most

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<sup>378</sup> U.S. Responses to First Panel Questions, paras. 276-280 (discussing *EC – Customs Matters*).

<sup>379</sup> U.S. Responses to First Panel Questions, para. 284-293; U.S. SWS, paras. 658-659.

<sup>380</sup> EC Responses to Second Panel Questions, para. 280.

<sup>381</sup> U.S. Responses to First Panel Questions, para. 286 (citing sources).

<sup>382</sup> U.S. FWS, paras. 705 (global), 733 (U.S.), 767 (EC), 772 (all other countries); U.S. SWS, paras. 698 (EC), 701 (all other countries), 731 (U.S.).

<sup>383</sup> U.S. FWS, paras. 804-809; U.S. SWS, paras. 724-729.

<sup>384</sup> U.S. FWS, paras. 769, 779-796.

of the customers lost to Airbus in this period. It is further uncontested that, in at least some of these lost sales, price undercutting by Airbus was the key factor in the outcome.<sup>385</sup> Whether the events that led to Airbus's increased market share, depressed and suppressed prices, lost sales, and price undercutting in 2001-2003 were the "effect of the subsidy" is therefore of great relevance in determining whether the continuation of most of these conditions "today" is also the "effect of the subsidy."

240. Rather than deny these incontrovertible facts, the EC points to the increase in total LCA demand from 2004 forward as a significant change in market conditions.<sup>386</sup> Yet this increase in demand has not resulted in a reversal of the dominant position captured by Airbus at Boeing's expense in the down cycle of 2001-2003. Thus, increased demand alone does not diminish the relevance of the 2001-2003 period to the existence of adverse effects "today."

**205. Could the EC explain its view, as expressed in paragraph 370 of its SNCOS, that "a proper causation analysis must consider if, and how, the subsidies changed the commercial behaviour of the recipient." What is the basis in the text of the SCM Agreement for this view?**

Comment

241. The United States agrees with the EC that, for purposes of demonstrating serious prejudice in this dispute, the proper causation standard under the SCM Agreement is a "but for" test. Something – such as one of the market conditions enumerated in Article 6.3 – must have happened in the market that would not have happened "but for" the subsidy. In this dispute, the United States has demonstrated that several of the Article 6.3 conditions are the effect of the subsidy through a two-step causation analysis. First, the United States has shown that the challenged EC and Airbus government subsidies have changed the commercial behavior of Airbus in two ways – by affecting its launch decisions and by affecting its subsequent pricing decisions. As a second step, the United States has shown that the Article 6.3 conditions have resulted from the Airbus launch and pricing decisions that, in turn, are the result of the subsidies.

242. From the EC's response to this question from the Panel, the United States infers that the EC does not object to the structure of the U.S. demonstration of causation. That is, the EC does not contest that a Member may demonstrate causation by first showing how the subsidy changed the commercial behavior of the recipient, and then by showing how this altered commercial behavior resulted in one or more types of serious prejudice. Rather, the EC questions whether

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<sup>385</sup> U.S. FWS, paras. 779-796.

<sup>386</sup> EC Responses to Second Panel Questions, para. 287.

the United States has shown that, as a factual matter, serious prejudice exists in this case. Its objection to the U.S. approach to showing causation therefore appears to be factual, not legal, in nature.

243. With respect to the first change in the commercial behavior of Airbus that results from the subsidies – the launch of aircraft that would not have existed but for the subsidy, at least not at the time or in the way that they were launched – the EC states only that the U.S. demonstration “fails as a factual and legal matter to support its adverse effect claims.”<sup>387</sup> Thus, the EC focuses here entirely on the second prong of the U.S. causation demonstration. In other words, the EC does not deny that “but for” the challenged subsidies, “either Airbus would not exist, some or all of Airbus’ LCA would not exist, or some or all of Airbus’ LCA would not have entered the market at the time or with the features it did.”<sup>388</sup> As the United States has repeatedly observed, without EC objection, the EC has studiously and consistently avoided any denial of a significant portion of the U.S. showing in this regard.<sup>389</sup>

244. The EC does not further elaborate upon, or even refer to, its earlier arguments on this point. The United States has already refuted them, and will not do so again here.<sup>390</sup>

245. The EC does contest, however, the U.S. showing that the challenged subsidies have changed Airbus’s pricing practices, in that they have made possible a deliberate strategy by Airbus of pricing to gain market share. According to the EC, the United States has asserted without proof that all subsidies to Airbus, regardless of when provided, “translate into automatic, nondiscretionary present reductions in LCA prices.”<sup>391</sup> The EC of course provides no citation for this alleged U.S. assertion, because – as the Panel by now is well aware – the United States asserts nothing of the kind. Rather, the United States has shown that (1) Airbus has chosen to pursue a pricing strategy of sacrificing profitability to win sales on price and therefore increase its market share,<sup>392</sup> (2) Airbus has been successful in this policy during the reference period, increasing its market share by 20 percentage points to over 50 percent of global LCA deliveries,

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<sup>387</sup> EC Responses to Second Panel Questions, para. 294.

<sup>388</sup> EC Responses to Second Panel Questions, para. 294.

<sup>389</sup> U.S. FNCOS, para. 129; U.S. SWS, paras. 575-576; U.S. SNCOS, para. 140.

<sup>390</sup> U.S. SWS, paras. 563-574, 584-587.

<sup>391</sup> EC Responses to Second Panel Questions, para. 297.

<sup>392</sup> U.S. FWS, paras. 777, 835.

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albeit at the cost of suppressed and depressed global LCA prices,<sup>393</sup> and (3) Airbus could not have successfully pursued this strategy without the financial flexibility provided by subsidies.<sup>394</sup>

246. The EC trots out a series of no fewer than ten arguments in an attempt to rebut this showing. Some of these arguments have been repeated – and refuted – on multiple occasions, while others are completely new. None have merit.

247. First, the EC repeats its contention that the magnitude of the subsidy is too small to have any effects.<sup>395</sup> The United States has already responded to this assertion in detail.<sup>396</sup>

248. Second, the EC misrepresents the U.S. argument in another dispute to attribute to the United States the view that a company that is unconstrained in its access to capital markets will use “any available subsidy” by returning it to its shareholders rather than using it to lower prices.<sup>397</sup> The EC then points to a report by its consultants purporting to show that EADS and BAe Systems were unconstrained in their access to capital markets in the relevant period.<sup>398</sup> From this, the EC concludes that under its characterization of the U.S. argument in this other dispute, Airbus would not use any subsidy to lower prices.

249. The United States is extremely hesitant to refer here to factual arguments made in another dispute. The present dispute is complex enough, and this Panel need not – and should not – concern itself with matters that will properly be decided elsewhere. However, given the importance of the point raised by the EC to the present dispute, and to avoid the entirely unfounded implication that the United States has taken inconsistent positions in the two disputes,<sup>399</sup> it is important to respond clearly and precisely to the EC argument on this point.

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<sup>393</sup> U.S. FWS, paras. 705, 804-809.

<sup>394</sup> U.S. SWS, paras. 591-627.

<sup>395</sup> EC Responses to Second Panel Questions, para. 295.

<sup>396</sup> U.S. Responses to First Panel Questions, paras. 247-257; U.S. SWS, paras. 599-613; U.S. SNCOS, paras. 176-186.

<sup>397</sup> EC Responses to Second Panel Questions, para. 298.

<sup>398</sup> Exhibit EC-905.

<sup>399</sup> The United States, at least, seeks to avoid taking inconsistent positions in different disputes. The same cannot be said for all other Members.

250. In that other dispute, the complaining Member presented an economist's report purporting to demonstrate that a company receiving subsidies *that increase its non-operating cash flow* (not just any subsidy) would likely use such subsidies to reduce prices, but only on the assumption that the company in question is constrained in its access to capital.<sup>400</sup> Among the points made in response by the United States in that dispute was that Boeing is, in fact, not constrained in its access to capital, and therefore that the economist's report in question, on its own terms, did not apply to Boeing.<sup>401</sup> Contrary to the statement of the EC, the United States did not state in that dispute that "*an LCA producer will have no incentive to use any available subsidy to reduce prices or make other investments.*"<sup>402</sup> Rather, the U.S. argument in that dispute related to a *particular theory*, advanced by the complaining Member, about alleged subsidies of a *particular nature* and whether that theory applied, on the facts, to a *particular LCA producer*.

251. The point the United States made in that dispute is that there is no sound basis to assume, as the complaining Member's economist did, that alleged subsidies unrelated to the production or development of LCA – or, to use that economist's formulation, alleged subsidies that are the functional equivalent of "non-operating cash flow" – have an impact on LCA pricing. To the contrary, as that economist recognized, it is widely accepted in the economic literature that the level of non-operating cash flow has no effect on the level of investment (including investments with potential price effects) for companies with unconstrained access to capital markets.

252. By contrast, the nature of the challenged subsidies in *this* dispute is very different. All of the subsidy programs in this dispute directly reduce the cost and risk of LCA product development for Airbus. The Airbus governments provide Launch Aid precisely because Airbus did not have access to the necessary capital to fund product launches,<sup>403</sup> or because if it did raise the necessary capital on commercial terms, it would destroy the financial stability of the company.<sup>404</sup> The capital markets rely on this government support to give EADS the high credit

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<sup>400</sup> US FWS in DS 353, para. 827

([http://www.ustr.gov/assets/Trade\\_Agreements/Monitoring\\_Enforcement/Dispute\\_Settlement/WTO/Dispute\\_Settlement\\_Listings/asset\\_upload\\_file930\\_13177.pdf](http://www.ustr.gov/assets/Trade_Agreements/Monitoring_Enforcement/Dispute_Settlement/WTO/Dispute_Settlement_Listings/asset_upload_file930_13177.pdf)).

<sup>401</sup> US FWS in DS 353, paras. 834-839

([http://www.ustr.gov/assets/Trade\\_Agreements/Monitoring\\_Enforcement/Dispute\\_Settlement/WTO/Dispute\\_Settlement\\_Listings/asset\\_upload\\_file930\\_13177.pdf](http://www.ustr.gov/assets/Trade_Agreements/Monitoring_Enforcement/Dispute_Settlement/WTO/Dispute_Settlement_Listings/asset_upload_file930_13177.pdf)).

<sup>402</sup> EC Responses to Second Panel Questions, para. 298 (emphasis added).

<sup>403</sup> U.S. SWS, paras. 575-590.

<sup>404</sup> See U.S. SWS, para. 638 and sources cited therein.



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ratings that it has.<sup>405</sup> Subsidized loans from the EIB, the subsidized provision of infrastructure, and R&D grants closely related to specific LCA projects supplement this reduction in development costs.<sup>406</sup> Debt forgiveness and equity infusions rebuild the balance sheet of Airbus when it is weakened by excessive spending on product development.<sup>407</sup> Nothing in the latest report by the EC's consultants even purports to challenge any of these facts or to discuss the economic implications of the very different nature of the subsidies challenged in this dispute and the alleged subsidies in the other dispute referenced by the EC.

253. As the United States has explained, in the 2001-2005 reference period Airbus developed new LCA at an extraordinary pace, completing development of the A340-500/600, undertaking the full-scale development and marketing of the A380, and launching the A350. Notwithstanding the major burden that these simultaneous, highly capital-intensive projects placed on Airbus's financial position, Airbus chose just this moment to launch a price war with Boeing, particularly regarding sales to low-cost carriers.<sup>408</sup> The EC and the Airbus governments use subsidies to enable Airbus to do more in the LCA market at the same time than Airbus could ever have had the financial resources to do on its own – launch multiple new aircraft, buy market share for existing aircraft through lower pricing, or both.<sup>409</sup>

254. Thus, the U.S. causation argument in this dispute is fully consistent with the U.S. causation argument in the dispute referenced by the EC. The differences in the design, structure, and operation of the measures in the two disputes fully account for the differences in the

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<sup>405</sup> Moody's Investor Service, *Moody's confirmation of EADS highlights government's role as odd rescuers* (Mar. 12, 2007) (Exhibit US-450); see also U.S. FWS, para. 146; U.S. FOS, para. 24 and note 17; U.S. Responses to First Panel Questions, para. 30. In addition, a recent EADS publication confirmed that Moody's credit rating in particular reflects the commitment of support from the Airbus governments:

Other investors point to the huge value that resides in EADS and in Airbus for Europe; they believe neither could be left to fail. Beyond the symbols, the stakes are too high for European technologies, exports, tax revenues and jobs. This view resonates in Moody's credit rating which assumes an implicit support of EADS's home countries.

