

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

**EXECUTIVE SUMMARY OF THE  
FIRST WRITTEN SUBMISSION OF THE UNITED STATES**

July 16, 2007

## INTRODUCTION

1. Immediately after the United States filed its request for consultations challenging the European Communities' ("EC") massive subsidies to Airbus, indeed later on the exact same day, the EC filed its consultation request in this dispute. The EC made no secret<sup>1</sup> of the fact that it was only filing its request in order to respond to the U.S. challenge.<sup>2</sup> The EC has also been clear that it expects the WTO examination of its programs to lead to "assured embarrassment."<sup>3</sup> In this light, the purpose of this dispute seems clear – to divert attention from the EC's "embarrassment" by creating the appearance that the United States subsidizes large civil aircraft even more than do the EC and its Member States. By systematically exaggerating and misstating the amounts involved in this companion dispute and inaccurately characterizing the nature of the programs at issue, the EC has sought to amass a subsidy allegation that would appear quite large. An evaluation of these programs consistent with the requirements of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement") establishes that the amounts involved are not only vastly less than the EC alleges,<sup>4</sup> but the programs involved are, for the most part, not even specific subsidies within the meaning of the SCM Agreement. And, in any event, the EC fails to establish that the alleged subsidies caused adverse effects to EC interests. Therefore, the Panel should reject the EC's claims that these programs are actionable subsidies.

### I. PROCEDURAL BACKGROUND AND ISSUES

2. In the procedural section of its first written submission, and then throughout the following arguments, the EC repeatedly asks the Panel to treat information referenced by the EC as the "best information available" and to draw adverse inferences with regard to certain facts. In fact, the EC selected information that was decidedly not the "best," as it routinely disregarded readily available facts that contradicted its theories, even when those facts appeared in documents cited by the EC. Moreover, the EC first written submission provides neither a factual basis nor valid legal justification for the Panel to take the radical step of drawing adverse inferences. Therefore, the Panel should proceed as panels normally do, by requiring the complaining party to meet its burden of proof and set out a *prima facie* case of inconsistency with the covered agreements.

3. The EC argues that adverse inferences are appropriate because, in the EC's view, the United States failed to cooperate with information gathering when it (1) "opposed initiation of the Annex V process in this dispute" and (2) "opposed an early decision by the Panel on the

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<sup>1</sup> See for example the October 1, 2004 report in AFX "EU, US fail to reach agreement on Airbus subsidies; US says may lodge WTO case" in which European Commission spokesman in Washington, Anthony Gooch, is quoted: "The EU spokesman said Europe would make an "immediate and prompt" response to a US complaint to the WTO."

<sup>2</sup> It is difficult to understand how the EC considered that its actions were consistent with the requirement in Article 3.10 of the DSU that complaints and counter-complaints in regard to distinct matters are not to be linked.

<sup>3</sup> See October 4, 2004 report in Bloomberg "Boeing, Airbus Aid May Violate Trade Rules, EU Says" quoting from an EC memo.

<sup>4</sup> For example, NASA R&D contracts were less than 1/10th the amount alleged by the EC.

European Communities’ preliminary ruling request.”<sup>5</sup> With regard to the EC preliminary ruling request, it was the Panel that set the schedule. The United States simply expressed its views as to when the Panel should address the EC’s ruling request. The Panel was free to reject those views, but did not. And, once the Panel set a deadline, the United States responded one week in advance – hardly the action of a party that was inappropriately seeking to delay resolution of the EC preliminary ruling request.

4. As for opposing initiation of an Annex V process, the key point – and one that the EC has itself repeatedly made – is that the EC began DS353 to address problems arising from its disagreement with the United States about the validity of the panel request in DS317.<sup>6</sup> The United States never opposed initiation of an Annex V process with regard to the EC’s claims of subsidization of large civil aircraft. In fact, it participated actively in the DS317 proceeding, submitting more than 40,000 pages of documents. The only thing the United States opposed was an unprecedented *second* Annex V process merely because the EC unilaterally decided, absent any guidance from the panel or the facilitator, that the United States failed to cooperate with the first. Thus, there is no support for the EC’s view that the United States failed to cooperate with information gathering with regard to its claims.

5. The EC also has pending a request for the Panel to exercise its discretion under Article 13 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes*. We ask the Panel to find that the EC’s request is moot, as the filing of the EC first written submission has narrowed the scope of the EC arguments. Furthermore, the U.S. first written submission contains a large volume of information rebutting the EC’s arguments, and the EC also apparently made use of some of the Annex V materials from DS317 in its submission. Therefore, the predicate of the EC’s request – the supposed lack of information on the programs challenged by the EC – no longer holds true (if it ever did).

## **II. ESTABLISHING THE EXISTENCE OF A SUBSIDY REQUIRES A DEMONSTRATION THAT THERE WAS A FINANCIAL CONTRIBUTION THAT CONFERRED A BENEFIT, AND THAT THE BENEFIT WAS SPECIFIC TO LARGE CIVIL AIRCRAFT.**

6. Establishing the existence of a subsidy requires proof that there is a financial contribution, that it confers a benefit, and that the benefit is specific. Article 1.1(a)(1) defines four categories of financial contribution. If a measure does not fall within those categories, it is not a subsidy for purposes of the SCM Agreement. In this regard, it is noteworthy that Article 1.1(a)(1)(iii) of the SCM Agreement covers only situations in which “a government provides goods or services other than general infrastructure, or purchases goods.” The exclusion of purchases of services from this definition is clear: (1) services are explicitly mentioned with respect to government provisions but not purchases, and, (2) the final version of the SCM

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<sup>5</sup> ECFWS, para. 60.

<sup>6</sup> Request for Consultations by the EC – Addendum, WT/DS353/1, p. 1 (1 July 2005); Request for the Establishment of a Panel by the European Communities, WT/DS353/2 (20 January 2006); Minutes of Meeting Held in the Centre William Rappard on 2 February 2006, WT/DSB/M/204, para. 2 (24 February 2006).

Agreement eliminated an explicit reference to purchase of services contained in earlier drafts.<sup>7</sup> This limitation on the definition of “financial contribution” must be given effect by excluding government purchases of all services from treatment as a financial contribution.<sup>8</sup> Thus, to use the definition of “purchase” outlined above, when the government confers something of value in exchange for the recipient supplying a service, there is no financial contribution.

7. Whether a financial contribution confers a benefit depends on whether it provides treatment more favorable than is available on the market. The treatment is evaluated from the perspective of the recipient, and not from the cost to the government of providing the financial contribution. A financial contribution given to one entity may not be treated as a subsidy to another, unrelated entity unless the complaining part establishes that it “passed through” to the other entity.

