

***** AS DELIVERED *****

UNITED STATES – MEASURES AFFECTING TRADE IN LARGE CIVIL AIRCRAFT (SECOND COMPLAINT):

RECOURSE TO ARTICLE 21.5 OF THE DSU BY THE EUROPEAN UNION (DS353)

**OPENING ORAL STATEMENT OF THE UNITED STATES
AT THE SUBSTANTIVE MEETING OF THE PANEL WITH THE PARTIES**

October 29, 2013

1. Mr. Chairman, members of the Panel, we are aware that the EU in another proceeding has taken the view that subsidies can be withdrawn and compliance achieved for purposes of Article 7.8 of the SCM Agreement¹ by simply waiting for the life of those subsidies to end. But this has not been the approach of the United States in this dispute and not what we have done to the subsidies subject to the DSB's recommendations and rulings. To the contrary, the U.S. approach to implementation has been much more robust; for each of the subsidies found to exist and cause adverse effects in the original proceeding, the United States either took action to withdraw the subsidies, or took steps to remove the adverse effects.

2. To summarize, NASA² and DoD³ have greatly reduced the amount of research they pay Boeing to conduct under the relevant contracts and assistance instruments. NASA has modified the way it conducts research so as to remove the aspects of its practices that led to the findings against its pre-2007 contracts. The U.S. Congress terminated FSC/ETI⁴ in 2006, and Boeing has not received FSC/ETI tax deductions since then. The value of tax breaks associated with pre-2007 Wichita industrial revenue bonds ("IRBs") is tiny, the City of Wichita has not issued any new IRBs to Boeing, and the program is no longer specific. By withdrawing FSC/ETI, the United States removed the adverse effects of the Washington B&O⁵ tax rate reduction, which was too small by itself to cause adverse effects.

3. We have devoted literally hundreds of pages to these points already, and will not belabor them here. We will focus here on the fundamental contradiction embedded in the EU argument – that they are seeking to show that the adverse effects of the allegedly continuing subsidies have increased during a period when the only credible evidence shows that their value has decreased, and decreased dramatically. And so we find the EU engaged in a number of unsustainable efforts to inflate the value of the measures it is challenging, in order to mask the reality that the measures at issue, which the United States has for the most part withdrawn and reduced in value, cannot be causing any adverse effects, let alone the magnified effects that the EU alleges.

4. Let's start by taking a quick look at the real value of some of these numbers, as opposed to how the EU seeks to portray them.

- In the real world, NASA's annual aeronautics research spending after 2006 was more than 60 percent lower than its pre-2006 peak. The evidence shows that NASA payments and provision of facilities, equipment, and employees to Boeing were less than \$200 million in the entire 2007-2012 period. The EU simply ignores these data, and relies on a methodology rejected by the original panel to inflate that number to \$1.8 billion, nine times higher.⁶

¹ *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement").

² National Aeronautics and Space Administration.

³ Department of Defense.

⁴ Foreign Sales Corporation and Extraterritorial Income.

⁵ Business and Occupation.

⁶ EU First Written Submission, para. 56.

- DoD greatly reduced funding of assistance instruments through program elements that the Appellate Body found to confer subsidies. The total value in the 2007-2012 period came to less than \$25 million. Yet the EU alleges DoD subsidies of \$2.9 billion – more than 100 times higher. Most of this increase – around 1.9 billion of it – comes from the EU’s injection into this dispute of DoD’s purchase of the P-8A, an aircraft whose primary mission is to combat submarines. That transaction occurred in 2004, and was a purchase of goods, which the EU has previously excluded from the scope of its claims. It is difficult to see how DoD’s purchase of the P-8A could be a measure taken to comply with a dispute that commenced *after* the transaction occurred. The rest of the increased value comes from the EU’s revival of failed claims against procurement contracts from the original proceeding and an unreliable method for valuing the putative financial contributions.
- In the real world, the Washington state B&O tax rate reduction was worth less than \$50 million annually in the 2007-2012 period.⁷ The EU’s estimate is approximately 50 percent higher only because it relies on a 2003 forecast instead of the up-to-date figures the state reported in response to the Panel’s request under Article 13 of the DSU.⁸
- The U.S. Congress terminated the FSC/ETI program in 2006, and Boeing has indicated that it received no tax benefits under the program after that time. The EU insists that the program remains, but even its exaggerated figure of \$11.74 million for the 2007-2012 period is vastly lower than the \$2.2 *billion* found for the 1989-2006 period.⁹

These are just the most obvious examples of the exaggerations in the EU’s numbers. The graphs we have distributed show how dramatically the situation has changed. The left-hand column shows the financial contribution values found in the original proceeding. (For comparison purposes, we used a tentative maximum value for DoD assistance instruments suggested, but not endorsed, by the original panel.) The right-hand column shows the comparable amounts in the 2007-2012 period. Because the two data sets reflect different periods, we have also provided annual averages on the second graph. These graphs show that the value of these measures has fallen dramatically, and rests now at a level too low to have any adverse effects.