Pierre de Bassuet, *EADS Aero-Notes* (Aug. 17, 2007) at 2 (emphasis added) (Exhibit US-662).

<sup>406</sup> U.S. FWS, paras. 821-823; U.S. SWS, paras. 623-625; U.S. Responses to Second Panel Questions, paras. 167-168.

<sup>407</sup> U.S. FWS, para. 825-826; U.S. SWS, paras. 626-627; U.S. Responses to Second Panel Questions, para. 168.

<sup>408</sup> U.S. Comments on EC SNCOS, paras. 45-47.

<sup>409</sup> In this sense, the pricing aspect of the U.S. causation argument is quite similar to – and, in fact, is not wholly independent of – the product development aspect of that argument discussed above.

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economic analysis of their impact, or lack of impact, on the LCA market. The evidence in this case demonstrates that the subsidies provided by the EC and the Airbus governments changed the commercial behavior of Airbus in ways that caused adverse effects to the interests of the United States. That the evidence in the other dispute shows no adverse effects is a matter to be shown in that other dispute.

255. Third, the EC asserts that, according to a certain business case document, Launch Aid [ ].<sup>410</sup> As the United States has already shown, the EC’s references to business case documents show nothing of the kind.<sup>411</sup>

256. Fourth, the EC asserts that, given high LCA demand, Airbus has no incentive “today” to use pricing to build market share.<sup>412</sup> The EC contention, of course, did not apply earlier in the reference period when demand was not high, and – as already shown above – the adverse effects from that period continue “today.” Moreover, as the United States has already shown, Airbus is increasing its production capacity, including to 40 aircraft per month for the A320, in ways that, according to Boeing’s public statements, are not sustainable over the long run even considering current market conditions.<sup>413</sup>

257. Indeed, a recent industry publication cited senior executives of two major aircraft financing company as confirming that Airbus has priced for market share and has a continued incentive, even in 2007, to act in ways that keep prices down for market share purposes:

Fred Klein, president of Aviation Specialists ... says ... “Airbus keeps the tap open wider than Boeing and cuts prices to move airplanes. In my opinion, cutting on new prices hurts long-term values.” ... But {Avitas’s} Douglas Kelly, vice president for asset valuation ... says ... “I would expect possibly a little lower pricing on the A320 because Airbus was pricing for market share. Now that they have 50%, you wouldn’t expect much differential.” Klein disagrees. Airbus discounting on the A320 not only has been a past practice, he believes that with Airbus boosting production to as many as 40 A320 family members a month to get the cash flow needed to carry the company through the

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<sup>410</sup> EC Responses to Second Panel Questions, para. 300 (citing EC SWS para. 1071, in turn citing Exhibit EC-362 (HSBI)).

<sup>411</sup> U.S. SCOS, para. 55.

<sup>412</sup> EC Responses to Second Panel Questions, para. 301.

<sup>413</sup> U.S. Responses to Second Panel Questions, paras. 226-231.

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A380 tribulations means that steep discounting will continue. This will depress current market and future values, Klein says.<sup>414</sup>

And, as the United States has shown, the most recent information about 737 prices shows that prices have [ ] with increased demand – contrary to what the EC theory would predict.<sup>415</sup>

258. Fifth, the EC states that Airbus does not necessarily have the opportunity to use pricing to win sales, because many sales do not meet the EC definition of “competitive” sales.<sup>416</sup> It would seem to follow from this assertion that Airbus does, in fact, have the opportunity to make use of subsidies in those sales that meet the EC’s highly restrictive definition of “competitive.” In any event, as the United States has shown, market pricing levels affect *all* sales, even those the EC would deem “non-competitive.” If the initial supplier in such sales insisted on an above-market price, the sales would quickly become “competitive.”<sup>417</sup>

259. Sixth, the EC says that the U.S. analysis improperly attributes to the subsidies market effects that arise from other factors previously identified by the EC.<sup>418</sup> As the EC adds nothing to its prior arguments on this point, the United States refers the Panel to its previous responses.<sup>419</sup>

260. Seventh, the EC raises an entirely new alleged “other factor” that supposedly affected Airbus pricing, namely fluctuations in the exchange rate between the Euro and the U.S. dollar.<sup>420</sup> As a preliminary matter, the United States wonders why the EC decided to wait until this very late stage in this dispute to raise this matter. If, as the EC now says, exchange rates affected the lost sale campaigns or the price depression and suppression claims the United States set forth in its first written submission nearly eleven months ago, it is surprising that the EC would only now mention this factor for the first time.

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<sup>414</sup> Scott Hamilton, “Airbus Targets Appraisers on Values,” *Jetrader* (June 2007) at 12-14 (Exhibit US-663).

<sup>415</sup> U.S. SWS, para. 726,

<sup>416</sup> EC Responses to Second Panel Questions, para. 302.

<sup>417</sup> U.S. SWS, paras. 614-618.

<sup>418</sup> EC Responses to Second Panel Questions, paras. 303-306.

<sup>419</sup> U.S. Responses to First Panel Questions, paras. 294-301; U.S. SWS, paras. 708-711.

<sup>420</sup> EC Responses to Second Panel Questions, paras. 307-308.

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261. It is true that LCA sales in the global market are priced in U.S. dollars, while a significant portion – but by no means all or even most – of Airbus’s costs are denominated in Euros.<sup>421</sup> However, the Euro has been appreciating against the U.S. dollar throughout the reference period. For example, the EADS 2002 Annual Report states that about one-half of the decreased revenues for Airbus in 2002 as compared to 2001 was due to “the weaker US Dollar.”<sup>422</sup> Indeed, the value of the U.S. dollar against the Euro peaked in 2001 – when Airbus’s global share of the LCA market was at 38 percent and before the lost sales, price depression, and price suppression demonstrated by the United States began – and has been declining ever since.<sup>423</sup> Thus, fluctuations in the exchange rate – which have become steadily *less* favorable to Airbus since 2001 – cannot explain the increase in Airbus’s market share, the lost sales, or the significant price depression and suppression over this period.

262. The reason that the EC did not advance this argument earlier, therefore, is not difficult to discern. The facts fail to support it, and indeed contradict it.

263. Eighth, the EC states that the United States wrongly perceives the existence of price suppression because it measures the expected increase in LCA prices over the 2001-2005 or 2001-2006 period using the U.S. producer price index for aircraft manufacturing.<sup>424</sup> Once again, the EC is quite tardy in raising this claim, as the United States has used this metric from its very first submission,<sup>425</sup> and commented on this question several months ago in response to the Panel’s earlier questions.<sup>426</sup> And, once again, the facts do not support the EC assertion, as the United States explains in more detail in its comments on the EC response to Question 213, below.

264. Ninth, the EC speculates that the price effects identified by the United States may simply be the result of the ordinary competition between two competitive producers that could be

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<sup>421</sup> According to EADS, Airbus’s costs that are denominated in dollars provide a “natural hedge” against about half of Airbus’s dollar revenues. EADS Financial Statements and Corporate Governance 2006 at 46 (Exhibit US-664).

<sup>422</sup> EADS Annual Report 2002 at 60 (Exhibit US-665).

<sup>423</sup> Annual Average Exchange Rate, Euro to U.S. Dollar, 1999-2007, [www.oanda.com](http://www.oanda.com) (last visited Oct. 3, 2007) (Exhibit US-666).

<sup>424</sup> EC Responses to Second Panel Questions, para. 309.

<sup>425</sup> U.S. FWS, paras. 743, 804; Exhibit US-402.

<sup>426</sup> U.S. Responses to First Panel Questions, para. 317.

anticipated in any market even in the absence of subsidies.<sup>427</sup> The United States does not dispute that, if Airbus had not received the challenged subsidies, it would engage in competition to sell whatever LCA it might have been able to launch with commercial financing. However, the United States has shown that such an Airbus would look very different from the one that exists – and therefore whatever competition would exist “but for” the subsidies would be quite different from what has actually occurred. The EC does not offer any evidence that would suggest otherwise.

265. Tenth, and finally, the EC states that the United States has not attempted to quantify the per-aircraft current subsidy benefit for each aircraft sold in the reference period and therefore has failed to provide sufficient evidence to sustain its claims.<sup>428</sup> If the United States had actually claimed, as the EC bewilderingly insists on asserting, that subsidies to Airbus cause serious prejudice solely because they “translate into automatic, nondiscretionary present reductions in LCA prices,”<sup>429</sup> then a per-aircraft subsidy calculation could conceivably have some relevance. But that is not our case. What we have shown quantitatively – using the EC’s own data on Launch Aid disbursement and repayment schedules – is that if Airbus had to repay the Launch Aid it has received from the Airbus governments at commercial rates, it would have been unable to sustain the activities it has undertaken, and that this is true by a wide margin.<sup>430</sup> This is the quantitative evidence relevant to the claim that the United States has actually made, and the United States has provided it.

**206. Is it the EC’s view that subsidies must be “the determining factor in a lost sale, suppressed price, or decreased market share,” as suggested by paragraph 406 of its SNCOS? If so, could the EC please indicate the legal basis for this view.**

Comment

266. Article 6.3 provides that serious prejudice may arise if the “effect of the subsidy” is one or more of the conditions set forth therein. The United States and the EC have interpreted this provision as establishing a “but for” test – the relevant condition is the “effect of the subsidy” if,

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<sup>427</sup> EC Responses to Second Panel Questions, para. 310.

<sup>428</sup> EC Responses to Second Panel Questions, para. 312.

<sup>429</sup> EC Responses to Second Panel Questions, para. 297.

<sup>430</sup> U.S. Responses to First Panel Questions, paras. 247-257; U.S. SWS, paras. 610-613; U.S. SNCOS, paras. 176-186.

“but for” the subsidy, the condition would not have occurred. The panel reports in *Korea – Commercial Vessels* and *US – Cotton Subsidies* cited by the EC<sup>431</sup> took a similar approach.

267. The United States therefore considers that, in order to find serious prejudice under Article 6.3, the subsidy must be a *necessary* cause of one or more of the described market conditions. However, the subsidy need not be the only such cause. Depending on the facts of a given case, a market condition identified in Article 6.3 might not have existed “but for” a number of factors, including, but not limited to, subsidies. As long as the subsidy is one such “but for” cause, then these market conditions are the “effect of the subsidy” regardless of whether they may also be the “effect of” other factors as well.

268. The Appellate Body report in *US – Cotton Subsidies* confirms this view. Other factors must be considered in order to ensure that their effects are not attributed to the subsidies – i.e., in order to ensure that the market condition is, in fact, the “effect of the subsidy.”<sup>432</sup> In other words, other factors must be considered to apply the “but for” causation test that is called for by the text of Article 6.3. If the market conditions are caused *entirely* by other factors – i.e., they would exist even without subsidies – then they are not the “effect of the subsidy.”

269. The text of Article 6.3 therefore does not support any notion of “weighing” possible multiple causes of subsidies. Rather, other causes must be considered in determining whether, on the facts of a particular situation, the Article 6.3 condition is or is not the “effect of the subsidy.” Other causes are not relevant for other purposes, such as evaluating which of multiple “but for” causes is the greatest or most important such cause.

270. Based on the EC’s discussion of the term “determining factor” in its response to the question from the Panel, it is unclear to the United States whether that term accurately conveys the “but for” nature of the causation standard set forth in Article 6.3. Accordingly, the United States does not believe it to be a useful or appropriate expression in articulating the standard in the text of Article 6.3.

**207. Could the EC explain the relevance of improvements in the operating performance of Boeing to the assessment of serious prejudice? Is it the EC’s view that, assuming the Panel were to find, for instance, that the effect of the subsidy/ies in this dispute is to displace or impede the exports of a like product of the United States from a third country market, the Panel would have to then assess whether such displacement or impediment is reflected in the current operating performance of Boeing?**

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<sup>431</sup> EC Responses to Second Panel Questions, paras. 316-317.