### **III. DOD RESEARCH, DEVELOPMENT, TESTING, AND EVALUATION (“RDT&E”) ACTIVITIES DO NOT PROVIDE A SUBSIDY TO BOEING’S LARGE CIVIL AIRCRAFT.**

8. The U.S. Department of Defense (“DoD”) conducts research, development, testing, and evaluation activities to develop weapons and other systems to advance its ability to protect U.S. national security. DoD personnel conduct many of these activities themselves at the DoD’s many research facilities. DoD also contracts with private manufacturers, private research laboratories, and universities to conduct research into topics of interest to DoD. One such contractor is Integrated Defense Systems (“IDS”), the Boeing division responsible for defense contracting activities. Boeing Commercial Aircraft (“BCA”), the division that produces large civil aircraft, is not a party to these RDT&E contracts.

9. The EC’s first written submission argues that these contracts with IDS for military research actually convey benefits to BCA’s production of large civil aircraft. This contention rests on two unsupported (and incorrect) assertions: (1) that DoD “funding for LCA-related R&D activities through what they call ‘contracts’ . . . are in reality grants to Boeing/MD for LCA-related R&D expenses,”<sup>9</sup> and (2) that “Boeing is not required to pay anything in return for this RDT&E funding.”<sup>10</sup> This framing of the claim creates a fictitious measure – DoD funding of

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<sup>7</sup> Draft Text by the Chairman, MTN/GNG/NG10/W/38/Rev.2 (27 November 1990) (Cartland III) (“For the purpose of this Agreement, a subsidy shall be deemed to exist if . . . a government provides goods or services other than general infrastructure, or purchases goods or services . . .”) (emphasis added). The United States notes that, under Article 32 of the Vienna Convention on the Law of Treaties, “recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31.”

<sup>8</sup> The drafters were, in general, clear that they intended a limited universe of government measures to be considered financial contributions. *US – Export Restraints*, para. 8.69 (“Obviously, Article 1 as ultimately adopted incorporates the requirement of a financial contribution by a government or other public body as a necessary element of a subsidy. The submissions by participants to the negotiations suggest that the proponents’ purpose behind including this element was to limit the kinds of government actions that could fall within the scope of the subsidy and countervailing measure rules.”).

<sup>9</sup> ECFWS, para. 457.

<sup>10</sup> ECFWS, para. 765.

“dual use” research that provided “nothing in return” to the U.S. government.<sup>11</sup> No such program exists or existed. The EC uses this fiction to disregard reality, which is fatal to its claims:

- DoD contracts with IDS to engage in explicitly military research that is of interest to DoD and advances the United States’ national defense objectives, generally to design more advanced weapons or other defense systems or to reduce the cost of such systems.
- DoD tasks Boeing scientists to perform work defined by DoD, receives voluminous data and scientific reports on the outcome of that work, and receives the right to convey the research results to any other company for use on any government project.
- DoD remuneration to Boeing for this contracted research is subject to an elaborate legal regime and rigorous government auditing and enforcement to ensure that the government is not overpaying for the services received.

In short, under RDT&E contracts, DoD purchases research and development services, and does so for a market-based price. Under the SCM Agreement, government purchase of services is not a financial contribution. Even, assuming *arguendo* that purchase of services was a financial contribution, the EC can point to no evidence that the U.S. government paid more than adequate remuneration for those services. Therefore, there is no subsidy.

10. The EC seeks to bypass these fundamental, and insurmountable, problems by calling the contractual payments at issue “grants.” However, in refusing to grapple with the reality of the government payments at issue, the EC fails to make a *prima facie* case that the measures meet the three criteria for an actionable subsidy: financial contribution, benefit, and specificity.

11. Therefore, the EC’s extended allegations of so-called “dual use” technology or knowledge transfer are besides the point, as they do not and cannot manufacture a subsidy from underlying transactions that confer neither a financial contribution nor benefit to Boeing. In any event, the EC’s “dual use” assertions fail even by their own terms – they rest on a false premise that DoD’s military research is designed to assist the civilian sector, they ignore the severe technological and legal limitations on the use of military technology for civil aircraft, and they ascribe to Boeing a use of military-origin “knowledge” that is inconsistent with Boeing’s own practice and U.S. law.

12. First, the false premise: DoD has indeed in the past funded limited research on “dual use” technologies. But the EC misrepresents the nature of the programs. “Dual use” from DoD’s perspective involves leveraging commercial technology for military purposes. The

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<sup>11</sup> ECFWS, para. 766.

explicit design and objective is not to move resources to the civil sector, but rather to move resources from the civil sector to the military sector. The EC has the flow backwards.

13. Second, the technological realities: The EC ignores fundamental technological differences between military and civilian missions and requirements. DoD procures research to fulfill military functions, which differ in important ways from the needs of commercial aircraft. Military aircraft carry only pilots or soldiers (but are increasingly unmanned), often fly at supersonic speeds, must evade radar, survive bullet holes and land in rocky deserts or thick jungles, and drop paratroopers and/or cargo. Civil aircraft carry commercial passengers (including demanding, and high revenue-generating, first-class passengers), fly only at subsonic speeds, are required to be seen on radar, and land at busy hub airport runways. The technologies that allow military aircraft to do their mission are expensive – and unnecessary – for a commercial aircraft. Thus, even items that are “potentially” or “theoretically” useful to large civil aircraft are not what aircraft designers or aircraft customers consider either commercially viable or feasible.

14. Third, the legal limitations: Because of their military nature, technologies developed under a DoD RDT&E contract will generally be included in the U.S. Munitions List, which results in the imposition of stringent controls under U.S. International Traffic in Arms Regulations (“ITAR”) on the export and transfer of any resulting defense articles and technical data related to those articles. These restrictions make it effectively impossible to use controlled technologies on large civil aircraft because, by their nature, the aircraft can potentially fly anywhere, including to countries proscribed by U.S. law, regulation and policy from receiving access to U.S. defense articles and technical data. As a result, Boeing has a policy of excluding the use of ITAR-controlled articles and technical data on its large civil aircraft, and has developed rigorous internal procedures to ensure that this does not occur. Boeing applied this policy to the 787, the aircraft the EC alleges was aided most by DoD RDT&E activities, to ensure that the 787 incorporates only technologies with a proven civil origin.

15. Finally, even if the EC had succeeded in demonstrating that there was a feasible civil use for knowledge Boeing obtained during performance of a DoD RDT&E contract, such a use would not satisfy any of the criteria for finding a subsidy. It is not a financial contribution. Nor is there a benefit. The existence of knowledge synergies between different business units of a company does not confer a benefit. Such knowledge is, like any other experience that a commercial actor develops in the course of its business, a normal part of commercial relationships.