5. The EU exaggerations as to the value of the subsidies alleged in this proceeding are just the most outward and visible sign of legal and factual errors that run throughout the EU case.

6. With regard to the research and development measures it challenges, for every step of the analysis – financial contribution, benefit, and specificity – the EU is wrong. In evaluating the

⁷ Exhibit EU-38 (revised).

⁸ *Understanding on Rules and Procedures Governing the Settlement of Disputes*.

⁹ Exhibit EU-38 (revised), note 1; Document USA13-656(BCI).

existence of a financial contribution, the Appellate Body has called for a two-step process. First, a panel must “scrutinize” the design and operation of a measure and identify all of its principal characteristics. Second, it must evaluate whether the measure falls under one or more of the subparagraphs of Article 1.1(a)(1) of the SCM Agreement.¹⁰ However, the EU tries to bypass this searching inquiry by simply asserting – with no support or reasoning – that all of the measures at issue are financial contributions because they are identical to those previously found to be WTO inconsistent. This is both incorrect and insufficient to meet the EU’s burden of proof on this issue.

7. In evaluating whether a financial contribution confers a benefit, the Appellate Body has emphasized the need to conduct a comparison with a market benchmark sufficiently similar to the government transaction at issue to indicate what a market actor would pay if it were in the government’s position.¹¹ When the transaction involves a purchase, the Appellate Body has called for an analysis based on what a private actor would pay for what the government bought, rather than asking whether the private actor would have purchased something different. On this issue, too, the EU ignores the Appellate Body’s guidance, proposing to replace the benchmark comparison with a misplaced assertion that no private actor would purchase what NASA, DoD, and the FAA did. Even if that were true – and it is not – it would be beside the point. The proper question is whether the government paid too much for what it got under the modified NASA contracts and DoD assistance instruments, the DoD procurement contracts, or the FAA CLEEN other transaction agreement (“OTA”). As we have shown, the answer to that question is “no.”

8. Finally, in asserting the existence of specificity, the EU ignores that the benefit that it alleges – that private parties contracting with the government get to retain certain intellectual property rights – has already been found to be non-specific. That should end the inquiry. The EU tries to avoid this conclusion by arguing that these generally available measures become specific because they are conveyed through instruments issued by agencies with sectoral focus – NASA, DoD, and the FAA. However, the Appellate Body already rejected this argument.¹²

9. I will be addressing these arguments in more detail after we conclude this introduction. At that time, I will also address the first four topics that the Panel requested the parties to address.

10. The EU’s approach to the other alleged subsidies is also misguided and evidences the extent to which the EU has attempted to eschew the constraints imposed by DSU Article 21.5. This is an obvious response to the U.S. compliance with the DSB’s recommendations and rulings, and the fact that the only remaining subsidy – the Washington B&O tax rate reduction – is simply too small. The EU’s claims in this regard concern the South Carolina measures, the

¹⁰ *Canada – Renewable Energy (AB)*, para. 5.120.

¹¹ *Canada – Renewable Energy (AB)*, para. 5.235.

¹² *US – Large Civil Aircraft (AB)* para. 760.

FAA's CLEEN program, and Washington measures other than the Washington B&O tax rate reduction. None of these measures share a close nexus with a measure taken to comply or the DSB's recommendations and rulings. The EU's claims also extend to the FSC/ETI tax measure and the subsidy associated with IRBs issued by Wichita, Kansas – subsidies which the United States has in fact already withdrawn. The desperate nature of the EU's case is further demonstrated by the claim that each and every measure in this dispute provides a subsidy that is both contingent on exports and also on the use of domestic over imported goods, in addition to being inconsistent with GATT Article III. The EU arguments fail with respect to all of these measures and claims.

11. Mr. Johnson will be addressing these issues in greater detail after I finish discussing the research and development measures challenged by the EU.