<sup>432</sup> *US – Cotton Subsidies (AB)*, para. 437.

Comment

271. According to the EC, the displacement and impedance of U.S. LCA exports to third-country markets cannot rise to the level of “serious” prejudice if Boeing’s financial performance is good.<sup>433</sup> As the United States has shown, however, the market share shift in favor of Airbus at the expense of Boeing over the relevant period is highly significant – 19 percentage points in the world market (from 38 percent in 2001 to 57 percent in 2005)<sup>434</sup> and 20 percentage points in markets other than the United States and the EC (from 36 percent in 2001 to 56 percent in 2005).<sup>435</sup> A loss of 20 percentage points of market share over such a brief period is unquestionably – in the words of the panel in *US – Cotton Subsidies* quoted by the EC in its response – “‘important,’ ‘not slight or negligible,’ or meaningful.”<sup>436</sup> Nothing about Boeing’s financial performance can render one-fifth of the world market unimportant or negligible.

272. However, the EC response goes well beyond the question posed by the Panel. The EC takes the occasion of the Panel’s question about the relevance of Boeing’s financial performance to the U.S. claim under Article 6.3(b) to reply – for the first time – to the *entirety* of the U.S. demonstration of displacement and impedance of U.S. LCA exports in third country markets presented nearly eleven months ago in its first written submission.<sup>437</sup> However, the EC’s belated arguments fail to undermine the U.S. claim.

273. As an initial matter, the U.S. presented its *prima facie* case in support of its Article 6.3(b) claim with respect to the enormous shift in market share in third country markets generally during the reference period, which was – as one would expect – reflected in the largest third-country markets (Australia and China) and other major third-country markets.<sup>438</sup> Although many third-country markets are too small for clear trends to be apparent, even over a five-year period, the United States considers that this evidence – together with evidence of price depression and suppression in the global market, numerous significant lost sales, and of the manifest impact of

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<sup>433</sup> EC Responses to Second Panel Questions, paras. 327.

<sup>434</sup> U.S. FWS, para. 705 & Table 1.

<sup>435</sup> U.S. FWS, para. 772 & Table 9.

<sup>436</sup> EC Responses to Second Panel Questions, para. 326 (quoting *US – Cotton Subsidies (Panel)*, para. 7.1392 (defining “serious” prejudice)).

<sup>437</sup> U.S. FWS, paras. 771-775; *see also* U.S. SWS, paras. 701-705.

<sup>438</sup> U.S. FWS, para. 772.

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subsidies on the commercial behavior of Airbus during the period – is more than sufficient to establish that the effect of the subsidy is that U.S. exports to third-country markets were displaced or impeded during the period. In fact, as the United States has shown, if the Panel finds that individual third-country markets are too small for a meaningful analysis of displacement or impedance, the SCM Agreement allows the Panel to make a finding under Article 6.3(b) with respect to all third-country markets as a whole, and the EC does not contest this.<sup>439</sup>

274. However, the EC simply ignores the compelling evidence with respect to what it agrees is a global LCA market, and focuses on factors in individual sales campaigns. Even so, the EC arguments are largely based on three main contentions, all of which are wrong.

275. With respect to the U.S. claims regarding Australia, Brazil, India, Mexico, and Singapore, the EC argues that new Boeing and Airbus aircraft delivered to customers in these countries through the intermediation of leasing companies are not “exports” to these markets but rather to the home country of the leasing company in question. However, leasing companies often are simply an alternative method for financing aircraft that the LCA producer sells directly to an airline customer or supplement an airline’s fleet of owned LCA with additional LCA (usually of the same model) on a temporary basis. The EC contention that the sale of LCA by Boeing or Airbus to a leasing company is unrelated to the subsequent placement of those LCA with customers is simply false.

276. Indeed, as Christian Scherer of Airbus explains, rather than “[

].”<sup>440</sup> In short, as he explains, [

].<sup>441</sup> Thus, simply because a leasing company played a role in a particular delivery, it cannot be concluded that the LCA manufacturer had no relationship whatsoever with the ultimate customer or that the delivery in question did not involve an “export” to the home market of that customer.

277. In other cases, customers purchasing new aircraft from a given LCA manufacturer will also lease aircraft of the same model on a temporary basis, to efficiently expand its fleet based on its own operating schedule rather than the manufacturer’s available delivery schedule. For

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<sup>439</sup> U.S. FNCOS, paras. 174-175; U.S. SWS, para. 704.

<sup>440</sup> Statement of Christian Scherer, para. 34 (Exhibit EC-14) (BCI).

<sup>441</sup> Statement of Christian Scherer, para. 38 (Exhibit EC-14) (BCI).



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example, three large new Airbus customers in India arranged for leased aircraft as a “bridge” so they could begin operating Airbus aircraft even before receiving their first deliveries, and Airbus announced these leasing deals as part of its sales to these customers:

Kingfisher Airlines, India’s new value-based carrier, has ... signed a memorandum of understanding for the acquisition of four Airbus A320s from Airbus, and taken options on eight more. In addition, it is in negotiation with leasing companies for the lease of a further four A320s. Deliveries of the leased aircraft will begin in the first quarter of 2005, while those of the new aircraft from Airbus will start in the last quarter of 2005.<sup>442</sup>

Air Deccan ... will acquire two new Airbus A320s from Airbus, and has taken options on two more. In addition, it will lease a further five A320s from Singapore Aircraft Leasing Enterprise (SALE). Deliveries of the leased aircraft will begin in July this year {2004}, while those of the new aircraft from Airbus will start in September 2005.<sup>443</sup>

Deliveries are due to begin as early as the first quarter of 2007, but Jet Airways will become the first Indian operator of the Airbus A330 even sooner, in May 2006, when it takes delivery of the first of several aircraft leased from ILFC.<sup>444</sup>

It is evident, from Airbus’s own public descriptions of these transactions, that the arrangement of these leases formed an integral part of Airbus’s A320 sales to these three Indian carriers. These leased aircraft, which were delivered new to airlines in India, are therefore deliveries of Airbus LCA to India, not to Singapore (the home country of SALE) or the United States (the home country of ILFC), which displaced or impeded exports of Boeing LCA to the Indian market within the meaning of Article 6.3(b).

278. Another fundamental flaw in the EC treatment of third-country markets is its assumption that Boeing exports to these markets were not displaced or impeded if they increased in *absolute* terms, even if Boeing’s overall market share decreased. Thus, for example, the EC explains that although Boeing’s market share in China decreased from 71 percent (22 deliveries of 31 total) in 2001 to 45 percent (64 deliveries of 142 total) in 2006, there is no serious prejudice because the absolute number of Boeing deliveries increased from 22 to 64.<sup>445</sup> Nothing in Article 6.3(b) or

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<sup>442</sup> Airbus press release, *Kingfisher Airlines to launch services with Airbus A320s* (July 21, 2004) (Exhibit US-667).

<sup>443</sup> Airbus press release, *Air Deccan to acquire Airbus A320s* (Feb. 25, 2004) (Exhibit US-668).

<sup>444</sup> Airbus press release, *Jet Airways to acquire ten Airbus A330-200s/300s with options for ten more* (June 14, 2005) (Exhibit US-669).

<sup>445</sup> EC Responses to Second Panel Questions, para. 371.

Article 6.4 suggests that a displacement or impedance requires a showing of an *absolute* decline in exports to a given market. Rather, Article 6.4 in particular focuses entirely on market share. The EC’s argument with respect to China – and a similar argument with respect to India – must fail. Similarly, the EC’s argument that there is no displacement or impedance in Korea because the absolute number of Airbus deliveries (in a shrinking market) did not decrease fails as well.

279. Yet another assumption of the EC approach is its unsupported contention that “{n}ormal competition in a competitive duopoly implies that both competitors obtain a market share somewhere between 40 and 60 percent.”<sup>446</sup> From this, the EC concludes that any shift in market share that is roughly between these figures, such as those in Australia, cannot be the effect of subsidies, but is simply the result of normal competition. The EC offers no evidence in support of its assertion that Airbus is entitled to a 40 percent world market share, or that it would have at least a 40 percent world market share without subsidies.

280. Finally, with respect to China in particular, the EC contends that subsidies cannot have played any role whatsoever in Airbus’s increased market share because all purchases of LCA in China are made through the state-controlled China Aviation Supplies Imports and Exports Corporation.<sup>447</sup> According to the EC, therefore, all LCA deliveries to China are “non-commercial” in nature and cannot be impacted by subsidies.<sup>448</sup> In support of its conclusion, the EC references “a 2005 aviation analyst’s report,” but fails not only to provide the report but even to name the analyst or the title of the report.<sup>449</sup>

281. However, the evidence that the EC does provide indicates that, while LCA purchases in China are as a formal matter made through the state-owned importing company, individual airlines in China request particular Boeing or Airbus LCA models and negotiate the terms of their purchase with Boeing or Airbus, as do airline customers in other countries. To quote the U.S. securities filing of China Southern Airlines provided by the EC:

The CAAC requires all Chinese airlines to acquire their aircraft through China Aviation Supplies Import and Export Corporation (“CASC”), an entity controlled by the CAAC. If a Chinese airline plans to acquire an aircraft, the airline must first seek approval from the CAAC and NDRC. The airline must, as a condition of approval, provide specific acquisition plans, which are subject to modification by the CAAC and NDRC. If the

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<sup>446</sup> EC Responses to Second Panel Questions, para. 352.

<sup>447</sup> EC Responses to Second Panel Questions, para. 368.

<sup>448</sup> EC Responses to Second Panel Questions, para. 375.

<sup>449</sup> EC Responses to Second Panel Questions, para. 375.

CAAC and NDRC approve an aircraft acquisition, the airline negotiates the terms of the acquisition with the manufacturer together with CASC because CASC possesses the license required to import or export aircraft, and CASC receives a commission in respect thereof.<sup>450</sup>

282. Additional evidence confirms that Airbus (and Boeing) compete for the business of Chinese airlines; the Chinese government does not, as the EC would have it, simply bestow market share on Airbus. For example, when Airbus announced that it has “signed a contract” with China Eastern Airlines for the purchase of twenty A330-300 LCA in 2004, Airbus then-CEO Noel Forgeard praised the airline for having “chosen” Airbus aircraft.<sup>451</sup> And, as Boeing marketing materials prepared for China Eastern Airlines during this period demonstrate, Boeing tried to win this sale by offering and marketing the 767 directly to China Eastern Airlines.<sup>452</sup>

283. For these reasons, the EC’s belated attempt to respond to the U.S. Article 6.3(b) claim is thoroughly unpersuasive.

**208. Is it the EC’s view that the Panel may not conduct an analysis of adverse effects on an aggregated basis with respect to the alleged LA /MSF subsidies or the other alleged subsidies in dispute? If the EC would differentiate between different subsidies, on what basis would it do so?**

Comment

284. The EC sets forth, in paragraphs 437 through 440 of its response, four factors that it considers “should be taken into account for purposes of assessing the nature of various subsidies” in order to determine whether an aggregated adverse effects analysis is permissible. Of these four EC factors, the third one – “whether and how a subsidy changes the commercial behaviour of a recipient” – is the most fundamental.<sup>453</sup> Indeed, each of the other three factors proposed by the EC is relevant only to the extent that it has a bearing on how the subsidies distort the marketplace through their effects on the behavior of their recipients:

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<sup>450</sup> China Southern Airlines, Form 20-F (June 30, 2004) (Exhibit EC-915).

<sup>451</sup> Airbus press release, *China eastern airlines signs contract with Airbus on purchasing 20 A330-300s* (Oct. 9, 2004) (Exhibit US-670).

<sup>452</sup> Boeing Commercial Airplanes, *767 Operational Advantages*, Marketing Presentation for China Eastern Airlines (July 2003) (Exhibit US-671).

<sup>453</sup> EC Responses to Second Panel Questions, para. 439.

- The age of a subsidy may be relevant to the causation analysis, if the benefit or distorting effect of the subsidy in the marketplace changes over time.
- Whether a subsidy is tied or untied, or whether a subsidy is recurring or non-recurring, may be relevant to the causation analysis, if these factors are informative in analyzing how the subsidy distorts the market.
- Whether a subsidy reduces recurring or non-recurring costs may be relevant to the causation analysis, if this factor is informative in analyzing how the subsidy distorts the market.