#### **IV. NASA R&D**

16. The National Aeronautics and Space Administration (“NASA”) is most widely known as the agency that put a man on the moon, and today continues to conduct a variety of exploratory activities designed to expand human knowledge. This is, in fact, a vital part of its stated mission, and has been since NASA was established in the 1950s with the declaration that “it is the policy of the United States that activities in space should be devoted to peaceful purposes for the benefit of all mankind.” Recognizing further that “the general welfare and security of the United States

require that adequate provision be made for aeronautical and space activities,” the U.S. Congress has also directed NASA to sponsor leading-edge research in aeronautics and space technology in the ultimate interests of the public.

17. Reading the EC’s submission, it might seem as if NASA was established and funded for the benefit of Boeing. In fact, the EC treats virtually the entire operation and budget of NASA’s Aeronautics Research Mission Directorate as a subsidy to a few companies in the aerospace sector, even though most of NASA’s aeronautics research budget went to support research at the NASA Centers (infrastructure and salaries to NASA employees), contracts with a far broader group of companies, and independent research facilities, and grants to universities. Equally important, in most cases, the research work performed under NASA aeronautics programs is made publicly available (consistent with national security and foreign policy), and may be drawn upon not only by Boeing, but also by Airbus and the companies supplying Airbus.

18. In disregarding the broad scope of NASA’s aeronautics research, the EC greatly overstated – by nine or ten times – the amount of money NASA paid for aeronautics research contracts with Boeing. The EC asserts that NASA paid Boeing \$10.4 billion in “grants,” but the actual amount that NASA paid Boeing was less than \$750 million. Even more importantly, the EC ignored the fact that Boeing did not receive those funds as a “grant.” They were a purchase by NASA of research services performed for a variety of public purposes. As the purchase of a service is not a financial contribution, these NASA payments for research services are not a financial contribution and, therefore, are not actionable subsidies.

19. Instead of looking at the facts of the NASA contracts, many of which the EC included with its first written submission, the EC focuses instead on statements made about NASA’s aeronautics research and its usefulness to the aerospace community. NASA, Congress, industry, and academia have, at various times, attempted to make a case for augmenting the attention to, and budget for, the aeronautics elements of NASA’s mission, and the EC has selectively quoted all such statements to that effect. In fact, NASA’s aeronautics mission is put into context by the organizational chart of the NASA Advisory Council (“NAC”), which shows that aeronautics is the focus of only one of its six subcommittees (the others being audit and finance, exploration, human capital, science, and space operations).<sup>12</sup>

20. The EC also attempts to inflate Boeing’s role in setting NASA’s priorities by noting that Boeing employees periodically served on the NAC. However, the Council membership draws from a broad variety of perspectives, including retired astronauts, retired military officers, academics, business, civil society, and even an attorney employed by Sidley Austin LLP, the EC’s Outside Advisors in this dispute.<sup>13</sup> There are currently no Boeing employees on the NAC. Even in 2005, when Boeing Senior Vice President Jim Jamieson was on the NAC, he was only one of more than 20 board members.<sup>14</sup> In any event, the Advisory Council is just that – advisory – and it is the NASA Administrator who sets the agency’s research agenda.

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<sup>12</sup> NASA Advisory Council Organizational Chart (Exhibit US-100)

<sup>13</sup> NASA Advisory Council Members List (Exhibit US-101).

<sup>14</sup> Exhibit EC-312.

21. It is also important to note that the relatively limited amount of aeronautics-focused work that NASA does (in-house and subcontracted), does not confer any competitive advantage. As the EC concedes, NASA's R&D activities are far removed from the actual development and production of particular large civil aircraft models.<sup>15</sup> Rather, the research it does is focused on basic tools and technologies that can improve the efficiency and safety of all aircraft – from single-seat general aviation aircraft to very large aircraft configurations, including a revolutionary-configuration Blended Wing Body and traditional-configuration A380. And many of the “aircraft” that NASA has studied under the programs addressed by the EC do not even remotely resemble large civil aircraft, including the designs for a hypersonic Highly Reliable Reusable Launch System, a (hypersonic) scramjet, a supersonic jet, a blended wing body, and rotorcraft. And finally, the results of NASA research are disseminated publicly, except where prohibited by U.S. export controls. These are scarcely the actions of an agency seeking to confer a competitive advantage on domestic producers.

22. The EC also asserts that the NASA provided goods and services to Boeing for less than adequate remuneration in the form of work performed by NASA employees or use of NASA facilities. Under U.S. law, NASA provides such services only pursuant to agreements under “Space Act Agreements,” which require the private participant to provide a “fair and reasonable” contribution to NASA in return for any services supplied by the agency. In fact, a review of NASA's Space Act Agreements with Boeing shows that the company provided the government adequate remuneration for the services supplied, which means that the arrangement did not confer a benefit within the meaning of the SCM Agreement.

23. In its efforts to calculate the value of payments to Boeing, the EC tries to equate the alleged provision of goods and services to Boeing with NASA's operating budget. In other words, it asserts that the cost to NASA of paying employees and running NASA's operations was actually a service provided to Boeing. However, the government provides nothing to Boeing when NASA's scientists and engineers do what they do every day, such as turn on the lights in their offices, travel to international conferences, go to the doctor using their federal health insurance and collect pensions when they retire, or any of the other activities they perform in furtherance of NASA's objectives.

**V. INDEPENDENT RESEARCH AND DEVELOPMENT (“IR&D”) AND BID AND PROPOSAL (“B&P”) REIMBURSEMENTS UNDER DoD AND NASA CONTRACTS DO NOT CONFER A SUBSIDY.**

24. IR&D and B&P reimbursements are a mechanism that U.S. government contracting law uses to ensure that government contractors get what suppliers in the commercial marketplace get – a payment that covers their indirect costs of doing business. IR&D is “independent” in the sense that the contractor undertakes the R&D for its own account, independent of a request from the customer. It is the military analog to the R&D lines that both Airbus and Boeing show on their financial statements for their civil aircraft operations. B&P consists of costs that the

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<sup>15</sup> ECFWS, para. 463 (“It is clear that the US Government is not in the business of manufacturing LCA or its parts.”)

contractor undertakes in preparing documents to seek government business. Its commercial sector analog is in selling expenses that companies treat as a subtraction from revenue.

25. Where the U.S. government buys a product at the price set by the commercial market, IR&D and B&P are not “reimbursed.” They are subsumed in the payment, just as in any commercial transaction. However, for many goods or services the government buys, there is no set commercial price. In these situations, the U.S. government may determine what to pay by calculating the cost to the supplier of supplying the good or service and adding a “fee” that allows the supplier to register a profit. In these situations, the IR&D and B&P costs allocable to the good or service are part of the cost calculation. When the government pays for the good or service, part of its payment “reimburses” those IR&D and B&P costs.

