

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

***(WT/DS316)***

**SECOND SUBMISSION OF  
THE UNITED STATES OF AMERICA**

**FINAL NON-BCI VERSION**

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<i>Argentina – Poultry</i>	Panel Report, <i>Argentina – Definitive Anti-Dumping Duties on Poultry from Brazil</i> , WT/DS241/R, adopted 19 May 2003
<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>Australia – Leather (Article 21.5)</i>	Panel Report, <i>Australia – Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States</i> , WT/DS126/RW and Corr.1, adopted 11 February 2000
<i>Canada – Aircraft (Panel)</i>	Panel Report, <i>Canada – Measures Affecting the Export of Civilian Aircraft</i> , WT/DS70/R, adopted 20 August 1999, as modified by the Appellate Body Report, WT/DS70/AB/R
<i>Canada – Aircraft (AB)</i>	Appellate Body Report, <i>Canada – Measures Affecting the Export of Civilian Aircraft</i> , WT/DS70/AB/R, adopted 20 August 1999
<i>Chile – Price Band System (AB)</i>	Appellate Body Report, <i>Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products</i> , WT/DS207/AB/R, adopted 23 October 2002
<i>EC – Bananas III (AB)</i>	Appellate Body Report, <i>European Communities – Regime for the Importation, Sale and Distribution of Bananas</i> , WT/DS27/AB/R, adopted 25 September 1997
<i>EC – Biotech</i>	Panel Report, <i>European Communities – Measures Affecting the Approval and Marketing of Biotech Products</i> , WT/DS291/R, WT/DS292/R, WT/DS293/R, circulated 29 September 2006
<i>EC – Poultry (AB)</i>	Appellate Body Report, <i>European Communities – Measures Affecting the Importation of Certain Poultry Products</i> , WT/DS69/AB/R, adopted 23 July 1998
<i>EC – Sugar Subsidies (Australia) (Panel)</i>	Panel Report, <i>European Communities – Export Subsidies on Sugar; Complaint by Australia</i> , WT/DS265/R, adopted 19 May 2005, as modified by the Appellate Body Report, WT/DS265/AB/R, WT/DS266/AB/R, WT/DS283/AB/R
<i>EC – Sugar Subsidies (AB)</i>	Appellate Body Report, <i>European Communities – Export Subsidies on Sugar</i> , WT/DS265/AB/R, WT/DS266/AB/R, WT/DS283/R, adopted 19 May 2005

<i>Guatemala – Cement I (AB)</i>	Appellate Body Report, <i>Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico</i> , WT/DS60/AB/R, adopted 25 November 1998
<i>Guatemala – Cement II</i>	Panel Report, <i>Guatemala – Definitive Anti-Dumping Measures on Grey Portland Cement from Mexico</i> , WT/DS156/R, 17 November 2000
<i>India – Autos</i>	Panel Report, <i>India – Measures Affecting the Automotive Sector</i> , WT/DS/146/R, WT/DS175/R, adopted 5 April 2002
<i>Indonesia – Autos</i>	Panel Report, <i>Indonesia – Certain Measures Affecting the Automobile Industry</i> , WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, adopted 23 July 1998
<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>Korea – Commercial Vessels</i>	Panel Report, <i>Korea – Measures Affecting Trade in Commercial Vessels</i> , WT/DS273/R, adopted 11 April 2005
<i>Mexico – HFCS (Article 21.5) (AB)</i>	Appellate Body Report, <i>Mexico – Anti-Dumping Investigation of High-Fructose Corn Syrup (HFCS) from the United States: Recourse to Article 21.5 by the United States</i> , WT/DS132/AB/RW, adopted 21 November 2001
<i>Mexico – Soft Drinks (AB)</i>	Appellate Body Report, <i>Mexico – Tax Measures on Soft Drinks and Other Beverages</i> , WT/DS308/AB/R, adopted 24 March 2006
<i>US – Cotton Subsidies (Panel)</i>	Panel Report, <i>United States – Subsidies on Upland Cotton</i> , WT/DS267/R, adopted 21 March 2005, as modified by the Appellate Body Report, WT/DS267/AB/R
<i>US – Cotton Subsidies (AB)</i>	Appellate Body Report, <i>United States – Subsidies on Upland Cotton</i> , WT/DS267/AB/R, adopted 21 March 2005
<i>US – Countervailing Measures (Panel)</i>	Panel Report, <i>United States – Countervailing Measures Concerning Certain Products from the European Communities</i> , WT/DS212/R, adopted 8 January 2003, as modified by the Appellate Body Report, WT/DS212/AB/R
<i>US – Countervailing Measures (AB)</i>	Appellate Body Report, <i>United States – Countervailing Measures Concerning Certain Products from the European Communities</i> , WT/DS212/AB/R, adopted 8 January 2003

<i>US – Countervailing Measures (21.5)</i>	Panel Report, <i>United States – Countervailing Measures Concerning Certain Products from the European Communities – Recourse to Article 21.5 of the DSU by the European Communities</i> , WT/DS212/RW, adopted 27 September 2005
<i>US – Lamb Meat (Panel)</i>	Panel Report, <i>United States – Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia</i> , WT/DS177/R, WT/DS178/R, adopted 16 May 2001, as modified by the Appellate Body Report, WT/DS177/AB/R, WT/DS178/AB/R
<i>US – Lead Bars (Panel)</i>	Panel Report, <i>United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom</i> , WT/DS138/R, adopted 7 June 2000, as modified by the Appellate Body Report, WT/DS138/AB/R
<i>US – Offset Act (Byrd Amendment) (AB)</i>	Appellate Body Report, <i>United States – Continued Dumping and Subsidy Offset Act of 2000</i> , WT/DS217/AB/R, WT/DS234/AB/R, adopted 27 January 2003
<i>US – Softwood Lumber Dumping (Panel)</i>	Panel Report, <i>United States – Final Dumping Determination on Softwood Lumber from Canada</i> , WT/DS264/R, adopted 31 August 2004, as modified by the Appellate Body Report, WT/DS264/AB/R
<i>US – Softwood Lumber CVD Final (Panel)</i>	Panel Report, <i>United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada</i> , WT/DS257/R and Corr.1, adopted 17 February 2004, as modified by the Appellate Body Report, WT/DS257/AB/R

## I. INTRODUCTION

1. The Panel now has before it two very different explanations of the evolution of the large civil aircraft (“LCA”) industry within the European Communities (“EC”) from its inception almost four decades ago to its present status as the world’s largest producer of LCA. The explanation provided by the United States is based on a careful and thorough presentation of evidence and analysis of how that evidence relates to the disciplines of the WTO *Agreement on Subsidies and Countervailing Measures* (“SCM Agreement”), which is the covered agreement relevant to settlement of this dispute. The explanation provided by the EC omits key facts, repeatedly misrepresents panel and Appellate Body reports, and seeks to avoid the inescapable conclusions that result from application of the SCM Agreement by referring instead to agreements that are not before the Panel. While the explanations differ, however, the core facts remain:

- The governments of France, Germany, the United Kingdom, and Spain (“the Airbus governments”) have provided Airbus with \$15,000,000,000 in Launch Aid since 1969, enabling Airbus<sup>1</sup> to launch each new model of LCA and each major derivative.
- Launch Aid consistently takes the form of financial contributions repayable through a levy on each delivery of the financed aircraft, with lower levies imposed on earlier deliveries than on later deliveries.
- Launch Aid for the A380, A340-500/600, and A330-200 was provided in reliance on Airbus and government forecasts of substantial exports and in consideration for Airbus’s commitment to a level of sales performance that it could meet only through exportation.
- The European Investment Bank (“EIB”) has provided loans to Airbus totaling approximately Euro 1,600,000,000 to support the development of LCA.
- The Airbus governments (including regional authorities) have created industrial sites – such as the site created by transforming wetlands at the Mühlenberger Loch in Hamburg and the Aéroconstellation site created by transforming agricultural land in Toulouse – undertaking investments that Airbus itself otherwise would have had to make, which the governments then leased or sold to Airbus without charging for the considerable expense associated with creation of the sites.
- The government of Germany, in 1998, settled a DM 9,400,000,000 debt owed to it by Deutsche Airbus by allowing the company to make a one-time payment of DM 1,735,000,000.
- The Airbus governments have provided equity infusions to Airbus – including the German government’s purchase of a 20 percent share in Deutsche Airbus for DM

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<sup>1</sup> For the definition of “Airbus” used herein, see U.S. First Written Submission (“FWS”), para. 44 & note 24.

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505,000,000 in 1989 followed by a return of that stake to Deutsche Airbus's parent (MBB) three years later, and the French government's equity infusions to Aérospatiale totaling FF 7,150,000,000 over the period 1987 to 1993 and its transfer to Aérospatiale in 1998 of shares in Dassault worth approximately FF 5,280,000,000.

- The EC, the Airbus governments, and various regional governments have provided grants to Airbus totaling approximately Euro 3 billion to support LCA research and development.
- If Airbus had been required to fund its aircraft launches without Launch Aid or the other EC and Airbus government subsidies, it would not have been able to launch any of the LCA models that it has introduced, sold, and delivered to date.
- In its almost 40-year history, Airbus has increased its share of the global LCA market from zero to 57 percent and has built and delivered more LCA than Boeing in each year since 2003.
- Airbus has taken numerous major sales from Boeing in recent years, often through the use of aggressive pricing, which continues to depress LCA prices despite two years of record demand.

2. In its first written submission, as well as in its statements at the first Panel meeting and its answers to the Panel's questions, the United States made the case that the financial contributions that the EC and the Airbus governments indisputably provided to Airbus are subsidies within the meaning of Article 1 of the SCM Agreement, that they are specific within the meaning of Article 2, that through the use of these subsidies the EC and Airbus governments are causing adverse effects to the interests of the United States within the meaning of Article 5, and that, with respect to certain provisions of Launch Aid, the EC and the Airbus governments have granted or maintained subsidies contingent upon export performance, in breach of Article 3.

3. Looking at the same indisputable facts, the EC attempts to tell a very different story. That story is exemplified by the EC's explanation that it looks at this dispute through the lens of the "specific characteristics" of the LCA industry, including its status as "one of the last mass-employment industries in economically developed countries, with a highly skilled workforce" and "an industry in which a lot of pride is invested, which is considered strategic and is closely interwoven with defence industries."<sup>2</sup> In the EC's view, the massive subsidies provided to Airbus's LCA development and production are justified by these "specific characteristics" of the LCA industry – though, of course, this view has no basis in the SCM Agreement.

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<sup>2</sup> EC First Oral Statement ("FOS"), para. 5.

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4. A similar perspective comes through in the EC's response to the Panel's Question 73. There, the EC asserts that in evaluating whether a financial contribution to Airbus confers a benefit and thus constitutes a subsidy, "the market cannot be viewed in the abstract." Instead, according to the EC, one must take into account that "{t}he LCA market is characterised by heavy government intervention and international regulation."<sup>3</sup> In other words, following this logic, the EC's subsidies to the LCA industry are self-justifying: As a result of the consistent and significant subsidization of Airbus by the EC and the Airbus governments, "{t}he LCA market is characterised by heavy government intervention," which characteristic must be taken into account (to avoid viewing the market "in the abstract") in determining whether subsequent financial contributions to the LCA industry constitute subsidies within the meaning of the SCM Agreement. The EC thus implies that because LCA development and production in the EC are already so heavily subsidized, a determination of whether financial contributions confer benefits must be based on a comparison to existing subsidies rather than to "the market . . . in the abstract." By this logic, one quickly reaches the point where the very concept of "benefit" is defined away and, therefore, no financial contribution to LCA development and production ever constitutes a subsidy.

5. The EC applies the same logic in its discussion of infrastructure that the Airbus governments provide to Airbus. Thus, for example, the EC defends Hamburg's provision of an industrial site to Airbus without charge for the immense cost to create the site by filling wetlands at the Mühlenberger Loch on the ground that it is "in the public interest of Hamburg" inasmuch as "it provides new possibilities for . . . industrial activity to the benefit of the entire city."<sup>4</sup> If the EC were correct (which it is not), virtually all government-provided industrial sites would come under the "general infrastructure" exception to the SCM Agreement, even if created for and provided to a specific enterprise.<sup>5</sup>

6. The fact that infrastructure or any other government financial contribution to an enterprise or to an industry with "specific characteristics" might lead to the creation of jobs, give a boost to the economy, or serve other important economic, political, or social objectives does not exempt the financial contribution from the disciplines of the SCM Agreement. Were it otherwise, virtually every financial contribution by a government or other public body would fall

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<sup>3</sup> EC Responses to Panel's Questions Following the First Substantive Meeting ("EC Responses to First Panel Questions"), para. 117.

<sup>4</sup> EC Responses to First Panel Questions, para. 226.

<sup>5</sup> See Australia Third Party Submission, para. 54 ("Australia does not consider that the mere fact that a government creates infrastructure for public policy reasons in order to 'enable members of the public at large' (e.g. combating unemployment, fostering economic development, raising living standards) necessarily makes it 'general infrastructure.'") (quoting EC FWS, paras. 716 and 724).

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outside of the SCM Agreement, because governments typically justify their actions in terms of important economic, political, or social policy objectives.

7. Perhaps realizing this weakness in its argument, the EC has offered up a number of other defenses, none of which are any more persuasive than its appeal to the “specific characteristics” of the LCA industry within the framework of European economic, political, and social policy. The EC asks the Panel to believe either:

- that 40 years of steady financial contributions to Airbus worth billions of Euros conferred no benefit on Airbus’s LCA development and production (and thus do not constitute subsidies within the meaning of Article 1 of the SCM Agreement);<sup>6</sup>
- or that, even if these financial contributions confer benefits, the benefits have been “extinguished” or “extracted” through the restructuring of the relationship among the entities receiving the contributions;<sup>7</sup>
- or that, even if the benefits have not been “extinguished” or “extracted,” significant portions of the financial contributions are exempt from obligations under the SCM Agreement by virtue of other international agreements;<sup>8</sup>
- or that, even if the financial contributions are not exempt from obligations under the SCM Agreement, they had a negligible impact on the interests of the United States and in no case were contingent upon export performance.<sup>9</sup>

8. In short, as the EC would have it, billions of Euros in support for Airbus’s LCA development and production are either legally or factually irrelevant. The United States submits that this story simply is not credible. It is not credible that Airbus sought, and the EC and Airbus governments provided, billions of Euros of financial contributions that conferred no benefit. That certainly is not how the markets see it, as evidenced, for example, by credit rating agencies, which sustain strong ratings for Airbus and its parent company (EADS) on the expectation that

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<sup>6</sup> See, e.g., EC FWS, paras. 550-553 (Launch Aid), 858-859 (German infrastructure), 1108 (EIB loans), 1161-1164 (French equity infusions), 1216 (German equity infusion).

<sup>7</sup> See, e.g., EC FWS, paras. 226-383.

<sup>8</sup> See, e.g., EC FWS, paras. 92-153.

<sup>9</sup> See, e.g., EC FWS, paras. 1634, 1776, 2054-2057, 2136, 2230 (adverse effects), and 584, 605 (contingency on export performance).



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Airbus will continue to benefit from “an entrenched inclination for state protection.”<sup>10</sup> Nor is it how Airbus and the Airbus governments themselves see it.<sup>11</sup>

9. It also is not credible that subsidies were “extinguished” or “extracted” through transactions that merely restructured the relationship among subsidized enterprises. It is not credible that agreements that pre-date the SCM Agreement and that are not “covered agreements” within the meaning of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (DSU) (and, in one case, expressly preserved the parties’ rights under agreements negotiated under the auspices of the *General Agreement on Tariffs and Trade 1947*) somehow supersede the SCM Agreement. It is not credible that subsidies provided pursuant to contracts in consideration for Airbus’s commitment to make repayments over levels of sales achievable only through exportation are not subsidies contingent upon export performance within the meaning of Article 3.1(a) and footnote 4 of the SCM Agreement. And it is not credible that billions of euros worth of financial contributions that conferred benefits on Airbus’s LCA development and production had no or minimal effect on U.S. interests.

10. In this submission the United States will demonstrate that nothing the EC has said in response to the U.S. initial presentation of evidence and arguments in this dispute undermines the U.S. *prima facie* case. The EC has failed to show that Launch Aid or any of the other LCA subsidies identified by the United States do not constitute subsidies. In fact, with respect to Launch Aid, the EC has conceded the existence of subsidies, limiting its challenge to the amount of the subsidies. Likewise, the EC has conceded that (with the exception of the A380), Airbus would not have launched any of its LCA models without the Airbus governments’ commitment of Launch Aid.

11. The U.S. argument in this submission will proceed in the following order: First, in Parts II and III, the United States will address various EC defenses that seek either to have claims dismissed on procedural grounds or to have them considered based on rules other than the applicable provisions of the SCM Agreement. In Part IV, the United States will discuss Launch Aid, and in Part V it will discuss particular grants of Launch Aid that constitute prohibited export subsidies. In Parts VI through X, the United States will address the EC and member State measures other than Launch Aid that constitute subsidies within the meaning of Article 1 of the SCM Agreement that are specific within the meaning of Article 2. In Part XI, the United States will address the EC’s contention that certain subsidies have been “extinguished” or “extracted.” Finally, in Part XII, the United States will responded to the EC’s arguments with respect to the U.S. showing of adverse effects.

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<sup>10</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.

<sup>11</sup> See U.S. FWS, paras. 152-157.

**II. THE EC ERRONEOUSLY ASSERTS THAT CLAIMS ARE OUTSIDE THE PANEL’S TERMS OF REFERENCE**

12. In its first written submission, the EC (largely repeating arguments from its preliminary ruling request) asks the Panel to dismiss certain claims on the grounds that they allegedly are outside the Panel’s terms of reference or were not adequately identified in the U.S. request for establishment of a panel. In responding to the EC’s preliminary ruling requests, the United States has demonstrated that these requests should be rejected. The United States will not repeat that demonstration here, but will make a few additional points in light of the EC’s more recent articulations of its arguments.

**A. The date on which Launch Aid for the A300, A310, and A320 was first provided does not determine whether it is covered by the SCM Agreement**

13. As in its preliminary ruling request, the EC continues to pursue the deeply flawed position that a subsidy is not covered by the SCM Agreement if the subsidy first came into existence prior to January 1, 1995.<sup>12</sup> The United States previously has explained why this position must be rejected.<sup>13</sup>

14. What is remarkable about the EC’s adherence to its position is that it ignores entirely that the relevant question under the SCM Agreement is not when a subsidy first came into existence. The relevant question is whether the Member providing the subsidy is causing, through the use of the subsidy, adverse effects to the interests of other Members. Answering that question does not depend on when the subsidy first came into existence. As Japan puts it in its third party submission, “{A} subsidy ‘situation’ is ongoing so long as the benefit of that subsidy continues to exist.”<sup>14</sup>

15. In the case at hand, the EC contends that Launch Aid provided for the A300, A310, and A320 was disbursed before January 1, 1995, and is “therefore not within the temporal scope of Article 5 of the *SCM Agreement*.”<sup>15</sup> However, Airbus was still in the process of repaying these provisions of Launch Aid after January 1, 1995, and indeed is still in the process of doing so today. Accordingly, the financial contributions continued to confer benefits under these

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<sup>12</sup> See EC FWS, paras. 361-379; EC FOS, para. 47; EC Responses to First Panel Questions, paras. 4-10.

<sup>13</sup> See, e.g., U.S. Response to Updated Preliminary Ruling Request, paras. 4-40.

<sup>14</sup> Japan Third Party Submission, para. 8; see also *id.*, paras. 2-6 (discussing VCLT art. 28); see also Australia Third Party Submission, para. 24 (“{D}epending on the nature of a subsidy granted, it may continue to exist through the ongoing conferral of a benefit to the subsidized product.”).

<sup>15</sup> EC FWS, para. 363.

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provisions of Launch Aid, and the subsidies, therefore, had not ceased to exist prior to entry into force of the SCM Agreement on January 1, 1995. Indeed, the subsidies have not ceased to exist to this day and continue to confer enormous benefits.<sup>16</sup>

16. In this regard, in its statement at the first Panel meeting, the United States pointed out that as the last deliveries of the A300 and A310 are due to occur this July, any Launch Aid amounts for these models that are outstanding at that time will not be repaid and, therefore, will be treated as grants to Airbus for accounting purposes.<sup>17</sup> The EC replied that “{t}he original interest rate should reflect the risk of non-repayment; to try and capture non-repayment as a grant amounts to double-counting.”<sup>18</sup> However, the Launch Aid at issue does not reflect the risk of non-repayment, as it was provided on an interest-free basis.<sup>19</sup> Further, treating the outstanding amount of a loan as a grant when it effectively is forgiven is consistent with the EC’s own practice under its countervailing duty law.<sup>20</sup>

17. For the foregoing reasons as well as those set out in previous submissions and statements of the United States, the provisions of Launch Aid for the A300, A310, and A320 are properly within the Panel’s terms of reference.

### **B. The U.S. panel request complies with Article 6.2 of the DSU**

18. The U.S. request for the establishment of a panel in this disputes identifies the measures at issue with the specificity required by Article 6.2 of the DSU. In its response to the EC’s preliminary ruling requests, the United States showed that the EC’s allegations to the contrary are baseless.<sup>21</sup> In its first written submission, the EC replies to the U.S. response. However, its reply does nothing to support its assertion that the U.S. panel request was deficient.

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<sup>16</sup> See NERA Economic Consulting, *Quantification of Benefit of Launch Aid*, pp. 2-4 (May 24, 2007) (Exhibit US-606) (**BCI**).

<sup>17</sup> See U.S. FOS, paras. 28-29.

<sup>18</sup> EC Responses to First Panel Questions, para. 42.

<sup>19</sup> See U.S. FWS, paras. 180-183.

<sup>20</sup> See Guidelines for the Calculation of the Amount of Subsidy in Countervailing Duty Investigations, 98/C 394/04 (Dec. 17, 1998), sec. E(g) (“Forgiveness of debt held by government or government-owned banks relieves a company of its repayment obligations and should therefore be treated as a grant. If the subsidy is to be allocated, the allocation period should begin at the time of the forgiveness of the debt. The amount of subsidy will be the outstanding amount of the debt forgiveness (including all interest accrued.)” (Exhibit US-537).

<sup>21</sup> See U.S. Response to EC Preliminary Ruling Requests, paras. 41-83 (Nov. 15, 2006).

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19. In its response to the EC's preliminary ruling request, the United States showed that not only is the U.S. panel request clear on its face, but the attendant circumstances leave no doubt as to the identity of the measures being challenged. Those attendant circumstances include the U.S. consultation request, including the Statement of Available Evidence attached to the request; details of the consultations, including questions in writing posed to the EC and EC member States;<sup>22</sup> and statements at meetings of the Dispute Settlement Body (DSB) in which the U.S. panel request was on the agenda.

20. The EC does not contest that the attendant circumstances the United States discussed in its earlier submission made the identity of the challenged measures unmistakable. Instead, the EC contests the permissibility of relying on particular attendant circumstances.<sup>23</sup> As the EC notes, the attendant circumstances to which the United States has referred are identical to those discussed by the panel in *US - Lamb Meat*. The EC seems to believe that *US - Lamb Meat* is distinguishable from the case at hand because the issue there was "the scope of the legal claims" rather than the identity of the measure being challenged.<sup>24</sup> Yet, the EC fails to explain why certain attendant circumstances may be relied upon to demonstrate that the legal claims were adequately identified in a panel request but not to demonstrate that the measures at issue were adequately identified. The EC simply proclaims such a distinction to exist, citing no authority whatsoever.

21. The EC also misrepresents the reasons the United States discussed details of the consultations that preceded the request for panel establishment in this dispute. The EC thus states that "the consultations cannot be considered to add precision to the Panel request."<sup>25</sup> But that was not the reason the United States referred to them. The panel request was sufficiently precise on its face; the details of the consultations simply demonstrated that the EC could have had no doubt as to the identity of the measures being challenged.

22. The EC notes that the scope of consultations may be different from the scope of a panel request and that, in particular, measures that were the subject of consultations may be excluded from a panel request.<sup>26</sup> That is true, but entirely beside the point. Given that consultations are a necessary step prior to requesting a panel, the fact that consultations were held with regard to

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<sup>22</sup> In referring to details of the consultations as an attendant circumstance, the United States does not suggest that a Member can expand the scope of consultations by means of the questions asked or statements made during consultations.

<sup>23</sup> See EC FWS, paras. 180, 181.

<sup>24</sup> EC FWS, para. 181.

<sup>25</sup> EC FWS, para. 180.

<sup>26</sup> EC FWS, para. 180.

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particular measures cannot be ignored in assessing how a responding party understood the words used in a panel request.

23. With regard to the EC's challenge to the U.S. claim with respect to European Investment Bank (EIB) financing for Aérospatiale Super Transporteurs, the EC relies on paragraphs 88-95 of its preliminary ruling request.<sup>27</sup> At those paragraphs, the EC asserted that the measure at issue is outside the Panel's terms of reference because it was not the subject of consultations. The United States responded by demonstrating that this assertion is wrong as a matter of both law and fact.<sup>28</sup> The EC has not even tried to rebut that argument, simply resting on its original, erroneous assertions.

24. Finally, in addition to demonstrating that the U.S. panel request conforms with the requirements of Article 6.2 of the DSU, the United States also demonstrated that the EC has failed to show prejudice from the deficiencies it alleges.<sup>29</sup> In particular, the United States noted: the 16-month period during which the EC had possession of the detailed questions from the Annex V Facilitator; the steps the United States took following the EC's filing of its preliminary ruling request (holding additional consultations and filing a second panel request); the extraordinarily long period (12 weeks) the EC had in which to file its first written submission; and the EC's failure to follow up on the allegation of insufficient specificity it made at the DSB meeting at which the U.S. panel request was considered.

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<sup>27</sup> EC FWS, para. 185. As noted in the U.S. response to the Panel's Question 12, the United States does not intend to pursue its claim with respect to the 1997 EIB loan to Aérospatiale for the Super Transporteurs. *See* U.S. Responses to First Panel Questions, para. 80. However, the United States continues to pursue its claim with respect to the 1993 EIB loan to Aérospatiale in the amount of Euro 112,614,303 for the Super Transporteurs program. *See* U.S. FWS, para. 407.

<sup>28</sup> U.S. Response to EC Preliminary Ruling Requests, paras. 67-74 (Nov. 15, 2006).

<sup>29</sup> *See* U.S. Response to EC Preliminary Ruling Requests, paras. 76-83 (Nov. 15, 2006).

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### III. THE DEFINITION OF “SUBSIDY” IS SET OUT IN ARTICLE 1 OF THE SCM AGREEMENT, NOT IN NON-COVERED AGREEMENTS OR IN OTHER SCM AGREEMENT PROVISIONS

25. In its first written submission, its statement at the first Panel meeting, and its answers to the Panel’s questions, the EC looks to sources of law other than Article 1 of the SCM Agreement for purposes of determining whether provisions of Launch Aid constitute subsidies. First, the EC argues that three non-covered agreements – the Tokyo Round Subsidies Code, the 1992 agreement, and the *Agreement on Trade in Civil Aircraft* (“1979 Agreement”) – are somehow relevant to the settlement of this dispute.<sup>30</sup> For reasons the United States discussed in previous submissions and statements – most notably, the fact that these are not covered agreements within the Panel’s terms of reference – the Panel should reject the EC’s arguments.<sup>31</sup>

26. Additionally, the EC argues, based on footnote 16 of the SCM Agreement, that “the relevant test for determining whether a {Launch Aid} contract in the large civil aircraft sector constitutes a subsidy is the reasonableness of the {delivery} forecasts.”<sup>32</sup> However, footnote 16 is attached not to Article 1 of the SCM Agreement (where the term “subsidy” is defined), but to Article 6.1(d) (an expired provision pertaining to a circumstance in which serious prejudice is deemed to exist). As footnote 16 has nothing to do with whether Launch Aid confers a benefit and thus constitutes a subsidy, this argument too must be rejected.<sup>33</sup>

#### A. Non-covered agreements are not within the Panel’s terms of reference

27. Preliminarily, the United States recalls that outside the context of this dispute, the EC too has recognized that non-covered agreements do not provide the applicable rules in WTO dispute settlement. Thus in *India - Autos*, the EC argued that “the 1997 Agreement between the European Communities and India was not a ‘covered agreement’ within the meaning of Articles 1 and 2 DSU. Therefore, India could not invoke that Agreement in order to justify the violation of its obligations under the GATT and the TRIMs Agreement.”<sup>34</sup>

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<sup>30</sup> See, e.g., EC FWS, paras. 92-153 and 380-441; EC FOS, paras. 21-27; EC Responses to First Panel Questions, paras. 11-18 and 36-44.

<sup>31</sup> See, e.g., U.S. Response to Updated EC Preliminary Ruling Requests, paras. 29-51; U.S. FOS, paras. 30-34; U.S. Responses to First Panel Questions, paras. 1-13.

<sup>32</sup> EC FWS, para. 456.

<sup>33</sup> See U.S. FOS, paras. 35-41.

<sup>34</sup> *India - Autos*, footnote 71. Interestingly, in support of the quoted proposition the EC cited the Appellate Body report in *EC - Poultry*, the very report it now cites in support of the opposite proposition. Compare *id.* with EC FWS, para. 137. See also *India - Autos*, paras. 4.38 (summarizing EC argument that because the 1997

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28. Additionally, the United States notes that the third parties that have addressed the issue recognize that non-covered agreements are not within the Panel’s terms of reference.<sup>35</sup> Indeed, Brazil makes an important point in noting the error in the EC’s assertion that it would be appropriate for the Panel to interpret the SCM Agreement in light of the 1992 agreement because “{t}he European Communities and the United States are the only WTO members whose interests are affected by an application of the SCM Agreement in the field of large civil aircraft.”<sup>36</sup> As Brazil observes, “The Panel’s findings in this dispute will have a direct and significant impact on other WTO Members whose producers of aircraft and other products are facing the market distorting effects of subsidies.”<sup>37</sup> Even with respect to the very product at issue here – large civil aircraft – recent press accounts of possible new entrants into the market, such as China, belie the EC’s assertion.<sup>38</sup>

29. Notwithstanding the text of the DSU and consistent panel and Appellate Body findings to the contrary, the EC continues to argue that non-covered agreements are relevant to this dispute. For example, in its response to the Panel’s Question 61, the EC asserts that even though the Tokyo Round Subsidies Code is not a covered agreement it may be invoked as part of the EC’s defense because it constituted “the relevant legal framework” when certain measures came into existence.<sup>39</sup> The EC’s theory, for which it provides no support, is that the list of covered agreements identified in Appendix 1 to the DSU serves merely “to identify those instruments upon which *a claim* can be based in order to establish a Panel.” In the EC’s view, other sources

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Agreement was not a “covered agreement” “the rights and obligations of the parties under the 1997 Agreement were not enforceable under the DSU”), 4.40 (same), 4.42 (same).

<sup>35</sup> See Australia Third Party Submission, paras. 9 (“It is not the function of panels to seek to clarify the provisions of non-covered agreements. The 1979 Agreement falls into the latter category. The 1992 Agreement also falls into the latter category.”), 14 (“If all parties are required to have accepted a subsequent practice for Article 31(3)(b) {of the VCLT} to apply, it seems unlikely that the drafters of Article 31 would have intended, by the use of the identical term ‘the parties’ in Article 31(3)(c), that rules of international law which are only applicable in relations between a subset of the parties to a treaty could be taken into account under Article 31(3)(c) in interpreting that treaty.”); Brazil Third Party Submission, para. 4

<sup>36</sup> Brazil Third Party Submission, para. 8 (quoting EC FWS, para. 148).

<sup>37</sup> Brazil Third Party Submission, para. 8.

<sup>38</sup> See, e.g., *Will China Join the Jet Set?*, BusinessWeek Online, March 23, 2007 (Exhibit US-605); Scott Hamilton, *China vows to produce Large Commercial Aircraft*, Leeham.net, March 20, 2007 (Exhibit US-632); Siobhain Ryan, *China Jumbo Planes To Compete With Boeing, Airbus*, Dow Jones, April 9, 2007 (Exhibit US-633).

<sup>39</sup> EC Responses to First Panel Questions, para. 37.

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of law may be invoked in WTO dispute settlement if they form “the relevant legal framework against which a past measure should be properly measured.”<sup>40</sup>

30. This argument ignores that the covered agreements listed in Appendix 1 to the DSU provide not only the basis for entering the dispute settlement system, but also the basis for resolving disputes under that system. Thus, the standard terms of reference set out in Article 7.1 of the DSU call on a panel to examine the matter referred to the DSB “in the light of the relevant provisions in . . . covered agreements,” not non-covered agreements. Likewise, Article 11 states that “a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements,” not non-covered agreements.<sup>41</sup> (Emphases added.)

31. Other provisions of the DSU that undermine the EC’s view include Article 3.2, which states Members’ recognition that the WTO dispute settlement system “serves to preserve the rights and obligations of Members under the covered agreements,” Article 3.4, which contemplates “achieving a satisfactory settlement of the matter in accordance with the rights and obligations under this Understanding and under the covered agreements,” not non-covered agreements; and Article 19.1, which prescribes the recommendation to be made “{w}here a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement,” making no exception where the measure is found to be consistent with a non-covered agreement. (Emphases added.)

32. In fact, when the drafters of the DSU intended “predecessor agreement{s}” to the covered agreements – such as the Tokyo Round Subsidies Code – to be relevant, they said so explicitly. Thus Article 3.11 provides:

With respect to disputes for which the request for consultations was made under GATT 1947 or under any other predecessor agreement to the covered agreements before the date of entry into force of the WTO Agreement, the relevant dispute settlement rules and procedures in effect immediately prior to the date of entry into force of the WTO Agreement shall continue to apply.

The absence of any reference to “predecessor agreements” elsewhere in the DSU (except in Article 8.1, in the context of describing persons “well-qualified” to serve on panels) and the absence of any reference at all to other non-covered agreements confirms that such agreements are not relevant other than in the circumstance described in Article 3.11.

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<sup>40</sup> EC Responses to First Panel Questions, para. 37 (emphasis in original).

<sup>41</sup> Indeed, if the EC’s theory were correct (which it is not) then the Tokyo Round Subsidies Code should have governed the EC’s claim in the *US - FSC* dispute, since that was “the relevant legal framework” when the measure at issue in that dispute “came into existence.” Yet, the EC did not take that position in that dispute.



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33. The EC does not even attempt to reconcile its view concerning the relevance of non-covered agreements in general, and the Tokyo Round Subsidies Code in particular, with the text of the DSU.<sup>42</sup> The only support it cites for what it claims to be “a fundamental rule of international law” permitting reliance on non-covered agreements is a 1928 arbitral award.<sup>43</sup>

34. For the forgoing reasons, as well as those set forth in previous U.S. submissions and statements, the Panel should reject the EC’s assertion that non-covered agreements have any bearing on this matter.

**B. There is no basis under the covered agreements for applying what the EC refers to as “estoppel” arising from the 1992 agreement**

1. The covered agreements do not contain a rule of “estoppel”

35. As the United States argued at length in connection with the EC’s preliminary ruling request, the 1992 agreement is not a covered agreement and therefore (as just discussed) is not relevant to this dispute.<sup>44</sup> The EC’s invocation of that agreement amounts to an attempt to have this Panel resolve a non-WTO dispute. It is well established that this is not a permissible use of WTO dispute settlement.<sup>45</sup>

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<sup>42</sup> In its first written submission, the EC suggests that the Tokyo Round Subsidies Code is relevant to an analysis of subsidies that came into existence prior to entry into force of the WTO Agreement because Annex IV to the SCM Agreement refers to such subsidies (in paragraph 7) and also refers to calculating the amount of subsidies according to the cost to the granting government (in paragraph 1). *See* EC FWS, para. 386. However, the calculation in Annex IV is explicitly “for the purpose of 1(a) of Article 6,” not for the purpose of determining whether a subsidy within the meaning of Article 1 of the SCM Agreement exists.

<sup>43</sup> *See* EC Responses to First Panel Questions, para. 38. The EC’s reliance on a report from 1928 contrasts starkly with its attempt at an earlier phase in this dispute to discredit as “ancient” a 1976 commentary on the VCLT by the chairman of the drafting committee for the conference that adopted the VCLT. *See* EC Responses to Panel Questions in Connection With the EC’s Preliminary Ruling Request, para. 82 (Dec. 18, 2006); U.S. Comments on EC Responses to Panel Questions in Connection With the EC’s Preliminary Ruling Request, para. 56 (Dec. 21, 2006).

<sup>44</sup> *See* U.S. Response to EC PRR, paras. 96-98 (Nov. 15, 2006); U.S. Response to Updated EC PRR, paras. 41-45 (Nov. 29, 2006); *see also* U.S. FOS, paras. 33-34.

<sup>45</sup> *See, e.g., Mexico - Soft Drinks (AB)*, para. 56 (“We see no basis in the DSU for panels and the Appellate Body to adjudicate non-WTO disputes.”); *Argentina - Poultry*, paras. 7.41-7.42 (panel declining to apply WTO provisions in particular way in light of findings by MERCOSUR tribunal).

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36. In its previous submissions and statements, the EC has argued that, even though the 1992 agreement is a non-covered agreement, it is relevant because it gives rise to “estoppel.”<sup>46</sup> The Panel should reject this argument, because it has absolutely no basis in the covered agreements. The WTO Members have not consented to provide for the application of what the EC refers to as “estoppel” in WTO dispute settlement. The panel and Appellate Body reports on which the EC relies are not to the contrary.

37. The EC purports to ground its “estoppel” argument in the “good faith” obligation under Article 3.10 of the DSU, although it provides only a cursory explanation of why. However, that provision does not use the term “estoppel” and does not even implicitly support the EC’s argument, which consists of little more than an assertion. The EC asserts its position to be “in line with the relevant WTO jurisprudence.”<sup>47</sup> However, not only do the panel and Appellate Body reports on which the EC relies not support its position, they actually undermine that position. Its reliance on those reports is misplaced and, indeed, extremely misleading.

38. The EC relies primarily on the panel and Appellate Body reports in *EC - Sugar Subsidies*. Yet, for the EC to claim these reports to be “in line” with its position is simply to ignore what they had to say on the issue of estoppel. The panel in *EC - Sugar Subsidies* began its discussion by stating:

In the Panel’s view, it is far from clear whether the principle of estoppel is applicable to disputes between WTO Members in relation to the WTO rights and obligations. The principle of estoppel has never been applied by any panel or the Appellate Body. Estoppel is not mentioned in the *DSU* or anywhere in the *WTO Agreement*.<sup>48</sup>

39. In the discussion that followed, the panel’s doubt as to the applicability of estoppel in WTO dispute settlement did not lessen. Rather, the panel engaged in an examination of factors that would have to be considered if, hypothetically, estoppel were relevant to WTO dispute settlement. It considered that one of those factors would be “‘the largely self-regulating’ nature of the requirement in the first sentence of Article 3.7 {of the DSU, regarding initiation of dispute settlement}.”<sup>49</sup>

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<sup>46</sup> See, e.g., EC FWS, paras. 96, 401; EC FOS, para. 25; EC Responses to First Panel Questions, paras. 19-32.

<sup>47</sup> EC Responses to First Panel Questions, para. 20.

<sup>48</sup> *EC - Sugar Subsidies (Australia) (Panel)*, para. 7.63.

<sup>49</sup> *EC - Sugar Subsidies (Australia) (Panel)*, para. 7.67 (quoting *Mexico - HFCS (Article 21.5) (AB)*, para. 73, in turn quoting *EC - Bananas III (AB)*, para. 135).

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40. Moreover, the Appellate Body in *EC - Sugar Subsidies* shared the panel's doubts about the applicability of the principle of estoppel to WTO dispute settlement, stating:

We agree with the Panel that it is far from clear that the estoppel principle applies in the context of WTO dispute settlement. Indeed, on appeal, the participants and third participants have advanced highly divergent views on the concept itself and its applicability to WTO dispute settlement.<sup>50</sup>

41. The EC's quotation from paragraph 312 of the Appellate Body report is notable for its omission of both the sentence immediately preceding and the sentence immediately following.<sup>51</sup> In the sentence immediately preceding the passage quoted by the EC, the Appellate Body said:

Moreover, the notion of estoppel, as advanced by the European Communities, would appear to inhibit the ability of WTO Members to initiate a WTO dispute settlement proceeding.<sup>52</sup>

42. And in the sentence following the quoted passage the Appellate Body stated:

Thus, even assuming *arguendo* that the principle of estoppel could apply in the WTO, its application would fall within these narrow parameters set out in the DSU.<sup>53</sup>

43. In short, the EC's attempt to derive an "estoppel" rule from the "good faith" obligation under Article 3.10 of the DSU is not "in line" with the panel and Appellate Body reports in *EC - Sugar Subsidies*. Nor does it "follow {} from established case law of previous panels."<sup>54</sup>

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<sup>50</sup> *EC - Sugar Subsidies (AB)*, para. 310.

<sup>51</sup> See EC Responses to First Panel Questions, para. 20.

<sup>52</sup> *EC - Sugar Subsidies (AB)*, para. 312.

<sup>53</sup> *EC - Sugar Subsidies (AB)*, para. 312 (emphasis added).

<sup>54</sup> EC Responses to First Panel Questions, para. 23. Here, the EC cites to the panel reports in *Argentina - Poultry* and *Guatemala Cement II*. While both panels discussed the concept of estoppel, neither one actually found that concept to be applicable in WTO dispute settlement. See *Argentina - Poultry*, footnote 58 ("{}e do not consider it necessary to determine whether or not we would have had the authority to apply the principle of estoppel if the relevant conditions had been satisfied. Nor do we consider it necessary to determine whether the three conditions proposed by Argentina are sufficient for the application of that proposal."); *Guatemala - Cement II*, para. 8.24.

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### 2. Even by its own terms, the EC's "estoppel" argument must fail

44. Finally, even by its own terms, the EC's "estoppel" argument with respect to the 1992 agreement must fail. For reasons discussed in response to the Panel's question 127, the 1992 agreement does not constitute a "clear and unambiguous statement of fact" that measures covered by that agreement would not be subject to WTO dispute settlement.<sup>55</sup> To the contrary, the fifth recital to the 1992 agreement expresses the parties' "intention to act without prejudice to their rights and obligations under the GATT and under other multilateral agreements negotiated under the auspices of the GATT."

45. The EC's attempt to explain how the 1992 agreement might give rise to "estoppel" is entirely unpersuasive. In addition to the points set out in the U.S. response to Question 127, the United States makes the following comments on the EC's argument.

46. First, the EC provides no support for its assertion that Article 10.1 of the 1992 agreement "meant that a party should not bring a case against another party in the WTO system."<sup>56</sup> In fact, that assertion is contradicted by the subsequent paragraphs in Article 10.

47. Second, the EC provides no support for its assertion that the fifth recital to the 1992 agreement was referring to the 1979 Tokyo Round Subsidies Code.<sup>57</sup> That assertion is undermined by the fact that the recital uses the generic, plural term "other multilateral agreements." Had the parties intended to refer to a particular agreement, such as the Tokyo Round Subsidies Code, they easily could have done so, as they did in the second recital, which refers to the GATT Agreement on Trade in Civil Aircraft.<sup>58</sup>

48. Third, the EC's attempt to dismiss the relevance of recitals to the 1992 agreement by asserting that they "simply recall the circumstances in which the agreement {was} concluded"<sup>59</sup> fails to help the EC's argument. Even assuming, *arguendo*, that the EC's characterization is correct, an exposition of "the circumstances in which the agreement {was} concluded" demonstrates facts on which the parties to the agreement have relied. It therefore contradicts the EC's claim that it relied on an understanding that measures covered by the 1992 agreement would not be subject to claims under the SCM Agreement.

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<sup>55</sup> See U.S. Responses to First Panel Questions, paras. 402-407.

<sup>56</sup> EC Responses to First Panel Questions, para. 28.

<sup>57</sup> EC Responses to First Panel Questions, para. 34.

<sup>58</sup> See U.S. Responses to First Panel Questions, para. 404.

<sup>59</sup> EC Responses to First Panel Questions, para. 33.

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49. Fourth, the EC asks why it would have shared with the United States information about pre-1992 provisions of Launch Aid absent its reliance on a supposed statement that those measures would not be challenged.<sup>60</sup> The answer is that Article 8.8 of the 1992 agreement prevents the use of such information in “possible trade disputes.” And, in fact, the United States has not used any of the information the EC provided to it in consultations under the 1992 agreement in this dispute.

50. Finally, apart from the text of the 1992 agreement itself, other facts undercut the EC’s assertion that the EC relied on a supposed statement that the United States would not challenge measures covered by the agreement in WTO dispute settlement. For example, when the text of the 1992 agreement was presented to the GATT Aircraft Committee, the U.S. delegate explained that “{r}egarding the relation of this text to the Uruguay Round text . . . there had been no attempt to resolve this issue in the context of the bilateral negotiations.”<sup>61</sup>

51. The EC’s subsequent unsuccessful efforts to multilateralize the 1992 agreement demonstrate a recognition that Launch Aid was vulnerable to challenge.<sup>62</sup> If the EC actually believed that the 1992 agreement prevailed over the SCM Agreement in its relations with the United States in the LCA sector, and if it actually believed (as it now states) that “{t}he European Communities and the United States are the only WTO members whose interests are affected by an application of the *SCM Agreement* in the field of large civil aircraft,”<sup>63</sup> then it would have had little incentive if any to pursue multilateralization of the 1992 agreement.

52. Finally, on the day that the A380 was launched, which coincided with a U.S.-EU summit, President Clinton told President Chirac (who held the EU Presidency at the time) that “if financing was not on commercial terms it could create ‘a serious problem affecting the US-EU relationship.’” The European Commission immediately replied that if the United States pursued WTO dispute settlement the EC would do so as well.<sup>64</sup>

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<sup>60</sup> EC Responses to First Panel Questions, para. 30.

<sup>61</sup> Minutes of the Meeting of the Committee Held on 16 July 1992, AIR/M/32, para. 17.

<sup>62</sup> See, e.g., Elements of the Framework for Negotiations, Communication from the European Community, AIR/RN/8, p. 4 (para. 3 under “Modifications of the Dunkel Text”) (Apr. 20, 1993) (“As in the bilateral EC/US Agreement, it is therefore thought justified to introduce a provision to the effect that existing government support and subsidies would not be actionable. This would consequently require an approach different from that of the draft Subsidy Agreement.”).

<sup>63</sup> EC FWS, para. 148.

<sup>64</sup> Edward Alden and Kevin Done, *Subsidy row hits Airbus launch*, Financial Times, p. 1 (Dec. 20, 2000) (Exhibit US-533).

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53. Thus, not only is the EC's "estoppel" argument wrong as a matter of law, it also relies on a misrepresentation of the text of the 1992 agreement and of U.S.-EC relations involving the LCA sector. For these reasons as well as those set out in prior U.S. submissions and statements, the EC's invocation of the 1992 agreement, including its effort to demonstrate that provisions of Launch Aid are consistent with that agreement, are irrelevant. The relevant agreement for resolving this dispute is the SCM Agreement.

**C. Footnote 16 of the SCM Agreement does not provide a rule for determining whether Launch Aid confers a benefit and thus constitutes a subsidy within the meaning of Article 1 of the SCM Agreement**

54. In addition to arguing that non-covered agreements provide rules relevant to resolving this dispute, the EC focuses on footnote 16 of the SCM Agreement. Footnote 16 is attached to an expired provision of the SCM Agreement (Article 6.1(d)), which stated that "{s}erious prejudice . . . shall be deemed to exist in the case of . . . direct forgiveness of debt." Footnote 16 qualified that provision by explaining that

Members recognize that where royalty-based financing for a civil aircraft programme is not being fully repaid due to the level of actual sales falling below the level of forecast sales, this does not in itself constitute serious prejudice for the purposes of this subparagraph.

55. The EC urges the Panel to rely on footnote 16 in determining whether the Airbus governments' provisions of Launch Aid constitute subsidies within the meaning of Article 1 of the SCM Agreement. Specifically, it asserts that "the relevant test for determining whether a {Launch Aid} contract in the large civil aircraft sector constitutes a subsidy is the reasonableness of the forecasts {of aircraft sales}."<sup>65</sup>

56. In its statement at the first Panel meeting, the United States explained that the EC's understanding of footnote 16 is incorrect.<sup>66</sup> To that explanation, the United States adds the following points.

57. First and foremost, in focusing on "the reasonableness of the forecasts" as "the relevant test" the EC ignores the return that a government demands in providing Launch Aid. Whether forecasts are reasonable or not is irrelevant if the return the government demands is lower than what a market creditor would demand for comparable financing; for example, if the government-provided assistance is interest-free. In this regard, the EC confuses two distinct concepts when it

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<sup>65</sup> EC FWS, para. 456.

<sup>66</sup> U.S. FOS, paras. 35-41.

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asserts that “the ‘reasonableness of forecasts’ test is effectively applying a ‘market’ benchmark.”<sup>67</sup> The “market” benchmark is a reference to the terms (in particular, the interest rate) the market would demand as compensation for the risks associated with Launch Aid-type financing in which repayment is promised over a specified schedule. It is not synonymous with the “reasonableness” of that schedule.

58. Second, while the EC acknowledges that “{f}ootnote 16 does not . . . discuss under which conditions royalty-based financing constitutes a subsidy,”<sup>68</sup> it nevertheless insists that footnote 16 is relevant to that inquiry. In effect, the EC seeks to take footnote 16 out of context and elevate its status to that of a general rule applicable to all inquiries under the SCM Agreement. Without explanation, the EC asserts that in all contexts – not just the context of Article 6.1(d) – “the drafters of the *SCM Agreement* looked at the level of forecast sales as the decisive factor of royalty-based financing.”<sup>69</sup>

59. The EC’s elevation of the status of footnote 16 leads it to suggest that the Panel engage in a construction of Article 1 of the SCM Agreement that amounts to an utter distortion of customary rules of interpretation of international law. Rather than base its construction on the actual terms of Article 1, the Panel, according to the EC, should base its construction on “the absence” of terms from Article 1. Recognizing that footnote 16 is attached to Article 6.1(d) and has no link whatsoever to Article 1, the EC asserts that “the absence of any comparable footnote attached to Article 1 of the *SCM Agreement* constitutes an invitation to make a common-sense differentiation as to the reasonableness of such forecasts.”<sup>70</sup> Of course, customary rules of interpretation of international law do not support this “invitation,” and the Panel should decline it.<sup>71</sup>

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<sup>67</sup> EC Responses to First Panel Questions, para. 119.

<sup>68</sup> EC FWS, para. 453; *see also* EC Responses to First Panel Questions, para. 55 (“{F}ootnote 16 is not directly linked to the determination of a subsidy under Article 1.”).

<sup>69</sup> EC FWS, para. 455 (emphasis added); *see also id.*, para. 451; EC Responses to First Panel Questions, para. 55; *id.*, para. 57.

<sup>70</sup> EC FWS, para. 455 (emphasis added).

<sup>71</sup> The EC asserts that “{t}he drafters of the *SCM Agreement* were not required to regulate the specifics of MSF loans with footnotes to all relevant provisions of the agreement.” EC Responses to First Panel Questions, para. 56. But that misses the point. The drafters did take account of “the specifics of MSF loans” in a footnote tied to a particular provision, Article 6.1(d). This shows that the drafters knew how to take account of this factor when they wanted to do so. Similarly, the chapeau to Article 14 shows that the drafters knew how to create a link to Article 1 when they wanted to do that. *See* U.S. FOS, para. 38. The fact that the drafters did not include the text of footnote 16 in Article 1 or establish a link between footnote 16 and Article 1 cannot simply be dismissed, as the EC would have it. *See, e.g., US - Gasoline (AB)*, p. 23 (“interpretation must give meaning and effect to all the terms of a treaty”); *Japan - Alcohol (AB)*, p. 12 (same).

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60. Moreover, the EC errs when it claims that the United States shares the EC's bizarre interpretation of Article 1, which relies on the absence of the very text the EC says should guide that interpretation. The EC bases that assertion on a March 19, 2003 U.S. communication to the WTO Negotiating Group on Rules. The EC focuses on the following sentence: “‘Obviously, if royalty-based financing is based on assumptions and sales projections that would be rejected by the market a benefit has been bestowed.’”<sup>72</sup>

61. The EC then paraphrases the U.S. statement in a manner that is completely misleading. It states, “‘Clearly, this means that in the US view MSF would only be a subsidy if the market forecasts on which repayment obligations are based are not reasonable.’”<sup>73</sup> That is not the meaning of the U.S. statement, “‘clearly’” or otherwise. The United States did not purport to identify the “‘only’” circumstance in which royalty-based financing would bestow a benefit; it identified one such circumstance in which that result would be “‘obvious { }.’” Also, contrary to the EC paraphrase, the U.S. statement did not refer only to “‘market forecasts;’” it referred to “‘assumptions and sales projections.’” Such assumptions would include the very factors the EC ignores: the rate of return and other key terms of Launch Aid.

62. A third error in the EC's understanding of footnote 16 is its suggestion that the provision does not mean that Launch Aid confers a benefit and thus constitutes a subsidy.<sup>74</sup> If anything, the existence of the footnote is persuasive evidence that Launch Aid does constitute a subsidy. The very fact that the drafters of the SCM Agreement saw a need to clarify that a particular circumstance involving the implementation of Launch Aid contracts “‘does not in itself’” constitute deemed serious prejudice suggests that the drafters presumed that the provision of Launch Aid confers a benefit and thus constitutes a subsidy. There would have been no need to make the clarification otherwise.

63. Furthermore, footnote 16 is additional evidence that the SCM Agreement applies to the Launch Aid that Airbus received prior to January 1, 1995. At the time the agreement was being negotiated, Airbus was “‘not fully repaying’” the Launch Aid it had received for the A300 and the A310 programs. It was these pre-existing programs that the EC was trying to protect with

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<sup>72</sup> EC FWS, para. 457 (quoting Communication from the United States, WTO/TN/RL/W78, p. 5).

<sup>73</sup> EC FWS, para. 458 (emphasis added).

<sup>74</sup> See EC FWS, para. 454; EC Responses to First Panel Questions, para. 54.



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footnote 16. The negotiating history to the EC's (unsuccessful) efforts to multilateralize the 1992 agreement confirms this point.<sup>75</sup>

64. For the foregoing reasons, as well as those set out in previous U.S. submissions and statements, the Panel should reject the EC's suggestion that footnote 16 of the SCM Agreement provides the "test" for determining whether provisions of Launch Aid to Airbus confer benefits and thus constitute subsidies within the meaning of Article 1.

#### **IV. THE LAUNCH AID PROGRAM AND INDIVIDUAL PROVISIONS OF LAUNCH AID CONFER BENEFITS ON AIRBUS'S DEVELOPMENT OF LCA AND THUS CONSTITUTE SUBSIDIES UNDER ARTICLE 1 OF THE SCM AGREEMENT**

65. In its first written submission, the United States demonstrated that the Launch Aid Program as well as individual provisions of Launch Aid to Airbus constitute financial contributions that confer benefits on Airbus and that, therefore, are subsidies within the meaning of Article 1 of the SCM Agreement. The United States also showed that these subsidies are specific within the meaning of Article 2.<sup>76</sup>

66. The EC's response was first to put up a series of defenses all seeking to shield against an analysis of whether Launch Aid confers a benefit within the meaning of Article 1 of the SCM Agreement.<sup>77</sup> As discussed in Parts II and III above, these defenses included arguments that certain provisions of Launch Aid are outside the temporal scope of this dispute; that a benefit analysis should be based on non-covered agreements; that the United States is "estopped" from challenging Launch Aid; and that relevant rules for analyzing the benefit conferred by Launch Aid are contained in provisions of the SCM Agreement other than Article 1. For the reasons set out above and in previous U.S. submissions and statements, none of these defenses is well founded.

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<sup>75</sup> See generally Elements of the Framework for Negotiations, Communication from the European Community, AIR/RN/8, p. 4 (para. 3 under "Modifications of the Dunkel Text") (Apr. 20, 1993) ("As in the bilateral EC/US Agreement, it is therefore thought justified to introduce a provision to the effect that existing government support and subsidies would not be actionable. This would consequently require an approach different from that of the draft Subsidy Agreement.").

<sup>76</sup> See U.S. FWS, paras. 85-320.

<sup>77</sup> The EC does not contest that provisions of Launch Aid constitute financial contributions within the meaning of Article 1.1(a)(1) of the SCM Agreement. Nor does it contest that provisions of Launch Aid are specific within the meaning of Article 2.

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67. The EC also asserted that the United States had not challenged Launch Aid “as a subsidy programme,”<sup>78</sup> and therefore declined to engage on that U.S. claim at all. As the United States demonstrated in its statement at the first Panel meeting and in its responses to the Panel’s questions, that assertion is incorrect.<sup>79</sup>

68. In a portion of the EC’s first submission labeled as its “alternative legal argument,” the EC finally confronted the merits of the U.S. demonstration that provisions of Launch Aid confer a benefit on Airbus. There, the EC attempted to show that the United States had overstated the relevant market benchmark and understated the expected return associated with Launch Aid. In this part of its submission, the United States will show that both aspects of the EC’s critique are fatally flawed. The discussion that follows sets out the main errors in the EC’s argument. Additional discussion of these issues is contained in the U.S. HSBI appendix. A more detailed discussion of the EC’s errors is set out in a detailed expert’s report that the United States provides as Exhibit US-534 (**HSBI**).<sup>80</sup>

### **A. The appropriate benchmark for determining whether Launch Aid confers a benefit is a market benchmark**

69. As a preliminary matter, the United States recalls that the question in a benefit analysis under Article 1.1(b) of the SCM Agreement is “whether the recipient has received a ‘financial contribution’ on terms more favorable than those available to the recipient in the market.”<sup>81</sup> While this point may seem obvious, it bears repeating, because the EC continues to make assertions that call into question the use of a market-based benchmark. For example, in its answers to the Panel’s questions, the EC stated that “the market cannot be viewed in the abstract,”<sup>82</sup> and that “government investors like other investors operate in the context of the particular market at issue, rather than an abstract ‘market.’”<sup>83</sup> Based on this view, the EC asks the Panel “to take account of the specificities of the real situation of the LCA market.”<sup>84</sup>

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<sup>78</sup> EC FWS, para. 343.

<sup>79</sup> See U.S. FOS, paras. 19-26; U.S. Responses to First Panel Questions, paras. 25-41; see also U.S. FWS, paras. 91-164.

<sup>80</sup> NERA Response to Whitelaw Report (Exhibit US-534) (**HSBI**). Pursuant to paragraph 52(*kbis*) of the May 23, 2007 revision of the BCI/HSBI Procedures, the United States is providing with this submission an HSBI-Redacted Version of Exhibit US-534. The redacted version is labeled Exhibit US-534a.

<sup>81</sup> *Canada - Aircraft (AB)*, para. 157; see also U.S. FWS, para. 110 and footnote 110.

<sup>82</sup> EC Responses to First Panel Questions, para. 117.

<sup>83</sup> EC Responses to First Panel Questions, para. 122.

<sup>84</sup> EC Responses to First Panel Questions, para. 118.

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70. The EC seems to assume that the proper benchmark for measuring whether Launch Aid confers a benefit on Airbus is financing provided by an investor who has no choice but to invest in the LCA sector. That is the clear implication of its assertion that “{g}overnment investors like other investors operate in the context of the particular market at issue.” (Emphasis added.) But that assertion plainly is incorrect. Unlike the Airbus governments, “other investors” do not “operate in the context of the particular market at issue,” whether the LCA market or any other sector-specific market. What distinguishes other investors from the Airbus governments is that other investors have a choice. They are not motivated by the demands of industrial policy to put their money into the LCA sector or any other particular sector. They are free to put their money into whatever investments they believe will fetch the highest return. For this very reason, the return that an “other investor” demands from a Launch Aid-like investment in Airbus will not depend on the “specificities” to which the EC refers.

71. In short, there is no basis for departing from a market benchmark for determining whether Launch Aid confers a benefit on Airbus and thus constitutes a subsidy within the meaning of Article 1 of the SCM Agreement.<sup>85</sup>

### **B. The EC admits that Launch Aid confers a benefit on Airbus and thus constitutes a subsidy within the meaning of Article 1 of the SCM Agreement**

72. In its statements at the first Panel meeting, the United States pointed out that even under the EC’s own analysis, the EC concedes that Launch Aid confers a benefit on Airbus and thus constitutes a subsidy.<sup>86</sup>

73. In fact, the EC openly admits that for the A320 and A330/A340, Launch Aid was provided either interest-free (Germany and Spain), at the rate of inflation (France), or at the government’s cost of borrowing (UK).<sup>87</sup> The panel in the *Canada - Aircraft* dispute treated a similar admission by Canada with respect to the Technology Partnerships Canada (TPC) program as dispositive with respect to the existence of a benefit and thus a subsidy.<sup>88</sup>

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<sup>85</sup> See U.S. Responses to First Panel Questions, para. 54 (explaining that, contrary to EC suggestion, Appellate Body report in *US - Countervailing Measures* said nothing about using a benchmark other than commercial market transactions in determining whether a financial contribution confers a subsidy).

<sup>86</sup> See U.S. FOS, paras. 15-16, 53; Exhibit US-448, p. 2; U.S. FOS (**HSBI and BCI**), paras. 2-3, 36.

<sup>87</sup> EC FWS, para. 388.

<sup>88</sup> *Canada - Aircraft (Panel)*, paras. 9.312-9.313.

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74. The EC also does not dispute that Launch Aid for the A300 and A310 was provided interest-free and thus confers a benefit.<sup>89</sup> Indeed, the EC did not even address the A300 and A310 in the “corrected” analysis set out in its expert’s report.<sup>90</sup>

75. This then leaves the A330-200, the A340-500/600, and the A380. For all of these models as well – whether one uses the benchmark rates calculated by the United States or those calculated by the EC – Launch Aid confers a benefit on Airbus.<sup>91</sup>

76. Subsequent statements by the EC confirm this admission. For example, in responding to the Panel’s question as to why Airbus resorted to Launch Aid for the A380 if [ ], the EC explained:

The company selected a combination of financial instruments that would allow it to achieve the highest projected net present value and the highest projected internal rate of return for the programme, *i.e.*, maximize the programme’s profitability, while taking into account the impact of available financing instruments on the company’s own financial exposure and risk, as well as the industrial viability of the programme.<sup>92</sup>

77. The necessary implication of this statement is that Launch Aid confers a benefit on Airbus with respect to the A380 program. Including it in the “combination of financial instruments” “maximizes the programme’s profitability.” In other words, declining Launch Aid and opting instead for commercial financing would not have “maximize{d} the programme’s profitability.”<sup>93</sup> This point is confirmed by information the EC has designated as HSBI, to which the United States referred in its non-public statement at the first Panel meeting.<sup>94</sup>

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<sup>89</sup> See U.S. FWS, paras. 180-183.

<sup>90</sup> See Exhibit EC-11 (**HSBI and BCI**) at Exhibit 3. In its response to the Panel’s Question 77, the EC acknowledges that its “alternative legal argument” on Launch Aid “does not directly address MSF loans for the A300 and A310 programmes.” EC Responses to First Panel Questions, para. 128. It then simply asserts that the analysis in its “alternative legal argument” “would apply equally to loans for the A300 and A310.” *Id.*, para. 130.

<sup>91</sup> Compare Ellis Report (**BCI**) at 27 (setting out U.S.-calculated benchmark rates) and Ellis Report HSBI Appendix at 3 (setting out interest rates at which Launch Aid is provided by model and by government) (Exhibit US-80 (**HSBI and BCI**)) with Whitelaw Report at Exhibit 3 (setting out EC-calculated benchmark rates) (Exhibit EC-11 (**HSBI and BCI**)); see also Exhibit US-448 at 2 (comparison of actual Launch Aid rates vs. benchmarks in one of the Airbus member States).

<sup>92</sup> EC Responses to First Panel Questions, para. 126.

<sup>93</sup> See also EC Responses to First Panel Questions, paras. 89, 108.

<sup>94</sup> See U.S. FOS (**HSBI and BCI**), para. 2.

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78. While the EC concedes that even following its analysis Launch Aid confers a benefit, its analysis is deeply flawed in ways that significantly understate that benefit. The United States reviewed some of these flaws in its statements at the first Panel meeting.<sup>95</sup> In the remainder of this part as well as in the HSBI appendix and the expert's report included as Exhibit US-534, the United States elaborates on those flaws.

### **C. The EC's criticism of the benchmark set out in the Ellis Report is baseless**

79. The Ellis Report (Exhibit US-80) that the United States included with its first written submission sets out an analysis that determines a market benchmark (*i.e.*, interest rate) for the provision of financing with terms comparable to Launch Aid. It does this on a model-by-model, country-by-country basis and then compares the benchmark interest rate to the interest rate actually set forth in each of the Launch Aid contracts at issue. The "spread" between the benchmark rate and the actual rate is the benefit conferred by the provision of Launch Aid.

80. The EC challenges both the U.S. benchmark and the U.S. understanding of the actual rates of return to the Airbus governments. The United States will address each of these arguments in that order.

81. With respect to the calculation of a benchmark, the EC accepts the U.S. approach of beginning with a risk-free interest rate and adding to it a general corporate borrowing rate and then a project-specific risk premium.<sup>96</sup> Its challenge is focused exclusively on how the United States determined the appropriate risk premium.

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<sup>95</sup> See U.S. FOS, paras. 44-58; U.S. FOS (**HSBI and BCI**), paras. 4-36.

<sup>96</sup> See EC FWS, paras. 489-490.

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1. Launch Aid is properly characterized as a hybrid form of financing, rather than pure debt

82. In the EC's view, the risk premium associated with Launch Aid must be based on the proposition that Launch Aid is a debt instrument, rather than a hybrid instrument with both debt-like and equity-like qualities.<sup>97</sup> The EC latches on to excerpts from the Ellis Report taken out of

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<sup>97</sup> See EC FWS, paras. 483-486.

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context to suggest that the United States agrees with this characterization.<sup>98</sup> When the Ellis Report is read as a whole, however, it is clear that it does not treat Launch Aid as pure debt.<sup>99</sup>

83. Indeed, Launch Aid has a number of features that would make it inappropriate to treat it as pure debt. For example, like equity and unlike debt, Launch Aid does not entitle the Airbus governments to repayment with interest over a specified period of time. Repayment depends entirely on sales, which may or may not occur according to the schedule forecast in the Launch Aid contract. The EC attempts to dismiss this feature by asserting that “these loans do in fact amortize.”<sup>100</sup> But that observation has nothing to do with establishing Launch Aid’s risk profile.

84. Likewise, the providers of Launch Aid share a shareholder’s risk with respect to non-repayment. Like a shareholder, the Airbus governments have no recourse in the event of non-repayment of their investment. They have no ability to exercise any rights under a lien on the company’s assets or any other security.

85. The EC asserts that [

<sup>101</sup>] But if insufficient operating profits make it impossible to pay corporate bondholders, the bondholders may declare the company to be in default and pursue whatever remedies they have in that circumstance. Providers of Launch Aid cannot pursue remedies for default in the event of non-repayment over the schedule forecast in the Launch Aid contract.

86. Moreover, the EC fails to recognize that while the risk assumed by a corporate bondholder (or a shareholder, for that matter) is spread across a company’s multiple projects, the risk assumed by the providers of Launch Aid is concentrated in a single project.

87. [

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<sup>98</sup> See EC FWS, para. 489; EC Responses to First Panel Questions, para. 77.

<sup>99</sup> See, e.g., Ellis Report, pp. 2-3 (introducing concept of “Launch Aid” by describing its essential features but without labeling it as “debt” or “equity”); p. 19 (describing Launch Aid risk characteristics that must be taken into account in establishing the appropriate risk premium) (Exhibit US-80 (BCI)).