12. The EU's inclusion of measures outside the scope of this compliance proceeding is among the tactics employed by the EU to inflate the potential for adverse effects. In reality, there are no adverse effects caused by any un-withdrawn subsidies. To avoid this consequence and nevertheless seek a finding of non-compliance, the EU effectively abandons the framework from the original proceeding in favor of an entirely new case. For example, the EU attempts to establish product markets that are markedly different from those in the original proceeding and have no valid evidentiary support. The EU alleges that R&D subsidies now cause price effects, but fails to clearly identify which R&D subsidies cause price effects and which cause technology effects. The EU relies on this obfuscation to avoid dealing with the counterfactual launch of the 787 in 2006, and the broader absence of technology effects attributable to U.S. subsidies. The EU requests cumulation of alleged R&D subsidies with alleged price effects subsidies, despite that such subsidies were not cumulated in the original proceeding. The EU also fails to establish that untied subsidies alleged to cause price effects are capable of causing lower Boeing prices, and fails entirely to quantify the portion of such subsidies it alleges to be used for that purpose. Thus, the EU's adverse effects case not only does not follow from the DSB's recommendations and rulings, but the new case the EU pursues is not even explained sufficiently to allow an understanding of what is alleged, much less established as a legal matter.

13. Mr. Janovitz will be addressing these issues in greater detail.

I. RESEARCH AND DEVELOPMENT MEASURES

14. The United States thanks the Panel for its request that the parties address certain issues in their oral statement. To facilitate our discussion of the issues relating to whether U.S. R&D measures are specific subsidies, we will first discuss the legal framework for determining the existence of a financial contribution, and then apply that framework to each class of measures challenged by the EU. We will then do the same for benefit, and then for specificity. We will then close by addressing the terms of reference issue that the Panel has asked the parties to address.

A. Financial Contribution

1. Principles for evaluating the existence of a financial contribution

15. The legal analysis of whether a measure is a subsidy for purposes of the SCM Agreement begins with the question whether, to use the words of Article 1.1, “there is a financial contribution.” The Agreement defines this concept in terms of a list of categories, which are in turn defined by the characteristics of the measures in question – what if anything is provided, who provided it, who received it, and what the recipient provided in return. From the outset, it is clear that the analysis depends on these facts. If a measure is not in one of the Article 1.1 categories, it is not a financial contribution. This exercise also has implications for the analysis of whether the financial contribution confers a benefit, which depends on which one or more of the Article 1.1 categories the measure falls into.

16. The central legal problem with the EU’s arguments regarding financial contribution is that they seek to bypass this analysis. For the most part, the EU does not address the actual measures it is challenging – NASA, DoD, and FAA contracts and agreements with Boeing. Instead, it relies on generalized descriptions of certain programs administered by these agencies, and extrapolates the supposed characteristics of the transactions with Boeing without regard to, and often directly in contradiction to, the measures themselves. In essence, it is seeking to substitute broad and inaccurate generalizations for fact, which is insufficient to support a claim under the SCM Agreement.

17. This is not the approach indicated by the SCM Agreement, or taken in adopted reports that addressed the question of financial contribution. In particular, the Appellate Body in *US – Large Civil Aircraft* emphasized that the proper analysis starts by looking at *all* of the characteristics of the transactions in question, identifying which are relevant, and then examining whether the transactions fall into any of the categories of financial contribution.

18. In that dispute, and in *Canada – Renewable Energy*, the Appellate Body found that Article 1.1(a)(1) does not “preclude” the possibility of a transaction being more than one of the types of financial contribution.¹³ At the same time, the Appellate Body emphasized that the categories are “not the same” and set out “distinct legal concepts.”¹⁴ Its treatment of electricity purchase contracts under the feed-in-tariff (“FIT”) program illustrates the balance between the distinctions among the categories and the possibility that they overlap. The Appellate Body found, based on a detailed consideration of the facts, that there was a purchase of goods because the government obtained possession of a good by making a payment of some kind.¹⁵ It then considered Japan’s position that the FIT contracts could *also* be considered to be “direct transfers of funds,” a different category of financial contribution. The Appellate Body disagreed because “we do not see in Japan’s arguments any aspects different from, or in addition to, those

¹³ *Canada – Renewable Energy (AB)*, para. 5.119.

¹⁴ *Canada – Renewable Energy (AB)*, para. 5.120.