26. The EC contends that Boeing includes BCA expenses in its IR&D and B&P costs and thereby charges the government for costs associated with large civil aircraft. It provides no support for this assertion. Moreover, if Boeing incurs IR&D or B&P costs that relate to civil aircraft activities, government accounting rules would require allocation of a portion of those costs to the civil aircraft division (namely, BCA). IR&D and B&P are only reimbursed by the U.S. Government pursuant to cost-based contracts. BCA has no such contracts and, accordingly, receives no such reimbursements.

27. In any event, assuming *arguendo* that such the U.S. IR&D and B&P rules conferred a benefit, they are not specific, as they are available to all contractors with the U.S. government in all sectors.

## **VI. THE TREATMENT OF PATENT RIGHTS, DATA RIGHTS, AND TRADE SECRETS UNDER U.S. GOVERNMENT CONTRACTS DOES NOT CONFER A SUBSIDY.**

28. The EC asserts that the U.S. government “transfers” or “waives” patent and data rights to its government contractors, and that this alleged transfer conveys a benefit specific to Boeing. It is wrong on all counts. Under U.S. law, an inventor is the initial holder of the rights to a patentable invention. This rule holds true whether the inventor conceives the patentable invention independently, under contract to a private partner, or under contract with the government. Thus, the question in a government contract is not whether the government will “transfer” or “waive” patent rights, but is instead what rights the government receives as part of the exchange of value under the contract, and what rights the inventor retains. Since the contracts themselves are subject to competitive bidding, or procurement rules designed to achieve a result equivalent to competitive bidding, the resulting allocation of patent rights is consistent with market considerations. Moreover, the ultimate assignment of patent rights that the EC attacks is, in fact, the general rule under U.S. government contracting law and, therefore, is not specific. As for data rights, the concept of “waiver” is not applicable. Data rights may be licensed, but the EC has not made any claims in this regard.

29. The EC devotes most of its analysis to selective quotations regarding the policy underlying U.S. rules for the attribution of rights in patents conceived by persons working under contracts with the government. The EC is correct that 30 years ago, the United States had a

general policy of taking all rights to patents conceived under government contracts, and then granting nonexclusive licenses to any applicant that wished to use a patent. The EC is also right that 27 years ago, as a result of the Bayh-Dole Act, the United States changed its general policy to allow contractors to retain their patent rights, while the government would acquire only those patent rights it needed. The government rights take the form of a license to use the patent for any “government use,” which includes use of the patent by any government contractor engaged in government business. The key point is that it was a general policy, available to any contractor under any contract with any agency. In the parlance of the SCM Agreement, the patent rules are not specific.

30. The EC tries to create the appearance of non-specificity by noting that NASA achieves this result by “waiving” patent rights that would otherwise accrue to the agency by operation of law. (For historic reasons, NASA’s statute grants it full title to patentable inventions made by a contractor under a contract with NASA.) However, the EC disregards that the “waiver” process is simply the way that NASA executes the government-wide policy of allowing contractors to retain rights to patentable inventions they make while working under a government contract. substantive outcome is the same.

31. In any event, the allocation of patent rights and data rights is part of the bargain that the government strikes with its contractors, usually through a competitive bidding process. As we have shown above, that bargain resulted in the purchase of services for no more than adequate remuneration. Assuming *arguendo* that such a purchase can be a financial contribution, a position with which we disagree, the adequacy of remuneration establishes that there is no benefit.

## **VII. U.S. DEPARTMENT OF COMMERCE ADVANCED TECHNOLOGY PROGRAM**

32. The EC’s challenge to a U.S. Department of Commerce program known as the Advanced Technology Program (“ATP”) lacks merit because ATP is a broad-based, non-specific program. ATP assists a broad range of companies in funding early-stage, high-risk research and turning it into innovative technologies that could deliver broad-based economic rewards for the United States as a whole. ATP does not fund the development of particular products, but supports early-stage enabling technologies that are essential to the development of new products, processes, and services across diverse application areas.

33. ATP has funded 768 projects in a broad array of technology areas that extend across the fields of advanced materials and chemicals, biotechnology, electronics, computer hardware, communications, information technology, and manufacturing. ATP does not target specific companies or institutions to receive funding or participate in projects; these entities participate in ATP of their own initiative. The selection of ATP projects is done on a peer-reviewed, competitive basis and is subject to established selection criteria.

34. Boeing participated in eight ATP projects as a member of a consortium, rather than on its own, and received an amount of funding that is trivial in comparison with the cost of developing and producing large civil aircraft. The ATP funding that Boeing received is not an actionable

subsidy because it was not specific to Boeing. ATP is an extremely broad program that provides funding to a diverse array of industries and technology sectors. The authorizing legislation does not limit eligibility to certain enterprises, which means that it is not *de jure* specific pursuant to Article 2.1(a) of the SCM Agreement. Furthermore, ATP is also not *de facto* specific under Article 2.1(c).

#### **VIII. THE U.S. DEPARTMENT OF LABOR GRANT TO EDMONDS COMMUNITY COLLEGE WAS NOT A SUBSIDY TO BOEING.**

35. Contrary to the EC's portrayal, a very small U.S. Department of Labor grant awarded to Edmonds Community College pursuant to the High Growth Job Training Initiative did not provide a subsidy to Boeing. The High Growth Job Training Initiative was created to help workers take advantage of job opportunities in high growth, high demand, and economically vital sectors of the U.S. economy. It applies to 14 broad industry sectors, such as biotechnology, energy, financial services, health care, and information technology, that cover much of the U.S. economy. Pursuant to this initiative, the Department of Labor has awarded over 150 grants to a wide range of entities across the United States for a diverse array of topics.

36. Edmonds Community College received one such grant, in the amount of approximately \$1.5 million, for the development of an advanced manufacturing curriculum with broad applicability to various industries. This grant did not provide a subsidy to Boeing because Boeing did not benefit from it, nor was the grant specific under Article 2.1. The grant provided no benefit to Boeing because it was not used to provide training to Boeing employees, as the EC alleges. Moreover, the Department of Labor grant is not *de jure* specific to Boeing because these grants are not explicitly limited to "certain enterprises," but are broadly available across 14 diverse industry sectors and may be used for a variety of purposes across many sub-sectors. The grants are also not *de facto* specific because they have been distributed across the 14 different industry sectors, with aerospace receiving far fewer grants than other industries. Furthermore, the curriculum that Edmonds Community College developed relates to skills that cut across a wide range of manufacturing industries and is in no way limited to the aerospace sector.