<sup>100</sup> EC Responses to First Panel Questions, para. 83.

<sup>101</sup> EC Responses to First Panel Questions, para. 82.

<sup>102</sup> EC Responses to First Panel Questions, para. 84.

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2. The U.S. benchmark reflects the hybrid nature of Launch Aid

89. Having established that Launch Aid has both debt-like and equity-like characteristics, the Ellis Report calculated a benchmark that reflects these characteristics. Ellis first selected a risk premium based on research on financing for projects with risk profiles comparable to the launch of a new LCA model. To be conservative, Ellis selected the lowest risk premium indicated by this research – a premium of seven percent above a market index of return. Ellis then added this premium to the sum of a risk-free interest rate and Airbus’s corporate debt rate. Use of Airbus’s corporate debt rate rather than its equity rate or weighted average cost of capital reflects the fact that Launch Aid does have certain debt-like qualities; use of the corporate debt rate has, however, had the effect of yielding a lower, more conservative benchmark than adding the premium to the equity rate or weighted average cost of capital.

90. To confirm the accuracy of this benchmark, Ellis tested it against four other methodologies. Each of these cross-checks yielded a comparable benchmark. In the expert

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<sup>103</sup> See Exhibit EC-113. The title of the document is “[ ] for [ ]” See also *id.*, art. 2.1 (establishing the financiers agreement to “make available to the Company a committed [ ]”).

<sup>104</sup> EC Responses to First Panel Questions, para. 84.

<sup>105</sup> [ ] Loan Agreement, Art. 18.3(a) (Exhibit EC-113 (BCI)).

<sup>106</sup> [ ] Loan Agreement, Art. 7.2(a) (Exhibit EC-113 (BCI)).

<sup>107</sup> [ ] Loan Agreement, Art. 1.1 (definition of “Margin”) and Art. 10.1 (interest rate defined to mean [ ] (Exhibit EC-113 (BCI)).



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report included with the present submission, a cross-check against a fifth methodology again confirms the accuracy of the benchmark in the Ellis Report.

91. The EC and its expert criticize the U.S. benchmark and the methodologies used to confirm it on several grounds. An expert report attached to this submission (Exhibit US-534) responds to this criticism in detail and demonstrates the soundness of the U.S. benchmark. In this section and the next section, as well as in the HSBI appendix, the United States highlights several key points.

92. First, the EC asserts that it is inappropriate to add what it calls “a project-specific risk premium derived from equity returns” to Airbus’s cost of debt.<sup>108</sup> It suggests that an equity risk premium should be added only to the corporate cost of equity. However, adding the risk premium that Ellis identified to Airbus’s corporate cost of debt was done precisely to reflect the hybrid nature of Launch Aid. The result is no different than if Ellis had added the risk premium to Airbus’s cost of equity (as the EC indicates would be proper) and then reduced the sum to account for Launch Aid’s debt-like qualities.

93. Second, the EC alleges that “use of an equity measure {for the risk premium} is at odds with the risk profile and terms of MSF loans.”<sup>109</sup> That statement is wrong for two reasons. First, it ignores Launch Aid’s equity-like qualities, as described above, and relies on the erroneous assumption that Launch Aid has a risk profile comparable to that of pure debt.<sup>110</sup> Second, it assumes incorrectly that the risk premium identified by Ellis is “an equity measure.” As explained in the U.S. response to the Panel’s Question 8, the KSS paper that Ellis used to identify an appropriate risk premium examines the cost of equity of newly-public firms. But the results are relevant to estimating the cost of capital for private venture capital investment whether in the form of debt, equity, or hybrid financing.<sup>111</sup>

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<sup>108</sup> EC FWS, para. 493.

<sup>109</sup> EC FWS, para. 494.

<sup>110</sup> In discussing the equity-like qualities of Launch Aid, the United States previously noted the observation of the *Canada - Aircraft* panel regarding Canada’s TPC, which shares Launch Aid’s essential features: “TPC contributions are similar to equity investments in that, as with equity investments, TPC contributions will only be repaid if the funded projects are commercially successful.” See U.S. FWS, para. 145 and footnote 141 (quoting *Canada - Aircraft (Panel)*, footnote 619). The EC asks this Panel to disregard that observation because the EC understands it to be *obiter dictum*. EC FWS, para. 497. But, whatever relevance the observation of the *Canada - Aircraft* panel had to that dispute, it paints an accurate picture of Launch Aid-type financing.

<sup>111</sup> U.S. Responses to First Panel Questions, paras. 58-61.

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94. The EC also criticizes the method Ellis used to derive a risk premium from the KSS paper. But, as described in the expert report filed with this submission, the EC evidently misunderstands the interpretation that the KSS authors themselves gave to their results.<sup>112</sup>

3. The EC fails to discredit the confirmatory analyses in the Ellis report

95. As noted above, the benchmark established in the Ellis report is confirmed by four alternative methodologies. The EC criticizes each of them but fails to discredit any of them. The expert report included with this submission rebuts each of the EC's criticisms and discusses a fifth confirmatory methodology. Here, the United States discusses key points with respect to three of the methodologies. The United States reserves discussion of the other two for its HSBI appendix.

96. One of the cross-checks that Ellis undertook to confirm the risk premium he established for Launch Aid was a comparison to the widely-used Ibbotson Associates data on historical risk premia on large company stocks. That data revealed a risk premium of 7.08 percent (that is, eight basis points higher than the Ellis risk premium).<sup>113</sup>

97. The EC criticizes this cross-check on the grounds that a risk-premium based on equity does not reflect Launch Aid's risk profile, and that recent scholarship finds the Ibbotson data to overstate the equity risk premium.<sup>114</sup> However, as already noted, this criticism ignores Launch Aid's equity-like qualities. It also seems to assume that equity is always riskier than debt, though this is not necessarily the case with respect to low-rated debt.<sup>115</sup> Finally, the scholarship on which the EC and its expert rely is extremely recent (including three working papers from 2006), would not have been known to managers when the Launch Aid at issue was provided, and (unlike Ibbotson) does not represent a consensus approach to measuring equity risk.<sup>116</sup>

98. A second cross-check in the Ellis Report is a comparison to the 8 percent risk premium used in a 1997 European Commission state aid decision regarding Launch Aid that the Spanish government provided to CASA.<sup>117</sup> The EC argues that the comparison is not appropriate because of circumstances in that case indicating that "Spanish support threatened to have a considerable,

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<sup>112</sup> See NERA Response to Whitelaw Report, pp. 8-10 (Exhibit US-534) (HSBI).

<sup>113</sup> Ellis Report, p. 21 (Exhibit US-80 (BCI)).

<sup>114</sup> EC FWS, paras. 513-516.

<sup>115</sup> See NERA Response to Whitelaw Report, p. 19 (Exhibit US-534) (HSBI).

<sup>116</sup> See NERA Response to Whitelaw Report, pp. 15, 19 (Exhibit US-534) (HSBI).

<sup>117</sup> Ellis Report, p. 21 (Exhibit US-80 (BCI)).

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negative effect on intra-Community trade.”<sup>118</sup> However, that argument confuses the Commission’s risk premium analysis with its analysis of the aid’s impact on intra-Community trade; in fact, these were separate issues. Also, the EC’s characterization of the regional aircraft market at issue in the 1997 decision as “highly-competitive” implies that similar risk factors are not present in the LCA market, although the EC does not and cannot offer any support for that suggestion.<sup>119</sup>

99. A third cross-check in the Ellis Report is a comparison to the discount rate that [

] Again, this cross-check confirmed the accuracy of the U.S. benchmark. The EC criticizes this analysis, first, on the grounds that it is based on equity risk and relies on the Ibbotson Associates data. For the reasons discussed above, these criticisms are not well founded.

100. Additionally, the EC contends that comparison to the [

] However, unlike the alternative benchmark the EC now proposes, [

] as opposed to a methodology developed expressly for purposes of advocating one position in litigation.<sup>120</sup> Moreover, that methodology is consistent with the consensus view on the equity risk premium at the time, rather than more recently emerging and still vigorously debated views on the equity risk premium.<sup>121</sup>

4. The [ ] contract and the EC’s “equity ceiling” do not undermine the U.S. benchmark

101. The EC claims that its criticism of the U.S. benchmark is “corroborated” by two cross-checks: a comparison to the 1998 contract between [ ] for financing development of the [ ], and a comparison to its expert’s calculation of what the EC describes as an “equity ceiling”

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<sup>118</sup> EC FWS, para. 533.

<sup>119</sup> See U.S. FOS (**HSBI and BCI**), paras. 32-34.

<sup>120</sup> The same point can be made with respect to the EC’s criticism (EC FWS, para. 527) of Ellis’s cross-check based on the UK government’s critical project appraisal for the A380. See U.S. FOS (**HSBI and BCI**), para. 29.

<sup>121</sup> For discussion of the irrelevance of the EC’s point that [ ], see U.S. FOS (**HSBI and BCI**), paras. 30-31.

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(i.e., a cost of equity based on a supposed maximum equity risk premium). Neither cross-check undermines the U.S. benchmark.

a. [ ]

102. The EC describes the [ ] contract as “comparable” to Launch Aid.<sup>122</sup> However, as discussed in the U.S. statement at the first Panel meeting, this is a gross mischaracterization.<sup>123</sup> Key differences between the terms of the [ ] contract and the terms of Launch Aid contracts mean that [ ] took on far less risk than the Airbus governments. These differences include:

- The participants in the [ ] pledged only [ ] apiece, in contrast to the French government, which provided [ ] for the same project.<sup>124</sup>
- The [ ] contract provided for full repayment over [ ] aircraft as contrasted to [ ] under the French Launch Aid contract for the A340-500/600.<sup>125</sup>
- As of the [ ] signing of the [ ] contract, Airbus already had 120 firm orders and commitments for the A340-500/600 – that is [ ] more than the [ ] sales needed for full repayment.<sup>126</sup>

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<sup>122</sup> EC FWS, para. 505.

<sup>123</sup> U.S. FOS (**HSBI and BCI**), paras. 5-15.

<sup>124</sup> [ ] Loan Agreement, Schedule 1 (Exhibit EC-113 (**BCI**)); *Protocole d'Accord entre l'Etat et Aerospatiale relatif au programme Airbus A340-500 et A340-600*, Art. 3 (“A340-500/600 Protocol”), DS316-EC-BCI-0000276 (Exhibit US-35 (**BCI**)).

<sup>125</sup> [ ] Loan Agreement, Art. 7.1 (Exhibit EC-113 (**BCI**)); A340-500/600 Protocol, Art. 6.2, DS316-EC-BCI-0000276 (Exhibit US-35 (**BCI**)).

<sup>126</sup> See, e.g., Airbus, *Airbus Industrie Announces Order of 3,000<sup>th</sup> Aircraft* (Sept. 9, 1998) (stating that “the A340-500 and A340-600 have gained more than 120 firm orders and commitments since launch late last year”) (Exhibit US-535). The United States intended to provide this exhibit with its statement at the first Panel meeting but, due to an oversight, did not do so. It includes the exhibit with this submission.

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- The interest rate under the [ ] contract, according to the EC, was [ ] percent, as contrasted to [ ] percent under the French Launch Aid contract and [ ] percent under the Spanish Launch Aid contract for the same project.<sup>127</sup>
- The [ ] contract contained a [ ] whereby [ ]<sup>128</sup>
- Per sale levies under the [ ] contract are [ ], in contrast to the [ ] under the French and Spanish Launch Aid contracts for the same project, whereby levies are [ ]<sup>129</sup>
- The [ ] contract provides for a [ ]<sup>130</sup>
- The [ ] contract was structured to reach full repayment by [ ] in contrast to the French and Spanish Launch Aid contracts, which anticipated repayment over [ ]<sup>131</sup>

103. Despite the United States having called attention to these significant differences affecting the risk associated with Launch Aid and the risk associated with the [ ] contract, the EC

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<sup>127</sup> EC FWS, para. 505; 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)).

<sup>128</sup> [ ] Loan Agreement, Art. 18.3(a) (Exhibit EC-113 (BCI)).

<sup>129</sup> [ ] Loan Agreement, Art. 7.1 (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 3 (“Octavo”) and 6 (“Quinta”) (Exhibit US-37(BCI)).

<sup>130</sup> [ ] Loan Agreement, Art. 7.2(a) (Exhibit EC-113 (BCI)).

<sup>131</sup> [ ] Loan Agreement, Art. 1 (definition of “Margin”) and Art. 10.1 (interest rate is [ ]) (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)).

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continues to mischaracterize these instruments as containing “similar” terms and conditions.<sup>132</sup> The EC does not even address the contrast. Instead, it asserts that [

] <sup>133</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.

104. The EC eventually protests that it “does not contend that the risk incurred by [ ] is fully comparable to the risk incurred by the Member States [ ].” It then acknowledges two differences: [

] The EC then asserts that “these distinctions” do not explain the difference between what it believes to be the risk premium under the [ ] – and the risk premium determined in the Ellis report – 700 basis points.<sup>134</sup>

105. But, of course, the United States never said that the difference was attributable only to these two distinctions. As noted above, there are many other significant distinctions, all with the effect of lowering the risk to the [ ] which the EC never addresses.

106. Two additional points in the EC’s discussion of the [ ] contract are highly misleading. First, the EC notes that in [

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<sup>132</sup> EC Responses to First Panel Questions, para. 66.

<sup>133</sup> EC Responses to First Panel Questions, para. 67.

<sup>134</sup> EC Responses to First Panel Questions, para. 71.

<sup>135</sup> EC Responses to First Panel Questions, para. 69.

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107. What the EC ignores is the provision in the [

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108. Second, the EC challenges the U.S. statement at the first Panel meeting that by the time the [

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<sup>138</sup>] However, whereas the United States has relied on a public Airbus statement, the EC provides no evidence at all, basing its assertion on “Airbus proprietary internal information.”<sup>139</sup> The United States respectfully suggests that this bald, unsupported assertion cannot rebut the U.S. demonstration based on Airbus’s own public statement (which presumably was consistent with what Airbus was telling [ ] at the time).

*b. “Equity ceiling”*

109. Additionally, the U.S. benchmark is not undermined by what the EC refers to as an “equity ceiling.” The EC attempts to show that the risk premium for Launch Aid could not exceed what it believes to be a maximum equity risk premium and that, therefore, a market benchmark cannot exceed the benchmark implied by that maximum premium.<sup>140</sup>

110. As discussed in the expert’s report attached as Exhibit US-534, this argument is based on several flawed assumptions.<sup>141</sup> First, it wrongly assumes that the risk of a single project cannot

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<sup>136</sup> [ ] Loan Agreement, Art. 1 (definition of “Margin”) and Art. 10.1 (interest rate is [ ] (Exhibit EC-113 (BCI));

<sup>137</sup> See U.S. FOS (HSBI and BCI), para. 9 (citing Airbus, *Airbus Industrie Announces Order of 3,000<sup>th</sup> Aircraft* (Sept. 9, 1998) (stating that “{t}he A340-500 and A340-600 have gained more than 120 firm orders and commitments since launch late last year”) (Exhibit US-535)); EC Responses to First Panel Questions, para. 70 (challenging U.S. statement).

<sup>138</sup> EC Responses to First Panel Questions, para. 70.

<sup>139</sup> EC Responses to First Panel Questions, para. 70 and footnote 39. The EC also asserts that at the time [ ] “certain airlines had non-binding options to order A340-500/600 aircraft” and that “{a}irlines frequently decline to exercise such options.” *Id.*, footnote 39. The EC provides no support for these assertions. And, an Airbus press release only [ ] stated that “{s}ince their commercial launch in June 1997, the two new versions of the A340 have won 100 per cent of all new business recorded in their respective categories, accumulating 130 orders and commitments from 10 world class customers.” Airbus, *Singapore Airlines Orders A340-500* (Feb. 11, 1999) (Exhibit US-536) (Emphasis added).

<sup>140</sup> EC FWS, para. 508.

<sup>141</sup> See also U.S. FOS (HSBI and BCI), paras. 16-19.

exceed the risk of a company's equity. But if the single project is riskier than the company's average project, then financing for the single project may well exceed the company's cost of equity.

111. Second, in setting its equity ceiling, the EC relied on a sample of companies – including diversified companies and companies not primarily in the commercial aircraft business – whose sensitivity to economy-wide risk factors is likely to be lower than that of LCA projects.

112. Third, the EC's determination of an equity risk premium is based largely on very recent research that does not represent a consensus approach to measuring equity risk. The EC's determination also is contradicted by other evidence, which the EC has designated as HSBI, and which is discussed in the NERA report provided with this submission.<sup>142</sup> Aside from the fact that this research is still the subject of heated debate, it would not have been available to a market investor at the time the Launch Aid contracts at issue were entered into and, therefore, is not an appropriate basis for identifying a market benchmark.

**D. The EC's alternative benchmark, based on financing provided to Airbus by risk-sharing suppliers, is inappropriate due to the peculiar incentives of risk-sharing suppliers**

113. The EC offers an alternative to the U.S. benchmark. Specifically, it determines a risk premium based on project-specific returns for certain Airbus "risk-sharing suppliers." However, this comparison is inapposite, because the situation of risk-sharing suppliers is far different from that of an ordinary, market-based provider of Launch Aid-type financing to Airbus, whose sole interest presumably is to maximize its return on that financing.<sup>143</sup>

114. First, as discussed in the expert's report filed with this submission, investment capital provided by banks and other financial entities is highly mobile, whereas a supplier's capital is relatively immobile in the short and intermediate terms. It is tied up in the tangible and intangible assets associated with manufacturing whatever input the supplier is in the business of manufacturing. An investor can easily decide that returns in the air conditioning industry, for example, are not high enough and choose instead to make an investment in the telecommunications industry, but an air conditioner manufacturer will continue to seek opportunities to supply air conditioners or related products.<sup>144</sup>

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<sup>142</sup> See NERA Response to Whitelaw Report, pp. 19-21 (Exhibit US-534) (HSBI).

<sup>143</sup> See NERA Response to Whitelaw Report, pp. 22-28 (Exhibit US-534) (HSBI); U.S. FOS (HSBI and BCI), paras. 20-27.

<sup>144</sup> See NERA Response to Whitelaw Report, pp. 27-28 (Exhibit US-534) (HSBI).



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115. Because suppliers have a narrower range of choices than investors, suppliers' required rate of return on a given project will tend to be lower than investors' required rate of return on the same project.

116. Second, the return that a risk-sharing supplier demands of Airbus under a particular contract is likely to be influenced by a variety of factors that would have no relevance to an investor. These include anticipated revenue from future business with Airbus, sales of replacement parts, and servicing of goods supplied. Anticipated future revenue streams may well cause a supplier to underbid on a contract with Airbus. As Fitch noted in its analysis of Airbus, “{M}ost suppliers provide components at or close to cost and make their returns in the aftermarket.”<sup>145</sup>

117. Third, as the expert's report notes, a supplier may provide more than one component to Airbus and may adjust the rate it demands under one supply contract according to the rate it demands under a different supply contract. Also, the rates provided for in supply contracts may anticipate the likelihood of amendments as specification changes occur.<sup>146</sup> These factors may cause the rate of return reflected in any given supply contract to be less than the supplier's actual anticipated return based on the different facets of its relationship with Airbus taken together.

118. Finally, as the expert report notes, some of Airbus's suppliers may be shielded from the sorts of risk to which providers of Launch Aid are exposed by contractual commitments under which Airbus undertakes to purchase a minimum quantity of supplies regardless of actual aircraft deliveries, thus assuming some of the risk of delays or project failures.<sup>147</sup>

119. Additional features that make Airbus's contracts with risk-sharing suppliers an inappropriate basis for establishing a benchmark are discussed in the HSBI appendix and in the expert's report.

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<sup>145</sup> Fitch Ratings, Special Report, *Diverging Flight Paths: Boeing and Airbus Large Commercial Aircraft Industry Update* (Nov. 15, 2006), at 6 (Exhibit US-451).

<sup>146</sup> See NERA Response to Whitelaw Report, p. 27 (Exhibit US-534) (HSBI).

<sup>147</sup> See NERA Response to Whitelaw Report, p. 23 (Exhibit US-534) (HSBI). (citing Fitch Ratings, Special Report, *Diverging Flight Paths: Boeing and Airbus Large Commercial Aircraft Industry Update* (Nov. 15, 2006), at 7 (Exhibit US-451)).

**E. The EC’s criticism of the returns on Launch Aid identified in the Ellis report is baseless**

120. In addition to criticizing the market benchmark for Launch Aid-type financing established in the Ellis report, the EC criticizes the report’s reference to the returns on Launch Aid actually identified in the Launch Aid contracts as the basis for comparison to the benchmarks. In the EC’s view, identifying the returns on Launch Aid requires taking account of what the EC calls the “internal rate of return” as well as the effect of taxation.<sup>148</sup> The EC is wrong on both counts.

1. Internal rate of return

121. With respect to the EC’s first argument, the United States notes again that its determination of the benefit conferred by Launch Aid relies on a comparison between a market benchmark and the actual interest rates set out in the Launch Aid contracts. What the EC calls the “internal rate of return” is based not on the actual interest rate set out in a Launch Aid contract but on “the business case delivery forecast . . . over the life of an aircraft programme.”<sup>149</sup> In other words, this rate is a function not just of the levies to repay the Launch Aid amount but also anticipated royalties on later deliveries.

122. However, as the Ellis report observes, the royalty percentages in the Launch Aid contracts are [ ] – between [ ] – and royalties are due only after a large number of deliveries has been made. Even if forecast delivery schedules turn out to be accurate, royalties will not come due until 17 or more years after the initial disbursement of Launch Aid. As Ellis puts it, “Because of the very substantial uncertainty attached to any royalties due this far out into the future and depending entirely on Airbus successfully selling more planes than the specified royalty-based thresholds, they would play a marginal role, at most, in a commercial lender’s financing decision.”<sup>150</sup>

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<sup>148</sup> EC FWS, paras. 536-546.

<sup>149</sup> EC Responses to First Panel Questions, para. 541.

<sup>150</sup> Ellis Report, Full HSBI Version Appendix, pp. 5-6.

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123. Any potential return from future royalties may be further reduced by [ ]<sup>151</sup> In this regard, it also is notable that certain Launch Aid contracts set [ ]<sup>152</sup>

2. Tax effects

124. With respect to tax effects, the EC argues that the returns on Launch Aid to the Airbus governments are higher than the rates actually set out in the Launch Aid contracts because, the EC asserts, Airbus paid tax on Launch Aid for the A320, A330/340 basic, A330-200, and A340-500/600.<sup>153</sup> In the EC’s view, this means that the effective rate of return on the after-tax amount of Launch Aid is higher than the nominal rate of return on the pre-tax amount. This argument is seriously flawed for both factual and legal reasons.

125. As a factual matter, first, it should be noted that the EC’s argument does not pertain to the A380.<sup>154</sup> But even for the models to which the argument does apply, the EC has been less than straightforward about the facts. For example, in its Question 71, the Panel asked the EC to substantiate its assertion “that LA/MSF provided for the A320, A330/A340, A330-200 and the A340-500/600 was subject to taxation.” The EC’s answer amounted to a non-response.

126. First, the EC identified the corporate tax rates applicable in each of the EC member States in the years in which the relevant models were launched.<sup>155</sup> That information has nothing to do with the Panel’s question. Then the EC stated that it “confirms that the MSF borrowers paid all corporate taxes that were due in the tax periods that affect these programmes.”<sup>156</sup> But that answer, too, is entirely irrelevant. The issue is not whether the Airbus companies paid their

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<sup>151</sup> See, e.g., German A380 Launch Aid Contract, Sec. 10, clause 1), DS316-EC-BCI-0000345 ([ ] (Exhibit US-72 (BCI)); French A380 Launch Aid Protocole, Art. 7.3, DS316-EC-BCI-0000249 (same) (Exhibit US-75 (BCI)).

<sup>152</sup> See, e.g., French A380 Launch Aid Protocole, Art. 7.3, DS316-EC-BCI-0000249 ([ ] (Exhibit US-75 (BCI)); UK A330/A340 Launch Aid Contract, Art. 2.4.5 (providing for [ ] (Exhibit EC-86 (BCI)); UK A320 Launch Aid Contract, Art. 2.4.3 (providing for [ ] (Exhibit EC-94 (BCI)).

<sup>153</sup> EC FWS, paras. 542-546.

<sup>154</sup> See EC Responses to First Panel Questions, para. 102. It also is notable that the EC’s tax argument makes no mention of the A300 and A310.

<sup>155</sup> EC Responses to First Panel Questions, para. 110.

<sup>156</sup> EC Responses to First Panel Questions, para. 112.

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taxes. (Neither the Panel nor the United States has questioned that.) The issue is whether the Launch Aid amounts were subject to taxation and whether tax on such amounts was paid. The EC has asserted that they were, but has studiously avoided the Panel's question and provided no evidence to support its assertion.

127. In any event, even if the EC could support its assertion, as a legal matter the assertion is irrelevant. Tax effects have no bearing on whether a financial contribution confers a benefit under the SCM Agreement.

128. It is well established that the relevant comparison for determining whether a financial contribution confers a benefit on the recipient is the market.<sup>157</sup> Market-based lenders set interest rates without regard to taxes that the recipients may subsequently pay to their governments. Therefore, it would be inappropriate to adjust the actual rates in Launch Aid contracts upwards to account for the effects of taxes. This point is widely understood and accepted. Neither the United States nor the EC, for example, allows a party to adjust for tax effects when calculating the amount of the benefit under its domestic countervailing duty regime.<sup>158</sup>

129. The EU Council and Commission, in a recent countervailing duty case, explained the rationale for not allowing an adjustment for tax effects. Discussing certain financial contributions to Indian exporters that were treated as grants, the Council and Commission stated:

According to the information available, it can indeed not be excluded that these grants, at a later stage, may increase a company's overall tax liability. However, this would be a future event, and will depend on many factors, most of which are influenced by commercial decisions made by the company itself. Such factors do not only relate to pricing and sales issues, but also concern other issues that determine overall tax liability, such as decisions concerning depreciation rates, the carrying forward of losses and many other factors. All these decisions influence the tax bracket that will finally be applied to the company in a specific tax year. It is therefore not possible to determine exactly to what extent benefits obtained from DEPB sales have contributed to the applicable tax rate.<sup>159</sup>

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<sup>157</sup> See U.S. FWS, para. 110.

<sup>158</sup> See, e.g., *Guidelines for the Calculation of the Amount of Subsidy in Countervailing Duty Investigations*, 98/C 394/04, at G.2 (Dec. 17, 1998) (“No allowance can be made for any tax effects of subsidies. . . .”) (Exhibit US-537).

<sup>159</sup> Council Regulation (EC) No. 74/2004 of 13 January 2004 imposing a definitive countervailing duty on imports of cotton-type bedlinen originating in India, OJ L12/1, 17.1.2004, p. 6 (recital 50) (emphasis added) (Exhibit US-538).

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130. Furthermore, the EC fails to explain why, in its view, it is appropriate to take account of tax effects but not other effects of Launch Aid. For example, one of the benefits of Launch Aid is that it allows the Airbus companies to reduce the amount of debt they would otherwise carry on their balance sheets. These reductions in debt have an impact on their commercial debt ratings, and thus on their overall borrowing costs. Although the EC would reduce the amount of benefit that Airbus receives from Launch Aid to account for the alleged effects of taxation, it fails to increase the benefit to account for the money Airbus saves through its reduced borrowing costs.

131. Finally, even if the EC's alternative interest rate calculations were valid (which they are not), they still fall below the commercial benchmarks proposed by the United States and the EC, as the tables in paragraphs 510 and 546 of the EC's first written submission confirm.

### **V. PROVISIONS OF LAUNCH AID FOR THE A330-200, A340-500/600, AND A380 ARE CONTINGENT UPON EXPORT PERFORMANCE AND THEREFORE PROHIBITED UNDER ARTICLE 3.1(a) OF THE SCM AGREEMENT**

132. In its first written submission, the United States demonstrated that Launch Aid for the A330-200, A340-500/600, and A380 is contingent upon export performance and therefore prohibited under Article 3.1(a) of the SCM Agreement. For each provision of Launch Aid, the United States showed (1) the "granting" of a subsidy; (2) that is "tied to" (3) "actual or anticipated exportation or export earnings."<sup>160</sup>

133. The EC disputes that the provision of Launch Aid is the granting of a subsidy, and that, of course, is the subject of the previous discussion in this submission. The EC does not dispute that on granting Launch Aid the Airbus governments anticipated exportation or export earnings. Instead, in responding to the U.S. prohibited subsidy claims, the EC focuses on the issue of Launch Aid's "tie to" "anticipated exportation or export earnings."

134. Specifically, the EC focuses on the U.S. point that Launch Aid contracts provide for repayment over levels of sales that necessarily involve exports. The EC believes that the United States errs by basing its argument on the repayment of Launch Aid rather than the provision of Launch Aid. However, this mischaracterization of the U.S. case misses the fundamental point: That the contractual commitment to provide Launch Aid is made in return for a contractual commitment by Airbus to repay the Launch Aid on a basis that necessarily involves exports. It is this exchange of commitments that the United States emphasizes. This is the key element of Launch Aid's tie to anticipated export performance.

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<sup>160</sup> SCM Agreement, Art. 3.1(a), footnote 4; *see also* U.S. FWS, para. 330 (quoting *Canada – Aircraft (AB)*, para. 169).

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135. The EC portrays the United States as arguing that the grant of Launch Aid is tied to anticipated exportation or export earnings merely because the Airbus governments expected that there would be exports of the LCA models developed as a result of Launch Aid.<sup>161</sup> But the United States does not argue that the governments' expectations of exportation or export earnings alone make the provision of Launch Aid contingent upon export performance. Those expectations unquestionably are an important part of the picture. But an equally important part of the picture is the fact that the governments' decision to provide Launch Aid was made in reliance on and in return for a commitment by Airbus to undertake a course of action that necessarily involves exports. The governments' expectations – informed by Airbus's Business Cases, Global Market Forecasts, and Launch Aid applications and by the governments' own critical project appraisals – were an essential precondition to the governments' decisions to provide Launch Aid.

136. It is not just that the governments hoped or knew that Airbus would export the models supported by Launch Aid. Rather, the anticipation of exportation or export earnings is the essential predicate for the decision of the governments to provide Launch Aid in the first place. And, once the governments commit to providing Launch Aid, that tie is reinforced through provisions in the Launch Aid contracts themselves, including warranties by Airbus of the accuracy of the forecasts that form the basis for the contract and, most notably, the establishment of per sale repayment schedules under which full repayment can be achieved only if there are exports. It is this contractual tie that distinguishes the provision of Launch Aid from the provision of a subsidy based on the mere expectation that the subsidy would result in exportation.

137. Before turning to the EC's arguments, it is useful to recall some of the key evidence that substantiates not only the governments' expectations of export performance but also the fact that their decision to grant Launch Aid depended upon those expectations and upon commitments by Airbus to work toward fulfilling those expectations:

- The governments' expectations of exports and export earnings for the A380 were based, for example, on Airbus's Global Market Forecast, which projected that 57 percent of orders for aircraft with 400 seats or more would come from the Asia-Pacific region, in contrast to only 20 percent (or just 247 aircraft) from Europe.<sup>162</sup>

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<sup>161</sup> See, e.g., EC FWS, paras. 558-559, 632-633, 638-640, 646-648, 656.

<sup>162</sup> Airbus, Global Market Forecast 2000, at 37 (Exhibit US-358). Airbus also predicted that six of the top ten airports served by aircraft with more than 400 seats would be located in the Asia-Pacific region; only two would be located in Europe. Airbus Industrie, GMF '99, at 42 (Exhibit US-356).

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- For the A340-500/600, almost half of the firm orders that Airbus had already received when the governments were still deciding on the provision of Launch Aid were export sales.<sup>163</sup>
- And on the date that the French government signed the A330-200 Launch Aid contract, 100 percent of the firm orders that the company had received for the A330-200 were exports.<sup>164</sup>

138. Moreover, the Launch Aid contracts themselves anticipate delivery levels that far exceed the number of aircraft that the company and the governments expect Airbus to sell in Europe:

- In the case of the A380, for example, forecasts are as high as [ ] passenger versions and [ ] cargo versions in 20 years.<sup>165</sup>
- The Spanish A340-500/600 contract [ ]<sup>166</sup>

139. Several of the Airbus government project appraisals for the A330-200, A340-500/600 and A380 [ ]<sup>167</sup>

140. The central role that this anticipation of exports played at the time of the application for and decision to grant Launch Aid is also confirmed by the fact that when Airbus was trying to

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<sup>163</sup> See Exhibit US-368. The source of the data in the exhibit is Airclaims. The French Launch Aid contract is dated December 29, 1998. See French A340-500/600 Agreement, at 1 (Exhibit US-36 (BCI)). The Spanish Launch Aid contract is dated December 28, 1998. See Spanish A340-500/600 Agreement, at 1 (Exhibit US-37 (BCI)).

<sup>164</sup> Dubai-based Emirates Airlines had ordered 16, the U.S. leasing company ILFC had ordered four, and Canada 300 airlines had ordered two. See Exhibit US-368. The source of the data in the exhibit is Airclaims. The Launch Aid contract is dated [ ]. DS316-EC-BCI-0000316, 320 (Exhibit US-78 (BCI)). A protocol to the contract is dated [ ]. DS316-EC-BCI-0000316 (Exhibit US-78 (BCI)). See also United States First Written Submission, para. 381.

<sup>165</sup> See Anlage 1 zum A380 Darlehensvertrag, DS316-EC-BCI-0000369, at 0000381 (Exhibit US-357 (BCI)); Spanish A380 Agreement, DS316-EC-BCI-0000549, at 3 (“Septimo”) (Exhibit US-73 (BCI)).

<sup>166</sup> Spanish A340-500/600 Agreement, DS316-EC-BCI-0000535, at 2 (Exhibit US-37 (BCI)).

<sup>167</sup> See, e.g., France, A380 project appraisal, DS316-EC-HSBI-0001174, at 9-10; UK, A380 project appraisal, DS316-EC-HSBI-0001211, at 35-36; French A340-500/600 project appraisal, DS316-EC-HSBI-0001143, at 10, 15; French A330-200 project appraisal, DS316-EC-HSBI-0001199, at 4; see also U.S. FWS, HSBI App., paras. 29-30, 34-37, 46-48, 55.

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persuade the governments to provide the Launch Aid, it justified its request in part by pointing to potential export earnings, stressing the importance of export sales to the project's success – arguing, for example, that it would lead to an [ ]<sup>168</sup> – and by pointing to the highly export oriented nature of the company as a whole.<sup>169</sup>

141. That the Airbus governments actually relied on anticipation of exports – thus tying their grants of Launch Aid to that anticipation – is evidenced in the Launch Aid contracts themselves. For example, the German Launch Aid contract for the A380 makes [ ]

[ ]<sup>170</sup> In the UK Launch Aid contract for the A380, the company makes [ ]  
[ ]<sup>171</sup> Similar provisions are found in the other A330-200, A340-500/600 and A380 Launch Aid contracts and will be discussed below.

142. Of course, in granting Launch Aid, the governments rely not just on Airbus's representations about the accuracy of its forecasts but on Airbus's own commitment to perform. Launch Aid is granted in contracts, in which the government commits to do something (*i.e.*, provide Launch Aid) in consideration for Airbus's commitment to do something (*i.e.*, produce a given LCA model and repay the Launch Aid on a per delivery basis). That exchange of commitments is the essence of the contractual relationship. And, in Airbus's case, the performance it commits to is performance which, given demand in the EC relative to global demand, can be achieved only by exporting.

143. In committing to provide Launch Aid, the Airbus governments could have insisted on any number of conditions or no conditions at all. They could have insisted on repayment over much smaller numbers of sales than actually are set out in the Launch Aid contracts (*e.g.*, numbers that could be reached without necessarily exporting). They could have insisted on repayment over a fixed schedule, regardless of sales. They could have foregone repayment – effectively treating Launch Aid as a grant. But instead of taking any of these possible

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<sup>168</sup> Anlage 1 zum A380 Darlehensvertrag, DS316-EC-BCI-0000369, at 0000417 (Exhibit US-357 (BCI)); *see also* US FWS, para. 349.

<sup>169</sup> *See* US FWS, para. 350. As the Appellate Body stated in the *Canada – Aircraft* dispute, in determining whether a particular subsidy is contingent “in fact” on exports, “the export orientation of a recipient may be taken into account as a relevant fact, provided that it is one of several facts which are considered and is not the only fact supporting a finding.” *Canada - Aircraft (AB)*, para. 173.

<sup>170</sup> German A380 Launch Aid Contract, Sec. 1, clause 5), DS316-EC-BCI-0000345 (Exhibit US-72 (BCI)).

<sup>171</sup> UK A380 Launch Aid Contract, Art. 3.1.4, DS316-EC-BCI-0000556 (Exhibit US-79 (BCI)).



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approaches, the Airbus governments took the approach of conditioning the provision of Launch Aid on repayment over levels of sales derived from Airbus's own Business Case and Global Market Forecasts and the governments' own project appraisals and other analyses, which levels of sales would necessarily involve exportation. Because the provision of Launch Aid is tied to export performance in this way it is a prohibited subsidy under Article 3.1(a) of the SCM Agreement.

144. The EC's response to the U.S. argument consists, first, of articulating an analytical framework not supported by the SCM Agreement and then purporting to show that Launch Aid for the A330-200, A340-500/600, and A380 does not meet the definition of export contingency suggested by this analytical framework. At the heart of this deeply flawed analytical framework is the proposition that to be contingent upon export performance, a subsidy must be a "consequence of" export performance. That proposition has absolutely no basis in the text of the SCM Agreement. In fact, it is contradicted by footnote 4 of the SCM Agreement, which provides that a subsidy is contingent upon export performance if the granting of the subsidy "is in fact tied to actual or anticipated exportation or export earnings."

145. In a second line of argument, the EC makes a futile attempt to deny the existence of Launch Aid's contractual tie to export performance. It does this through a combination of mischaracterization of the U.S. argument (suggesting, for example, that the U.S. has confused mere anticipation of export performance with contingency upon export performance) and reliance on irrelevant observations about the Launch Aid contracts (noting, for example, that Airbus could voluntarily prepay the Launch Aid amounts at any time).

146. Third, the EC misconstrues the evidence demonstrating that the level of sales over which Airbus commits to repay Launch Aid amounts cannot be met without exportation. Thus, the EC essentially reads the repayment provisions of the Launch Aid contracts out of context and asserts that they provide merely for performance by Airbus, not export performance.

147. In this part of its submission, the United States will elaborate on each of the errors in the EC's argument, demonstrating that the EC fails to undermine the U.S. *prima facie* case showing that Launch Aid for the A330-200, A340-500/600, and A380 is export contingent and thus prohibited.<sup>172</sup>

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<sup>172</sup> See also U.S. FOS, paras. 60-75.

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**A. Article 3.1(a) of the SCM Agreement defines a prohibited subsidy as a subsidy that is “contingent upon” export performance, not a “consequence of” export performance**

1. The EC’s fundamentally flawed analytical framework

148. The EC’s framework for analyzing Article 3.1(a) and footnote 4 of the SCM Agreement is set out at paragraphs 567 to 583 of its first written submission. That framework starts with the three core elements of Article 3.1(a): subsidy; export performance; and contingency. However, it then characterizes those elements in a way that pre-ordains the outcome the EC seeks to reach. Most crucially, the EC labels the grant of a subsidy as the “consequence” that must flow from the “condition” of export performance in order for the subsidy to be prohibited within the meaning of Article 3.1(a).<sup>173</sup>

149. In the EC’s view, the relationship between export performance and subsidy must be a condition-consequence or “if-then” relationship in order for the subsidy to come under Article 3.1(a).<sup>174</sup> According to the EC, a subsidy is export contingent only if a given increment of subsidy is doled out as a consequence of a given increment of export.<sup>175</sup>

150. Having set up this framework, the EC goes on to argue that Launch Aid is not contingent upon export performance because the provision of Launch Aid does not follow as a consequence of exportation. Rather, the EC explains, the consequence of exportation is the repayment of Launch Aid. Thus the EC believes it has demonstrated that provision of the Launch Aid subsidy is not contingent upon export performance.<sup>176</sup> In fact, the EC has failed in this demonstration because its analytical framework has no basis in the SCM Agreement.

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<sup>173</sup> EC FWS, paras. 578-579.

<sup>174</sup> See EC FWS, para. 591.

<sup>175</sup> See, e.g., EC FWS, paras. 556, 558, 567, 571, 572, 579, 589, 634, 655; EC FOS, para. 73; EC Responses to First Panel Questions, para. 138.

<sup>176</sup> See, e.g., EC FWS, paras. 579, 589, 600, 604, 634, 677, 681; EC FOS, paras. 68, 77; EC Responses to First Panel Questions, para. 138. The EC also argues that the United States confuses export performance with mere performance, since the Launch Aid contracts require Airbus to make repayments on a per sale basis, regardless of the origin of the sale. See, e.g., EC FWS, para. 587. As the United States discusses in Part V.C below, this argument mistakenly reads the Launch Aid contracts in a vacuum, without any regard for the market context in which they occur, in which the levels of performance mandated can be achieved only through exportation.

## 2. The EC's analytical framework has no basis in SCM Agreement

151. In its response to a question from the Panel, the EC recalled the Appellate Body's observation that "panels must interpret and apply the language actually used in the Treaty."<sup>177</sup> The United States agrees. Accordingly, the first point that must be made about the EC's framework for analyzing export contingency is that the term "consequence" is not "language actually used" in Article 3.1(a) or footnote 4 of the SCM Agreement.

152. In fact, at paragraph 578 of its first written submission, the EC admits that the term "consequence" is one it has invented for purposes of its argument.<sup>178</sup> It cites to no treaty text for this term (as there is none). Nor does it cite to any of the 29 panel and Appellate Body reports catalogued at footnote 446 of its first written submission.

153. Not only is the term "consequence" not used in Article 3.1(a) of the SCM Agreement, but "the language actually used in the Treaty" undermines the EC's assertion that under Article 3.1(a), the grant of a subsidy must be the "consequence" entailed by "the future factual fulfilment"<sup>179</sup> of export performance. As footnote 4 explains, a subsidy is contingent upon export performance if the granting of the subsidy is "tied to actual or anticipated exportation or export earnings." (Emphasis added.) The express reference to "anticipated exportation or export earnings" means that a subsidy is contingent upon export performance even if it is granted prior to – rather than as a "consequence" of – "the future factual fulfilment" of exportation.<sup>180</sup>

154. In fact, panels have found subsidies to be contingent upon export performance where the grant of a subsidy was tied to anticipated exportation rather than being a consequence of actual exportation. This was the case, for example, with respect to the Technology Partnerships Canada ("TPC") program at issue in the *Canada - Aircraft* dispute. As discussed in the U.S. first written submission, the TPC program was virtually identical to Launch Aid: Pursuant to TPC,

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<sup>177</sup> EC Responses to First Panel Questions, para. 151 (citing *Canada - Aircraft (AB)*, footnote 102).

<sup>178</sup> EC FWS, para. 578 ("The European Communities uses the term 'consequence' here, and throughout this Section, to refer to the outcome that the subsidy measure must place in a *contingent* relationship with the required condition (export performance).").

<sup>179</sup> EC FWS, para. 591.

<sup>180</sup> *Accord* Australia Third Party Submission, para. 33 ("The effect of using these five elements to analyse export contingency is to require that actual export performance comes before, and, in fact, causes a subsidy to be granted. Australia does not consider that the European Communities' approach reflects the text of Article 3.1(a) or is supported by previous WTO cases. The European Communities' analysis would render meaningless the first sentence of footnote 4 with its reference to tying the granting of a subsidy to anticipated exportation or export earnings.").

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Canada gave up-front funds to Bombardier to underwrite the costs of developing a new aircraft model, with repayment to be made via levies on sales.<sup>181</sup>

155. In analyzing whether TPC financing was export-contingent, the panel explained that “the factual evidence adduced must demonstrate that had there been no expectation of export sales . . . ‘ensuing’ from the subsidy, the subsidy would not have been granted.”<sup>182</sup> In other words, it was export sales following as a consequence of (*i.e.*, “ensuing from”) the subsidy rather than the subsidy following as a consequence of export sales that supported a finding of export contingency. Like the EC in this dispute, Canada argued that the subsidy at issue in *Canada - Aircraft* was “not conditional on exports taking place.”<sup>183</sup> In response, the panel stated:

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>184</sup>

156. Similarly, in *Australia - Leather*, the panel found Australia’s cash grant to the Howe company to be export contingent on the basis of its tie to anticipated export performance.<sup>185</sup> The grant contract provided for the government to make one payment at signing and two subsequent payments upon receipt of reports by Howe on its progress toward attaining certain performance targets, which Howe had committed to pursue on a “best endeavours” basis.<sup>186</sup> As the panel explained:

At the time the contract was entered into, the government of Australia was aware of this necessity {on Howe’s part to export in order to meet performance targets}, and thus anticipated continued and possibly increased exports by Howe. In our view, these facts effectively transform the sales performance targets into export performance targets. We thus consider that Howe’s anticipated export performance was one of the conditions for the grant of the subsidies.<sup>187</sup>

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<sup>181</sup> See U.S. FWS, paras. 148-151.

<sup>182</sup> *Canada - Aircraft (Panel)*, para. 9.339 (emphasis in original).

<sup>183</sup> *Canada - Aircraft (Panel)*, para. 9.343.

<sup>184</sup> *Canada - Aircraft (Panel)*, para. 9.343 (emphases added).

<sup>185</sup> *Australia - Leather*, para. 9.67.

<sup>186</sup> *Australia - Leather*, para. 9.62.

<sup>187</sup> *Australia - Leather*, para. 9.67.

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157. Thus, as in *Canada - Aircraft*, the grant of a subsidy in *Australia - Leather* was not a consequence of export performance but, nevertheless, was found to be tied to export performance within the meaning of Article 3.1(a) and footnote 4 of the SCM Agreement.<sup>188</sup> In fact, the EC's discussion of *Australia - Leather* in an attempt to make that panel report fit within the EC's analytical framework is utterly misleading.<sup>189</sup> The EC completely ignores that the Australian government's first disbursement under the grant to Howe was made upon signing of the grant contract – *i.e.*, before any of the anticipated export performance had occurred. The EC also ignores Australia's argument (similar to the EC's own argument in this dispute) that "a change in Howe's level of exports would not affect the disbursement of the funds," as well as the panel's response that "the pertinent consideration is the facts at the time the conditions for the grant payments were established, and not possible subsequent developments."<sup>190</sup>

158. In sum, the basis for the panel's finding in *Australia - Leather* was not, as the EC asserts, that "the consequence required by Article 3.1(a) and footnote 4 (grant of a subsidy) was demonstrated."<sup>191</sup> The basis was the grant contract's tie to anticipated export performance.

159. Because the EC's analytical framework is fundamentally flawed, the conclusion the EC draws from applying that framework to the Launch Aid contracts is equally flawed. The EC mistakenly focuses on the consequence of the exportation of LCA covered by Launch Aid contracts. It observes that the consequence is not the provision of a subsidy but, rather, the repayment of a subsidy.<sup>192</sup> It calls this consequence "the reverse of a grant of a subsidy, or a 'negative subsidy,'" and concludes that "{i}t is therefore the reverse of what is required by Article 3.1(a) of the *SCM Agreement*."<sup>193</sup>

160. However, because the EC has begun with a false premise, this conclusion is entirely irrelevant. The fact that the grant of a subsidy is not the consequence of actual exportation does not mean that the grant of a subsidy is not tied to export performance and therefore contingent upon export performance within the meaning of Article 3.1(a) and footnote 4 of the SCM Agreement.

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<sup>188</sup> See also *Australia - Leather (Article 21.5)*, para. 6.47.

<sup>189</sup> See EC FWS, para. 669.

<sup>190</sup> *Australia - Leather*, para. 9.70.

<sup>191</sup> EC FWS, para. 669.

<sup>192</sup> See, *e.g.*, EC FWS, paras. 579, 589, 642, 653.

<sup>193</sup> EC FWS, para. 589; see also EC FOS, para. 77.

**B. The EC ignores Launch Aid's contractual tie to export performance**

161. The EC compounds its error of relying on a non-text-based analytical framework by making a series of arguments seeking to show the lack of a tie between the provision of Launch Aid and export performance. Its efforts ultimately fail, as they rely on a combination of mischaracterization of the U.S. argument (for example, falsely accusing the United States of confusing anticipation of export performance with a tie to export performance) and insistence on various irrelevant points (such as the possibility of Airbus electing to prepay Launch Aid amounts and the consistency of the governments' forecasts of LCA sales with prudent business practices).

162. The United States will address each of the EC's arguments in turn. Before doing so, however, it is useful to recall the evidence and argument on which the United States relies to demonstrate Launch Aid's tie to export performance. Given the emphasis the EC has placed on rebutting an argument the United States never makes – *i.e.*, that the Airbus governments' mere anticipation of exports upon providing Launch Aid establishes a tie to anticipated exports – the United States begins this part of its submission with an extended discussion of the actual U.S. argument to eliminate any confusion that may have been engendered by the EC's response to the U.S. first written submission.

1. The U.S. has demonstrated that the provisions of Launch Aid for the A330-200, A340-500/600, and A380 are contractually tied to Airbus's export performance

163. In its first written submission, the United States demonstrated that Launch Aid for the A330-200, A340-500/600, and A380 constitutes a subsidy within the meaning of Article 1 of the SCM Agreement. As discussed above and in the U.S. statement at the first Panel meeting, the EC concedes this much, even if it disputes the amount of the subsidy.<sup>194</sup>

164. The Launch Aid subsidy is provided through contracts between each Airbus government and an Airbus company. The contracts consist of a commitment of performance on the part of the government undertaken in consideration for a commitment of performance on the part of the company. In particular, the government commits to disburse Launch Aid according to a set schedule in exchange for which the company commits to repay the Launch Aid amounts on the basis of a specified levy per sale over an agreed-to number of sales. As the EC itself explains, "the link of repayment to actual sales of the plane" is "the most characteristic feature" of Launch Aid.<sup>195</sup>

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<sup>194</sup> See U.S. FOS, paras. 15-17; U.S. FOS (HSBI and BCI), paras. 2-3.

<sup>195</sup> EC FWS, para. 449.

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165. The agreed-to number of sales over which Launch Aid is to be repaid is important, as this demonstrates that the governments provide Launch Aid in consideration not merely for performance but for export performance. As the United States has shown in its prior submissions and statements, for each contract, the number of sales over which Launch Aid is to be repaid is so large relative to demand in the EC for the LCA model at issue as to necessarily involve exportation in order to be achieved.<sup>196</sup> In this regard, the Launch Aid repayment schedules are like the “best endeavors” performance targets set out in the grant contract at issue in *Australia - Leather*. Here as there, facts demonstrating the size of the domestic market relative to the global market “effectively transform the sales performance targets into export performance targets.”<sup>197</sup> The United States will have more to say on this point in Part V.C below.

166. The United States stresses that the number of LCA sales over which Airbus commits to repay Launch Aid amounts and the need to export to reach that number are relevant not simply as an indication of the expectations of the parties to the Launch Aid contract. Rather, they establish that an essential condition for the provision of Launch Aid is a commitment to export.

167. To reinforce the point that under the Launch Aid contracts anticipated exportation is not merely a hope or aspiration of Airbus and the Airbus governments but an essential condition tied to the provision of Launch Aid, it is useful to review the terms that establish that tie in each of the contracts at issue. In the remainder of this section, the United States will elaborate on the demonstration in its first written submission that the provision of the Launch Aid subsidy is contractually tied to anticipated exportation. Then in the next section the United States will respond to the various arguments the EC has made in a vain attempt to deny the existence of that tie.

### *a. UK A380 Launch Aid Contract*

168. In its first written submission, the United States discussed the repayment terms of the UK Launch Aid contract for the A380 and demonstrated that by conditioning its provision of Launch Aid on repayment over [ ] sales, the UK government necessarily tied the aid to substantial exports.<sup>198</sup> Other terms and conditions in the contract corroborate the existence of this tie.

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<sup>196</sup> See, e.g., U.S. FWS, paras. 345-357, 363-373, 378-384, and HSBI Appendix, paras. 26-60; U.S. FOS, paras. 68-75.

<sup>197</sup> *Australia - Leather*, para. 9.67.

<sup>198</sup> See U.S. FWS, paras. 352-360.





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172. Further, the UK A380 Launch Aid contract includes a commitment by BAE Systems to [ <sup>204</sup>

] Thus, to obtain Launch Aid, the company had to commit to [ ].

173. Under Article 6, the UK government may [

] <sup>205</sup> This further demonstrates that the government’s performance (its provision of Launch Aid) is tied to Airbus’s performance, which, as previously discussed, cannot be accomplished without exportation.

174. Finally, Article 7.1(a) provides for the Company to [ ] <sup>206</sup> This again shows that the UK government did not simply provide Launch Aid in the hope that it would lead to export performance, but that it provided Launch Aid contingent upon performance by Airbus – to be demonstrated to the government through, *inter alia*, [ ] – which performance (for reasons already discussed) necessarily involves exportation.

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<sup>204</sup> UK A380 Launch Aid Contract, Art. 4.1, DS316-EC-BCI-0000556 (Exhibit US-79 (BCI)).

<sup>205</sup> UK A380 Launch Aid Contract, Art. 6.1.1.1, DS316-EC-BCI-0000556 (Exhibit US-79 (BCI)).

<sup>206</sup> UK A380 Launch Aid Contract, Art. 7.1, DS316-EC-BCI-0000556 (Exhibit US-79 (BCI)); *cf. Canada - Aircraft (Panel)*, para. 10.118 (referring to “the commitment to provide information ‘required’ by the Ministry of Industry pertaining to ‘progress achieved . . . as well as plans to fulfill’ these obligations” as evidence that Letters of Undertaking were binding).

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*b. German A380 Launch Aid Contract*

175. In its first written submission, the United States discussed the repayment terms of the German Launch Aid contract for the A380 and demonstrated that by conditioning its provision of Launch Aid on repayment over [ ] sales, the German government necessarily tied the aid to

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substantial exports.<sup>207</sup> Other terms and conditions in the contract corroborate the existence of this tie.

176. Section 1 of the German contract sets out certain [

] <sup>208</sup> Relatedly, the preamble to the contract notes that the German government is in possession of [

] <sup>209</sup>

177. Further demonstrating that the German government relied on [ ] is the fact that section 12 of the contract provides that [

] <sup>210</sup>

178. Also demonstrating a reliance on that information (and hence a tie between the provision of Launch Aid and the performance necessarily implied by that information) is the right of the government to [

] <sup>211</sup>

179. Moreover, section 2 of the German contract sets out [

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<sup>207</sup> See U.S. FWS, paras. 352-360.

<sup>208</sup> German A380 Launch Aid Contract, Sec. 1, clause 5), DS316-EC-BCI-0000345 (Exhibit US-72 (BCI)).

<sup>209</sup> See, e.g., Anlage 1 zum A380 Darlehensvertrag, DS316-EC-BCI-0000369, p. 7 (Exhibit US-357 (BCI)) [ ] p. 15 [ ] p. 44 [ ]

<sup>210</sup> German A380 Launch Aid Contract, Sec. 12, clause 2), DS316-EC-BCI-0000345 (Exhibit US-72 (BCI)).

<sup>211</sup> German A380 Launch Aid Contract, Sec. 12, clause 3)b), DS316-EC-BCI-0000345 (Exhibit US-72 (BCI)).

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180. Finally, attached to the German Launch Aid contract is an appendix (Appendix 14) entitled [

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181. The foregoing provisions show that the German government did not simply provide Launch Aid in the hope that it would lead to export performance but that it provided Launch Aid contingent upon performance by Airbus that (for reasons already discussed) necessarily involves exportation.

### *c. French A380 Launch Aid Contract*

182. In its first written submission, the United States discussed the repayment terms of the French Launch Aid contract for the A380 and demonstrated that by conditioning its provision of Launch Aid on repayment over [ ] sales, the French government necessarily tied the aid to substantial exports.<sup>214</sup> Other terms and conditions in the contract corroborate the existence of this tie.

183. Article 6.1 of the contract protocol

] <sup>215</sup> This obligation confirms that the contract represents a commitment on the part of the government in exchange for a commitment on the part of Airbus.

184. Under Article 1.3 of the contract protocol, Airbus undertakes [

] <sup>216</sup> Like the similar obligation in Article 4.1 of the UK A380 Launch Aid contract, this provision further demonstrates the tie between the government's commitment to provide Launch Aid and Airbus's commitment to [ .]

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<sup>212</sup> German A380 Launch Aid Contract, Sec. 2, clause 5), DS316-EC-BCI-0000345 (Exhibit US-72 (BCI)).

<sup>213</sup> German A380 Launch Aid Contract, Appendix 14, DS316-EC-BCI-0000532 (Exhibit US-125 (BCI)).

<sup>214</sup> See U.S. FWS, paras. 352-360.

<sup>215</sup> French A380 Launch Aid Protocole, Art. 6.1, DS316-EC-BCI-0000249 (Exhibit US-75 (BCI)).

<sup>216</sup> French A380 Launch Aid Protocole, Art. 6.1, DS316-EC-BCI-0000249 (Exhibit US-75 (BCI)).

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185. Also like the UK contract, the French contract obligates Airbus to [

] <sup>217</sup> This again shows that the French government did not simply provide Launch Aid in the hope that it would lead to export performance but that it provided Launch Aid contingent upon performance by Airbus – to be demonstrated to the government through, *inter alia*, [ ] – which performance (for reasons already discussed) necessarily involves exportation.

186. In the event that Airbus breaches its obligations under the A380 Launch Aid contract, the French government [ ] <sup>218</sup> further corroborating the link between the government’s performance and Airbus’s performance.

187. The foregoing provisions show that the French government did not simply provide Launch Aid in the hope that it would lead to export performance but that it provided Launch Aid contingent upon performance by Airbus which (for reasons already discussed) necessarily involves exportation.

*d. Spanish A380 Launch Aid Contract*

188. In its first written submission, the United States discussed the repayment terms of the Spanish Launch Aid contract for the A380 and demonstrated that by conditioning its provision of Launch Aid on repayment over [ ] sales, the Spanish government necessarily tied the aid to substantial exports.<sup>219</sup> Other terms and conditions in the contract corroborate the existence of this tie.

189. Notably, in its preamble the Spanish contract states that

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<sup>217</sup> French A380 Launch Aid Protocole, Art. 8.2, DS316-EC-BCI-0000249 (Exhibit US-75 (BCI)); *see also* French A380 Launch Aid Convention, Art. 3.1, DS316-EC-BCI-0000265 (Exhibit US-116 (BCI)).

<sup>218</sup> French A380 Launch Aid Protocole, Art. 9.1, DS316-EC-BCI-0000249 (Exhibit US-75 (BCI)).

<sup>219</sup> *See* U.S. FWS, paras. 352-360.

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190. [

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191. Under Article 1 of the Spanish Launch Aid contract, Airbus commits [

] <sup>221</sup> This obligation confirms that the contract represents a commitment on the part of the government in exchange for a commitment on the part of Airbus.

192. The foregoing provisions show that the Spanish government did not simply provide Launch Aid in the hope that it would lead to export performance but that it provided Launch Aid contingent upon performance by Airbus that (for reasons already discussed) necessarily involves exportation.

*e. French A340-500/600 Launch Aid Contract*

193. In its first written submission, the United States discussed the repayment terms of the French Launch Aid contract for the A340-500/600 and demonstrated that by conditioning its provision of Launch Aid on repayment over [ ] sales, the French government necessarily tied the aid to substantial exports.<sup>222</sup> Other terms and conditions in the contract corroborate the existence of this tie.

194. Article 7 of the main contract obligates Airbus [

] <sup>223</sup> This obligation confirms that the contract represents a commitment on the part of the government in exchange for a commitment on the part of Airbus.

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<sup>220</sup> Spanish A380 Launch Aid Contract at 3 (“Séptimo”), DS316-EC-BCI-0000549 (Exhibit US-73 (BCI)).

<sup>221</sup> Spanish A380 Launch Aid Contract at 4 (“Preimera”), DS316-EC-BCI-0000549 (Exhibit US-73 (BCI)).

<sup>222</sup> See U.S. FWS, para. 373, HSBI App., paras. 45-53.

<sup>223</sup> *Convention entre l'Etat et Aerospatiale concernant le développement des Airbus A340-500 et A340-600*, Art. 7 (“A340-500/600 Convention”), DS316-EC-BCI-0000289 (Exhibit US-36 (BCI)); see also *Protocole d'Accord entre l'Etat et Aerospatiale relatif au programme Airbus A340-500 et A340-600*, Art. 6.1 (“A340-500/600 Protocol”), DS316-EC-BCI-0000276 (Exhibit US-35 (BCI)).

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195. The contract also obligates Airbus to [

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<sup>225</sup>] This again shows that the French government did not simply provide Launch Aid in the hope that it would lead to export performance, but that it provided Launch Aid contingent upon performance by Airbus – to be demonstrated to the government through, *inter alia*, [ ] – which performance (for reasons already discussed) necessarily involves exportation.

196. Moreover, the protocol to the A340-500/600 Launch Aid contract requires Airbus [

] <sup>226</sup> This requirement further reinforces the contractual tie between the provision of Launch Aid and Airbus's export performance.

197. In the event that Airbus breaches its obligations under the A340-500/600 Launch Aid contract, the French government [ ] <sup>227</sup> further corroborating the link between the government's performance and Airbus's performance.

198. The foregoing provisions show that the French government did not simply provide Launch Aid in the hope that it would lead to export performance but that it provided Launch Aid contingent upon performance by Airbus that (for reasons already discussed) necessarily involves exportation.

### *f. Spanish A340-500/600 Launch Aid Contract*

199. In its first written submission, the United States noted that the EC and Spain redacted all of the numbers from the Launch Aid repayment schedule in the copy of the Spanish A340-500/600 Launch Aid contract that they provided to the Panel and the United States. This makes

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<sup>224</sup> A340-500/600 Convention, Art. 9 (third paragraph), DS316-EC-BCI-0000289 (Exhibit US-36 (BCI)); *see also* A340-500/600 Protocol, Art. 8 (second paragraph), DS316-EC-BCI-0000276 (Exhibit US-35 (BCI)).

<sup>225</sup> A340-500/600 Convention, Annexe B (clause 3), DS316-EC-BCI-0000289 (Exhibit US-36 (BCI)).

<sup>226</sup> A340-500/600 Protocol, Annexe 5 (second paragraph), DS316-EC-BCI-0000276 (Exhibit US-35 (BCI)).

<sup>227</sup> A340-500/600 Convention, Art. 10 (first paragraph), DS316-EC-BCI-0000289 (Exhibit US-36 (BCI)); *see also* A340-500/600 Protocol, Art. 9 (first paragraph), DS316-EC-BCI-0000276 (Exhibit US-35 (BCI)).

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it impossible to determine over how many deliveries Airbus must repay the financing.<sup>228</sup> Nevertheless, the Launch Aid contract anticipates [ ] worldwide sales of the aircraft over a 20-year period, however.<sup>229</sup> In light of the EC's and Spain's refusal to provide the actual information, the reasonable inference is that Airbus must repay the aid over a similar number of sales.<sup>230</sup> Based on this reasonable inference, the Spanish government necessarily tied its provision of Launch Aid to substantial exports. Other terms and conditions in the contract corroborate the existence of this tie.

200. As in the Spanish Launch Aid contract for the A380, the contract for the A340-500/600 contains certain representations in the preamble evidencing the information on which the Spanish government relied in deciding to provide Launch Aid. In particular, the preamble states that [

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201. Thus the Spanish government states explicitly that in providing Launch Aid for the A340-500/600 it is [ ]

202. Moreover, under Article 1 of the Spanish A340-500/600 Launch Aid contract, Airbus commits [

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<sup>228</sup> U.S. FWS, para. 373.

<sup>229</sup> Spanish A340-500/600 Agreement, DS316-EC-BCI-0000534, at 2 (third paragraph under "Primer") (Exhibit US-37 (BCI)).

<sup>230</sup> The United States respectfully reiterates its request that the Panel either use its authority under Article 13 of the DSU to request the EC and Spain to provide the necessary information or else draw the adverse inference that Airbus must repay the aid over [ ] sales.

<sup>231</sup> Spanish A340-500/600 Agreement, DS316-EC-BCI-0000534, at 1 (first paragraph under "Primer") (Exhibit US-37 (BCI)).

<sup>232</sup> Spanish A340-500/600 Agreement, DS316-EC-BCI-0000534, at 2 (fourth paragraph under "Primer") (Exhibit US-37 (BCI)).



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] <sup>233</sup> This obligation confirms that the contract represents a commitment on the part of the government in exchange for a commitment on the part of Airbus.

203. The foregoing provisions show that the Spanish government did not simply provide Launch Aid in the hope that it would lead to export performance but that it provided Launch Aid contingent upon performance by Airbus which (for reasons already discussed) necessarily involves exportation.

*g. French A330-200 Launch Aid Contract*

204. In its first written submission, the United States discussed the repayment terms of the French Launch Aid contract for the A330-200 and demonstrated that by conditioning its provision of Launch Aid on repayment over [ ] sales, the French government necessarily tied the aid to substantial exports.<sup>234</sup> Other terms and conditions in the contract corroborate the existence of this tie.

205. Article 6 of the protocol to the A330-200 Launch Aid contract obligates Airbus [ ] <sup>235</sup> This obligation confirms that the contract represents a commitment on the part of the government in exchange for a commitment on the part of Airbus.

206. The protocol also obligates Airbus to [

]<sup>236</sup> This again shows that the French government did not simply provide Launch Aid in the hope that it would lead to export performance but that it provided Launch Aid contingent upon performance by Airbus – to be demonstrated to the government through, *inter alia*, [ ] – which performance (for reasons already discussed) necessarily involves exportation.

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<sup>233</sup> Spanish A340-500/600 Agreement, DS316-EC-BCI-0000534, at 5 (third paragraph under “Primera”) (Exhibit US-37 (BCI)).

<sup>234</sup> See U.S. FWS, para. 384, HSBI App., paras. 55-60.

<sup>235</sup> *Convention entre l'Etat et Airbus France concernant le développement de l'Airbus A330-200* (“A330-200 Convention”) and *Protocole relatif au financement part l'Etat du Programme Airbus A330-200* (“A330-200 Convention and Protocole”), Protocole Art. 6.1, DS316-EC-BCI-0000316 (Exhibit US-78 (BCI)).

<sup>236</sup> A330-200 Convention and Protocole, Protocole Art. 7 (second paragraph), DS316-EC-BCI-0000316 (Exhibit US-78 (BCI)).

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207. Moreover, the protocol to the A330-200 Launch Aid contract requires Airbus [

] <sup>237</sup> This requirement further reinforces the contractual tie between the provision of Launch Aid and Airbus's export performance.

208. In the event that Airbus breaches its obligations under the A330-200 Launch Aid contract, the French government [ ] <sup>238</sup> further corroborating the link between the government's performance and Airbus's performance.

209. The foregoing provisions show that the French government did not simply provide Launch Aid in the hope that it would lead to export performance but that it provided Launch Aid contingent upon performance by Airbus which (for reasons already discussed) necessarily involves exportation.

2. In its attempt to show the absence of a tie between the provision of Launch Aid and anticipated export performance, the EC mischaracterizes the U.S. argument and relies on irrelevant observations about the Launch Aid contracts

210. Having reviewed the evidence and argumentation demonstrating that the provision of Launch Aid is tied to anticipated export performance, the United States now turns to the EC's vain attempt to show the absence of that tie. As set forth in this section, that attempt relies on several false or irrelevant arguments, none of which undermine the U.S. case.