285. Thus, the four factors proposed by the EC all relate to an analysis of how subsidies actually operate to distort the marketplace and cause adverse effects. Thus, the EC does not appear to dispute the validity of the approach taken by the panel in *US – Cotton Subsidies*, which stated that where “a sufficient nexus with” the subsidized product and a particular Article 6.3 condition “exists among the subsidies at issue so that *their effects manifest themselves collectively*, we believe that we may legitimately treat them as a ‘subsidy’ and group them and their effects together.”<sup>454</sup>

286. The United States has already explained that, as a factual matter, the several challenged subsidies in this case all operate in the same way to distort the market in a similar fashion, such that – in the just-cited words of the *US – Cotton Subsidies* panel – “their effects manifest themselves collectively.”<sup>455</sup> Thus, even under the EC’s proposed factors, an aggregate analysis of all the challenged subsidies is appropriate in this dispute.

**209. With reference to paragraph 163 of its Second Confidential Oral Statement (SCOS), is the EC of the view that displacement or impedance in third country markets for purposes of Article 6.3(a) must be evidenced by significant lost sales as provided for in Article 6.3(c)? Is the EC of the view that lost sales must be demonstrated to have occurred by reason of price competition in order to be considered for purposes of a finding under Article 6.3(c) of the SCM Agreement? If so, could the EC explain the legal basis for either or both of these views?**

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<sup>454</sup> *US – Cotton Subsidies (Panel)*, para. 7.1192 (emphasis added).

<sup>455</sup> U.S. Responses to Second Panel Questions, paras. 163-169.

Comment

287. The EC contends that the only way the United States can demonstrate displacement and impedance in third country markets under Article 6.3(b) – and presumably in the EC market under Article 6.3(a) as well – is by demonstrating the existence of particular lost sales in those markets under Article 6.3(c).<sup>456</sup> However, the text of Article 6.3(a)-(b) contains no such requirement. Indeed, with respect to claims under Article 6.3(b), Article 6.4 expressly provides for an analysis exclusively in terms of trends in the relative market share and makes no mention of an analysis of particular transactions.

288. The EC does not deny any of this. Rather, the EC argues that in the context of the LCA industry, it is only possible to demonstrate *causation* – that is, to demonstrate that market share trends in favor of the subsidized product are in fact the effect of the subsidy – through the identification of particular lost sales that would not have been lost “but for” the subsidy. The EC then goes on to acknowledge that nothing in Article 6.3(c) requires that lost sales be shown to be caused by price undercutting, but insists that such a showing is implicitly required by the U.S. arguments in this particular dispute. The United States has already fully explained why this is not the case,<sup>457</sup> and the latest EC arguments add nothing to what has gone before.

289. As a general matter, in *any* case in which there is displacement or impedance of imports or exports “but for” the subsidy, it will necessarily be true that there are particular transactions that would have led to imports or exports that did not occur “but for” the subsidy. However, nothing in the SCM Agreement requires a showing of both displacement or impedance and lost sales in order to prove either one. Rather, serious prejudice can be demonstrated by a showing with respect to either or both of these market conditions, depending on the nature of the available evidence.

290. As explained more fully in the U.S. comments on the EC response to question 207, above, the United States has put forth evidence that demonstrate the validity of its claims of displacement and impedance and of significant lost sales. That this evidence does not completely overlap is not – contrary to the EC’s a priori opinions about how the United States could have structured its case – a weakness of the U.S. case. Rather, that multiple types of evidence independently support a finding of multiple types of serious prejudice confirms the strength of the U.S. demonstration.

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<sup>456</sup> EC Responses to Second Panel Questions, paras. 446-453.

<sup>457</sup> U.S. Responses to First Panel Questions, paras. 307-315; U.S. Responses to Second Panel Questions, paras. 176-180.

**210. Referring to paragraphs 433-434 of the EC’s SNCOS, it appears that the EC is arguing that the fact that Boeing made subsequent sales of LCA eliminated any adverse effect resulting from a prior lost sale. Is the Panel correct in its understanding of the point being made? Could the EC explain the basis for the view that mitigation of adverse effects caused by a subsidy precludes a finding that the prior lost sale was “significant”? Does such a view in the context of the aircraft sales discussed in the EC SNCOS not rest on a presumption of an absolute limit on production capacity?**

Comment

291. As the United States indicated to the Panel at the second meeting with the parties and developed in more detail in its preliminary comments on this question, Boeing does not face any absolute limit on its production capacity.<sup>458</sup> However, the EC continues to insist – against the evidence – that several Boeing models are “sold out for years to come,” in the sense that Boeing could not sell any more delivery slots for these models even if it wanted to.<sup>459</sup> Thus, for example, the EC states that Boeing has no more delivery slots available for the 787 through 2014.<sup>460</sup>

292. Yet very recent events, occurring even after the EC submitted its response to the Panel’s questions, demonstrate further that the EC is simply wrong on this point. On September 27, 2007, British Airways announced a significant order for A380s and Boeing 787s. With respect to the latter, the airline secured 24 firm orders and 18 options, all for delivery between 2010 and 2013.<sup>461</sup> As the United States explained in its initial response to this question, and as the Boeing documents the EC is relying on themselves state expressly, when Boeing says it is “sold out” of a particular aircraft, this includes both orders that Boeing has received and orders that it hopes to receive in the future.<sup>462</sup>

293. Thus, it is simply not the case that Boeing (or Airbus) face absolute LCA production constraints. It is true, as the EC notes, that neither Boeing nor Airbus can increase production

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<sup>458</sup> U.S. Responses to Second Panel Questions, paras. 227-229.

<sup>459</sup> EC Responses to Second Panel Questions, para. 471.

<sup>460</sup> EC Responses to Second Panel Questions, para. 481.

<sup>461</sup> Kevin Done, *BA Places Landmark Order for Airbus A380s and Boeing 787s*, Financial Times (Sept. 28, 2007) (Exhibit US-672).

<sup>462</sup> U.S. Responses to Second Panel Questions, paras. 227-229.

levels easily and quickly, given the need to coordinate with suppliers.<sup>463</sup> Nonetheless, Boeing and Airbus can increase production levels in the medium term if they believe it is advantageous to do so. Indeed, as pointed out above in the comments on the EC response to question 205, Airbus has already announced such increases despite their likely price-depressing effects. Thus, LCA producers manage their medium-term and long-term production schedule based on the number of LCA that they *expect to deliver*, based on current sales. It is therefore, as a factual matter, not true that because Boeing has set its production schedule based on the number of LCA it has in fact sold and currently expects to sell, it would not have increased its production schedule if it had not lost as many sales to Airbus.

294. The EC errs for an additional reason when it asserts that Boeing actually benefitted from losing sales to Airbus prior to 2004, because it not only was able to sell those delivery slots to other customers, but supposedly would have done so in 2005 or later at a higher price than it could have commanded in earlier periods when demand was weaker.<sup>464</sup> This quite remarkable argument fails not only because Boeing does not have a finite number of delivery slots, but also because it does not, as the EC asserts without proof, necessarily receive higher prices for deliveries at any given moment resulting from sales in 2005 and later than it would have received from sales in 2004 and earlier.

295. The parties have on several occasions referred to the typical “price escalation” provision in LCA order contracts. Thus, for example, if a campaign begins in 2004, both Airbus and Boeing will generally express their offers in 2004 dollars, with an escalation provision setting forth the methodology by which the offer price will be increased to account for inflation in order to derive the final delivery price, which is payable upon delivery several years after the initial order. Thus, as explained more fully in the comments on the EC response to question 213, when order prices fail to increase in line with the normal escalation provisions, deliveries based on older orders will be priced higher than deliveries based on more recent orders made in a period when order prices are suppressed. As the United States has shown, LCA prices were suppressed throughout the 2001-2005 period and [ ] into 2006 and beyond.<sup>465</sup>

296. Thus, the EC is completely incorrect when it speculates that there is an “advantage” to Boeing in losing sales to Airbus, so it can then sell those same delivery slots later at a higher price.

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<sup>463</sup> EC Responses to Second Panel Questions, para. 482.

<sup>464</sup> EC Responses to Second Panel Questions, para. 475.

<sup>465</sup> U.S. FWS, paras. 804-808; U.S. SWS, paras. 724-729.

**211. Could the EC expand on the statement at paragraph 44 of its SNCOS that “WTO panels must provide an objective assessment of whether there are *present adverse effects* resulting from *current subsidies*” (emphasis added) to find a violation of Article 5 of the SCM Agreement in light of the views expressed by the Appellate Body at paragraph 477 of its report in *United States – Upland Cotton*?**

Comment

297. The EC adds nothing in its response to this question from the Panel, that it has not already said in prior submissions. The United States has already refuted the EC’s prior arguments on this point and refers the Panel to its prior submissions on this point.<sup>466</sup>

**212. Could the EC explain the legal basis for the statement, at paragraph 370 of its SNCOS, that “a proper causation analysis must consider if, and how, the subsidies changed the commercial behaviour of the recipient. In other words, did the recipient have the incentive to use the subsidy given the circumstances of the sales campaign? And, even assuming that part or all of the alleged theoretical subsidy benefit was used in that sales campaign, a further step requires assessment of whether its use was the cause of *the* adverse effects.” (emphasis in original).**

Comment

298. As the EC refers to the Panel to its responses to questions 205, 206, 209, and 214 in response to this question, the United States would also refer the Panel to its comments on those response.

**213. With reference to paragraph 441 of its SNCOS, and putting aside the question of causation, does the EC acknowledge, as a matter of fact, that “prices for *certain* aircraft have not increased in line with inflation” (emphasis in original)?**

Comment

299. In its first written submission, the United States pointed to the U.S. producer price index for airplane manufacturing as a reasonable proxy for the amount by which LCA prices could be expected to rise in the absence of suppression by some external factor.<sup>467</sup> Using this metric, the

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<sup>466</sup> U.S. SWS, paras. 670-684; U.S. SNCOS, paras. 142-148.

<sup>467</sup> U.S. FWS, paras. 743, 804; Exhibit US-402; *see also* U.S. First Responses to Panel Questions, para. 317.



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United States showed that 737, 747, and 767 prices [ ]<sup>468</sup> For the 777, this metric showed a slightly different pricing pattern, [ ], largely due to the unique price disadvantage of the A340 due to its significantly higher fuel consumption relative to the 777, such that the price effect of the A340 on the 777 is somewhat attenuated when fuel prices are high.<sup>469</sup>

300. The EC does not deny these pricing trends, but objects to the use of the U.S. airplane manufacturing producer price index as the relevant proxy for cost inflation on two grounds. First, it suggests that Boeing's operating margin is a better proxy for the cost inflation experienced by Boeing.<sup>470</sup> Second, the EC objects to the use of a U.S.-specific pricing index, given that Boeing has "10,000 suppliers in nearly 70 countries" and that Boeing's production costs will therefore not necessarily change with inflation in the United States.<sup>471</sup>

301. The EC's proposed alternative metric for the relevant cost "inflation" – Boeing's operating margin – is without theoretical or practical foundation. The number of LCA delivered in any given year during the relevant period has varied greatly, and the ratio of operating profits to costs can be expected to vary with the volume of units sold, entirely apart from any underlying changes in price levels. Trends in actual operating margin, therefore, considered without reference to the large number of changes in the actual volume of deliveries, tell nothing about the pricing levels that would be expected in the absence of external price-suppressing factors.

302. Moreover, the EC fails to recognize that U.S. producer prices are in fact highly relevant to how LCA prices are in fact established. As the EC explains, the U.S. airplane manufacturing producer price index reflects changes in costs for U.S. labor and materials.<sup>472</sup> The EC also provides as Exhibit EC-926 a press report explaining that the "price escalation" clauses – by which order prices are indexed to inflation to derive the actual price to be paid at delivery – are in fact driven by the same factors.<sup>473</sup> Indeed, according to this article, the typical escalation formula used by Airbus is based on U.S. labor costs in the aerospace industry, energy costs, and

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<sup>468</sup> U.S. FWS, paras. 804-807; U.S. SWS, para. 726.