#### **IX. FSC/ETI IS A SUBSIDY, BUT BOEING HAS STATED THAT IT WILL NOT CLAIM BENEFITS FROM THIS SUBSIDY AFTER 2006.**

37. The United States does not dispute that FSC/ETI has been found to be a financial contribution that confers a benefit, and is specific, nor do we contest the EC estimate of FSC/ETI benefits related to large civil aircraft during the 1989 to 2006 period. But, based on certified statements by Boeing's officers, it ceased receiving FSC/ETI benefits as of December 31, 2006. Accordingly, with regard to any claims of threat of serious prejudice, FSC/ETI benefits should not enter into the analysis. As the EC's sole claim with regard to FSC/ETI in this dispute is that it provided a subsidy to Boeing's production and development of large civil aircraft, there is no need for the Panel to make any finding with regard to application of FSC/ETI in any other sectors. Moreover, as we demonstrate below, FSC/ETI benefits did not cause adverse effects to the interests of the EC.

## **X. THE WASHINGTON STATE TAX MEASURES**

38. The State of Washington is a major center for aerospace development and production. However, for many years prior to 2007, aerospace manufacturing activities faced one of the highest effective tax rates in the State of Washington. The State sought to alleviate the concerns of aerospace manufacturers by enacting an aerospace tax package, the most significant component of which was a reduction in the tax rate of Washington’s Business and Occupation (“B&O”) tax for aerospace manufacturing activities. The B&O tax rate reduction served to bring the aerospace manufacturing effective tax rate closer to (but still higher than) the average effective tax rate of other business activities in the State. It does not provide a subsidy at all, let alone to Boeing, as the EC claims.

39. Contrary to the EC’s claim, the B&O tax reduction is not a financial contribution to Boeing under Article 1.1(a)(1) of the SCM Agreement because the State of Washington has not foregone any revenue that is “otherwise due” – a determination that is made with reference to the State’s own tax system. In Washington’s activities-based tax system, various business activities have different tax rates within a certain range. The tax rate reduction for aerospace manufacturing is part of Washington’s regular adjustment of its tax rates and falls within the range of tax rates for other activities. As such, it is not revenue foregone that is otherwise due. An examination of the State of Washington’s effective tax rate confirms this conclusion. Even with the B&O tax rate reduction, the average effective tax rate for aerospace manufacturing remains higher than the average effective tax rate for all businesses in the State, due to “pyramiding” of the B&O tax – *i.e.*, the taxation of goods at each stage in the production process.

40. The EC does not challenge only the tax reduction to Boeing. It contends that tax reductions to Boeing’s unrelated suppliers are in fact a benefit to Boeing. Assuming *arguendo* that the B&O tax rate reduction for aerospace manufacturing is a financial contribution, the EC has provided no basis to believe that the tax rate reductions to other unrelated and independent aerospace manufacturers pass through to Boeing.

41. The EC also claims that certain other Washington state and local tax measures are subsidies that are inconsistent with the SCM Agreement – B&O tax credits, certain sales and use tax exemptions, leasehold excise tax exemptions, property tax exemptions, and a local B&O tax rate reduction. But most of these tax measures are not subsidies at all, and those that are subsidies are either not actionable or are too small to cause adverse effects. In some cases, for instance, the tax measures are not specific to Boeing. In other cases, Boeing has not and will not use the tax measures at issue because they are tied to events, such as the building of a new Boeing manufacturing facility for the 787, that did not and will not occur.

## **XI. THE INFRASTRUCTURE AND OTHER MEASURES IN THE STATE OF WASHINGTON ARE NOT WTO-INCONSISTENT SUBSIDIES.**

42. In addition to challenging Washington State tax measures, the EC also challenges certain general infrastructure projects and six other measures taken by the State of Washington. None of

these measures, however, constitute actionable subsidies within the meaning of the SCM Agreement because they do not meet one or more of the Agreement's requirements for a potentially actionable subsidy – (1) a financial contribution, (2) that confers a benefit, and (3) is specific.

43. First, the EC contests two road improvement projects contemplated by the State on major public highways. But these projects are not subsidies because the roads are quintessential general infrastructure; they are open to all and serve a broad range of people, businesses, and communities. Second, the EC challenges improvements to the Port of Everett – a busy port used by many industries, but these improvements also serve a broad range of people, businesses, and communities. They are accordingly not specific. Third, the EC erroneously asserts that Washington has provided a subsidy to Boeing by freezing the rates that it pays for certain utilities. In fact, Boeing pays the same rates as other commercial, industrial, and government customers, which means that it receives no financial contribution in the form of revenue foregone that is otherwise due. Fourth, the EC contests Boeing's payment of certain landing fees at a municipal airport, which are also not subsidies to Boeing. These fees are covered by an agreement between the airport and Boeing, which makes clear that there is no financial contribution or benefit because Boeing effectively pays a higher rate under the agreement than other airport users.

44. Fifth, the EC maintains that the State of Washington is subsidizing Boeing by providing State employees who offer regulatory and other assistance to Boeing in the normal course of their employment. But such assistance by State employees, which is only a small portion of their total workload, provides no financial contribution or benefit to Boeing. Even assuming a benefit, the project coordinators are not specific to Boeing because numerous other projects receive similar assistance from the State. Sixth, certain litigation costs that may arise out of an agreement between Boeing and the State of Washington are also not a subsidy, as the EC alleges. The State transfers no funds to Boeing for litigation expenses that the company chooses to incur, so there is no financial contribution. Seventh, the EC asserts that the State of Washington is providing subsidies to Boeing in the form of tax and other incentives for Boeing's 747 Large Cargo Freighter. But Washington State is not providing any special tax incentives to this airplane, and is therefore not foregoing any revenue otherwise due. It is also not providing other goods or services for this aircraft. Eighth and finally, the EC's claims regarding certain job training measures and an employment center that will revert to public use also lack merit.

## **XII. THE STATE OF KANSAS' TAX MEASURES ARE NOT ACTIONABLE SUBSIDIES.**

45. The EC challenges two tax measures in the State of Kansas, neither of which is a WTO-inconsistent subsidy. First, the EC contests Industrial Revenue Bonds ("IRBs") issued by the City of Wichita as an ongoing actionable subsidy to Boeing, despite the fact that Boeing ceased its large civil aircraft operations in Kansas in 2005. Before that time, Boeing – like many companies in Kansas – used bond financing pursuant to a widely available and long-standing economic incentive program. The EC attempts to minimize the significance of these facts by distorting the nature of the bond program and asserting that the post-2005 benefits have been

“passed through” to Boeing based on an economist’s opinion not grounded in the facts of this case. But the EC’s subsidy claims regarding the Wichita bonds lack merit.

46. The IRBs are not a financial contribution because the City of Wichita is not foregoing revenue on personal property. Kansas no longer assesses property or sales tax on commercial and industrial machinery and equipment. Thus, even without the IRBs, no tax revenue would be due to Kansas or its subdivisions from any business on its machinery and equipment, which represents most of the property financed with the IRBs at issue.