- a. *The United States does not equate anticipation of export performance with contingency on export performance*

211. Perhaps the most frequently repeated of the EC arguments addressed to the U.S. demonstration of the tie between the provision of Launch Aid and anticipated export performance is the argument that "anticipation does not demonstrate contingency."<sup>239</sup> However, in making this observation (and then reiterating it throughout its discussion of export

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<sup>237</sup> A330-200 Convention and Protocole, Annexe 5 (second paragraph), DS316-EC-BCI-0000316 (Exhibit US-78 (BCI)).

<sup>238</sup> The article on termination (Protocole Article 8) does not appear in the copy of the A330-200 Convention and Protocole provided as Exhibit US-78. However, it does appear in the copy provided as Exhibit EC-90.

<sup>239</sup> EC FWS, para. 558; *see also id.*, paras. 610, 633, 646, 651, 653, 656, 677, 685; EC FOS, paras. 77-78; EC Responses to First Panel Questions, paras. 134, 144-145, 150. A variant on this argument is the EC's unsupported suggestion that the United States is arguing for standard based on a subsidy's effect on exports. *See* EC Responses to First Panel Questions, para. 145.

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contingency) the EC is responding to an argument the United States has not made. Rather than addressing the actual U.S. argument on export contingency (as discussed in the preceding section), the EC has set up what it pretends to be the U.S. argument and then makes a great show of knocking it down.

212. It is true – indeed, the EC does not even dispute – that in providing Launch Aid for the A330-200, the A340-500/600, and the A380, the Airbus governments anticipated that these models would be exported. But, the United States does not argue that this fact alone makes the provision of Launch Aid contingent upon export performance. As discussed in the preceding section, it is the contractual commitment on the part of Airbus to repay Launch Aid over levels of sales that cannot be reached without exportation that makes the provision of Launch Aid contingent upon export performance. That commitment is the consideration that Airbus gives the Airbus government in exchange for the government’s commitment of Launch Aid. It is this contractual tie that distinguishes the provision of Launch Aid from the provision of a subsidy based on the mere expectation that the subsidy would result in exportation.

213. Indeed, if the United States really were making the argument that the EC challenges, then there would be no reason to confine that argument to the particular provisions of Launch Aid at issue. Precisely because of Airbus’s export-orientation, the nature of the LCA product, and the global market for LCA, the United States would have every incentive to challenge every subsidy to Airbus as necessarily export-contingent. But the United States has not done so, because its argument is not that the mere expectation of exports makes the provision of subsidies export contingent.

214. Just as in *Australia - Leather* it was a contractual tie to export performance that distinguished the grant contract from the loan contract<sup>240</sup> – even though in both cases the Australian government anticipated exports – so, here, the contractual tie to a level of performance that necessarily involves exports is an important element that makes the provision of Launch Aid export contingent.

*b. The U.S. demonstration that the provision of Launch Aid is contingent upon export performance is consistent with its demonstration that Launch Aid confers a benefit*

215. Related to the EC’s mischaracterization of the U.S. export contingency argument is an assertion that the EC has caught the United States contradicting itself. Specifically, the EC

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<sup>240</sup> Compare *Australia - Leather*, para. 9.71 (“payments {under grant contract} are conditioned on Howe’s agreement to satisfy, on the basis of best endeavours, the aggregate performance targets”) with *id.*, para. 9.74 (“There is nothing in the loan contract that explicitly links the loan to Howe’s production or sales, and therefore nothing in its terms, the design of the loan payment, or the repayment provisions that would tie the loan directly to export performance, or even sales performance.”).

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perceives an inconsistency between the U.S. demonstration that Launch Aid confers a benefit on Airbus and the U.S. demonstration that the provision of Launch Aid is contingent upon export performance. The EC sees the former proposition as based on the premise that “the Member State *did not anticipate* a return,” while it sees the latter proposition as based on the premise that “the Member State *did anticipate* a return.”<sup>241</sup> In fact, the EC mischaracterizes both propositions.

216. The United States does not argue that Launch Aid confers a benefit because “the Member State did not anticipate a return.” Even the statement from the U.S. first written submission quoted by the EC belies the EC’s understanding of the U.S. argument. As quoted by the EC, the United States explained that “the French government is not guaranteed any return, even of principal {on Launch Aid for the A330-200}.”<sup>242</sup> That statement of course is true and has absolutely nothing to do with whether the French government (or any other Airbus government for that matter) anticipated a return when it provided Launch Aid.

217. As the United States went on to explain following the statement quoted by the EC, the lack of a guarantee of a return to the government (due to the unsecured nature of Launch Aid financing) is one of several substantial risks that the government assumes in providing Launch Aid. Given those risks, the potential return provided for in the Launch Aid contract is substantially lower than the return a commercial investor would demand for comparable financing. It is this differential that constitutes a key benefit conferred by Launch Aid.<sup>243</sup>

218. The fact that the Airbus governments are not guaranteed a return under Launch Aid contracts is not at all inconsistent with the fact that they anticipate a return. Indeed, the same could be said of virtually any investment. A person undertakes an investment anticipating that he will recoup the amount invested plus some return. The possibility that he may recoup less than he had anticipated (*i.e.*, the fact that he is not guaranteed a return) is reflected in the rate of return he demands.

219. Thus, contrary to the EC’s argument, the fact that the Airbus governments anticipate a return on Launch Aid does not contradict the demonstration that Launch Aid confers a benefit. And the fact that the governments are not guaranteed a return does not contradict the demonstration that the provision of Launch Aid is tied to anticipated exports. Moreover, the EC wrongly portrays the United States as arguing that “the alleged {Launch Aid} subsidy is an

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<sup>241</sup> EC FWS, para. 648 (emphases in original).

<sup>242</sup> EC FWS, footnote 538 (quoting U.S. FWS, para. 237) (emphasis added).

<sup>243</sup> U.S. FWS, paras. 237-239.

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export contingent subsidy because the Member State *did anticipate* a return.”<sup>244</sup> As discussed above, it is not the anticipation of a return that makes the provision of Launch Aid export contingent; what makes Launch Aid export contingent is the conditioning of the provision of Launch Aid on a commitment by Airbus to repay the Launch Aid (including the anticipated return) over a level of sales that necessarily involves exportation.

*c. The U.S. argument does not mean that loans are more likely than grants to be found export contingent*

220. Also related to the EC’s mischaracterization of the U.S. export contingency argument is the assertion that following that argument “financial contributions that foresee a return (such as loans) are more susceptible to be found to contain a prohibited export contingent subsidy than financial contributions in the form of outright grants.”<sup>245</sup> Here again, the EC assumes incorrectly that the United States sees Launch Aid as export contingent simply because the Airbus governments “foresee a return.” But that is not the U.S. argument. It is not the foreseeing of a return that makes Launch Aid export contingent but the conditioning of the provision of Launch Aid on a commitment by Airbus to repay Launch Aid over levels of sales that necessarily involve exportation.

221. Moreover, as the United States recalled in its statement at the first Panel meeting, an actual refutation of the EC’s argument is the panel report in *Australia - Leather*. That dispute involved both a grant contract (which did not foresee a return) and a loan contract (which did foresee a return), both to a highly export-oriented company. Yet, it was the grant contract that the panel found to be export contingent, while finding the loan contract not export contingent. The possibility of a return to the government had nothing to do with the panel’s analysis. What was relevant to the distinction between the grant contract and the loan contract was the presence of a tie to anticipated exportation in the former and the absence of such a tie in the latter.<sup>246</sup>

*d. Airbus’s option to prepay Launch Aid does not undermine the contractual tie between the provision of Launch Aid and anticipated exportation*

222. An additional aspect of the EC’s futile attempt to show the absence of a tie between the provision of Launch Aid and anticipated exportation is its reference to points that have no bearing whatsoever on an export contingency analysis. The first of these is its assertion that “the

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<sup>244</sup> EC FWS, para. 648 (emphasis added).

<sup>245</sup> EC FWS, para. 569; *see also id.*, paras. 645, 684; EC FOS, para. 80.

<sup>246</sup> *See* U.S. FOS, para. 71; U.S. FWS, paras. 358-359 (discussing the panel report in *Australia - Leather*).

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contract provides for the company to elect to make accelerated repayment of both principal and interest at any time.”<sup>247</sup>

223. The very statement of this proposition clearly demonstrates why it is irrelevant. The possibility of accelerated repayment is an option that Airbus may “elect.” Unlike repayment over the number of deliveries specified in the Launch Aid contract, it is not an obligation. [

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]”<sup>250</sup> In sum, Airbus’s committing to accelerated repayment is not a condition for the governments’ provision of Launch Aid.

224. Furthermore, there is nothing uncommon about the possibility of accelerating repayment of a loan. A borrower routinely has the option to prepay its loan. If the EC were correct in suggesting that the option to prepay severs the tie between the provision of a loan and export performance, then it would be virtually impossible to ever find a subsidy provided through a loan contract to be contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement. This, to use the EC’s words, would be “manifestly absurd and unreasonable.”<sup>251</sup>

225. Finally, with respect to both the German and the UK Launch Aid contracts for the A380, not only does the option to prepay not help the EC’s argument, it actually undermines that argument. In particular, both contracts [

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<sup>247</sup> EC FWS, para. 590; *see also id.*, paras. 654, 673; EC Responses to First Panel Questions, para. 150 (third bullet point).

<sup>248</sup> German A380 Launch Aid Contract, Sec. 8, clause 1) (emphasis added), DS316-EC-BCI-0000345 (Exhibit US-72 (BCI)).

<sup>249</sup> German A380 Launch Aid Contract, Sec. 7, clause 4) (emphasis added), DS316-EC-BCI-0000345 (Exhibit US-72 (BCI)).

<sup>250</sup> UK A380 Launch Aid Contract, Arts. 5.9 and 8 (emphases added), DS316-EC-BCI-0000556 (Exhibit US-79 (BCI)).

<sup>251</sup> EC FWS, para. 569.

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226. Not only do these facts show that the prepayment option does not sever Launch Aid’s tie to export performance, they actually reinforce the tie. [

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*e. BAE’s repayment “guarantee” does not undermine the contractual tie between the provision of Launch Aid and anticipated exportation*

227. A second point to which the EC refers, but which has no bearing on an export contingency analysis, is the “guarantee” that British Aerospace Public Limited Company provides for “the obligations under the UK A380 contract.”<sup>256</sup> This point is irrelevant because, as the United States discussed in its statement at the first Panel meeting, the “guarantee” is not a guarantee of repayment of Launch Aid.<sup>257</sup> It does not protect the government against the risk that Launch Aid will not be repaid due to lack of sales of the A380. It merely provides that if BAE Systems fails to make timely payment to the UK government following delivery of an A380, the government may turn to the company’s parent for payment.<sup>258</sup>

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<sup>252</sup> German A380 Launch Aid Contract, Sec. 8, clause 2) (emphasis added), DS316-EC-BCI-0000345 (Exhibit US-72 (BCI)).

<sup>253</sup> UK A380 Launch Aid Contract, Arts. 5.9 and 8 (emphases added), DS316-EC-BCI-0000556 (Exhibit US-79 (BCI)).

<sup>254</sup> UK A380 Launch Aid Contract, Schedule 3, para. 9.1, DS316-EC-BCI-0000556 (Exhibit US-79 (BCI)).

<sup>255</sup> UK A380 Launch Aid Contract, Schedule 3, paras. 3 and 4, DS316-EC-BCI-0000556 (Exhibit US-79 (BCI)).

<sup>256</sup> EC FWS, para. 673.

<sup>257</sup> See U.S. FOS, para. 73.

<sup>258</sup> UK A380 Launch Aid Contract, Schedule 4, DS316-EC-BCI-0000556 (Exhibit US-79 (BCI)).

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228. Because the British Aerospace “guarantee” does not ensure repayment of Launch Aid regardless of whether Airbus succeeds in delivering [ ] copies of the A380, it does not sever the tie between the provision of Launch Aid and Airbus’s commitment to a level of performance that necessarily involves exportation. In this regard, the EC’s attempt to analogize British Aerospace’s “guarantee” to the security provided by Howe’s parent company (ALH) to the government of Australia in *Australia - Leather* is entirely inapposite.<sup>259</sup> In that dispute, the security provided by Howe’s parent (in the form of a lien on its assets and undertakings) was a true guarantee of repayment of the government loan, as opposed to a “guarantee” to pay levies due to the government on a per sale basis.<sup>260</sup>

229. Finally, it is notable that while the EC asserts that “{i}n all cases there are related companies or commercial activities that guarantee alternative sources of repayment,” the only cases for which it provides support are the UK A380 contract and the German A380 contract.<sup>261</sup> This is somewhat surprising in light of the approach the EC asserts it has taken in responding to the U.S. prohibited subsidy claims. The EC’s broad-brush approach to the issue of “guarantees” seems to be at odds with its assertion that “the European Communities argues by considering individually and in turn each of the seven measures at issue . . . in relation to each of which the facts and adduced ‘evidence’ are different.”<sup>262</sup> In any event, even if the parents of other companies provided “guarantees” of the sort provided by British Aerospace, they would be irrelevant to the issue at hand for the reasons just described.

*f. The commercial rationale the EC posits for conditioning the provision of Launch Aid on repayment schedules that cannot be met without exportation does not undermine the contractual tie between the provision of Launch Aid and anticipated exportation*

230. Finally, the EC seeks to show that there is no contractual tie between the provision of Launch Aid and anticipated exports by alluding to “countervailing explanations” for the Airbus governments’ decision to condition the provision of Launch Aid on Airbus’s commitment to repay Launch Aid over levels of sales that necessarily involve exports.<sup>263</sup> It asserts that “{t}he United Kingdom’s consideration of sales in assessing whether to provide financial support for

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<sup>259</sup> See EC FWS, para. 673.

<sup>260</sup> See *Australia - Leather*, paras. 9.74-9.75.

<sup>261</sup> EC FWS, footnote 570; EC Responses to First Panel Questions, footnote 44.

<sup>262</sup> EC Responses to First Panel Questions, para. 137; see also EC FOS, para. 72 (asking the Panel to “assess each of the seven measures individually on its own merits” and stressing that “{t}his is also a point to which the European Communities attaches very considerable importance”).

<sup>263</sup> EC FWS, paras. 657-666; see also EC FOS, para. 80.



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the project at issue was a prudent way to evaluate whether to invest taxpayers' money."<sup>264</sup> And it asserts that "timing repayment with deliveries also serves to allocate risk between the company and the United Kingdom."<sup>265</sup>

231. But, as the EC itself admits, these observations do not address the existence of a contractual tie between Launch Aid and export performance but, rather, "the United Kingdom's motivations for using deliveries as the trigger for repayment."<sup>266</sup> The EC fails to explain how the government's motivations for conditioning the provision of a subsidy on the recipient's commitment to repay over a level of sales that will necessarily involve exports have anything to do with determining the existence of such a contingent relationship. Even if the EC were correct in asserting that "the fact that some deliveries involve exportation was not the parties' reason for constructing the repayment terms by reference to deliveries,"<sup>267</sup> that would be entirely irrelevant.

232. Article 3.1(a) and footnote 4 of the SCM Agreement are indifferent to the "motivations" or "reason{s}" for the granting of a subsidy being tied to actual or anticipated exportation or export earnings. What is relevant is that the granting of a subsidy "is in fact tied to actual or anticipated exportation or export earnings." Accordingly, as with the other points to which the EC alludes in its effort to disprove the contractual tie between the provision of Launch Aid and Airbus's export performance, its reference to the government's "motivations" and "reason{s}" is irrelevant.

233. Moreover, as the United States discussed at the first Panel meeting, to the extent that the EC's observations have any bearing at all on the issue at hand, they actually reinforce the U.S. point with respect to export contingency.<sup>268</sup> As the EC acknowledges, when Launch Aid was provided for the A380 (and presumably for each of the other models at issue) "repayment was expected."<sup>269</sup> This means that the conditions on the provision of Launch Aid must be understood as consistent with the governments' expectation of repayment. In the case of the UK government's provision of Launch Aid for the A380, for example, repayment of Launch Aid over [ ] deliveries must be understood as consistent with the government's expectation of repayment. What that necessarily implies, given the nature of the A380 and its potential

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<sup>264</sup> EC FWS, para. 638.

<sup>265</sup> EC FWS, para. 662.

<sup>266</sup> EC FWS, para. 665 (emphasis added).

<sup>267</sup> EC FWS, para. 665.

<sup>268</sup> See U.S. FOS, paras. 67-68.

<sup>269</sup> EC FWS, para. 638.

market,<sup>270</sup> is that the government has tied the provision of Launch Aid to anticipated export sales.

234. In sum, the EC’s observation that in setting forth the repayment conditions in the Launch Aid contracts the Airbus governments were simply being “prudent” and taking into account “legitimate commercial considerations,” when coupled with an understanding of the size of the market for planes as large as the A380, amounts to an admission that the governments tied the provision of Launch Aid to anticipated exports.

**C. The EC misconstrues evidence demonstrating that the performance Airbus commits to undertake in consideration for Launch Aid is export performance**

235. In parts A and B above, the United States demonstrated that the EC’s response to the U.S. export contingency claims must fail, first, because the EC has constructed a deeply flawed analytical framework for addressing the issue (suggesting, contrary to the text of the SCM Agreement, that for a subsidy to be contingent upon export performance it must be a “consequence” of exportation), and, second, because the EC has mischaracterized U.S. arguments and relied on observations that are irrelevant (*e.g.*, Airbus’s right to prepay Launch Aid; repayment conditions’ basis in legitimate commercial considerations). A third problem with the EC’s response is that in an effort to show that the United States has somehow confused “export performance” with mere “performance,” the EC misconstrues the evidence.

236. In its first written submission, the United States provided extensive evidence demonstrating that for Airbus to meet its repayment obligations under the Launch Aid contracts for the A330-200, A340-500/600, and A380 it must export. As these repayment obligations are the key contractual condition for the governments’ provision of Launch Aid, the evidence demonstrates that the provision of Launch Aid is tied to anticipated exports within the meaning of Article 3.1(a) and footnote 4 of the SCM Agreement.<sup>271</sup>

237. The EC’s only response to this demonstration is to assert repeatedly that the repayment terms of the Launch Aid contracts are “origin neutral” and that the evidence does not show that these terms “vary at all by reference to the European Communities and the rest of the world.”<sup>272</sup> But these observations are beside the point. Indeed, they suggest a test that has absolutely no basis in the SCM Agreement.

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<sup>270</sup> See, *e.g.*, U.S. FWS, paras. 346, 354-357.

<sup>271</sup> See U.S. FWS, paras. 345-357, 363-373, 378-384, and HSBI App., paras. 26-60.

<sup>272</sup> See, *e.g.*, EC FWS, paras. 615-629.

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238. The EC seems to contend that Launch Aid would be contingent upon export performance only if the Launch Aid contracts expressly provided that repayment must be made from export sales (*i.e.*, terms that “vary . . . by reference to the European Communities and the rest of the world”). But the SCM Agreement does not provide that a subsidy is contingent upon export performance, and thus prohibited, only if the instrument tying the subsidy to actual or anticipated exportation or export earnings makes an express demarcation between domestic sales and export sales. Indeed, if such a provision existed, then the panel in *Australia - Leather* would not have been able to find the grant contract in that dispute export contingent. As the panel explained, that contract provided for “an aggregate sales performance target . . . broken down into four interim sales targets.”<sup>273</sup> It did not “vary . . . by reference to {Australia} and the rest of the world.” Nevertheless, the panel found that facts demonstrating that “the Australian market for automotive leather {was} too small to absorb Howe’s production” “effectively transform{ed} the sales performance targets into export performance targets.”<sup>274</sup>

239. The evidence in this dispute leads to a similar conclusion. The EC calls the Launch Aid contract repayment terms “origin-neutral.” But they are “origin-neutral” only if considered in a vacuum, without any reference to the realities of the market in which the LCA models at issue are sold. The United States put forward evidence from Airbus’s Global Market Forecast for 1999 demonstrating that Airbus projected demand in Europe for aircraft with more than 400 seats to represent only 23 percent of worldwide orders, or a total of just 278 aircraft.<sup>275</sup> A similar forecast appears in [

] <sup>276</sup> And the United States referred to additional corroborating evidence in its HSBI appendix.<sup>277</sup>

240. The United States also put forward evidence from the A380 Launch Aid contracts demonstrating that the Airbus governments conditioned the provision of Launch Aid on repayment over levels of sales substantially greater than 247 aircraft: [

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<sup>273</sup> *Australia - Leather*, para. 9.62.

<sup>274</sup> *Australia - Leather*, para. 9.67.

<sup>275</sup> Airbus Industrie, GMF ‘99, at 41 (Exhibit US-356). Airbus’s Global Market Forecast for 2000 projected demand in Europe for aircraft with more than 400 seats to represent only 20 percent of worldwide orders, or a total of 247 aircraft. Airbus, Global Market Forecast 2000, at 37 (Exhibit US-358); *see also* U.S. FWS, para. 346.

<sup>276</sup> *See* U.S. FWS, para. 346 (citing Anlage 1 zum A380 Darlehensvertrag, DS316-EC-BCI-0000369, at 0000388 (Exhibit US-357 (BCI))).

<sup>277</sup> *See* U.S. FWS, HSBI App., paras. 34-37.

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]<sup>278</sup> And the United States pointed out that Airbus’s forecast of European demand for 247 aircraft with more than 400 seats was a reference to total European demand, as opposed to demand for just the A380. Assuming that orders of the A380 represent less than 100 percent of forecast demand, the levels of exportation necessarily implied by the A380 Launch Aid contracts are even greater.<sup>279</sup>

241. This evidence refutes the EC’s assertion that the repayment terms in the A380 Launch Aid contracts are “origin-neutral.” They are no more so than the ostensibly origin-neutral “aggregate sales performance target” in the grant contract found to be export contingent in *Australia - Leather*.<sup>280</sup> To meet its contractual obligation to repay Launch Aid, Airbus must export. As Airbus’s undertaking of that obligation was a condition for the governments’ undertaking their obligation to provide Launch Aid, the provision of Launch Aid is tied to anticipated exportation within the meaning of Article 3.1(a) and footnote 4 of the SCM Agreement.

242. The United States put forward similar types of evidence demonstrating that the provisions of Launch Aid for the A340-500/600 and the A330-200 are contractually tied to Airbus’s commitment to repay the Launch Aid over numbers of deliveries that necessarily involve exportation.<sup>281</sup> As is the case for the A380, the EC’s assertion that the repayment terms in these contracts are “origin-neutral” ignores the evidence of the realities of the market in which these LCA models are sold.

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<sup>278</sup> U.S. FWS, paras. 353-356.

<sup>279</sup> In fact, referring to the discussion of demand for aircraft with more than 400 seats in Airbus’s 1999 Global Market Forecast, the EC states that the document “does not specifically identify the territory of the European Communities, but refers in general terms to a wider territory of ‘Europe’, which reference encompassed in 1999 (and today) a large number of other countries.” EC FWS, para. 617. That observation means that some of the 247 aircraft demand forecast for “Europe” actually constitutes exports from the EC to other parts of “Europe.” That being the case, the export performance necessarily implied by the A380 Launch Aid contracts is greater still.

<sup>280</sup> *Australia - Leather*, paras. 9.62 and 9.67.

<sup>281</sup> See U.S. FWS, paras. 363-373, 378-384, and HSBI App., paras. 45-52, 58-59. The discussion at the foregoing paragraphs of the U.S. HSBI appendix refutes the EC’s assertions at paragraphs 675 and 679 of its first written submission (and paragraph 149 of its responses to the Panel’s questions) that the United States has failed to demonstrate that the numbers of deliveries needed to repay Launch Aid for the A340-500/600 and A330-200 exceed projections of demand for those models in the EC. Moreover, the United States recalls that the EC and Spain have redacted all of the numbers from the Launch Aid repayment schedule in the Spanish contract for the A340-500/600. In light of their refusal to provide that information, the Panel should draw the logical inference that the contract requires Airbus to repay the Launch Aid over the [ ] worldwide sales anticipated in the contract. See U.S. FWS, para. 373 and footnote 441.

243. Finally, in its answer to the Panel’s Question 79, the EC set out a variation on its erroneous argument that the United States confuses “performance” with “export performance.” It asserts that “the United States is asking the Panel to read {Article 3.1(a) and footnote 4 of the SCM Agreement} as if they prohibited subsidies contingent upon export performance ‘or upon performance, if that *includes* export performance.’”<sup>282</sup> Although the EC put the latter phrase in quotation marks as if to attribute it to the United States, it provides no citation and indeed cannot do so, as the United States never said it. This is yet another instance of the EC setting up and knocking down an argument the United States has not made.

244. The United States does not argue that a subsidy is prohibited if it is contingent “upon performance, if that *includes* export performance.” The Launch Aid contracts do not merely provide for performance that includes export performance; they provide for performance that – given the LCA product and the nature of demand for that product – necessarily involves export performance. The United States relies on the actual language of Article 3.1(a) and footnote 4 of the SCM Agreement, which provides that a subsidy is prohibited if the granting of the subsidy is “tied to actual or anticipated exportation or export earnings.” The provision of Launch Aid for the A330-200, A340-500/600, and A380 is tied to anticipated exportation or export earnings as it is provided in contracts in return for Airbus’s commitment to make repayments on a per sale basis over levels of sales that necessarily involve exportation. The possibility that Airbus may also make some sales that do not involve exportation does not sever the tie to anticipated exportation, as the EC seems to suggest.

**D. The EC’s attempt to distinguish the circumstances of this dispute from *Australia - Leather* is fatally flawed**

245. In the above parts of the discussion of export contingency, the United States has referred to the panel report in *Australia - Leather*, elaborating on how the findings in that report support the U.S. claims here and showing how the EC misrepresents those findings.<sup>283</sup> In this part, the United States will make several additional points demonstrating that the EC misreads the *Australia - Leather* report.

246. First, the EC ascribes undue significance to the fact that the recipient of the grant contract in *Australia - Leather* (the Howe company) was “*the only Australian exporter of automotive leather.*”<sup>284</sup> Contrary to the EC’s characterization, the panel did not describe this fact as “integral

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<sup>282</sup> EC Responses to First Panel Questions, para. 144.

<sup>283</sup> See also U.S. FWS, paras. 334-342, 358-359; U.S. Responses to First Panel Questions, paras. 77-79, footnotes 82 and 83.

<sup>284</sup> EC FWS, para. 668 (emphasis in original).

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and necessary.”<sup>285</sup> It described it as “relevant” and one of several facts that “support{ed}” the panel’s conclusion.<sup>286</sup> And, in any event, Airbus is the only EC exporter of LCA.

247. Second, as discussed above, in trying to making the *Leather* report fit within its non-text-based “condition-consequence” framework, the EC mischaracterizes key facts of the dispute.<sup>287</sup> In particular, it neglects to mention that one of the three grant disbursements found to be export contingent was made upon the signing of the grant contract, before any of the anticipated exportation had occurred. It also neglects to mention the panel’s rejection of Australia’s argument that “a change in Howe’s level of exports would not affect the disbursement of the funds” as legally irrelevant.<sup>288</sup>

248. Third, the EC ascribes undue significance to the fact that Australia provided the grant contract to Howe after automotive leather was removed from eligibility for benefits under certain other programs.<sup>289</sup> As with Howe’s status as the sole exporter of automotive leather, this fact was “tak{en} into consideration,”<sup>290</sup> but not treated as dispositive.

249. Fourth, the EC’s attempt to compare the loan contract at issue in *Australia - Leather* to the Launch Aid contracts at issue here ignores that unlike Airbus’s sale-based repayment obligations under the Launch Aid contracts, the *Leather* panel found “nothing in the loan contract that explicitly links the loan to Howe’s production or sales, and therefore nothing in its terms, design of the loan payment, or the repayment provisions that would tie the loan directly to export performance, or even sales performance.”<sup>291</sup>

250. Finally, as discussed above, the EC’s references to Airbus’s “right” to prepay Launch Aid and to the “guarantee” of performance provided in one of the Launch Aid contracts are entirely irrelevant. In any event, these facts bear no resemblance to the “lien on the assets and undertakings of ALH {Howe’s parent}” that secured repayment of Australia’s loan to Howe.<sup>292</sup>

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<sup>285</sup> EC FWS, para. 668.

<sup>286</sup> *Australia - Leather*, para. 9.69.

<sup>287</sup> See EC FWS, para. 669.

<sup>288</sup> *Australia - Leather*, para. 9.70.

<sup>289</sup> EC FWS, para. 670.

<sup>290</sup> *Australia - Leather*, para. 9.63.

<sup>291</sup> *Australia - Leather*, para. 9.74.

<sup>292</sup> *Australia - Leather*, para. 9.75.

**E. The EC’s reliance on the SCM Agreement preparatory work is unfounded, as it addresses arguments the United States does not make**

251. At the conclusion of the EC’s discussion of export contingency in its first written submission, the EC engages in a review of certain portions of the preparatory work for the SCM Agreement. Recourse to this supplementary means of interpretation is appropriate only in certain circumstances, such as when the interpretation of a provision in accordance with its ordinary meaning in context and in light of the agreement’s object and purpose would “leave the meaning ambiguous or obscure” or “lead to a result which is manifestly absurd or unreasonable.”<sup>293</sup>

252. The EC asserts that recourse to the preparatory work as a supplementary means of interpretation is appropriate based on its belief that the U.S. approach to Article 3.1(a) of the SCM Agreement would lead to manifestly absurd or unreasonable results. However, that belief is founded on arguments the United States has not made.

253. As discussed above, the United States does not argue that “an outright subsidy grant . . . should be treated more favourably than a financial contribution that foresees a return.”<sup>294</sup> Nor does it argue that “any subsidy to a company operating in a global market, and which is anticipated to make global sales in the future, is a prohibited export contingent subsidy.”<sup>295</sup> As already mentioned, if the United States actually believed the latter proposition to be true, then the Panel must wonder why the United States has not challenged the numerous subsidies to Airbus other than seven provisions of Launch Aid at issue here as export contingent.

254. Since the United States does not make the arguments the EC addresses, the EC’s reliance on the SCM Agreement preparatory work is not appropriate and, in any event, does nothing to further its case and does not merit any further discussion.

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<sup>293</sup> *Vienna Convention on the Law of Treaties*, art. 32; see EC FWS, para. 682.

<sup>294</sup> EC FWS, para. 684.

<sup>295</sup> EC FWS, para. 685.

**VI. LOANS TO AIRBUS FROM THE EUROPEAN INVESTMENT BANK ARE SPECIFIC SUBSIDIES WITHIN THE MEANING OF THE SCM AGREEMENT**

255. From time to time, the European Investment Bank (“EIB”) – “the EU’s policy-driven bank,”<sup>296</sup> which promotes itself as a “not-for-profit institution” that “passes on the benefits {of its “excellent ‘AAA’ credit reputation”} to its clients in the form of loans at fine rates”<sup>297</sup> – has loaned money to Airbus for the development of large civil aircraft. This financing includes a Euro 700,000,000 loan for the A380 in 2002, and an additional 1,060,000,000 in loans provided from 1988 to 1993 for the development of various Airbus models.<sup>298</sup>

256. In its first written submission, the United States demonstrated that the EIB loans confer a benefit on Airbus within the meaning of Article 1.1(b) of the SCM Agreement. In particular, the loans constitute financial contributions to Airbus provided on terms more favorable than those available in the market. Accordingly, the loans constitute subsidies under Article 1 of the SCM Agreement.<sup>299</sup> Additionally, the United States showed that these subsidies are specific within the meaning of Article 2 of the SCM Agreement. It showed that the EIB does not provide the loans automatically, but rather on a discretionary basis, that each loan is separately negotiated directly with the relevant Airbus company, and that the amounts of EIB loans Airbus has received are disproportionately large.<sup>300</sup>

257. The EC responded principally by contesting that the EIB loans are specific and that they confer a benefit.<sup>301</sup> In its answers to the Panel’s Questions 13-15, the United States showed that

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<sup>296</sup> European Investment Bank, *Financing Europe’s Future*, at 1 (Exhibit US-151).

<sup>297</sup> EIB, FAQs, Projects & Loans at 1-2, <http://www.eib.org/faq/faq.asp?faq=65> (emphasis added) (Exhibit US-160).

<sup>298</sup> See U.S. FWS, paras. 395 and 407.

<sup>299</sup> See U.S. FWS, paras. 396-404, 409-416.

<sup>300</sup> See U.S. FWS, paras. 405-406, 417-420.

<sup>301</sup> See EC FWS, paras. 1012-1055, 1056-1103. The EC also made certain other arguments, which the United States has addressed in its answers to the Panel’s questions. For example, the EC contends that loans whose face amounts have been repaid are not properly before the Panel. See EC FWS, paras. 1001-1003. The United States addressed this issue in its response to the Panel’s Question 18, noting among other things that a subsidized loan may continue to provide a benefit or cause adverse effects after it is repaid, just as a subsidy grant may continue to provide a benefit or cause adverse effects after it is granted. See U.S. Responses to First Panel Questions, paras. 127-129. Additionally, in discussing the EIB loan claims as well as various other claims, the EC asserted that the United States failed to meet a supposed requirement to show that subsidies “passed through” to Airbus SAS when the recipients of those subsidies reorganized their relationship to one another to form that company in 2001. See EC FWS, paras. 1057-1059. The United States addressed this issue in its response to the Panel’s Question 16, noting among other things that the EC had borrowed the concept of “pass through” from one context and sought to apply it



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the EC has failed to rebut the U.S. demonstration of specificity. Among other flaws, the EC's argument relies heavily on an approach to disproportionality for purposes of determining whether a subsidy is *de facto* specific that would measure each loan provided by the EIB against the totality of EIB lending over its entire five-decade-long history – an approach that effectively would excuse massive, long-established subsidy programs such as the EIB from the disciplines of the SCM Agreement.<sup>302</sup> The U.S. response to the Panel's Question 19 also demonstrated that the EC is wrong to suggest that EIB loans do not confer a benefit on Airbus because of supposed (but completely unsubstantiated) "obligations imposed by the EIB" that, according to the EC, a commercial lender does not impose on its borrowers.<sup>303</sup>

258. In the present submission, the United States first will show that the EC errs in contending that EIB loans do not confer a benefit on Airbus. The United States then will elaborate on its demonstration from previous submissions that the EIB loans to Airbus are specific within the meaning of Article 2 of the SCM Agreement.

**A. The EC fails to show that loans provided to Airbus by the policy-driven, non-profit, triple-A rated EIB do not confer a benefit on Airbus**

259. In its first written submission, the United States referred to the EIB's own statements and compared the terms of the EIB's loans to Airbus with a market benchmark to demonstrate that the loans confer a benefit on Airbus. The EC's criticisms of both aspects of the U.S. *prima facie* case are unfounded.

1. The EIB readily acknowledges that it lends on terms more favorable than those available in the market

260. The United States has presented evidence showing that the EIB's very purpose is to provide financing on terms more favorable than those available in the market. For example, the EIB Statute states:

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in an unrelated context, even though the SCM Agreement imposes no requirement on the United States to undertake the accounting exercise the EC suggests. *See* U.S. Responses to First Panel Questions, paras. 108-123; *see also id.*, paras. 124-126 (addressing related issue of EC's allegation that [ ] [ ]).

<sup>302</sup> *See* U.S. Responses to First Panel Questions, paras. 81-107; 365-370.

<sup>303</sup> *See* U.S. Responses to First Panel Questions, paras. 130-135.

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{T}he Bank shall grant loans to its members or to private or public undertakings for investment projects to be carried out in the European territories of Member States, to the extent that funds are not available from other sources on reasonable terms.<sup>304</sup>

261. Similarly, in describing its role to the public, the EIB touts the benefits of the financing it provides as follows:

{B}anking by the member states gives the EIB the highest possible credit rating (AAA). . . This in turn enables the Bank to invest in projects of public interest that would otherwise not get them money – or would have to borrow it more expensively.<sup>305</sup>

262. The EC misleadingly attempts to downplay the unmistakable import of these and other similar admissions of the benefit conferred by EIB loans. For example, the EC asserts that the requirements that EIB interest rates “be set at a level enabling EIB ‘to meet its obligations, to cover its expenses and to build up a reserve fund’” and that the EIB “‘not grant any reduction in interest rates’” mean that “the bank’s Statute expressly prohibits the bank from subsidising any borrower.”<sup>306</sup> But that is not what these provisions mean.

263. All banks – regardless of whether they are for-profit or (as the EIB) not-for-profit – are required “to meet . . . obligations, to cover . . . expenses and to build up a reserve fund.”<sup>307</sup> The mere fact of having to do these things does not mean that the terms of EIB loans are not more favorable than those available in the market. What distinguishes a market lender from the EIB is that a market lender, in addition to meeting obligations, covering expenses, and building up a reserve fund, seeks a profit, whereas the EIB does not. The EIB confirms this in explaining that the only “surplus” that the EIB achieved in the period 1988 to 2005 was used for its reserve fund.<sup>308</sup>

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<sup>304</sup> Statute of the EIB, Art. 18(1) (emphasis added) (Exhibit US-150); see U.S. FWS, para. 401.

<sup>305</sup> EIB, What Does the Bank Do? [http://europa.eu.int/institutions/eib/index\\_en.htm](http://europa.eu.int/institutions/eib/index_en.htm) (Exhibit US-153); see also U.S. FWS, paras. 398-399.

<sup>306</sup> EC FWS, paras. 1061-1062 (quoting Statute of the EIB, Arts. 19(1) and 19(2)); see also EC Responses to First Panel Questions, para. 196.

<sup>307</sup> See, e.g., Basel II capital requirements, para. 40 (Exhibit US-539).

<sup>308</sup> See EIB Website, “Liquidity - Reserves - Risk Management,” [http://www.eib.org/investor\\_info/borrower/creditstanding/liquidity-reserves-risk-management.htm](http://www.eib.org/investor_info/borrower/creditstanding/liquidity-reserves-risk-management.htm) (Exhibit US-540); see also EIB Website, “What is the EIB’s financial profile?” [http://www.eib.org/investor\\_info/borrower/creditstanding/liquidity-reserves-risk-management.htm](http://www.eib.org/investor_info/borrower/creditstanding/liquidity-reserves-risk-management.htm) (Exhibit US-541).

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264. Further, the prohibition in Article 19(2) of the EIB Statute on “grant{ing} any reduction in interest rates” is not a prohibition on providing financing on terms better than those available in the market, as the EC suggests. It simply prevents the EIB from charging a rate that would not enable it “to meet its obligations, to cover its expenses and to build up a reserve fund.”

265. The EC’s attempt to discount the significance of Article 18(1) of the EIB Statute is similarly unavailing. Article 18(1) states:

Within the framework of the task set out in Article 267 of {the EC} Treaty, the Bank shall grant loans to its members or to private or public undertakings for investment projects to be carried out in the European territories of Member States, to the extent that funds are not available from other sources on reasonable terms.<sup>309</sup>

266. The EC does not explain why this language does not constitute an admission that the role of the EIB is to provide financing on better-than-market terms. Instead, it asserts that Article 18(1) “can be compared with” provisions in the statutes of the World Bank and other multilateral institutions and that the United States described this “type of language” in a U.S. regulation as “hortatory.”<sup>310</sup> Even if these assertions were true (a point that the United States does not concede), they would be entirely irrelevant to the matter at hand. The meaning of Article 18(1) of the EIB Statute, read in context, is clear and is not affected by provisions in the statutes of other organizations or in other countries’ laws that the EC deems to be “comparable” or of the same “type.”<sup>311</sup>

267. Finally, unable to avoid the various admissions by the EIB about the preferential nature of its lending practices, the EC asserts that “the *SCM Agreement* is not concerned, when

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<sup>309</sup> Statute of the EIB, Art. 18(1) (Exhibit US-150). As quoted at paragraph 1005 of the EC’s first written submission, Article 267 of the EC Treaty confirms, *inter alia*, that the EIB is to “operat{e} on a non-profit making basis.”

<sup>310</sup> EC FWS, paras. 1063-1065.

<sup>311</sup> The EC’s suggestion that in the *US - Cotton Subsidies (Article 21.5)* dispute the United States characterized “the very same type of language included in Article 18 of the EIB Statute” as “nothing more than ‘hortatory’” (EC FWS, para. 1065) is entirely misleading. First, the EC incorrectly attributes the language that it quotes to a U.S. regulation. *Id.* In fact, the quoted language is Brazil’s (erroneous) characterization of certain language from the U.S. regulation. See *United States – Subsidies on Upland Cotton*, Recourse to Article 21.5 of the DSU by Brazil, U.S. First Written Submission, para. 108 (Dec. 15, 2006) (quoting Brazil First Submission, para. 357), available at [http://www.ustr.gov/assets/Trade\\_Agreements/Monitoring\\_Enforcement/Dispute\\_Settlement/WTO/Dispute\\_Settlement\\_Listings/asset\\_upload\\_file545\\_5598.pdf](http://www.ustr.gov/assets/Trade_Agreements/Monitoring_Enforcement/Dispute_Settlement/WTO/Dispute_Settlement_Listings/asset_upload_file545_5598.pdf).

Second, the United States did not argue that the “type” of language actually used in the U.S. regulation at issue was necessarily “merely ‘hortatory.’” Rather, the United States showed that this language was hortatory as a matter of fact given that guarantees were made to “scores of . . . foreign bank obligors {that} enjoy an investment grade credit rating.” See *id.*, para. 110.

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analyzing a subsidy, with whether the grantor as an abstract matter ‘seeks’ a certain rate of return,” and that “what matters is whether a benefit is conferred on the recipient of the challenged financial contribution.”<sup>312</sup>

268. The United States does not disagree that the relevant question is whether a benefit is conferred on the recipient. In showing that the EIB, like the TPC program at issue in *Canada - Aircraft*, “neither seeks nor earns a commercial rate of return,”<sup>313</sup> the United States has not suggested a different standard for the determination of benefit; in particular, it has not suggested a cost-to-government approach. Rather, this fact shows that the EIB’s AAA credit rating coupled with its non-profit status translates into a benefit to EIB loan recipients, such as Airbus. The fact that the EIB provides loans at cost whereas commercial banks seek a profit by definition demonstrates the conferral of a benefit on Airbus as the recipient of EIB loans.<sup>314</sup>

### 2. The EC admits that EIB loans before 1999 did not include a risk premium

269. Despite its efforts to deny that EIB loans confer a benefit on Airbus, the EC openly admits that prior to 1999 – thus, with regard to the loans provided to Airbus from 1988 to 1993 – interest on EIB loans did not include a risk premium.<sup>315</sup> In other words, EIB loans prior to 1999 were by definition preferential to those available in the market, because the EIB (unlike a market lender) did not charge a premium to compensate the risk it assumed in providing financing to the borrower.

270. Even with respect to the 2002 EIB loan to EADS for A380 development, the EC is less than clear as to whether the interest rate actually included a risk premium. It simply asserts that “{a} risk premium also is applicable to the [

]”<sup>316</sup> It provides no evidence to substantiate this assertion. Nor does it identify the level of the

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<sup>312</sup> EC Responses to First Panel Questions, para. 197.

<sup>313</sup> *Canada - Aircraft (Panel)*, para. 9.314; see also U.S. FWS, para. 413.

<sup>314</sup> The panel in *Canada - Aircraft* concluded that TPC assistance constituted a subsidy because TPC “neither seeks nor earns a commercial rate of return.” *Canada - Aircraft (Panel)*, paras. 9.314-9.315. In a bizarre non-sequiter, the EC suggests that that conclusion is not relevant here because in that dispute “Canada refused to provide any documentation of the specific terms of the measures in question.” EC Responses to First Panel Questions, para. 194. The United States fails to see what Canada’s non-cooperation in the *Canada - Aircraft* dispute has to do with the legal conclusion that a financial contribution by a government entity that neither seeks nor earns a commercial rate of return is a subsidy.

<sup>315</sup> EC FWS, para. 1070.

<sup>316</sup> EC FWS, para. 1071.



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economic consulting firm calculated an appropriate market benchmark and demonstrated that the rates under the EIB loans are lower than the benchmark, thus conferring a benefit on Airbus.<sup>321</sup>

275. NERA concludes that the commercial rate for a loan with the characteristics of the 2002 EIB loan to EADS (European borrower, rated A3/A-, loan in Eurodollars, 10-year maturity) would have been 5.68 percent in [ ]<sup>322</sup> That is approximately [ ] basis points [ ] than the actual rate the EIB charged of [ ]<sup>323</sup>.

276. For the 1992 loan to Aérospatiale, NERA calculates a benchmark rate of 10.46 percent.<sup>324</sup> That is approximately [ ] basis points [ ] than the actual rate the EIB charged of [ ] percent.<sup>325</sup>

277. Thus, with respect to the EIB loans for which the EC has provided relevant information, NERA confirms the conclusion that results from the EIB's own statements and the analysis set out in the U.S. first written submission: EIB loans confer a benefit on Airbus.

278. Moreover, as noted in the U.S. first written submission, in addition to the interest rate differential, another feature that makes at least the 2002 EIB loan preferential as compared to market-based loans is the absence of a commitment fee.<sup>326</sup> The EC responds that the absence of a commitment fee is due to a borrower's uncertainty as to when financing provided by the EIB will be disbursed and what the final interest rate (which the EC says is set at a date after the loan contract is signed) will be.<sup>327</sup> However, the EC provides no basis for asserting that a commercial borrower faces any less uncertainty in this respect than a borrower from the EIB. And, more fundamentally, the EC misunderstands the purpose of a commitment fee. As the NERA EIB Loans to Airbus report explains, when a lender commits to provide a borrower funding at a later date it is giving the borrower a valuable option. A commitment fee compensates the lender for

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<sup>321</sup> See NERA, The EIB Loans to Airbus (Exhibit US-542) (BCI).

<sup>322</sup> NERA, The EIB Loans to Airbus, p. 7 (Exhibit US-542) (BCI).

<sup>323</sup> See EC FWS, para. 1094.

<sup>324</sup> NERA, The EIB Loans to Airbus, p. 6 (Exhibit US-542) (BCI).

<sup>325</sup> See DS316-EC-BCI-0000644.

<sup>326</sup> See U.S. FWS, para. 402.

<sup>327</sup> EC Responses to First Panel Questions, paras. 202-203.

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providing that option. This is unrelated to the possibility of a delay between a borrower's eventual request to draw on the funding and actual disbursement.<sup>328</sup>

4. The EC's proposed commercial benchmark for the 2002 EIB loan is methodologically flawed and substantially understates the commercial rate

279. Finally, while the EC purports to calculate its own commercial benchmark (at least with respect to the 2002 EIB loan),<sup>329</sup> its methodology suffers from a number of serious flaws, as also discussed in the NERA EIB Loans to Airbus report. First, the EC bases its benchmark on bonds issued by domestic borrowers in the United States, disregarding known yield differences between such bonds and dollar-denominated bonds issued by borrowers outside the United States. (That is, rates on the latter tend to be about 30 to 33 basis points higher than rates on the former.) Second, the EC makes the mistake of using a benchmark that is quoted on a semi-annual basis even though the EIB loan at issue has an interest rate quoted [ ] – another error that results in an understated benchmark. Third, as already noted, the EC fails to take into account the fact that a commercial lender would charge the borrower a commitment fee for the valuable option of being able to draw on financing at a later date.<sup>330</sup> In view of these and other errors that NERA discusses, the EC's benchmark fails to rebut the U.S. demonstration that EIB loans confer a benefit on Airbus.

**B. The EC fails to rebut the U.S. showing that the EIB loans to Airbus are specific**

280. In its first written submission, the United States demonstrated that the EIB loans to Airbus are specific within the meaning of Article 2 of the SCM Agreement. In particular, the United States showed that the 2002 EIB loan is disproportionately large in comparison to other relevant funding under the EIB's "i2i" loan program and that it was provided as a discretionary "individual" loan.<sup>331</sup> With regard to the 1988 - 1993 loans, the United States showed that eligibility for those loans was far from automatic; that they were all "individual loans;" and that the amounts of these loans, too, are disproportionately large.<sup>332</sup>

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<sup>328</sup> See NERA, *The EIB Loans to Airbus*, p. 4 and footnote 7 (Exhibit US-542) (BCI).

<sup>329</sup> See EC FWS, paras. 1090-1103.

<sup>330</sup> See NERA, *The EIB Loans to Airbus*, pp. 3-5 (Exhibit US-542) (BCI).

<sup>331</sup> See U.S. FWS, paras. 405-406; see also U.S. Responses to First Panel Questions, paras. 92-102.

<sup>332</sup> See U.S. FWS, paras. 418-420; see also U.S. Responses to First Panel Questions, paras. 103-107.

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281. In its response, the EC first asserts that the EIB loans are not specific under Article 2.1(a) of the SCM Agreement because, in its view, “EIB financing is not limited to any enterprise, industry or group thereof.”<sup>333</sup> Second, the EC tries to demonstrate that the EIB loans are *de jure* non-specific under Article 2.1(b) of the SCM Agreement because, in its view, “the EIB uses *objective* criteria and a single uniform appraisal methodology applied *across the board* in the same manner to any project.”<sup>334</sup> Finally, the EC contends that the loans are not *de facto* specific under Article 2.1(c) because, it asserts, the amounts of the loans are not disproportionately large.<sup>335</sup>

282. The United States has already rebutted this last argument (regarding disproportionality) in detail in its responses to the Panel’s Questions 13-15 and 119.<sup>336</sup> Here, it will focus on the EC’s Article 2.1(b) argument and then briefly address the EC’s Article 2.1(a) argument.

1. The EIB loans to Airbus are not *de jure* non-specific under Article 2.1(b) of the SCM Agreement

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

Where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions<sup>2</sup> governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to. The criteria or conditions must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification.

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<sup>2</sup> Objective criteria or conditions, as used herein, mean criteria or conditions which are neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application, such as number of employees or size of enterprise.

284. Article 2.1(b) states the conditions under which a subsidy is to be considered *de jure* non-specific, just as Article 2.1(a) states the conditions under which a subsidy is to be considered *de jure* specific.<sup>337</sup> As a third party in the *US - Softwood Lumber CVD Final* dispute, the EC explained the distinction between specificity and non-specificity by stating that Article 2.1

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<sup>333</sup> EC FWS, para. 1022.

<sup>334</sup> EC FWS, para. 1023.

<sup>335</sup> EC FWS, paras. 1032-1050.

<sup>336</sup> See U.S. Responses to First Panel Questions, paras. 81-107 and 365-370.

<sup>337</sup> See generally U.S. Responses to First Panel Questions, paras. 354-359.



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requires an assessment of ‘general availability’, that is a determination of whether a subsidy selectively benefits certain industrial sectors or certain enterprises, or is rather a broad economic policy measure, such as the reduction of corporate taxes.<sup>338</sup>

285. The EC fails to show that EIB lending meets the EC’s own previous articulation of what is required to show that a subsidy is non-specific or, more importantly, the standard for *de jure* non-specificity set out in Article 2.1(b) of the SCM Agreement. In fact, despite repeated assertions that eligibility for EIB lending is “objective” and “automatic,” the EC’s position is belied by its own explanation.

286. In particular, the EC describes multiple layers of review that must be completed in order for the EIB to approve a loan application. These include: “the determination of eligibility . . . by the analyst/engineer/economist assigned to a project;” consideration by “the EIB’s project appraisal team” “composed of representatives of all the concerned Directorates of the bank;” Management Committee decision “whether or not to submit a loan proposal to the Board of Directors;” and Board of Directors decision whether or not to grant the loan.<sup>339</sup> This process shows that obtaining an EIB loan is anything but “automatic.” To the contrary, it indicates the exercise of discretion at each step of the way.

287. Not only does the EIB loan decision process as described by the EC show that eligibility is not automatic, but the factors considered during that process show that the criteria or conditions governing eligibility are subjective rather than objective. The EC states that determination of eligibility “flow{s} from the *Eligibility Guidelines*.”<sup>340</sup> Yet a review of the Eligibility Guidelines reveals just how subjective they are. The guidelines are broken down by “eligibility title,” with each such title containing a list of “categories of investment.” For example, categories of investment listed under the “economic and social cohesion” eligibility title include such vague categories as “improvement of the efficiency and/or quality of the infrastructure” and “alleviation of social problems or exclusion.”<sup>341</sup> Similarly, categories of investment listed under the “environment” eligibility title include items such as “renewable energy (wind, solar, biomass, biofuels, etc.)” and “waste management (including waste

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<sup>338</sup> Third Party Oral Statement by the European Communities, *US - Softwood Lumber CVD Final (Panel)*, paras. 14, 15 (Feb. 12, 2003) (emphasis added) (Exhibit US-476).

<sup>339</sup> See EC FWS, paras. 1025-1028.

<sup>340</sup> EC FWS, para. 1025.

<sup>341</sup> *EIB - Eligibility Guidelines – Checking consistency of EIB operations with EU Objectives*, p. 7 (“*EIB Eligibility Guidelines*”) (Exhibit EC-161).

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reduction, re-use, recovery & disposal).<sup>342</sup> Other categories reflect a similar level of subjectivity.<sup>343</sup>

288. With respect to the project appraisal step in the EIB loan approval process, the EC again refers to subjective factors, such as “economic benefits,” that require an exercise of discretion on the part of the project appraisal team.<sup>344</sup>

289. The EC’s response to the Panel’s Question 84 further reveals the serious flaws in the EC’s effort to portray EIB lending as *de jure* non-specific under Article 2.1(b). The Panel asked the EC to explain how the criteria in the EIB Eligibility Guidelines are of the same nature as those described in footnote 2 of the SCM Agreement, “in particular, how they are ‘economic in nature and horizontal in application, such as number of employees or size of enterprises.’”

290. The EC’s response began with a convoluted explanation of the EC’s understanding of footnote 2 that did not actually address the question posed. The explanation culminated in an illustration in which a WTO Member decides “to adopt a measure which would grant some financial contribution, e.g. 100 000 EUR, to all environment-friendly projects, across all sectors and to all companies regardless of their size.” In the EC’s view, “such a measure would be non-specific as companies from all sectors can participate.”<sup>345</sup>

291. However, what the EC fails to acknowledge is that the example it gives does not meet footnote 2’s definition of “objective criteria or conditions” precisely because someone must decide whether a given project is “environment-friendly” in the first place. In this respect, the EC’s example is unlike the examples in footnote 2 – “number of employees or size of enterprise” – which are criteria or conditions that can be objectively determined. Determining whether a project meets the criterion or condition of being “environment-friendly” requires an exercise of subjective judgment and, therefore, is not “objective” within the meaning of Article 2.1(b) and footnote 2. For the same reason, the criteria in the EIB Eligibility Guidelines are not “objective” within the meaning of those provisions.<sup>346</sup>

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<sup>342</sup> *EIB Eligibility Guidelines*, pp. 23-24 (Exhibit EC-161).

<sup>343</sup> See generally EC FWS, para. 1006 (describing EIB “main policy objectives” in terms that make clear that criteria are not “objective,” “neutral,” and “economic in nature”).

<sup>344</sup> EC FWS, para. 1027. See EIB, “The Project Cycle at the European Investment Bank,” at 4 (July 12, 2001) (Exhibit US-166) (explaining that criteria for each EIB appraisal “are tailored to each individual project”).

<sup>345</sup> EC Responses to First Panel Questions, para. 184.

<sup>346</sup> The EC’s confusion in understanding Article 2.1(b) is further reflected in its counter-example. The EC states that if a Member decided “to adopt a measure granting the same amounts to environment-friendly projects in the steel industry, for instance, the Member would be granting a specific measure that would not qualify as including

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292. After setting out its flawed understanding of footnote 2, the EC then purports to apply that understanding to the EIB Eligibility Guidelines. However, its discussion amounts to little more than unsubstantiated assertion. For example, it calls the Guidelines “a very good example of criteria which are economic in nature and horizontal in application, and which are not favouring enterprises of any sector (or even any size),” but provides absolutely no demonstration of why this characterization is accurate.<sup>347</sup> As discussed above, it is not.

293. The EC goes on to state that applying the EIB Eligibility Guidelines “is obviously objective as it is neutral, does not discriminate against certain undertakings and it is economic in nature in the sense of its inherent or essential quality and effect as well as it is horizontal in application.”<sup>348</sup> But while this statement uses terms that appear in Article 2.1(b) of the SCM Agreement, the EC never explains how the EIB program comports with those terms. Accordingly, the EC has failed to show that EIB lending is *de jure* non-specific.

2. EIB loans are specific as they are provided in the form of individual loans that are subject to significant discretion

294. With almost no discussion, the EC asserts that “{t}he challenged EIB loans . . . cannot be specific under Article 2.1(a) *SCM Agreement*.”<sup>349</sup> It appears to base that position on the absence of explicit limitations on eligibility for EIB loans. However, as the United States explained in response to the Panel’s Question 117, if the unique terms and conditions of a given subsidy contract are sufficiently different from the terms and conditions of other contracts granted under the same subsidy program, this can cause the subsidy at issue to fall outside the parameters of the broader program of which it is a part. In that case, the subsidy ought to be considered separately from the larger program for purposes of a *de jure* specificity analysis under Article 2.1(a) of the SCM Agreement. The granting authority, through the unique terms and conditions of the contract, “explicitly limits access to a subsidy to certain enterprises,” which subsidy therefore should be found to be specific under Article 2.1(a).<sup>350</sup>

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‘objective criteria or conditions’ as defined by footnote 2.” EC Responses to First Panel Questions, para. 184. But in that example, the subsidy would be considered specific under Article 2.1(a) and there would not be any need to analyze whether the measure included “objective criteria or conditions” within the meaning of footnote 2.

<sup>347</sup> EC Responses to First Panel Questions, para. 187.

<sup>348</sup> EC Responses to First Panel Questions, para. 188.

<sup>349</sup> EC FWS, para. 1022.

<sup>350</sup> See U.S. Responses to First Panel Questions, paras. 349-352.

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295. In this regard, the United States reminds the Panel that the EC has refused to provide the information that the Panel would need to evaluate the unique terms and conditions of most of the EIB loans at issue. Of the 12 loans, the EC provided information on the terms and conditions of only the 2002 loan to EADS for R&D related to the A380 and the 1992 loan to Aérospatiale related to the A330/A340. Moreover, the EC refused to provide information about other EIB lending that might allow for an analysis of the manner in which the EIB exercised its discretion in providing loans to Airbus as compared with other borrowers.<sup>351</sup>

296. The EC states that “the EIB uses in its contracts a standard form of provisions and clauses” and provides an example as Exhibit EC-609.<sup>352</sup> However, while this standard form contains certain boilerplate language that apparently is standard from one contract to another, it shows that the EIB does not take a standard approach to matters such as [ ] and other terms that could distinguish a given loan from other loans that are typical of a program.<sup>353</sup>

297. In short, the EC has not shown that the EIB loans “cannot be specific under Article 2.1(a) *SCM Agreement*.”<sup>354</sup>

### **VII. THE EC’S ERRONEOUS UNDERSTANDING OF “GENERAL INFRASTRUCTURE” AND REGIONAL SPECIFICITY, AS WELL AS RELATED ERRORS, FAIL TO UNDERMINE THE U.S. SHOWING THAT PROVISION OF INFRASTRUCTURE AND INFRASTRUCTURE-RELATED GRANTS ARE SUBSIDIES**

298. In its first written submission, the United States showed that the Airbus governments provide subsidies to Airbus by providing it with infrastructure on better-than-market terms and by providing it with infrastructure-related grants. The EC’s response rests largely on the argument that much of what the United States has challenged constitutes “general infrastructure” within the meaning of Article 1.1(a)(1)(iii) of the *SCM Agreement* and, therefore, is excluded from the definition of “subsidy.” To make that argument, the EC asserts a broad definition of

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<sup>351</sup> See *Replies to Questions by the Facilitator under Annex V of the SCM Agreement by the European Communities* (Nov. 18, 2005), Q80 and Q82 (Exhibit US-5 (BCI)).

<sup>352</sup> EC Responses to First Panel Questions, para. 192.

<sup>353</sup> See, e.g., Exhibit EC-609 (BCI), para. 1.04 (leaving a blank to fill in [ ]); 3.01 (leaving a blank for [ ]); 4.01 (leaving blank the [ ]); and 4.03 (indicating that [ ]).

<sup>354</sup> EC FWS, para. 1022.

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“general infrastructure” that finds no support in the text, context, or object and purpose of the SCM Agreement or, indeed, in the EC’s own practice under its state aids regime.

299. Additionally, the EC responds to U.S. claims regarding infrastructure-related grants by arguing that the grants are available to all enterprises (as opposed to a subset of enterprises) within a designated geographical region within the jurisdiction of the granting authority. The EC misreads Article 2.2 of the SCM Agreement as providing that subsidies provided within a particular region are specific only if they are provided to a subset of enterprises within the region – a reading that would render Article 2.2 redundant with Article 2.1(a). As with its theory of general infrastructure, this theory of regional specificity lacks support in the text, context, or object and purpose of the SCM Agreement or, indeed, in the EC’s own practice under its countervailing duty law.

300. Finally, the EC seeks to overcome the U.S. factual demonstration of the existence of various infrastructure-related subsidies. But as shown in previous submissions and statements, and as will be shown further below, the EC fails in this line of argument as well.

301. In this part of its submission, the United States will begin by making a few points about the meaning of the term “general infrastructure” (elaborating on the U.S. response to the Panel’s Question 20).<sup>355</sup> The United States then will address the EC’s arguments regarding the industrial site that German authorities created for and provided to Airbus by filling wetlands at the Mühlenberger Loch. Next, the United States will address the EC’s theory regarding regional specificity as it applies to German and Spanish infrastructure-related grants.

302. In its answers to the Panel’s questions, the United States provided detailed discussions of its claims regarding the infrastructure provided to Airbus in Toulouse, France and in Bremen, Germany.<sup>356</sup> Therefore, the United States will touch only briefly on those claims, as well as certain factual issues regarding its other infrastructure-related claims.

**A. The “general infrastructure” exception to the definition of “subsidy” is not an exception for any grant of infrastructure that fulfills public policy goals**

303. Article 1.1 of the SCM Agreement deems a subsidy to exist if there is a financial contribution where “a government provides goods or services other than general infrastructure, or purchases goods” and a benefit is thereby conferred. (Emphasis added.)

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<sup>355</sup> See U.S. Responses to First Panel Questions, paras. 136-139; U.S. FOS, para. 79.

<sup>356</sup> See U.S. Responses to First Panel Questions, paras. 140-151 (Toulouse), 152-154 (Bremen), 155-157 (Bremen), 158-161 (Bremen), 162-166 (Toulouse).

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304. In its response to the Panel’s Question 20, the United States set out a definition of “general infrastructure” based on the ordinary meaning of that term in context and in light of the object and purpose of the SCM Agreement. To qualify as general infrastructure under Article 1.1(a)(1)(iii) of the SCM Agreement, infrastructure must include, involve, or affect all or nearly all the parts of a whole territory or community; must be completely or nearly universal, as opposed to partial, particular, or local.<sup>357</sup>

305. The EC has proffered a very different definition that focuses on the fulfillment of broad public policy goals. It understands infrastructure to be “general infrastructure” if it “is provided for the benefit of the public at large.” It includes within that concept, *inter alia*, goods and services that “enable members of the public at large, thereby fulfilling a public policy objective.”<sup>358</sup> This is a notion to which the EC frequently returns in its effort to characterize the industrial sites and other goods provided exclusively or preferentially to Airbus as “general infrastructure.”<sup>359</sup> It uses the notion of a public policy objective to introduce an element of discretion and deference into the definition of “general infrastructure,” suggesting that it is up to each WTO Member itself to decide what it believes is “general” infrastructure. Or, as the EC put it, “WTO Members accorded themselves a large margin of appreciation for what they consider to constitute ‘general infrastructure.’”<sup>360</sup> Thus, for example, the EC takes the view that if infrastructure “provides new possibilities for . . . industrial activity to the benefit of the entire city,” it is general infrastructure, even if it is provided to a single enterprise, as in the case of the industrial site created for and provided to Airbus at the Mühlenberger Loch.<sup>361</sup>

306. The problem with this view is that it does not comport with the ordinary meaning of the term “general infrastructure” in context and in light of the SCM Agreement’s object and purpose. Although the EC’s analysis begins with dictionary definitions, it soon departs from those definitions and invests select “examples” and “categories” with meaning not borne out by

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<sup>357</sup> See U.S. Response to First Panel Questions, para. 137; see also Australia Third Party Submission, para. 53; *id.*, para. 54 (“Australia does not consider that the mere fact that a government creates infrastructure for public policy reasons in order to ‘enable members of the public at large’ (e.g., combating unemployment, fostering economic development, raising living standards) necessarily makes it ‘general infrastructure.’”).

<sup>358</sup> EC FWS, para. 716; see also *id.*, para. 719 (referring to goals of “raising standards of living” and “ensuring full employment,” as expressed in preamble to the WTO Agreement, as object and purpose relevant to interpretation of the term “general infrastructure”).

<sup>359</sup> See, e.g., EC FWS, paras. 706, 711, 721, 724, 923; EC Responses to First Panel Questions, paras. 223, 226, 234; EC FOS, para. 88.

<sup>360</sup> EC FWS, para. 712.

<sup>361</sup> EC Responses to First Panel Questions, para. 226.

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the text.<sup>362</sup> The result is an EC-invented definition of the term “general infrastructure” that amounts to an extremely broad exception, undercutting the basic rule that a subsidy may consist of government-provided goods or services that confer a benefit.

307. Governments routinely act with the intention of “fulfilling a public policy objective.” If any grant of infrastructure that met that test were deemed to be general infrastructure – even if granted to a specific enterprise – then virtually every grant of infrastructure would be excluded from the SCM Agreement’s definition of “subsidy.” But that result would deprive the word “general” in the phrase “general infrastructure” of any meaning, contrary to customary rules of interpretation of public international law.

308. While the EC seeks support from the *travaux préparatoires* for the SCM Agreement,<sup>363</sup> it is difficult to see how that helps its position. None of the government interventions that it cites support the view that a grant of infrastructure is not a subsidy as long as it fulfills a public policy objective. Indeed, even the EC’s own intervention – which referred to government conduct being non-actionable if it “merely contribute{s} to setting the terms and conditions of a country’s economic and business environment” and “{does} not alter the competitive position of firms”<sup>364</sup> – contradicts its current position. The creation and provision of infrastructure to serve the needs of one specific company or industry sector, and which is used only by that company or sector, hardly meets the standard the EC articulated during the Uruguay Round, even if such action happens to increase employment, stimulate the local economy, or otherwise fulfill a public policy objective.

309. Moreover, the public-policy-focused approach to general infrastructure that the EC urges the Panel to adopt in this dispute is contrary to the approach the EC follows under its own state aids regime. As the European Commission explained in one recent decision:

{N}o state aid elements . . . are present . . . where . . . infrastructure financed by the State is open to all potential users on equal and non-discriminatory terms, as no particular undertaking or production among the users may be shown to be favoured over others in a way that distorts competition. . . . However, where public financing is used to provide

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<sup>362</sup> Compare EC FWS, paras. 714-715 (discussing dictionary definitions of “infrastructure” and “general”) with *id.*, para. 716 (identifying three categories of “general infrastructure” without reference to any source).

<sup>363</sup> See EC FWS, paras. 721-723.

<sup>364</sup> Elements of the Negotiating Framework, Submission by the European Community, MTN.GNG/NG10/W/31, p. 8 (Nov. 27, 1989) (emphasis added).

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infrastructure for a particular user, giving it an advantage over its competitors, the financing falls within the scope of the state aid control.<sup>365</sup>

310. In sum, a grant of goods is “general infrastructure” and thus excluded from the definition of “subsidy” under Article 1.1(a)(1)(iii) of the SCM Agreement if it is available to all members of the public on the same terms and conditions. If the government creates infrastructure adapted to the particular needs of one company and then provides the infrastructure to that company for its exclusive or preferential use, it is not general infrastructure, and it is subject to the SCM Agreement rules.