<sup>469</sup> U.S. FWS, para. 808; U.S. SWS, paras. 727-728.

<sup>470</sup> EC Responses to Second Panel Questions, paras. 509-510.

<sup>471</sup> EC Responses to Second Panel Questions, para. 511.

<sup>472</sup> EC Responses to Second Panel Questions, para. 510.

<sup>473</sup> *Escalation: The Great Industry Scam*, Aircraft Economics (May/June 2005), at 34 (Exhibit EC-926).

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costs of materials.<sup>474</sup> If even Airbus indexes its own LCA prices to U.S. cost inflation for the aerospace sector, it is difficult to see how the EC can plausibly contend that U.S. airplane manufacturing cost inflation is not a reasonable proxy for LCA cost inflation generally.

303. The article provided by the EC also explains when that LCA prices fail to keep up with the Airbus and Boeing escalation formulas (which are based on the same factors as the U.S. airplane manufacturing producer price index), this price decline severely harms airlines that placed orders in an earlier period. If, for example, one airline places an order in 1999 for 2005 delivery and another places an order in 2003 for 2005 delivery, both will pay a similar, escalated price in 2005 if LCA order prices were generally rising with producer inflation. But, given that order prices in fact fell substantially in the 2001-2005 period, the customer that placed the 1999 order pays a higher price for a 2005 delivery than does the customer that placed the order at a suppressed or depressed price in 2003. As the EC's article (published in mid-2005) explains:

{C}ustomers that ordered aircraft three or four years ago are finding that they are forced to pay far more than the aircraft's market value when they are delivered. ... Customers are finding it particularly annoying that they are paying 15% more than list price for an aircraft they ordered five years ago, when new aircraft prices have not risen at all, and airlines ordering large numbers of aircraft – such as AirAsia, easyJet or Ryanair – are getting a lower price than they did five years ago. “Suckers, like us, who ordered aircraft between 1995 and 2000 are stuck with aircraft that have been inflated and are costing us far more than they are worth,” says one senior finance manager at a flag carrier.<sup>475</sup>

This evidence – provided by the EC – unequivocally demonstrates that LCA prices by mid-2005 were below “market value” if, like airlines that placed their orders before 2001, one treats prices as increasing in line with inflation. Indeed, as the United States has already explained, Boeing was forced to reduce its prices on earlier, unfilled orders to offset harm to certain customers in extreme situations for precisely this reason.<sup>476</sup>

304. Finally, the EC's article also suggests that escalation factors often *exceed* the level that would otherwise be expected based solely on the U.S. labor and materials costs reflected in the U.S. producer price index.<sup>477</sup> If so, then the U.S. producer price index would be a *conservative*

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<sup>474</sup> *Escalation: The Great Industry Scam*, Aircraft Economics (May/June 2005), at 34, 37 (Exhibit EC-926).

<sup>475</sup> *Escalation: The Great Industry Scam*, Aircraft Economics (May/June 2005), at 34 (Exhibit EC-926).

<sup>476</sup> U.S. FWS, para. 806.

<sup>477</sup> *Escalation: The Great Industry Scam*, Aircraft Economics (May/June 2005), at 37 (Exhibit EC-926).

estimate of the LCA price increases that would be typically expected in a stable pricing environment.

305. For these reasons, the EC’s attempt to dismiss the relevance of the U.S. producer price index to determine whether price suppression has occurred must fail. Indeed, the evidence provided by the EC validates the U.S. approach.

**214. With reference to paragraph 443 of its SNCOS, is the EC of the view that, in the absence of low or negative operating margins reported by Boeing in 2006 and the first quarter of 2007, the Panel is precluded as a matter of law from finding significant price suppression?**

Comment

306. The EC response to this question improperly conflates the test for material injury – for which the operating performance of the domestic industry is an important factor to be considered – with that for serious prejudice. Whether price suppression is significant depends on the degree to which prices are suppressed relative to what they would otherwise have been, “but for” the subsidy. Nothing in the EC response addresses this issue.

307. With respect to the relevance of Boeing’s operating performance to a serious prejudice analysis, the United States would refer the Panel to its prior submissions.<sup>478</sup>

**III. QUESTIONS TO BOTH PARTIES**

**A. LA / MSF**

**215. In their general characterizations of the challenged measures, the Parties have advanced two different positions - the United States describes the LA / MSF loans as *hybrid* financing instruments; whereas, to the EC, they are *project-specific debt* financing instruments. To what extent do the Parties believe that either of their characterizations is dispositive of the question of which of the benchmarks identified in the Ellis or Whitelaw Reports is appropriate in this dispute?**

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<sup>478</sup> U.S. SWS, paras. 694-695.

Comment

308. It appears that the United States and the EC agree that it is the actual risk-related characteristics of Launch Aid, rather than the label used to describe those characteristics, that should determine the appropriate market benchmark for analyzing the benefit conferred by Launch Aid.<sup>479</sup> However, apart from that general proposition, the parties plainly disagree on which is the appropriate benchmark.

309. In previous submissions, the United States has explained in detail why its proposed benchmark is appropriate and why the EC's is not.<sup>480</sup> In its comment on the EC's response to Question 174, above, the United States addresses a further problem with the EC's proposed benchmark, which also has been discussed by Australia and Brazil – *i.e.*, the fact that the returns on financing provided by risk-sharing suppliers to Airbus will be influenced by the very fact that Airbus receives Launch Aid.<sup>481</sup>

310. Given the EC's insistence in its response to Question 215 and elsewhere that its risk-sharing supplier benchmark is the appropriate one for the Panel to use, the United States takes this opportunity to underscore the problems with that benchmark. As a general matter, the Panel should bear in mind that during this entire dispute settlement proceeding the only evidence the EC has provided to support its proposed benchmark is a 5-page excerpt from a single contract with one risk-sharing supplier.<sup>482</sup> Indeed, the EC's attempt to redeem its benchmark in its second confidential oral statement is notable for its frequent reliance not on actual evidence, but on reports of conversations that the EC's consultant, Professor Whitelaw, says he had with "Airbus procurement officials."<sup>483</sup>

311. Given the EC's designation of much of the information concerning its proposed benchmark as HSBI, the United States supplements this comment in the HSBI Appendix to this submission.

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<sup>479</sup> Compare U.S. Responses to Second Panel Questions, para. 232, with EC Responses to Second Panel Questions, para. 518.

<sup>480</sup> See U.S. Responses to Second Panel Questions, para. 232 and footnote 316 (citing previous discussion of U.S. benchmark); *id.*, para. 236 and footnote 322 (citing previous discussion of EC benchmark).

<sup>481</sup> See Australia Responses to Panel Questions to Third Parties, p. 1 (response to Question 1); Brazil Third Party Oral Statement, para. 11.

<sup>482</sup> See U.S. SCOS, para. 31.

<sup>483</sup> See EC SCOS, paras. 82, 83, 87.

## B. PROHIBITED EXPORT SUBSIDIES

**216. The Panel understands that both parties have expressed the view that the legal standard for the determination of in fact and in law export contingent subsidies is the same, but that the type of evidence that may be relied upon to demonstrate one or other type of export contingent subsidy differs (United States, FWS, para. 327; EC, FWS, para. 606). To what extent are the Parties arguing that footnote 4 should inform the Panel’s assessment of the United States claims relating to the existence of *both* in fact, and in law, export contingent subsidies? For instance, are the Parties saying that the notion of “actual or anticipated exportation or export earnings” is of equal application to demonstrating the existence of both types of export contingent subsidies?**

### Comment

312. The EC’s response to this question largely repeats concepts contained in its response to Question 175. Accordingly, the United States refers the Panel to its comment on the EC’s response to that question. A few additional points in the EC’s response to Question 216 warrant comment.

313. First, the EC calls for “an interpretation of Article 3.1(a) and footnote 4 that is internally coherent and respects the overall design and architecture of that provision, taken as a whole.”<sup>484</sup> As the United States pointed out in its comments on the EC’s oral statement at the second Panel meeting, in repeatedly referring to “the overall design and architecture” of Article 3.1(a) and footnote 4, the EC seeks to avoid interpretation of those provisions according to their ordinary meaning, in context, and in light of the object and purpose of the SCM Agreement.<sup>485</sup> In any event, as discussed in the above comment on the EC’s response to Question 175, the EC’s approach to export contingency leads to a result that is anything but “internally coherent.” Among other problems, that approach conflates the concepts of “actual” and “anticipated” exportation and leads to a different legal standard for *de jure* export contingency (which may be established on the basis of what the EC calls the “initial grant” of a subsidy) than for *de facto* export contingency (which may be established only on the basis of an event – the occurrence of exportation – that the EC calls “completing the grant”).<sup>486</sup>

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<sup>484</sup> EC Responses to Second Panel Questions, para. 522.

<sup>485</sup> See U.S. Comments on EC SNCOS, paras. 14-17.

<sup>486</sup> See EC Responses to Second Panel Questions, paras. 71-72.

314. Second, the EC’s attempt to sum up what it believes to be “the required contingency” under Article 3.1(a) of the SCM Agreement – “if export, then subsidy”<sup>487</sup> – underscores the unsupported nature of its approach. Nowhere does the SCM Agreement provide for the “if-then” relationship between exportation and the granting of a subsidy that the EC posits. To be contingent upon export performance the granting of a subsidy need not follow export performance, as the EC’s “if-then” formulation suggests. This is made quite clear by footnote 4, which provides that the standard set out 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.” The formulation, “if export, then subsidy” may capture a tie to actual exportation, but not to anticipated exportation.

315. Third, the EC repeats the erroneous assertion that *de jure* export contingency must be determined based only on “the text of the measure.”<sup>488</sup> In this regard, the United States refers the Panel to its response to Question 146, in which the United States explains that *de jure* export contingency should be determined not only on the basis of the text of the measure, but also how the measure “actually work{s}.”<sup>489</sup>

**217. To what extent do the Parties consider that the motivations or reasons for granting a subsidy are relevant to the inquiry into whether a subsidy is in fact contingent upon export performance?**

Comment

316. First, the EC’s response to this question once again misrepresents the views of the United States regarding the relevance of evidence of motivations or reasons for granting a subsidy. The United States has not “repeatedly stated that it excludes motivations or reasons from its case.”<sup>490</sup> The “repeated{” statements to which the EC alludes are sentences in two paragraphs from the U.S. second written submission, which the EC has taken entirely out of context.<sup>491</sup> For an accurate representation of the U.S. views regarding evidence of motivations or reasons, the United States refers the Panel to the U.S. response to this question.

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<sup>487</sup> EC Responses to Second Panel Questions, para. 524.

<sup>488</sup> EC Responses to Second Panel Questions, para. 520.

<sup>489</sup> *Canada – Autos (AB)*, para. 128 (discussed in U.S. Responses to Second Panel Questions, paras. 61-71).

<sup>490</sup> EC Responses to Second Panel Questions, para. 528.

<sup>491</sup> See U.S. Comments on EC SNCOS, para. 18.

317. Second, the EC's attempt to discredit evidence of motivations or reasons for granting a subsidy as "inherently suspect"<sup>492</sup> is baseless and inconsistent with the EC's own reliance on alleged government motivations (albeit, without citing any evidence at all) to demonstrate what it calls "countervailing explanations" for the design of Airbus's obligations under Launch Aid contracts.<sup>493</sup> As Australia observed in its third party oral statement, recalling the report of the Appellate Body in *Canada – Aircraft*, "to establish export contingency, the requisite relationship of contingency 'must be *inferred* from the total configuration of the facts constituting and surrounding the granting of the subsidy, none of which on its own is likely to be decisive in any given case."<sup>494</sup> The "total configuration of the facts" includes the government's motivation for providing a subsidy.<sup>495</sup>

318. Indeed, other dispute settlement panels considering prohibited subsidy claims have taken account of evidence of a government's motivations or reasons for undertaking the measure at issue. In *Australia – Leather*, for example, the panel took into account press reports of statements by government officials as "relevant to {its} analysis of the facts and circumstances surrounding the design and grant of {Australia's} assistance {to the Howe company}."<sup>496</sup> Likewise, as discussed in the U.S. response to this question, the panel in *Canada – Aircraft* took into account evidence of the Canadian government's export-related intent in providing grants under the Technology Partnership Canada program.<sup>497</sup>

319. Third, there is no basis in the SCM Agreement or in the DSU for the EC's proposed rule for evaluating evidence of a government's motivations or reasons for adopting a measure,

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<sup>492</sup> EC Responses to Second Panel Questions, para. 528.