47. Even if the IRBs provide a financial contribution, they are still not an actionable subsidy because they are not specific within the meaning of Article 2 of the SCM Agreement. IRBs are a transparent and generally available program, provided for in Kansas law, that the State of Kansas and its subdivisions have been administering and applying to companies from a broad range of industries for more than 40 years. IRBs are also not *de facto* specific because Boeing’s percentage of IRBs is not disproportionate. Furthermore, although the IRBs are not an actionable subsidy, the United States also notes that any benefit of the IRBs to an independent and unrelated company (Spirit Aerosystems) did not pass through to Boeing.

48. Second, the EC challenges Kansas Development Finance Authority (“K DFA”) bonds as an actionable subsidy to Boeing, even though Boeing never received or even applied for K DFA bonds. The EC nonetheless attempts to allocate K DFA tax benefits away from the actual recipient of the bond financing – Spirit, an independent and unrelated company – to Boeing. As with its claims regarding IRBs, the EC asserts that K DFA’s intent to issue bonds for Spirit was known before Boeing’s sale of Spirit closed, and, on that basis, concludes that the sales price must have reflected expected future bond financing.

49. Neither the facts nor economic theory support a finding that the K DFA bonds were a subsidy to Boeing. First, the subsidies are not a financial contribution to Boeing, which never received K DFA bond financing. Second, the EC incorrectly assumes that Spirit was assured of the future interest payment rebate at the time the transaction price was agreed – and, moreover, that the amount of the future interest payment rebate benefit was known at that time. Third, the EC argument is based on a mistaken theory that the value of a future expected tax benefit would necessarily be captured by the seller.

### **XIII. ILLINOIS CORPORATE RELOCATION PROGRAM**

50. Contrary to the EC’s claims, certain measures taken by the State of Illinois and its localities pursuant to the Corporate Headquarters Relocation Act (“CHRA”) and other state and local law do not constitute actionable subsidies to Boeing. The CHRA provides that the State of Illinois will reimburse qualifying relocation costs for corporate headquarters. Moreover, they were for amounts that were minimal in comparison with the cost of developing and producing large civil aircraft. The relocation expenses that Boeing received pursuant to that act are not a WTO-inconsistent subsidy, as the EC alleges, because the reimbursement of such expenses was not specific to Boeing or similar enterprises.

51. State tax credits provided by Illinois pursuant to another state law – the Economic Development for a Growing Economy (“EDGE”) Tax Credit Act – also do not provide an actionable subsidy to Boeing, despite the EC’s claims to the contrary. Companies of all sizes in a broad range of industries are eligible to apply for and have received EDGE tax credits. As such, they are not specific within the meaning of Article 2.1 of the SCM Agreement.

52. Furthermore, the EC’s claims regarding property tax abatements provided for under Illinois law are without merit. The Illinois Property Tax Code allows any taxing district in the State to abate the property taxes of a wide variety of enterprises. The CHRA amended the relevant provision of the code to include relocated corporate headquarters among the types of enterprises eligible to receive property tax abatements. The property tax abatements provided by two localities in the State of Illinois are not WTO-inconsistent subsidies because they are not specific to Boeing. Finally, the EC challenges a very small lease termination payment made by the City of Chicago on behalf of Boeing, which the United States does not contest.

#### **XIV. ALLEGEDLY EXPORT-CONTINGENT SUBSIDIES**

53. In addition to claiming that the tax measures enacted by the State of Washington pursuant to a piece of legislation known as “HB 2294” are actionable subsidies, the EC also asserts that these tax measures are prohibited subsidies under Article 3.1(a) of the SCM Agreement. But the EC’s claim that these Washington State tax measures are contingent on export performance has no merit. The plain language of HB 2294 makes clear that its tax incentives are in no way tied to actual or anticipated export performance.

54. The EC erroneously claims HB 2294 did not become effective until the State of Washington signed an agreement with a commercial airplane manufacturer to locate a manufacturing facility in the State that *will produce* 36 superefficient airplanes, such as the Boeing 787, per year. It then asserts that Boeing could not sell 36 such airplanes domestically and that, consequently, the HB 2294 tax measures are *de facto* export-contingent. In fact, to become effective, HB 2294 only required that a manufacturing facility with the *capacity to produce* 36 superefficient airplanes be located in the State. Actual production quantities were irrelevant. As such, HB 2294 is in no way tied to actual or anticipated exportation or export earnings – the standard under Article 3.1 for finding a prohibited *de facto* export-contingent subsidy.

#### **XV. THE PROGRAMS IDENTIFIED BY THE EC DID NOT CAUSE ADVERSE EFFECTS TO EC INTERESTS**

55. The years 1995-2005 were a period of steady triumph for Airbus. It became the largest producer of civil aircraft in the world, increasing its share of deliveries from 33 percent to 57 percent, and its share of orders from 16 percent to 50 percent. It successfully converted from a consortium to an integrated company, with a profit margin of more than ten percent. And, it developed a revolutionary new aircraft, the A380, designed to carry more people farther than any civil aircraft before it. In May of 2006, Airbus’s parent company, EADS, reported at its general meeting that:

Revenues increased by 10% to €22,179 million (FY 2004: €20,224 million). Airbus' EBIT margin improved from 9.5% to 10.4%. With 1,111 gross orders in 2005, Airbus achieved an all-time record order intake and as a result outsold its competitor for the fifth year in a row. ... At the end of 2005, the Airbus order book amounted to €202 billion based on list prices. This is an increase of 48% over year-end 2004. The order book represents a total 2,177 commercial aircraft (2004: 1,500).<sup>16</sup>

The Airbus management also reported that the company had almost finished testing of the A380, that it expected to deliver the first A380 to Singapore Airlines “at the end of 2006,”<sup>17</sup> and that another new aircraft launched that year, the A350, had secured 172 orders by the end of 2005.

56. Only a month later, the situation took an unfavorable turn. By then, production problems that would lead to a significant delay in the delivery of the first A380, and cost Airbus billions of euros in penalty charges and added costs, had come to light. As a result, the value of EADS shares dropped 25 percent *in one day*. Airbus also had to face the consequences of its decision to focus its engineering and other resources on the A380. That decision meant that Airbus's effort to bring to market its A330 replacement and 787 competitor, the A350, fell far short of customer expectations. The co-CEO of EADS resigned amidst suspicions of insider trading, and two successive Airbus CEOs resigned before year end, largely as a result of the A380 delays and their effects.

57. EADS's report to shareholders in May 2007 recognized that 2006 had been “a disappointing year” for Airbus.<sup>18</sup> It explained the difficulties as:

- (1) *Problems with the A380*. “{P}roduction difficulties encountered for the A380 led to delays in its projected delivery schedule, with first A380 currently scheduled for delivery in October 2007. The resulting costs and charges associated with these delays will impose a significant burden on EADS' future financial program.”<sup>19</sup>
- (2) *Problems with the A350*. “A350 related charges, €0.5 billion in increased R&D . . . are other important contributors to the loss.”<sup>20</sup>

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<sup>16</sup> EADS, Documentation for the Annual General Meeting, p. 6 (May 4, 2006) (“EADS 2005 Documentation”) (Exhibit US-266).