**B. The creation of an industrial site at the Mühlenberger Loch expressly and exclusively for Airbus that was then provided to Airbus on non-commercial terms was not the provision of general infrastructure**

1. The EC does not dispute the core facts

311. In its first written submission, the EC concedes the following core facts established by the United States in its first written submission concerning the provision of newly created land to Airbus in Hamburg:

- The City of Hamburg created artificial land from wetland and river areas located West of the existing Airbus facility in the Mühlenberger Loch and North of the existing Airbus runway in the Rüschanal.<sup>366</sup>
- The City of Hamburg invested roughly Euro 700 million into creating the site for Airbus,<sup>367</sup> an amount eight times more than the total value of the site, roughly Euro 87 million.<sup>368</sup>

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<sup>365</sup> European Commission, Decision of 21 December 2005, Aid No N 503/2005, UK Great Yarmouth Outer Harbour, pp. 4-5 (emphases added) (Exhibit US-546); *see also* European Commission, XXVth Report on Competition Policy, COM(96)126 final, para. 175 (“In principle, as long as access and usage remain public and general, such {infrastructure investments} will not constitute aid. . . . For there to be a distortion that might qualify as aid, the infrastructure-related advantages should be conferred selectively, with the aim of helping specific firms: for example, a purpose-built facility for the sole use of one undertaking or discriminatory access restrictions.”) (Emphasis added.) (Exhibit US-547).

<sup>366</sup> *See* EC FWS, paras. 752 and 755.

<sup>367</sup> *See* EC FWS, para. 758. As discussed below, the United States maintains that the real costs were approximately Euro 750 million.

<sup>368</sup> *See* the summary of the lease agreement provided by the Hamburg government through the Hamburg Economic Ministry to the Hamburg Parliament: Hamburgische Bürgerschaft, Vorläufiger Auszug aus dem Protokoll der öffentlichen Sitzung des Wirtschaftsausschusses vom 11. Januar 2007, Prot. Nr. 18/33, at p. 6 (Exhibit EC-562).



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- The lease price paid by Airbus for the land – Euro 3.60 per square meter – was determined based on the alleged value of the land, rather than the rent necessary to generate a reasonable return on Hamburg’s investment in creating the land.<sup>369</sup>
- The full lease price only applies starting in 2020.<sup>370</sup> The effective reduction in lease price, calculated over 20 years, is about 30 percent, saving Airbus almost Euro 30 million even based on the subsidized lease price.

312. Thus, there is no dispute between the EC and the United States that the City of Hamburg created the artificial land free of charge and free of risk for Airbus – and thereby allowed Airbus to expand its existing facilities to accommodate A380 production.

313. The EC’s approach to addressing these undisputed fact is to treat the creation of the site (*i.e.*, “turning wetland into usable land”), the building of flood protection measures, and the building of special-purpose facilities on the site as three separate transactions, each distinct from one another, as well as being distinct from and unconnected to the lease of the newly created land and special purpose facilities to Airbus.<sup>371</sup> The EC argues that the creation of the site, in and of itself, did not constitute a financial contribution to Airbus but, rather, the provision of general infrastructure within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement.

314. Believing it has established that proposition, the EC then turns to the lease, treating it no differently from an ordinary commercial lease in which it was not necessary to first create the artificial land that is the subject of the lease. By separating the lease transaction from the land-creation transaction (as well as the related flood protection and facilities-creation transactions), the EC tries to argue that there was no basis for taking account of the creation of the infrastructure in establishing the lease rate and that the lease rate, therefore, accords with a market-based lease rate. But this approach ignores the reality that the City of Hamburg invested Euro 750 million into creating a site to the specifications of Airbus, an amount that Airbus otherwise would have had to spend itself on the expansion of its existing site.

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<sup>369</sup> Hamburgische Bürgerschaft, Vorläufiger Auszug aus dem Protokoll der öffentlichen Sitzung des Wirtschaftsausschusses vom 11. Januar 2007, Prot. Nr. 18/33, at p. 6, Anlage 1 and Anlage 2 (“Based on a land value of 55.00 EUR/m<sup>2</sup>, the annual ground rent is 3.60 EUR/m<sup>2</sup>.”) (Exhibit EC-562). Only the lease price for the facilities that Hamburg constructed on the artificial land is based on the investment costs for those facilities, a total of approximately Euro 61 million – not even ten percent of the total investment.

<sup>370</sup> EC FWS, para. 761; Hamburgische Bürgerschaft, Vorläufiger Auszug aus dem Protokoll der öffentlichen Sitzung des Wirtschaftsausschusses vom 11. Januar 2007, Prot. Nr. 18/33, at p. 6, Anlage 2 (Exhibit EC-562).

<sup>371</sup> *See, e.g.*, EC FWS, paras. 747-748.

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315. Based on its view that the individual transactions should be viewed in isolation from one another, the EC professes confusion as to whether the United States is challenging the creation of the Airbus site or the provision of the site to Airbus.<sup>372</sup> However, the United States has left no doubt on this question: The United States is challenging the provision of the newly created site (*i.e.*, the newly created land and the special purpose facilities installed thereon) to Airbus on terms that are non-commercial because they fail to take account of the enormous investment required to create the tailor-made site.<sup>373</sup> The fact that creation of the site and provision of the site to Airbus were linked, as opposed to distinct transactions having nothing to do with one another as the EC would have it, is confirmed by the Hamburg government's own admission in a report to the Hamburg Parliament:

{T}he improvement to the infrastructure of the area and its subsequent lease to AI is, in principle, a subsidy within the meaning of Article 1 (1) (iii) of the GATT Subsidy Agreement.<sup>374</sup>

### 2. The Airbus site is not general infrastructure

316. In a vain attempt to distance the creation of the Airbus site at the Mühlenberger Loch from the provision of the site to Airbus, the EC first argues that the wetland was filled in order to fulfil a “public task,” *i.e.*, the “development of the port.”<sup>375</sup> It asserts that “{d}ue to its geographical position (being surrounded by water), Hamburg only has limited space to offer to its citizens for housing or its companies usable industrial land to settle.”<sup>376</sup> And it asserts that “{i}ndustrial sites are scarce in Hamburg,”<sup>377</sup> so that if and when the Airbus lease ends, Hamburg will be able to lease the site to another user, including, in particular, for use as a container terminal.<sup>378</sup>

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<sup>372</sup> EC FWS, paras. 746-749.

<sup>373</sup> See U.S. FWS, paras. 431-442.

<sup>374</sup> Hamburgische Bürgerschaft, Drs. 16/4734, Mitteilung des Senats an die Bürgerschaft, at 3 (“Bei der infrastrukturellen Herrichtung der Fläche und ihrer anschließenden Vermietung an AI handelt es sich . . . grundsätzlich . . . um eine Subvention im Sinne des Artikel 1 Absatz 1 (iii) des GATT-Subventionsübereinkommens.”) (Exhibit US-183).

<sup>375</sup> EC FWS, para. 777-778.

<sup>376</sup> EC Responses to First Panel Questions, para. 225.

<sup>377</sup> EC FWS, para. 778.

<sup>378</sup> EC FWS, para. 778; EC Responses to First Panel Questions, paras. 233, 242-246.

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317. The EC is wrong on all counts. First, there is sufficient space for industrial and residential use in Hamburg. Second, it is simply untrue that the site was created for the purpose of developing the port. Third, the site was created exclusively for the purpose of allowing Airbus to expand its existing facilities. Fourth, in light of the geographical situation and the restrictions imposed under German planning law, the site cannot be leased to and used by any other user.

a. *There is an “abundant supply” of industrial land in Hamburg*

318. The EC asserts that land for industrial and residential use in Hamburg is limited because Hamburg is “surrounded by water.”<sup>379</sup> This is wrong. Hamburg is located on the river Elbe, but it is certainly not surrounded by water. In fact, there are no other significant bodies of water in the Hamburg area that limit space for industrial or residential use.<sup>380</sup> As Hamburg’s Minister for the Economy put it recently:

Hamburg continues to grow and boasts sufficient surface area for companies moving to the city as well as to those wishing to expand and develop here. In total, the City owns 45% of the land area covering the Federal State of Hamburg. This newly drawn map shows the high quality and abundant supply of office space and commercial real estate. . . . Hamburg has just the right property to suit all needs. . . . We will therefore make every investor a customized offer of land in Hamburg.<sup>381</sup>

319. In fact, in July 2005, for example, the City of Hamburg itself offered to sell about 862.4 hectares (or 8.6 million square meters) of industrial sites at various locations in Hamburg, including in the vicinity of the harbor.<sup>382</sup> Similarly, the discussions about suitable locations for Airbus’s A380 facilities also show that there is sufficient space even for very large industrial facilities.

320. Before deciding to locate the A380 facilities next to the existing site in the Mühlenberger Loch, Airbus and the City of Hamburg examined three alternative sites: Hasselwerder/Rosengarten (1,475,000 million square meters), Rüsshalbinsel (870,800 million square meters), and Westerweiden (1,002,800 million square meters). Airbus and the City of

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<sup>379</sup> EC Responses to First Panel Questions, para. 225.

<sup>380</sup> See City of Hamburg, *Gewerbeimmobilien in Hamburg, Grundstücke und Objekte für Industrie, Handwerk, Produktion und Dienstleistung*, February 2005 (Exhibit US-549).

<sup>381</sup> See City of Hamburg, *Gewerbeimmobilien in Hamburg, Grundstücke und Objekte für Industrie, Handwerk, Produktion und Dienstleistung*, February 2005 (Exhibit US-549).

<sup>382</sup> See the overview of industrial sites offered by the City of Hamburg submitted as Annex 3 to the Keunecke Report (Exhibit US-189).

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Hamburg chose the Mühlenberger Loch and the Rüschanal over these alternative sites because these areas were not suitable for Airbus' specific purposes, but not because there was no land available for industrial use.<sup>383</sup>

*b. The creation of the site was not harbor-related*

321. The EC's assertion that the creation of the new, artificial land in the Mühlenberger Loch was motivated by the need for additional land for the harbor and thus undertaken to fulfil a public task – the development of the harbor – is both legally irrelevant and factually wrong. It is legally irrelevant because, as discussed above, the test for whether infrastructure is general is not whether it serves some "public policy objective." Rather, the test is whether the land is available to all on the same terms and conditions or whether it has been created with a specific company or industry in mind and to the specifications of that specific company or industry.<sup>384</sup> As will be shown below, the newly created land is not available to users other than Airbus.

322. As for the facts, a closer examination shows that the creation of the site for Airbus does not serve the development of the Port of Hamburg, but was undertaken exclusively for Airbus. Rather than provide any evidence to the contrary, the EC rests its case on mere assertions, general explanations of demand for land inside the harbor area, and anecdotal examples of land created or planned inside the harbor area for container terminals (such as the container terminal "Burchardkai," projects planned in "Mittlerer Freihafen," and the planned extension of the Eurogate terminal).<sup>385</sup>

323. The United States does not dispute that Hamburg has created or plans to create new land inside the harbor area to be used for harbor purposes. But this has nothing to do with the measure at issue in this dispute. Several key points highlight the EC's error.

324. First, the EC's argument as developed in its first written submission is based entirely on a misquotation from the Port Development Act, which defines the provision of sites for harbor-related purposes as a "public task." In fact, the EC's quotation omits the Act's most important phrase – "in the Harbor Area" (in the German original "*im Hafengebiet*") – twice in the same sentence.<sup>386</sup>

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<sup>383</sup> Cf. Realisierungsgesellschaft Finkenwerder mbH (ReGe), A380-Werksweiterung im Mühlenberger Loch - eine Bilanz, p. 10 (Exhibit US-182).

<sup>384</sup> See, e.g., U.S. FOS, para. 79; U.S. Responses to First Panel Questions, paras. 136-139.

<sup>385</sup> See EC Responses to First Panel Questions, paras. 228 and 242.

<sup>386</sup> See EC FWS, para. 777. The first two sentences of Sec. 1, para. 5 of the Port Development Act as translated and quoted by the EC read as follows: "The development of the harbour and the necessary provision of sites that can be used for harbour-related purposes is a public task of the city of Hamburg. In order to fulfil this task,

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325. When the Port Development Act is quoted correctly, it becomes evident that it does not cover the creation of the Airbus site. The Act, including the “public task” to develop and provide sites,” applies only to the “Harbor Area” as defined by the Act.<sup>387</sup> But, as the EC grudgingly admitted in responding to the Panel’s Question 93, the entire site created from wetland and river areas in the Mühlenberger Loch and Rüschkanal is located outside the Harbor Area as defined by the Act.<sup>388</sup> Accordingly, the Port Development Act does not support the EC’s argument that the land created for Airbus is general infrastructure.

326. Second, not only is the Airbus site at Finkenwerder not in the Harbor Area, it actually was carefully carved out of the Harbor Area by the Hamburg government, because the Hamburg government itself acknowledged that the site serves no harbor-related purpose whatsoever. In particular, the Rüschkanal previously had been part of the Harbor Area as defined by the Port Development Act prior to its conversion into land for Airbus. It was excluded from the Harbor Area through an amendment to the Act,<sup>389</sup> because the creation of land for the purpose of expanding Airbus’s site does “not serve any harbor purposes.” As the Hamburg government explained:

{T}he water areas of the Rüschkanal and the Elbe river . . . are designated by the Port Development Act as being Harbor Area. . . . Since the final production and assembly of the A3XX aircraft and the required extension of the runway do not serve any harbor purposes, the filling of the existing mouth of the Rüschkanal could only be permitted by

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the City shall purchase the property of these sites and keep ownership of them.” Quoted correctly, however, the provision reads as follows: “The development of the harbour and the necessary provision of sites that can be used for harbour-related purposes is a public task of the city of Hamburg. In order to fulfil this task, the City shall purchase the property of the sites located in the Harbour Area and keep ownership of the sites located in the Harbour Area and already owned by it.” (Emphases added.)

<sup>387</sup> The “Harbor Area” – *i.e.*, the area already used for harbor purposes (“*Hafennutzungsgebiet*”) and the area designated for harbor expansion (“*Hafenerweiterungsgebiet*”) – has been delineated in the “Harbor Area Map” (“*Hafengebietsplan*”) and has been described in an Annex to that Act. *See Hafenenwicklungsgesetz* (Port Development Act), sec. 2, para. 2 and the map attached to the Act as “Anlage 1” (Exhibit US-556). The government of Hamburg made the scope of the Port Development Act very clear when introducing it in the Hamburg Parliament: “The Harbor Development Act contains a basic principle that harbor development constitutes a task to be performed by the state. . . . The geographic area in which this public task is to be performed must therefore be fixed by statute with respect to the entire Harbour Area.” Hamburgische Bürgerschaft, Mitteilung des Senats an die Bürgerschaft, Hafenenwicklungsgesetz, Drs. 9/3205, p. 1 (at para. 2) and p. 2 (at para. 3) (translated from the German original). (Exhibit US-550).

<sup>388</sup> *See* EC Responses to First Panel Questions, para. 244 (admitting that “from a strictly legal perspective” the land at issue does not come within the Harbor Area).

<sup>389</sup> Aches Gesetz zur Änderung des Hafenenwicklungsgesetzes vom 14. Juli 1999, Hamburgisches Gesetz- und Verordnungsblatt, Teil I, 1999, S. 154 (Anlage 1k) (Exhibit US-551).

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way of an exception. . . . {T}his would constitute an exemption from a mandatory legal provision. This path would, however, pose a significant legal risk, since this would . . . permit a different use of the Harbor Area.<sup>390</sup>

327. In other words, the Hamburg government itself confirmed that the creation of land for the expansion of the Airbus facilities had nothing to do with the harbor and its extension and, in fact, violated the Port Development Act prior to its amendment.

328. Third, the EC wrongly alleges that the Harbor Area has “been extended in a westerly direction” and that “{w}ith the ‘Extension of Container Terminal Eurogate’ . . . the harbour will border the Airbus Deutschland facilities.”<sup>391</sup> The EC’s conclusion that “{t}he next step in harbour extension to the West would be towards *Mühlenberger Loch*”<sup>392</sup> is not supported by the facts.

329. It is simply not true that Hamburg plans to expand the harbor to the West. Rather, it is clear from the design of the Harbor Area and the Harbor Expansion Area (“*Hafenerweiterungsgebiet*”) that the City of Hamburg plans to expand the harbor to the South.<sup>393</sup> This plan has not changed since 1982,<sup>394</sup> and there are no indications that the City of Hamburg intends to expand the harbor further to the West. The Hamburg Port Authority’s “Masterplan 2015” does not suggest any measures beyond the current borders of the Harbor Area and the Harbor Expansion Area to the South.<sup>395</sup> In fact, the “*Hafenentwicklungsplan*”

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<sup>390</sup> Hamburgische Bürgerschaft, Mitteilung des Senats an die Bürgerschaft, Achtes Gesetz zur Änderung des Hafenentwicklungsgesetzes, hier: Änderung des Hafengebiets im Mündungsbereich des Rüschanals und vor der Aufhöhungsfläche des Mühlenberger Lochs, Drs. 16/2646, p. 1 (Exhibit US-552).

<sup>391</sup> EC Responses to First Panel Questions, para. 242; *see also id.*, para. 246.

<sup>392</sup> EC Responses to First Panel Questions, para. 243.

<sup>393</sup> *See* Sec. 2 para. 2 of the “*Hafenentwicklungsgesetz*” (Port Development Act) as well as the areas labelled “*Hafenerweiterungsgebiet Zone I*” and “*Hafenerweiterungsgebiet Zone II*” marked in the maps referred to in this provision and attached to the Act as “Anlage 1” and “Anlage 1a” (Exhibit US-556). *See also* the map entitled “*Der Hafen von Hamburg*” (“The Harbor of Hamburg”) submitted as Exhibit US-557.

<sup>394</sup> The EC points out that the Port Development Act “can and has in the past been adjusted in line with the needs for the development of the harbour.” EC Responses to First Panel Questions, para. 243. However, all of these changes were minuscule. *Compare* the map attached to the “*Hafenentwicklungsgesetz*” (Port Development Act) as “Anlage 1” (Exhibit US-556) from 1982 *with* the map published in 2005 by the Hamburg Port Authority and entitled “*Der Hafen von Hamburg*” (“The Harbor of Hamburg”) (Exhibit US-557).

<sup>395</sup> Hamburg Port Authority, Masterplan 2015, Ausbaubersichten für den Hafen, dated 1 June 2006 (Exhibit US-558).

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(“Port Development Plan”) foresees that even the scheduled Harbor Expansion Areas (“*Zone I*” and “*Zone II*”) will only be developed in part.<sup>396</sup>

330. Moreover, even after the “Extension of the Container Terminal Eurogate,” neither the terminal nor the harbor will “border the Airbus Deutschland facilities.”<sup>397</sup> This measure does not extend the harbor to the West. Rather, Eurogate’s container terminal will be extended onto a peninsula North of the current terminal that has always been part of the Harbor Area and is currently used for a liquids terminal and fuel storage.<sup>398</sup> Thus, the size of the harbor will be unaffected by that extension. The western border of the extended Eurogate terminal will still be approximately 2 kilometers East of the existing Airbus facilities and about 3 kilometers East of the new Airbus facilities. Between the new terminal and those facilities, there is the village of Finkenwerder, with residential and industrial areas as well as small leisure ports.<sup>399</sup>

331. Finally, other assertions the EC makes in its attempt to argue that creation of the Airbus site at the Mühlenberger Loch was harbor-related are equally incorrect. For example, the EC suggests that the existing harbor is too small for the expected increase in container handling.<sup>400</sup> However, improvements already planned within the existing Harbor Area are sufficient to meet the projected demand for additional container terminal capacity.<sup>401</sup> Further capacity can easily be created in the existing Harbor Area.<sup>402</sup> The EC also suggests that the existing Harbor and

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<sup>396</sup> Hamburg Port Authority, *Im Fokus dynamischer Wachstumsmärkte, Chancen und Entwicklungspotentiale des Hamburger Hafens*, 2005, at 30-34 (Exhibit US-553), including, in particular, the maps contained at pp. 30, 32 and 34. An English version of the “*Hafenentwicklungsplan*” (Port Development Plan) is available at [http://www.hamburg-port-authority.de/index.php?option=com\\_content&task=view&id=148&Itemid=117&lang=english](http://www.hamburg-port-authority.de/index.php?option=com_content&task=view&id=148&Itemid=117&lang=english). The relevant portions are sections 4.1 and 4.2. For the harbor expansion area at *Altenwerder* (“*Zone I*”) see also Hamburg Port Authority, *Hafenerweiterung Altenwerder West* (Exhibit US-559).

<sup>397</sup> See EC Responses to First Panel Questions, para. 242.

<sup>398</sup> See the map entitled “*Der Hafen von Hamburg*” (“The Harbor of Hamburg”) submitted as Exhibit US-557. See also the map provided by the EC as Exhibit EC-618. The black line on the map designates the borderline of the harbor area; the map published by the City of Hamburg attached as Exhibit US-560. The United States has marked the existing Eurogate terminal and the planned extension on the map.

<sup>399</sup> See the map published by the City of Hamburg attached as Exhibit US-560.

<sup>400</sup> See EC Responses to First Panel Questions, para. 246.

<sup>401</sup> See Hamburg Port Authority, *Im Fokus dynamischer Wachstumsmärkte, Chancen und Entwicklungspotentiale des Hamburger Hafens*, 2005, at 33-34 (Exhibit US-553). For an English version see [http://www.hamburg-port-authority.de/index.php?option=com\\_content&task=view&id=148&Itemid=117&lang=english..](http://www.hamburg-port-authority.de/index.php?option=com_content&task=view&id=148&Itemid=117&lang=english..)

<sup>402</sup> See Hamburg Port Authority, *Hafenerweiterung Moorburg - Planungsskizze* (Exhibit US-554).

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Harbor Expansion Area are not sufficient to accommodate outstanding requests for sites.<sup>403</sup> But that too is not the case.<sup>404</sup>

*c. The site was created exclusively for Airbus*

332. Having established that the Mühlenberger Loch site was not created for port development purposes, the United States will now reaffirm what already has been demonstrated in its first written submission – that there was, and is, no intention to use the land for any purpose other than expansion of Airbus facilities.

333. The EC is re-writing the history of the Airbus expansion into the Mühlenberger Loch and the Rüschanal when it describes the events that led to the creation and provision of the site to Airbus in the following terms: “Hamburg removed the publicly owned land from public use, namely by renting it to a private company.”<sup>405</sup> In reality, there was no “publicly owned land” that could be “removed from public use” by renting it to Airbus. There was only a wetland and water area in the Mühlenberger Loch and the Rüschanal, which were transformed into artificial land exclusively for Airbus. This fact is confirmed by contemporaneous statements by the European Commission, the Hamburg government, and the Hamburg Court of Appeals.

334. When approving the conversion of the Mühlenberger Loch – an internationally protected wetland – into land for the “expansion of the manufacturing site of Daimler Chrysler Aerospace Airbus GmbH (DASA) at Hamburg-Finkenwerder,”<sup>406</sup> the European Commission noted the following:

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<sup>403</sup> See EC Responses to First Panel Questions, para. 245 and Exhibit EC-619.

<sup>404</sup> According to the EC, current demand totals between 88.79 to 102.51 hectares. It suffices to note that the size of the Harbor Expansion Area alone is about nine times that size, *i.e.*, 919 hectares, ignoring the land still available within the existing Harbor Area. See Hafen Hamburg Marketing e.V., Port Areas, <http://www.hafen-hamburg.de/content/view/385/100/lang,en> (Exhibit US-555).

<sup>405</sup> EC FWS, para. 781.

<sup>406</sup> Translation of the title of the document European Commission, Stellungnahme vom 19. April 2000 zur Erweiterung des Betriebsgeländes von Daimler Chrysler Aerospace Airbus (DASA) in Hamburg-Finkenwerder, K(2000)1079 endg. (Exhibit EC-547 (BCI)).



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335. Similarly, the government of Hamburg, through the Realisierungsgesellschaft Finkenwerder mbH (ReGe), noted in a detailed description of the creation of the Mühlenberger Loch and Rüschkanal sites entitled “A380-Site Expansion in the Mühlenberger Loch”<sup>408</sup> that:

A requirement for finding suitable sites in Hamburg offering the necessary net useable area of about 140 hectares for the A380 plant expansion was immediate proximity to the existing aircraft production facility in Hamburg-Finkenwerder. This is the only place where the synergies with the existing final assembly plant for A319 and A321 standard fuselage airplanes could be utilized.<sup>409</sup>

336. Finally, in a judgment of February 19, 2001, concerning the plan approval decision (“*Planfeststellungsbeschluss*”) for the creation of the land in the Mühlenberger Loch and the Rüschkanal entitled “DA-Erweiterung A3XX” (“DA-Expansion A3XX”), the Hamburg Administrative Appeals Court noted that the approval decision “established the conditions required for an extension of the construction sites of the intervener {i.e., Airbus} in Hamburg-Finkenwerder, with a view to enabling the production of the A3XX jumbo aircraft.” The Court went on to explain:

In September 1997, the Senate of the defendant {i.e., the government of Hamburg} decided to create the conditions required for enabling the construction of the A3XX jumbo aircraft in Hamburg-Finkenwerder as planned by the intervener. In June 1998, the defendant submitted a tender to the intervener to become the location for the production of the A3XX. . . . The major reason cited for filing the requests {for the approval to

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<sup>407</sup> European Commission, Stellungnahme vom 19. April 2000 zur Erweiterung des Betriebsgeländes von Daimler Chrysler Aerospace Airbus (DASA) in Hamburg-Finkenwerder, K(2000)1079 endg., at pp. 1-3 of the English version of the decision (emphases added) (Exhibit EC-547 (BCI)).

<sup>408</sup> Translated title of the document Realisierungsgesellschaft Finkenwerder mbH (ReGe), A380-Werkserweiterung im Mühlenberger Loch - eine Bilanz (Exhibit US-182).

<sup>409</sup> Realisierungsgesellschaft Finkenwerder mbH (ReGe), A380-Werkserweiterung im Mühlenberger Loch - eine Bilanz, p. 10 (emphases added) (Exhibit US-182).

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create the land} was that the existing site and runway were inadequate for the construction and delivery of the proposed A3XX jumbo aircraft. {It was claimed that:} ‘The additional need for land results from the required assembly halls, parking positions, the apron and the towing routes, a de-icing and cleaning area, a second compensation wheel and new taxiways. The runway must be extended and broadened so as to allow for the safe take-off and landing of the A3XX aircraft. The construction of a peninsular in the Elbe river and the relocation of the Rüschanal are essential for the extension of the runway. The construction of a 320-meter-long quayside is necessary in order to enable aircraft components to be delivered by water. The production of a jumbo aircraft having the capacity to carry up to 800 passengers is necessary in order to remain competitive with rival Boeing.’<sup>410</sup>

337. The agreements concluded between the City of Hamburg and Deutsche Airbus further confirm that the creation of artificial land in the Mühlenberger Loch and the Rüschanal was specifically for Airbus. For example, on July 9, 2004, the City of Hamburg and Airbus Deutschland GmbH concluded a contract under which Airbus promised to undertake all investments needed for the production and delivery of the A380 Freighter, including investments in the buildings on the newly created artificial land in the Mühlenberger Loch. In addition, Airbus agreed to rent the land needed for this purpose. Finally, Airbus agreed to pay damages to the City of Hamburg, including for the investments made by the City of Hamburg to provide the sites required by Airbus, in case Airbus decided not to locate A380 freighter production and delivery in Hamburg.<sup>411</sup>

338. Based on the contracts concluded between the City of Hamburg and Airbus, Hamburg threatened to sue for damages in the amount of the entire investment made by it when Airbus considered moving its final A380 assembly line from Hamburg to Toulouse. According to press reports confirmed by the government of Hamburg, Hamburg could claim up to Euro 700 million from Airbus based on the agreement of July 9, 2004.<sup>412</sup> It is obvious that an agreement like this

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<sup>410</sup> Oberverwaltungsgericht Hamburg, Judgement of 19 February 2001, Case No 2 Bs 370/00, paras. 2, 4-6, 9-12, 13, 18, 20-21 (at Juris), translated from the German original (emphasis added) (Exhibit US-561).

<sup>411</sup> The United States does not have a copy of the Airbus/Hamburg agreement of July 9, 2004. However, the agreement, including, in particular, the obligations to pay damages in the event of a breach by Airbus, has been described the City of Hamburg itself (Press Release, Airbus und Senat unterzeichnen Vertrag zur Sicherung der Start- und Landebahnverlängerung (July 9, 2004) (Exhibit US-562)) and in the press (e.g., Die Welt, Abzug aus Hamburg käme Airbus teuer (October 9, 2006) (Exhibit US-563); Focus, Grobe Managementfehler bei Airbus (October 7, 2006) (Exhibit US-564); Die Welt, Airbus: Ole von Beust hält Krisengipfel für Erfolg (October 6, 2006) (Exhibit US-565)).

<sup>412</sup> See, e.g., Die Welt, Abzug aus Hamburg käme Airbus teuer (October 9, 2006) (quoting the City of Hamburg’s press spokesman Lutz Mohaupt) (Exhibit US-563); see also Focus, Grobe Managementfehler bei Airbus (October 7, 2006) (Exhibit US-564); Die Welt, Airbus: Ole von Beust hält Krisengipfel für Erfolg (October 6, 2006) (Exhibit US-565).

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would not have been concluded if the City of Hamburg believed there to be any other use for the newly created land than the expansion of the Airbus industrial site.

*d. There are no alternative uses for the Mühlenberger Loch and Rüschkanal sites*

339. The EC asserts that the newly created land used by Airbus is publicly accessible and could be used by companies other than Airbus for purposes other than aircraft manufacturing. First, according to the EC, the “reclaimed area in *Mühlenberger Loch* is accessible via a publicly owned road, i.e., the dyke lane (‘Deichstraße’).”<sup>413</sup> Second, the EC asserts that the site “could easily be leased to another company” by the City of Hamburg “if the lease agreement with Airbus . . . were to be terminated one day.”<sup>414</sup> In particular, the EC contends that the land could be used as a container terminal.<sup>415</sup>

340. The EC thus suggests that even some remote possibility that one day the site might be used by another user turns it into general infrastructure, as long as the City of Hamburg retains formal ownership of the site. The United States disagrees with the EC’s legal conclusion. The EC admits that Airbus is currently the only user of the site and that use of the site has been reserved to Airbus for the next [ ] years, at least.<sup>416</sup> During that time, the site can neither be accessed nor used by any other company or person. In addition, as shown above, the site was created from wetland exclusively for Airbus and to its specifications. It would be very easy to circumvent the SCM Agreement if the provision of infrastructure by a WTO Member to specific companies or industries – even on a decades-long basis – were excluded from the agreement by virtue of being “general infrastructure” simply due to the Member’s retaining title to the infrastructure.

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<sup>413</sup> EC Responses to First Panel Questions, para. 229.

<sup>414</sup> EC Responses to First Panel Questions, para. 233.

<sup>415</sup> EC Responses to First Panel Questions, paras. 233 and 242-246.

<sup>416</sup> According to the lease agreement, provided by the EC as Exhibit EC-551 (BCI), [

] The initial investments by Airbus in such buildings, facilities and fittings alone was about Eur 1.1 billion. See EC Responses to First Panel Questions, para. 238.

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341. Moreover, the United States disagrees not only with the EC's legal conclusion, but also with the EC's characterization of the facts. In this section, the United States first will explain why Hamburg could not "easily lease the land to another company" – in fact, it could not lease the land to any company other than Airbus – and then will address the alleged accessibility of the Airbus site via the dyke lane.

(i) *No potential user other than Airbus*

342. German planning law prohibits any use of the site other than for aircraft manufacturing and aviation purposes. In asserting that the site is "a commercially usable area ('gewerbliche Baufläche') that "is not restricted to aviation industries,"<sup>417</sup> the EC is actively misleading the Panel.

343. To support its argument, the EC refers primarily to the *Flächennutzungsplan* ("Land Use Plan") for Hamburg.<sup>418</sup> Under German planning law, however, the *Flächennutzungsplan* is a high-level planning document that is not binding upon individual users and requires elaboration and implementation through so-called "*Bebauungspläne*" ("Land Construction Plans"). User-restrictions at the land-plot level are (and can only be) implemented through such "*Bebauungspläne*."<sup>419</sup>

344. And this is exactly what happened here. In the *Bebauungsplan Finkenwerder 37*, the government of Hamburg designated the newly created site partly as "*Sondergebiet Flugzeugwerk*" ("Special Area Aircraft Factory") and partly as "*Fläche für den Luftverkehr*" ("Area for Air Traffic").<sup>420</sup> In doing so, the government of Hamburg legally prohibited the use

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<sup>417</sup> EC Responses to First Panel Questions, para. 233.

<sup>418</sup> EC Responses to First Panel Questions, para. 233 and Exhibit EC-617.

<sup>419</sup> The very same *Flächennutzungsplan* ("Land Use Plan") for Hamburg cited by the EC as support for its assertion describes the relationship between this plan and the more detailed *Bebauungspläne* as follows: "In line with its function as an urban planning outline of objectives, the Land Use Plan (*Flächennutzungsplan*) pursuant to Section 5(1) of the German Construction Code (*Baugesetzbuch*) merely depicts the basic elements of the intended type of ground use. It leaves ample planning leeway in the preparation and implementation of the land construction plans (*Bebauungspläne*) to be created from it. Binding decisions regarding the land construction are first only taken by means of the land construction plans, which, pursuant to Section 8(2) of the Construction Code, are to be developed on the basis of the Land Use Plan. . . . Details which can first only be assessed on the basis of the land construction plans are not depicted. Furthermore, land uses on a minor scale are not shown." See City of Hamburg, *Flächennutzungsplan, Erläuterungsbericht, Neubekanntmachung vom Oktober 1997*, at 2.1.5 (emphases added) (Exhibit US-566).

<sup>420</sup> The *Bebauungsplan Finkenwerder 37* consists of three documents: the actual plan itself (a map of the site with specific user restrictions) (Exhibit US-567); a memorandum explaining the plan ("Begründung zum *Bebauungsplan Finkenwerder 37*") (Exhibit US-568); and a decree ordering the plan to enter into force, the

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of the newly created land for any purpose other than Airbus's aircraft assembly facilities, as the government itself explained:

The Land Construction Plan is aimed at establishing the conditions under planning laws for the further expansion of aircraft production in Hamburg Finkenwerder. . . . The areas designated for aviation purposes were fixed by a plan approval decision issued under aviation law on the basis of Sec. 8 of the Aviation Act of March 27, 1999 (BGBI. I p. 551), last amended on July 19, 2002 (BGBI. I, S. 2674, 2677). . . . A part of the newly raised land will be designated as special area for the purpose of the "aircraft factory" (Flugzeugwerk) in order to enable the factory sites of the existing plant to be extended in a westerly direction for the manufacture of jumbo aircraft. The special area designated as aircraft factory (Flugzeugwerk) area serves to accommodate facilities for the manufacture, testing, maintenance and repair of aircraft and aircraft components. . . . This ensures that these areas are made available exclusively for special use by the aircraft industry. The possibility of establishing other factories not aimed at the manufacture of aircraft or related factories (which could be established, for example, in the event of a designation as industrial (Industriegebiet) or commercial (Gewerbegebiet) area) is to be excluded at the Finkenwerder site.<sup>421</sup>

345. Thus, it is clear that the City of Hamburg could not lease the land to any other company but Airbus. Under German planning law, no other company would be allowed to use the land. In particular, the *Bebauungsplan Finkenwerder 37* does not allow any use of the land for a container terminal.

### (ii) *The dyke lane ("Deichstraße")*

346. The United States now turns to the EC's argument that the site can be accessed by the public using the dyke lane ("Deichstraße") and that this somehow suggests that the site is general infrastructure. The United States notes that the EC first claims, in responding to the Panel's Question 91, that the "reclaimed area provides for public access."<sup>422</sup> In the next paragraph, the EC limits its assertion and claims that the dyke lane can be "used as access to the quays with the

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"Verordnung über den Bebauungsplan Finkenwerder 37," Hamburgisches Gesetz- und Verordnungsblatt, Teil I, 6. September 2002, at 239-240 (Exhibit US-569). Within the boundaries of the plan (shown by the grey line surrounding the newly created land), some parts of the land are highlighted in yellow while other parts are white. The highlighted areas are designated "*Sondergebiet Flugzeugwerk*" ("Special Area Aircraft Factory"). The white area circumscribed by the purple line in the center of the newly created site is designated as "*Fläche für den Luftverkehr*" ("Area for Air Traffic"). Finally, the white area circumscribed by the thick blue line is the dyke, labelled "*Fläche mit wasserrechtlichen Regelungen*" ("Area Subject to Provisions of Water Law").

<sup>421</sup> City of Hamburg, Begründung zum Bebauungsplan Finkenwerder 37, at 3 and at 17-18 (Exhibit US-568).

<sup>422</sup> EC Responses to First Panel Questions, para. 229.

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Roll-on-Roll-off-Facility.”<sup>423</sup> Finally, two paragraphs later, the EC admits that the dyke lane cannot be used at all to access the site during the lease period. During that period, the dyke lane is open to use only by “Airbus employees and officials of Hamburg with a responsibility for dyke maintenance and security.”<sup>424</sup>

347. In fact, the dyke lane cannot be used at all to provide any meaningful access to the site that goes beyond the access needed to maintain the dyke. As explained above, most of the land on the site has been reserved either for use as an aircraft assembly facility or for use for aviation purposes. It is clear from the map that constitutes the *Bebauungsplan Finkenwerder 37* (including if looked at in conjunction with the photographs provided by the EC as Exhibit EC-616) that there is simply not sufficient space for an access road (as opposed to a dyke lane used to maintain the dyke) between the land so reserved and the dyke. In particular, at the Northern boundary of the newly created land, there is hardly any space between the “Sondergebiet Flugzeugwerk” (Special Area Aircraft Factory) and the river Elbe, and certainly not enough for any meaningful access to the Roll-on-Roll-off-Facility.<sup>425</sup>

348. Moreover, even assuming hypothetically that the restrictions under German planning law did not exist and that Airbus terminated its use of the newly created land, the site still would not be suitable for users other than Airbus. It is surrounded by water to the North (the river Elbe) and protected wetlands to the West and South (the remaining parts of the Mühlenberger Loch). To the East, the site borders the existing Airbus facilities and, in particular, the Airbus runway.<sup>426</sup> Thus, even if the site were to be opened to use by another user, access would be so limited that such use would in fact be impossible. First, the road access envisaged by the EC is all but impossible. The access road would have to be squeezed between the dyke and the space needed for the Airbus runway. And in light of the proximity of the runway, frequent and substantial traffic would not be allowed on such a road under international and German aviation safety

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<sup>423</sup> EC Responses to First Panel Questions, para. 230.

<sup>424</sup> EC Responses to First Panel Questions, para. 232.

<sup>425</sup> City of Hamburg, *Bebauungsplan Finkenwerder 37* (Exhibit US-567); *see also* the photographs provided by the EC as Exhibit EC-616 (in particular the photograph entitled “Enclosure 11”).

<sup>426</sup> *See* the satellite photograph of the Airbus site in Finkenwerder available from <http://maps.google.de>, attached as Exhibit US-570.

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standards.<sup>427</sup> Second, even the EC does not claim that the site could be linked to the railway network. However, a raillink is essential to operating container and other terminals.<sup>428</sup>

### 3. The dykes are not general infrastructure

349. The EC argues that at least the dykes – built at a cost of Euro 29.3 million (about four percent of the total cost of creating the artificial land) – should be considered general infrastructure and thus not a financial contribution to Airbus, as they are needed to protect not only the Airbus site, but also the areas adjacent to the Airbus site against floods.<sup>429</sup>

350. The United States does not dispute that, as a general matter, flood protection measures are general infrastructure, as they are used by the community as a whole. However, this is not true here.<sup>430</sup>

351. In this case, it would not have been necessary to build the flood protection system around the new, artificial land absent the creation of that land for Airbus in the first place. There was an existing flood protection system bordering and protecting the existing Airbus facilities in Finkenwerder to the river Elbe and the Mühlenberger Loch, and even a second flood protection system located between the existing Airbus facilities and Finkenwerder (the Neß-Hauptdeich).<sup>431</sup> Therefore, it would not have been necessary to build entirely new dykes absent the expansion of the Airbus site.

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<sup>427</sup> Under national and international safety rules, the runway must be surrounded by a significant safety zone (the so-called runway strip). This space is needed to ensure that aircraft that miss the runway during landings or run off the runway during starts or take-offs do not cause accidents involving third parties and are protected against such collisions themselves. The German Transport Ministry has therefore only recently required the *Neß-Hauptdeich* and the road to the East of the runway to be relocated further away from the runway.

<sup>428</sup> In fact, according to the Hamburg Port Authority, 70 to 75 percent of all containers with a final destination located over 150 kilometers from Hamburg are transported by rail. *See* Hamburg Port Authority, Modal Split between Rail and Road carriers in Container Hinterland Traffic >150 km, 2005 (Exhibit US-571).

<sup>429</sup> EC FWS, paras. 793-796.

<sup>430</sup> As the European Commission itself noted in a definition of general infrastructure for the purposes of applying the EC state aid rules, “{T}he characteristics of a specific case may show that such *{i.e., general}* infrastructure benefits a specific undertaking and may therefore warrant the conclusion of aid despite its *prima facie* appearance as public infrastructure.” European Commission, Communication to the European Parliament and the Council: Reinforcing Quality Services in Sea Ports. A Key for European Transport, COM/2001/0035 final, pp. 7-8 (Exhibit US-572).

<sup>431</sup> *See* the satellite photograph of the Airbus site in Finkenwerder available from <http://maps.google.de>, attached as Exhibit US-570.

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### 4. The terms of the provision of the site to Airbus are non-commercial

352. The EC concedes that the lease price for the site does not cover the cost of creating the site (with the exception of the creation of certain facilities, accounting for Euro 62 million, which is less than ten percent of the total Euro 750 million cost). The EC argues that the cost of creating the land is irrelevant to determining a market-based lease price. Therefore, in its view, it was consistent with commercial practice for Hamburg to use the value of the land – Euro 87 million, which is equivalent to Euro 55 per square meter – as the baseline for determining the lease price. To that amount, Hamburg applied a rate of return of 6.5 percent, resulting in an annual lease price of Euro 3.60 per square meter. However, in addition to ignoring the cost of creating the site, it assumed the entire risk that the artificial land created for Airbus may subside. In light of this risk, Hamburg agreed to a further reduction in the lease price of 45 percent spread over 20 years, resulting in an additional saving by Airbus of Euro [ ] million even compared with the agreed lease price.<sup>432</sup>

353. It will be recalled that “{t}he question whether a ‘financial contribution’ confers a ‘benefit’ depends . . . on whether the recipient has received a ‘financial contribution’ on terms more favourable than those available to the recipient in the market.”<sup>433</sup> From Airbus’s perspective, the terms of the lease that it got from the City of Hamburg are substantially more favorable than those available to Airbus in the market.<sup>434</sup> The EC’s attempt to argue otherwise is based on its fatally flawed premise that the creation of a tailor-made site for Airbus out of wetland and water areas should be treated separately from the site’s provision to Airbus.<sup>435</sup>

354. In the EC’s view, the Hamburg government’s investment in creating the site is irrelevant, because the EC considers the site to be general infrastructure.<sup>436</sup> However, as the above discussion shows, that characterization is inconsistent with the ordinary meaning of “general infrastructure” as that term is used in Article 1.1(a)(1)(iii) of the SCM Agreement. Accordingly, the existence of the land cannot be taken as a given in analyzing whether the terms of the lease to Airbus are consistent with a market benchmark. Rather, the Panel should determine whether the terms and conditions of the lease are consistent with the terms and conditions that a commercial

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<sup>432</sup> See City of Hamburg, *Bürgerschaft, Vorläufiger Auszug aus dem Protokoll*, January 11, 2007, at 6 (Exhibit EC-562).

<sup>433</sup> *US - Lead Bars (AB)*, para. 68; see generally U.S. FWS, para. 110.

<sup>434</sup> See U.S. FWS, paras. 432-442.

<sup>435</sup> See, e.g., EC FWS, para. 781 (“relevant inquiry must . . . be focused on the terms of the lease . . . not on the costs of the creation of the industrial site”); EC Responses to First Panel Questions, paras. 235-236.

<sup>436</sup> See EC FWS, para. 780 (“When it comes to evaluating such projects, the cost and the projected return in strict monetary terms is not of paramount importance.”).



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investor would have demanded in consideration for turning the wetland and water areas in the Mühlenberger Loch and the Rüschkanal into useable land and then leasing that land to Airbus, thereby enabling Airbus to expand its existing facilities.

- a. *A commercial investor would demand a return based on the entire cost of its investment*

355. As discussed in the U.S. first written submission, based on the expert report by the German real estate surveyor firm Dr. Keunecke & Stoehr (“Keunecke Report”), a commercial investor creating the Mühlenberger Loch site from wetlands and water areas and then leasing it to Airbus would have demanded a return of about 9 to 12 percent.<sup>437</sup> But even assuming, for the sake of argument, the 6.5 percent return demanded by the City of Hamburg,<sup>438</sup> the lease price still has nothing to do with what a commercial investor would require.

356. Applying a 6.5 percent return to Hamburg’s investment of Euro 690 million to create the land,<sup>439</sup> a commercial investor would have demanded an annual lease price of Euro 44.85 million for the land itself. Thus, even calculated at the rate of return suggested by the EC, the lease price that a commercial investor would demand to amortize the investment in the specific infrastructure – *i.e.*, the creation of the land for Airbus – is almost nine times more than the actual lease price of Euro 5.16 million.<sup>440</sup>

357. In addition, however, the EC explains that Airbus benefits from a substantial reduction even in the agreed lease price until 2019 to account for the risk that the newly created land will settle. Effectively, the lease price has been reduced by the City of Hamburg by approximately [ ] percent, to about Euro [ ] per square meter if calculated based on a 20-year term. This

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<sup>437</sup> See U.S. FWS, para. 438 (discussing Keunecke Report (Exhibit US-189)).

<sup>438</sup> EC FWS, para. 804.

<sup>439</sup> Euro 751 million [ ]. See EC FWS, para. 857. The United States maintains that total cost for the site was EUR 751 million. The EC’s argument that the Hamburg Court of Auditors’ calculation – on which the United States’s information is based – is “an earlier, now-outdated 2003 estimate” (EC FWS, para. 758) is simply wrong. In its report, the Court of Auditors noted that the Hamburg government had not included in its cost information certain interim financing cost incurred by the government-owned developer ProFi that should be included in the cost. See Hamburgische Bürgerschaft, Jahresbericht 2003 des Rechnungshofs (2003 Annual Report of the Court of Auditors), Drs. 17/2267, para. 385 (Exhibit US-188). The cost information now provided by the EC also does not include these costs.

<sup>440</sup> EC FWS, para. 761. If the lease of the land and the facilities is viewed as a whole, the lease price a commercial investor would charge (Euro 44.85 million plus the annual lease price for the facilities, Euro 5.62 million according to the EC (EC FWS, para. 763), totaling Euro 50.47 million) is still over five times higher than what Airbus effectively pays (Euro 5.62 million for the facilities according to the EC plus the effective lease price for the land (Euro 3.61 million), totaling Euro 9.23 million).

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results in a saving by Airbus of a total of Euro [ ] million even compared with the agreed lease price.<sup>441</sup> A commercial investor turning wetland and water areas into artificial land for a specific user, Airbus, would not have accepted such a reduction for risks that are inherent in the creation of new land from wetland and water areas (as opposed to risks associated with mistakes the investor may have made in the process). Thus, the lease price that a commercial investor would have demanded is more than [ ] times the effective average lease price paid by Airbus for the land, – *i.e.*, Euro [ ] million (taking into account the [ ] percent reduction).

358. Economically speaking, it is as if the City of Hamburg had provided Airbus a grant of approximately Euro 630 million – the amount of the investment Hamburg did not take into account when calculating the lease price<sup>442</sup> – to turn the Mühlenberger Loch and the Rüschanal into artificial land, thereby enabling Airbus to expand its Finkenwerder site for A380 production.

359. The EC argues that the cost of turning the wetland and water areas in the Mühlenberger Loch and the Rüschanal into a site for Airbus are irrelevant as a benchmark. In the EC's view, these costs do not reflect the benefit to Airbus, but the cost to the Hamburg government. As such, the EC says, these costs should be disregarded when determining the terms a commercial investor would have demanded in leasing the land to Airbus.<sup>443</sup>

360. However, the EC ignores that Hamburg's actions represent a substantial cost savings to Airbus. Had it not been for the government's creation of the land, Airbus would have had to make that investment itself and would have incurred the very cost that the government incurred but did not pass on to Airbus. In this regard, the example the EC sets out at paragraph 827 of its first written submission actually supports the U.S. point. The example involves a government that has a 15 percent cost of borrowing but lends money to a company at a market rate of five percent. The EC correctly concludes that the company in that simple example receives no benefit because it could have gotten the loan from a private source at the same cost, five percent. In other words, the EC compares what the company had to pay the government with what it would have had to pay a market lender. Likewise, the United States compares what Airbus had to pay (or, rather, did not have to pay) Hamburg for its creation of an industrial site made to

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<sup>441</sup> The volume of the reduction, both per square meter and in total can be determined based on a comparison of the actual cash flow (Annex 8 Rev.T of the Land Lease Agreement) (Exhibit EC-561) (BCI) with the hypothetical cash flow had the City of Hamburg charged Euro 3.60 per square meter (or Euro [ ] as agreed in principle (based on Annex 4 Rev T) (Exhibit EC-561) (BCI).

<sup>442</sup> Euro 751 million [ ] (70 percent of the value of the land of Euro 87 million, taking into account the lease price reduction that a private investor would not have accepted).

<sup>443</sup> See, e.g., EC FWS, paras. 820-827; EC Responses to First Panel Questions, para. 239. The EC takes a similar (and equally flawed) approach to its discussion of the sale to Airbus of land on the Aéroconstellation site in Toulouse, France on below-market terms. See EC FWS, paras. 930-935.

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Airbus's specifications with what it would have had to pay a market provider of that good. What it would have had to pay is what Hamburg in fact did pay to procure the good in the first place.

361. That saving the cost of having to create the site itself is a significant benefit to Airbus becomes obvious when one considers the framework agreement concluded between Airbus and the City of Hamburg on July 9, 2004. Under that agreement, Airbus agreed that it would compensate the City of Hamburg for the entire cost of creating the artificial land if it decided to move its A380 production and delivery out of Hamburg.<sup>444</sup> In other words, Hamburg paid for the expansion of the Airbus site to realize a public policy objective, the creation of jobs and the support of A380 production. Or, as Hamburg's then Economics Minister Uldall put it: "Based on the lease alone, the investment indeed does not reach break-even. The whole thing should be considered in a broader public policy perspective."<sup>445</sup> The framework agreement therefore shows that, absent this public policy objective of supporting Airbus – an objective that a private investor would not have pursued – Airbus would have had to pay for the creation of the site. Not having to incur that cost is a benefit to Airbus.

*b. The Airbus lease price is below the price Airbus would have paid in the market, even if the investment in creating the land is not taken into account*

362. Even assuming, for the sake of argument, that the value of pre-existing land is the right basis for determining a market price for Airbus's lease, the actual lease price still falls below a market benchmark. The lease price for the land was determined based on the value of the land, with a return on investment equal to the "*Liegenschaftszinssatz*" (property interest rate).<sup>446</sup> In addition, the parties agreed to reduce this lease price significantly because parts of the land were expected to settle, requiring Airbus to make certain additional investments it would not have incurred had the land not been newly created from wetlands and water areas.<sup>447</sup> This reduction

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<sup>444</sup> As explained above, the United States does not have a copy of the Airbus/Hamburg agreement of July 9, 2004. However, the agreement, including, in particular, the obligations to pay damages in the event of a breach by Airbus, has been described by the City of Hamburg itself (Press Release, Airbus und Senat unterzeichnen Vertrag zur Sicherung der Start- und Landebahnverlängerung (July 9, 2004) (Exhibit US-562)) and in the press (e.g., Die Welt, Abzug aus Hamburg käme Airbus teuer (October 9, 2006) (Exhibit US-563); Focus, Grobe Managementfehler bei Airbus (October 7, 2006) (Exhibit US-564); Die Welt, Airbus: Ole von Beust hält Krisengipfel für Erfolg (October 6, 2006) (Exhibit US-565)).

<sup>445</sup> Hamburger Abendblatt, "Airbus! Hark Bohm, Verlegen Bauer, Senator Uldall streiten beim Abendblatt," p. 3/7 ("Mit dem Zins alleine wäre die Investition in der Tat unrentabel. Das Ganze muss volkswirtschaftlich betrachtet werden.") (Exhibit US-192).

<sup>446</sup> See EC FWS, para. 802.

<sup>447</sup> EC FWS, para. 761.

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was calculated based on [ ]<sup>448</sup>

363. Neither of these two aspects of the lease price calculation is consistent with a market benchmark. Before turning to these calculation issues, however, the United States will address a point regarding the process that Hamburg used to determine whether the terms of the lease with Airbus were consistent with market conditions. As the EC notes, in January 2003, the owner of the title to the site (a special entity established by Hamburg, known as ProFi) requested the Hamburg Committee of Experts for Property Values to examine the terms of the lease.<sup>449</sup>

364. What the EC fails to note is that members of the office of the Committee of Experts for Property Values apparently had been [ ]

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[ ] raises serious doubts as to the credibility of the expert opinions provided by the EC, the more so because the [ ] usually is deeply involved in the preparation of the analysis and the drafting of the opinion.

365. Turning to the Committee's October 23, 2003 opinion, two key points should be noted. First, the opinion treats settlement of the newly created land as "a defect in the leased property."<sup>451</sup> However, even following the EC's theory that it was appropriate for purposes of setting a lease price to treat the site as if it were existing land, this "defect" should have been taken into account in determining the value of the land. Instead, the lease took it into account through a rent reduction based on costs that Airbus might incur to deal with eventual land settlement. In accepting this approach, the Committee of Experts failed to determine a market price for the land – *i.e.*, a price that the City of Hamburg could have obtained in the market from other potential users of the site. What it actually determined was a price specific to Airbus.

366. Second, the Committee's approach is also flawed in that it relied on the *Liegenschaftszinssatz* to determine the rent. This interest rate is not a suitable basis for

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<sup>448</sup> Committee of Experts for Property Values in Hamburg, Report, G03.0058 M21, October 23, 2003, at 8-16 of the English translation (Exhibit EC-563) (BCI).

<sup>449</sup> EC FWS, para. 764.

<sup>450</sup> Committee of Experts for Property Values in Hamburg, Report, G03.0058 M21, October 23, 2003, at 2-3 of the English translation (Exhibit EC-563) (BCI).

<sup>451</sup> Committee of Experts for Property Values in Hamburg, Report, G03.0058 M21, October 23, 2003, at 8 of the English translation (Exhibit EC-563) (BCI); *see also* EC FWS, para. 761.

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determining what return, and thus lease price, a private lessor would have been able to achieve from letting the land in question.

367. The *Liegenschaftszinssatz* is only a calculating factor used in one of three possible methods<sup>452</sup> for the valuation of land under the “*Wertermittlungsverordnung*” (“Valuation Regulation”); it provides no guidance as to the market rent that may be achieved for a specific property.

368. Moreover, the *Liegenschaftszinssatz* is used only for the valuation of built-up land,<sup>453</sup> and only insofar as the value of the building(s) themselves is concerned.<sup>454</sup> The value of vacant land (such as the land leased to Airbus by the City of Hamburg) is supposed to be determined using the *Vergleichswertverfahren*.<sup>455</sup>

369. And the *Liegenschaftszinssatz* is an average value, based on a very broad range of other properties. In reality, however, the return that can be earned from a particular property is highly individualized and depends on the risks associated with investing in that property. The *Liegenschaftszinssatz* is usually not available at such a regional or even property-specific level. Tellingly, the Committee of Experts itself noted that

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<sup>452</sup> The three methods are: a comparative valuation method (*Vergleichswertverfahren*); a method based on return on investment (*Ertragswertverfahren*); and a method based on the material value of the assets (*Sachwertverfahren*).

<sup>453</sup> *Kleiber* in Ernst/Zinnkahn/Bielenberg, BauGB, § 7 WertV, para. 28, states that the *Ertragswertverfahren* is suitable to determine the value of properties whose valuation is mainly determined by returns from, in particular, leases of residential or commercial buildings. (Exhibit US-574).

<sup>454</sup> Sec 15 (1) WertV states: “*Bei Anwendung des Ertragswertverfahrens ist der Wert der baulichen Anlagen, insbesondere der Wert der Gebäude, . . . zu ermitteln.*” (Exhibit US-574).

<sup>455</sup> See *Kleiber* in Ernst/Zinnkahn/Bielenberg, BauGB, § 7 WertV, para. 18, according to which the *Vergleichswertverfahren* is the default method to be used for the valuation of vacant land. (Exhibit US-574).

<sup>456</sup> Committee of Experts for Property Values in Hamburg, Report, G03.0058 M21, October 23, 2003, at 6 of the English translation (emphasis added) (Exhibit EC-563) (BCI).

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370. In sum, the approach taken by the Committee is entirely artificial and does not reflect, [ ], the rate of return that would have applied in the market place.<sup>457</sup>

371. Finally, even assuming that the land leased by the City of Hamburg had already existed (and that a market-based lease price would not, therefore, have reflected the cost of creating the land in the first place), a private landowner certainly would have demanded a premium from Airbus over the lease price it would have charged any other lessee, given that this site is adjacent to Airbus's existing facilities and is the only site that Airbus could use to locate its A380 production in Germany (as discussed above). Such a premium could have been up to three times the "generally applicable" commercial lease price.<sup>458</sup>

### **C. Regional infrastructure grants in Germany and Spain are specific within the meaning of Article 2.2 of the SCM Agreement**

372. In its first written submission, the United States challenged grants for the construction of Airbus and EADS manufacturing and assembly facilities provided by a regional government in Germany and by national, regional, and local governments in Spain, supported in some cases by the European Regional Development Fund.<sup>459</sup> With one exception,<sup>460</sup> the EC does not contest that these grants confer benefits on, and therefore constitute subsidies to, Airbus's LCA

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<sup>457</sup> The Committee at least should have looked at levels of return for other sites to review whether the level of return determined by it for the Finkenwerder site is plausible. Information available for other sites in Hamburg and elsewhere indicates, however, that commercial investors appear to ask for a monthly lease price of at least about Euro 1.00 per square meter (rather than the Euro [ ] per square meter effectively paid by Airbus and the Euro 0.30 per square meter agreed to as the full lease price). For example, DB Services Immobilien GmbH offers a site in Hamburg Rothenburgsort for a monthly rent of Euro 1.00 per square meter. (Exhibit US-575). Also, in August 2004, the Berlin Chamber of Commerce (Industrie- und Handelskammer Berlin) published average lease prices paid for simple storage and logistics space in Berlin. According to this report, open storage sites (*i.e.*, empty land that can be used for storage purposes and thus sites that are very similar to vacant industrial sites) were leased in Berlin at monthly lease prices of Euro 1.20 to Euro 2.00 per square meter for inner city locations and Euro 0.75 to Euro 1.00 per square meter for outer areas. *See* (Exhibit US-576). Generally speaking, real estate prices in Hamburg are far higher than in Berlin. *See* Deutsche Immobilien-Partner, Markt&Fakten, 2003 and 2006 (Exhibit US-577).

<sup>458</sup> In fact, when Airbus and the City of Hamburg attempted to purchase existing agricultural land in the village of Neuenfelde for the extension of the runway to the South of the existing Airbus site, some owners refused to sell. Hamburg's response was to triple its offer from Euro 20.50 per square meter to Euro 61.50 per square meter. *See, e.g.*, Michael Schwelien, in *Die Zeit*, Äpfel oder Airbus (October 21, 2004) (Exhibit US-578). Later, Airbus even offered an additional Euro 3 million on top of Hamburg's already increased offer. *See, e.g.*, *Die Welt*, Airbus will Verlegung von Kirche für A380-Landebahn bezahlen (October 12, 2004) (Exhibit US-579).

<sup>459</sup> *See* U.S. FWS, paras. 488-489 (Germany), 494-513 (Spain).

<sup>460</sup> The exception concerns an October 2004 grant of Euro 61,900,000 by the government of Andalusia to EADS-CASA investment in the municipalities of Sevilla and La Rinconada. *See* EC FWS, paras. 974-978.

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activities. Instead, the EC argues that none of these grants is specific within the meaning of Article 2 of the SCM Agreement.

373. The EC’s argument rests on two mistaken propositions regarding Article 2. The first is that for a subsidy to meet the regional specificity test under Article 2.2, it must be limited to a subset of enterprises within a designated geographical region. The second is that even if a subsidy meets the EC’s mistaken standard of regional specificity under Article 2.2, it nevertheless may be found non-specific by virtue of Article 2.1(b). In this section, the United States demonstrates why each of these propositions is incorrect and, indeed, inconsistent with the EC’s own approach to regional specificity under its countervailing duty law.

1. A subsidy need not be limited to a subset of enterprises within a region to be “specific” within the meaning of Article 2.2 of the SCM Agreement

374. Article 2.2 of the SCM Agreement reads, in relevant part: “A subsidy which is limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority shall be specific.” Importantly, the term “certain enterprises” as used in this sentence is a defined term. As stated in Article 2.1, the term “certain enterprises” as used in the SCM Agreement means “an enterprise or industry or group of enterprises or industries.” It does not mean “a subset of enterprises.”

375. Nevertheless, the EC asserts what it calls an “*e contrario*” reading of Article 2.2, whereby “a subsidy would appear to be non-specific if it is available to *all* enterprises located within a designated geographical region under the jurisdiction of the granting authority.”<sup>461</sup> Following this “*e contrario*” reading, a subsidy would be specific under Article 2.2 only if it were available to a subset of enterprises (but not all enterprises) located within a designated geographical region within the jurisdiction of the granting authority.<sup>462</sup>

376. The EC’s reading of Article 2.2 is not support by the text understood in context and in light of the object and purpose of the SCM Agreement. Nor is it supported by the negotiating history of Article 2.2 or by the EC’s own practice under its countervailing duty law.

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<sup>461</sup> EC FWS, para. 733.

<sup>462</sup> See EC Responses to First Panel Questions, para. 260.

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### *a. Text of Article 2.2*

377. A fundamental tenet of treaty interpretation is that the interpreter “must give meaning and effect to all the terms of the treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.”<sup>463</sup> Yet, adopting the EC’s proposed reading of Article 2.2 would do just that. In particular, it would reduce Articles 2.1(a) and 8.2(b) of the SCM Agreement to redundancy or inutility.<sup>464</sup>

378. Article 2.1(a) provides that a subsidy “shall be specific” if access is “explicitly limited” to “certain enterprises.” Yet, the EC would read Article 2.2 to provide the same thing – that is, to require that a subsidy be explicitly limited to certain enterprises in order to be specific. Following this reasoning, the only difference between Articles 2.1(a) and 2.2 is that, under the latter, the certain enterprises to which a subsidy is explicitly limited happen to be located within a designated geographical region within the jurisdiction of the granting authority. But even if they were not located within a designated geographical region, the subsidy granted to them still would be specific under Article 2.1(a) by virtue of the explicit limitation. Thus, the EC’s “*e contrario*” reading of Article 2.2 renders is incorrect, as it renders that article redundant with Article 2.1(a).<sup>465</sup>

379. In fact, the EC appears to acknowledge this redundancy, referring to it euphemistically as “structural overlap.”<sup>466</sup> It asserts that such “structural overlap” is “not uncommon to international treaty-making” and alludes to “many instances where one principle is laid down in an opening paragraph and further spelt out in a later paragraph with respect to a more specific feature.”<sup>467</sup> Yet, the EC does not cite to even a single instance, let alone “many instances,” to support its position. More fundamentally, the EC fails to reconcile its understanding of international treaty-making with the basic rule of effectiveness in treaty interpretation, as discussed above.

380. Further, the EC’s reading of Article 2.2 is undermined by its redundancy not only with Article 2.1(a), but also with Article 8.2(b). That provision made subsidies in the form of assistance to disadvantaged regions non-actionable during the period when the article was in

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<sup>463</sup> *Japan – Alcohol (AB)*, at 12.

<sup>464</sup> See U.S. FOS, paras. 90-94.

<sup>465</sup> *Accord Australia* Third Party Submission, paras. 55-56.

<sup>466</sup> EC Responses to First Panel Questions, para. 263.

<sup>467</sup> EC Responses to First Panel Questions, para. 263.



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force, as long as the subsidies met certain criteria.<sup>468</sup> One of those criteria was that the subsidies be “non-specific (within the meaning of Article 2) within eligible regions.” Yet, under the EC’s reading of Article 2.2, if a subsidy provided to a particular region is non-specific within that region, then it is not specific under Article 2.2 in the first place. Following that logic, it would have been unnecessary to provide that a regional subsidy is non-actionable if, *inter alia*, it is non-specific within the region.<sup>469</sup>

381. In this regard, it also is notable that Article 8.1(b) refers to “subsidies which are specific within the meaning of Article 2 but which meet all of the conditions provided for in paragraphs 2(a), 2(b) or 2(c) below.” The drafters of the SCM Agreement thus understood that a subsidy could “meet all of the conditions provided for in {Article 8.2(b)}” – including the condition of being “non-specific (within the meaning of Article 2) within eligible regions” – and still be “specific within the meaning of Article 2.” Article 8.1(b) confirms that, contrary to the EC’s understanding, the quality of being “non-specific within eligible regions” does not prevent a subsidy from being “specific within the meaning of Article 2.” Under the EC’s reading of Article 2.2, Article 8.1(b) would make no sense.<sup>470</sup> For this additional reason, therefore, the EC’s proposed construction of Article 2.2 must be rejected.

### *b. Negotiating history*

382. The EC professes to find support for its reading of Article 2.2 in the SCM Agreement negotiating history. However, its discussion of the history is inaccurate and ultimately does not support the EC’s conclusion.

383. During the negotiation of Article 2.2, some delegations argued that the SCM Agreement should treat all subsidies by sub-national authorities as automatically specific, simply because the subsidies were only available to enterprises within the geographical region in question. The EC was one of the proponents of this view. As the EC explained at the time:

Indeed, there is no difference, as to their economic effect, between a subsidy granted by a regional or local government to all firms in that region on one hand, and the same subsidy

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<sup>468</sup> Pursuant to Article 31 of the SCM Agreement, Article 8 applied only for a period of five years following entry into force of the WTO Agreement.

<sup>469</sup> See U.S. FOS, paras. 92-93.

<sup>470</sup> Nor would clauses (i) and (iii) of Article 8.2(b) make any sense. Those clauses set out criteria that must be met for “assistance to disadvantaged regions within the territory of a Member given pursuant to a general framework of regional development and non-specific (within the meaning of Article 2) within eligible regions” to be non-actionable. But under the EC’s theory, the very fact of being “non-specific within eligible regions” would make subsidies non-specific for purposes of Article 2 and thus non-actionable, even without meeting the criteria in clauses (i) and (iii).

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granted to the same firms in the same region but by the central government on the other hand.<sup>471</sup>

384. Others delegations argued that subsidies granted by sub-national authorities should be treated as specific only if they are limited to enterprises in a designated geographical region within the jurisdiction of the sub-national government.