<sup>493</sup> See, e.g., EC FWS, para. 665 (discussing what the EC alleges to be "{t}he United Kingdom's motivations for using deliveries as the trigger for repayment"). An important difference between the U.S. discussion of government motivations and the EC's discussion, is that the United States relies on evidence, while the EC relies on mere assertion. Compare U.S. Responses to Second Panel Questions, paras. 254-255 (summarizing evidence demonstrating Airbus governments' export-related motivations for providing Launch Aid) with EC FWS, paras. 657-666 (discussing alleged "countervailing explanations" for structure of Launch Aid without citing any evidence).

<sup>494</sup> Australia Third Party Oral Statement, para. 9 (quoting *Canada – Aircraft (AB)*, para. 167) (first emphasis in *Canada – Aircraft (AB)* report; second emphasis in Australia Third Party Oral Statement).

<sup>495</sup> See Australia Third Party Oral Statement, paras. 10, 14.

<sup>496</sup> *Australia – Leather*, footnote 210; see also *id.*, paras. 9.63-9.71.

<sup>497</sup> See U.S. Responses to Second Panel Questions, para. 252 (citing *Canada – Aircraft (Panel)*, para. 9.340).

according to which “{s}tatements after the event or attributable to particular persons or entities would not be relevant.”<sup>498</sup> The EC derives this rule from what it alleges to be principles of statutory interpretation that Members “sometimes” provide for in their municipal law. The EC deems these to be “basic principles of legal interpretation.”<sup>499</sup>

320. However, whatever relevance these principles may “sometimes” have in the interpretation of municipal legislation, they have no relevance at all in WTO dispute settlement. Article 11 of the DSU requires a panel to “make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements.” Article 11 does not contain rules of evidence, let alone the limiting rule of evidence that the EC proposes. Article 11 does not provide that a panel should make “an objective assessment of the facts,” except with respect to statements that are made after the event or that are attributable to particular persons or entities. Accordingly, the Panel should reject the EC’s suggested rule of evidence.

321. Fourth, contrary to the EC’s assertion,<sup>500</sup> the United States has addressed the EC’s “countervailing explanations” of Launch Aid repayment provisions and shown these explanations to be irrelevant. In its second written submission, the United States pointed out that even assuming, *arguendo*, the accuracy of the EC’s characterization of the UK government’s motivations<sup>501</sup> – a characterization based on mere assertion and no evidence – that would not undermine the existence of the tie between the provision of Launch Aid and anticipated exportation. Such motivations would not alter the fact that in exchange for the provision of Launch Aid by the UK government (and each of the other Airbus governments), Airbus undertakes a contractual obligation that it cannot fulfill without exporting.<sup>502</sup>

322. Moreover, as the United States discussed in its response to Question 217, while the EC’s “countervailing explanations” of the Launch Aid repayment provisions address the fact of repayment on a per-delivery basis, they do not address the number of deliveries over which

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<sup>498</sup> EC Responses to Second Panel Questions, para. 533.

<sup>499</sup> EC Responses to Second Panel Questions, para. 533.

<sup>500</sup> See EC Responses to Second Panel Questions, para. 531.

<sup>501</sup> As noted in the U.S. response to Question 217, the EC makes its “countervailing explanations” argument only with respect to the UK government’s provision of Launch Aid for the A380. It then simply adopts that argument *mutatis mutandis* with respect to the other grants of Launch Aid at issue. See U.S. Responses to Second Panel Questions, para. 249 and footnote 336.

<sup>502</sup> See U.S. SWS, paras. 230-234; see also U.S. Responses to Second Panel Questions, paras. 248-250.



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Launch Aid is to be repaid.<sup>503</sup> Taken together with the EC’s acknowledgment that “repayment was expected,”<sup>504</sup> the number of deliveries further demonstrates that the provision of Launch Aid is tied to anticipated exportation. As the governments providing Launch Aid expected repayment, the provisions of the Launch Aid contracts setting out the number of deliveries over which repayment is to be made must be understood to be consistent with that expectation. Because that number cannot be reached without exportation, it follows that the provision of Launch Aid is tied to anticipated exportation.<sup>505</sup>

323. Fifth, the EC’s discussion of the terms of risk-sharing supplier contracts with Airbus has no bearing on the relevance of evidence of governments’ motivations or reasons for providing Launch Aid. Like the EC’s allegation of “countervailing explanations” for the repayment terms in Launch Aid contracts, its discussion of repayment terms under risk-sharing supplier contracts is based entirely on assertion and is devoid of any evidentiary support.<sup>506</sup> However, even if the EC had substantiated its assertion that repayment terms under risk-sharing supplier contracts resemble repayment terms under Launch Aid contracts, this would not detract from the wealth of evidence, including evidence of government motivations, showing that the provision of Launch Aid is tied to anticipated exportation.

324. Finally, the EC once again misrepresents the findings of the panel in *Australia – Leather*.<sup>507</sup> It ignores entirely the first of the three payments the Australian government made to Howe, which was made before exportation had occurred and which the panel found to be tied to anticipated exportation (undermining the EC’s view of what “tied to anticipated exportation” means).<sup>508</sup> And, it ignores the substantial period of performance by Howe under the grant contract even after Howe received the third and final payment from the government (further undermining the EC’s view of what “tied to anticipated exportation” means).<sup>509</sup>

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<sup>503</sup> See U.S. Responses to Second Panel Questions, para. 249. This glaring omission is evident again in the EC’s response to Question 217. See EC Responses to Second Panel Questions, para. 531.

<sup>504</sup> EC FWS, para. 638.

<sup>505</sup> See U.S. SWS, para. 233; U.S. Responses to Second Panel Questions, para. 249.

<sup>506</sup> See EC Responses to Second Panel Questions, para. 532.

<sup>507</sup> See EC Responses to Second Panel Questions, para. 534.

<sup>508</sup> See *Australia – Leather*, paras. 9.62, 9.71.

<sup>509</sup> See U.S. SNCOS, para. 24.

325. The EC also mischaracterizes the nature of the report Howe was required to provide to the Australian government as a report “detailing Howe’s export performance to date,”<sup>510</sup> when, in fact, the report concerned sales performance.<sup>511</sup> What was significant about this report was that, given relative demand for automotive leather in Australia and in the rest of the world, the panel found that the sales performance targets to be detailed in the report amounted to export performance targets.<sup>512</sup> Similarly, evidence of relative demand for Airbus’s LCA models in the EC and the rest of the world is relevant to understanding the nature of the performance by Airbus to which provisions of Launch Aid are tied; the evidence shows that the sales performance to which the provision of Launch Aid is tied necessarily entails export performance.<sup>513</sup>

326. For all of the foregoing reasons, as well as those set out in previous U.S. submissions and statements, the Panel should reject the EC’s approach to evidence demonstrating the export-related motivations of the governments providing Launch Aid to Airbus.

### C. EIB LOANS

**218. Please describe what you consider to be the attributes of a “subsidy programme” - that is, the factors that make it possible to identify the existence of a “subsidy programme” - for the purpose of Article 2.1(c). To what extent can such attributes or factors be found in the lending activities of the EIB?**

#### Comment

327. The EC’s response to this question is notable for its avoidance of the issue of how to construe the term “program.” The EC states that “the most relevant attributes of a subsidy programme are those that make financing provided under such a programme a subsidy.”<sup>514</sup> The EC thus takes it for granted that the meaning of “program” is understood and that the only relevant issue is what distinguishes a “subsidy program” from some other type of program. However, that approach plainly misses the point of the question. In contrast, the U.S. answer to this question discusses the meaning of “program,” and hence “subsidy program,” in accordance

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<sup>510</sup> EC Responses to Second Panel Questions, para. 534 (emphasis added).

<sup>511</sup> See *Australia – Leather*, para. 9.62.

<sup>512</sup> See *Australia – Leather*, para. 9.67.

<sup>513</sup> See, e.g., U.S. FWS, para. 358.

<sup>514</sup> EC Responses to Second Panel Questions, para. 536.

with the ordinary meaning of the term in context and in light of the object and purpose of the SCM Agreement.<sup>515</sup>

328. In avoiding the issue of how to construe the term “program,” the EC fails to justify its position that all lending by the EIB over a 50-year period constitutes a single subsidy program. It asserts that “there is virtually no material difference between the challenged loans and the 8,400 other loans provided by the EIB,” and that this is why all lending by the EIB should be treated as a single program.<sup>516</sup> However, the only evidence it cites for this proposition are general descriptions of how the EIB operates.<sup>517</sup>

329. Later in its response, the EC criticizes the approach suggested by the United States for analyzing the specificity of EIB loans. Its criticism continues the EC’s insistence that specificity must be evaluated in the context of a “program,”<sup>518</sup> although, as the United States previously has explained, that view is not supported by the text of the SCM Agreement.<sup>519</sup> And, despite declining to offer an explanation of what “program” means, the EC contends that by not showing the existence of certain factors (*i.e.*, “ring-fenced pools of funding” and “financial conditions attached to a particular objective”) the United States has not established the existence of a subsidy program.<sup>520</sup> However, the EC fails to identify the basis for a requirement to establish these factors.

330. In sum, the EC has not reconciled its position that all lending by the EIB over 50 years is a “subsidy program” with the ordinary meaning of that term in context and in light of the object and purpose of the SCM Agreement. Nor has the EC even established that the specificity of the EIB loans must be analyzed in the context of a subsidy program, as opposed to another appropriate frame of reference, such as the EIB’s own classifications of its lending activity. For reasons the United States previously has discussed, the Panel should reject the EC’s approach to analyzing the specificity of the EIB loans and instead consider those loans in the context of an appropriate frame of reference. That frame of reference may be a subsidy program (as in the

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<sup>515</sup> See U.S. Responses to Second Panel Questions, paras. 261-264.

<sup>516</sup> EC Responses to Second Panel Questions, para. 538.

<sup>517</sup> See EC Responses to Second Panel Questions, footnote 542; *see also* U.S. Responses to Second Panel Questions, paras. 84-98.

<sup>518</sup> See EC Responses to Second Panel Questions, para. 541.

<sup>519</sup> See U.S. Responses to Second Panel Questions, paras. 257-259.

<sup>520</sup> See EC Responses to Second Panel Questions, para. 541.

case of the i2i program, under which the 2002 loan to EADS was granted), or it may be a category that the EIB itself uses to classify its lending activity (as in the case of the economic sector and policy objectives under which the EIB classified the earlier Airbus loans).<sup>521</sup>

#### D. INFRASTRUCTURE

**219. At paragraphs 51-53 of its SCOS, the United States makes an argument concerning the French-German compromise solution to the question of the location of the A380 site (in response to an argument made by the EC that the decision to co-locate the A380 assembly site [ ]). Would the parties please comment on the United States' argument, including its underlying premises, and discuss the implications for assessing the 'benefit' conferred on Airbus if this argument were accepted.**

#### Comment

331. In its response to Question 219, the EC lays out what the United States described in its response to the same question as an “inefficiency defense.”<sup>522</sup> Thus, the EC argues that [

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332. As the United States previously explained, this “inefficiency defense” has no basis in the SCM Agreement and, if accepted, would lead to absurd results.<sup>524</sup> The relevant basis for analyzing the benefit conferred by a financial contribution is the market, not the alternative options a recipient might have pursued in the absence of the financial contribution.<sup>525</sup> Moreover, subsidies often are given to induce economic actors to commit to what otherwise would be an inefficient allocation of resources. Treating such inefficient allocations as offsets to the benefit

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<sup>521</sup> See U.S. Responses to First Panel Questions, paras. 81-91, 92-102, 103-107, 365-370.

<sup>522</sup> See U.S. Responses to Second Panel Questions, paras. 275-278.

<sup>523</sup> See EC Responses to Second Panel Questions, paras. 547-549. Contrary to the EC's assertion (*id.*, para. 548), the United States does not “accept{ }” the EC's characterization of the effects of co-locating final assembly of the A380.