¹⁵ *Canada – Renewable Energy (AB)*, paras. 5.123-5.128.

characteristics that led us to agree with the Panel that the transactions at issue constitute government ‘purchases {of} goods.’¹⁶ In other words, a transaction does not fall into multiple categories under Article 1.1(a)(1) because a single set of facts is susceptible to competing interpretations. Rather, multiple categorization becomes possible only when, after the initial conclusion that the transaction fits in a category, there are additional significant characteristics that establish the existence of an *additional* (rather than an alternative) categorization.

19. The Panel has asked the parties to discuss the relevance of the characteristics of pre-2007 NASA procurement contracts and DoD assistance instruments, as identified in paragraph 611 of the Appellate Body report, to the characterization of other research and development measures in this dispute. The paragraph bears the title “summary of the main characteristics of the measures,” indicating that it sums up the extensive factual discussion that precedes it. That paragraph ends with the statement that those characteristics led to a conclusion that the transactions were “akin to a species of joint venture.” The Appellate Body’s subsequent analysis of this intermediate finding led to the legal conclusion that the measures were a “direct transfer of funds” and, therefore, a financial contribution. However, a footnote emphasized both that this finding was “based on the particular characteristics of those measures,” and in the following sentence, that the Appellate Body made no such finding with regard to any other measure.¹⁷

20. The EU views paragraph 611 as setting up a test under which a measure is “akin to a species of joint venture” and a “direct transfer of funds” if it possesses all of those factors, without regard to any other consideration. (The EU is explicit on this point, insisting that the Panel should stop its analysis once it has completed consideration of the paragraph 611 factors.¹⁸) This is not a valid reading of the Appellate Body’s reasoning. The report presents paragraph 611 as a “summary” of the lengthy discussion of the facts that precedes it, illustrating that the inquiry is highly fact-intensive. The comparable analysis in paragraphs 5.122 through 5.131 of *Canada – Renewable Energy* further supports this conclusion, as conducts a rigorous, thorough discussion of all of the relevant facts before coming to any conclusion. Thus, paragraph 611 does not establish a test. It is instead a list the “principal characteristics” of the measures before the Appellate Body, as derived from the facts laid out in paragraphs 593 through 610 of the report. A different set of facts could accordingly result in a different set of “principal characteristics.” For a different measure, one of the characteristics set out in paragraph 611 might be present, but not a “principal” characteristic. Or, it might be a “principal characteristic,” but lead to a different conclusion when considered in the light of other characteristics. Thus, the most that can be said is that the characteristics identified in paragraph 611 may be relevant, but that their weight and the conclusion they support depend on the facts.

¹⁶ *Canada – Renewable Energy (AB)*, para. 5.131.

¹⁷ *US – Large Civil Aircraft (AB)*, para. 620, note 1298.

¹⁸ EU Second Written Submission, para. 251.

21. In this particular proceeding, the factors identified in paragraph 611 take on an additional significance. Thus, if this test is insufficient, as the United States has shown to be the case, the EU has failed to make a *prima facie* case, and no further inquiry is necessary.

2. Application of the financial contribution analysis to the transactions at issue

22. At this point, it is useful to review how these principles apply to the transactions covered by the EU claims. As we have discussed these issues at length in our written submissions, we will focus here on a few key points. In particular, we assume that except as indicated by its questions, the Panel does not need further argumentation from us regarding the U.S. preliminary ruling request.

23. The first key point is that the various financial contributions alleged by the EU are, for the most part, not separate measures. Rather, the payments, any provisions of facilities, equipment, or employees, and any attribution of intellectual property rights are typically part of a single transaction. To attempt to extract one from the others creates a false and deceptive picture of the nature of the transaction. For example, to attempt as the EU does to look separately at provision of goods is to ignore that they are part of what the contractor gets to perform services for the government, rather like arguing that the buyer of an automobile gets the tires for free.

24. The second key point is that each of the relevant groups of transactions operates differently, and has different defining features. Thus, conclusions regarding pre-2007 NASA research contracts and DoD assistance instruments do not apply to DoD general research contracts, contracts under the DoD military aircraft program elements, the FAA CLEEN OTA, or post-2006 NASA contracts. The differing characteristics of these measures lead to different results. In particular:

- As the Appellate Body found, all DoD assistance instruments and the pre-2007 NASA contracts are “akin to a species of joint venture” and, therefore, a “direct transfer of funds” under Article 1.1(a)(i) of the SCM Agreement.
- For DoD contracts under the general research program elements, which in our view are outside the Panel’s terms of reference, the government contribution consists almost exclusively of payments of money, and the contractor commits almost exclusively to provide services. To take just one example, Air Force Contract FA8620-11-C-5212 provides for a payment of \$1.8 million on the government’s part, and performance of a statement of work (“SOW”) on the part of the contractor.¹⁹ That SOW is HSBI, but we can say by way of summary that it provides almost exclusively for the conduct of services.²⁰ Thus, these contracts are most accurately described as purchases of services.