385. The November 7, 1990 draft text that the Negotiating Group on Subsidies and Countervailing Measures transmitted for further negotiation “at the higher level” reflected the first approach. It would have provided (in Article 2.1(d)) that a regional subsidy is specific “irrespective of the nature of the granting authority.” In other words, regardless of whether the granting authority was national or regional, the fact that a subsidy was limited to a “designated geographical region” would automatically make it specific.<sup>472</sup>

386. However, in the final text, the negotiators opted for the other approach. Thus, under what is now Article 2.2 of the SCM Agreement, a subsidy meets the regional specificity test only if it is “limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority.” Unlike the corresponding provision in the November 7, 1990 draft text, this provision means that if the granting authority is a regional government the subsidy is not specific under Article 2.2 unless it is limited to a designated geographical region within the territory over which that government has jurisdiction.

387. It is the latter debate that is reflected in the evolution of the SCM Agreement’s provision on regional specificity. Contary to the EC’s suggestion, the drafters did not discuss, and certainly did not agree, to further require that the subsidy be limited to a subset of enterprises within the geographical region in question.

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<sup>471</sup> Elements of the Negotiating Framework, Submission by the European Community, MTN.GNG/NG10/W/31, at 6 (November 27, 1989).

<sup>472</sup> MTN/GNG/NG10/23, Art. 2.1(d) (Nov. 7, 1990).

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*c. EC practice*

388. Finally, the EC's proposed construction of the regional specificity provision in Article 2.2 is contrary to its own practice. In its response to the Panel's Question 98, the EC asserts that this is not the case.<sup>473</sup> However, the only evidence it provides is the EC CVD Regulation which,

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<sup>473</sup> See EC Responses to First Panel Questions, paras. 268-269.

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as the EC states, simply transposes the relevant provisions from the SCM Agreement without stating how they are interpreted under EC law.<sup>474</sup>

389. A recent countervailing duty proceeding demonstrates that the EC's approach to regional specificity in its own law is not consistent with the reading of Article 2.2 it advocates here. In July 2001, the European Commission initiated a countervailing duty proceeding with respect to imports of sulphanilic acid originating from India. One of the issues in that proceeding concerned the granting of certain incentives by the regional government in the Indian state of Maharashtra.<sup>475</sup> As the Commission explained, "The main component of {these incentives} has been the granting of sales tax benefits to industries in developing and backward regions of the State."<sup>476</sup>

390. The Commission did not find the Maharashtra incentives to be limited to a subset of enterprises. Nevertheless, it found them to be specific, explaining:

The scheme is only available to companies having invested within certain designated geographical areas within the State of Maharashtra. It is not available to companies located outside these areas. The level of benefit is different according to the area concerned. The scheme is therefore specific in accordance with Article 3(2)(a) and Article 3(3) of the basic Regulation.<sup>477</sup>

391. In conclusion, the EC's proposed reading of Article 2.2 of the SCM Agreement is contrary to the ordinary meaning of that provision, would render other provisions of the agreement redundant, is not supported by the negotiating history of Article 2.2, and is not even

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<sup>474</sup> See EC Responses to First Panel Questions, para. 268 and Exhibit EC-623.

<sup>475</sup> See Commission Regulation (EC) No 573/2002 of 3 April 2002 imposing a provisional countervailing duty on imports of sulphanilic acid originating in India, OJ L87/5, 4.4.2002 ("Sulphanilic Acid from India Provisional CVD Regulation"), pp. 11-12 (recitals (63) to (74)) (Exhibit US-580).

<sup>476</sup> Sulphanilic Acid from India Provisional CVD Regulation, p. 11 (recital (63)) (Exhibit US-580).

<sup>477</sup> Sulphanilic Acid from India Provisional CVD Regulation, p. 12 (recital (68)) (Exhibit US-580). This finding was confirmed in the regulation imposing a definitive countervailing duty. See Council Regulation (EC) No 1338/2002 of 22 July 2002 imposing a definitive countervailing duty and collecting definitively the provisional countervailing duty imposed on imports of sulphanilic acid originating in India, OJ L196/1, 25.7.2002, p. 4 (recital (32)) (Exhibit US-581). See also Council Regulation (EC) No 1891/97 of 26 September 1997 imposing a definitive countervailing duty on imports of farmed Atlantic salmon originating in Norway, OJ L267/19, 30.9.1997, recital (26) ("With regard to the business development grants in central regions, investment grants in assisted areas and business development grants in assisted areas, access to the subsidy is limited to enterprises in certain regions and specificity therefore exists.") (Exhibit US-582); *id.*, recital (28) ("{T}he grants which are restricted to certain regions are by definition specific.").

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consistent with the EC's own practice. For all of these reasons, the EC's proposal should be rejected.

2. A finding of specificity under Article 2.2 is conclusive and is not subject to further analysis under Article 2.1(b)

392. The EC's error in its construction of Article 2.2 is compounded by a further error in its understanding of the relationship between Article 2.2 and Article 2.1(b). Thus, the EC asserts that "even if regional aid programmes were considered to limit access to the subsidy under Article 2.1(a) of the *SCM Agreement* to those enterprises located in the designated area, such programmes could be non-specific within the meaning of Article 2.1(b) of the *SCM Agreement*."<sup>478</sup> The EC thus perceives a hierarchical relationship, whereby a finding of non-specificity under Article 2.1(b) will prevail over a finding of specificity under Article 2.2. However, as discussed in the U.S. response to the Panel's Question 118, the text of the *SCM Agreement* does not support this theory.<sup>479</sup>

393. Article 2.2 provides, "A subsidy which is limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority shall be specific." It does not provide (as the EC suggests) for a provisional finding of specificity subject to further analysis under Article 2.1(b). When the drafters of the *SCM Agreement* wanted to make one provision subject to another then knew how to do so.<sup>480</sup> They did not do so in the case of Articles 2.2 and 2.1(b).

394. The EC plainly wants to reach the conclusion that a finding of non-specificity under Article 2.1(b) will prevail over a finding of specificity under Article 2.2, because even under its unsupported reading of Article 2.2, certain of the regional infrastructure subsidies at issue would be found to be specific. However, as no plausible reading of the text will support that conclusion, the EC resorts to the invention of new terms. This notwithstanding its recalling "that the Appellate Body has observed that panels must interpret and apply the language actually used in the Treaty."<sup>481</sup> Thus the EC invents the concepts of "'unrestricted' non-specificity" and

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<sup>478</sup> EC FWS, para. 739; *see also id.*, para. 728.

<sup>479</sup> *See* U.S. Responses to First Panel Questions, paras. 353-364.

<sup>480</sup> *See, e.g.*, *SCM Agreement*, art. 6.4 (making certain findings "subject to the provisions of paragraph 7"); art. 6.6 (requiring Members in whose markets serious prejudice is alleged to have arisen to make certain information available to the panel and parties, "subject to the provisions of paragraph 3 of Annex V"); art. 27.2(b) (making Article 3.1(a) inapplicable to certain developing country Members "subject to compliance with the provisions in paragraph 4").

<sup>481</sup> EC Responses to First Panel Questions, para. 151 (citing *Canada - Aircraft (AB)*, footnote 102).

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“‘focused’ non-specificity.”<sup>482</sup> Despite what its use of quotation marks might suggest, neither of these terms is “language actually used in the Treaty.” Nor does the Treaty make the criteria of Article 2.1(b) “the decisive test”<sup>483</sup> for determining specificity or non-specificity.

395. As the EC’s theory of the relationship between Articles 2.2 and 2.1(b) lacks any basis in the text read in context and in light of the object and purpose of the SCM Agreement it must be rejected.

3. The EC has failed to rebut the U.S. showing that German and Spanish infrastructure-related grants are actionable subsidies

396. As noted at the beginning of this Part VII.C, with one exception (which will be discussed below) the EC does not contest that the German and Spanish infrastructure-related grants challenged by the United States confer benefits on, and therefore constitute subsidies to, Airbus’s LCA activities. The EC’s only defense is that the grants are not specific within the meaning of Article 2 of the SCM Agreement. However, for the reasons just discussed, this defense is based on two theories that find no support in the text, context, or object and purpose of the SCM Agreement. Accordingly, the Panel should find that the EC has failed to rebut the U.S. *prima facie* showing that the grants at issue are actionable subsidies.

**D. Other EC errors in discussion of U.S. infrastructure claims**

397. As noted in the introduction to this part of its submission, in addition to the issues already discussed, the United States wishes to address particular points raised by the EC concerning the U.S. infrastructure-related claims that have not been addressed elsewhere. The points concern the Aéroconstellation site in Toulouse, France; the runway extension at the Bremen airport; one of the Spanish infrastructure grants; and the Welsh grant for Airbus’s Broughton facility.

1. The EC fails to undermine the U.S. demonstration that provision of the Aéroconstellation site to Airbus confers a benefit on Airbus

398. In its first written submission, the United States showed that French authorities transformed agricultural land in Toulouse into a site (the ZAC Aéroconstellation) suitable for use by Airbus as a production, testing, and delivery site for the A380, and then sold the site to Airbus at a below-market price. The United States also showed that the authorities leased so-called EIG facilities at the site (*e.g.*, taxiways, parking, etc.) to Airbus at a below-market price. Finally, the United States showed that the authorities created certain road-work related to the

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<sup>482</sup> EC FWS, paras. 731 and 740.

<sup>483</sup> EC FWS, para. 740.

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Aéroconstellation site, which it provided to Airbus free of charge. As demonstrated in the U.S. first written submission, each of these measures is a subsidy within the meaning of Article 1 of the SCM Agreement, and each is specific within the meaning of Article 2.<sup>484</sup>

399. The EC's principal response is to argue that the goods the French authorities provided to Airbus constitute general infrastructure within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement and therefore are excluded from the definition of "subsidy."<sup>485</sup> In its response to the Panel's Questions 20 and 23, the United States showed why the EC is wrong.<sup>486</sup> The U.S. response to Question 20 also showed that, contrary to what the EC asserts, the measures taken at the Routes Départementales 901, 902, and 963 in connection with establishment of the Aéroconstellation site were *de facto* specific to Airbus, within the meaning of Article 2.1(c) of the SCM Agreement.<sup>487</sup>

400. The above discussion in this Part V of the present submission further demonstrates the flaws in the EC's "general infrastructure" argument. As is the case with respect to the A380 facility in Hamburg, the EC's characterization of the A380 facility in Toulouse relies on an overly broad understanding of "general infrastructure." Following that understanding, goods constitute general infrastructure if their creation is the result of "a legitimate policy choice."<sup>488</sup> However, as discussed above, the EC's understanding finds no basis in the ordinary meaning of the text of Article 1.1(a)(1)(iii) of the SCM Agreement in context and in light of the agreement's object and purpose.

401. Moreover, as with the Hamburg site, the EC's contention that the United States has taken a cost-to-the-government approach to showing the existence of a subsidy as a result of the provision of the Toulouse site to Airbus is mistaken.<sup>489</sup> The EC ignores the fact that by

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<sup>484</sup> See U.S. FWS, paras. 456-485.

<sup>485</sup> See EC FWS, paras. 922-947.

<sup>486</sup> See U.S. Responses to First Panel Questions, paras. 136-151.

<sup>487</sup> The EC claims only that the measures taken at the Routes Départementales 901, 902, and 963 were not specific in law, asserting that "{t}hese improvements are not specific to Airbus France . . . within the meaning of Article 2.1(a) of the SCM Agreement" because access to those improvements was not "explicitly" limited to Airbus. EC FWS, para. 946. However, it is clear from the facts presented in the U.S. response to Question 20 that (i) the overpasses for taxiways at the Route Départementale 901 (one of the improvements) are, in fact, used exclusively by the users of the Aéroconstellation site and primarily by Airbus, and that (ii) the access infrastructure, in particular the traffic circles, created at the Routes Départementales 902 and 963, is used, in fact, exclusively or primarily for access to the Airbus A380 facilities. See U.S. Responses to First Panel Questions, paras. 149-151.

<sup>488</sup> EC FWS, para. 923.

<sup>489</sup> See EC FWS, paras. 930-935.

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transforming agricultural land into an industrial site and then providing it to Airbus at a below-market price, the French authorities have conferred a benefit on Airbus in the form of a cost savings. As with the Hamburg site, had the government not created the Aéroconstellation site for and provided it to Airbus, the company would have had to make the investment itself.<sup>490</sup>

402. The EC makes two additional arguments with respect to the Toulouse infrastructure provided to Airbus, which the United States addresses in this section. First, the EC asserts that the price Airbus paid for the Aéroconstellation land, [ ] per square meter, was a market price.<sup>491</sup> Second, the EC alleges that the United States has not provided sufficient evidence to show that the terms of the lease of the EIG facilities were not commercial (while, however, not even attempting to demonstrate that these terms were actually commercial).<sup>492</sup>

a. *Airbus did not pay a market price for land in the Aéroconstellation site*

403. The EC wrongly believes that the United States used a cost-to-government approach in analyzing whether the sale of the Aéroconstellation land to Airbus constituted a subsidy.<sup>493</sup> In fact, taking into account the investment made by Grand Toulouse in developing the site is not a cost-to-government approach.<sup>494</sup> In principle, the EC appears to agree with that proposition, as evidenced by its discussion of the *Scott Paper* case in its first written submission.<sup>495</sup>

404. The EC's answers to the Panel's Question 92 lends further support to that proposition. The Panel asked whether there are "any circumstances in which it would be appropriate for the Panel to take into account the costs of creating and developing the land for a specific user for the purpose of ascertaining the existence of a benefit." The EC's answer suggests that, in the EC's view, such an approach would at least be justified in cases where the government had undertaken "internal development" measures (such as "internal roads" or "internal supply lines").<sup>496</sup>

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<sup>490</sup> See Part VII.B.4.a, *supra*.

<sup>491</sup> See EC FWS, paras. 927-935.

<sup>492</sup> See EC FWS, paras. 936-938.

<sup>493</sup> See EC FWS, paras. 928-935.

<sup>494</sup> See U.S. Responses to First Panel Questions, paras. 162-166.

<sup>495</sup> See EC FWS, paras. 789-790.

<sup>496</sup> EC Responses to First Panel Questions, para. 236.



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405. That is precisely what the government of Grand Toulouse did in creating the Aéroconstellation site. It spent about Euro 77.9 million on just such internal development measures (*i.e.*, not including the creation of external access roads, and not even including the internal EIG facilities, such as the technical galleries used for the internal supply of water and electricity).<sup>497</sup> Thus, for each of the 950,000 square meters of land up for sale in the ZAC Aéroconstellation, Grand Toulouse spent Euro 82 on turning agricultural land into land fit for industrial use.

406. A commercial owner of the land either would have sold the land “as is” to Airbus 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.<sup>498</sup> Assuming that Airbus paid, as the EC says, [ ] per square meter for the land on which it built its A380 facilities, and assuming, as the EC also says, that the value of the “bare”<sup>499</sup> land was about Euro 25 per square meter,<sup>500</sup> Grand Toulouse provided Airbus with site preparation work worth Euro [ ] per square meter for free.<sup>501</sup>

407. On the 51 hectares acquired by it, Airbus thus saved approximately [ ] that it would otherwise have had to spend itself on turning the agricultural land into a site fit for use by it as the location for its A380 facilities.

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<sup>497</sup> Euro 77.9 million is the difference between the total Euro 158 million that French authorities spent to develop the Aéroconstellation site (*see* U.S. FWS, para. 468) and the 80.1 million of that amount attributable to EIG facilities (*see* U.S. FWS, para. 475).

<sup>498</sup> The EC compared the price of land in the ZAC Aéroconstellation to the price of land in the [ ]]. EC FWS, para. 928. However, the EC earlier explained that public authorities in France buy, improve, and sell the land in ZACs to “promot{e} general economic development.” EC FWS, para. 923. Thus, prices for land in ZACs are, by definition, not market prices, but prices set in accordance with local economic policy objectives. Accordingly, the comparison the EC proposes says nothing about whether the sales price Airbus paid was a market price.

<sup>499</sup> *See* the Atisreal study provided by the EC as Exhibit EC-18 (BCI) at p. 10.

<sup>500</sup> *See* the EC FWS, para. 929: The EC gives a range of Euro 24 to Euro 27 per square meter; *see also* the Atisreal study provided by the EC as Exhibit EC-18 (BCI) at p. 18.

<sup>501</sup> Euro 82 for the development work, plus Euro 25 for the land equals Euro 107 per square meter. Deducting the [ ] per square meter allegedly paid by Airbus leaves [ ] unpaid.

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*b. The lease price paid by Airbus for the EIG facilities is non-commercial*

408. In addition to having paid a price for the land it acquired in the Aéroconstellation site that was far below the price a market-based landowner would have demanded, Airbus also does not pay a lease price reflecting market conditions for the EIG facilities.<sup>502</sup> In its first written submission, the EC addresses the lease of the EIG facilities only very briefly. It asserts that the United States has not shown that the EIG facilities lease confers a benefit on Airbus.<sup>503</sup> However, the EC does not put on any evidence of its own to show that the lease does not confer a benefit; nor does it dispute any of the facts about the lease price submitted by the United States in its first submission.<sup>504</sup>

409. Based on publicly available information, the United States has established that the terms and conditions of the EIG lease are as follows: The lease price for the EIG facilities is calculated so as to amortize the investment cost of Euro 80.1 million over 40 years, plus a small mark-up of 2.2 percent for Euro 62.6 million and of 4.5 percent for the remaining Euro 17.5 million. In addition, the lease price is progressive, *i.e.*, it is significantly lower at the beginning of the lease term and increases over time.<sup>505</sup>

410. These arrangements are obviously not commercial. Assuming equal annual payments,<sup>506</sup> the terms of the lease translate into a lease price of Euro 2.3 million per year for the EIG facilities covered by the Euro 62.6 million share<sup>507</sup> and of Euro 0.9 million for the EIG facilities covered by the Euro 17.5 million share,<sup>508</sup> adding up to a total lease price of Euro 3.1 million. Translated into the initial net return on the EIG facilities,<sup>509</sup> Grand Toulouse generates a 3.7

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<sup>502</sup> See U.S. FWS, paras. 473-475.

<sup>503</sup> See EC FWS, paras. 937-938.

<sup>504</sup> The EC still refuses to provide any information concerning the terms and conditions of the EIG lease agreement and the amount effectively paid by Airbus for the EIG facilities used by it.

<sup>505</sup> See U.S. FWS, paras. 473-475.

<sup>506</sup> In fact, as noted above, the evidence shows that the lease did not provide for equal annual payments but for progressively increasing payments, which is the source of additional benefit to Airbus.

<sup>507</sup> See the calculation attached as Exhibit US-583.

<sup>508</sup> See the calculation attached as Exhibit US-583.

<sup>509</sup> French real estate companies define the initial net return, or “taux de rendement initial”, as the relationship between the rent net of taxes and charges at the time of investment/sale and the investment/sales price (all expenses included). See, *e.g.*, Atisreal, *esynthèse*, Le Marché de l’Investissement en France, p. 10 (February

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percent initial net return on the Euro 62.6 million share; a 5.1 percent initial net return on the Euro 17.5 million share; and a combined 3.9 percent initial net return on the entire investment of Euro 80.1 million in building the EIG facilities. In contrast, a commercial investor in industrial real estate in Toulouse would have required, between 2002 and 2004 (*i.e.*, when the lease terms were negotiated),<sup>510</sup> an initial net return of between 9 and 11 percent,<sup>511</sup> or a lease price of between Euro 7.2 million and Euro 8.8 million.<sup>512</sup>

411. The non-commercial nature of the lease price is further aggravated by three additional factors. First, the lease price calculation undertaken by Grand Toulouse is based exclusively on the cost of creating the EIG facilities and ignores the value of the 119 hectares of land on which the EIG facilities were built. Assuming, for the sake of argument, a land value of approximately Euro 25 per square meter<sup>513</sup> and a 9 to 11 percent commercial net initial return, the annual rent for the land alone would have been between Euro 2.25 and 2.75 per square meter, or between Euro 2.68 million and Euro 3.27 million, for the land alone. Instead, Grand Toulouse provides the land to Airbus for free.

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2007) (Exhibit US-584).

<sup>510</sup> As the United States explained in its first written submission, the initial lease agreement was concluded in 2002 and modified twice, in 2003 and 2004. U.S. FWS, paras. 473-475.

<sup>511</sup> See CB Richard Ellis, *L'Immobilier d'Entreprise en Régions. Market Review. The French Provincial Property Market, 2004*, pp. 6 and 59 (initial net returns for industrial real estate in Toulouse ranged from 9.5 to 12 percent in 2003) (Exhibit US-585); CB Richard Ellis, *L'Immobilier d'Entreprise à Toulouse, 2005*, p. 25 (initial net returns for industrial real estate in Toulouse range between 9 and 10 percent) (Exhibit US-586); Cushman & Wakefield, *Les Marchés Immobiliers, Bureaux, Activités, Commerces. Marché Locatif et de l'Investissement*, January 2004 (between 2001 and 2003, initial net returns on industrial real estate were between 9 and 11 percent) (Exhibit US-587).

<sup>512</sup> Even if one treats the EIG investment as a 40-year loan, accepting, for the sake of argument, the approach taken by Grand Toulouse, the interest rate would be far too low. The 2.2 percent interest rate agreed in 2002 and applicable to the Euro 62.6 million share of the total cost of creating the EIG facilities is less than half of the 2002 risk-free long-term government bond yield for France (which was 4.86 percent, according to Eurostat data) and less than a third of the general corporate borrowing rate of 6.83 percent established for Airbus France for 2002 in the expert's report provided as Exhibit US-80 (*see* Ellis Report at Exhibit 3 (Exhibit US-80 (BCI))). The 4.5 percent interest rate agreed in 2004 for the Euro 17.5 million share, while slightly above the 2004 risk-free government bond yield for France, is still 30 percent lower than the general corporate borrowing rate of 6.17 percent established for Airbus France for 2004 in the expert's report provided as Exhibit US-80 (*see* Ellis Report at Exhibit 3 (Exhibit US-80 (BCI))). In addition, a 40-year loan at a fixed interest rate would have carried a significant mark-up for the duration of the loan and for the risk that (refinancing) interest rates would increase during that long period. Therefore, even if viewed and analyzed as a Euro 80.1 million loan, the lease agreement for the EIG facilities would not have been commercial.

<sup>513</sup> See EC FWS, para. 929.

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412. Second, the lease price increases progressively, further reducing the effective net initial return to far below the 3.9 percent mentioned above. Grand Toulouse calculated the lease price like a hypothetical loan with a 2.2 percent interest rate that is repaid in equal annual installments. After having established these hypothetical annual installments, Grand Toulouse granted Airbus an additional advantage because it deferred payment of these annual installments. Rather than asking for the full amounts from the beginning of the lease, the lease price increases progressively, from [ ] of the average lease price in 2007 to [ ] only about fifteen years later, in 2022/23, [ ] in 2032/33, and [ ] in 2042/44.<sup>514</sup>

413. Finally, the lease price is not subject to [ ], but remains [ ] over the course of 40 years.<sup>515</sup> A private investor would not have acted this way, but would have asked for an [ ] of the lease price to reflect the [ ] of money.<sup>516</sup> The absence of an [ ] clause results in an additional, very large advantage for Airbus.<sup>517</sup>

414. In sum, the average annual lease price of Euro 3.1 million demanded by Grand Toulouse for Airbus's use of the EIG facilities on the Aéroconstellation site is substantially below a market price. A market-based landowner would have asked for an annual lease price of between Euro 9.9 million and Euro 12.1 million for the facilities and the land. In addition, a market-based landowner would not have accepted a deferral of the lease payments (or would have demanded payment for such deferral). Finally, a private investor would have required an [ ]

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<sup>514</sup> This projection is based on the initial 2002 lease agreement that has been provided by the EC as part of another document, the statutes of the AFUL, to which it is attached as Annex 3 (Exhibit EC-124) (BCI). This initial lease agreement contains a [ ] that was calculated based on the then-expected total cost of Euro [ ] million. The EC has not provided the 2003 and 2004 modifications of the lease agreement that reflect the increase in costs. However, from the documents publicly available and submitted by the United States with its first written submission, it is clear that the determination of the lease payments on the increased costs were calculated in exactly the same way as the initial lease agreement. *See* Conseil de Communauté de Grand Toulouse, Délibération no. 2004-05-ADU-01 (May 28, 2004), pp. 4-5 (Exhibit US-214).

<sup>515</sup> *See* the initial 2002 lease agreement, attached as Annex 3 to the statutes of the AFUL (Exhibit EC-124) (BCI).

<sup>516</sup> *See* INSEE, Informations Rapides, Série "Principaux Indicateurs", Indice du coût de la construction, 12 January 2007, p. 2: "The cost of construction index is used, in particular, to adjust lease prices agreed in lease agreements for commercial property." ("L'Indice du coût de la construction est notamment utilisé pour réviser les loyers des baux commerciaux.") (Exhibit US-588).

<sup>517</sup> From the third quarter of 1997 to the third quarter of 2006, lease prices indexed to the INSEE cost of construction index increased annually by 2.86 percent on average. *See* INSEE, L'Indice du Coût de la Construction. (Exhibit US-589). Based on the terms of the lease agreement as modified in 2004, Airbus pays, on average, Euro 3.1 million over the course of 40 years. If one ties the annual payment of these Euro 3.1 million to the INSEE cost of construction index, as a private investor would have done, and assumes an average annual increase of cost of construction by 2.86 percent, the annual lease price would increase to Euro 4.00 million by 2012; Euro 5.30 million by 2022; Euro 7.02 million by 2023; and Euro 9.31 million by 2042.

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J. Since Airbus is the exclusive user of at least 80 percent of the EIG facilities,<sup>518</sup> Airbus receives a benefit of between Euro 5.4 million and Euro 7.2 million per year, plus the additional benefits from the deferral and the lack of [            ].

2.     The EC fails to undermine the U.S. demonstration that provision of the Bremen airport runway extension confers a benefit on Airbus

415.    In its first written submission, the United States showed that the provision of an extended runway, including additional noise protection measures, to Airbus as a “company runway”<sup>519</sup> at Bremen airport for the transport of Airbus wings from Bremen to Toulouse is a subsidy, within the meaning of Articles 1 and 2 of the SCM Agreement.<sup>520</sup> The EC responded by arguing, first, that the extension of the runway as well as the noise protection measures are general infrastructure and, second, that there is no benefit to Airbus from the runway extension because Airbus pays a user fee calculated on the same basis as that paid by any other user of Bremen airport (*i.e.*, the maximum landing weight).<sup>521</sup>

416.    In response to the Panel’s Questions 20 and 22, the United States demonstrated why the extension of the runway and the noise protection measures are not general infrastructure.<sup>522</sup> Here, the United States addresses the EC’s argument that the Bremen measures confer no benefit on Airbus.

417.    The EC admits that Airbus does not pay any fee for the use of the runway extension that would allow Bremen airport (or the City of Bremen) to recoup the investment made in the runway extension.<sup>523</sup> However, it believes that Airbus nevertheless does not receive a benefit from its exclusive use of the runway extension

because it is landing heavier aircraft, and is in turn paying a higher user fee, as would any other user landing similarly heavy aircraft. . . . Heavy aircraft trigger the highest user fees under the City’s regulation. In other words, the City of Bremen earns higher fees

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<sup>518</sup> See U.S. Responses to Panel First Questions, para. 145.

<sup>519</sup> Bremische Bürgerschaft, Antrag (Entschließung der Fraktion der SPD), Drs. 12/194 (Exhibit US-195).

<sup>520</sup> See U.S. FWS, paras. 450-455.

<sup>521</sup> See EC FWS, paras. 869-870 (general infrastructure) and 871-874 (no benefit).

<sup>522</sup> See U.S. Responses to First Panel Questions, paras. 152-154 (runway extension) and 158-161 (noise protection).

<sup>523</sup> EC FWS, paras 873-874; EC Responses to First Panel Questions, paras. 256-257.

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from use of the extended runway, since aircraft using that runway pay the highest weight-related fee.<sup>524</sup>

418. The EC misunderstands the fee regulation adopted by the City of Bremen and misinterprets the facts. First, under the City's fee regulations, “{t}he landing fee is based on the maximum take-off weight of the aircraft as stipulated in the Airplane Flight Manual.”<sup>525</sup> The maximum take-off weight has nothing to do with the actual take-off weight that determines the actual length of runway needed for take-offs. It is therefore also not dispositive of whether or not a departing or landing aircraft uses the extended runway. Second, regardless of the maximum take-off weight, users other than Airbus are not allowed to use the extended runway. Third, the EC mistakenly suggests that the maximum take-off weight of the Beluga or the Super Guppy aircraft (the two aircraft types currently and in the past used by Airbus to transport wings from Bremen) is particularly high.<sup>526</sup>

419. Therefore, a fee arrangement based on the (theoretical) maximum take-off weight does not ensure that Airbus pays for the use of the extended runway. Users of Bremen airport serving the airport with aircraft with a maximum take-off weight exceeding that of the Beluga (and previously the Super Guppy) may be required to pay a higher fee although they are not allowed to use the extended runway. The United States therefore maintains that, absent an arrangement that ensures that the City of Bremen is compensated for the runway infrastructure created specifically for Airbus and open for use only by Airbus, Airbus receives a benefit from having been provided with this infrastructure.

3. The EC fails to undermine the U.S. demonstration that the Andalusian government's Euro 61.9 million grant for EADS-CASA's Sevilla/La Rinconada facility is a specific subsidy

420. As noted in part VII.C above, with one exception, the EC's only defense to the U.S. showing that Spanish infrastructure grants are specific subsidies is a failed attempt to demonstrate a lack of specificity within the meaning of Article 2 of the SCM Agreement. The one exception concerns the U.S. claim concerning an October 2004 grant of Euro 61.9 million

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<sup>524</sup> EC Responses to First Panel Questions, para. 257.

<sup>525</sup> City of Bremen, Entgeltordnung für den Verkehrsflughafen Bremen, 2004, Part 1.2 (Exhibit EC-580).

<sup>526</sup> The Super Guppy has a maximum take-off weight of 77 tonnes; the Beluga has a maximum take-off weight of 155 tonnes. By way of comparison, the A300-600 Freighter has a maximum take-off weight of 170.5 tonnes; the A330-200 Freighter has a maximum take-off weight of 233 tonnes; and the A340-200 has a maximum take-off weight of 275 tonnes. See Airbus, Product Viewer, 18 May 2007 (Exhibit US-590); Flugzeuginfo.net, B-377 SG Super Guppy, 2006, available at [www.flugzeuginfo.net](http://www.flugzeuginfo.net) (Exhibit US-591).

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from the regional government of Andalusia to EADS-CASA for an investment project in the municipalities of Sevilla and La Rinconada.<sup>527</sup>

421. The EC's response to this claim is to assert that the grant is not being used for large civil aircraft activities.<sup>528</sup> However, the evidence that the EC provides fails to substantiate this assertion. One of its exhibits (EC-140 (**BCI**)) is a "PowerPoint" type presentation dated November 2006 that simply describes the layout and other specifications of the EADS-CASA facility in Sevilla. It contains no information about the grant money or how it has been invested.

422. A second exhibit (EC-139 (**BCI**)) is similarly uninformative with respect to the status of the grant. It consists of a series of slides (11 out of what is indicated as being a 37-slide document) dated December 2006, showing the layout of the EADS-CASA Tablada plant and summarizing certain projects apparently performed at that plant. Two of the slides indicate that work at this plant is done for Airbus's A380 and A320 models. Indeed, the EC admits as much in its first written submission.<sup>529</sup>

423. The EC's only other evidence on this issue is Exhibit EC-138 (**BCI**), an information leaflet on EADS's plant in Puerto de Santa María, which says nothing about EADS-CASA's use of the grant. However, the document does confirm that work at this plant involves [

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424. As none of the foregoing evidence even addresses the U.S. *prima facie* case, the EC necessarily has not rebutted that case.

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<sup>527</sup> See U.S. FWS, paras. 512-513.

<sup>528</sup> See EC FWS, paras. 974-978.

<sup>529</sup> See Exhibit EC-139 (**BCI**), pp. 12 (A380) and 17 (A320); EC FWS, para. 976 ("The sales to Airbus Spain concern almost entirely the A320 model, with a very small portion concerning the A380 model.").

<sup>530</sup> Exhibit EC-138 (**BCI**), seventh page.

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4. The EC fails to undermine the U.S. demonstration that the Welsh government's £19.5 million grant for Airbus's Broughton facility is a specific subsidy

425. Finally, in its first written submission, the United States showed that a £19.5 million grant the Welsh Assembly provided to BAE Systems in September 2000 is a financial contribution that confers a benefit on Airbus's LCA production and is therefore a subsidy within



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the meaning of Article 1 of the SCM Agreement. The United States also showed that the subsidy is specific within the meaning of Article 2.<sup>531</sup>

426. The circumstances surrounding this grant are important to understanding why it is a specific subsidy. As discussed in the U.S. first written submission, originally BAE Systems applied for the grant under the Welsh Assembly's Regional Selective Assistance ("RSA") scheme. Subsidies provided under that scheme are specific within the meaning of Article 2.2 of the SCM Agreement, as they are limited to certain "assisted areas" in Wales.<sup>532</sup>

427. The Welsh Assembly rejected that application, which provoked an uproar including, among other things, a threat by BAE Systems to move A380 wing production from Wales to Germany.<sup>533</sup> In the wake of this reaction, the Welsh Assembly relented and provided the £19.5 million grant to BAE Systems, albeit formally under schemes other than the RSA scheme.<sup>534</sup>

428. The EC's response is that the Welsh grant is not specific within the meaning of Article 2 of the SCM Agreement. It alleges that the grant actually consists of three separate grants provided under two different schemes and that neither scheme meets the specificity tests set forth in Article 2.1 or 2.2.<sup>535</sup>

429. However, the EC fails to address the circumstances under which the grants were provided, as summarized above. It ignores entirely BAE Systems's application for a grant under the RSA scheme and the reaction provoked by the rejection of that application. Thus it deals with the grants ultimately provided as if there had been no prior history and the slate was clean when BAE Systems sought those grants. In short, it disregards the totality of the evidence, focusing only on events starting with BAE's application for the grants that ultimately were provided. The EC also fails to address the [

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430. The United States respectfully suggests that the Panel should examine the circumstances surrounding the Welsh grant in their totality and that in doing so it should conclude that the grant indeed is specific within the meaning of Article 2 of the SCM Agreement.

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<sup>531</sup> See U.S. FWS, paras. 490-493.

<sup>532</sup> U.S. FWS, para. 491 and footnote 589.

<sup>533</sup> See U.S. FWS, para. 492.

<sup>534</sup> See U.S. FWS, para. 492.

<sup>535</sup> EC FWS, paras. 993-996.

<sup>536</sup> See U.S. FWS, para. 493.

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### VIII. THE GERMAN GOVERNMENT SUBSIDIZED AIRBUS BY SETTLING DM 9.4 BILLION IN DEBT OWED BY DEUTSCHE AIRBUS FOR A ONE-TIME PAYMENT OF DM 1.7 BILLION

431. In 1998, Deutsche Airbus owed the German government approximately DM 9,400,000,000 in LCA-related debt. In that same year, Deutsche Airbus and the German government reached an agreement whereby the company made a one-time, lump sum payment of DM 1,735,000,000, in consideration for which the government extinguished the remainder of the debt. As a result, Deutsche Airbus was not required to repay the approximately DM 7,700,000,000 difference between the face amount of the debt and the amount of its lump sum payment to the government (not to mention any interest).<sup>537</sup>

432. The EC does not dispute these facts. Nevertheless, it would have the Panel believe that the elimination of DM 7,700,000,000 in debt did not confer a benefit on the company. Its theory is that the 1998 transaction was not really debt forgiveness but, rather, a fair-value payment for the net present value of the outstanding debt.<sup>538</sup>

433. As the United States previously has explained, while it does not accept the EC's characterization of the 1998 transaction, the characterization – whether as debt forgiveness or as a settlement based on the net present value of the debt – does not change the fact that the transaction conferred a benefit. Under either characterization, the German government effectively turned potential benefits that Deutsche Airbus might have enjoyed in the future from savings on debt provided interest-free by the German government into an actual cash grant of DM 7.7 billion provided in 1998.<sup>539</sup>

434. Also, it should be recalled that under the terms of the government's 1989 aid package to Deutsche Airbus (as amended in 1992), the company would have had to start making annual payments to the government, from 2001 forward, depending on the company's level of profitability. Given the unpredictability of its future profitability, there was substantial uncertainty over how high each annual payment would be and therefore how far into the future the payments would continue. That uncertainty translated into uncertainty over the ultimate size

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<sup>537</sup> See U.S. FWS, paras. 529-535.

<sup>538</sup> See EC FWS, paras. 1198-1202. The EC also uses this occasion to repeat its “pass-through” theory, wrongly suggesting that having shown that the government conferred a benefit on Deutsche Airbus, the United States had a further obligation to account for that benefit when Deutsche Airbus restructured its relationship with other subsidized Airbus entities. See EC FWS, paras. 1172-1173. As the United States has explained, this “pass-through” theory is specious. See, e.g., U.S. Responses to First Panel Questions, paras. 108-123, 168-169.

<sup>539</sup> See U.S. FOS, paras. 95-99; U.S. Responses to First Panel Questions, paras. 191-200.

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of the benefit Deutsche Airbus would receive as a result of the aid package. The 1998 transaction eliminated that uncertainty, ensuring that Deutsche Airbus received the full benefit of DM 7.7 billion regardless of how profitable the company might or might not be in the future.<sup>540</sup>

435. In the EC's view, the U.S. response to the EC's characterization of the 1998 transaction amounts to the assertion of a new claim.<sup>541</sup> This accusation is false. The United States simply has responded to the EC on its own terms, demonstrating that even if, *arguendo*, the EC's characterization of the 1998 transaction were accurate, the transaction still conferred a benefit on Airbus and thus constitutes a subsidy within the meaning of Article 1 of the SCM Agreement.<sup>542</sup>

436. The EC's theory that the United States really is challenging the German government's 1989 aid package to Deutsche Airbus rather than the 1998 debt settlement, and that the aid package is outside the Panel's terms of reference because it was not identified in the U.S. panel request is mistaken. First, in point of fact, the EC's assertion that "{t}he US panel request does not include any reference to the 1989 restructuring measure, either in connection with, or in addition to, the 1998 settlement"<sup>543</sup> is patently false. The EC's quotation from the U.S. panel request makes this abundantly clear. The request refers, in relevant part, to

{t}he assumption and forgiveness by the EC and the member States of debt resulting from launch aid and other financing for large civil aircraft development and production, including debt accumulated by Deutsche Airbus that was forgiven by the German government in 1997 and 1998.<sup>544</sup>

437. This passage from the U.S. panel request unmistakably refers not only to the German government's "forgiveness" of debt owed by Deutsche Airbus but also to its earlier "assumption . . . of . . . debt accumulated by Deutsche Airbus." The government's assumption of debt accumulated by Deutsche Airbus necessarily refers to the 1989 aid package, which the United States discussed in detail in its first written submission.<sup>545</sup>

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<sup>540</sup> See U.S. Responses to First Panel Questions, para. 194 (quoting Daimler-Benz, Annual Report 1997, pp. 96-97 (Exhibit US-262)); *id.*, para. 200.

<sup>541</sup> See EC Closing Statement at First Panel Meeting, para. 23; EC Responses to First Panel Questions, paras. 285-302.

<sup>542</sup> See U.S. Responses to First Panel Questions, paras. 201-205.

<sup>543</sup> EC Responses to First Panel Questions, para. 293.

<sup>544</sup> WT/DS316/2, p. 2 (point 4) (emphases added).

<sup>545</sup> See U.S. FWS, paras. 518-528.

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438. Thus, even if the EC's theory about the nature of the U.S. challenge were correct (which it is not), its assertion that the 1989 German aid package to Deutsche Airbus is outside the Panel's terms of reference is incorrect.

439. Second, the EC mistakes the relevance of the 1989 aid package to the U.S. claim. The United States is not challenging the aid package in and of itself. If it were doing so, it would have focused on the benefit the German government conferred on Airbus from 1989 until the debt settlement in 1998 and the adverse effects to U.S. interests caused by the conferral of that benefit.

440. What the United States is challenging is the 1998 debt settlement transaction. That transaction – the payment of DM 1,735,000,000 to extinguish a debt of DM 9,400,000,000 – appears to be a forgiveness of the approximately DM 7,700,000,000 difference between the face amount of the debt and the amount the company actually paid the government.<sup>546</sup> Indisputably, Deutsche Airbus owed the German government one amount, paid it a much smaller amount, and thereafter owed it nothing. It is on this basis that the United States, in its first submission, argued that the transaction constitutes a financial contribution that confers a benefit and thus constitutes a subsidy within the meaning of Article 1 of the SCM Agreement.<sup>547</sup>

441. In light of the EC's response that the 1998 transaction was an exchange for fair value rather than debt forgiveness, the United States reexamined the transaction from the point of view of the EC's characterization. That necessarily entailed consideration of the elements that determined the fair value of the debt, notably its highly preferential repayment terms. The reexamination showed that following the EC's characterization leads economically to the same result as originally observed by the United States: Through the debt settlement, the German government effectively transformed potential benefits that Deutsche Airbus might have enjoyed in the future from savings on debt provided interest free by the government into a cash grant of DM 7.7 billion provided in one lump sum in 1998.

442. In short, contrary to the EC's accusation, the United States has not introduced a new claim into this dispute. It simply has responded to an EC argument by showing that even accepting, *arguendo*, the premise of that argument, the 1998 settlement of Deutsche Airbus's debt to the German government still conferred a benefit on Airbus and therefore constitutes a subsidy under Article 1 of the SCM Agreement.

### **IX. THE EC FAILS TO UNDERMINE THE U.S. SHOWING THAT GERMAN AND FRENCH EQUITY INFUSIONS CONFERRED BENEFITS ON AIRBUS**

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<sup>546</sup> See U.S. Responses to First Panel Questions, footnote 232 (setting out ordinary meaning of "forgive").

<sup>547</sup> See U.S. FWS, paras. 529-535.

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443. In its first written submission, the United States showed that Airbus benefits from equity infusions provided by the German and French governments at moments when a market-oriented investor would not have made such investments due to the dire financial condition of the French and German Airbus companies, respectively. The United States showed that equity infusions made under such conditions constitute subsidies within the meaning of Article 1 of the SCM Agreement, and it showed that the German and French equity infusions at issue are specific within the meaning of Article 2.<sup>548</sup>

444. The EC's response is to challenge the proposition that providing equity to Airbus when the German and French governments did was not consistent with the usual investment practice of private investors in the territory of Germany and France, respectively.<sup>549</sup> To make its case with respect to the German infusion, the EC engages in a serious re-writing of history, relying on a false benchmark that it holds up as a market benchmark. It asserts that "at the same time" that the government made its investment a private investor, "Daimler (through MBB)," also made an investment in Deutsche Airbus – omitting the fact that Daimler's willingness to make its investment depended heavily on the government first providing a substantial aid package which included the government's own investment.<sup>550</sup>

445. To make its case with respect to the French infusion, the EC relies on evidence such as statements by management (rather than potential private investors) at and around the time the government made its investments in Aérospatiale and *ex post* information about returns supposedly realized on those investments. It also looks selectively at indicators of financial performance, ignoring the most relevant indicators (such as return on equity) that a private investor would have examined.<sup>551</sup>

446. In this part of its submission, the United States will elaborate on the EC's errors in attempting to defend both sets of equity infusions as consistent with the usual practice of private investors.

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<sup>548</sup> See U.S. FWS, paras. 537-556 (German equity infusions), 557-620 (French equity infusions).

<sup>549</sup> See EC FWS, paras. 1110-1171 (French equity infusions), 1205-1221 (German equity infusions). Additionally, the EC repeats in this context its so-called "pass-through" theory, suggesting that having established that subsidies were provided to Airbus companies, the United States had an additional obligation to account for the continuation of those subsidies when the Airbus companies restructured their relationship to one another to form Airbus SAS. See *id.*, paras. 1109 and 1203. For reasons discussed previously, this theory is fatally flawed. See, e.g., U.S. Responses to First Panel Questions, paras. 108-123 and 168-169.

<sup>550</sup> See EC FWS, para. 1216; see also EC Responses to First Panel Questions, paras. 274-276.

<sup>551</sup> See EC FWS, paras. 1110-1171; see also U.S. Responses to First Panel Questions, paras. 173-175 and 176-186.

**A. The German equity infusions were not consistent with the usual practice of private investors**

447. In its first written submission, the EC concedes the core facts submitted by the United States in its first written submission: In 1989, the German government, through the government-owned bank Kreditanstalt für Wiederaufbau (“KfW”), provided DM 505 million in fresh capital to Deutsche Airbus.<sup>552</sup> This capital injection was part of a large aid package for Deutsche Airbus that also included the repayment of private debt by the German government, the deferral of Launch Aid repayments, a loan for the production of the A320, and insurance against exchange rate risks.<sup>553</sup>

448. According to the EC, the DM 505 million injection was effectuated through [

] <sup>554</sup>

449. The EC also explains that the German government, when making the DM 505 million investment in Deutsche Airbus through KfW, agreed with MBB and Deutsche Airbus that (i) MBB would purchase the Deutsche Airbus shares held by KfW by 1999 at the latest, at their fair market value, and (ii) Deutsche Airbus would [

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450. The EC argues that the government’s DM 505 million equity infusion did not confer a benefit on Airbus because KfW paid the same price per share as MBB. It also seeks to dismiss evidence relied upon by the United States as irrelevant. The EC is wrong on both counts.<sup>556</sup>

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<sup>552</sup> See EC FWS, para. 1214.

<sup>553</sup> See EC FWS, para. 1180.

<sup>554</sup> See EC FWS, para. 1214 and footnote 983.

<sup>555</sup> See EC FWS, paras. 1180 and 1209.

<sup>556</sup> Separately from its argument with respect to the original DM 505 million equity infusion into Deutsche Airbus, the EC argues that the 1992 return of KfW’s shares in Deutsch Airbus also did not constitute a subsidy. See EC FWS, paras. 1205-1210. The United States addressed the latter argument in its responses to the Panel’s Questions 25. See U.S. Responses to First Panel Questions, paras. 169 and 206-212. In the interest of avoiding unnecessary repetition, the United States will not repeat that discussion here.

## FINAL NON-BCI VERSION

### 1. The purchase price paid by MBB is not the relevant benchmark

451. The purchase price paid by MBB (or, as the EC puts it, “Daimler, through MBB”) for the newly issued shares in Deutsche Airbus is not a relevant benchmark for determining whether the German government’s equity infusion was consistent with the usual investment practice of private investors in Germany.

452. First, the EC misrepresents the facts. The EC states that the newly issued Deutsche Airbus shares “were sold to Daimler, through MBB,”<sup>557</sup> misleadingly suggesting that Daimler became a new direct investor in Deutsche Airbus and purchased shares in Deutsche Airbus. This is wrong. Daimler invested in MBB, the parent company of Deutsche Airbus, not in Deutsche Airbus. It purchased a 50.3 percent majority stake in MBB, in part through a capital increase, in part through the acquisition of shares and the conclusion of voting agreements.<sup>558</sup> For this transaction, MBB issued DM 258 million in new shares, representing 30.7 percent of all MBB shares, which it sold to Daimler for DM 993 million. Of these DM 993 million, MBB used DM 800 million to purchase DM 294 million of the newly issued Deutsche Airbus shares, or 31.6 percent of all Deutsche Airbus shares. None of this indicates that Daimler, as the EC suggests, paid DM 2.72 per Deutsche Airbus share.

453. Moreover, the acquisition by MBB (or by “Daimler, through MBB”) of shares in Deutsche Airbus cannot be viewed in isolation and used as a benchmark to determine whether the injection by KfW of DM 505 million into Deutsche Airbus was consistent with the usual investment practice of private investors. Rather, this acquisition was part of a much more complex set of transactions that served to achieve “the gradual transfer of the German share in Airbus to complete industrial responsibility by 2000 at the latest.”<sup>559</sup>

454. Or, as the Monopolkommission put it when reviewing the transaction under German merger control rules:

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<sup>557</sup> EC FWS, para. 1214.

<sup>558</sup> The acquisition was structured in two parts: a December 21, 1989 increase in MBB’s capital stock by DM 258 million nominal to DM 858 million nominal (MBB 1989 Annual Report, at 68 (Exhibit US-592)) and the acquisition by Daimler-Benz of shares from and conclusion of voting right agreements with existing MBB shareholders (*Id.*, at 12).

<sup>559</sup> MBB 1989 Annual Report, p. 12 (translated from the German original) (Exhibit US-592). The sentence reads as follows: “The acquisition of a majority shareholding by Daimler-Benz AG in MBB is tied to the conclusion of a complex set of agreements with the Federal Republic of Germany, designed to remove of “old burdens” {*i.e.*, old private debt, existing exchange rate risks etc.} (*Alllastensanierung*) the gradual transfer of the German share in Airbus to complete industrial responsibility by 2000 at the latest.”

## FINAL NON-BCI VERSION

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Daimler-Benz linked its stake in MBB to a series of commitments by the federal government, and they significantly limit any risk to Daimler-Benz which is associated with the acquisition of the German share of Airbus. . . . First, the federal government participates in the Airbus risk as a *co-owner* of {Deutsche Airbus}. . . . Second, the German federal government bears the preponderance of the *burden of re-structuring* the German share of Airbus. . . . Third, repayment claims by the federal government, which exist for most federal support, have been delayed far into the future. . . . Fourth, the federal government has assured Daimler-Benz that it is willing to keep supporting the *development of new Airbus programs*. . . . {T}he merger offers an opportunity to shift the entrepreneurial risk from the federal government to the industry *over the very long haul*. Most of the risks of financing development and sales will of course most likely continue to be borne by the federal government.<sup>560</sup>

455. Thus, if anything, the conditions imposed by Daimler on its investment in MBB (which led to the injection of additional capital by MBB into Deutsche Airbus) demonstrate that a private investor was only prepared to make an (even indirect) investment in Deutsche Airbus with government support. Without the significant subsidy package that Deutsche Airbus received from the German government, Daimler was not prepared to make even an investment in Deutsche Airbus' parent MBB, let alone in Deutsche Airbus itself.

456. In this regard, it is misleading for the EC to suggest (as it does in response to the Panel's Question 100) that the aid package provided by the German government to Airbus must be viewed in isolation from the DM 505 million capital injection made by the KfW.<sup>561</sup> The EC portrays the transactions as a two-stage process: a restructuring of a "financially troubled company" followed by an investment by KfW in a healthy company. The EC asserts that if, "following the financial restructuring measures, a government injects capital on equal terms with a private investor, such a capital injection does not confer a benefit on the recipient company."<sup>562</sup> Thus, the EC contends that the aid package and the injection were "two separate elements"<sup>563</sup> and comes to the conclusion that "KfW's investment in Deutsche Airbus was consistent with the usual investment practice by private investors in Germany because KfW invested in the restructured Deutsche Airbus at the same terms as a private investor."<sup>564</sup>

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<sup>560</sup> Monopolkommission, paras. 129 to 134 (Exhibit US-30). (Translated from the German original. Italics in the original. Underlining added.)

<sup>561</sup> See EC Responses to First Panel Questions, paras. 271-276.

<sup>562</sup> EC Responses to First Panel Questions, para. 273.

<sup>563</sup> EC Responses to First Panel Questions, para. 274.

<sup>564</sup> EC Responses to First Panel Questions, para. 276.



## FINAL NON-BCI VERSION

457. This separation of the alleged “restructuring package” – *i.e.*, of a comprehensive subsidy package – from the KfW capital injection is artificial and not supported by the facts. The injection of capital by KfW was clearly part of the restructuring package rather than an unrelated follow-on event. In fact, even the EC itself, in its summary of the “restructuring package” in its first written submission, describes the “time-limited equity investment in Deutsche Airbus by {KfW}” as one of five measures to support Deutsche Airbus. The EC goes on to note that this “element of the restructuring package reflected the continued interest and stake of the German government in the outcome of the restructuring process.”<sup>565</sup> Thus, rather than a separate transaction subsequent to the aid package, the KfW injection was part and parcel of the aid package and served to “continue” the aid package into the future.

458. This assessment by the EC itself is supported by contemporaneous documents, including the detailed analysis of the transaction by the German Monopolkommission quoted above, that show that, at the time the investment was made, the acquisition of a 20 percent shareholding by the German government (through KfW) was one of a series of measures and one of the pre-conditions for Daimler-Benz to acquire a stake in MBB.<sup>566</sup>

459. Given the foregoing circumstances, the EC errs in contending that MBB’s purchase of shares in Deutsche Airbus is an appropriate benchmark for determining whether the German government’s equity infusion into Deutsche Airbus was consistent with the usual investment practice of private investors in Germany.

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<sup>565</sup> EC FWS, para. 1180 (emphasis added).

<sup>566</sup> Monopolkommission, paras. 129-134 (Exhibit US-30).

## FINAL NON-BCI VERSION

2. The evidence relied upon by the United States shows that the German government's investment was not consistent with the usual investment practice of private investors in Germany

460. In addition to urging an inappropriate benchmark for analyzing whether the German equity infusion conferred a benefit, the EC errs in its attempt to discredit the evidence relied upon by the United States.<sup>567</sup> The EC incorrectly suggests that the United States based its assessment of Deutsche Airbus's equity-worthiness solely on an assessment of the financial condition of the company's parent (MBB). While noting the dire state MBB was in when Daimler invested in MBB, the United States pointed in particular to the financial distress that Deutsche Airbus was in at the time and was expected to be in for the foreseeable future.

461. For example, the United States referred to the significant liabilities on Airbus's balance sheet that the German government partly eliminated in 1987 to give the "German Airbus partner MBB the possibility of taking on new shareholder capital so as to be better prepared for the Airbus risks."<sup>568</sup> But even that write-off of DM 1.9 billion proved insufficient for Deutsche Airbus to recover. In particular, the continuing and substantial risks from changes in the DM/dollar exchange rate led to a further deterioration of Deutsche Airbus's financial situation. The German government thus noted in late 1988:

{D}ue to the modified exchange situation, further burdens have since arisen or are expected. . . . {A pan-European} restructuring {of Airbus} cannot be achieved in the short-term, because the sale {of Deutsche Airbus} to other Airbus partners or through the capital markets is currently impossible, due to the financial problems of the Airbus program.<sup>569</sup>

462. In sum, the German government was entirely correct when it listed the DM 505 million capital injection by KfW into Deutsche Airbus as a "Subvention" – or, in English, as a subsidy – for Airbus. Given its inconsistency with the usual investment practice of private investors, that is what it was.<sup>570</sup>

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<sup>567</sup> See EC FWS, para. 1217 (calling U.S. evidence "obscure" and "irrelevant").

<sup>568</sup> German Economics Ministry, Press Release, Daimler-Benz - MBB/Erklärung des Bundesministeriums für Wirtschaft zur Neustrukturierung der Luftfahrtindustrie (Exhibit US-259); see U.S. FWS, para. 546.

<sup>569</sup> German Economics Ministry, Press Release, Daimler-Benz - MBB/Erklärung des Bundesministeriums für Wirtschaft zur Neustrukturierung der Luftfahrtindustrie (Exhibit US-259).

<sup>570</sup> See U.S. FWS, para. 540 (citing the German government's statement in BT-Drs. 13/8409, at 13-14 (Exhibit US-31)). The EC argues that this statement is irrelevant because the term "Subventionen" used in the German original "can have a number of different meanings in English." See EC FWS, para. 1217 and footnote 988. The United States consulted several German/English dictionaries for a translation of the term "Subventionen" into English. They all provide one and the same translation into English – the word "subsidy" – and do not suggest it

**B. The French equity infusions were not consistent with the usual practice of private investors**

463. In this section, the United States first shows that the EC has failed to rebut the U.S. showing that the four French government equity infusions into Aérospatiale that took place from 1987 to 1993 conferred benefits and thus constitute subsidies. The United States then will address the government's 1998 transfer of its shares in Dassault to Aérospatiale and show that the EC has failed to rebut the U.S. showing that this financial contribution, too, conferred a benefit and thus constitutes a subsidy.

1. The EC's argument with respect to the 1987-1993 equity infusions mistakenly relies on *ex post* information, statements by management, and only partial financial data

464. As noted above, the EC's attempt to show that French government equity infusions into Aérospatiale from 1987 to 1993 were consistent with the usual practice of private investors suffers from three main flaws. First, it relies on *ex post* data about supposed returns on the investments, rather than data contemporaneous with the investments. Second, it focuses on the perspective of management at the time the investments were made, rather than the perspective of private investors. And, third, it focuses selectively on the data an investor would look at in deciding whether to purchase an equity stake in a company and disregards some of the most significant data.<sup>571</sup>

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could mean anything but a measure by which the recipient receives a benefit. *See, e.g.*, Dietl/Lorenz, Dictionary of Legal, Commercial and Political Terms, 1992, p. 657; Oxford/Duden, German Dictionary, 2<sup>nd</sup> edition 1999, p. 718. (Exhibit US-594). In addition, the EC suggests that the United States has misinterpreted the German government's response to the question asked by a Member of the Parliament. There is no room for interpretation of the German government's response, and therefore also no room for misinterpretation: The Parliamentarian asked for a list of the "Subventionen" (or, in English, subsidies) provided to Airbus, and the German government provided a list of measures in response, including Launch Aid, the 1989 subsidy package (including the exchange rate insurance scheme, the repayment of Airbus' private debt by the German government, the A320 loan, and the DM 505 million capital injection made by the German government through the KfW), and the sales financing subsidies provided to Airbus.

<sup>571</sup> *See generally* U.S. Responses to First Panel Questions, paras. 170-172, 173-175, and 176-186.

## FINAL NON-BCI VERSION

*a. EC mistakenly relies on ex post data*

465. Investors, as the EC rightly notes are focused on potential earnings in the years ahead.<sup>572</sup> To assess future potential earnings, an investor looks at the current financial health of a company (as indicated, for example, by its balance sheet and financial ratios) and its future prospects. It does so on the basis of information available at the time just prior to the decision to make the investment.<sup>573</sup> For example, an investor may look at a company's financial ratios, its recent return on equity, its debt-to-equity ratio, its expected future cash flows, and any other contemporaneous information that may allow the investor to formulate reasonable expectations as to the potential return on its investment.

466. By contrast, it goes without saying that no investor can take into account at the time of investment the actual future performance of the target of the investment. Nor can the investor take account of any other information that only becomes known at a later date.

467. Bearing the foregoing principles in mind, when the United States analyzed the 1987-1993 French equity infusions it considered precisely the contemporaneous information that a private investor would have considered at the time of each infusion: *i.e.*, core financial ratios of the company (debt-to-equity, debt coverage ratio, and return-on-equity) and contemporaneous information on future prospects, such as information contained in the company's own annual reports.<sup>574</sup>

468. By contrast, the EC's criticism of the U.S. analysis relies heavily on *ex post* information that the French government (or a private investor) could not have known when making its equity infusions in Aérospatiale. For example, the EC refers to what it calls a "contemporaneous" U.S. National Research Council study that it suggests would reflect industry sentiment during the period in which the French government provided its equity infusions to Aérospatiale.<sup>575</sup> In reality, this "contemporaneous" study is a 1994 study, whereas the last of the four equity

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<sup>572</sup> See EC FWS, para. 1140.

<sup>573</sup> See *Korea - Commercial Vessels*, para. 7.491 ("{W}e consider that the terms of the debt-for-equity swap should not be analysed *ex post*, on the basis of the price at which DSME's shares were publicly traded, or the price offered by potential buyers of DSME. Instead, the terms of the debt-for-equity swap should be assessed in light of the facts before creditors at the time they decided upon them." (Emphasis added)).

<sup>574</sup> See, *e.g.*, U.S. FWS, paras. 599-603 (financial health) and 603 (future prospects); *see also id.*, paras. 569 (discussing equity relative to long-term borrowings and liabilities in 1986 as part of consideration of 1987/1988 equity infusions), 570 (looking at debt-to-equity ratios relative to those of peers in 1986 and 1987 as part of consideration of 1987/1988 equity infusions), 603 (discussing 1993 annual report in context of consideration of 1993 equity infusion).

<sup>575</sup> EC FWS, para. 1118.

## FINAL NON-BCI VERSION

infusions that the US challenges was provided on December 31, 1993.<sup>576</sup> Moreover, even this 1994 study notes an outlook on the commercial aircraft market tinged by “considerable pessimism concerning the next several years.”<sup>577</sup>

469. Additionally, the EC refers to the actual rate of return of [ ] that it alleges the French government eventually earned on its equity infusion in Aérospatiale.<sup>578</sup> As the EC’s own chart calculating this return (Exhibit EC-171) shows, it was calculated based on the value of the company at the time of the EADS IPO in 2000/2001. Not only is this a decade after the equity infusions that the EC suggests it justifies, it is also the value of the company after a decade of not just equity infusions, but Launch Aid, EIB loans, various types of R&D support, and provisions of infrastructure and infrastructure grants by the Airbus governments to the company. Moreover, in the shorter term, Aérospatiale’s value suffered heavily and could only be maintained through further massive government support.

470. Further, in its discussion of Aérospatiale’s performance and prospects, the EC emphasizes Aérospatiale’s “return to profitability in 1996” and the fact that it remained profitable through the merger with MHT and the creation of EADS in 2000.<sup>579</sup> But those facts occurred entirely after the 1988-1993 equity infusions, and indeed, the billions of dollars in equity infusions and Launch Aid provided in the late 1980s and early 1990s played a large role in making the company profitable again.

471. By contrast, the EC does not provide any evidence of contemporaneous studies or analyses by the French government on the investment prospects of Aérospatiale at the time of the equity infusions. This lack of evidence is all the more remarkable in light of the express request by the Annex V Facilitator that the EC provide precisely such information.<sup>580</sup> The EC’s failure to do so indicates that the French government did not take into account the financials and business prospects of Aérospatiale the way a private investor would.

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<sup>576</sup> U.S. FWS, para. 594.

<sup>577</sup> See EC FWS, para. 1119 (quoting Exhibit EC-170 at pp. 65 and 66).

<sup>578</sup> EC FWS, paras. 1122, 1130.

<sup>579</sup> EC FWS, para. 1136.

<sup>580</sup> See, e.g., *Questions from the Facilitator for the European Communities Pursuant to Annex V of the SCM Agreement*, Q100(g) (Oct. 7, 2005) (Exhibit US-4 (BCI)).

## FINAL NON-BCI VERSION

*b. EC mistakenly focuses on perspective of Aérospatiale management*

472. In addition to its reliance on information post-dating the French equity infusions rather than on contemporaneous information, the EC response to the U.S. claims is notable for its numerous references to the perspective of management, rather than the perspective of a private investor.<sup>581</sup> Thus, the EC refers to management’s understanding of “the need to boost investment in the company’s development activities,”<sup>582</sup> management’s “contempla{tion} {of} a new long-haul programme,”<sup>583</sup> management’s understanding that “it is imperative to invest even during periods of weak performance,”<sup>584</sup> and so forth.

473. But, as the United States discussed in its response to the Panel’s Question 28,<sup>585</sup> management’s perspective is not relevant to the issue at hand. Management’s point of view is hardly that of a private investor (*i.e.*, the relevant benchmark for determining whether equity infusions confer a benefit). Whereas a private investor has virtually limitless options for investing its capital, management is ostensibly focused on how to maximize the returns of a single investment (in this case, Aérospatiale).

474. In short, the fact that Aérospatiale management may have perceived a need for new capital at various times does not mean, as the EC suggests, that an equity infusion provided in response to that perceived need is consistent with the usual practice of private investors.

*c. The EC’s reference to Aérospatiale’s profitability in select periods fails to show that the government’s equity infusions are consistent with the usual practice of private investors*

475. A third flaw in the EC’s attempt to show that the French government’s equity infusions in Aérospatiale did not confer benefits is its selective review of relevant performance indicators. In particular, the EC focuses on a few years of minimal profitability for Aérospatiale (1987, 1988 and 1991) and order increases in the late 1980s to suggest a pattern of good prospects and a healthy financial situation for the company. In 1987, 1988 and 1991, the EC points out, Aérospatiale was profitable, and these financial results “would have been before the French State

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<sup>581</sup> See, *e.g.*, EC FWS, paras. 1116, 1120, 1131, 1139, 1145-1147, 1153, and 1155.

<sup>582</sup> EC FWS, para. 1120.

<sup>583</sup> EC FWS, para. 1134.

<sup>584</sup> EC FWS, para. 1139.

<sup>585</sup> See U.S. Responses to First Panel Questions, para. 183.

## FINAL NON-BCI VERSION

when it was assessing whether to make the 1988, 1989 and 1992 capital injections.”<sup>586</sup> Several paragraphs later, the EC points to increases in Airbus’s sales and increasing order backlog.<sup>587</sup>

476. What the EC does not mention is that the “profits” were marginal at most. In 1987 and 1988, Aérospatiale’s net income was a mere FF 50 million and FF 93 million, respectively – as compared to a FF 1.25 billion equity infusion in each year,<sup>588</sup> and total turnover of almost FF 25 billion and almost FF 28 billion, respectively, in those same years.<sup>589</sup> In 1991, profit was still only FF 38 million, and the company would have posted a loss if not for two extraordinary income items that were not related to Airbus operations.<sup>590</sup>

477. More fundamentally, while the EC focuses on Aérospatiale’s minimal profitability in certain years, it neglects entirely the company’s truly abysmal balance sheet, its troublesome financial ratios, and the poor prospects it would have faced if it had not received very significant additional government financing.<sup>591</sup> Aérospatiale’s debt ratio was substantially higher than that of its peer group (10.9 compared to 6.2 in 1986, and 8.2 compared to 4.9 in 1987); its debt coverage ratio at several points during the relevant period did not even allow it to cover short-term debt; and its return on equity was very poor (9.8% compared to 45.2% for its peer group in 1986; 4.2% compared to 17.2% in 1987; and negative 1.3% compared to 15.4% in 1988).<sup>592</sup>

478. These indicators, combined with the absence of any French government analysis of the sort of contemporaneous data a private investor would have considered before making an investment in Aérospatiale, combined with the EC’s repeated references to the perspective of management (as opposed to private investors) in its effort to defend the French government actions all confirm the conclusion the United States reached in its first written submission: The French government’s equity infusions in Aérospatiale from 1987 to 1993 were not consistent with the practice of private investors; they therefore conferred a benefit on Aérospatiale and constitute subsidies within the meaning of Article 1 of the SCM Agreement.

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<sup>586</sup> EC FWS, para. 1137.

<sup>587</sup> EC FWS, paras. 1148 and 1149.

<sup>588</sup> Aérospatiale SNI Comptes de l’Exercice 1987 (Exhibit EC-176), p. 5; Aérospatiale Comptes de l’Exercice 1988 (Exhibit EC-172), p. 5.

<sup>589</sup> Aérospatiale SNI Comptes de l’Exercice 1987 (Exhibit EC-176), p. 5; Aérospatiale Comptes de l’Exercice 1988 (Exhibit EC-172), p. 6.

<sup>590</sup> Aérospatiale 1990 Annual Report, at 16 (Exhibit US-289).

<sup>591</sup> See U.S. Responses to First Panel Questions, paras. 178-179.

<sup>592</sup> See U.S. FWS, paras. 570 and 571.

2. The French government's 1998 transfer of its shares in Dassault to Aérospatiale conferred a benefit on Aérospatiale

479. Like the four equity infusions the French government provided to Aérospatiale from 1987 to 1993, the government's December 1998 transfer to Aérospatiale of its 45.76 percent equity stake in Dassault Aviation ("Dassault") was not consistent with the usual investment practice of private investors. As discussed in the U.S. first written submission, Aérospatiale was in dire financial circumstances at the time of the transfer.<sup>593</sup> Nevertheless, by contributing its Dassault shares, the French government made what amounted to a FF 5,280,000,000 equity infusion that increased Aérospatiale's consolidated total capital by about 20 percent.<sup>594</sup>

480. In trying to portray this transaction as something other than the conferral of a benefit on Aérospatiale, the EC makes two arguments. First, it argues that "nothing of economic significance occurred," because the French government effectively did nothing more than transfer its Dassault shares to itself, simply moving the shares into another entity owned by the government – *i.e.*, Aérospatiale.<sup>595</sup> Second, the EC argues that when Aérospatiale was later combined with Matra Hautes Technologies to form ASM, the value of its "45.76 percent stake in Dassault was fully captured in the price charged for ASM shares in the public offering that took place in 1999."<sup>596</sup> Neither argument is correct.