<sup>524</sup> This observation is equally applicable with respect to the issue of “benefit” as it is with respect to the issue of “adverse effects.” The United States stresses this point given the apparent shift in focus of the underlying EC argument from adverse effects to benefit. Compare EC SWS, paras. 1077-1089 (focusing on adverse effects) with EC SCOS, paras. 20-21 (focusing on benefit).

<sup>525</sup> See *Canada – Aircraft (AB)*, para. 157.

conferred by a subsidy would amount to an exemption from SCM Agreement disciplines found nowhere in the text of that agreement.<sup>526</sup>

333. In addition to repeating its unsupported “inefficiency defense,” the EC’s response to Question 219 is notable for its equally erroneous suggestion that the benefit analyses for different financial contributions should be combined into a single, aggregate benefit analysis.<sup>527</sup> Nothing in the SCM Agreement supports the EC’s contention that “[ ]”) associated with one financial contribution may be used to offset the benefit conferred by a different financial contribution.<sup>528</sup> Article 1 of the SCM Agreement provides that “a subsidy shall be deemed to exist if . . . there is a financial contribution . . . and a benefit is thereby conferred.” (Emphases added.) In other words, it requires a determination of a correspondence between a particular financial contribution and a particular benefit, as opposed to a determination of “any overall net financial benefit”<sup>529</sup> from multiple financial contributions.<sup>530</sup>

334. In sum, the Panel should reject both the EC’s invocation of an “inefficiency defense” and its suggestion of a combined benefit analysis for multiple financial contributions.

**220. In determining whether there has been a financial contribution within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement, which party bears the onus of establishing that goods or services provided by a government are not (or are) general infrastructure?**

Comment

335. The United States refers the Panel to the U.S. response to this question.<sup>531</sup>

**221. What factors are relevant to the determination as to whether infrastructure is ‘general’ for purposes of Article 1.1(a)(1)(iii) of the SCM Agreement and how does this**

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<sup>526</sup> See U.S. Responses to Second Panel Questions, paras. 276-277.

<sup>527</sup> See EC Responses to Second Panel Questions, para. 549.

<sup>528</sup> EC Responses to Second Panel Questions, paras. 548-549.

<sup>529</sup> EC Responses to Second Panel Questions, para. 549.

<sup>530</sup> This does not mean, however, that upon finding multiple subsidies to exist the adverse effects of those subsidies cannot be examined cumulatively for purposes of an analysis under Article 5 of the SCM Agreement. See *US – Cotton Subsidies (Panel)*, para. 7.1192.

<sup>531</sup> See U.S. Responses to Second Panel Questions, paras. 279-282.

**determination differ from the determination as to whether a subsidy is ‘specific’ within the meaning of Article 2?**

Comment

336. In previous submissions and statements, the United States has demonstrated that the EC’s understanding of the term “general infrastructure” for purposes of Article 1.1(a)(1)(iii) of the SCM Agreement does not accord with the ordinary meaning of that term, in context, and in light of the object and purpose of the agreement.<sup>532</sup> In its response to Question 221, the EC attempts to show an inconsistency between the understanding of “general infrastructure” set out by the United States in this dispute and the understanding of that same term set out by the United States in a different dispute (*i.e.*, DS353). While submissions in a different dispute have no relevance to the settlement of the present dispute, the EC’s portrayal of the U.S. position is so misleading that the United States feels compelled to set the record straight.

337. In fact, the U.S. understanding of the term “general infrastructure” described in the submission cited by the EC is entirely consistent with the U.S. understanding set out in the present dispute. If the Panel wishes to confirm this, the United States invites it to compare paragraph 46 of the DS353 submission cited by the EC with paragraphs 136 and 137 of the U.S. response to the Panel’s Question 20 in this dispute.

338. Especially misleading is the EC’s erroneous attribution to the United States of the position that general infrastructure includes “installations or services . . . that further public objectives, such as ‘the social development of the population.’”<sup>533</sup> The reference to “further{ing} public objectives” appears nowhere in the passage cited by the EC or anywhere else in the U.S. discussion of the meaning of “general infrastructure.” It is a concept that the EC uses in discussing “general infrastructure” and has no basis in the ordinary meaning of that term in context and in light of the object and purpose of the SCM Agreement.<sup>534</sup>

339. Likewise, the EC takes the U.S. reference to “the social development of the population” completely out of context. In the DS353 submission cited by the EC, the United States gave as one example of activities that should be treated as general infrastructure “social services for the

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<sup>532</sup> See U.S. FNCOS, para. 79; U.S. Responses to First Panel Questions, paras. 136-138, 140; U.S. SWS, paras. 303-310; U.S. SNCOS, paras. 79-82; U.S. Comments on EC SNCOS, para. 33.

<sup>533</sup> EC Responses to Second Panel Questions, para. 555.

<sup>534</sup> See U.S. SWS, paras. 305-307 (discussing EC’s incorrect understanding of “general infrastructure”).

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social development of the population.”<sup>535</sup> Unlike the EC, the United States does not take the position that any good or service that furthers “social development,” including for example by increasing tax revenue or stimulating employment, constitutes general infrastructure.<sup>536</sup>

340. In short, no one should be misled by the EC’s attempt to distort the U.S. position or its understanding of the term “general infrastructure.”

341. The United States also takes this opportunity to comment on the responses to the Panel’s Question 8 to the third parties. First, the United States notes that both Australia and Japan reject the EC’s suggestion that infrastructure is presumed to be general unless specifically limited.<sup>537</sup> As discussed in the U.S. second non-confidential oral statement, such a presumption has no basis in the text of the SCM Agreement.<sup>538</sup>

342. The only third party that believes there is such a presumption is Canada.<sup>539</sup> In its response to the Panel’s Question 8 to third parties, Canada refers to its discussion of this issue in its written submission. However, none of its explanations there substantiate the position that infrastructure is presumed to be general unless specifically limited.<sup>540</sup> For example, there is no logical reason that placement of the reference to general infrastructure in Article 1 of the SCM Agreement translates into such a presumption. Furthermore, the very fact that Article 1 refers to “general infrastructure” (emphasis added) indicates that the drafters of the SCM Agreement recognized that not all infrastructure is general, a fact that further undermines Canada’s assertion of a presumption as to the characterization of infrastructure.

343. Second, the United States calls the Panel’s attention to Brazil’s observation that “infrastructure may not be ‘general’ because access is limited to certain entities based on *de jure*

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<sup>535</sup> US FWS in DS 353, para. 47 (emphasis added)  
([http://www.ustr.gov/assets/Trade\\_Agreements/Monitoring\\_Enforcement/Dispute\\_Settlement/WTO/Dispute\\_Settlement\\_Listings/asset\\_upload\\_file930\\_13177.pdf](http://www.ustr.gov/assets/Trade_Agreements/Monitoring_Enforcement/Dispute_Settlement/WTO/Dispute_Settlement_Listings/asset_upload_file930_13177.pdf)).

<sup>536</sup> See, e.g., EC SNCOS, para. 216; U.S. Comments on EC SNCOS, para. 38.

<sup>537</sup> See Australia Responses to Questions to Third Parties, p. 3; Japan Responses to Questions to Third Parties, p. 2.

<sup>538</sup> See U.S. SNCOS, para. 80.

<sup>539</sup> See Canada Responses to Questions to Third Parties, para. 7.

<sup>540</sup> See Canada Third Party Written Submission, paras. 28-31.

or *de facto* conditions.”<sup>541</sup> Similarly, Australia notes that “any analysis of infrastructure needs to be undertaken on a case-by-case basis, taking into account all relevant facts and circumstances.”<sup>542</sup> These observations contrast with the view expressed by the EC and Canada that infrastructure is presumed to be “general” and is “remov{ed}” from that status only when limitations on its use are “clearly specified” and “restricted by regulation.”<sup>543</sup> In other words, the EC and Canada contend that only *de jure* restrictions on use render infrastructure non-general. That contention is incorrect, and the contrary understanding expressed by Brazil and Australia is correct.<sup>544</sup>

344. When the drafters of the SCM Agreement intended to draw a distinction between *de jure* and *de facto* conditions, they did so expressly. This is illustrated by the treatment of *de jure* and *de facto* specificity in Article 2, and the treatment of *de jure* and *de facto* export contingency in Article 3.1(a). Conversely, in *Canada – Autos*, the Appellate Body found that the absence of a distinction between *de jure* and *de facto* contingency upon use of domestic over imported goods in Article 3.1(b) meant that none existed.<sup>545</sup> Likewise, the absence of a distinction between *de jure* and *de facto* conditions in the reference to “general infrastructure” in Article 1 indicates that no such distinction exists. Accordingly, the suggestion by the EC and Canada that infrastructure is non-general only if it is subject to *de jure* use restrictions is not supported by the text of the SCM Agreement.

345. In any event, even if there were a requirement that use restrictions be *de jure* in order to render infrastructure non-general, such a requirement would be met with respect to the infrastructure claims at issue in this dispute.<sup>546</sup>

346. Finally, Canada makes the assertion that even when the use of infrastructure is limited to certain enterprises, the infrastructure may still be general if the limitation is “temporary and

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<sup>541</sup> Brazil Responses to Questions to Third Parties, para. 14 (emphasis added); *see also id.*, para. 15.

<sup>542</sup> Australia Responses to Questions to Third Parties, p. 4 (emphasis added); *see also id.* (response to Question 9 to third parties).

<sup>543</sup> U.S. SNCOS, para. 80 (discussing EC SWS, paras. 333, 336-339); *see also* Canada Third Party Written Submission, para. 26.

<sup>544</sup> *See* U.S. Responses to Second Panel Questions, paras. 283-286.

<sup>545</sup> *See Canada – Autos (AB)*, paras. 139-143.

<sup>546</sup> *See, e.g.*, U.S. Responses to First Panel Questions, paras. 144-147 (Aéroconstellation site), paras. 153-154 (Bremen airport runway extension); U.S. SWS, paras. 332-345 (Mühlenberger Loch site); U.S. Responses to Second Panel Questions, paras. 106-108 (road improvements to allow Airbus to access Aéroconstellation site).



where general use is likely to resume in the foreseeable future.”<sup>547</sup> The EC appears to endorse this view but, curiously, overlooks Canada’s reference to general use being “likely to resume in the foreseeable future.”<sup>548</sup>

347. Canada cites no support for its assertion regarding temporary use restrictions. However, even if the factor it identifies were relevant to a determination of whether infrastructure is general infrastructure, it would not apply to the facts of this dispute. The only provision of infrastructure to which Canada suggests it might apply is Airbus’s Mühlenberger Loch industrial site.<sup>549</sup> However, that provision of infrastructure does not meet Canada’s test of general use being likely to resume in the foreseeable future. The bare land created by filling the Mühlenberger Loch wetland has been improved with substantial infrastructure specific to Airbus;<sup>550</sup> Airbus is currently the only user of the site; its exclusive use of the site is ensured at least for the next [ ] years;<sup>551</sup> and German planning law prohibits any alternative use of the land.<sup>552</sup> Accordingly, even under Canada’s proposed test regarding temporary use restrictions on infrastructure, the Airbus industrial site would not qualify as general infrastructure.

## E. EXTINCTION AND EXTRACTION OF ALLEGED SUBSIDIES

**222. Are there any circumstances in which the transfer of funds or other assets by the recipient of a subsidy to an entity other than the granting authority constitutes a ‘repayment’ or withdrawal of the subsidy for purposes of the SCM Agreement? Are there any circumstances in which the transfer of funds or other assets by the recipient of a**

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<sup>547</sup> Canada Responses to Questions to Third Parties, para. 7; Canada Third Party Written Submission, para. 38.

<sup>548</sup> See EC SWS, para. 340.

<sup>549</sup> See Canada Responses to Questions to Third Parties, para. 9.

<sup>550</sup> See U.S. FWS, paras. 424-429; U.S. SWS, paras. 332-338.

<sup>551</sup> See U.S. SWS, para. 340 and footnote 416.