<sup>17</sup> EADS 2005 Documentation, p. 20 (Exhibit US-266).

<sup>18</sup> EADS, Documentation for the Annual General Meeting, p. 7 (May 4, 2007) (“EADS 2006 Documentation”) (Exhibit US-267).

<sup>19</sup> EADS 2006 Documentation p. 7 (Exhibit US-267).

<sup>20</sup> EADS 2006 Documentation, p. 7 (Exhibit US-267).

- (3) *Appreciation of the Euro against the Dollar.* “{L}ess attractive dollar hedges are other important contributors to the loss.”<sup>21</sup>

Airbus predicted more losses in 2007, based largely on the same three factors: “further costs to support the A380 program, potential A350XWB launch charges, higher R&D expenses, as well as the impact of the worsening U.S. Dollar parity to the Euro.”<sup>22</sup> *Significantly, there was no mention of competition from Boeing or the effects of subsidies to Boeing as a source of Airbus’s problems.*

58. These were not the only reasons that Airbus was having trouble. Two other important factors played a role during this period, although EADS pays them little attention:

- (4) *Problems with the A340.* When Airbus launched the A340 for long-haul service in the late 1980s, it placed four engines on the aircraft, and has retained that configuration in all subsequent models. As prices for aviation fuel increased in the 2000s, that made the A340 much less popular than the 777, which was more fuel efficient because it carried only two engines.
- (5) *Problems with pricing.* In 2002, Airbus had launched a price war, dropping its prices for A320s low enough that low-cost carriers would switch from the 737, which they had previously favored. The effect was to lower prices for all single-aisle aircraft. Boeing reluctantly lowered prices on the 737 only after belatedly realizing that matching Airbus was necessary to prevent further market share losses.

59. Even with these varied difficulties, EADS could still point to a number of Airbus successes in 2006:

The Airbus division delivered a record number of aircraft in 2006 (434 versus 378 in 2005). This led to revenues of €25,190 million representing a 14% increase compared to the previous year (FY 2005: €22,179 million). ... With 824 gross orders (790 net orders), Airbus achieved its second best year in terms of sales, including 673 Single Aisles, 134 A330s, A340s and A350s as well as 17 A380s.<sup>23</sup>

As a result of this strong sales performance, Airbus has increased its record backlog by 17% to 2,533 aircraft at the end of 2006, giving Airbus 51% of all outstanding orders.<sup>24</sup>

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<sup>21</sup> EADS 2006 Documentation, p. 24 (Exhibit US-267).

<sup>22</sup> EADS 2006 Documentation, p. 29 (Exhibit US-267).

<sup>23</sup> EADS 2006 Documentation, p. 24 (Exhibit US-267).

<sup>24</sup> EADS 2006 Documentation, p. 7 (Exhibit US-267).

60. And, at the Paris Air Show just this past month, Airbus CEO Louis Gallois announced that “{t}his air show confirmed that Airbus is very much back in the market.” The statistics confirm his assessment:

- “Airbus announced a record 425 aircraft orders worth \$61.7 billion for the week, triple the sales it announced during the 2006 trade event.”
- “Airbus’s orders, combined with 303 commitments to purchase planes it announced during the week, equaled the number of aircraft that typically roll off its assembly lines during a two year stretch.”
- “Airbus appeared to shore up market confidence in its A350 WXB, the aircraft designed, and redesigned, to counter Boeing’s hot selling 787 Dreamliner. The 141 firm orders announced by the European plane maker during the trade event included a \$3.7 billion order from Singapore Airlines, one of the industry’s blue chip players, announced Friday.”<sup>25</sup>

61. Airbus’s record-setting performances in terms of its large civil aircraft production, sales, revenues, market share gains and profits between 2000-2005, and its evidently quick recovery from the A380 and A350 problems that made 2006 a “disappointing” year indicate that any downturn was temporary. It does not constitute serious prejudice, and, therefore, does not qualify for a remedy under Article 7.

62. However, even if the Panel were to agree that Airbus’s setbacks with the A380, the A350, the A340, or any other of its aircraft rose to the level of serious prejudice, a subsidy is actionable under Article 6.4 only if that prejudicial condition is “the effect of the subsidy.” The EC has failed entirely to clear this hurdle. The EC concedes that standard requires a “but for” causation test. To succeed, the complaining party must show that but for the subsidization, the serious prejudice would not have occurred. The EC also recognizes that this test requires a counterfactual analysis of how Airbus and Boeing would have performed in the absence of the alleged subsidization.<sup>26</sup> It must, in other words, present evidence to show that “but for” these alleged subsidies, Boeing’s development or pricing of large civil aircraft would have been materially different in a manner that one of the serious prejudice factors resulted.

63. The EC’s chain of reasoning proceeds as follows: (1) early stage research programs, and military research and development programs, under which Boeing performs work for the U.S. Government that is not linked to the development, production and sale of any particular commercial aircraft, have subsidized BCA’s operations; (2) the alleged benefit of those programs vastly exceeds the amount actually paid to Boeing under the government’s contracts with Boeing; (3) Boeing would not have been ready to launch the 787 when it did without the “knowledge, experience, and confidence” Boeing gained while performing research services under those contracts;<sup>27</sup> and (4) an economic model created by Professor Luis Cabral indicates that subsidies that increase “non-operating cash flow” lead to “price effects” in the form of

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<sup>25</sup> Julie Johnsson, “Airbus finds its lost love in Paris,” *Chicago Tribune* (June 23, 2007) (Exhibit US-268).

<sup>26</sup> ECFWS, para. 1062.

<sup>27</sup> ECFWS, para. 1334.

“aggressive pricing,” especially on competitive sales of the A330, A350 Original, A320, and A340.

64. Thus, the EC’s serious prejudice case against the Boeing 737 and 777 is based *entirely* on the alleged price effects of the alleged subsidies, and the serious prejudice case against the 787 is based on a *combination* of the alleged price effects of the alleged subsidies and the product development advantages the EC claims that Boeing gained from the alleged subsidies. However, it presents no credible evidence in support of either theory.