481. The problem with the EC's first argument is that it assumes that the relevant point of view is that of the government rather than that of Aérospatiale. As the EC itself has recalled in other parts of its submissions, the issue in a benefit analysis under Article 1.1(b) of the SCM Agreement is the benefit to the recipient rather than the cost to the government.<sup>597</sup> The French government may have been indifferent as to the form in which it held its Dassault shares – whether directly or through its stake in Aérospatiale. But that does not mean that no benefit was conferred on Aérospatiale when it received the Dassault shares.

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<sup>593</sup> See U.S. FWS, paras. 610-612.

<sup>594</sup> 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 50-54 (Exhibit US-302); Collin (Yvon), Senate Report No. 414 (1998-1999), "l'Industrie Aéronautique Européenne ou l'Impératif de l'Union," at 128 (Exhibit US-303). See also press release of the French Finance Ministry, *Transfer des Actions par l'Etat au capital de Dassault Aviation* (May 15, 1998) (Exhibit US-304).

<sup>595</sup> EC FWS, para. 1167; see also EC Responses to First Panel Questions, para. 281.

<sup>596</sup> EC Responses to First Panel Questions, para. 284.

<sup>597</sup> See, e.g., EC FWS, paras. 931-935.



## FINAL NON-BCI VERSION

482. Moreover, the EC’s assertion that “nothing of economic significance occurred” is belied by the arrangements that the French government had to make with Dassault in order to effectuate the share transfer. As discussed in the U.S. first written submission, in order to persuade the private owners of Dassault to consent to what amounted to a tie-up with Aérospatiale, the French government had to give up the valuable double voting rights associated with its shares in Dassault.<sup>598</sup> The United States fails to see how this is consistent with the EC’s characterization that “nothing of economic significance occurred.”

483. As for the EC’s second argument, concerning the return the French government ultimately received for its transfer of the Dassault shares, this too is wrong. The EC admits that

{o}ne way in which a ‘benefit’ could have been conferred by the transfer of the French State’s Dassault shares to Aérospatiale is if, in selling a significant portion of its interest in ASM to Lagardère and the public in 1999, the French State would have failed to secure adequate compensation for its Dassault shares.<sup>599</sup>

But that is precisely what happened.

484. An analysis by corporate finance and investment expert Lauren D. Fox attached to this submission (“the Fox Report”) finds that a significant way in which the French government “failed to secure adequate compensation for its Dassault shares” was by giving up its double voting rights, as just mentioned.<sup>600</sup> The Fox Report establishes that the value of voting control in a typical entity is 30 percent above the value of the individual shares. Applying that standard, the report finds that the Dassault share transfer resulted in a **[[HSBI]]** percent loss in value for the French government, or FF **[[HSBI]]** billion.<sup>601</sup>

485. An additional way in which the French government “failed to secure adequate compensation for its Dassault shares” was through its reliance on valuation reports which, according to the Fox Report, are not independent “fairness opinions” but merely valuations by

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<sup>598</sup> See U.S. FWS, paras. 616-618.

<sup>599</sup> EC Responses to First Panel Questions, para. 283.

<sup>600</sup> Lauren D. Fox, 1998 Dassault Share Transfer Valuation Report (“Fox Report”) (Exhibit US-595) (**HSBI**). Pursuant to paragraph 52(*kbis*) of the May 23, 2007 revision of the BCI/HSBI Procedures, the United States is providing with this submission an HSBI-Redacted Version of Exhibit US-595. The HSBI-Redacted Version is labeled as Exhibit US-595a.

<sup>601</sup> See Fox Report, at 6 (Exhibit US-595) (**HSBI**).

investment banks seeking to ratify a previously identified outcome.<sup>602</sup> In this regard, it is notable that the valuation reports post-date the actual Dassault transaction.

486. As the French government “failed to secure adequate compensation for its Dassault shares,” it did not act consistently with the usual practice of private investors. As discussed in the U.S. first written submission, it acted in pursuit of industrial policy goals rather than commercial goals.<sup>603</sup> Accordingly, contrary to the EC’s argument, the French government’s 1998 transfer of Dassault shares to Aérospatiale was an equity infusion that conferred a benefit and thus constitutes a subsidy within the meaning of Article 1 of the SCM Agreement.

#### **X. THE EC FAILS TO UNDERMINE THE U.S. SHOWING THAT EUROPEAN COMMISSION AND MEMBER STATE GRANTS OF RESEARCH AND DEVELOPMENT FUNDING TO AIRBUS ARE SPECIFIC SUBSIDIES**

487. In its first written submission, the United States laid out the various ways in which the European Commission and the Airbus governments subsidize Airbus by helping to fund its research and development (“R&D”) efforts through the provision of outright grants. In particular, the United States demonstrated that financial contributions made pursuant to EC Framework Programs (“FPs”) and dedicated member State and sub-national R&D subsidy programs established for the specific purpose of funding aeronautics research constitute subsidies within the meaning of Article 1 that are specific within the meaning of Article 2 of the SCM Agreement.<sup>604</sup>

488. Under the FPs, the EC disburses grants from budgets that it establishes specifically for aeronautics research. It refers to these budgets variously as specific “areas” (under FP 2, FP 3, and FP 4), “key actions” (under FP 5), “thematic priorities” (under FP 6). According to the EC, these grants serve to “improv{e} the competitiveness of the European aeronautical industries . . . .”<sup>605</sup> The EC has provided some Euro [ ] in FP aeronautics grants to projects led by

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<sup>602</sup> See Fox Report, at 4-5 (Exhibit US-595) (HSBI).

<sup>603</sup> See U.S. FWS, para. 615.

<sup>604</sup> See U.S. FWS, paras. 621-703.

<sup>605</sup> See, e.g., European Commission, Fourth Framework Programme, Aeronautics Related Research, Synopses of Current Projects Selected Under the 1995 Call for Proposals (1996) (Area 3A Aeronautics Technologies), at xx (Exhibit US-314).

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Airbus or in which Airbus has participated and which focused on particular aeronautics technologies or production processes.<sup>606</sup>

489. Under the member State and sub-national subsidy programs, Airbus has received specific grants of up to Euro [ ] from the German Federal and Länder governments;<sup>607</sup> up to Euro 1.2 billion from the French government;<sup>608</sup> up to [ ] from the UK government;<sup>609</sup> and loans in the amount of Euro [ ] from the Spanish government.<sup>610</sup>

490. The EC responds by asserting that the United States has overstated the amount of R&D subsidies provided to Airbus and that it has included payments under programs that are not specific within the meaning of Article 2 of the SCM Agreement.<sup>611</sup> The EC is wrong on both counts, as the United States shows in this part of its submission.<sup>612</sup>

### **A. The EC arbitrarily deems “not relevant” R&D amounts granted under EC Framework Programs**

491. The EC admits that Airbus has received Euro 648.9 million in R&D subsidies.<sup>613</sup> However, that number understates the amount actually received, as it reflects an arbitrary

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<sup>606</sup> See U.S. FWS, paras. 628-630 (Euro 18.75 million for FP2), 631-635 (Euro [ ] for FP3), 636-640 (Euro [ ] for FP4), 641-645 (Euro 509 million for FP5), and 646-650 (Euro 450 million for FP6).

<sup>607</sup> See U.S. FWS, paras. 654-677.

<sup>608</sup> See U.S. FWS, paras. 678-684.

<sup>609</sup> See U.S. FWS, para. 690.

<sup>610</sup> See U.S. FWS, paras. 693 and 698.

<sup>611</sup> See EC FWS, para. 1219.

<sup>612</sup> Related to its contention that the United States has overstated the amount of R&D subsidies provided to Airbus are the EC’s claims that certain subsidies are “outside the temporal scope of Article 5 of the SCM Agreement” (*e.g.*, EC FWS, paras. 1220, 1223, 1230, 1275) and that the United States has not shown that subsidies granted to predecessors to Airbus SAS “passed through” to Airbus SAS (*e.g.*, *id.*, paras. 1219, 1234, 1262). The United States has shown in prior submissions that both of these assertions are erroneous. *See, e.g.*, with respect to temporal scope: U.S. Response to Updated EC Preliminary Ruling Request, paras. 4-28; U.S. Responses to Panel Questions Concerning the Temporal Scope of the SCM Agreement, paras. 19-23; U.S. Comments on EC Answers to Panel Questions Concerning the Temporal Scope of the SCM Agreement, paras. 34-35; and, with respect to “pass-through”: U.S. Responses to First Panel Questions, paras. 108-123, 213.

<sup>613</sup> EC FWS, para. 1220.

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determination that certain recipients of LCA-related R&D subsidies are “relevant companies”<sup>614</sup> and others are not. Adding back in the amounts the EC arbitrarily excludes, the total R&D subsidies Airbus actually has received under both the EC Framework Programs and national and regional programs likely exceeds Euro 3 billion.<sup>615</sup>

492. The EC’s arbitrary exclusion of R&D subsidy amounts pertains to both the FPs and the member State and regional subsidy programs. The United States discusses the FPs in this section and section B and the member State and regional programs in sections C and D below.

493. For most of the FPs, the EC discloses only civil aeronautics R&D funding provided to the legal entities Airbus Germany, Airbus France, Airbus Spain and Airbus UK.<sup>616</sup> For FP2, the EC also discloses amounts that went to MBB-Transport Aircraft Group, Aerospatiale Division Avions, CASA Getafe, and British Aerospace Commercial Aircraft.<sup>617</sup> The EC argues that other FP funding provided to Airbus companies for civil aeronautics R&D projects is going to companies that are “{not} relevant for this dispute.”<sup>618</sup> It fails to explain, however, why LCA-related funding provided to other Airbus companies is not “relevant.”

494. As discussed in the U.S. response to the Panel’s Question 34,<sup>619</sup> the EC still has not disclosed all of the amounts that went to Aérospatiale Division Avions (which it included for FP2 but not for any of the other FPs), and none of the amounts that went to Deutsche Aerospace Airbus GmbH, Aérospatiale, and BAe Airbus. Also, it included funds to Airbus UK for some FP projects but not all. These are all Airbus companies, and the EC has not explained why monies given to these companies are “not relevant.” FP-funded civil aeronautics R&D projects in which these entities were involved are listed in the left-hand column in Exhibit US-485.

495. The EC also has not disclosed grants to EADS, EADS Deutschland, BAE Systems and other Airbus entities. The right-hand column in Exhibit US-485 provides an overview of projects that included these R&D subsidy recipients. The EC has failed to explain why the Panel

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<sup>614</sup> EC FWS, para. 1224.

<sup>615</sup> Identifying a precise amount is impossible given the EC’s failure to provide relevant information. The approximate amount of Euro 3 billion comes from summing the amounts of Framework Program funding and national and regional funding noted above and in the U.S. first written submission.

<sup>616</sup> See EC FWS, paras. 1236, 1238, 1240, 1242.

<sup>617</sup> See EC FWS, para. 1234.

<sup>618</sup> EC FWS, para. 1224.

<sup>619</sup> US Responses to First Panel Questions, paras. 216-220.

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should exclude these subsidies in considering the total amount of R&D subsidies provided to Airbus.

496. Other evidence shows the extensive participation of Airbus companies in aeronautics-related research funded under EC Framework Programs and thus the arbitrary nature of the EC's inclusion of R&D amounts to only certain companies. For example, the United States has demonstrated, and the EC has acknowledged, that Airbus participated in most of the 28 aeronautics research projects that the EC funded under the Second Framework Program.<sup>620</sup> Moreover, all of the challenged FP funding was provided under the aeronautics budgets of the EC Framework Programs which, by definition, means that the funding was for civil aeronautics research and development.

497. The United States refers to Exhibit US-318 which sets out the specific Airbus FP Projects under each of the FPs. That FP monies have conferred massive benefits on Airbus's LCA activities can also easily be seen from a document published by the European Commission that shows graphically the FP origins of core pieces of A380 technology.<sup>621</sup>

498. The EC's continued refusal to disclose amounts of R&D funding other than to companies it considers "relevant" and to provide project-by-project breakdowns of the Framework Program budgets (including a breakdown for projects in which Airbus participated), as specifically requested by the Annex V Facilitator, makes it impossible for the United States and, ultimately, the Panel to assess the precise amounts of FP funding that benefit Airbus's LCA activities. What is clear, however, is that the total amount of FP subsidies granted to Airbus is substantially higher than amounts that the EC has already acknowledged. Publicly available information indicates that the total amount may be as high as Euro 1.2 billion.<sup>622</sup> In view of the EC's continued refusal to provide information on all R&D amounts granted for Airbus LCA activities under the EC Framework Programs and its failure to explain why it has provided information on grants to some companies but not others, the United States maintains its request to the Panel to find that Airbus has received subsidies in the amounts identified by the United States in its first written submission.

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<sup>620</sup> See U.S. FWS, para. 628 and evidence cited therein; EC FWS, para. 1234.

<sup>621</sup> European Commission, *The European Strategic Agenda for Aeronautics Research and the 7<sup>o</sup> FP of the European Commission* (Exhibit US-634).

<sup>622</sup> The Euro 1.2 billion amount is the sum of the amounts indicated in paragraphs 630, 635, 640, 645, and 650 of the U.S. first written submission. In determining these amounts, the United States has relied on best available information in light of the EC's lack of cooperation.

**B. The EC fails to show that grants for aeronautics R&D under the EC Framework Programs are not specific**

499. In addition to showing that the EC has provided R&D grants to Airbus under the EC Framework Programs and that these grants confer benefits on Airbus, the United States demonstrated that the grants are specific to Airbus and/or the aeronautics industry within the meaning of Article 2 of the SCM Agreement. In particular, the United States demonstrated that the subsidies are specific “in law,” because each Framework Program has a sub-budget that is specific to the aeronautics industry. The United States also showed that the subsidies are specific “in fact” because the predominant users of the grants are aeronautics companies.<sup>623</sup>

500. In response, the EC argues that “{t}he Second, Third, Fourth and Fifth Framework Programmes do not have sub-budgets specific to the aeronautics industry.”<sup>624</sup> The United States notes that the EC does not dispute the existence of such a sub-budget in the Sixth Framework Programme. Indeed, the evidence is clear that FP6 includes such a sub-budget. As the United States indicated in its response to the Panel’s Question 36, FP6 is divided into a “Specific Programme Integrating and Strengthening the European Research Area,” a “Specific Programme Structuring the European Research Area,” and a “Specific Programme” for nuclear research.<sup>625</sup> Each “specific programme” has its own implementation rules and a separate, dedicated budget. The “specific programmes” are further broken down into separate budgets for particular research areas or industries. Thus, for example, the EC established dedicated subsidy programs for aeronautics R&D that are specially set aside (*i.e.*, “ring-fenced”) within the Framework Program’s overall funding system. This is the sub-budget to which the United States refers.

501. With respect to the Second through Fifth Framework Programs, the EC seems to be arguing semantics. Although it does not acknowledge the existence of formal “sub-budgets” under these programs, it does seem to acknowledge that the programs “allocate . . . portions of their budget to research activities such as ‘aeronautics and space’ or ‘aeronautics.’”<sup>626</sup> It is this allocation that renders the R&D grants at issue specific, whatever the formal label attached to those allocations (whether “sub-budget” or otherwise) may be.

502. The aeronautics sub-budgets under each of the FPs are “ring-fenced” amounts of money made available to support a particular set of objectives. The European Commission is in charge

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<sup>623</sup> See U.S. FWS, paras. 651-653; U.S. Responses to First Panel Questions, paras. 221-222, 223-225.

<sup>624</sup> EC Responses to First Panel Questions, para. 307.

<sup>625</sup> US Responses to First Panel Questions, para. 223; *see, e.g.*, “FP6 in Brief”, [http://ec.europa.eu/research/fp6/pdf/fp6-in-brief\\_en.pdf](http://ec.europa.eu/research/fp6/pdf/fp6-in-brief_en.pdf), p. 4 (Exhibit US-497).

<sup>626</sup> EC Responses to First Panel Questions, para. 308.

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of operation of the sub-budgets and adoption of a “work program” under each sub-budget. In the case of the aeronautics sub-budgets, the “work program” sets out the technical content of funded areas of civil aeronautics R&D.<sup>627</sup>

503. Budgeted funds are made accessible through calls for project proposals issued by the Commission in accordance with the aeronautics work program under each FP. Calls for aeronautics R&D projects establish specific criteria that eligible proposals must meet, including the type of project, criteria for the evaluation of proposals, the number of project participants, and, most notably, the area and specific topic of research as well as the budget for the call.<sup>628</sup>

504. In addition to making a semantic argument based on the labeling of some but not all ring-fenced allocations for aeronautics R&D as “sub-budgets,” the EC argues that specificity should be analyzed not at the level of the sub-budget but at the level of the entire Framework Program.<sup>629</sup> Accepting that argument, however, would lead to absurd results. A Member could make virtually any subsidy to “certain enterprises” non-specific simply by formally joining it under one roof with other subsidies to other certain enterprises and calling the combined subsidies a “program.” Neither the text, nor the context, nor the object and purpose of the SCM Agreement support taking the formalistic approach that the EC suggests.<sup>630</sup>

505. The mere fact that a Framework Program is labeled a “program” does not mean that the program as a whole is the appropriate level at which to undertake a specificity analysis.<sup>631</sup> Under the EC’s Framework Programs it is at the sub-budget level that amounts of money are “ring-fenced” and criteria and conditions for eligibility are set. Accordingly, it is at this level that the question of specificity should be examined.

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<sup>627</sup> For FP5, *see* *New Perspectives in Aeronautics*, at 34, in European Commission, *Growth Workprogramme 1998-2002* (December 2000) (Exhibit US-488); *see also*, for FP6, *Thematic Priority 1.4 Aeronautics and Space, Work Programme 2002-2006* (Exhibit US-489).

<sup>628</sup> *See, e.g.*, for the sixth Framework Program, European Commission, *Calls for proposals for indirect RTD actions under the specific programme for research, technological development and demonstration: ‘Integrating and strengthening the European Research Area’*, OJ C 315/1 (December 17, 2002), Annexe 7, which details the conditions for the aeronautics call identified as FP6-Aero-1. Research topics referenced in the call (at 8. “Areas called and instruments”) are selected in accordance with the Work Program established by the EC Commission for Aeronautics. For the sixth Framework Program, *see* European Commission, *Thematic Priority 1.4, Aeronautics and Space, Work Programme (2002-2006), Version 2004 (“Work Program FP6”)*, pp. 1 - 16 (Exhibit US-489).

<sup>629</sup> *See* EC FWS, para. 1245; EC Responses to First Panel Questions, para. 308.

<sup>630</sup> *Cf.* U.S. Responses to First Panel Questions, para. 92.

<sup>631</sup> In fact, the very title “Framework Program” is indicative of the broad, overarching role played by the FPs, as distinct from the individual subsidies or subsidy programs covered by each “framework.”

506. Finally, with respect to the *de facto* specificity of aeronautics R&D grants under the Framework Programs, it is useful to recall the relevant numbers. Airbus civil aeronautics research projects received approximately [ ] under FP2, constituting [ ] of the Euro 35 million budget reserved for aeronautics research under “BriteEuram Area 5, Specific Activities relating to Aeronautics;”<sup>632</sup> [ ] under FP3, which is [ ] of the Euro 56 million budget;<sup>633</sup> [ ] under FP4, which is [ ] of the Euro 245 million budget for aeronautics;<sup>634</sup> and, with funding of [ ], [ ] of the Euro 700 million aeronautics sub-budget for FP5.<sup>635</sup> Finally, Airbus programs received [ ] under FP6, representing [ ] of that program’s Euro 840 million aeronautics sub-budget.<sup>636</sup> Clearly, such numbers show predominant use by Airbus (as well as showing Airbus’s receipt of disproportionately large amounts of FP aeronautics funding).<sup>637</sup>

**C. The EC understates R&D subsidies provided to Airbus by German, French, UK, and Spanish authorities**

507. With respect to R&D subsidies provided to Airbus by German, French, UK, and Spanish authorities, the EC argues that: (i) Airbus was not the recipient of substantial amounts of the money at issue; (ii) certain German “LuFo” grants were mere commitments rather than actual grants; (iii) Spanish “PTA” loans do not confer a benefit, despite their [ ] interest rate, [ ] maturity, and [ ] terms; (iv) UK “TP” grants and Spanish “PROFIT” loans are not specific; and (v) Spanish “PROFIT” loans are not within the Panel’s terms of reference. Each of these arguments is erroneous. The United States will address the first three in this section and the remaining two in the next section.

1. Member State R&D subsidies benefit Airbus

508. The United States has demonstrated that the governments of Bavaria, Hamburg, and Bremen provided grants of [ ], [ ], and Euro 11,000,000, respectively to EADS and Daimler-Benz (the Bavaria grants), EADS Airbus GmbH and Airbus

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<sup>632</sup> See U.S. FWS, paras. 628, 630 and footnote 775.

<sup>633</sup> See U.S. FWS, paras. 631, 635 and footnote 781.

<sup>634</sup> See U.S. FWS, paras. 636, 640 and footnote 787.

<sup>635</sup> See U.S. FWS, paras. 641 and 645.

<sup>636</sup> See U.S. FWS, paras. 646 and 650.

<sup>637</sup> See U.S. Responses to First Panel Questions, para. 222.



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Deutschland GmbH (the Hamburg grants), and Airbus Bremen.<sup>638</sup> All of the recipients are Airbus companies,<sup>639</sup> and all of the money was provided for civil aeronautics projects.

509. Indeed, the EC explicitly acknowledges that the Bavarian grants are LCA related.<sup>640</sup> The Hamburg grants were provided to EADS Airbus GmbH and Airbus Deutschland, and supported, *inter alia*, the development, integration, and testing of the cabin environment of the A380.<sup>641</sup> Nevertheless, the EC refuses to clarify the precise breakdown of Bavarian, Hamburg, and Bremen funding, arguing that much of the money is not relevant.<sup>642</sup> The available information, however, clearly indicates that the money was provided to Airbus companies for LCA-related activities. The Panel, therefore, should find that all of these German subsidies conferred benefits on Airbus.

510. With regard to R&D grants that the French government provided to the aeronautics industry between 1986 and 2005,<sup>643</sup> the EC concedes that an amount of [ ] was provided to Airbus France between 1995 and 2005.<sup>644</sup> It alleges that the remaining part of the Euro 809 million budgeted under these programs from 1994 to 2005 was provided to companies not relevant for the present dispute,<sup>645</sup> and has refused to provide further information on disbursements under the programs, even though all of this money was for civil aeronautics.<sup>646</sup> It

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<sup>638</sup> See U.S. FWS, paras. 667-677.

<sup>639</sup> See U.S. FWS, para. 44 note 24 (defining “Airbus companies”).

<sup>640</sup> In its response to a question posed by the Annex V Facilitator, the EC states that “Daimler Benz and EADS received funding for 9 projects (related to LCA).” See *Replies to Questions by the Facilitator under Annex V of the SCM Agreement by the European Communities* (Nov. 18, 2005), Q188(c) (Exhibit US-5 (BCI)).

<sup>641</sup> The project is called “CASIV” (“Cabin System Integration and Verification testing”). See Werum Software & Systems, Pressemitteilung Messdatenmanagementsysteme, Testdatenmanagementsystem von Werum im Einsatz für Tests des A380. (Exhibits US-483 and US-483a).

<sup>642</sup> See EC FWS, paras. 1260, 1266, 1268.

<sup>643</sup> The EC contends that the U.S. claim regarding the French R&D grants is outside the Panel’s terms of reference. See EC FWS, para. 1274. For the reasons set forth in part II.B above, the EC is wrong. The EC also contends that French R&D funding for the period 1986 to 1994 is outside the temporal scope of Article 5 of the SCM Agreement. *Id.*, para. 1275. This, too, is wrong. See, e.g., U.S. Comments on EC Answers to Panel Questions Concerning the Temporal Scope of the SCM Agreement, paras. 34-35.

<sup>644</sup> EC FWS, para. 1279. During the Annex V process, the EC acknowledged that this amount was even higher, namely Euro [ ], if one includes payments in 1994. See U.S. FWS, para. 679.

<sup>645</sup> EC FWS, para. 1276.

<sup>646</sup> See U.S. FWS, para. 678.

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is unclear from the EC's summary argument which companies that received French civil aeronautics R&D funding it considers "not relevant" and why. Moreover, the EC has not disclosed any of the French R&D grants provided to Airbus between 1986 and 1993. In total, therefore, the EC has not disclosed some Euro [ ] in French aeronautics R&D grants.<sup>647</sup>

511. The logical inference to be drawn from the EC's continued refusal to provide the information requested with respect to French civil aeronautics R&D grants is that the entire amount for the period 1986 to 2005 confer benefits on Airbus's LCA operations.

512. With regard to R&D grants for civil aeronautics provided by the UK government under the CARAD and ARP programs, the United States notes that the EC admits that Airbus received [ ] from January 1992 through October 2005, in contrast to the [ ] identified in the U.S. first written submission.<sup>648</sup> Likewise, the United States takes note of the EC's admission that Airbus has received an additional [ ] under the UK's Technology Programme.<sup>649</sup>

### 2. German LuFo grants to Airbus amount to Euro 217 million

513. With regard to R&D funding from the German Federal government, the EC concedes the provision of Euro [ ] in grants to Airbus under LuFo I to III. However, it suggests that the U.S. claim that, in fact, Euro 217 million was provided inappropriately includes funding not yet received by July 1, 2005.<sup>650</sup> The Förderkatalog demonstrates that a firm commitment had been provided for the disbursement of the remaining Euro [ ] (Euro 217 million minus [ ])<sup>651</sup> and there is no indication that such money has not been or will not be disbursed. In this regard, the United States notes that a subsidy within the meaning of Article 1 of the SCM Agreement includes "potential direct transfers of funds" as well as an actual direct transfer of funds. Thus, even if the EC were correct in characterizing certain

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<sup>647</sup> As indicated at paragraph 678 of the U.S. first written submission, public information indicates that the responsible French authority budgeted Euro 3.91 million for civil aeronautics R&D from 1986 to 1993 and Euro 8.09 million from 1994 to 1995, totaling Euro 1.2 billion. Of that amount, the EC admits only Euro [ ] (EC FWS, para. 1279), leaving almost Euro [ ] undisclosed.

<sup>648</sup> Compare U.S. FWS, para. 686 with EC FWS, para. 1289. As noted previously, the EC contention that R&D grants from 1992 to 1994 are outside the temporal scope of Article 5 of the SCM Agreement is incorrect. See, e.g., U.S. Comments on EC Answers to Panel Questions Concerning the Temporal Scope of the SCM Agreement, paras. 34-35.

<sup>649</sup> EC FWS, para. 1293.

<sup>650</sup> EC FWS, paras. 1256-1258.

<sup>651</sup> See U.S. FWS, para. 663.

amounts as “commitments” rather than “disbursements,” that would not be a basis for excluding those amounts from the Panel’s consideration.

3. Spanish PTA loans at [ ] and [ ] maturities by definition confer a benefit

514. The EC argues that the United States has not shown that loans provided to Airbus by the Spanish government under the PTA program confer a benefit on Airbus because the United States has not performed a comparison to a market benchmark.<sup>652</sup> However, as the United States pointed out in its first written submission, PTA loans are [ ], carry repayment terms from [ ] and have deferred repayment schedules.<sup>653</sup> Therefore, the terms of the loans are, by definition, preferential to terms available in the market. It is unclear which other evidence the EC considers would be necessary to demonstrate the conferral of a benefit in such circumstances.

**D. Spanish PROFIT loans and UK Technology Programme grants, like all of the other R&D subsidies at issue, are specific**

515. Finally, the EC argues that two of the member State R&D subsidy programs at issue – Spain’s PROFIT program and the UK’s Technology Programme (“TP”) are not specific within the meaning of Article 2 of the SCM Agreement. It also argues that the PROFIT program is outside the Panel’s terms of reference. Once again, the EC is wrong on all counts.

1. PROFIT program

516. The U.S. claim with respect to loans provided under the PROFIT program plainly is within the Panel’s terms of reference. This Panel is operating under standard terms of reference, which refer to the U.S. request for establishment of a panel. The latter document identifies the measures at issue as including:

The provision by the EC and the member States of financial contributions for aeronautics-related research, development, and demonstration (“R&D”), undertaken by Airbus, whether alone or with others, or in any other way to the benefit of Airbus, including. . .

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<sup>652</sup> EC FWS, para. 1313. The EC also contends that R&D grants from 1993 to 1994 are outside the temporal scope of Article 5 of the SCM Agreement. *Id.*, para. 1312. As noted previously, this assertion is incorrect. *See, e.g.*, U.S. Comments on EC Answers to Panel Questions Concerning the Temporal Scope of the SCM Agreement, paras. 34-35.

<sup>653</sup> *See* U.S. FWS, para. 693; U.S. FOS, para. 112.

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- (d) Funding from the Spanish government, including regional and local authorities, since 1993 for civil aeronautics-related R&D projects in which Airbus participated. . . .<sup>654</sup>

517. As the PROFIT program plainly comes within the latter description it is within the Panel's terms of reference, and the EC's assertion to the contrary is in error.<sup>655</sup>

518. The EC's argument that PROFIT loans to Airbus are not specific is equally erroneous. As with the EC Framework Programs, the EC mistakenly argues that for specificity purposes, PROFIT should be analyzed at the level of the broad "umbrella" under which it is implemented, rather than at the individual program level.<sup>656</sup> As explained in the U.S. first written submission, however, PROFIT establishes sector-specific research programs for aeronautics, the Programa Nacional de Aeronautica (2000 to 2003) and the Subprograma Nacional de Transporte Aero (2004 to 2007).<sup>657</sup> Both of these sector-specific programs have their own research objectives and priorities that determine eligibility for the receipt of subsidies.<sup>658</sup> The research objectives and priorities clearly single out the aeronautics industry as the recipient of the subsidies, and research proposals must be aeronautics-related in order to be eligible for funding.<sup>659</sup> The PROFIT loans are, therefore, specific under Article 2.1 of the SCM Agreement.<sup>660</sup>

### 2. Technology Programme

519. With regard to the UK's Technology Programme, the United States notes that the EC itself has acknowledged that the program is sub-divided into 43 "research themes" targeting a

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<sup>654</sup> WT/DS316/2, p. 3 (point (6)).

<sup>655</sup> See generally Part II.B, *supra* (showing that, contrary to EC claim, U.S. panel request conforms with DSU, art. 6.2).

<sup>656</sup> EC FWS, para. 1319.

<sup>657</sup> U.S. FWS, para. 697.

<sup>658</sup> See, Order of March 7, 2000 (Exhibit US-349) and Order ITC/1038/2005 of April 14, 2005, BOE num. 95 (April 21, 2005), p. 13765/Annex II Section 14, sub-section 4 (attachment 16A) (Exhibit US-355).

<sup>659</sup> US FWS, para. 703, including the evidence cited at footnote 867.

<sup>660</sup> The United States also notes that the EC refused the Annex V Facilitator's request for recipient-specific information regarding the aeronautics PROFIT loans. See US FWS, paras. 699, 702. The EC's refusal to provide this information makes it impossible to do a detailed analysis of *de facto* specificity under Article 2.1(c) of the SCM Agreement. The United States respectfully suggests that based on the EC's lack of cooperation the Panel should draw the logical inference that had the EC provided the information requested it would have supported a finding of *de facto* specificity.

limited set of industries.<sup>661</sup> Moreover, each of the research themes has its own budget and tends to be highly industry-specific. Thus, for example, the “Advanced Materials” research theme has composite development in the aeronautics industry as its clear target, and calls under this research theme to date have singled out aeronautics industry composite research. The R&D funding provided to Airbus and the aeronautics industry under the Technology Programme is therefore specific within the meaning of Article 2.1 of the SCM Agreement.

**XI. SUBSIDIES TO AIRBUS WERE NEITHER “EXTINGUISHED” NOR “EXTRACTED” THROUGH RESTRUCTURING OF THE RELATIONSHIP AMONG AIRBUS COMPANIES LEADING TO THE CREATION OF EADS AND AIRBUS SAS**

520. Although the EC disputes that billions of Euros of financial contributions to Airbus conferred benefits on Airbus’s LCA development and production, it ultimately cannot avoid the conclusion that they did. Confronted with this reality, the EC attempts to mount a defense based on the assertion that subsidies to Airbus disappeared as a result of transactions leading to the creation of EADS in 2000 and Airbus SAS in 2001, as well as transactions subsequent to their creation. The EC focuses on the following transactions: (1) the 1999 creation of Aérospatiale-Matra S.A (“ASM”) through the combination of Aérospatiale SNI and Matra Hautes Technologies, and the offering of 17 percent of the shares in ASM to the public; (2) CASA’s transfer of Euro 342.4 million to its owner, the government of Spain; (3) DASA’s transfer of Euro 3,133 million to its owner, DaimlerChrysler; and (4) public offerings of shares in EADS representing between 0.93 percent and 9.95 percent of total shares. The EC also focuses on transactions that occurred in 2004 and 2006, after the creation of EADS and Airbus SAS, consisting of (5) public offerings of shares in EADS representing between 2.75 percent and 7.5 percent of total shares, and (6) the exercise of a put option by BAE Systems in October 2006, in which it sold its 20 percent stake in Airbus SAS to EADS.

521. For reasons explained in prior phases of this dispute, the EC’s theory of how subsidies to Airbus were either “extinguished” or “extracted” is deeply flawed.<sup>662</sup> Initially, the EC sought to rely on panel and Appellate Body reports from disputes in the countervailing duty (“CVD”) context concerning the effects of a full privatization on pre-privatization subsidies.<sup>663</sup> It tried to show that the logic of those reports applies to the various Airbus transactions, even though this dispute is not a CVD dispute, and even though none of the transactions it cites involved anything remotely resembling a full privatization. As the United States pointed out, those reports stand

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<sup>661</sup> See EC FWS, para. 1307.

<sup>662</sup> See U.S. FOS, paras. 115-125; U.S. Closing Statement at First Panel Meeting, paras. 17-21; U.S. Responses to First Panel Questions, paras. 119-122, 321-348.

<sup>663</sup> See EC FWS, paras. 198-202.

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for the proposition that, in the CVD context, a full privatization may result in the extinction of pre-privatization subsidies where the privatization involves the sale of all or substantially all of the subsidized entity, at arm's length and for fair market value, and where the seller relinquishes control of the entity.<sup>664</sup> Since the transactions cited by the EC do not meet these criteria, the reports do not help the EC's argument.

522. Confronted with this fact, the EC has changed its argument. Instead of arguing that prior panel and Appellate Body reports support its theory, it now argues simply that they do not undermine that theory. Thus, it explains that the key Appellate Body finding in *US - Countervailing Measures* regarding the effects of a full privatization “does not imply that subsidies may not be extinguished, extracted, withdrawn, or repaid in other circumstances.”<sup>665</sup> It invites the Panel to find subsidies “extinguished” or “extracted” in such “other circumstances” – including cash transfers from subsidized entities to their owners, a public offering of as little as 0.93 percent of the shares of the parent of a subsidized entity, and the parent's buyback from a related party of shares in the subsidized entity.

523. The EC does not explain why a finding of “extinction” or “extraction” of subsidies would be justified in these “other circumstances” based on the text of the SCM Agreement read in context and in light of its object and purpose. Nor does it address aspects of the prior panel and Appellate Body reports that indicate that such a finding is not justified. For example, while it accuses the United States of “appear{ing} to place undue weight on the criteria of ‘change of control,’”<sup>666</sup> it ignores that it was the EC itself that urged this criterion on the panel and the Appellate Body in *US - Countervailing Measures*. It did so in response to the U.S. argument that the more general theory of “extinction” the EC had initially advanced in that dispute would mean that publicly traded companies would escape SCM Agreement disciplines, because ownership of such companies changes constantly.<sup>667</sup> Given that the EC had focused on change of control, as well as transfer of all or substantially all of the seller's interest in the subsidized enterprise, the panel expressly focused on those criteria too, as did the Appellate Body.<sup>668</sup>

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<sup>664</sup> See U.S. Responses to First Panel Questions, paras. 324-343.

<sup>665</sup> EC Responses to First Panel Questions, para. 313.

<sup>666</sup> EC Responses to First Panel Questions, para. 313.

<sup>667</sup> *US - Countervailing Measures (Panel)*, para. 7.62; see U.S. Responses to First Panel Questions, para. 331.

<sup>668</sup> *US - Countervailing Measures (Panel)*, para. 7.62; see also *id.*, paras. 7.39, 7.65; *US - Countervailing Measures (AB)*, para. 85.

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524. Now, the EC effectively seeks to revive the more general “extinction” theory that it abandoned in *US - Countervailing Measures* when confronted with its logical implications. Yet, its argument still does nothing to address those implications.<sup>669</sup>

525. In response to the Panel’s Question 56, the United States explained why the panel and Appellate Body reports on which the EC relies do not support its “extinction” and “extraction” theory. Here, the United States examines the various transactions the EC cites and shows that none of them resulted in the extinction or extraction of any of the subsidies the EC and the Airbus governments provided to Airbus.

### **A. Transactions relating to creation of EADS and Airbus SAS did not “extinguish” subsidies**

526. The EC’s “extinction” argument is based on four sets of transactions: (i) the 1999 corporate tie-up between Aerospatiale and Matra Hautes Technologies (“Matra”); (ii) the 2000 creation of EADS; (iii) the exercise by BAE of its put option in 2006; and (iv) the offerings of small portions of EADS shares between 2000 and 2007.<sup>670</sup> This last set of transactions includes:

- the offering of 9.95% of the EADS shares to “free float” purchasers in 2000;
- the offering of 6.47% of the shares to institutional purchasers in 2000;
- the offering by the French State of 0.93% of its direct shares<sup>671</sup> in 2001;
- the offering by Lagardère of 2.07% of its direct shares in 2001;

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<sup>669</sup> In this regard, the EC notably mischaracterizes the Appellate Body’s findings in *US - Countervailing Measures*. At footnote 192 of the EC’s Responses to First Panel Questions, the EC cites paragraphs 126-127 of the Appellate Body report in that dispute, asserting that this establishes the “rebuttable presumption that arm’s length fair market value sale extinguishes previously bestowed subsidy.” (Emphasis added.) See also EC Responses to First Panel Questions, para. 388. In fact, the Appellate Body refers not to an “arm’s length fair market value sale,” but to an “arm’s-length, fair market value privatization.” The distinction is important, because a privatization, as the Appellate Body explained earlier in its report, involves a relinquishment of a control and a transfer of “all or substantially all the property.” *US - Countervailing Measures (AB)*, para. 85; see also *id.*, paras. 117 and 118.

<sup>670</sup> See generally EC FWS, paras. 226-283. The EC’s “extraction” argument is dealt with separately in the next section.

<sup>671</sup> Direct shares in EADS simply confer an ownership interest, whereas indirect shares are shares held through an entity known as EADS Participations B.V. which, as discussed below, exercises control of EADS through a pooling of indirect shares.

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- the hedging/forward deal and securities lending agreement by DaimlerChrysler concerning 2.73% of its direct shares in 2004, (to be effectuated in 2007 at the earliest<sup>672</sup>);
- the hedging/forward deal and securities lending agreement by DaimlerChrysler concerning 7.5% of its indirect shares in 2006, (to be effectuated in 2007 at the earliest<sup>673</sup>); and
- the issuance of mandatory exchangeable bonds by Lagardère concerning 7.5% of its indirect shares in 2006, (to be effectuated between 2007 and 2009 at the earliest<sup>674</sup>).

527. Preliminarily, the United States again recalls that by the EC Commission's own admission, the transactions resulting in the creation of EADS and Airbus SAS did not "affect the quality or nature of control of Airbus."<sup>675</sup> They represented nothing more than "a restructuring and rationalisation of the existing legal partnership between the parties {that previously had coordinated their Airbus activities through Airbus GIE}."<sup>676</sup> The EC has yet to reconcile these statements with its view that the transactions at issue resulted in the "extinction" of subsidies.

528. Moreover, it is telling that when asked how it responds to the U.S. statement that "{n}one of {the pertinent} transactions involved a transfer of 'all or substantially all' of the subsidized entity to private interests," the EC simply ignored the phrase "all or substantially all."<sup>677</sup> By its omission, the EC concedes that none of the pertinent transactions involved a transfer of all or substantially all of the seller's interest in the subsidized entity, thus failing to

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<sup>672</sup> See DaimlerChrysler, AG, Interim Report Q2 2006, at 21 (Exhibit EC-64); DaimlerChrysler AG, Semi-Annual Report Fiscal Year 2006, at 7, 8 (Exhibit US-597); DaimlerChrysler AG, Interim Report Q2 2006 at 21 (Exhibit EC-64).

<sup>673</sup> DaimlerChrysler, AG, Interim Report Q2 2006, at 21 (Exhibit EC-64); DaimlerChrysler AG, Semi-Annual Report Fiscal Year 2006, at 7, 8 (Exhibit US-597); DaimlerChrysler AG, Interim Report Q2 2006 at 21 (Exhibit EC-64).

<sup>674</sup> *Reuters*, "Lagardere boosts media focus with EADS share sale" (April 5, 2006) (Exhibit US-635); *Evening Standard (London)*, "EADS shares to bring founding pair £1.4bn each" (April 5, 2006) (Exhibit US-636).

<sup>675</sup> Commission of the European Communities, Merger Procedure, Case No. COMP/M.1745 - EADS, paras. 15-16 (May 11, 2000) (Exhibit US-479).

<sup>676</sup> European Commission, Press Release of 18 October 2000, "European Commission Clears the Creation of the Airbus Integrated Company" (Exhibit US-496).

<sup>677</sup> See EC Responses to First Panel Questions, para. 314.



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meet one of the key criteria that could cause a transaction to result in the “extinction” of subsidies.

529. Turning to the particular transactions at issue, the United States calls five key points to the Panel’s attention. First, several of the transactions that the EC alleges have resulted in the extinction of subsidies granted to Airbus occurred well after the establishment of this Panel and, therefore, have no bearing on the resolution of this dispute. As the Appellate Body explained in its report in *Chile - Price Band System*:

{G}enerally speaking, the demands of due process are such that a complaining party should not have to adjust its pleadings throughout dispute settlement proceedings in order to deal with a disputed measure as a ‘moving target.’<sup>678</sup>

530. For this reason, as well as others discussed below, the following transactions cited by the EC are irrelevant to the question at hand: (i) the October 2006 BAE Systems exercise of its put option; (ii) the hedging/forward deal and securities lending agreement by DaimlerChrysler concerning 7.5% of its indirect shares in EADS, which could not occur until 2007; (iii) the hedging/forward deal and securities lending agreement concerning 2.73% of DaimlerChrysler’s indirect shares in EADS, which could not occur until 2007;<sup>679</sup> and (iv) the issuance of mandatory exchangeable bonds by Lagardère concerning 7.5% of its indirect shares in EADS in 2006.

531. Second, several of the transactions referred to by the EC are not even actual sales of shares. Thus, for example, although the EC asserts that DaimlerChrysler “sold” EADS shares in July 2004,<sup>680</sup> in fact DaimlerChrysler entered into a “securities lending agreement.”<sup>681</sup> And the hedge/forward deal concerning the 7.5% stake in EADS that DaimlerChrysler entered into in April 2006<sup>682</sup> was described by DaimlerChrysler itself as a transaction that “does not meet the

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<sup>678</sup> *Chile - Price Band System (AB)*, para. 144; see also *Indonesia - Autos*, para. 14.9 (“{W}e note that in previous GATT/WTO cases, where a measure included in the terms of reference was otherwise terminated or amended after the commencement of the panel proceedings, panels have nevertheless made findings in respect of such a measure.”); *id.*, footnote 642 (citing various WTO and GATT panel reports).

<sup>679</sup> See DaimlerChrysler, AG, Interim Report Q2 2006, at 21 (Exhibit EC-64); DaimlerChrysler AG, Semi-Annual Report Fiscal Year 2006, at 7, 8 (Exhibit US-597); DaimlerChrysler AG, Interim Report Q2 2006 at 21 (Exhibit EC-64).

<sup>680</sup> EC FWS, para. 262.

<sup>681</sup> DaimlerChrysler AG, Interim Report Q2 2006, at 21 (Exhibit EC-64).

<sup>682</sup> EC FWS, para. 264.

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criteria of a sale.”<sup>683</sup> And the transaction concerning Lagardère’s 7.5% stake was not a sale but an issuance of mandatory exchangeable bonds.<sup>684</sup>

532. Third, all of the post-panel-establishment transactions and all but one of the remaining transactions that the EC argues “extinguished” parts of the subsidies to Airbus concern between 1% and at most 9.95% of the shares in the entities concerned. In other words, they involved significantly less than “all or substantially all” of the shares of those entities and are distinguishable in this regard from transactions that have been found to result in the extinction of subsidies.<sup>685</sup> Even if one takes all EADS share offerings together, the total is only approximately 16% of EADS’s shares. In the one instance where the transaction concerned more than 10% of a company’s shares – the Aérospatiale-Matra tie-up and subsequent minority flotation – the Fox Report discussed in Part IX.B.2 above finds that the seller (*i.e.*, the French government) received less than fair value.<sup>686</sup>

533. Fourth, none of the transactions cited by the EC resulted in the seller “no longer {having} any controlling interest”<sup>687</sup> in the company at issue. In this regard, too, these transactions are distinguishable from transactions that have been found to result in the extinction of subsidies.<sup>688</sup> In the case of EADS, control is retained in the hands of the company’s founders through a pooling of “indirect shares” in an entity called EADS Participations B.V. EADS Participations has the exclusive power to exercise the voting rights attached to the pledged shares. It is through this vehicle that the founders still control the majority of the voting rights in EADS.<sup>689</sup> None of the offerings of EADS shares concerned pooled shares, and no control was transferred through any of the transactions mentioned by the EC.

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<sup>683</sup> DaimlerChrysler, AG, Interim Report Q2 2006, at 21 (Exhibit EC-64).

<sup>684</sup> *Reuters*, “Lagardere boosts media focus with EADS share sale” (April 5, 2006) (Exhibit US-635); *Evening Standard (London)*, “EADS shares to bring founding pair £1.4bn each” (April 5, 2006) (Exhibit US-636).

<sup>685</sup> See U.S. Responses to First Panel Questions, paras. 321-343.

<sup>686</sup> See Fox Report, at 4-6 (Exhibit US-595).

<sup>687</sup> *US - Countervailing Measures*, para. 7.62; see also *US - Countervailing Measures (AB)*, para. 84.

<sup>688</sup> See U.S. Responses to First Panel Questions, paras. 321-343.

<sup>689</sup> See EADS, *Business, Legal and Corporate Responsibility 2006*, p. 102 (Exhibit US-601); see also *Sarkozy vows to help struggling European plane-maker Airbus*, The Associated Press, May 18, 2007 (quoting newly elected French President Nicolas Sarkozy as saying, “How can you entice new shareholders to invest in the company with a shareholder pact which gives new shareholders the obligation to pay, but not the right to vote”) (Exhibit US-598).

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534. Indeed, EADS itself notes in its 2005 Annual Report that “these transactions have not impacted the balance of control between the core shareholders in EADS’ corporate governance as set forth in the shareholder agreements.”<sup>690</sup> Exhibits US-600 and US-601, showing the control structure of EADS at the time of the IPO in 2000 and in December 2006, demonstrate that control has not changed.

535. Similarly, in the case of the creation of ASM, the French government did not relinquish control of Aérospatiale-Matra. Rather, it retained at least some control through a 48% stake in the entity as well as a “golden share.”<sup>691</sup>

536. Finally, the EC has in no way demonstrated that the transactions it cites occurred at arm’s length and for fair market value. In the case of ASM, for example, the corporate tie-up between Aérospatiale and Matra was negotiated privately between the French government and Lagardère.<sup>692</sup> As such, conditions characteristic of a market transaction – such as the “unfettered interplay of supply and demand” and “broad-based access to information on equal terms”<sup>693</sup> – were absent. Not surprisingly, even a report from the French Senate suggests that Aérospatiale was undervalued, giving Lagardère and those who purchased shares following the partial flotation a sweetheart deal.<sup>694</sup> Similar concerns were voiced in the press, and valuations of Aérospatiale were openly referred to as “seriously underestimated.”<sup>695</sup>

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<sup>690</sup> EADS, Business, Legal and Corporate Responsibility, Reference Document 2005 Part 3, at 56 (Exhibit US-599).

<sup>691</sup> See Décret no. 99-97 du 15 février 1999 instituant une action spécifique de l’Etat au capital de la société Aérospatiale, société nationale industrielle, Journal Officiel de la République Française (Feb. 16, 1999), at 2428 (Exhibit US-453); see also Reuters, *France publishes AS/Matra “golden share” decree* (Feb. 16, 1999) (Exhibit US-454).

<sup>692</sup> According to press reports, the French government made a surprise announcement about the merger in July 1998 and did not publish the official plan in the French Official Journal until the weekend prior to March 8, 1999. Full details were published only after approval by the government’s Privatization Commission. See, e.g., Business Week, *Birth of a Giant: The inside story of how Europe’s toughest bosses turned Airbus into a global star: EADS*, July 10, 2000, p. 170 (Exhibit US-548).

<sup>693</sup> *US - Countervailing Measures (AB)*, para. 122.

<sup>694</sup> Sénat, No. 414 (session ordinaire 1998-1999), Rapport d’Information, Commission des Finances du Contrôle Budgetaire et des Comptes Economiques de la Nation sur la restructuration de l’Industrie aeronautique européenne, pp. 144-145, 155 (Exhibit US-573). See also, Assemblée Nationale, Avis No. 1866, p. 26 (Exhibit US-593).

<sup>695</sup> See, e.g., *Aerospatiale - Matra merger in weeks*, Reuters, February 11, 1999 (Exhibit US-596).

**B. None of the transactions cited by the EC resulted in the “extraction” of Airbus LCA subsidies**

537. In its first written submission, in addition to setting out its theory of subsidy “extinction,” the EC set out a separate theory of subsidy “extraction.”<sup>696</sup> According to the latter theory, subsidy is “extracted” from an enterprise when the enterprise makes a cash transfer to its owner. The amount of subsidy thereby eliminated, according to the EC, is the amount of the transfer. While acknowledging that “this circumstance has not yet been addressed by the WTO,” the EC proclaimed (with scant explanation and citation to no authority whatsoever) that “the situation is analogous in economic terms to arm’s-length, fair market value sales or direct repayment to a government.”<sup>697</sup>

538. In its opening statement at the first Panel meeting, the United States explained that not only does this “extraction” theory lack any basis in the SCM Agreement but, if it were correct (which it is not), it would amount to a blueprint for easy circumvention of the SCM Agreement.<sup>698</sup> The EC’s response to the Panel’s Question 112 further demonstrates that the EC’s “extraction” theory is groundless and must be rejected.<sup>699</sup>

539. First, while the EC makes vague references to “the WTO treatment of change of ownership,” “the test for cash extraction,” and “the established WTO rules,” it never states where in the SCM Agreement this “treatment,” “test,” or “rules” can be found.<sup>700</sup> It does not do so because it cannot do so; the SCM Agreement is devoid of any reference to the “treatment,” “test,” or “rules” on which the EC relies. For this reason alone, the Panel should reject the EC’s “extraction” theory.

540. Second, and especially striking, is the EC’s assertion that “the test for cash extraction is a ‘but for’ test.”<sup>701</sup> What makes this unsupported statement so remarkable is that earlier in the very same submission – in responding to a question on export-contingent subsidies, in which it was asked to react to the proposition that “the EC Member States knew that the expected

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<sup>696</sup> See EC FWS, paras. 220-225.

<sup>697</sup> EC FWS, para. 225.

<sup>698</sup> U.S. FOS, paras. 122-125.

<sup>699</sup> The question asked the EC, “{W}hat specific evidence is there to show that these payments {by CASA and DASA} were actually made in order to repay loans or grants (alleged subsidies) received by the two entities?” It is notable that the EC never actually answered this question.

<sup>700</sup> EC Responses to First Panel Questions, paras. 317, 318, 319.

<sup>701</sup> EC Responses to First Panel Questions, para. 318.

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performance {under Launch Aid contracts} could not be achieved but for exports” – the EC recalled that “the Appellate Body has observed that panels must interpret and apply the language actually used in the Treaty” and stated, therefore, that “the European Communities contests the legal relevance of the term ‘but for.’”<sup>702</sup>

541. Third, as there is no treaty text to support its argument, the EC refers instead to what it calls “economic common sense.”<sup>703</sup> It provides no citation to a textbook or any other support for this “economic common sense.” Indeed, it barely provides an explanation of what it means by this reference. The few sentences of explanation it does provide are set forth at paragraph 320 of its responses to the first set of questions from the Panel. There the EC states:

Simply put, “but for” the alleged subsidy, CASA and DASA would have had a lesser value. But for the extractions, the value of those alleged subsidies would have remained with CASA and DASA, and been available for use and exploitation by the buyers to fuel the adverse effects alleged by the United States. When cash was withdrawn from those entities by their sellers in advance of sale, those payments served necessarily to extract from the company any value it otherwise may have enjoyed.<sup>704</sup>

542. However, the EC ignores that the same statements could be made of any investment in CASA and DASA, not just subsidized investments. Presumably, the owners of CASA and DASA made some contributions to the companies’ capital on market terms over the years. One may presume this to be the case, as the EC does not indicate that subsidies accounted for 100 percent of the companies’ capitalization. “‘But for’ {such non-subsidized investments}, CASA and DASA would have had a lesser value.” Yet, when cash was transferred from CASA and DASA to their respective owners (*i.e.*, the government of Spain and DaimlerChrysler), the EC inexplicably assumes that the transferred funds represented the subsidies previously provided to CASA and DASA, rather than the non-subsidized investments.

543. The EC accuses the United States of “invent{ing} a ‘same dollar’ test.”<sup>705</sup> But, in fact, it is the EC that invents a special accounting rule. Under that rule, when a subsidized entity transfers cash to the account of its owner, the transferred money is first attributed to any subsidies provided to the entity; presumably, once the amount transferred equals the amount of

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<sup>702</sup> EC Responses to First Panel Questions, para. 151 (citing *Canada - Aircraft (AB)*, footnote 102) (emphasis added); see also *US - FSC (AB)*, para. 91 (“{W}e have certain abiding reservations about applying any legal standard, such as this ‘but for’ test, in the place of the actual treaty language.”).

<sup>703</sup> EC Responses to First Panel Questions, para. 317; EC FWS, para. 220;

<sup>704</sup> EC Responses to First Panel Questions, para. 320 (footnote omitted).

<sup>705</sup> EC Responses to First Panel Questions, para. 319.

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pre-transfer subsidies, each additional euro transferred is attributed to non-subsidized investment. Of course, the EC offers no support for this accounting rule, as there is none.

544. More fundamentally, the EC’s “extraction” theory relies on a supposed separation between a company and its shareholders – the very separation that the EC successfully opposed in *US - Countervailing Measures*.<sup>706</sup> In that dispute, the United States argued that a privatization did not automatically extinguish pre-privatization subsidies, because the privatization merely effectuated a change of owners, while the subsidies continued to benefit the productive entity regardless of its owner. As the panel in that dispute summarized: “The United States argues that the Panel should not treat money taken out of an owner’s pocket as having been taken out of the company, potentially eliminating subsidies that reside in the company.”<sup>707</sup>

545. At the EC’s urging, the panel and Appellate Body rejected that argument. Thus, the panel explained that

for the purpose of the benefit determination under the SCM Agreement, no distinction should be made between a company and its shareholders, as together they constitute a producer, a natural or legal person that may be the ‘recipient’ of the benefit to be assessed.<sup>708</sup>

546. Yet, this is precisely the distinction the EC is asking the Panel in this dispute to make. The EC is asking the Panel to find that money transferred from CASA to its shareholder (the government of Spain) and from DASA to its shareholder (DaimlerChrysler) had the effect of “extracting” subsidies previously provided to CASA and DASA. That would directly contradict the reasoning of the panel and the Appellate Body in *US - Countervailing Measures*.

547. If it is the case that money taken out of an owner’s pocket amounts to money taken out of the company, potentially eliminating subsidies that reside in the company, then the converse must also be true: 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.” The EC’s assertion that when money from DASA “was extracted by Daimler” it was “diverted for other

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<sup>706</sup> See *US - Countervailing Measures (Panel)*, para. 7.50 (“SCM Agreement does not make any reference or any distinction between shareholders and the company when it discusses the need to establish the benefit”); see also *id.*, para. 7.54; *US - Countervailing Measures (AB)*, paras. 110-115; *US - Lead Bars (Panel)*, para. 6.82 (“In the context of privatizations negotiated at arm’s length, for fair market value, and consistent with commercial principles, the distinction between a company and its owners is redundant for the purpose of establishing ‘benefit.’”).

<sup>707</sup> *US - Countervailing Measures (Panel)*, para. 7.50.

<sup>708</sup> *US - Countervailing Measures (Panel)*, para. 7.54.

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purposes”<sup>709</sup> ignores this logic and seeks to resurrect the very distinction between company and shareholder that the EC successfully fought to eliminate for purposes of a benefit analysis under the SCM Agreement in *US - Countervailing Measures*.

548. In this regard, it should be recalled that in rejecting the distinction between firms and owners for purposes of determining whether a benefit from a financial contribution exists within the meaning of the SCM Agreement, the Appellate Body observed that the opposite approach

could potentially undermine the *SCM Agreement* by opening wide a door enabling subsidizing governments to circumvent that Agreement’s provisions by bestowing benefits directly on the firm’s owners rather than on the firms themselves.<sup>710</sup>

549. The very same observation can be made of the EC’s “extraction” theory. Finding that subsidies are “extracted” when money is transferred from subsidized firms to their owners effectively would create opportunities for the laundering of subsidies. For example, following receipt of a government financial contribution that confers a benefit within the meaning of Article 1 of the SCM Agreement, a company could transfer cash in the amount of the benefit to its parent – thus “extracting” the subsidy in the EC’s view – only to have its parent make a contribution to capital in the same amount at a later date – thus restoring the benefit originally provided by the now “extracted” subsidy.

550. Indeed, following the EC’s logic, it would seem that a company “extracts” subsidies every time it buys back stock or pays dividends to its shareholders – both types of transactions that involve a transfer of cash from the company to its owners. Yet, if this were so, then opportunities to circumvent the SCM Agreement would abound.

551. Finally, the EC seems to argue that the transfers of cash from CASA to the government of Spain and from DASA to DaimlerChrysler were analogous to repayments of subsidies and thus constituted withdrawals of subsidies within the meaning of Article 4.7 and 7.8 of the SCM Agreement.<sup>711</sup> However, the EC ignores an important distinction between these transactions and actual repayments of subsidy. When withdrawal of a subsidy is effectuated by repayment, the government that provided the subsidy in the first place receives cash from the subsidized entity and gives up nothing in return. That is not what happened in the CASA and DASA transactions.

552. In the case of DASA, it was not even the original providers of subsidies – the government of Germany and regional governments within Germany – that received the cash. Rather, the

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<sup>709</sup> EC Closing Statement at First Panel Meeting, para. 13.

<sup>710</sup> *US - Countervailing Measures (AB)*, para. 115.

<sup>711</sup> See EC FWS, paras. 223-224, 287.

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cash was transferred to a private entity – DaimlerChrysler. As a result of that transaction, DaimlerChrysler gave something up in the sense that it received a smaller stake in EADS than it would have received if the cash transfer had not occurred.

553. Likewise, CASA transferred cash to the government of Spain, as a result of which the government of Spain gave something up by receiving a smaller stake in EADS when the CASA assets were transferred to EADS. While the government of Spain was the entity that provided subsidies to CASA, that in and of itself does not make the cash transfer from CASA a repayment of subsidies. Unlike a repayment, in which the government would have received something and given up nothing, here the government effectively gave up the larger stake in EADS that it would have received without the cash transfer.

554. In other words, the transactions leading to the creation of EADS resulted in the owners of CASA and DASA respectively receiving a mix of cash and stock in EADS. Had they not received any cash – that is, had the transactions that the EC refers to as “extractions” not occurred – they would have received more stock. Indeed, it was precisely to have the relative shares in EADS held by the owners of CASA and DASA comport with a preconceived notion of ownership ratios that led to the cash transfers. Thus, the owners gave something up in order to get the cash from CASA and DASA. By contrast, in a transaction that could be characterized as a repayment of subsidies, cash would have gone to the governments that provided the subsidies and the governments would have given nothing up in return.

555. For the foregoing reason, the EC is wrong to portray the transfers of cash by CASA and DASA to the government of Spain and DaimlerChrysler respectively as analogous to repayments effectuating withdrawals of subsidies.

## **XII. THE EC FAILS TO REBUT THE U.S. DEMONSTRATION THAT THE SUBSIDIES HAVE CAUSED ADVERSE EFFECTS TO THE INTERESTS OF THE UNITED STATES**

556. In its prior submissions, the United States has demonstrated that, through the use of Launch Aid and the other challenged subsidies, the EC and the Airbus governments have profoundly distorted competition in the global LCA market in favor of Airbus. Specifically, the United States has shown:

- But for the subsidy, Airbus could not have launched any of its major LCA models at the time and in the way that it did. Therefore, the LCA family that Airbus has offered customers in the past and offers them today would not exist – at least not in its present form – without the subsidy.
- But for the subsidy, Airbus would not have had the resources to pursue all its strategic objectives, i.e., the rapid development of a whole series of LCA products



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(each of which requires enormous, long-term capital investments with the prospect of profits, if any, many years into the future) *and* the simultaneous use of aggressive pricing to build long-term market share.

557. The United States has further demonstrated that the competitive advantages that Airbus receives from Launch Aid and the other subsidies have resulted in tangible, significant harm to the interests of the United States that constitutes adverse effects within the meaning of Article 5 of the SCM Agreement. Specifically, the United States has shown:

- The effect of the subsidy is to displace or impede exports of Boeing LCA into the EC LCA market and the imports of Boeing LCA into significant third-country LCA markets, in that Boeing's share of these markets has declined sharply since 2001 due to competition from Airbus LCA that would not have existed or that would not have been priced so competitively but for the subsidy.
- The effect of the subsidy is significant lost sales of Boeing LCA to Airbus LCA in the global market, in that Boeing has lost numerous specific sales campaigns since 2001, with a cumulative value of many billions of dollars, to Airbus LCA that would not have existed or that would not have been priced so competitively but for the subsidy.
- The effect of the subsidy is significant price undercutting of Boeing LCA by Airbus LCA in the global market, in that Airbus's lower offered price has been the decisive element in many of the specific sales campaigns Boeing has lost to Airbus since 2001 and it is able to offer these lower prices because of the subsidy.
- The effect of the subsidy is significant price depression or price suppression in the global LCA market, in that the price Boeing has received for its worldwide LCA sales has declined or failed to increase commensurately with costs since 2001, due to declines in market pricing resulting from the low prices that Airbus has been able to offer because of the subsidy or due to competition from aircraft models that would not have existed but for the subsidy.
- Subsidized imports of Airbus LCA in the U.S. market have caused material injury to Boeing – the only U.S. domestic LCA producer – by taking market share, depressing or suppressing prices, and thereby negatively impacting Boeing's U.S. LCA production activities.
- The nature of the subsidies and their ongoing effects threaten further such adverse effects in the imminent future.

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558. The EC has submitted many hundreds of pages on the topic of adverse effects. Yet it is remarkable how little the EC addresses the actual claims of the United States in this dispute. For example, the United States has shown that the cumulative benefit of subsidies over many years gives Airbus the flexibility to pursue multiple costly market strategies at the same time. Instead of rebutting this argument, the EC puts great effort into attempting to show that the expected impact of Launch Aid on the net present value of an aircraft program at the time of launch provides Airbus little extra disposable revenue with which to offer price discounts on that particular model years after launch. The argument fails even on its own terms, as the United States will show in detail below. But more importantly, even a successful EC argument along these lines would hardly constitute a rebuttal of the U.S. claim. The EC's (failed) attempts to disprove this and other claims that the United States has not made should not distract the Panel from the EC's more significant failure to respond to the claims the United States has made.

559. In the remainder of this submission, the United States will first summarize how Launch Aid distorts the LCA market in favor of Airbus and respond to the EC submissions on this point. Next, the United States addresses the EC arguments with respect to certain cross-cutting issues and demonstrates the validity of the U.S. approach to the analysis of the adverse effects. Finally, the United States responds to the EC arguments with respect to the particular types of adverse effects and shows how the market distortions produced by Launch Aid and the other subsidies cause each type of adverse effects.

### **A. The EC does not rebut the U.S. demonstration that Launch Aid profoundly distorts competition in LCA markets**

560. The United States has demonstrated that Launch Aid distorts LCA markets in at least two independent and significant ways. First, Launch Aid shifts much of the commercial risk of LCA launch decisions from Airbus to the Airbus governments, thereby causing Airbus to launch aircraft models that, in the absence of the subsidy, would not have been launched. Second, the EC and Airbus governments provide Airbus with significant additional cash flow and other financial resources on non-market terms during the lengthy period between launch investment and the recovery of that investment, which in turn allows Airbus to be much more aggressive in pricing LCA to gain market share.

561. The EC has rebutted neither of these showings. To the contrary, the EC submissions reinforce and support the U.S. showing of these economic effects of Launch Aid and the other subsidies.

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1. Launch Aid distorts Airbus's launch decisions and conditions the Airbus LCA family available in the market

562. The United States has demonstrated that Launch Aid provided by the Airbus governments has had a decisive impact on each of Airbus's key launch decisions. This is shown both by the economic model of Dr. Gary Dorman, which was discussed in some detail in the first Panel meeting, and statements by Airbus, the EC and the Airbus governments, and independent observers confirming the decisive role that Launch Aid played in the Airbus decision to proceed with each launch. The EC's attempt to rebut Dr. Dorman's model fails, and in any event, the EC has largely chosen not to contest that Launch Aid has in fact been decisive in most of Airbus's key launch decisions.

a. *The Wachtel critique of the Dorman model is fatally flawed*

563. The impact of Launch Aid on the decision to launch a particular aircraft program is shown by the model developed by Dr. Gary Dorman.<sup>712</sup> Dr. Dorman shows that the net present value of an LCA project is highly sensitive to assumptions with regard to unit costs, unit pricing, and projected sales volume over a period of many years after the original launch decision and that Launch Aid lowers the threshold level for these parameters for which the net present value of the program is positive and thus commercially viable. Thus, Launch Aid fundamentally distorts the decision to launch LCA models. As British economist Kim Kaivanto observed:

Launch Aid commits European governments to absorbing much of any possible losses, so even if Airbus is risk averse, it has little incentive not to adopt a risky, aggressive strategy.<sup>713</sup>

And this is precisely what Airbus has done.

564. The EC accepts that the economic viability of an LCA project is ordinarily assessed by an LCA manufacturer using a "net present value" approach, in which the projected cash inflows and outflows associated with the program are compared, discounted to the present using an appropriate discount rate.<sup>714</sup> The EC also appears to acknowledge that there is substantial uncertainty about the likely cash flows at the time of launch, and that this uncertainty needs to be

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<sup>712</sup> Gary J. Dorman, *The Effect of Launch Aid on the Economics of Commercial Airplane Programs* (Nov. 6, 2006) ("Dorman Report") (Exhibit US-70).