<sup>552</sup> See U.S. SWS, paras. 342-345. The EC asserts that the law “can easily be amended to provide for other industrial uses when such need arises in the future.” EC SNCOS, para. 206. However, the same can be said of any measure. If a measure breaches a Member’s obligations under a covered agreement, the possibility of the measure’s being amended is no defense to the breach. Likewise, the possibility of German planning law being amended does not change the fact that under current law, use of the Mühlenberger Loch site other than as an industrial site for Airbus is precluded. The Panel’s role is to consider the facts as they exist, not as they might exist in the future. See DSU Art. 11 (“{A} panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case.”).

**subsidy to the granting authority would not constitute the ‘repayment’ or withdrawal of the subsidy for purposes of the SCM Agreement?**

Comment

348. The EC’s response to this question largely repeats points the EC made in response to questions 198 through 201. Accordingly, the United States refers the Panel to its comments on those responses, above. With regard to the EC’s assertion of the relationship between its “extraction” theory and adverse effects, the United States refers the Panel to the U.S. response to Question 169.<sup>553</sup>

349. The EC’s response to Question 222 is notable for its admission that “where a granting authority provides something of equal value in exchange for cash or other assets from the recipient of a subsidy, no ‘repayment’ or other ‘withdrawal’ of the subsidy has occurred.”<sup>554</sup> The United States agrees with this proposition.<sup>555</sup> It is for this reason (as well as others previously discussed) that the Panel should reject the EC’s characterization of the Government of Spain’s retention of cash upon its contribution of CASA to EADS as a repayment of subsidies.

350. The United States explained this point in its own response to Question 222.<sup>556</sup> Given the EC’s reiteration of its belief that it has rebutted the U.S. argument,<sup>557</sup> the United States takes this opportunity to underscore why Spain’s retention of cash cannot be viewed as a repayment of subsidies.

351. As previously explained, in retaining Euro 340 million in cash in connection with its contribution of CASA, the Government of Spain gave up the larger share of EADS that would have been attributable to its contribution if it had included that cash. It is in this sense that the retention of cash involved a *quid pro quo*.<sup>558</sup>

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<sup>553</sup> See U.S. Responses to Second Panel Questions, paras. 221-225.

<sup>554</sup> EC Responses to Second Panel Questions, para. 559.

<sup>555</sup> See U.S. Responses to Second Panel Questions, para. 297.

<sup>556</sup> See U.S. Responses to Second Panel Questions, paras. 297-301.

<sup>557</sup> See EC Responses to Second Panel Questions, footnote 563.

<sup>558</sup> See U.S. Responses to Second Panel Questions, para. 300.

352. Another way to look at this transaction is to consider the situation if Spain had contributed CASA to EADS, including the Euro 340 million in cash, and subsequently sold shares back to EADS for Euro 340 million. The net result would be precisely the same as the transaction that actually occurred. That is, the Government of Spain would be left with Euro 340 million in cash and a 6.25 percent share of EADS. Yet, as this perspective illustrates, the government has given something up – *i.e.*, shares in EADS – in order to get the cash. By contrast, a cash transfer potentially amounting to a repayment of subsidies would not have been accompanied by the government of Spain replacing the cash with something of value (*i.e.*, a portion of the shares corresponding to its original contribution of CASA assets to EADS).

353. Although the order of the transactions that brought CASA into EADS is different from the hypothetical just described, the net result is the same. Because the retention of cash resulted in Spain having a lesser stake in EADS than otherwise would have been attributable to its contribution of CASA assets (just as in the buy-back scenario), the retention is properly characterized as an exchange of value for value rather than as a repayment of subsidies.

354. The EC's only response to the U.S. demonstration that CASA's transfer of cash to its owner did not repay, withdraw, or "extract" subsidy is to pose the rhetorical question, "How can a company such as CASA become a non-subsidized entity?"<sup>559</sup> While that question is not relevant to this dispute, the answer is straightforward. One way for a company such as CASA to become a non-subsidized entity is for its government owner to withdraw previously granted subsidies without providing something in return, such as a reduction in the government's interest in the company proportionate to the amount withdrawn. Another way (as has been addressed by the panel and the Appellate Body in *US – Countervailing Measures*) is for the government to privatize the company in an arm's-length, fair-market-value sale, involving all or substantially all of the company and a relinquishment of any controlling interest by the government.<sup>560</sup> However, Spain's retention of cash in connection with its contribution of CASA, in exchange for a share of EADS proportionate to CASA's reduced size, did not entail either of these alternatives. For this reason, therefore, the Panel should reject the EC's characterization of Spain's retention of cash as a "repayment" of subsidies.

**223. Could the Parties please comment on the assertion at para. 55 of the EC's SNCOS that United States and international accounting standards "require the purchaser of a company to adjust the balance of any loan carrying a below market rate to reflect a market interest rate, thereby recognizing that the seller extracted the value of the below market**

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<sup>559</sup> EC SCOS, para. 6.

<sup>560</sup> See *US – Countervailing Measures (Panel)*, para. 7.62; *US – Countervailing Measures (AB)*, para. 85.

**rate loan in the price of the business”? Does the change in the “book” value of the liability impact the repayment terms of any such loans transferred to the purchaser?**

Comment

355. As discussed in the U.S. response to this question, the accounting standards cited by the EC pertain to “the purchaser of a company.”<sup>561</sup> None of the transactions alleged by the EC to have “extinguished” or “extracted” subsidies involved the purchase of a company. In its response to Question 223, the EC fails to explain the relevance of the cited accounting standards to transactions involving stakes of less than 10 percent in a company.<sup>562</sup>

**F. CAPITAL INVESTMENTS AND SHARE TRANSFERS**

**224. What is the relevant test for determining whether, in a claim concerning Part III of the SCM Agreement, government provision of equity capital can be considered to confer a ‘benefit’ under Article 1.1(b)? To the extent that the parties consider that it is relevant whether the investment decision can be regarded as consistent with the usual investment practice of private investors in the territory of the Member, do the parties consider that the usual investment practice of private investors should be determined in light of the specific circumstances surrounding the government investment? Specifically, how (if at all) do the parties consider the following circumstances, in which a government provision of equity capital was made, to be relevant to determining the usual investment practice of private investors:**

- (a) where the recipient entity is financially distressed, the government is a significant creditor of that entity and the capital contribution occurred in the context of a restructuring of that entity;**
- (b) where the recipient entity is wholly-owned by the government, and the capital contributions were made in order to meet the ongoing capital requirements of the entity;**
- (c) where the recipient entity is wholly-owned by the government and the capital contribution occurred in the context of a consolidation of the government’s assets in anticipation of a sale of shares in that entity.**

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<sup>561</sup> U.S. Responses to Second Panel Questions, para. 303 (quoting EC SNCOS, para. 56 (emphasis added)).

<sup>562</sup> See U.S. SWS, para. 532.

Comment

356. The EC's response to Question 224 is notable for two reasons. First, the EC acknowledges that "the overriding 'benefit' inquiry in Article 1.1(b) cannot be conducted in the abstract."<sup>563</sup> The United States agrees with this proposition and, therefore, finds remarkable the EC's persistent reliance on abstractions when it comes to analyzing the benefit conferred by the equity infusions at issue in this dispute. For example:

- With respect to the French government's contribution of its shares in Dassault Aviation to Aérospatiale, the EC neglects the facts and focuses instead on the abstract question of whether it is "inconsistent with the usual investment practice of a private owner to pool wholly-owned, complementary assets together in anticipation of a combined sale of those assets."<sup>564</sup>
- With respect to the German government's DM 505 million equity infusion to Deutsche Airbus, the EC neglects the facts and focuses instead on the abstract question of whether "it is contrary to usual investment practice in the United States, Germany and elsewhere for existing creditors and new investors in a restructuring situation to inject fresh capital into a company that prior to the restructuring was on the verge of failure."<sup>565</sup>
- In the case of French government equity infusions to Aérospatiale from 1987 to 1993, the EC neglects facts relevant to Aérospatiale in particular and focuses instead on evidence concerning aircraft demand in general.<sup>566</sup>

357. Following the EC's own observation, the Panel should decline the EC's suggestion, when it comes to particular equity infusions, that the Panel pursue abstract inquiries. Rather, as the United States has argued in connection with each of the equity infusions, the Panel should address the particular facts before it.

358. The second reason the EC's response to Question 224 is notable is that, while it asserts that the usual investment practice of private investors may differ according to the situation at

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<sup>563</sup> EC Responses to Second Panel Questions, para. 568.

<sup>564</sup> EC Responses to Second Panel Questions, para. 217; *see* U.S. Comment on EC Response to Question 196, *supra*.

<sup>565</sup> EC Responses to First Panel Questions, para. 268.

<sup>566</sup> *See* EC SWS, para. 535; U.S. SNCOS, para. 102.

hand, it ignores aspects of such practice that are not situation-dependent. For example, as discussed in the U.S. response to the same question, it is the usual investment practice of private investors to base their investment decisions on contemporaneous analyses.<sup>567</sup> That aspect of usual investment practice does not vary according to the different circumstances described in the Panel’s question.

359. Similarly, it is inconsistent with the usual investment practice of private investors to provide capital to a company simply because the company’s management believes an infusion to be “imperative.”<sup>568</sup> Again, this aspect of usual investment practice is not situation-dependent.

360. In sum, the United States agrees that a benefit analysis of equity infusions (or any other financial contribution for that matter) “cannot be conducted in the abstract.” For that reason, the United States finds surprising the EC’s approach to defending the equity infusions at issue in this dispute. At the same time, it is not the case that all aspects of the usual investment practice of private investors differ from circumstance to circumstance. There are usual investment practices – such as reliance on contemporaneous analyses – that are not situation-dependent. Tellingly, the EC ignores these practices, reflecting the absence of evidence that they were followed in deciding to provide the equity infusions at issue in this dispute.

#### G. ADVERSE EFFECTS

**225. The EC has argued that there are multiple subsidized products at issue in this dispute, and multiple corresponding like products. If the Panel were to accept the EC’s view, would the Panel be required to assess the question of injury under Article 5(a) with respect to more than one domestic industry? If so, how do the Parties consider that the Panel might undertake such an assessment, in view of the fact that there is only one company in the United States producing large civil aircraft?**

#### Comment

361. The United States considers that nothing in its response to this question<sup>569</sup> need be altered or is affected by the EC’s response, and therefore continues to stand by that earlier response.

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<sup>567</sup> See U.S. Responses to Second Panel Questions, paras. 310-318, 323-325, 327-329.

<sup>568</sup> EC SWS, para. 531; see also U.S. Responses to First Panel Questions, paras. 183-184; U.S. SWS, paras. 472-474; U.S. SNCOS, para. 103.

<sup>569</sup> U.S. Responses to First Panel Questions, paras. 330-334.



LIST OF ADDITIONAL U.S. EXHIBITS

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

<u>U.S. Exhibit</u>	<u>Description</u>
661	Print-out from [ ] website (HSBI)
662	Pierre de Bassuet, <i>EADS Aero-Notes</i> (Aug. 17, 2007)
663	Scott Hamilton, “Airbus Targets Appraisers on Values,” <i>Jetrader</i> (June 2007) at 12-14
664	EADS Financial Statements and Corporate Governance 2006 at 46
665	EADS Annual Report 2002 at 60
666	Annual Average Exchange Rate, Euro to U.S. Dollar, 1999-2007, <a href="http://www.oanda.com">www.oanda.com</a> (last visited Oct. 3, 2007)
667	Airbus press release, <i>Kingfisher Airlines to launch services with Airbus A320s</i> (July 21, 2004)
668	Airbus press release, <i>Air Deccan to acquire Airbus A320s</i> (Feb. 25, 2004)
669	Airbus press release, <i>Jet Airways to acquire ten Airbus A330-200s/300s with options for ten more</i> (June 14, 2005)
670	Airbus press release, <i>China eastern airlines signs contract with Airbus on purchasing 20 A330-300s</i> (Oct. 9, 2004)
671	Boeing Commercial Airplanes, <i>767 Operational Advantages</i> , Marketing Presentation for China Eastern Airlines (July 2003)
672	Kevin Done, <i>BA Places Landmark Order for Airbus A380s and Boeing 787s</i> , <i>Financial Times</i> (Sept. 28, 2007)
673	The Handbook of Fixed Income Securities, pp. 396-401 (Frank J. Fabozzi, ed.) (7 <sup>th</sup> ed., 2005)