¹⁹ Air Force Contract FA8650-11-C-5121, p. 2 (Exhibit USA-119(HSBI)).

²⁰ Air Force Contract FA8650-11-C-5121, SOW, pp. 27-30/55 (Exhibit USA-119(HSBI)).

- For the largest DoD military aircraft program elements, KC-46 and P-8A, the government contribution consists almost exclusively of payments of money, and the contract commits almost exclusively to provide goods. The KC-46 contract is a good example. It sets a firm fixed price, with some provisions rewarding efficient performance, for Boeing to deliver aerial refueling tankers to the U.S. Air Force. While the contract calls for testing and evaluation procedures, they are directed to the ultimate goal of procuring the military equipment for DoD. Thus, these transactions are most accurately described as purchases of goods.
- For many other “military aircraft” program elements, DoD purchased upgrades or enhancements that involved services rather than goods. The AWACS DRAGON project is a good example. DoD and ministries of defense in certain NATO countries, including many EU member States, paid Boeing to upgrade systems used on the AWACS aircraft. Although modernization involved some new equipment, the main effort was in integrating modern technology into the existing AWACS systems.²¹ Thus, these types of transactions are best understood as purchases of services.
- After 2006, NASA’s role changed in light of new budgetary realities and a modification of aeronautics research policies. Whereas NASA had previously made payments and provided facilities, equipment, and employees, in a new environment with drastically reduced funding for aeronautics research, its contribution consisted almost exclusively of payments, while Boeing provided almost exclusively its own facilities, equipment, and employees. Contract NNL07AA48C provides a good example, specifying only payments on the part of NASA, and research activities on the part of Boeing.²² Thus, these types of transactions are best understood as purchases of services.

25. The EU has never disputed the facts that we have outlined with respect to DoD contracts under the general research program elements, some of the contracts under the “military aircraft” program elements, and post-2007 NASA contracts. It has argued instead that other considerations support the conclusion that the transactions are “direct transfers of funds,” and that the Panel should simply disregard the fact that the government paid money to obtain services, and gloss over other significant ways in which these transactions differ from the measures found to be WTO-inconsistent subsidies. Our final key point is to reiterate that a proper evaluation of the existence of a financial contribution requires a consideration of all of the characteristics of a transaction. Considered in this context, the principal characteristics of these transactions are that the government provides primarily money, and the contractor provides primarily non-monetary services in return. Thus, these transactions were purchases of services.

²¹ Air Force Contract FA19628-01-D-0016, p. 3 (Exhibit EU-170).

²² Contract NNL07AA48C (Exhibit US-105).

26. The United States has explained in its submissions why purchases of services are not a financial contribution, and we will not repeat those points in this oral presentation. We will only emphasize that even if the Panel finds that a transaction properly characterized as a purchase of services is a financial contribution, the fact of a purchase is relevant to the analysis of whether the transaction confers a benefit.

3. *Implications of Canada – Renewable Energy*

27. The Panel has asked the parties to discuss the implications of the Appellate Body’s reasoning in *Canada – Renewable Energy* to transactions involving a procurement of services. Given the framing of the request, we will first discuss purchases of services in general, before showing that the facts of this proceeding indicate a procurement of services.

28. When presented with a transaction involving a procurement of services, a panel would first have to consider all characteristics of the transaction, scrutinize its “design and operation”, and “identify its principal characteristics { }.” It would also have to remain open to the possibility that the transaction, in the words of the Appellate Body, “may be complex and multifaceted.”²³ Based on its conclusion as to the “principal characteristics” of the measure derived from that exercise, the panel would need to examine whether “different aspects of the same transaction may fall under different types of financial contribution.”²⁴

29. This portion of the analysis presents a consideration on which the Panel’s hypothetical is silent – whether the “principal characteristics” of the transaction indicate a “procurement of services” or whether the procurement aspects are not “principal characteristics.” For the sake of simplicity, we’ll refer to that latter situation as one in which the procurement aspect is ancillary to the transaction. It appears that if the procurement of services was ancillary to the transaction, that aspect would not alter the analysis of whether there was a financial contribution. To give one example, the FIT contracts addressed in *Canada – Renewable Energy* involved the provision of electricity, which the panel and the Appellate Body treated as a good. It is quite likely that in the process of generating and transmitting that electricity to the government purchaser, the supplier performed a variety of services. However, these did not affect the analysis.