<sup>713</sup> Kim Kaivanto, *Premise and Practice of UK Launch Aid*, 40 *Journal of World Trade* 495, 498 (2006) (Exhibit US-2).

<sup>714</sup> EC FWS, para. 1760.

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taken into account in the launch decision.<sup>715</sup> The United States notes that in the UK project appraisal for the A320, recently provided by the EC, the government acknowledges that “[  
I.]”<sup>716</sup>

565. The EC response to the U.S. argument on the nature and market effects of Launch Aid, as outlined in its report by Dr. Wachtel,<sup>717</sup> are instead primarily focused on the parameters and implications of Dr. Dorman’s model, rather than on its basic structure. Moreover, none of the EC objections has merit.

566. As an initial matter, the economist selected by the EC to review Dr. Dorman’s model, Dr. Wachtel, is a macroeconomist without relevant experience in the particular and unique economic structure of the LCA industry.<sup>718</sup> Indeed, his analysis of the number of firms that could be expected to exist in particular segments of the LCA market is expressly not derived from any considerations that apply to the LCA industry in particular, but rather is conducted in the “spirit” of a prior study of the number of participants in local markets for doctors, dentists, druggists, plumbers, and tire dealerships.<sup>719</sup>

567. Dr. Wachtel thus does not consider the particular importance that economies of scale play in the LCA industry, as do other economists who have actually studied the LCA industry. For example, the 1995 study by Neven and Seabright for the British government models the impact of the subsidized entry of Airbus into the LCA market on Boeing and McDonnell Douglas.<sup>720</sup> They point out that “scale economies are so important in this technology that, if a producer enters a market at all, it will always do so at a scale of production that makes a significant difference to its competitors’ sales.”<sup>721</sup>

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<sup>715</sup> See U.S. FOS (HSBI and BCI) para. 54.

<sup>716</sup> UK Department of Trade and Industry study of sales prospects of the A320 (1983), para. 8.1 (Exhibit EC-594) (BCI).

<sup>717</sup> Paul Wachtel, *Critique of “The Effect of Launch Aid on the Economics of Commercial Airplane Programs”* by Dr. Gary J. Dorman, Jan. 31, 2007 (“Wachtel”) (Exhibit EC-12).

<sup>718</sup> A review of Dr. Wachtel’s publicly available *curriculum vitae* shows that he has extensive experience in monetary policy and transition economies but no prior experience in evaluating the economics of LCA development or other studies of particular industries. See Exhibit US-607.

<sup>719</sup> Timothy F. Bresnahan & Peter C. Reiss, *Entry and Competition in Concentrated Markets*, 99 Journal of Political Economy 977, 991 tbl.3 (1991) (cited in Exhibit EC-19 note 2).

<sup>720</sup> Damien Neven & Paul Seabright, *European Industrial Policy: The Airbus Case* (1995) (“Neven & Seabright”) (Exhibit US-382).

<sup>721</sup> Neven & Seabright at 10-11 n.3 (Exhibit US-382).

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568. Further, while Neven and Seabright (and other academic economists who have studied the LCA industry) divide the LCA market into different segments for purposes of modeling each manufacturers' launch of an aircraft in a particular segment, they also take into account scope economies across different segments.<sup>722</sup> Dr. Wachtel's approach – like that of the EC generally in this dispute – treats each LCA market segment as entirely distinct. Thus, under Dr. Wachtel's approach, wherever manufacturers can each expect to sell around 500 aircraft in a particular market segment over a 15-year period, each can expect to break even and so will enter that segment.<sup>723</sup> On this analysis, there could be twelve LCA manufacturers in the 100-200 seat LCA "market," given that the number of sales in the segment from 1991 to 2005 is 12 times the "breakeven" point.

569. Of course, there are not twelve producers of 100-200 LCA, so Dr. Wachtel does not draw out this point expressly. There are not twelve such producers, however, precisely because of the points that Dr. Wachtel's paper ignores – the scope efficiencies for larger producers driven by the importance of the full LCA family to the development of each individual model.

570. The EC also complains that the Dorman analysis ignores allegedly "significant" effects from increased demand for LCA resulting from price competition.<sup>724</sup> Neither Dr. Wachtel nor the EC has presented any evidence of the existence of such offsetting benefits. Economists who have studied the LCA market, however, find little or no increase in the number of LCA sales based on the general level of LCA pricing. For example, Gernot Klepper's study of the effect of the entry of Airbus into the LCA market assumes that "the price elasticity of demand for aircraft in general will most likely be rather small."<sup>725</sup> The harm to Boeing from suppressed or depressed prices for its products is thus likely to far outweigh any benefit from increased total LCA demand resulting from lower prices, if in fact any such increased demand occurs at all.

571. Ultimately, Dr. Wachtel's analysis is simply inapposite, as it is being used to rebut an argument that the United States does not make, namely that "Boeing would not face any competition had Airbus not launched a particular LCA."<sup>726</sup> As the United States has already explained, it does not contend that Boeing or the United States is entitled to a monopoly in part or all of the LCA market – although it is certainly relevant in this regard that the second LCA

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<sup>722</sup> Neven & Seabright at 23 (Exhibit US-382).

<sup>723</sup> Wachtel, paras. 7-8 (Exhibit EC-12).

<sup>724</sup> EC FWS, para. 2309.

<sup>725</sup> Gernot Klepper, *Entry into the Market for Large Transport Aircraft*, 34 European Economic Review 775, 785 (1990) (Exhibit US-377).

<sup>726</sup> EC FWS, para. 2308.

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producer that Airbus displaced happened to be a U.S. producer.<sup>727</sup> Instead, the United States argues that even if Airbus would have entered a particular LCA market segment at some other time with a different aircraft (in terms of technical capabilities, specifications, and other characteristics), the effect on the U.S. LCA industry would have been different. That Airbus enters market segments at a time and in a way that it can only do because of subsidies cannot but have a distorting impact on the market.

572. Next, the EC – again relying on Dr. Wachtel – asserts that the net present value of Dr. Dorman’s illustrative aircraft program is so low, at \$1.35 billion, that the parameters of the model must have been chosen so as to make the net present value seem lower and more sensitive to adverse market consequences than would be the case for an actual program.<sup>728</sup> The United States has already presented a comparison of the Dorman parameters with certain HSBI information provided by the EC.<sup>729</sup> Industry observers of the A380 project predicted much lower net present values for the A380 project, even assuming that the project would be successful.<sup>730</sup> Further, contrary to the EC’s assertion, the Dorman model fully takes into account repayments of Launch Aid in calculating the impact of Launch Aid. Indeed, this is precisely why the Dorman model shows that the impact of Launch Aid increases as fewer aircraft are sold and fewer repayments are made.<sup>731</sup>

573. Finally, the EC asserts that, even if Launch Aid does permit Airbus to launch aircraft that it could not have launched, there is no adverse effect from a subsidized launch for one of two reasons: either (1) demand for a commercially successful aircraft would lead Airbus to launch the aircraft without Launch Aid (albeit somewhat later) or (2) the aircraft is commercially unsuccessful and no one is harmed by the launch but Airbus.<sup>732</sup> However, the United States has demonstrated that there is harm both from the acceleration of a launch and by the launch of a commercially unsuccessful plane.<sup>733</sup> As to the first, if one accepts the EC’s assertion that Airbus sold its A340-500 to Thai Airways because Airbus brought this ultra-long-range aircraft to

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<sup>727</sup> U.S. FOS, paras. 147-151.

<sup>728</sup> EC FWS, paras. 2310-2311.

<sup>729</sup> U.S. FOS (HSBI and BCI), paras. 51-55.

<sup>730</sup> For example, the Harvard Business School paper submitted by the EC estimated that the net present value of the A380 project was \$348 million. Benjamin Esty & Pankaj Ghemawat, *Airbus vs. Boeing in Super Jumbos* (Harvard Business School Strategy Working Paper No. 02-061, Feb. 2002) at 49 (Exhibit EC-344).

<sup>731</sup> Dorman Report, Table 3 (Exhibit US-70).

<sup>732</sup> EC FWS, paras. 2313-2314.

<sup>733</sup> U.S. FOS, paras. 152-153.

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market before Boeing was able to produce a comparable ultra-long-range aircraft,<sup>734</sup> then Airbus was able to win this sale only because it launched the A340-500/600 when it did. To the second point, even where customers are now able to choose between the 777 and the A340 – and generally prefer the 777 because of, among other things, its superior fuel economy – Airbus has publicly stated that it competes by calculating the burden of extra fuel costs on A340 customers and reducing the A340 price by an equivalent amount, thus putting continued pricing pressure on Boeing despite the A340's lack of commercial success.<sup>735</sup>

574. In sum, Dr. Wachtel's paper does not rebut the key lessons of Dr. Dorman's analysis – that Launch Aid substantially shifts the commercial risk of launch decisions to governments and that other competitors are adversely affected thereby.

*b. The EC does not contest that Launch Aid was necessary for every Airbus launch prior to the A380*

575. In its first written submission, the United States summarized evidence demonstrating that the EC and Airbus itself have publicly stated that Launch Aid was a “prerequisite” for the launch of all existing Airbus models.<sup>736</sup> The EC contested this showing only for the A380. Thus, as the United States observed at the first Panel meeting, it appears that the EC does not contest that Launch Aid was an essential “prerequisite” for the launch of all Airbus aircraft prior to the A380.<sup>737</sup> As the EC did not object to this inference, it may be taken as given that the EC agrees that without Launch Aid, none of the earlier launches would have taken place as they did.

576. In any event, the contemporaneous statements of Airbus and EC officials already referenced by the United States are clear enough that Airbus could not have launched any of these aircraft without subsidies. But it is nonetheless significant that the EC agrees that subsidies were necessary for the launch of all of the Airbus LCA that have been delivered to date.

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<sup>734</sup> EC FWS, para. 2109.

<sup>735</sup> See U.S. FWS, para. 808 & nn.1018-1019.

<sup>736</sup> U.S. FWS, paras. 830-832; as cited in *id.* para. 831, the term “prerequisite” was used by then-Airbus CEO Bernard Lathiere (Exhibit US-15).

<sup>737</sup> U.S. FOS, para. 129.

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*c. Launch Aid was necessary for the launch of the A380*

577. Moreover, the EC claim in this dispute that Launch Aid was not necessary for the launch of the A380<sup>738</sup> is contradicted by the evidence. For example, the stated policy of the UK government is to provide Launch Aid only if the recipient demonstrates, *inter alia*, “that Government investment is essential for the project to proceed on the scale and in the time-scale specified in the application.”<sup>739</sup> That the UK government provided Launch Aid for the A380 project therefore leads to the conclusion that Airbus had demonstrated to the UK government’s satisfaction that Launch Aid was “essential” to the full realization of the project. Indeed, the Secretary of State for Trade and Industry confirmed to Parliament that “the launch of the A380 ... would not have been possible if it had not been for the commitment of the British Government to launch” the program.<sup>740</sup>

578. The United States has already cited a French government report with respect to projected A380 financing requirements:

In the case of the {A380}, since the development cost of the future jumbo jet is estimated to be 50 billion francs, the expenses Aérospatiale must bear would be about 18.8 billion francs. . . . It seems doubtful that the enterprise would be in a position to find outside financing to meet its needs. . . . Above all, however, such external financing would apparently add excessively to the financial expenses incurred by the firms, and would throw their balance sheets out of equilibrium because of the low level of their equity capital.<sup>741</sup>

As this statement makes clear, even if Airbus was confident that the net present value of the A380 project would be positive without Launch Aid, it does not necessarily follow that Airbus would have been able to launch the project using its own resources and such “outside financing” as may have been available to it on commercial terms. For the French government, the problem was not just finding the outside financing – which should theoretically be available in the capital markets to fund any truly commercially viable project – but “above all” the financial impact of such financing, even assuming it could be found, on the balance sheet of Airbus.

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<sup>738</sup> EC FWS, paras. 1759-1776.

<sup>739</sup> Department of Trade and Industry, *Aerospace and Defence Industries, Launch Investment* (Exhibit US-106).

<sup>740</sup> Answer of Patricia Hewett, Secretary of State for Trade and Industry, Hansards Debates, col. 1088 (Mar. 3, 2005) (Exhibit US-436).

<sup>741</sup> 1997 French Senate Report at 72 (Exhibit US-18).



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579. Indeed, the EC acknowledges that the French equity infusions into Aérospatiale were necessary in order to fund investments, including LCA launches, because “{i}nternally generated cash flow was not sufficient, and a prudent debt-to-equity ratio placed limits on the amount of new debt that could be borne.”<sup>742</sup> The inadequacy of current LCA sales revenues to fund the many new Airbus LCA projects on the schedule that Airbus desired was cited as a justification for seeking Launch Aid as early as the 1980s, when Sir Austin Peace, the chairman of British Aerospace, explained that slower than expected sales of the A300 and A310 would have resulted in the launch of the A320 being “pushed further into the future than previously anticipated” without Launch Aid.<sup>743</sup> The French A380 report confirms that similar concerns about the overall financial stability of Airbus if it had to fund A380 development solely from commercial sources were significant in the deliberations leading up to the decision to request and grant Launch Aid for the A380 project.

580. Moreover, the effects of Launch Aid and the other subsidies go well beyond the impact of the subsidy on the expected net present value of the A380 project at the time of launch. By shifting much of the risk of this project to the Airbus governments, Launch Aid enabled Airbus to obtain a lower cost of capital for the portion of the A380 development cost that it funded from its own resources.<sup>744</sup> In addition, the provision of Launch Aid for prior projects (much of which remained and remains unpaid) and other subsidies, such as the French equity infusions and the German debt forgiveness, also assisted Airbus in being able to fund the portion of A380 development costs not covered by Launch Aid, infrastructure subsidies, and other government assistance. All of these benefits must be considered when evaluating whether the A380 would have been launched, but for the subsidy.

581. The EC has designated much of the specifics of its A380 arguments as HSBI. The United States has already responded to that evidence and refers the Panel to the discussion of this evidence at the first Panel meeting.<sup>745</sup>

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<sup>742</sup> EC FWS, para. 1135.

<sup>743</sup> *Costs Push British Toward Joint Efforts*, Aviation Week & Space Technology (May 30, 1983) (Exhibit US-439).

<sup>744</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 Moody’s Investor Service, *Moody’s Assigns A3 Rating to New Euro Mtn Program of European Aeronautic Defence and Space Company EADS N.V.* (Feb. 6, 2003) (Exhibit US-56); Moody’s Global Credit Research, *Moody’s confirms EADS A1 rating*, (Mar. 9, 2007) (Exhibit US-464); CreditSuisse, *Value versus Risk*, EADS upgrade rating, at 14 (June 15, 2006) (Exhibit US-465).

<sup>745</sup> U.S. FOS (HSBI and BCI), paras. 51-57.

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582. Additionally, the United States notes that the negative impact of additional development costs and unanticipated A380 delivery delays – 2,500,000,000 Euro according to EADS,<sup>746</sup> an amount widely acknowledged to be very significant – demonstrates the importance of Launch Aid as a financial stabilizer during the early years of A380 development. That is, during the period when most of the A380 development costs were incurred and no deliveries were expected, Airbus had the use of more than 2,500,000,000 Euro from the French, German, and Spanish governments<sup>747</sup> and £530,000,000 from the British government<sup>748</sup> at risk-shifting, below-market rates. The negative financial impact on Airbus of not having access to Launch Aid during this period, then, would have been equally, if not more, significant.

583. Accordingly, the evidence indicates that Launch Aid played a central role in the launch of the A380, just as it did for the launch of all other Airbus aircraft.

*d. Launch Aid causes harm even if Boeing launches a competing aircraft*

584. The EC further contends that, even if the effect of the subsidy is to allow Airbus to launch an LCA model it would not otherwise have launched, any adverse effects end if Boeing launches an aircraft that competes with the subsidized Airbus model.<sup>749</sup> This is both logically and factually incorrect.

585. As a logical matter, either Boeing would have launched the competing aircraft referred to by the EC even if Airbus did not launch its subsidized aircraft, or Boeing would not have done so. If Boeing would have launched the aircraft anyway, then “but for” the subsidy its model would not have had to compete with the subsidized Airbus model, which would not have existed. Adverse effects from this competition that occurred only because of the subsidy would be manifested as lost sales, displacement and impedance of Boeing sales, and price suppression. On the other hand, if Boeing only launched the competing aircraft to respond to the subsidized presence of the Airbus model, then Boeing had to divert capital and resources to meet the Airbus challenge that, but for the subsidy, could have been used elsewhere. This, too, would result in similar adverse effects in some part of the LCA market. Thus, whether Boeing launched its model in response to Airbus or not, adverse effects would be expected.

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<sup>746</sup> EADS press release, *EADS 2006 results dominated by Airbus loss* at 4 (Mar. 9, 2007) (Exhibit US-463).

<sup>747</sup> U.S. FWS, paras. 265, 273, 282.

<sup>748</sup> U.S. FWS, para. 290.

<sup>749</sup> EC FWS, paras. 2288-2304.

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586. As a factual matter, competition in the LCA industry is complex, and no one can say with certainty whether, how, or when Boeing (or McDonnell Douglas or another competitor) would have acted if the EC had not provided the subsidies that allowed the Airbus launches. The 1995 Neven and Seabright study referred to above, however, models the impact of the subsidized Airbus launches up to the date of that study, and finds that Boeing's lost profits amounted to more than \$100 billion and that McDonnell Douglas's profits were reduced by two-thirds.<sup>750</sup> The EC provides no evidence that would suggest that the Neven and Seabright figures – which were, after all, calculated at the request of the UK government – are inaccurate. Indeed, as noted above, these economists observe that “scale economies are so important in this technology that, if a producer enters a market at all, it will always do so at a scale of production that makes a significant difference to its competitors' sales.”<sup>751</sup> Thus, the EC's speculation that Boeing is not harmed by the subsidized launch of an Airbus aircraft if it can launch a competitor is not only unsupported by evidence, but is also not credible in the context of the economics of LCA production.

587. In any case, that Boeing chooses to meet subsidized competition to the best of its ability does not eliminate the adverse effects caused by the subsidy. That one of the three U.S. LCA producers that existed when Airbus began its subsidized entry into the LCA market is still making every effort to compete in the marketplace distorted by the subsidies is not evidence that the subsidies have not had adverse effects.

*e. “But for” EC and Airbus government subsidies, Airbus's product development strategy and available aircraft family would be very different*

588. In essence, the EC response to the U.S. demonstration of the distorting effects of Launch Aid is *not* to contend that Launch Aid has had no impact on Airbus's launch decisions. Rather, the EC contends that the United States, by arguing that subsidies created the existing supply, in fact argues that Boeing should have a monopoly in the LCA market; it then rebuts this straw man by arguing that even without the subsidized Airbus entry, there would have been another competitor with exactly the same product line as Airbus, such that the competitive position of Boeing would be the same as it is with subsidies.

589. The EC argument is pure speculation devoid of evidentiary support; the EC does not (and indeed cannot) demonstrate a counterfactual in which an alternative producer behaving just like the subsidized Airbus entity enters the market. There are many possible ways that the LCA market could have developed over the last three decades if subsidies had not been provided to

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<sup>750</sup> Damien Neven & Paul Seabright, *European Industrial Policy: The Airbus Case* at 2-3 (1995) (Exhibit US-382).

<sup>751</sup> Neven & Seabright at 10-11 n.3 (Exhibit US-382).

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Airbus. It is conceivable that Airbus could have emerged as a viable producer without subsidies, but the EC agrees that without subsidies Airbus would have been more cautious about product launches; it would have launched fewer aircraft, more slowly, and with different technical characteristics. Or, if Airbus had not emerged as a competitor, the most likely outcome would be that another U.S. producer would have survived to compete with Boeing.<sup>752</sup> Perhaps some combination of these outcomes would have occurred, or another Member would have experienced the growth of a competitive LCA industry. But in any of these cases, there would have been less displacement or impedance of U.S. exports, less price suppression, less price undercutting, and fewer lost sales for the U.S. LCA industry as a whole.

590. The United States does not object to competition among LCA producers. What the United States objects to is the use of subsidies to gain advantage in that competition – which is what the SCM Agreement does not permit the EC or the Airbus governments to do. That they have provided Airbus with such an advantage by providing subsidies that were necessary for the development of the Airbus LCA family is, in the end, uncontested.

2. The EC does not rebut the U.S. demonstration that Launch Aid also distorts LCA pricing

591. The United States has also shown that the effect of Launch Aid on prices of aircraft after they are launched is a second and *independent* economic distortion of the LCA market caused by Launch Aid. The EC largely ignores the U.S. argument. Instead, the EC focuses on rebutting an argument that the United States has not made. The EC therefore has failed to rebut the U.S. demonstration in this regard.

a. *The EC misrepresents the U.S. causation argument*

592. The EC response to the U.S. submissions with regard to the price effects of the subsidy uniformly assumes that the *only* way the subsidies provided to Airbus can affect prices is by providing a “pool” of extra funds that can be spent on price discounts.<sup>753</sup> Moreover, according to the EC, the amount of subsidy “available” to Airbus to “spend” on price discounts for any given aircraft in any given year is equal to the projected increase in the net present value of that particular LCA program caused by Launch Aid for that model, allocated across each individual

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<sup>752</sup> U.S. FOS, paras. 147-151.

<sup>753</sup> The EC appears to believe that an LCA producer that receives funds from an exogenous source might “spend” those funds by providing discounts on LCA sales that it might not otherwise provide. For example, the EC argues that when Swissair failed to follow through on its orders of A340s due to the airline’s bankruptcy, [

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aircraft and year.<sup>754</sup> Implicit in the EC approach is the proposition that the subsidies affect prices by providing the manufacturer with “free money” that it can choose, at its discretion, to spend on price discounts, or not at all.

593. But the type of price effect described by the EC is *not* the price effect of the subsidies that the United States has challenged. Instead, the United States makes two key arguments with respect to the impact of the specific Airbus subsidies on market prices.

594. First, because the subsidies have been instrumental in creating Airbus’s LCA product family, they necessarily create supply-side pressure on market prices. LCA market prices are set by the interplay of demand for, and supply of, LCA. Subsidies that are instrumental in creating significant supply will have a significant impact on market prices. In the LCA market where, for the past ten years, Boeing and Airbus have been the only suppliers and Airbus has increased its market share to more than 50 percent, the supply-side price impact of Launch Aid and other subsidies to Airbus has been particularly significant.

595. Second, the impact of Launch Aid on the overall financial performance of the LCA business of Airbus as a whole allows it the flexibility to price all of its LCA more aggressively than it otherwise could. Airbus has followed a two-pronged market strategy – an aggressive pace of aircraft launches in order to develop and maintain a full family of aircraft and aggressive pricing of those aircraft in order to gain market share. *If* Airbus had launched some or all of its aircraft without Launch Aid, the company would have faced significant financial pressures to fund its ambitious LCA development program from its own resources, given that the profits, if any, in this industry are realized so many years after the initial investment in the aircraft model. Launch Aid and other subsidies have reduced this financial pressure both directly, by providing Airbus with large amounts of capital at below-market rates that need not be paid back if the aircraft program is unsuccessful, and indirectly, by lowering its overall financial risk and thus its overall cost of capital. This has allowed Airbus to keep to this aggressive launch schedule, while simultaneously following its publicly stated policy of pursuing what it considers an appropriate market share, even when doing so impacts short-term profitability.<sup>755</sup>

596. In the absence of the subsidy, Airbus would not be able to do all these things at once. As explained above, the EC and the Airbus governments have often pointed to the fragile financial condition of Airbus as part of the rationale for giving Launch Aid, in that Airbus would be too heavily exposed to commercial lenders if it had to fund product development using commercial funds (if, in fact, any such lenders could be found). The subsidy is not a simple pool of cash that

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<sup>754</sup> *E.g.*, EC FWS, para. 1864.

<sup>755</sup> *See, e.g.*, Airbus Annual Review 2005 (Jan. 2006) at 18 (“{T}o Airbus, one percent in profitability matters more than one percent in market share, provided it remains at an average 50 percent market share.”) (Exhibit US-441).

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Airbus can “spend” as it will, but a necessary condition for Airbus to pursue multiple costly and risky strategies at the same time.

597. The EC argument, therefore, does not rebut the argument that the United States has made. Nor does the EC rebut the evidence that the United States has presented to support its argument, including:

- the evidence summarized above that Launch Aid was instrumental in creating Airbus’s LCA supply;
- the evidence summarized above that the EC and Airbus governments provide Launch Aid and other subsidies because Airbus has insufficient equity to take on the amount of commercial debt that would be necessary if it funded its LCA launches without government assistance;
- the evidence summarized above that the financial impact of Launch Aid on the short-term cash flow of Airbus during periods of major launches is very substantial;
- the evidence presented at the first Panel meeting that net Launch Aid (i.e., new Launch Aid disbursements less repayments of prior Launch Aid) accounted for a substantial share of Airbus’s free cash flow during the 2001-2005 period;<sup>756</sup>
- the evidence summarized above that Airbus enjoys a more favorable credit rating, and therefore has access to private capital at lower rates than it otherwise would, as a direct result of the subsidies.

The EC “rebuttal” does not respond to any of these points.

598. Further, the EC explains that the [

].<sup>757</sup> In fact, [

].<sup>758</sup> Thus, the [

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<sup>756</sup> U.S. FOS, para. 160; Deutsche Bank, *EADS: Risks Mispriced – Downgrade to Sell*, Jan. 9, 2007, at 7 (Exhibit US-459).

<sup>757</sup> Statement of Christian Scherer, para. 105 (Exhibit EC-14).

<sup>758</sup> Statement of Christian Scherer, para. 106 (Exhibit EC-14).

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I.

*b. The magnitude of the subsidy is large*

599. The EC further complains that the United States has not demonstrated that the subsidies have caused adverse effects because it fails to quantify with precision the benefit that Launch Aid provides to Airbus and asserts that the magnitude of the benefit of Launch Aid and certain other subsidies is too small to produce significant adverse effects.<sup>759</sup> The EC's contention is incorrect for several reasons. First, the United States is under no obligation to provide a detailed quantification and allocation of the subsidy benefit. Second, the EC's attempt to show a small current benefit from Launch Aid is riddled with significant errors. Finally, any reasonable calculation of the magnitude of the subsidy demonstrates that it is – contrary to the EC's claims – very large.

*(i) No obligation to quantify the subsidy benefit*

600. As the United States explained in response to the Panel's questions, nothing in Part III of the SCM Agreement calls for a precise calculation or allocation of the subsidy benefit.<sup>760</sup> As the Appellate Body stated in the *US – Cotton Subsidies* dispute, "Article 6.3(c) deals with the 'effect' of a subsidy, and not with the financial accounting of the amount of the subsidy."<sup>761</sup> The same holds true for the other types of adverse effects described in Article 6.3. Indeed, the EC explained to the Appellate Body in that dispute that "there is no basis for transposing directly the quantitative focus and more detailed methodological observations of Part V into the provisions of Part III of the *SCM Agreement*."<sup>762</sup>

601. The reason that panels and the Appellate Body have consistently found that the quantification of the subsidy benefit is unnecessary in serious prejudice disputes is evident – the focus in Part III of the SCM Agreement is on the effect of the subsidy, while in Part V the focus is on the amount of countervailing duty to be applied to offset a subsidy provided to imports that are causing or threatening to cause injury. The magnitude of the subsidy benefit is relevant to a serious prejudice claim only to the extent that it confirms whether the subsidy is of sufficient magnitude to cause the claimed effects. All else being equal, a larger subsidy could be expected

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<sup>759</sup> EC FWS, paras. 1569-1634.

<sup>760</sup> U.S. Responses to First Panel Questions, para. 249.

<sup>761</sup> *US – Cotton Subsidies (AB)*, para. 476.

<sup>762</sup> Third Party Submission of the European Communities, *US – Cotton Subsidies (AB)*, Nov. 16, 2004, para. 44.

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to have greater effects, but the magnitude of the subsidy is only one of the many factors that bear upon how a subsidy has effects in the marketplace.<sup>763</sup>

602. Thus, the serious prejudice analysis does not call for a quantification of the subsidy benefit, but for a consideration of whether the magnitude of the subsidy is large enough to be the cause of the effects demonstrated by the United States. As shown above, Launch Aid and the other subsidies distort the LCA market in two principal ways – by allowing Airbus to bring new aircraft to market at a time and on a pace that would be impossible without subsidies, and by providing financial flexibility that allows Airbus to price aggressively to gain market share while simultaneously pursuing an ambitious and costly product development strategy. With respect to the first, as shown above, the magnitude of the subsidy is sufficient that, without the subsidy, Airbus could not have launched any of its principal LCA models – a point that the EC largely concedes. Further, as also shown above, net Launch Aid disbursements represented most of Airbus's free cash flow in the 2001-2005 period, especially early in the period when Airbus began to drive down prices to maintain and increase its market share. Thus, the new Launch Aid disbursements that Airbus was receiving in this period were of sufficient magnitude to affect its pricing policy.

603. The EC approach, by contrast, purports to calculate the expected impact of Launch Aid on the net present value of the aircraft program, at the time of the launch commitment, based on the assumption that the anticipated sales forecast is accurate. Once again, the EC rebuttal attacks a straw man of its own creation, rather than the actual arguments the United States has made. Indeed, as the United States has explained:

the effect of Launch Aid is not only – and not even primarily – to bestow extra money on the LCA manufacturer when it launches. The effect is also to shift much of the risk of launch to the government – and therefore to make the very fact of launch more likely.<sup>764</sup>

The EC argument ignores this latter effect of Launch Aid – as it must, since the EC agrees that the magnitude of Launch Aid has generally been sufficient to have a decisive effect on the outcome of Airbus's launch decisions.

604. The EC's failure to rebut the U.S. argument is evidenced by the following example. The United States demonstrated that the effect of the Launch Aid subsidy was to allow Airbus to offer A320s at low prices in 2001-2005 such that Boeing lost several major sales, Boeing LCA exports to various markets were displaced and impeded, and prices for Boeing 737 were suppressed in the global market, because (1) Airbus could not have launched the A320 when it did without Launch Aid and (2) because Airbus received an ongoing, cumulative benefit from

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<sup>763</sup> See *US – Cotton Subsidies (AB)*, para. 461; *US – Cotton Subsidies (Panel)*, paras. 7.1173.

<sup>764</sup> U.S. FOS, para. 141.



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past subsidized loans and additional subsidized loans made during this period to offset the financial stress of the launches of the A340-500/600, A380, and A350. The EC response is to inquire what the current benefit would be from a single lump-sum grant provided to Airbus at the time of the A320 launch. Even if the EC were correct about the amount of benefit currently allocable to a single, one-time grant provided in 1984, this would not amount to a rebuttal of the U.S. demonstration of causation.

(ii) *The EC vastly understates the amount of the subsidy benefit*

605. Even if a quantification of the subsidy benefit were relevant in this dispute, the United States has already shown that the purported quantification and allocation of the subsidy benefit performed by the EC's paid consultants at International Trade Resources ("ITR") contains numerous and systemic errors and flaws that render its conclusions unreliable and unuseable for the Panel's analysis.<sup>765</sup> These errors include:

- calculating the subsidy as a grant based on the projected impact on net present value at the time the Launch Aid was committed, rather than as a loan at below-market interest rates providing current benefits from interest savings;
- calculating the subsidy based on the projected schedule of LCA deliveries and repayments rather than on actual repayments made, while using actual rather than projected disbursements;
- calculating the subsidy net of the (theoretical) impact of taxation; and
- failing to implement its own stated methodology correctly by [

].<sup>766</sup>

606. The ITR methodology has a fundamental conceptual error that can be illustrated using a simple example. Suppose that a government provides a one-year loan of \$100 to a company that expects to sell 105 units. The loan is success-dependent, with \$1 to be repaid for each of the first 105 units sold. If all 105 units are sold as expected, the effective interest rate is 5%. Suppose that an equivalent commercial loan has an interest rate of 15%.

607. On the terms of the commercial loan, after one year the recipient would have had to repay \$115. Under the terms of the subsidized loan, assuming the project is successful and 105 units

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<sup>765</sup> U.S. Responses to First Panel Questions, paras. 250-254.

<sup>766</sup> U.S. Responses to First Panel Questions, para. 252.

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are delivered, only \$105 will be repaid to the government. In this case the benefit to the recipient is \$10, which is equal to the interest savings (5% subsidized rate versus 15% commercial rate) on the one-year loan. If, however, the project fails to meet expectations, the benefit to the recipient is even greater. For example, if only 90 units are sold, the effective subsidy is \$25, because only \$90 is actually repaid – in essence, a \$10 interest subsidy plus a \$15 loan forgiveness because of the failure to reach the sales target.

608. The ITR methodology, by contrast, measures only the impact on the net present value of the project, measured at the time of the financial contribution, from the favorable interest terms in the projected-sales scenario. In other words, ITR does not address the sales-dependent nature of repayment and any additional benefit that would flow from fewer than expected sales – let alone the *effect* of this type of financing.

609. Further, ITR measures the benefit only at the time of the financial contribution. In this example, ITR does not only limit the benefit to the \$10 interest subsidy, but calculated the value of that subsidy when the loan was made. In other words, because of the time value of money, the value of a \$10 interest savings one year from now, using the commercial interest rate of 15% as the discount rate, is only \$8.67. For ITR, then, the “benefit” from this sample subsidy is \$8.67. In other words, ITR ignores the value of the benefit *at the time it is received* – that is, when the higher interest payments would otherwise be due. For a subsidy like Launch Aid, where the time lag between the initial commitment of Launch Aid and its eventual repayment is substantial, the time at which one measures the benefit matters a great deal. By choosing to measure the benefit at the earliest conceivable moment, and before the benefit of the subsidy is actually received by the recipient, ITR artificially minimizes the dollar value of the benefit.

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(iii) *On any reasonable calculation, the benefit from Launch Aid is enormous*

610. Because the ITR methodology does not accurately measure the full magnitude of the subsidy benefit, the economists at NERA Consulting have made an estimate of the total benefit to Airbus from Launch Aid.<sup>767</sup> In its calculation, NERA assumed a 17-year loan period for each disbursement and the commercial benchmarks it previously developed (and that ITR used in its report). As in the example in the previous section, NERA asked how much of the actual or projected loan disbursements plus accumulated interest at the benchmark commercial rate still remained or would remain unpaid at the end of the loan period, in this case 17 years. Any repayments made after the 17-year loan period were used to reduce the outstanding balance. When calculated in this way, the total outstanding balance of all of the particular provisions of Launch Aid as of December 2006, based on the “stated rate” – that is, *projected* disbursements and repayments – was \$92.5 billion. If one bases the calculation on the “realized rate” – that is, *actual* disbursements and repayments, the total is \$129.9 billion.<sup>768</sup>

611. Moreover, these figures includes loan balances assumed to have been left unpaid in the past. To ensure an apples-to-apples comparison, NERA brought forward such balances using the government risk-free borrowing rate so that the final total can be expressed uniformly in current dollars. In 2006 dollars, the total benefit using projected disbursements and repayments is \$122.1 billion and using actual disbursements and repayments would be \$178.2 billion. At Airbus’s general, non-project-specific corporate borrowing rates – arguably the more accurate way to measure the impact of Launch Aid on the present financial condition of Airbus – the accumulated benefit in 2006 dollars would be larger still.<sup>769</sup>

612. Regardless of the exact methodology used to calculate the total benefit, however, it is evident that Airbus could not have launched its LCA family using commercial financing without Launch Aid, as the outstanding balances under any reasonable calculation methodology are clearly far more than Airbus could have sustained. But this is exactly what the EC itself concedes. Quantifying precisely how unsustainable the debt burden on Airbus would have been if it had embarked on its product development strategy of building an entire LCA family relying on funding at commercial rates is unnecessary to demonstrate that it *would* have been unsustainable, and by a wide margin.

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<sup>767</sup> NERA Economic Consulting, *Quantification of Benefit of Launch Aid* (May 24, 2007) (“NERA Quantification Report”) (Exhibit US-606).

<sup>768</sup> NERA Quantification Report at 4 (Exhibit US-606).

<sup>769</sup> NERA Quantification Report at 4 (Exhibit US-606).

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613. Thus, the relevant counterfactual for determining the effect of the subsidy is not to consider what the LCA market would be like if Airbus had launched all of its aircraft when it did and was an additional \$178.2 billion in debt. Rather, what would exist in the absence of the subsidy is an Airbus that did not launch the LCA family that it did, at least not in the way that it did. It is an Airbus that would have been significantly more cautious in product development, pricing strategy, or (most likely) both. Moreover, the magnitude of the difference between the LCA market as it is and as it would have been absent the subsidy is more than sufficient to have caused the particular adverse effects that the United States has been experiencing in recent years. This is all the SCM Agreement requires.

*c. The global LCA market is highly competitive and sensitive to price*

614. The EC also attempts to break the causal link between the challenged subsidies and the adverse effects by contending that many LCA sales do not involve “competition” between Airbus and Boeing, and that where sales are not “competitive” there is no possibility for subsidies to cause adverse effects.<sup>770</sup> The EC definition of a “competitive” sale, however, excludes many sales in which price competition between Airbus and Boeing is highly relevant.

615. First, many LCA orders are exercises of options that were granted as part of prior orders. As the EC explains, options “are secured at the same time of a purchase contract,” and a customer has the right to exercise the options to purchase additional LCA from the original manufacturer on the terms set in the original competition.<sup>771</sup> In addition, once a customer has selected Airbus or Boeing LCA, there are cost advantages in placing additional follow-on orders with the same manufacturer. Thus, the manufacturer that succeeds in winning an order from an airline gains an advantage in future orders from that customer.

616. For example, as described in the U.S. first submission, in 2004 AirAsia chose to purchase LCA from Airbus after an intense competition with Boeing in which it determined that “the offer from Airbus is priced well below Boeing’s.”<sup>772</sup> As a result of this campaign, AirAsia signed a Memorandum of Understanding with Airbus containing an order for 40 A320s plus options for 40 more. By the time that the actual purchase contract was announced on March 25, 2005, the order increased to 60 A320s plus 40 options.<sup>773</sup> According to AirAsia CEO Tony Fernandes, the

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<sup>770</sup> EC FWS, paras. 1415-1426.

<sup>771</sup> EC FWS, para. 1420; Statement of Christian Scherer, para. 48 (Exhibit EC-14).

<sup>772</sup> U.S. FWS, para. 787 (quoting Exhibit US-412). This campaign is discussed in more detail in the HSBI Appendix to this submission.

<sup>773</sup> Airbus press release, *AirAsia increases A320 commitment to 100 aircraft* (Mar. 25, 2005) (Exhibit US-608).

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airline decided to eliminate all of its existing 737s and to delay leases for 737s while waiting for A320 deliveries in order not to “sacrifice our cost structure.”<sup>774</sup> In July 2006, AirAsia converted its 40 options to firm orders for A320s and obtained 30 more options.<sup>775</sup> Then, in January 2007, AirAsia converted its 30 options into firm orders, placed 20 new firm orders, and obtained 50 more options, bringing its total purchase from Airbus to 100 firm orders and 50 options to date.<sup>776</sup>

617. All of these LCA orders by AirAsia are the outgrowth of the original 2004 sales campaign, in which AirAsia reversed an earlier strategic decision to build its entire fleet around the Boeing 737 and made a new strategic decision to build its entire fleet around the Airbus A320. But, according to the EC, [ ] AirAsia’s March 2005 decision to expand the original order from 40 aircraft to 60, [ ] AirAsia’s July 2006 decision to exercise the 40 options it negotiated as part of the 2004 sale, [ ] AirAsia’s January 2007 decision to place 50 more orders and obtain 50 more options.<sup>777</sup> This is plainly incorrect. The subsidy did not only affect the first 40 or 60 AirAsia purchases, while having no impact at all on the subsequent orders for 90 more aircraft (and 50 outstanding options). Rather, the effect of the subsidy was to affect *both* the initial sale *and* the subsequent orders, which [ ] because they were for all practical purposes decided in the original competition.

618. Further, current market pricing is relevant even in “non-competitive” sales. A customer may, for the reasons already given or other reasons, not go through a formal competitive process, but only if it believes that it is getting a market price. If a customer thinks that holding a competition will drive down the price, it will do so.<sup>778</sup> Thus, the spectre of Airbus pricing shadows every campaign, even those the EC would deem “non-competitive,” and thus impacts the pricing of Boeing LCA in every campaign. So, even if a sale is “non-competitive” on the EC’s definition, this does not mean that there are no price effects from market competition on these sales. Even when Boeing wins a supposedly “non-competitive” sale, it must provide its customer with the market price for LCA, even if that price has been depressed or suppressed because of the subsidies in other, “competitive” campaigns.

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<sup>774</sup> *Id.*

<sup>775</sup> AirAsia press release, *AirAsia firms up options for 40 more Airbus A320s and signs another 30 options* (July 20, 2006) (Exhibit US-378).

<sup>776</sup> Airbus press release, *100 more A320s for AirAsia* (Jan. 8, 2007) (Exhibit US-609).

<sup>777</sup> [ ]

[ ] Exhibit EC-14 Annex I (BCI).

<sup>778</sup> For an example of such a sale, see the HSBI Appendix.

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619. Specific examples of allegedly “non-competitive” sales campaigns in which Airbus-Boeing price competition played a significant role are discussed in detail in the HSBI Appendix.

3. The other subsidies complement Launch Aid and have cumulative effects

620. The United States focuses its complaint on the effects of Launch Aid. Not only does Launch Aid account for the bulk of the subsidy benefit provided to Airbus, but Launch Aid profoundly distorts the LCA market in ways that other forms of government support do not.

621. However, the other subsidies identified by the United States in this dispute, when provided in combination with Launch Aid, have the effect of amplifying and reinforcing to the market-distorting impact of Launch Aid. To the extent that these subsidies to Airbus have effects that are complementary to Launch Aid, their effects should be considered together with Launch Aid.

a. *Other subsidies also shift commercial risk of launch to subsidizing governments*

622. As just described, one effect of Launch Aid is to shift a portion of the cost and risk of LCA development from Airbus to the governments. Several of the subsidies provided to Airbus by the EC and the Airbus governments have a similar effect.

623. For example, *EIB loans* are similar to Launch Aid in that they are intended to provide low-interest loans to support LCA development projects. These loans are different from, and in fact less market-distorting than, Launch Aid, because they are not success-dependent or backloaded in the way that Launch Aid is. Nonetheless, when EIB loans are provided in a context in which Launch Aid is also provided, the EIB loans amplify the total impact of government funding even when its terms are less distortive than those of Launch Aid.

624. Likewise, certain provisions of Airbus-specific *infrastructure* – such as the A380 assembly sites at Hamburg and Toulouse – relieve Airbus of development costs (in this case, development costs for the A380) that Airbus would have had to incur if the governments had not provided the infrastructure on subsidized terms. When provided together with Launch Aid, infrastructure subsidies that defray the costs of aircraft development shift commercial risk away from Airbus and to the governments. The provision of Launch Aid and the provision of the Hamburg-Finkenwerder site both relieved Airbus of certain up-front development costs; if the A380 is unsuccessful and Airbus ceases production, Airbus walks away from any Launch Aid repayment obligations and walks away from the Hamburg-Finkenwerder site, having never had any obligations to cover the cost of creating the land. Both subsidies have the effect of limiting the risk of A380 failure to Airbus, making it more likely that Airbus would launch the A380 in the first place.

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625. As for subsidies for *research and technology*, at least some of the subsidies provided to Airbus are clearly related to LCA development. For example, the EC provided over 3,000,000 Euro for a study of the A380 wake vortex – an important issue related to the development of the A380 and its placement into commercial service.<sup>779</sup> Where research subsidies are provided to fund projects that would clearly otherwise be part of the launch of a given LCA model, the effects of such subsidies are also properly considered together with Launch Aid.<sup>780</sup>

*b. Other subsidies also increase Airbus's financial flexibility to pursue aggressive growth strategies*

626. Likewise, as described in prior sections, another impact of Launch Aid is to provide Airbus with the financial resources to pursue a number of costly, risky strategies simultaneously. All subsidies have at least some effect on the financial condition of recipient and all of the subsidies therefore contribute, at least to some degree, to the financial flexibility of Airbus. To the extent that subsidies have provided Airbus with financial resources that materially influenced its ability to take more aggressive market positions, whether in product development, pricing, or both, such subsidies contribute to that pricing flexibility and should be considered together.

627. In particular, *debt forgiveness* and *equity infusions* have played a significant role in improving Airbus's balance sheet and enabling Airbus to attract additional private investment and maintain its product development and pricing strategies. The United States has already cited the 1994 request for an equity infusion from the French government, which stated that [

] <sup>781</sup> Thus, in evaluating the financial impact of Launch Aid, the financial impact of these other subsidies should be considered as well.

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<sup>779</sup> See Competitive and Sustainable Growth Programme, 1998-2002 Project Synopsis: New Perspectives in Aeronautics, 2003, at 261 (Exhibit US-322).

<sup>780</sup> See also the evidence discussed in Section X of the HSBI Appendix to the U.S. first written submission.

<sup>781</sup> Aérospatiale report to Credit Lyonnais (1994) at 1 (Exhibit US-296), quoted in full in U.S. FWS, para. 826.

**B. The EC's legal and analytical approach to adverse effects is fundamentally flawed**

628. The United States next addresses several fundamental, cross-cutting issues in the EC analytical and legal analysis of adverse effects. In particular, the United States will address (1) the issues of the subsidized and like product, (2) the proper reference period for determining adverse effects, (3) the use of order and delivery data in assessing serious prejudice, and (4) the irrelevance of certain EC arguments with respect to the financial position of Boeing to the U.S. serious prejudice claims.<sup>782</sup>

1. There is one subsidized product (Airbus LCA) and one like product (Boeing LCA)

629. Both Boeing and Airbus offer a full family of LCA products to meet the diverse needs of airline customers. As the United States has demonstrated, the EC and the Airbus governments have provided subsidies that created and benefit the full Airbus LCA family and artificially enhance the market position of all Airbus LCA models to the competitive detriment of the “like” Boeing LCA family. The EC, by contrast, assumes – without supporting evidence or argumentation – that the effects of the subsidies are limited to particular segments of the LCA market.

630. To the extent that the United States understands the EC argument, there does not seem to be any disagreement between the parties that LCA customers purchase aircraft based upon the specific missions for which customers require LCA at any given time, and therefore both Airbus and Boeing will, in any given sales campaign, offer the LCA model or models that most closely match the customers' needs. Accordingly, it is true that, as the EC explains, “competition generally occurs” between similar models of Airbus and Boeing LCA.<sup>783</sup> However, the EC apparently agrees with the United States that the circumstances of a given campaign can lead airlines to consider Boeing and Airbus LCA that differ somewhat in seating capacity or other characteristics. Thus, while it is *usually* true that a customer considering a Boeing 737 would generally also consider an Airbus A320 while a customer considering an Airbus A340 would generally also consider a Boeing 777, even the EC recognizes that in certain circumstances competition does not necessarily follow the fivefold market delineation proposed by the EC.<sup>784</sup>

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<sup>782</sup> A number of these matters have already been addressed at some length in the U.S. responses to the Panel's questions following the first meeting.

<sup>783</sup> EC Responses to First Panel Questions, para. 333.

<sup>784</sup> *E.g.*, EC Responses to First Panel Questions, paras. 325-333.



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631. The United States does not agree with the EC, however, when it argues that these facts require the Panel to assess the “effect of the subsidy” with respect to individual alleged market segments, let alone the particular five market segments identified by the EC. Moreover, for each of the challenged subsidies, the “effect of the subsidy” is not limited to one particular segment of the LCA market. Because the “subsidized product” – the product that benefits from the subsidy – is in every case the Airbus LCA family, it is reasonable to conduct the adverse effects analysis on the basis of one subsidized product, taking into account size and other differences among various LCA models as appropriate.

*a. Launch Aid benefits the full Airbus LCA family*

632. The United States has shown that the Launch Aid Program as a whole, and each particular provision of Launch Aid, benefits the whole Airbus LCA family and has effects throughout the LCA market. In particular, the United States has identified six particular ways in which Launch Aid subsidizes the Airbus LCA family as a whole.

633. First, the EC, the Airbus governments, and Airbus itself recognize that a credible LCA producer must operate across the full market. As EADS recently explained to its shareholders: “A complete product portfolio is seen as necessary to serve the customer base and to maintain overall competitiveness.”<sup>785</sup> From the very beginning of Airbus, subsidies have been provided to facilitate “the development over time of five related aircraft types” so that Airbus could offer “a family of aircraft.”<sup>786</sup> Indeed, the EC recognizes expressly that a competitive LCA producer must be present in all market segments in order to meet all of its customers’ needs, and thus “no manufacturer of a single product or family of products, no matter how compelling, has survived in the LCA industry.”<sup>787</sup> Subsidies that facilitate the development of one Airbus LCA model therefore improve the marketability of all Airbus LCA models.

634. Second, technologies or production facilities developed as part of the launch of one Airbus LCA model are used or incorporated into production of other Airbus LCA models, both those already in existence and those developed later.<sup>788</sup> These “spill-over” benefits reduce development and production costs for all Airbus LCA, not only the models for which they were originally and nominally provided.

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<sup>785</sup> EADS, Report of the Board of Directors, in Documentation for the Annual General Meeting on Friday, May 4, 2007, at 30 (Exhibit US-503).

<sup>786</sup> Testimony of Alan Boyd, Chairman of Airbus Industrie of North America, Inc., to U.S. House of Representatives Subcommittee on Commerce, Consumer Protection, and Competitiveness, at 34 (June 23, 1987) (Exhibit US-386).

<sup>787</sup> EC FWS, para. 30.

<sup>788</sup> U.S. FWS, paras. 818-819; U.S. FOS, para. 130; U.S. FOS (HSBI and BCI), paras. 56-57.

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635. Third, Airbus uses “commonality,” or common elements among different LCA models that reduce the cost of operating multiple Airbus LCA models, as a central feature in selling the entire Airbus LCA fleet to customers.<sup>789</sup> Thus, as Airbus’s marketing materials explain, with Airbus “having a family save {s} you money.”<sup>790</sup> Subsidies that permit the development of each individual Airbus model therefore enable Airbus to pursue its business model of designing and selling a full LCA family. Market analysts have recognized, therefore, that if Airbus failed to follow through on its launch of the A350, this “could lead to lower market share in Airbus’ core single-aisle range, as many airlines want commonality, and buy larger and smaller aircraft in packages.”<sup>791</sup>

636. Fourth, Airbus uses one Airbus LCA model to sell other LCA models in “package” deals, either simultaneously or consecutively. For example, in response to a question from the Panel, the United States provided several examples of “bundled” Airbus (and Boeing) LCA sales and demonstrated that, in many other cases, previous purchases of one Airbus LCA model were an important factor in a customer’s decision to purchase other Airbus LCA models.<sup>792</sup>

637. The EC asserts that these “bundled” sales are relatively infrequent, and that in any case simultaneous sales of multiple LCA types are treated for accounting purposes as separate transactions.<sup>793</sup> Nonetheless, as the United States has shown, when Airbus makes such “bundled” sales, both Airbus and the purchasing airlines repeatedly state that the synergistic benefits of operating multiple aircraft types from the same manufacturer played an important role in the decision.<sup>794</sup> To the extent that even simultaneous orders for multiple aircraft types are negotiated and accounted for as separate transactions, this simply highlights that customer purchases of multiple aircraft types from a single manufacturer are similar whether they occur simultaneously or consecutively.<sup>795</sup> In both cases, customers perceive advantages in ordering from a common manufacturer, and the manufacturers in turn highlight these advantages in selling LCA.

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<sup>789</sup> U.S. Responses to First Panel Questions, paras. 228-232.

<sup>790</sup> Airbus, *Excellence Runs in the Family* (Exhibit US-390; also reproduced as page 9 of Exhibit US-448).

<sup>791</sup> Goldman Sachs, *EADS* (Nov. 21, 2006) at 21 (Exhibit US-613).

<sup>792</sup> U.S. Responses to First Panel Questions, paras. 422-428.

<sup>793</sup> EC Responses to First Panel Questions, paras. 446, 453.

<sup>794</sup> U.S. Responses to First Panel Questions, paras. 422-423.

<sup>795</sup> U.S. Responses to First Panel Questions, paras. 424-425.

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638. Fifth, Launch Aid reduces the debt burden on Airbus of building each individual LCA model, which in turn allows Airbus to move on to launch the next model much more easily and quickly than would otherwise have been possible. For example, when approving state aid for the A340-500/600 project, the EC observed that if Airbus had to “finance the development costs of the A340-500/600 solely from its own capital (or through bank loans), it would seriously weaken the financial structure of the company.”<sup>796</sup> Looking forward to the proposed A380 project, the French Senate likewise observed that commercial financing, even if the Airbus companies could obtain it, “would throw their balance sheets out of equilibrium because of the low level of their equity capital.”<sup>797</sup> Thus, the EC and the Airbus governments do not only provide Launch Aid in order to facilitate individual Airbus LCA launches, but also to keep Airbus solvent so that it can maintain its product development pace by launching additional aircraft projects in rapid succession.

639. Sixth, Launch Aid provides Airbus with additional cash flow that allows it to reduce prices of any LCA model whenever it concludes that a price reduction is necessary to capture orders that would otherwise have gone to Boeing. As the United States has pointed out, net receipts from Launch Aid (i.e., new Launch Aid disbursements less repayment of prior Launch Aid) accounted for nearly half of Airbus’s free cash flow from 2001-2005 and for *all* of its free cash flow in 2001 and 2002, precisely when Airbus intensified its effort to win sales and gain market share by aggressively underpricing Boeing and winning several major long-term sales.<sup>798</sup> The particular provisions of Launch Aid during this period thus not only permitted the ongoing development of the A340-500/600 and the A380, but also helped Airbus prepare to fund the A350 and to offer deep discounts on the A320.

640. Thus, the “effects of the subsidy” are never limited to any one LCA model. Rather, each provision of Launch Aid benefits the entire Airbus LCA family and has adverse effects on the entire like Boeing family. Accordingly, the “subsidized product” for each of the subsidies, and for all of the subsidies taken together, is Airbus LCA.

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<sup>796</sup> Letter from Karel Van Miert to Hubert Vedrine, *Reimbursable Advance to Aérospatiale for the Airbus A340-500/600 Program*, Aid No. N369/98, at 5 (7-8 in English translation) (Jan. 26, 1999) (Exhibit US-3).

<sup>797</sup> 1997 French Senate Report at 72 (Exhibit US-18).

<sup>798</sup> Deutsche Bank, *EADS: Risks Mispriced – Downgrade to Sell*, Jan. 9, 2007, at 7 (Exhibit US-459).

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*b. EC legal argument is without foundation*

641. The EC argues that the U.S. identification of the Airbus LCA family as the “subsidized product” and the corresponding Boeing LCA family as the “like product” is impermissible because not every Airbus LCA model is “like” every other Airbus LCA model or every Boeing

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LCA model. The EC argument confuses the identification of the “like product” with the identification of the “subsidized product.”

642. This confusion is particularly evident in the EC’s discussion of the panel report in *Indonesia – Autos*.<sup>799</sup> The panel in that dispute did not consider the question of the identification of the subsidized product. Indeed, the complaining parties identified the subsidized product as one particular model of automobile – the Timor – and neither the panel nor the responding Member appears to have disputed this:

In this case, the European Communities and the United States have alleged that the subsidies in question are conferred on the Timor. Accordingly, our analysis of the effects of these subsidies must be performed in relation to their effects on products which are “like products” to that passenger car.<sup>800</sup>

643. Further, it was undisputed that the subsidized product – the Timor – was defined as something much narrower than the class of all passenger automobiles. Rather, the Timor competed only in a particular “niche” of the Indonesian passenger automobile market.<sup>801</sup> Thus, in the panel’s view, EC and U.S. products that competed in different “niches” of that market were not “like products” to the Timor.<sup>802</sup> But this definition of the “like product” flowed directly from the definition of the “subsidized product.” The panel in that dispute was not confronted with subsidies provided on behalf of all passenger cars, and so did not consider the question of whether all “passenger cars” can be a single “subsidized product” and, if so, whether all “passenger cars” produced by a complaining Member is the proper “like product” to that “subsidized product.”

644. Moreover, the LCA market differs from the passenger automobile market in that most LCA are sold to customers who operate a fleet of LCA and who therefore derive advantages from purchasing a variety of LCA from the same manufacturer. By contrast, relatively few automobile customers would benefit from the ability to purchase a fleet of automobiles of varying sizes and models from a single manufacturer. LCA producers, even more than automobile producers, are in the business of designing, building, and selling *families* of products. Thus, even if it were appropriate to treat a subsidy to multiple automobile models as benefitting a number of individual “subsidized products,” each of which competes with different “like products” – something that the *Indonesia – Autos* panel did *not* find – it would not follow that this type of analysis would therefore also be appropriate for subsidies in the LCA industry.

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<sup>799</sup> EC Responses to First Panel Questions, paras. 414-418.

<sup>800</sup> *Indonesia – Autos*, para. 14.164.

<sup>801</sup> *Indonesia – Autos*, para. 14.183.

<sup>802</sup> *Indonesia – Autos*, para. 14.193.

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645. Indeed, the reasoning of the *Indonesia – Autos* panel, which defines the “like product” narrowly with respect to the “subsidized product,” would support a *broader* approach to the definition of the “subsidized product.” If, as the EC asserts, the subsidies must be divided up among several “subsidized products,” then the only effects of the subsidies that would be cognizable under the SCM Agreement would be those that impact the particular “like product” corresponding to the “subsidized product” to which a particular subsidy was allocated. But, where the subsidy provides benefits to the whole Airbus LCA family in competition with the whole Boeing LCA family, some of the effects of the subsidy would effectively be ignored in such a segmented analysis.

646. Indeed, as the United States has already demonstrated, the *US – Softwood Lumber Dumping* panel has rejected the claim that the definition of the “like product” in the Antidumping Agreement (which is identical to that in the SCM Agreement) requires that each item in the “product under consideration” must be “like” every other item within it.<sup>803</sup> Likewise, the EC, in its own practice under the Antidumping Agreement and the SCM Agreement, does not recognize any principle that would require such a narrow definition of the “product under consideration.” For example, in a countervailing duty investigation of ring binder mechanisms (“RBMs”) from India and Indonesia, the EC found that several hundred different models of RBMs were one “subsidized product”:

The models varied by size, shape, and number of rings, the size of the base plate and the system to open the rings (pull open or opening trigger). In the absence of a clear dividing line in the range of RBMs and given that all of them have the same basic physical and technical characteristics, and that the models of RBMs can, within certain ranges, replace each other, the Commission established that all RBMs constitute one single product for the purposes of the present proceeding.<sup>804</sup>

Like the RBMs examined by the EC, all LCA have the same “basic” physical and technical characteristics, notwithstanding size and other differences in models. Likewise, different models of LCA “can, within certain ranges, replace each other,” even if all LCA models are not uniformly substitutable for all other LCA models outside these ranges.

647. Thus, the EC’s own practice is at odds with its assertion that the SCM Agreement does not permit the Panel to treat different sizes of LCA as a single “subsidized product.” In addition, the EC assertion is inconsistent with what the EC argued to the panel in *Korea – Commercial Vessels*:

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<sup>803</sup> U.S. Responses to First Panel Questions, paras. 413-414 (citing *US – Softwood Lumber Dumping (Panel)*, para. 7.157).

<sup>804</sup> Council Regulation No. 977/2002, O.J. L 150/17, para. 14 (June 8, 2002) (Exhibit US-602).

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As long as the complainant identifies markets or products that are reasonable and coherent, the Panel should accept that definition. The Panel should reject the complainant's proposed definition only if it would make a market analysis impossible.<sup>805</sup>

The EC has provided no explanation for its position that the SCM Agreement permits a flexible approach to the definition of the “subsidized product” for purposes of the *Commercial Vessels* dispute and for purposes of its own trade remedies practice, but not in the context of LCA.

648. Finally, the EC is incorrect when, for example, it characterizes the U.S. argument with respect to depressed and suppressed prices for Boeing’s 737 as a claim that “A320 family prices caused the alleged suppression of only 737NG family prices.”<sup>806</sup> Rather, the United States has demonstrated, as it must, that depressed and suppressed prices for the 737 (and the 747, 767, and 777) are *the effect of the subsidy* which was bestowed on the full Airbus LCA family. Under the EC’s approach, which allows only for effects running between directly competitive models, the Panel would have to ignore the demonstrated effect of the Launch Aid Program and every particular provision of Launch Aid on the whole Boeing LCA family through “bundled” sales, expanded commonality, shared technology and production facilities, and financial effects. Nothing in the SCM Agreement requires such an artificial approach to analyzing the effects of the subsidy.

*c. The EC’s five proposed LCA “markets” are without factual basis*

649. Even if it were useful or reasonable to divide the LCA market into a number of submarkets, the EC fails to show why the effects of the subsidy are limited to competition within each of the five specific LCA “markets” identified by the EC.

650. First, there are no clear dividing lines between the five categories proposed by the EC. Rather, the EC proposes an arbitrary “subsidized product” definition based only on differences in seating capacity and assumes a fixed two-class or three-class seating configuration for each model. When examined closely, the 100-200, 200-300, 300-400, 400-500, and 500+ seat division that the EC proposes falls apart. For example, the EC insists that Airbus’s A320 family falls into the 100-200 seat category, but when a low cost carrier like easyJet, which operates on a single class basis, looks at the A321, it sees a plane that can carry up to 220 passengers. A definition of subsidized product based on a standard seating capacity that may or may not reflect the way airlines actually configure their cabins does not provide a basis on which to draw meaningful distinctions among LCA.

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<sup>805</sup> *Korea – Commercial Vessels*, Annex F-1, para. 33 (Oral Statement of the European Communities at the Second Panel Meeting).

<sup>806</sup> EC Responses to First Panel Questions, para. 413.

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651. In fact, in its own documents Airbus itself does not follow the particular five-market segmentation that the EC advocates here. For example, Airbus’s Global Market Forecast divides the aircraft market into a large number of segments, including a 250-seat segment that includes some 767, 777, 787, A330, A340, and A350 models and a 400-seat segment that includes both the 747 and the 777-300.<sup>807</sup> An Airbus marketing presentation from 2003 describes the [

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652. Additionally, there are competitions between Boeing and Airbus aircraft that the EC would place in different “markets,” such as the British Airways competition between the 777 and the A330 discussed at the Panel meeting.<sup>809</sup> Likewise, when Fed Ex cancelled its order for 10 A380 freighters, it immediately ordered 15 Boeing 777 freighters to replace them.<sup>810</sup> In addition, airlines fly aircraft from more than one of the EC categories on many common aircraft routes.<sup>811</sup> That there are particular reasons for an airline’s consideration of competing aircraft from different segments or for airlines’ choices of operating aircraft from different segments on similar routes is not relevant to determining the boundaries of the subsidized product; reasons can be supplied for the existence of any phenomenon. What matters is that competition *does occur* in a number of different ways across the lines of the market segments proposed by the EC, and this is precisely why both Airbus and Boeing have built families of LCA that address the diverse needs of different airlines. If such competition occurs, whatever the reason, then there is competition and the analysis of the effect of the subsidy on such competition should not be artificially limited.

653. Finally, differences in seating capacities among aircraft are one of the differences that are routinely “monetized” in comparing the values of different LCA offered by different suppliers. From the airline’s point of view, differences among, for example, an A380, A340, A330, 747, 777, 787, and 767 are primarily economic. That is, airlines weigh the purchase prices of different LCA against their operating efficiencies for a range of likely missions. The per-seat

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<sup>807</sup> Airbus Global Market Forecast 2006-2025 (Nov. 2006) at 88 (Exhibit US-614).

<sup>808</sup> Airbus Marketing Presentation by John Leahy (Nov. 11, 2003), DS316-EC-BCI-0005551, -0005555 (Exhibit US-615) (BCI).

<sup>809</sup> U.S. FOS, para. 169 (citing Exhibit US-461).

<sup>810</sup> *Singapore Airlines may buy more Boeing 777s*, Int’l Herald Tribune (Dec. 10, 2006) (Exhibit US-611).

<sup>811</sup> U.S. FWS, para. 728 (giving multiple examples).



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economic benefit of operating one or another aircraft on a particular route is offset by the per-seat cost, i.e., the purchase price, of each aircraft model. The EC, in defining the subsidized product as narrowly as it has, ignores the trade-off that airlines make between purchase price and seating capacity and, therefore, is at odds with the economics of the LCA market.

*d. Even assuming the EC market division, there is competition between the 747 and the A340 and A380*

654. Finally, even if the Panel were to find any merit whatsoever in the EC market segmentation, the EC contention that no Airbus models compete with the Boeing 747 is manifestly erroneous. Indeed, the A380 was developed for the express purpose of challenging the 747, and the United States has already identified a significant amount of evidence showing the reality of competition between the A380 and 747.<sup>812</sup>

655. The A340 also competes with the 747 to a significant degree. For example, when the EC approved state aid for the A340-500/600 project, the EC stated that the A340-600 in particular would “be able to compete with the Boeing 747-400 and 777-300,” observing: “With a capacity of 416 passengers and a range of 7,335 nautical miles, the Boeing 747-400 has performance characteristics that are relatively close to those of the A340-600 project.”<sup>813</sup> Indeed, the United States has identified confidential evidence showing that the A340-500/600 and A380 were both developed, in part, to compete with the 747 and the 777.<sup>814</sup>

656. The United States also notes that, in a press report submitted by the EC as an exhibit to its April 30 responses to the Panel’s questions, Mr. Boyle of British Airways is quoted as saying that the airline is considering both the A380 and the 747 and that it is “extremely unlikely” the airline would buy both for deliveries in the 2011 to 2013-14 time frame; it will be one or the other.<sup>815</sup>

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<sup>812</sup> U.S. Responses to First Panel Questions, paras. 235-242.

<sup>813</sup> Letter from Karel Van Miert to Hubert Vedrine, *Reimbursable Advance to Aérospatiale for the Airbus A340-500/600 Program*, Aid No. N369/98, at 3 & n.3 (5 & n.3 in English translation) (Exhibit US-3).

<sup>814</sup> U.S. FOS (HSBI and BCI), para. 63.

<sup>815</sup> *British Airways evaluates widebody proposals from Airbus and Boeing as it seeks 50 aircraft to replace 767s and 747-400s*, Flight International (Apr. 1, 2007) (Exhibit EC-625).

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### 2. The reference period should include data prior to 2004

657. The United States demonstrated the existence of adverse effects in its first written submission primarily by reference to market data for the period 2001-2005.<sup>816</sup> The EC contends, however, that the appropriate starting point for the Panel's adverse effects analysis is 2004, not 2001.<sup>817</sup> The EC offers four reasons in support of its position, none of which have merit.

658. First, the EC claims that Article 6.7(c) of the SCM Agreement precludes the use of data for the period 2001-2003 because the decline in demand for air travel in the aftermath of the events of September 11, 2001 "heavily distorted" the LCA market, thereby constituting *force majeure* within the meaning of Article 6.7(c).<sup>818</sup> The United States has already explained, in response to the Panel's questions, that Article 6.7 generally, and Article 6.7(c) in particular, preclude a finding of displacement or impedance within the meaning of Article 6.3 when certain enumerated events or situations unrelated to subsidization results in the displacement or impedance of exports.<sup>819</sup> Article 6.7(c) provides that, when an impairment of a complaining Member's share of an export market results from "natural disasters, strikes, transport disruptions or other *force majeure* substantially affecting production, qualities, quantities or prices of the product available for export from the complaining Member," it shall not be concluded that there is displacement or impedance of such exports constituting serious prejudice. Such factors limit the ability of the complaining Member to export its product for reasons having nothing to do with subsidies. Accordingly, these factors are deemed under Article 6.7 to break the causal link between subsidization and the loss of export market share.