65. With regard to its arguments regarding price effects, the EC performs a cursory “counterfactual analysis” in an attempt to meet the SCM Agreement’s causation standard. However, this analysis assumes, but does not prove, that in the absence of the alleged subsidies, Boeing’s prices would have increased by the amount of the alleged subsidization rate<sup>28</sup> – a proposition that the EC concedes is untrue.<sup>29</sup> The remainder of its “price effects” argument relies on (1) the *assertion* that 100 percent of a set of alleged tax benefits flow through to the prices Boeing charges its customers, and (2) an economic analysis (the “Cabral Report”<sup>30</sup>) that *assumes* the price effects of the other so-called “development subsidies” allegedly given to Boeing. In fact, insofar as Boeing’s pricing is concerned, the evidence, as opposed to the EC’s assertions and assumptions, is unequivocal on all of the following points:

- Boeing’s pricing is market-driven. It seeks the highest prices for its aircraft that the market will bear, without regard to the various payments that the EC challenges as subsidies.<sup>31</sup>
- Airbus has deliberately and systematically undercut Boeing’s pricing for all three types of large civil aircraft subject to the EC’s complaint in order to gain market share (the A320), to retain market share (A330), and to compensate for customer dissatisfaction with its competing aircraft (A340 and A350 Original).
- Boeing’s resistance to the pricing pressure put on it by Airbus is evident in both the campaign-specific evidence and, more generally, Boeing’s large market share losses. In fact, the evidence shows that Boeing’s market share losses to Airbus were greatest in the period when the alleged price effects were highest, thus disproving the EC’s claim of a link between the alleged subsidies and Boeing’s pricing.

66. With respect to “technology effects,” the EC presents no convincing reason to believe that Boeing would have developed the 787 later or more slowly in the absence of the alleged subsidization. In fact, the evidence demonstrates the opposite. When Boeing committed its

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<sup>28</sup> ECFWS, 1396-1402, paras. 1502-1504, and 1597-1599.

<sup>29</sup> The EC’s economic model – which assumes the price effects that it purports to derive – estimates that 85 percent of the value of any subsidy results in a price increase.

<sup>30</sup> Luis M.B. Cabral, *Impact of Development Subsidies Granted to Boeing*, New York University and CEPR (March 2007) (Exhibit EC-4).

<sup>31</sup> Statement of Clay Richmond (Exhibit US-275).

resources to the 787 program, Boeing and Airbus had access to the same composite and other technology. Boeing launched the 787 well before Airbus launched the A350 XWB – the first version of that aircraft to gain market acceptance – because Airbus’s resources were, at the time, committed to the A380. Airbus’s position in the mid-size aircraft segment was, in other words, a matter of choice – Airbus decided to focus on mastering the technology of a “super-jumbo” aircraft that was designed to service hub-to-hub routes. Boeing decided to focus on a smaller, more fuel-efficient point-to-point aircraft that could build on existing, generally available developments in composite technology and reductions in composite costs. Having decided to go in a different direction than Boeing, Airbus compounded its own problem after Boeing’s 787 launch by trying to rush the development of a competing “A350” based on a quick reworking of its aging A330. The alleged subsidies to Boeing were never the issue.

67. The EC also fails to address what EADS recognized last year – that the problems that Airbus has faced over the last 12 months are problems of its own making, and unrelated to the alleged subsidization. In fact, the problems Airbus created for itself extend beyond the A380 and A350 issues discussed above. For example, Airbus decided to bring its long-range A340 to market in the 1990s as a four-engine airplane. In an era of low-priced jet fuel, the decision may have been sound. In today’s environment of very high priced jet fuel, however, that decision has only caused problems. The A340 sells poorly because it performs poorly – it has been consistently rated at the very bottom of the large civil aircraft on the market by operators and investors. For the EC to claim, as it does, that subsidies, rather than the poor performance and operating economics of the A340, have caused the A340 to lose sales to Boeing’s more fuel-efficient twin engine 777 ignores all evidence regarding sales of these two aircraft.

68. Similarly, in 2000 Airbus committed billions of dollars to its A380 project. The A380, by far the largest commercial airplane ever built, is designed to fly a relatively small number of “hub-to-hub” routes. Boeing was always more skeptical about the level of demand for so large an airplane, believing that the greatest growth would be in direct “point-to-point” routes, which allow passengers to reach their destination without changing planes at congested hubs like Frankfurt, London Heathrow, or Tokyo Narita. Therefore, while Airbus was developing the A380, Boeing committed its development resources to the 787, a much smaller, much more fuel efficient aircraft based on composite technology, to fly those point-to-point routes. Because engineering resources are limited, Airbus’s decision to focus on the revolutionary A380 meant that it was impossible for it to create an equally revolutionary mid-size aircraft at the same time. Instead, it tried to make do with a low-cost reworking of the A330, calling it a new aircraft family (the “A350”) and marketing it in competition with the 787. The successive failures of this approach, as customers rejected ever more elaborate modifications to existing aircraft components, finally led Airbus to launch a truly new aircraft, the A350 XWB, which will not be ready for delivery until 2013, five years after the 787. Alleged subsidization of Boeing could not have caused Airbus’s shortage of qualified engineers, or a series of poor design decisions that customers rejected.

69. The EC does not, and cannot, claim that Airbus’s problems with production of the A380 are in any way related to anything done by Boeing. There is no doubt that the costly production delays – the A380 is two years behind schedule and billions of euros over budget – explain most,

if not all, of the loss Airbus reported in 2006, and the difficulty Airbus had in finding resources to develop the A350.

70. Thus, the available evidence not only disproves the causation case the EC seeks to make, but also proves that the serious prejudice about which the EC complains is, in fact, a direct result of product development and pricing choices deliberately made by Airbus. However, the SCM Agreement does not permit the EC to attribute to subsidies the effects of such other factors.

71. In closing, there is one other significant fact about Airbus's condition that the EC neglects to mention in its submission. Although Airbus recently experienced some adversity, its revenues and production are at near record levels, and its commercial situation is improving. The A380 is nearly ready for delivery to customers, and Airbus expects orders to pick up as the aircraft proves itself in revenue service. Airbus decided to scrap the poorly designed Original A350, and start over with the A350 XWB. The EC, Airbus, and most analysts predict that the new aircraft will gain more favor with customers.<sup>32</sup> Indeed, Airbus has already received an impressive 232 orders and commitments for the A350 XWB in the six months since program launch.<sup>33</sup> Airbus has also drastically changed its management team and undertaken a cost-cutting plan called "Power 8," which it believes will make it more competitive in a weak dollar environment. While these developments may be consuming revenue and cash flow from the company's financial statements today, they are investments that promise swift future improvements, as is now evident from the A350 XWB order book.

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<sup>32</sup> ECFWS, para. 1338 ("Airbus is now in a position to offer, with the anticipation of being able to deliver in 2013, a new-generation LCA that exhibits comparable or even better performance than Boeing's 787 family LCA").

<sup>33</sup> Airbus Press Release, "Renewed momentum for Airbus's leading products, and Paris Air Show with 425 firm orders" (June 22, 2007) (Exhibit US-377).