30. Assuming that the facts indicating a procurement of services are “principal characteristics,” *Canada – Renewable Energy* indicates that a panel would have to consider whether there are other principal characteristics indicating another aspect of the transaction. In this regard, the Appellate Body’s handling of Japan’s claim that FIT contracts also involved a “transfer of funds” is instructive. It found that there were no principal characteristics *in addition to those indicating a purchase of goods* that supported a finding of a transfer of funds.

31. To summarize, *Canada – Renewable Energy* indicates that a panel first needs to “scrutinize” the transaction in question to identify all of the principal characteristics. If some of

²³ *Canada – Renewable Energy (AB)*, para. 5.120.

²⁴ *Canada – Renewable Energy (AB)*, para. 5.120.

those principal characteristics indicate a procurement of services, it must also examine other principal characteristics to determine whether they indicate another “aspect” to the transaction. The panel must then evaluate whether the indicated aspects of the transaction are financial contributions.

32. The Appellate Body did not indicate in *Canada – Renewable Energy* whether a purchase of services is a financial contribution. For the reasons set out in our submission, we think that this is not the case.

33. We will close the discussion of financial contribution by applying this framework to the six groups of transactions challenged by the EU:

- **Pre-2007 NASA contracts and DoD assistance instruments.** The Appellate Body found the principal characteristics to be: both parties contribute resources, research topics are determined collaboratively, and both parties enjoy the fruits of the research. In the case of NASA, that involves use of aeronautics in U.S. government activities, and the dissemination of the results to the broader community. In the case of DoD, the referenced assistance instruments invest in dual-use technologies that ultimately benefit military applications.
- **DoD contracts under “general research” program elements.** Principal characteristics are that the government pays money, Boeing performs activities that constitute services, and the parties share any intellectual property resulting from those activities. Any government facilities, government property, or government employees involved in the transaction are so minor in value as to be ancillary to these objectives and, therefore, do not affect the analysis. The intellectual property provision should not affect the outcome either, because it is one of the results of the funded activity, and does not separately provide anything.
- **Post-2006 NASA contracts.** In light of significant changes in NASA’s contracting practices and major changes in aeronautics research programs, the legal outcome should be the same as with the DoD contracts under the general research program elements.
- **DoD contracts under the “military aircraft” program elements.** For systems acquisition contracts, the principal characteristics are that the government pays money and Boeing provides weapons systems. Given the amount of money at issue and the fact that systems contracts usually deal with relatively mature technologies, the division of intellectual property is ancillary to the transaction. This is also true of any government facilities, government property, or government employees involved in the contract.
- **The FAA CLEEN OTA.** Principal characteristics are that Boeing provides the majority of funding for environmental research that the FAA is interested in pursuing for its own public policy goals.

34. In line with this analysis, the United States respectfully requests the Panel to find that:

- DoD contracts under the “general research” program elements, post-2006 NASA contracts, and DoD contracts for improvements and upgrades under the “military aircraft” program elements are purchases of services and, as such, are not financial contributions.
- Pre-2007 NASA contracts and DoD assistance instruments were found to be “akin to a species of joint venture” and are, as such, “analogous to equity infusions” covered by Article 1.1(a)(1).²⁵ We emphasize that we take this view exclusively with regard to application of the SCM Agreement, and that this is not the view of the United States with respect to the characterization of these instruments under domestic law.
- DoD contracts for systems acquisitions under the “military aircraft” program elements are a purchase of goods.
- The FAA CLEEN OTA is “akin to a species of joint venture” in which the contractor provides the majority of the funding.

B. Benefit

35. We now move on to the question of benefit. The Panel has in particular asked the parties to discuss the implications of the Appellate Body’s reasoning on this issue in *Canada – Renewable Energy* to transactions involving procurement of services.

1. Legal framework

36. The Appellate Body began the analysis in *Canada – Renewable Energy* by referring back to its finding in *Canada – Aircraft* that “whether a benefit has been conferred should be determined by assessing whether the recipient has received a “financial contribution” on terms more favourable than those available to the recipient in the market.”²⁶ It confirmed that Article 14 of the SCM Agreement is “relevant context to determine whether a subsidy exists.”²⁷ This is uncontroversial, and applies to the evaluation of the benefit conferred by any financial contribution.