659. However, the downturn in the LCA market in 2001-2003 did not result from any inability of the U.S. industry to produce or export LCA. No disaster, natural or otherwise, prevented Boeing from producing, selling, or exporting aircraft. Rather, customers simply chose in increasing proportion to purchase LCA from Airbus rather than Boeing, as Airbus increased its share of the global LCA market from 38 percent in 2001 to 53 percent in 2003.<sup>820</sup> This choice

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<sup>816</sup> U.S. FWS, paras. 733-736, 738-748, 767-769, 772-774, 804-809.

<sup>817</sup> EC FWS, paras. 1493-1506.

<sup>818</sup> EC FWS, paras. 1494-1496.

<sup>819</sup> U.S. Responses to First Panel Questions, paras. 288-290.

<sup>820</sup> U.S. FWS, para. 705 & Table 1.

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meant that the burden of the market downturn fell disproportionately on Boeing, as Airbus itself recognized at the time.<sup>821</sup>

660. Second, the EC argues that the period 2004-2006 is a superior reference period because this time frame reflects “more normal and steady conditions of competition in the LCA markets” similar to those that exist today, while the 2001-2003 period was aberrational.<sup>822</sup> But this argument is without factual foundation. Indeed, as Figure 1 demonstrates, total LCA demand in 2005 and 2006 was unusually *high*, while the cyclical downturn in 2001-2003 was relatively shallow by historical standards.

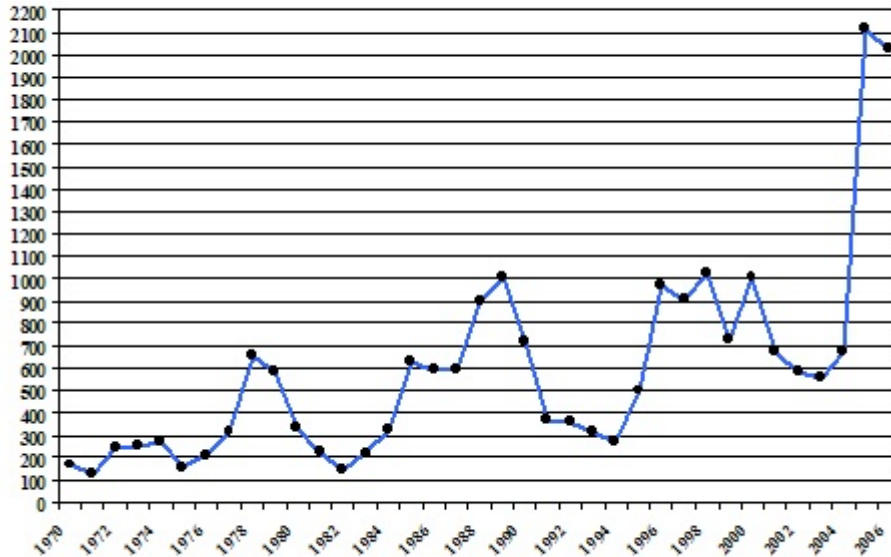
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<sup>821</sup> EADS Aero-notes: Letter to Shareholders, No. 3 (Nov. 2001) at 5 (“Airbus is entering the current recession in a more favourable situation than its American competitor because our market share is increasing strongly and that trend, to a great extent, compensates for the shrinking of the whole market.” (quoting Airbus CEO Noël Forgeard)) (Exhibit US-404).

<sup>822</sup> EC FWS, para. 1497.

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Figure 1: Global LCA Demand, by Total Orders  
(1970 – 2006)



661. Indeed, the quotations and other evidence provided by the EC in support of its assertions that the period 2001-2003 was somehow “unprecedented” all refer to conditions in the *passenger airline* industry, not the LCA industry.<sup>823</sup> As Figure 1 shows, however, the 2001-2003 downturn in LCA demand was not in any way “unprecedented,” regardless of what may have been occurring in the passenger airline industry. If anything, it is the increase in LCA demand in 2005 and 2006 that is “unprecedented” – and it to this period that the EC asks the Panel to limit its analysis.

662. Moreover, if the EC were correct in its contention that changes in market share from 2001 to 2003 were due to temporary phenomena unrelated to subsidization, one would expect the relative market shares of Boeing and Airbus to return to their “normal” levels after the market recovered in 2004. Yet this has not occurred. The global LCA delivery market share of Airbus, after increasing by 15 percentage points to 53 percent in 2003, was 53 percent in 2004, 57 percent in 2005, 53 percent in 2006, and 53 percent in the first quarter of 2007.<sup>824</sup> Even if, as the

<sup>823</sup> EC FWS, para. 1369; EC Responses to First Panel Questions, paras. 356-367.

<sup>824</sup> U.S. Responses to First Panel Questions, para. 286 (citing sources).

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EC alleges, the 2001-2003 period was somehow unusual, the large shift of market share from Boeing to Airbus during this period has continued to the present day. Thus, as the earlier increase in Airbus's market share is an effect of the subsidy, that Airbus has been able to maintain that increased market share (and to continue to displace or impede Boeing exports in the same proportions as in 2003) is also an effect of the subsidy.

663. Third, the EC refers to Appellate Body reports in disputes involving claims under the *Agreement on Safeguards* and the Antidumping Agreement and derives from these an alleged preference in WTO dispute settlement for focusing on the “most recent past.”<sup>825</sup> These reports, which interpret provisions governing the circumstances in which a safeguard measure may be taken or antidumping duties applied, provide no guidance in the context of an adverse effects analysis under Articles 5 and 6 of the SCM Agreement. As the United States has explained,<sup>826</sup> the legal effect of a DSB finding that a Member has breached its obligations under Article 5 is that the offending Member is required to “take appropriate steps to remove the adverse effects or ... withdraw the subsidy.”<sup>827</sup> Thus, unlike the safeguard or antidumping duty context, no immediate remedial measures are authorized or taken upon a panel decision finding a breach of Article 5.

664. The EC also refers to Article 6.4 of the SCM Agreement, which provides that the displacement or impedance of exports to third-country markets under Article 6.3(b) includes situations in which the relative market share of the subsidized product has changed to the disadvantage of the like product of the complaining Member “over an appropriately representative period sufficient to demonstrate clear trends in the development of the market for the product concerned, which, in normal circumstances, shall be at least one year.” To the extent that this provision provides useful context for other types of adverse effects claims, it establishes that the test for the adequacy of the reference period is whether it is “sufficient to demonstrate clear trends in the development of the market.” The EC's assertion that this provision evidences a “preference for a shorter period” of analysis is without any basis in the text.

665. Indeed, the LCA market and industry operate under unusually long time horizons. It takes several years to develop a new aircraft and bring it to market. Similarly, LCA sales typically are for deliveries over several years with options to purchase additional aircraft over a time frame that is longer still. These long product development and sales time horizons compel the use of a long enough period to permit an objective analysis of those trends.<sup>828</sup> The subsidies

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<sup>825</sup> EC FWS, paras. 1498-1502.

<sup>826</sup> U.S. Responses to First Panel Questions, paras. 441-442.

<sup>827</sup> SCM Agreement, Art. 7.8.

<sup>828</sup> See U.S. Responses to First Panel Questions, paras. 271-272.

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at issue are long-term loans intended to fund the launch of LCA that are produced and sold over a period of decades; any measurement of their effects must therefore take into account their long-term nature. In addition, an order placed in one year is filled by deliveries over a span of several years and is likely to have a significant impact on additional orders placed in further years. Airbus itself recognizes the importance of long-term trends in analyzing competition in the LCA industry:

No single year's order intake and market share in an industry with such long-term horizons can be taken as an indication of market position.<sup>829</sup>

Indeed, as previously discussed, sales campaigns concluded prior to 2001 continue to have direct effects on current LCA market conditions.<sup>830</sup>

666. Thus, to the extent that any particular market conditions in 2001-2003 may be different than other recent periods, the solution would be to expand the reference period further back in time so that the period is, in the terms of Article 6.4, "sufficient to demonstrate clear trends" in the market. The United States does not believe that this is necessary; there may be practical constraints in obtaining full market data in prior years, and indeed the EC refused to provide market data requested by the Annex V Facilitator for years prior to 2000.<sup>831</sup> As the United States has explained, it considers that a starting point of 2001 provides a sufficient horizon for it to make its prima facie case by "demonstrat{ing} clear trends in the market" while ensuring that data is reasonably available and reflective of current market conditions.<sup>832</sup>

667. Finally, the EC contends that a shorter reference period would be consistent with practice in prior serious prejudice disputes, particularly *US – Cotton Subsidies*.<sup>833</sup> However, the panel in that dispute stressed the importance of putting recent market "developments in a broader temporal context."<sup>834</sup> Indeed, while that panel made findings concerning the existence of serious prejudice over a period of four marketing years, it referred to data over an even longer period. For example, with reference to the costs incurred by U.S. cotton producers, the Appellate Body

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<sup>829</sup> Airbus, *Key Determinants*, at 11 (Exhibit US-379, see BCI Annex to the U.S. FWS).

<sup>830</sup> U.S. Responses to First Panel Questions, para. 272 (citing references in EC FWS and U.S. FWS to 1999 and 2000 campaigns).

<sup>831</sup> EC Responses to Questions from the Facilitator (Nov. 18, 2005), answers to questions 288, 292, 297, 320, 321, 322, 326, 327 (Exhibit US-5).

<sup>832</sup> U.S. Responses to First Panel Questions, para. 273.

<sup>833</sup> EC FWS, paras. 1503-1504.

<sup>834</sup> *US – Cotton Subsidies (Panel)*, para. 7.1199.

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noted with approval that “the Panel concluded that ‘the six-year period from 1997-2002 ... lends itself to an assessment of the medium- to longer-term examination of developments in the United States upland cotton industry.’”<sup>835</sup> If a six-year period was appropriate to examine the “medium-to longer-term” development of the market for upland cotton – an agricultural product that is planted, harvested, and marketed in a single year – an examination of medium- or long-term trends over time in the LCA industry is at least equally relevant.

668. Likewise, in the *Korea – Commercial Vessels* dispute, the EC submitted market data covering periods of six years (1997-2002) or ten years (1993-2002) prior to panel establishment.<sup>836</sup> The EC provides no explanation for its view that six or ten years of data are appropriate to demonstrate market trends in the commercial vessels industry, but no more than three years of data are appropriate to demonstrate market trends in the LCA industry.

669. Accordingly, the EC has failed to provide any justification for ignoring market data for years prior than 2004 or for excluding such data from any reference period used by the Panel in this dispute.

3. The EC’s focus on market developments subsequent to Panel establishment is legally and factually misplaced

670. The United States has demonstrated the validity of its claim, set forth in its request for the establishment of this Panel, that the challenged subsidies have caused adverse effects to the interests of the United States. The EC has chosen not to rebut this showing. Instead, the EC contends that the only question for the Panel is whether the adverse effects referred to in the U.S. panel request have ceased to exist:

The European Communities cautions, however, that the use of historical data, particularly from the period 2004-2005, is only relevant to assist the Panel in determining whether subsidies that caused past effects continue to cause *present* adverse effects. ... Even assuming *arguendo* that adverse effects may have occurred many years ago, this fact does not prove that such adverse effects are being caused *today, i.e.,* in 2006 and 2007.<sup>837</sup>

671. As a factual matter, the United States disagrees with the EC – the challenged subsidies not only “caused past effects” (as the EC appears to concede) but also are causing adverse effects today and, if no steps are taken to withdraw the subsidies or remove the adverse effects, are likely to continue to cause adverse effects for the foreseeable future. Indeed, as demonstrated in

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<sup>835</sup> *US – Cotton Subsidies (AB)* para. 453 (quoting *US – Cotton Subsidies (Panel)* para. 7.1354).

<sup>836</sup> *Korea – Commercial Vessels*, paras. 7.648-7.649, 7.658.

<sup>837</sup> EC Responses to First Panel Questions, para. 343 (underlining added, italics original).

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detail below,<sup>838</sup> most of the trends that demonstrate the adverse effects to the interests of the United States over the 2001-2005 period have continued unabated through 2006 and, to the extent data are available, into 2007. Where the trends show small improvements in 2006 when compared to 2005, these are largely due to temporary factors such as the 2006 delays in A380 production and A350 design rather than any elimination of the effects of the subsidies. In any event, the EC's exclusive focus on data for 2006 shows that it cannot contest that adverse effects had existed in the period through 2005; the EC certainly makes no effort to do so.

672. However, the EC argument is also legally misplaced. Even if the EC could demonstrate that adverse effects ceased to exist after the establishment of the Panel, such a showing would have no legal relevance with respect to the matter that is within the Panel's terms of reference.

673. The report of the panel in *EC – Biotech* is instructive in this regard. In that dispute, the EC asked the panel to decline to rule on a disputed measure – the EC's *de facto* moratorium on approvals of biotechnology products – on the basis that the measure had allegedly ceased to exist after the establishment of the panel. The panel stated clearly the issue before it:

The Panel notes that the question it is mandated to answer is whether on the date of its establishment, that is to say, on 29 August 2003, the European Communities applied a general *de facto* moratorium on approvals. We have answered this question in the affirmative. The European Communities argues, however, that we should not review the WTO-consistency of that measure on the grounds that the measure has ceased to exist.<sup>839</sup>

The panel went on to conclude that it had the authority to make findings on the WTO-consistency of the measure even if it had ceased to exist subsequent to the establishment of the panel,<sup>840</sup> that such findings would help “secure a positive solution” to the dispute,<sup>841</sup> and that it did not need to make findings on whether the measure was still in existence in order to make the recommendation required by Article 19.1 of the DSU.<sup>842</sup> The panel therefore refused to consider whether, as the EC had asserted, the measure had ceased to exist.<sup>843</sup>

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<sup>838</sup> See sections on individual claims under Article 5(a) and Article 6.3(a), (b), (c) below.

<sup>839</sup> *EC – Biotech*, para. 7.1301.

<sup>840</sup> *EC – Biotech*, paras. 7.1306-7.1308.

<sup>841</sup> *EC – Biotech*, paras. 7.1309-7.1312 (quoting DSU Art. 3.7).

<sup>842</sup> *EC – Biotech*, paras. 7.1313-7.1318.

<sup>843</sup> *EC – Biotech*, para. 7.1319.



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674. The reasoning of the *Biotech* panel applies equally in the present dispute. **First**, the existence of adverse effects at the time of panel establishment is plainly within the Panel’s terms of reference. The “matter” before this Panel is “the matter referred to the DSB by the United States” in its request for panel establishment.<sup>844</sup> This “matter” includes both the “measures” (that is, the challenged subsidies) and the “claims” made by the United States in that request.<sup>845</sup> That request, in turn, includes the U.S. claims that the challenged subsidies “are causing or threatening to cause injury to the U.S. industry” and “are causing or threatening to cause serious prejudice to the interests of the United States.”<sup>846</sup> Just as the “matter” referred to the *Biotech* panel included the EC *de facto* moratorium that existed on the date of that panel’s establishment, the “matter” referred to this Panel includes the adverse effects that existed on the date of this Panel’s establishment.

675. Indeed, it is well established that panels have authority to make findings with respect to measures as they existed at the time of panel establishment even though “a measure under review may have been subsequently removed or rendered less effective.”<sup>847</sup> Indeed, the EC did not go so far as to assert that the *Biotech* panel did not have the authority to make findings as to the WTO-consistency of the challenged measure as it existed when the panel was established.<sup>848</sup> Yet, in this dispute, the EC asserts that the only question for the Panel is the existence of adverse effects “today.”<sup>849</sup> The EC thus takes an even more extreme position here than it did in *Biotech*, as it claims that adverse effects occurring at the time of panel establishment are legally relevant only as historical context for determining whether the EC and Airbus governments are “today” in breach of Articles 5 and 6.<sup>850</sup>

676. In fact, in the *Indonesia – Autos* dispute the subsidizing Member claimed to have withdrawn the subsidy measure itself during the panel proceeding, and the complaining

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<sup>844</sup> Document WT/DS316/4, para. 2 (Oct. 25, 2005).

<sup>845</sup> *Guatemala – Cement I (AB)*, para. 72 (explaining that the term “matter referred to the DSB” in Article 7 of the DSU “consists of two elements: the specific *measures* at issue and the *legal basis of the complaint* (or the *claims*)” (emphasis original)).

<sup>846</sup> *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft*, Request for the Establishment of a Panel by the United States, Document WT/DS316/2 (May 31, 2005) (emphasis added).

<sup>847</sup> *India – Autos*, para. 7.26.

<sup>848</sup> *EC – Biotech*, para. 7.1308 & n.1190.

<sup>849</sup> *E.g.*, EC Responses to First Panel Questions, para. 335.

<sup>850</sup> EC Responses to First Panel Questions, paras. 343, 354.

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Members – including the EC – asked the panel to nonetheless “rule on all claims before it.”<sup>851</sup> The EC argued to the panel that, although a subsidy measure had allegedly been withdrawn, the withdrawal did

not provide for the reimbursement of the benefits already granted under the National Car Programme. As a result, those subsidies will continue to benefit future sales of National Cars. Accordingly, whether or not the measures adopted on 21 January 1998 are considered to have revoked effectively the National Car Programme, the Panel will be required to rule on the compatibility of those subsidies with the SCM Agreement.<sup>852</sup>

677. There is no textual basis in the SCM Agreement or the DSU to suggest that a panel’s terms of reference in a dispute under Part III of the SCM Agreement are different from those in any other dispute. The EC argues that the use of the present tense in Article 6.3 (which provides that serious prejudice includes cases in which the effect of the subsidy “is” displacement and impedance, price suppression, etc.) requires a focus on the effects “today.”<sup>853</sup> However, the EC’s lengthy disquisition on the meaning of the word “is” does not advance its argument. Article 6.3 merely defines certain situations as included in the concept of serious prejudice; when one of the conditions in Article 6.3 is fulfilled, there “is” serious prejudice at that time rather than at another time. Thus, the use of the present tense in Article 6.3 means that, serious prejudice may arise at the time that the effect of the subsidy “is” displacement and impedance, price suppression, or another type of market effect described therein. But nothing in Article 6.3 addresses the question of when a panel must find that serious prejudice or any of the particular market effects must exist in order to find a breach of the obligation in Article 5 not to use subsidies in a way that causes adverse effects to the interests of other Members.<sup>854</sup>

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<sup>851</sup> *Indonesia – Autos*, para. 14.9.

<sup>852</sup> *Indonesia – Autos*, para. 4.86.

<sup>853</sup> EC Responses to First Panel Questions, paras. 336-340.

<sup>854</sup> Contrary to the EC’s assertion, EC Responses to First Panel Questions, paras. 336, the U.S. position in the Article 21.5 proceeding in *US – Cotton Subsidies* is completely consistent with the approach taken here. In that proceeding, the question presented was whether the withdrawal of the so-called “Step 2” program as of August 1, 2006 (the first day of the 2006-07 marketing year for cotton in the United States) removed the adverse effects of a package of measures found to be causing serious prejudice by the original panel. Although the Step 2 program was eliminated as of August 1, 2006 and the Article 21.5 compliance panel was established on September 28, 2006 (i.e., after the 2006-07 marketing year had begun), Brazil argued that the panel should focus on marketing year 2005-2006 (and rely on Brazil’s “counter-factual” assessments of the effects of the Step 2 program and certain challenged measures) rather than the *actual* market data from marketing year 2006-2007, after withdrawal of the Step 2 program. The United States disagreed. The United States argued that the 2006-07 marketing year was the proper focus of the question and that the use of the term “is” in Article 6.3(c) supported this argument. In the U.S. view, (a) the use of the present tense confirmed that the focus was on any “present” serious prejudice (i.e., serious prejudice existing in the marketing year underway at the time of panel establishment) and (b) the ordinary meaning of “is” (*inter alia*, “that which exists, that which is; the fact or quality of existence”) confirmed that the focus should be on

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678. Likewise, the EC’s focus on Article 7.8 of the SCM Agreement, which refers to the obligation to take remedial action when a panel or Appellate Body report determines that a subsidy “has resulted” in adverse effects,<sup>855</sup> is equally misplaced. The use of the present perfect tense in this provision does not suggest, as the EC asserts, that a panel or Appellate Body must find that adverse effects have continued for some period after the establishment of the panel. The French text of Article 7.8 uses an ordinary past tense to refer to a finding that a subsidy “caused” adverse effects (“une subvention a causé des effets défavorables”), while the Spanish text simply refers to a finding that a subsidy “has had” adverse effects (“cualquier subvención ha tenido efectos desfavorables”).<sup>856</sup> Thus, Article 7.8 refers to an obligation that arises *whenever* a panel or Appellate Body report determines that a subsidy has resulted in adverse effects, and not only in the case when those adverse effects have had some particular duration.

679. Nor does the application of standard principles of dispute settlement to disputes involving claims of adverse effects render “inutile” the possibility of a claim of threat of serious prejudice, as the EC asserts.<sup>857</sup> As prior panels have observed, “present serious prejudice would more often be *preceded in time* by a prejudice that threatens to become serious, and serious prejudice would be the realization of a threat of serious prejudice.”<sup>858</sup> Thus, as long as the subsidy measures at least threatened serious prejudice when a panel was established, a panel would be able to provide appropriate rulings regardless of whether the serious prejudice materialized during the course of the panel proceedings.

680. Thus, the first element of the reasoning of the *Biotech* panel – that the existence of a valid claim that a measure existed and was breaching obligations that existed at the time of Panel establishment is within the Panel’s terms of reference – is satisfied.

681. The *second* question considered by the *Biotech* panel was whether making findings on the measure as it existed at the time of panel establishment would help “secure a positive solution” to the dispute.<sup>859</sup> In the present dispute, such findings would certainly assist the parties

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*actual* effects, not unsupported allegations about what the effects might have been in earlier periods. The question before the Article 21.5 panel in *Cotton* – whether withdrawal of the Step 2 program had effected a removal of serious prejudice in marketing year 2006-2007 (the particular marketing year in which the panel was established) – is entirely consistent with the question presented to this Panel.

<sup>855</sup> EC Responses to First Panel Questions, paras. 348-349.

<sup>856</sup> Emphasis added.

<sup>857</sup> EC Responses to First Panel Questions, paras. 350-353.

<sup>858</sup> *US – Cotton Subsidies (Panel)*, para. 7.1496.

<sup>859</sup> *EC – Biotech*, paras. 7.1309-7.1312 (quoting DSU Art. 3.7).

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to resolve the dispute. The subsidy measures and their market-distorting effects are the same today as they were when the Panel was established. To the extent that there have been any changes in Boeing's competitive position since the Panel was established, such changes reflect the unusual temporary surge in global LCA demand and the temporary production difficulties experienced by Airbus, and thus have no relation to any alleged withdrawal of the subsidies or alleged lessening of their long-term effects – neither of which have occurred. Indeed, it would frustrate rather than help the “positive solution” of this dispute for rulings to be made based on the short-term vicissitudes of the LCA market at the moment of the Panel decision rather than on the underlying, long-term effects of the subsidies that the United States has demonstrated.

682. Finally, the *third* element of the *Biotech* panel's analysis – that the panel could make sufficiently precise recommendations without making any findings on the alleged withdrawal of the measure after panel establishment – also applies in this dispute. Just as the *Biotech* panel's findings with regard to the challenged moratorium enabled the parties to consider what, if any, steps should be taken to remove the breach of the covered agreements that was found to exist as of the time of panel establishment, so too this Panel's findings with regard to the breach of Articles 5 and 6 of the SCM Agreement alleged by the United States will be sufficient to allow the parties in this dispute to determine how best to withdraw the subsidy or remove the adverse effects.

683. Thus, the United States considers that the question before the Panel is whether the claim in the U.S. panel request – that with respect to the challenged subsidies, the EC was then in breach of its obligations under Part III of the SCM Agreement – is valid. Evidence pertaining to any time period that is relevant to an assessment of that question should be considered by the Panel, but an assertion by the EC that the adverse effects ceased to exist at some later date should not be considered as a defense to the U.S. claim.

684. In this regard, it is notable that nothing in the EC first written submission, statements at the oral hearing, or answers to the Panel's questions so much as addresses whether the challenged subsidies caused adverse effects to the interests of the United States at any time prior to 2006. Instead, the EC focuses its submissions entirely on whether the effects of the subsidy have continued during the period after panel establishment. *In other words, the EC has chosen not to rebut the U.S. showing that the EC caused adverse effects through the use of subsidies over the 2001-2005 period up to and including the time of panel establishment.*

4. The EC's focus on orders rather than deliveries for claims of displacement and impedance is legally and factually misplaced

685. Data on LCA orders and deliveries each provide a different type of information about the state of the LCA market and both therefore should be considered, as appropriate, in determining the existence of adverse effects. The United States has already set forth, in response to the Panel's questions, the legal and factual considerations that affect the appropriateness of order

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data and delivery data in assessing various types of adverse effects claims.<sup>860</sup> The EC, by contrast, argues that order data is the most relevant metric for all types of adverse effects claims in this dispute.<sup>861</sup> Particularly with respect to claims of displacement and impedance, the EC arguments on this point are meritless.

686. The EC agrees that the ordinary meaning of the terms “imports” in Article 6.3(a) and “exports” in Article 6.3(b) carries “the notion of movement of goods.”<sup>862</sup> As contracts for the future “movement of goods,” orders are certainly relevant to an analysis of likely *future* trends in the LCA market, but the “movement of goods” that has actually occurred and is now occurring is captured by data on actual deliveries. The United States has presented data on deliveries to demonstrate the existence of displacement and impedance that has *already occurred* in the relevant markets, and has also presented data on orders to demonstrate the existence of a *threat* of further displacement and impedance in the imminent future. Nothing in the EC response rebuts this demonstration. Nor does the EC explain why the Panel should focus on orders that will not result in the “movement of goods” for many years to come, if at all, while ignoring the impact of subsidies on the “movement of goods” in the recent past, the present, and the imminent future.

687. Moreover, an exclusive analytical focus on *order* data leads to factually inaccurate conclusions, particularly in third-country markets where there are a relatively small number of transactions. This can be seen, for example, in an examination of the LCA market in Mexico. The United States has already shown that Airbus increased its share of LCA deliveries to Mexico from 29% in 2001 to 50% in 2005.<sup>863</sup> According to the EC, however, Boeing had a 100% share of the Mexican 100-200 seat LCA “order” market from 2001-2004, and although Airbus captured 76% of orders in 2005 (26 of 34), Boeing regained a 62% share in 2006 (16 of 26).<sup>864</sup> The EC’s view is apparently that Boeing is well on its way to regaining an alleged dominance in the Mexican market and therefore cannot be said to be experiencing “current” serious prejudice. A closer examination of the actual order and delivery data demonstrates otherwise.

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<sup>860</sup> U.S. Responses to First Panel Questions, paras. 429-436.

<sup>861</sup> EC Responses to First Panel Questions, paras. 458-469.

<sup>862</sup> EC Responses to First Panel Questions, paras. 462-463.

<sup>863</sup> U.S. FWS, para. 773.

<sup>864</sup> EC FWS, para. 1968. As the large majority of LCA orders and deliveries in Mexico since 2001 are 100-200 seat aircraft, the United States will not discuss other LCA in responding here to the EC arguments.

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688. First, most of the Airbus LCA deliveries in the Mexican market from 2001 to 2005 are accounted for by ten A318 and 12 A319 deliveries to Mexicana.<sup>865</sup> All of these deliveries were facilitated by orders from U.S. leasing companies, including Bouillon Aircraft Services, CIT Aerospace, GECAS, and ILFC.<sup>866</sup> The *orders* that resulted in these deliveries are therefore reported in the Airclaims database as U.S. orders, not Mexican orders. A focus on order data rather than delivery data would therefore omit consideration of almost all of the actual Airbus LCA being manufactured and delivered to Mexican customers from an analysis of the Mexican LCA market during the relevant period.<sup>867</sup>

689. Second, while Boeing continued to receive orders during the period from its traditional Mexican customer, Aeromexico, and Airbus continued to receive orders (via leasing companies) from Mexicana, two new airlines – Interjet and Volaris – placed their first LCA orders in 2005, and both orders were won by Airbus. According to Airclaims, Volaris ordered 16 A319s in 2005, while Interjet ordered ten A320s in 2005 and ten more A320s in 2006, accounting for all the Airbus orders acknowledged by the EC.<sup>868</sup> The EC acknowledges that [ ]<sup>869</sup>

690. Of these new orders, no LCA had been delivered in 2005 and only two Airbus LCA were delivered to Volaris in 2006. The 14 remaining Volaris deliveries are, according to the EC, scheduled for delivery in 2007-2010, while the 20 Interjet deliveries are scheduled to begin in 2007 and last until 2013.<sup>870</sup> On the U.S. view, Boeing's loss of Mexican market share in the recent past constitutes *actual* displacement and impedance of U.S. exports to Mexico, while the additional contracts for many new Airbus deliveries from 2006 through 2013 amount to an *actual threat* of further displacement and impedance in this market. The EC use of the data, however, suggests that Boeing's loss of "order" market share in 2005 was "reversed" in 2006 and that any displacement or impedance of Boeing exports is no longer of any concern. Given that the large majority of the production, delivery, and revenue from these sales has yet to occur, the EC approach hardly serves to facilitate an objective evaluation of the U.S. claims.

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<sup>865</sup> Exhibit EC-21 (Airclaims database).

<sup>866</sup> Exhibit EC-21 (Airclaims database).

<sup>867</sup> Counting orders by U.S. leasing companies on behalf of Mexican airlines as U.S. imports would also distort the analysis of the volume of imports for purposes of the material injury analysis.

<sup>868</sup> Exhibit EC-21 (Airclaims database); EC FWS, para. 1968.

<sup>869</sup> Exhibit EC-14, Annex I (BCI).

<sup>870</sup> Exhibit EC-21 (Airclaims database).

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691. Third, although Airclaims reports the Volaris orders in 2005 and splits the Interjet orders equally between 2005 and 2006, Airbus itself announced all the Interjet orders in 2005<sup>871</sup> and all the Volaris orders in 2006.<sup>872</sup> This illustrates the previously made U.S. observation that the date of LCA orders is somewhat subjective, in that the process by which an LCA order becomes “firm” occurs over a period of time, and different standards may apply to different sales in determining which sales to allocate to which years.<sup>873</sup> When only a few transactions are at stake, the placement of orders in one year rather than another can significantly affect the apparent trends. The date of delivery, by contrast, is objective.

692. Finally, the Airbus announcements of the Interjet and Volaris orders make clear that both orders included options for additional Airbus aircraft at terms negotiated in the original deal. For Interjet, the original 2005 campaign was for 20 aircraft, including ten firm orders and ten options. As Airclaims reports ten orders in 2005 and ten orders in 2006, it may be assumed that Interjet chose to exercise all of its options in 2006. [

],<sup>874</sup> but the Airbus press release confirms that the Interjet’s options were part of the original [ ] 2005 campaign. Further, the Volaris campaign resulted in 16 orders and 40 options, which may be exercised at some point in the future. Thus, the adverse impact of the Volaris and Interjet campaigns on the Mexican LCA market has only begun to have been felt by Boeing. Moreover, if Interjet or Volaris chooses to order more LCA in the future, their existing Airbus fleets will give Airbus an advantage in any further campaigns.

693. In sum, the EC’s proposed focus on LCA order data fails to capture the competitive reality of LCA markets for purposes of analyzing the U.S. displacement and impedance claims. Even if – as the EC asserts – Boeing’s share of orders increased somewhat in 2006, this would not diminish the reality or the harm from current and immediate future displacement or impedance of Boeing exports by Airbus LCA sold in the recent past. Moreover, Boeing’s share of 2006 orders was artificially inflated by the delays in Airbus’s A380 and A350 programs in that year. Thus, given that many of the 2006 orders received by Boeing are to be filled in 2010 or later, the Boeing order share in 2006 does not necessarily imply a corresponding increase in future delivery shares, because Airbus has plenty of time to obtain orders to be filled in those years as the A350 and A380 move closer to delivery. Accordingly, the Panel should evaluate the

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<sup>871</sup> Airbus press release, *Interjet orders up to 20 A320s* (Nov. 7, 2005) (Exhibit US-603).

<sup>872</sup> Airbus press release, *Volaris orders up to 56 Airbus A320 Family aircraft* (Jan. 12, 2006) (Exhibit US-604).

<sup>873</sup> U.S. Responses to First Panel Questions, para. 430.

<sup>874</sup> Exhibit EC-14, Annex I (BCI).

U.S. displacement and impedance claims primarily on the basis of the delivery data that the United States has presented.

5. Arguments about the financial condition of Boeing are not relevant to claims of serious prejudice

694. In the context of a claim of material injury, Article 15.4 of the SCM Agreement requires an inquiry into “the impact of the subsidized imports on the domestic industry,” including all economic factors relating to the “state of the industry.” However, there is no counterpart to Article 15.4 with respect to claims of serious prejudice. While the term “serious prejudice” carries the implication that the harm to the industry of the complaining Member is “serious,” the SCM Agreement does not require any inquiry into the specific impact of the subsidy on the various economic indices of the “state of the industry” of the complaining Member in the context of a serious prejudice analysis.<sup>875</sup>

695. Therefore, the EC argument that the financial condition of Boeing’s LCA division in 2006 precludes a finding of serious prejudice is misplaced.<sup>876</sup> Likewise, the EC assertion at the first Panel meeting that there is no serious prejudice because Boeing is currently not “in trouble” is likewise misplaced.<sup>877</sup> The panel in *Indonesia – Autos* found serious prejudice to the EC without finding that the EC auto industry was “in trouble,” and neither the panel nor the Appellate Body in *US – Cotton Subsidies* found that the Brazilian cotton industry was “in trouble.” Rather, those panels examined, as provided in Article 6.3, whether the effect of the subsidy was significant price suppression or displacement and impedance of imports. No further inquiry into the impact of those types of serious prejudice on the industry of the complaining Member was necessary or appropriate in those disputes, nor is such an inquiry appropriate here.

**C. The EC and Airbus governments have caused serious prejudice to the interests of the United States**

696. The United States demonstrated in its first written submission that each of the alleged types of serious prejudice in this dispute – displacement and impedance of imports of the like product (Boeing LCA) into the EC market within the meaning of Article 6.3(a), displacement and impedance of exports of the like product (Boeing LCA) into third-country markets within the meaning of Article 6.3(b), significant lost sales and price undercutting within the meaning of

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<sup>875</sup> The United States addresses the substance of the EC assertions about Boeing’s financial performance in the context of the material injury discussion, below.

<sup>876</sup> EC FWS, para. 1360.

<sup>877</sup> EC FOS, para. 130.



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Article 6.3(c), and significant price depression or suppression within the meaning of Article 6.3(c) – exist and are the effect of the subsidy.

697. Below, the United States updates the evidence already presented for each form of serious prejudice with data for 2006, demonstrating that the trends that have caused serious prejudice in the past show no signs of abating. In addition, the United States responds to various points raised in the EC first submission.

### 1. Displacement and impedance in the EC market

698. The United States previously demonstrated that Airbus increased its market share in the EC LCA market by 9 percentage points from 2001 to 2005, when measured by total volume of LCA delivered.<sup>878</sup> Table 1 shows that Airbus has continued to maintain its increased market share in 2006.

*Table 1. LCA Deliveries to EC Customers, 2001-2006<sup>879</sup>*

#### (A) Quantity of LCA delivered

	2001	2002	2003	2004	2005	2006
Airbus	114	114	98	109	103	116
Boeing	81	69	67	77	50	56

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<sup>878</sup> U.S. FWS, para. 767.

<sup>879</sup> Airclaims database, data query as of January 18, 2007.

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(B) Market share (quantity of LCA delivered)

	2001	2002	2003	2004	2005	2006
Airbus	58%	62%	59%	59%	67%	67%
Boeing	42%	38%	41%	41%	33%	33%

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### (C) Market share by value (list price)

	2001	2002	2003	2004	2005	2006
Airbus	54%	61%	57%	56%	66%	66%
Boeing	46%	39%	43%	44%	34%	34%

The similarity in the trends in market share by value, measured at list prices and the trends in market share by volume indicates that the steady increase in Airbus's share of the EC market over the period, and especially since 2004, is not being distorted by any change in the relative mix of different LCA models over the period.

699. The EC has little to say in response to these facts. It says, for example, that data on orders for individual models fluctuate significantly from year to year,<sup>880</sup> and that there are insufficient data points to discern any clear trends for larger models.<sup>881</sup> Once again, however, the EC fails to respond to the U.S. argument; instead it segments and breaks up the data in a way that magnifies random fluctuations and obscures trends. The data speak for themselves – significantly fewer Boeing LCA are being imported into the EC than was the case just a few years ago, as Boeing has lost significant market share to Airbus.

700. This displacement and impedance of imports of Boeing LCA is the effect of the subsidy. All of the market-distorting features of Launch Aid, both alone and together with the other subsidies, have effects in the EC market just as they do in every other part of the global LCA market. In particular, the capture by Airbus of several major Boeing customers such as easyJet accounts for a large portion of the shift in market share and, as shown below and in the HSBI Appendix, subsidies played a significant role in these sales. Airbus has delivered LCA to these customers in recent years that could have been expected to be Boeing sales. Further, Airbus will continue to do so for the foreseeable future.

### 2. Displacement and impedance in third-country markets

701. The United States previously demonstrated that Airbus increased its market share in third-country markets, taken as a whole, by 20 percentage points from 2001 to 2005, when measured by total volume of LCA delivered.<sup>882</sup> Table 2 shows that Boeing regained only five

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<sup>880</sup> EC FWS, paras. 1986, 1992-1993.

<sup>881</sup> EC FWS, paras. 2044, 2130.

<sup>882</sup> U.S. FWS, para. 772.

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percentage points of its share of these markets in 2006 and remains well below its share in 2001 and 2002.

*Table 2. LCA Deliveries to Customers Outside the U.S. and EC, 2001-2006*<sup>883</sup>

(A) Quantity of LCA delivered

	2001	2002	2003	2004	2005	2006
Airbus	88	95	142	151	202	254
Boeing	157	182	131	115	156	251

(B) Market share (quantity of LCA delivered)

	2001	2002	2003	2004	2005	2006
Airbus	36%	34%	52%	57%	56%	51%
Boeing	64%	66%	48%	43%	44%	49%

(C) Market share by value (list price)

	2001	2002	2003	2004	2005	2006
Airbus	34%	33%	50%	54%	53%	45%
Boeing	66%	67%	50%	46%	47%	55%

702. These markets other than the EC and the United States have grown substantially over the 2001-2005 period and have continued to grow in 2006. Total deliveries by Boeing and Airbus have increased in each year (except for a very small drop from 2003 to 2004).<sup>884</sup> Thus, the shift in market share in third-country markets largely results from Airbus gaining more of the increased demand than Boeing.

703. With respect to particular third-country markets identified in the U.S. first written submission, Boeing’s loss of market share to Airbus continued in 2006 in most markets. For

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<sup>883</sup> Airclaims database, data query as of January 18, 2007.

<sup>884</sup> Thus, the EC arguments about the alleged “market downturn” and contraction in demand in 2001-2003 does not apply to third-country markets in general.

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example, in China Airbus slightly improved its market share from 2005 to 2006, as shown in Table 3.

Table 3. LCA Deliveries to Customers in China, 2001-2006<sup>885</sup>

(A) Quantity of LCA delivered

	2001	2002	2003	2004	2005	2006
Airbus	9	7	222	35	56	76
Boeing	22	31	28	20	50	66

(B) Market share (quantity of LCA delivered)

	2001	2002	2003	2004	2005	2006
Airbus	29%	19%	44%	64%	53%	54%
Boeing	71%	81%	56%	36%	47%	46%

The small number of deliveries in other third countries makes one-year trends difficult to discern. While Boeing's market share increased from 2005 to 2006 in some of the countries identified in the U.S. first written submission and decreased in others, in no case did Boeing's market share recover to 2001 levels.

704. As with market share data in the EC market, these figures largely speak for themselves. Airbus made very large gains in third-country market share in 2003 and 2004 and, while Boeing has recovered some of the ground lost in those years, Airbus has maintained most of its gains in growing markets. The EC objections to the U.S. analysis are mostly limited to its generic complaints with regard to the definition of the subsidized product and the use of delivery data addressed above. As explained above in detail with respect to the Mexican market, however, order data in these relatively small markets is particularly misleading as to current market trends. Further, by artificially segmenting the LCA market, the EC further separates the limited data points in these countries in order to obscure the identification and analysis of market trends. To the extent that the Panel believes, however, that there is insufficient data to establish trends for

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<sup>885</sup> Airclaims database, data query as of January 18, 2007.

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individual third countries, it may evaluate the U.S. claim on the basis of all third country markets taken as a whole.<sup>886</sup>

705. This displacement and impedance of exports of Boeing LCA is the effect of the subsidy. All of the market-distorting features of Launch Aid, both alone and together with the other subsidies, have effects in individual third-country markets just as they do in every other part of the global LCA market.

### 3. Lost sales and price undercutting in the global LCA market

#### *a. The EC fails to take into account the applicable legal standard and the nature of competition in the LCA market*

706. In its first written submission, the United States provided detailed information on a number of specific sales that Boeing lost to Airbus during the 2001-2005 period. The EC does not dispute Boeing's losses in these sales, most of which resulted in the replacement of Boeing LCA with Airbus LCA. Instead, the EC claims variously that Boeing failed to offer a competitive aircraft, that Airbus did not significantly undercut Boeing's prices, that Airbus's pricing made good commercial sense, that the United States cannot show that Airbus's lower prices were caused by subsidies, that customers chose Airbus for reasons other than price, or some combination of these, and that therefore there is no causal link between the subsidy and the lost sales.

707. As a general matter, the EC arguments frequently misstate the legal standard in Article 6.3(c) of the SCM Agreement and contradict the EC's own analysis of conditions of competition in the LCA market. For example, the EC states that the United States must show that each lost sale was the result of subsidies that caused Airbus's price to be significantly lower than Boeing's price.<sup>887</sup> However, Article 6.3(c) is disjunctive – it provides that serious prejudice may arise when the effect of the subsidy is “significant price undercutting ... *or* significant price suppression, price depression *or* lost sales.”<sup>888</sup> In some cases, the effect of the subsidy may be price undercutting that leads to a lost sale, but this is not always the case nor is it required by the SCM Agreement. The effect of the subsidy, for example, may be a lost sale where an airline purchases an Airbus aircraft that, but for the subsidies, would not have existed at the time of the sale, such as the A380 or the A340-500/600. Lost sales and price undercutting are *independent* forms of serious prejudice, both of which are to varying degrees present in this dispute.

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<sup>886</sup> U.S. FOS, paras. 174-175.

<sup>887</sup> EC FWS, para. 1821.

<sup>888</sup> Emphasis added.

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708. The EC also asserts that certain “non-price” factors, such as delivery schedules, the precise seating capacity or configuration, cost savings associated with fleet commonality, the schedule of pre-delivery payments, or the value of asset or residual value guarantees, can also influence customer decisions and thus break any causal link between price and lost sales.<sup>889</sup> However, these types of “non-price” factors are routinely monetized and offset, as necessary, by price concessions in order to win sales. As Airbus executive Christian Scherer explains, “[

].”<sup>890</sup> And some of these “non-price” factors – such as the availability of aircraft with particular features or the availability of an LCA fleet with common features – are themselves effects of the subsidies, as already shown.

709. Even where the alleged “other factor” that influenced a lost Boeing sale is not directly or indirectly related to price or another effect of the subsidy – such as the alleged “arrogant” behavior of Boeing toward certain airlines or its alleged failure to focus on customer relations<sup>891</sup> – such concerns often, upon closer examination, turn out to be more than marginally price-related. For example, the EC claims that Boeing’s 2004 lost sale at Air Berlin was the result of Boeing having “mismanaged its customer relations.”<sup>892</sup> On a closer examination of the evidence supplied by the EC, however, the supposed “mismanagement” appears to be that Boeing was not as flexible on price as it needed to be to retain Air Berlin as a customer, particularly given the “fairly aggressive” proposals that Airbus was making to entice Air Berlin to switch from Boeing to Airbus.<sup>893</sup> Indeed, when Boeing agreed to make far more drastic price reductions to win Air Berlin back as a customer in November 2006, Air Berlin’s CEO told Boeing, “You guys are listening better today than you have listened in years and we really appreciate that.”<sup>894</sup> In this context, “arrogant” appears to mean little more than “not willing to be flexible on price,” while “listening” appears to mean “willing to be flexible on price.”

710. In this regard, it should also be pointed out that the quotations in paragraph 1465 of the EC submission attributed to Harry Stonecipher, the former CEO of Boeing, are in fact not statements of Mr. Stonecipher. The EC states that Mr. Stonecipher referred to “two large orders that Airbus may have won on pricing alone” – presumably Air Berlin and AirAsia – and went on to say “I’m not sure pricing was the whole issue.” However, the source cited by the EC

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<sup>889</sup> EC FWS, para. 1829; Exhibit EC-14, paras. 68-72.

<sup>890</sup> Statement of Christian Scherer, para. 95 (Exhibit EC-14).

<sup>891</sup> EC FWS, para. 1459-1466, 1829.

<sup>892</sup> EC FWS, para. 1910.

<sup>893</sup> EC FWS, para. 1911 (quoting interview with unnamed Airbus official).

<sup>894</sup> *Listening propels Boeing to the lead*, Seattle Post-Intelligencer (Dec. 20, 2006) (Exhibit US-610).

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attributes this statement, not to Mr. Stonecipher, but to a certain J.B. Groh, a market analyst with D.A. Davison & Co.<sup>895</sup> Thus, the “I” who expressed doubt about the conventional wisdom that the Air Berlin and AirAsia campaigns were based on “pricing alone” was *not*, as the EC asserts, the CEO of Boeing, but a private stock analyst.

711. A closer examination of the sales-specific campaign evidence demonstrates that, whether the airline’s decision ultimately was driven by price, the availability of new aircraft with specific performance characteristics, or some combination of the two, the Airbus advantage invariably traces back to the effects of subsidies. The United States will address next that campaign-specific evidence.

*b. When lost sales are based primarily on price, Airbus systematically undercut Boeing’s price*

712. From the late 1990s through at least 2005, Airbus won a series of campaigns at major low-cost carriers in the United States, Europe, and Asia. During this period, low-cost carriers were one of the fastest growing segments of the airline industry, and Boeing – as the incumbent supplier to many of these airlines – was positioned to experience sales growth along with these customers. Airbus won over a significant number of these customers by overcoming Boeing’s advantage as an incumbent supplier through pricing. As Airbus admits, [

].<sup>896</sup>

713. Thus, for example, easyJet stated publicly that Airbus provided it with “arrangements” that guaranteed that the maintenance cost to easyJet of its new Airbus aircraft would not be any greater than the maintenance cost it was then incurring for its existing Boeing fleet.<sup>897</sup> Indeed, the public evidence referenced in the U.S. first submission makes clear that the Airbus wins at easyJet, Air Berlin, and AirAsia – all exclusive Boeing customers at the time of the sale – were driven largely by price, and that the price advantage from Airbus had to be substantial in order to induce these customers to switch suppliers.<sup>898</sup>

714. In the HSBI Appendix, the United States demonstrates that the confidential information already supplied by the EC, as well as additional confidential information that we have been able

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<sup>895</sup> See *Boeing management and aftermarket suppliers are topics in Wall Street Transcript Aerospace/Defense Report* (Apr. 6, 2005) (Exhibit EC-287).

<sup>896</sup> Statement of Christian Scherer, para. 89 (Exhibit EC-14).

<sup>897</sup> easyJet, *Proposed Purchase of Airbus Aircraft and Notice of Extraordinary General Meeting* (Feb. 25, 2003) at 4 (Exhibit US-380).

<sup>898</sup> U.S. FWS, paras. 779-787.



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to obtain from Boeing, confirm that aggressive Airbus pricing was the key factor in Airbus's winning, and Boeing's losing, these key campaigns. And, as shown above, the magnitude of the subsidy and the importance of the financial flexibility provided by subsidies especially during this key period are more than sufficient to demonstrate the causal link between the subsidy and the Airbus pricing in these campaigns.

*c. The EC's alternative explanations for lost sales are not credible*

715. In other cases, the EC response to the U.S. lost sales arguments is to attempt to show that the attributes of the Airbus aircraft – whether the A380, the A340-500/600, or the A320 – were the reason for the Airbus win. Of course, the attributes of the aircraft are not unrelated to the subsidies that were essential for the development of these aircraft, and so the EC arguments fail to establish that subsidies did not cause the lost sales.

716. With respect to the sales won by the Airbus A380 at Emirates Airlines, Singapore Airlines, and Qantas, the EC argument also rests on the proposition that Boeing could not offer a substitute aircraft that could compete with the A380.<sup>899</sup> This aspect of the EC argument has already been disproven by events. The well-publicized delays in A380 deliveries have provided a real-world answer to the counterfactual question: Would Boeing have sold more LCA if the EC and the Airbus governments had not provided subsidies to bring the A380 to market? It is now clear that the answer is “yes” – airlines that ordered the A380 would otherwise have expanded their fleets with Boeing LCA.

717. For example, Chew Choon Seng, the CEO of Singapore Airlines, recently gave an interview in which he stated: “Boeing 777-300ERs, in our experience, would be a useful alternative to A380s. ... We could upsize the order if there are further delays with the A380.”<sup>900</sup> The same article noted that other carriers, including Emirates and FedEx, have also turned to the 777 to replace the A380.

718. Indeed, as noted above, the EC acknowledges that factors such as seating capacity that affect the value of particular aircraft for particular missions are routinely “monetized” in sales campaigns and, to the extent practicable, can be offset by price concessions.<sup>901</sup> A larger plane like the A380 may be better suited to a particular airline's business plan than a smaller plane like the 777, but the two aircraft can – and do – fly the same routes. Thus, it is simply not the case that airlines like Emirates Airlines, Singapore Airlines, or Qantas were indifferent to the price of the A380 compared to the price of other aircraft that could fly the same route. It is a matter of

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<sup>899</sup> EC FWS, paras. 1701-1725.

<sup>900</sup> *Singapore Airlines may buy more Boeing 777s*, Int'l Herald Tribune (Dec. 10, 2006) (Exhibit US-611).

<sup>901</sup> See Statement of Christian Scherer, para. 69 (Exhibit EC-14).

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public record that Airbus was offering the A380 at very low prices compared with the 747,<sup>902</sup> and the United States has already drawn the Panel’s attention to confidential information in this regard.<sup>903</sup>

719. Indeed, when the EC asserts that “[ ]],”<sup>904</sup> the conclusion to be drawn from this is not that the 747 does not compete with the A380. Rather, the EC statement reveals that [ ]].<sup>905</sup>

720. Likewise, the EC argument with respect to A340-500/600 sales to Iberia, South African Airways, and Thai Airways echoes its argument on the A380: Airbus had the right plane at the right time, while Boeing did not. Once again, however, this concedes the causal link: In the absence of Launch Aid, Airbus would not have been in a position to offer what it claims was the right plane at the right time.

721. Thus, for example, the EC states:

Thai Airways needed an aircraft to operate on its ultra-long routes from Thailand to the United States. At the time of the sales campaign, Airbus' A340-500/-600 was the only ultra-long-range aircraft in production. The Airbus A340s could therefore be delivered before the newly-launched Boeing equivalent – the Boeing 777-200LR.<sup>906</sup>

Because, as shown above and conceded by the EC, Launch Aid was critical to Airbus’s ability to bring the A340-500/600 to market when and as it did, the advantage Airbus had over Boeing in this competition was a direct consequence of subsidies. “But for” the subsidy, Thai Airways’ options were to purchase an LCA with less range or to order the Boeing 777-200LR with a longer wait until first delivery.

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<sup>902</sup> U.S. FWS, paras. 793-794 (citing and quoting sources).

<sup>903</sup> U.S. FOS (HSBI and BCI), para. 63 (citing Exhibit EC-362 at 18 (HSBI)).

<sup>904</sup> EC FWS, para. 1726.

<sup>905</sup> Likewise, when the EC states that [ ]], EC FWS, para. 2011, the logical inference is that [ ]].

<sup>906</sup> EC FWS, para. 2109 (footnote deleted).

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722. The United States addresses the confidential information provided by the EC about the other lost sales, as well as additional confidential information made available by Boeing, in the HSBI Appendix.

723. The evidence therefore confirms that the significant lost sales identified by the United States were lost primarily because of subsidies. In some cases, the evidence demonstrates that the mechanism by which subsidies caused these lost sales was significant price undercutting by Airbus; in other cases the evidence demonstrates that the mechanism was an acceleration of Airbus's ability to offer the aircraft at all. In all cases, therefore, the evidence demonstrates the existence of serious prejudice within the meaning of Article 6.3(c).

#### 4. Price depression and suppression in the global LCA market

724. The United States has already demonstrated that prices for Boeing LCA in the world market fell, or failed to rise in keeping with cost inflation, in the period from 2001-2005.<sup>907</sup> During this period, Airbus LCA was the only competition and, as just shown, Airbus was engaged in widespread and aggressive price undercutting.

725. In addition, the United States showed based on public information that certain major Boeing customers, including Ryanair, stated that they used the new, low Airbus pricing at major airlines as leverage to obtain additional price concessions from Boeing.<sup>908</sup> The United States discusses the confidential information provided by the EC in this regard, as well as additional confidential information supplied by Boeing, in the HSBI Appendix to this submission.

726. In addition, Boeing has provided the United States with revised index order prices to include orders made in 2006.<sup>909</sup> It is particularly striking that, despite two years of unprecedented high demand for LCA, prices for these three Boeing LCA models [ ] even when expressed in nominal dollars. If the figures are adjusted for inflation – the U.S. aerospace producer price index rose by 21.19% from 2001 to 2006 – the five-year price decline for these Boeing products is startling – [ ] percent for the 737, [ ] percent for the 747, and [ ] percent for the 767. Evidently, something has changed in the LCA market that has prevented prices for these Boeing models from increasing as one would

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<sup>907</sup> U.S. FWS, paras. 804-808.

<sup>908</sup> U.S. FWS, paras. 805-806.

<sup>909</sup> The revised charts are included as Exhibit US-612. The pricing trends for the 737, 747, and 767, which had been generally similar to one another in the 2001-2005 period, remained similar in 2006. Prices for the 737, for example, which in nominal (unadjusted) dollars were [ ]% of their 2001 level [ ] to [ ]% of their 2001 level. Prices for the 747 [ ] from [ ]% of 2001 levels in 2005 to [ ]% of 2001 levels in 2006. However, prices for the 767, which had [ ] to [ ]% of 2001 levels.

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expect with two years of sustained record demand. The evidence, particularly that described in the HSBI Appendix, indicates that aggressive Airbus pricing during these years has altered price expectations of customers in the market and continues to prevent prices from rising.

727. This is confirmed by an examination of pricing trends for Boeing's 777, which evidenced a different trend from other Boeing models in the 2001-2005 period and also showed a different trend in 2006. As the United States explained in its first submission, 777 prices [

].<sup>910</sup> However, rising fuel prices in 2006 particularly affected the competitiveness of the four-engine A340 with respect to the 777 twinjet. In early 2006, Airbus made a number of public statements indicating that it would "monetize" the higher fuel costs of the A340 by further discounting this model in order to remain competitive.<sup>911</sup> Apparently, however, the pricing flexibility available to Airbus in 2006 was not sufficient to offset the higher fuel prices, such that 777 prices [ ].

728. These facts raise an additional question – why did prices for the 777, but not prices for the 737, 747, and 767, [ ]? Particularly after 2003, it is evident that Airbus pricing practices affected the 777 as well as for other models, despite the clear superiority of the 777 in comparison to Airbus models of comparable size.<sup>912</sup> In 2006, however, the combination of particular market factors – including high demand and high fuel prices that highlighted the value advantage of the 777 – and the limitations on Airbus's pricing flexibility due to costs associated with the A380 production and A350 development delays, appear to have been of sufficient magnitude as to [ ], although not to [ ].

729. The pricing trends clearly demonstrate that Boeing prices were suppressed and depressed during the 2001-2005 period and largely remained so in 2006. That the price suppression and depression is the effect of the subsidy is demonstrated by the evidence set forth in previous sections that Airbus was the cause of the lower prices for LCA generally during this period, and is confirmed by the fact that the effect of price suppression and depression recedes first – and, so far, only – where Airbus's product offering has proven the weakest and at the time when Airbus's ability to leverage its subsidies to lower price to offset the difference is most strained.

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<sup>910</sup> U.S. FWS, para. 808.

<sup>911</sup> See U.S. FWS, para. 808 & n.1019 (citing and quoting sources).

<sup>912</sup> See U.S. FWS, para. 808 & n.1018 (citing and quoting sources).

**D. Subsidized U.S. imports of Airbus LCA have caused material injury to Boeing**

730. Finally, the United States has shown that the effects of subsidized imports of Airbus LCA into the U.S. market has caused material injury to the U.S. LCA industry.<sup>913</sup> The EC response to this demonstration has largely been to focus on the improvement in Boeing’s financial condition in 2006 in order to contend that, whatever the effects of Airbus LCA in the U.S. market, Boeing cannot be said to be suffering “current” material injury.<sup>914</sup>

1. Volume of imports

731. The United States previously demonstrated that Airbus increased its market share in the United States by 18 percentage points from 2001 to 2005, when measured by total volume of LCA delivered.<sup>915</sup> Table 3 shows that Boeing regained only five percentage points of its share of the U.S. market in 2006 and remains well below its share in 2001.

*Table 3. LCA Deliveries to U.S. Customers, 2001-2006*<sup>916</sup>

(A) Quantity of LCA delivered

	2001	2002	2003	2004	2005	2006
Airbus	122	91	60	60	71	61
Boeing	280	126	75	88	78	81

<sup>913</sup> U.S. FWS, paras. 730-763.

<sup>914</sup> EC FWS, para. 2159-2230.

<sup>915</sup> U.S. FWS, paras. 733, 735.

<sup>916</sup> Airclaims database, data query as of January 18, 2007.

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### (B) Market share (quantity of LCA delivered)

	2001	2002	2003	2004	2005	2006
Airbus	30%	42%	44%	41%	48%	43%
Boeing	70%	58%	56%	59%	52%	57%

### (C) Market share by value (list price)

	2001	2002	2003	2004	2005	2006
Airbus	28%	34%	44%	50%	53%	49%
Boeing	72%	66%	56%	50%	47%	51%

732. The EC claims that Boeing lost market share in the U.S. market in the 2001-2003 period largely because it allegedly was too dependant on U.S. airlines that were in financial difficulties during this time – particularly Northwest, United, US Airways, and Delta.<sup>917</sup> However, Airbus also was present in the U.S. market prior to 2001-2003 and also was a significant supplier to U.S. airlines that entered bankruptcy in this period. For example, Airbus's 122 U.S. deliveries in 2001 included 10 deliveries to Northwest Airlines, 16 deliveries to United Airlines, and 56 deliveries to US Airways – three of the four airlines that, according to the EC, Boeing was excessively dependent upon in the U.S. market.<sup>918</sup>

733. Both Airbus and Boeing, therefore, were affected by the decline in overall LCA demand in the U.S. market. The difference is that, through the downturn, Airbus increased its market share and has maintained that increased market share, largely through deliveries to new customers such as JetBlue, Frontier Airlines, and Virgin America, which it gained in head-to-head campaigns against Boeing from 1999 onwards.<sup>919</sup>

## 2. Price effects of imports

734. The first U.S. written submission included indexed pricing data for the 737, 747, and 777 in the U.S. market in the 2001-2005 period, although there were insufficient sales of the 747 or

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<sup>917</sup> EC FWS, paras. 1443-1446.

<sup>918</sup> Airclaims database (Exhibit EC-21); see EC FWS, para. 1443 & n.1251.

<sup>919</sup> U.S. FWS, paras. 738-740.

the 777 to provide a basis for evaluating pricing trends.<sup>920</sup> A revised graph with indexed U.S. pricing data for the 737 through 2006 is included with this submission.<sup>921</sup> This graph demonstrates that U.S. pricing for the 737 [

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3. Adverse impact on domestic industry

735. The first U.S. written submission also demonstrated that the loss of U.S. market share to Airbus, as well as the lost sales, price undercutting, and price depression described therein – which, as shown above, has largely continued into 2006 – caused material injury to Boeing during the relevant period.<sup>922</sup>

736. The EC discusses at length the improvement in Boeing’s financial condition in 2006 (while neglecting to mention that Airbus, too, had record deliveries and performance in the same year) and argues that, whatever may have been the case in the past, Boeing cannot be said to be experiencing material injury at the present time.<sup>923</sup> As discussed in detail above, however, the relevant question for an adverse effects claim under the DSU and the SCM Agreement is whether the EC was in breach of its obligation under Article 5(a) when the Panel was established.

737. Moreover, the improvement in the financial condition of Boeing must be placed in the context of unusually high demand in 2005 and 2006 in this cyclical industry. As the EC recognizes, “the LCA industry has an exaggerated business cycle which is particularly sensitive to external events.”<sup>924</sup> Further, Boeing has remained competitive despite its loss of market share in its home market and depressed prices, particularly in the downturn, by cutting costs and improving productivity. As a press report from 2003 recently submitted by the EC explains:

Moving production lines, consolidating suppliers, simplifying parts manufacture, and eliminating excess factory space – not to mention 35,000 lay-offs – have reduced costs and increased flexibility.<sup>925</sup>

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<sup>920</sup> U.S. FWS, paras. 741-745.

<sup>921</sup> Exhibit US-616.

<sup>922</sup> U.S. FWS, paras. 746-748.

<sup>923</sup> EC FWS, paras. 2159-2230.

<sup>924</sup> EC FWS, para. 29.

<sup>925</sup> *Boeing plays defense*, Business Week Online (June 3, 2003) (Exhibit EC-629).

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Despite the recovery in the financial health of Boeing, most of these U.S. jobs that were lost in the downturn have not returned.

738. Indeed, the events of 2006 demonstrate how significantly relief from subsidized competition improves the fortunes of the U.S. LCA industry. In 2006, Airbus could not effectively market either its A380 (because of production problems) or its A350 (which had to be redesigned). What 2006 shows is how the absence of a subsidized and aggressively marketed new Airbus aircraft improves the fortunes of the U.S. LCA industry – and, by contrast, how significant the adverse effects of Launch Aid and the other Airbus subsidies have been.

#### 4. Causation

739. Finally, the United States has explained that the material injury experienced by Boeing during the 2001-2005 period was caused by the subsidized imports.<sup>926</sup> According to the EC, however, the United States must not only demonstrate that injury was caused by the subsidized imports, as provided for in Article 15.5 and footnote 47 of the SCM Agreement, but also must show that the injury was the effect of the subsidy itself.<sup>927</sup>

740. As a factual matter, the United States has already demonstrated that the serious prejudice to the interests of the United States is the effect of the subsidy. The effect of the subsidy, as measured by changes in market share, lost sales, price undercutting, and price suppression or depression in other markets or the world market is not dissimilar to the effect of the subsidy as measured by changes in market share, lost sales, price undercutting, and price suppression or depression in the U.S. market. Thus, even if it were necessary to show, in a claim under Article 5(a), that the material injury is not only, as required by Article 15.5, the effect of the subsidized imports, but also the effect of the subsidy itself, the United States considers that, on the facts of this case, the showing that the serious prejudice is the effect of the subsidy applies, *mutatis mutandis*, to the effects of the subsidy in the U.S. market.

741. However, the EC attempt to read the “effect of the subsidy” standard in Article 6.3 into the context of a material injury inquiry under Article 5(a) is legally incorrect.<sup>928</sup> Article 6.3, by its terms, defines conditions in which “serious prejudice” may arise. If the drafters of the SCM Agreement intended Article 6.3 to apply to claims of material injury as well as serious prejudice, they would have used the term “material injury” or “adverse effects” in the chapeau of Article 6.3, not the term “serious prejudice.”

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<sup>926</sup> U.S. FWS, paras. 749-753.

<sup>927</sup> EC FWS, paras. 2144-2158.

<sup>928</sup> EC FWS, para. 2157.



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742. In any event, on the facts of this case, the Panel need not resolve the issue of whether a Member bringing a claim under Article 5(a) must demonstrate that material injury is both the effect of the subsidized imports and the effect of the subsidy.

### **XIII. CONCLUSION**

743. For the foregoing reasons, and the reasons previously stated, the United States again respectfully requests that the Panel find that:

- (1) Launch Aid provided to Airbus for the A380, the A340-500/600, and the A330-200 aircraft are export subsidies inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement.
- (2) The Launch Aid Program, individual provisions of Launch Aid, and the other measures at issue in this dispute are specific subsidies that cause or threaten to cause adverse effects to the United States and, thus, are inconsistent with Articles 5(a), 5(c), 6.3(a), 6.3(b), and 6.3(c) of the SCM Agreement.
- (3) The Launch Aid Program, individual provisions of Launch Aid, and the other measures at issue in this dispute are subsidies that are inconsistent with Article XVI:1 of the GATT 1994.
- (4) The breaches of the SCM Agreement and the GATT 1994 set forth above nullify or impair benefits accruing to the United States.

With respect to points (2) and (3), the United States wishes to be clear that, in order to ensure effective rulings and recommendations by the DSB in this dispute, it respectfully asks the Panel to make separate findings that the Launch Aid Program is a specific subsidy that causes or threatens to cause each of the forms of adverse effects alleged by the United States; that each provision of Launch Aid is a specific subsidy that causes or threatens to cause each of the forms of adverse effects alleged by the United States; and that the Launch Aid Program, each provision of Launch Aid, and the other measures at issue collectively cause or threaten to cause each of the forms of adverse effects alleged by the United States.

744. The United States further requests that the Panel recommend, pursuant to Article 4.7 of the SCM Agreement, that the European Communities, France, Germany, Spain, and the United Kingdom withdraw their export subsidies without delay. The United States respectfully requests that the Panel specify, pursuant to Article 4.7, that the time period for withdrawal be 90 days after the DSB adopts its recommendations and rulings in this dispute.

745. Finally, the United States further requests that the Panel recommend, pursuant to Article 7.8 of the SCM Agreement, that the European Communities, France, Germany, Spain,

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and the United Kingdom take appropriate steps to remove the serious prejudice and the threat of serious prejudice or withdraw their subsidies.

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## 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>
533.	Edward Alden and Kevin Done, <i>Subsidy row hits Airbus launch</i> , Financial Times, p. 1 (Dec. 20, 2000)
534.	NERA Response to Whitelaw Report ( <b>HSBI</b> )
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537.	Guidelines for the Calculation of the Amount of Subsidy in Countervailing Duty Investigations, 98/C 394/04 (Dec. 17, 1998)
538.	Council Regulation (EC) No. 74/2004 of 13 January 2004 imposing a definitive countervailing duty on imports of cotton-type bedlinen originating in India, OJ L12/1, 17.1.2004
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542.	NERA, The EIB Loans to Airbus ( <b>BCI</b> )
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554. Hamburg Port Authority, Hafenerweiterung Moorburg - Planungsskizze
555. Hafen Hamburg Marketing e.V., Port Areas
556. *Hafentwicklungsgesetz* (Port Development Act), Anlage 1 and Anlage 1a
557. “*Der Hafen von Hamburg*” (“The Harbor of Hamburg”) map
558. Hamburg Port Authority, Masterplan 2015, Ausbauabsichten für den Hafen, dated 1 June 2006
559. Hamburg Port Authority, Hafenerweiterung Altenwerder West
560. Map published by the City of Hamburg
561. Oberverwaltungsgericht Hamburg, Judgement of 19 February 2001, Case No 2 Bs 370/00, paras. 2, 4-6, 9-12, 13, 18, 20-21 (at Juris)
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563. Die Welt, Abzug aus Hamburg käme Airbus teuer (October 9, 2006)
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620. E-mail (3) from Kenneth W. Schulz (Boeing) **(HSBI)**
621. Internal Boeing presentation (2) **(HSBI)**
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