37. The Appellate Body further found that in evaluating a government purchase of goods:

{a} determination of the existence of a benefit under Article 1.1(b), read in the context of Article 14(d) of the SCM Agreement, requires a comparison between

²⁵ *US – Large Civil Aircraft (AB)*, para. 624.

²⁶ *Canada – Renewable Energy (AB)*, para. 5.163 (citing *Canada – Aircraft (AB)*, para. 157).

²⁷ *Canada – Renewable Energy (AB)*, para. 5.163 (citing *Canada – Aircraft (AB)*, para. 155).

actual remuneration and a market-based benchmark or proxy, and thus between amounts, in order to determine the existence of a benefit.²⁸

If remuneration is “adequate” relative to prevailing market conditions for the good in the country of purchase, there is no benefit.

38. The Appellate Body also emphasized that “the burden was on the complainants to identify a suitable benchmark and to make adjustments, where necessary.”²⁹ It considered that there were a wide variety of options – prices in the same market, an out-of-country benchmark, or a constructed benchmark.³⁰ Where there is a government administered price, a conclusion regarding benefit may be drawn from “{a}n analysis of the methodology that was used to establish the administered prices,” or from “price-discovery mechanisms such as competitive bidding or negotiated prices, which ensure that the price paid by the government is the lowest possible price offered by a willing supply contractor.”³¹

39. This guidance would certainly apply to the purchases of goods at issue in this dispute, namely, the DoD purchases of weapons systems. Assuming *arguendo* that a purchase of services is a financial contribution, in spite of its conspicuous omission from Article 1.1(a)(1)(iii), the same logic would apply by implication to purchases of services. There is a strong analogy to the Article 14 standard for evaluating purchases of goods and provisions of goods and services. Since governments are often in the position of buying or providing goods and services that private actors do not, or under conditions in which private actors do not act, the best “benchmark or proxy” will be what a private actor would charge or pay in comparable circumstances. To find otherwise, that the mere purchase or provision of a good or service unavailable to or from a private sources confers a benefit without regard to the other terms, would result in WTO inconsistency for the purchase or provision of many public goods and services.

40. As with a purchase of goods, the burden of identifying a suitable benchmark would fall on the complaining party. The EU has thoroughly failed to carry this burden.

41. In this regard, it is useful to consider the Appellate Body’s application of these legal principles to the facts before it in *Canada – Renewable Energy*. There, the Appellate Body rejected the argument that it could find the FIT program to confer a benefit because solar photovoltaic and wind energy producers would not be able operate in the Ontario market in the absence of the subsidy.³² It found that the proper benchmark was what the market would charge for the goods in question, and not whether the good would be provided at all.

²⁸ *Canada – Renewable Energy (AB)*, para. 5.165.

²⁹ *Canada – Renewable Energy (AB)*, para. 5.216.

³⁰ *Canada – Renewable Energy (AB)*, para. 5.226.

³¹ *Canada – Renewable Energy (AB)*, para. 5.228.

³² *Canada – Renewable Energy (AB)*, para 5.196.

42. This reasoning is not unique to government purchases and provisions of goods and services. To give another example, in *EC – Large Civil Aircraft*, the panel and Appellate Body were unable to find a commercial entity that provided financing comparable to LA/MSF. Under the approach taken by the EU in this proceeding, that would be the end of the analysis – the financing would confer a benefit because its terms are unavailable in the market. Instead, the panel constructed a proxy benchmark based on the terms of other forms of financing. Thus, it is not enough to show merely that one term of a government transaction is unique to the government – a complaining party must show that the government charged less (or paid more) for the transaction than a private actor would have charged or paid.

43. The Appellate Body also made a number of observations regarding the need to identify the proper market for making a comparison. The United States considers that those observations apply equally to the identification of a benchmark for a procurement of services. However, as neither party has challenged the appropriateness of comparisons based on the U.S. market, this finding does not appear to be applicable in this proceeding.

44. The EU’s failure to follow this guidance means that it has failed to establish the existence of a benefit for any of the six groups of transactions at issue in this proceeding.

2. *Measures taken to comply – NASA contracts and DoD assistance instruments as modified by the Licensing Agreements*

45. Now we will turn to the application of these principles to the measures at issue. The question clearly presented by this proceeding is whether the United States has complied with its obligations with regard to pre-2007 NASA contracts and DoD assistance instruments, which are the only R&D measures that were found to be inconsistent with WTO obligations. The EU has no credible argument on this point.

46. The Appellate Body found the NASA contracts and DoD assistance instruments to be transactions “akin to a species of joint venture” that “involve monetary and non-monetary contributions” in which “the subjects to be researched are often determined collaboratively” and “[t]he fruits of the research are shared.”³³ Thus, a proper benchmark would need to have these characteristics, allowing a comparison to determine whether the terms of the government transaction were more favorable than those available in the market. However, the benchmarks proposed by the EU fail this test. Regina Dieu’s statement from the original proceeding, as endorsed by Alistair Scott in this proceeding, describes a one-sided transaction in which one party provides all of the funding, and the other party retains none of the fruits of the research. It is accordingly not comparable to a transaction “akin to a species of joint venture.” The 2002 NIAR³⁴ contract cited by the EU is, in fact, atypical of that organization’s transactions. As Dr. Tomblin’s statement establishes, under a typical NIAR contract, the party performing the research gets rights similar to those available under the government measures at issue here.

³³ *US – Large Civil Aircraft (AB)*, para. 611.

³⁴ National Institute of Aeronautics Research.

Thus, the reference to NIAR’s practices supports only a finding that there is no benefit. And, articles advising parties to a research venture to maximize the rights they receive are merely advice that would apply equally to both parties to a transaction involving intellectual property. They do not establish, as the EU argues, that one party would always walk away with all of the rights, and the other party with none.

47. In short, the EU has cited nothing that would support its assertion that a private party entering into this “species of joint venture” would never accept the division of intellectual property rights that NASA and DoD did in the modified transactions. It is also important to underscore that the EU’s assertions address the wrong question. They focus on isolated examples of selected elements of certain transactions, despite the Appellate Body’s findings that “the market does not dictate a single outcome in the negotiation of intellectual property rights” and that there is a “diversity in the disposition of rights.”³⁵ Furthermore, even if the EU could prove that there was no market instrument providing substantive terms identical to these contracts and agreements, that would not end the benchmarking exercise. It would need to identify some proxy for a market transaction. The EU’s failure to do so means it has failed to meet the complainant’s burden of proof set out in *Canada – Renewable Energy*: “to identify a suitable benchmark and to make adjustments, where necessary.”³⁶ In WTO dispute settlement, that means that the EU’s claims have failed.

48. The United States has gone further to rebut the EU’s arguments. We have submitted a number of transactions demonstrating that the EU is wrong to assert that the market has a monolithic practice in which parties performing paid research never retain any of the rights to any intellectual property they create. In fact, our evidence demonstrates that market transactions, including Contract D, can be at least as favorable to the entity performing research as these government transactions were to Boeing. Much of this information is BCI, but our submissions and the Berneman Report discuss it in some detail. Thus, there is no basis to consider that these government transactions, as modified by the Licensing Agreements, provide anything to Boeing on terms more favorable than the market would provide.

49. We were surprised to see the EU’s assertion in its oral statement that the U.S. Constitution prohibits use of the rights the U.S. Government obtained under the Licensing Agreements. That is not our view, and we consider that we are in a better position to judge the application of the U.S. Constitution. Nonetheless, we will refer the EU arguments back to NASA and DoD Constitutional law experts.

³⁵ *United States – Large Civil Aircraft (AB)*, para. 653.

³⁶ *Canada – Renewable Energy (AB)*, para. 5.216.

3. Other aeronautics R&D measures – DoD contracts under the “general research” program elements, DoD contracts under the “military aircraft” program elements, and the FAA CLEEN OTA

50. We now move on to a discussion of whether the other aeronautics R&D measures would confer a benefit if they were financial contributions. The evidence shows that they do not.

51. The Panel has asked the parties to discuss the relevance to this inquiry of the evidence that the Appellate Body used to complete the analysis regarding NASA contracts and DoD assistance instruments. The Panel asked the parties to discuss this issue in light of certain findings made in *Canada – Renewable Energy*. The Appellate Body’s reasoning indicates that the evidence cited by the Panel, consisting of Contracts A through F, has no relevance to the analysis of benefit for procurement of services, such as the other aeronautics research and development measures.

52. In paragraph 5.130 of the *Canada – Renewable Energy* report, the Appellate Body noted that the “characterization of a transaction under Article 1.1(a) of the SCM Agreement may have implications for the manner in which the assessment of whether a benefit is conferred is to be conducted.”³⁷ In particular, Article 14 of the SCM Agreement indicates that the method for calculating the value of the benefit will depend on the type of financial contribution at issue. Thus, the fact that the other R&D transactions involve purchases of services or purchases of goods means that the analysis of the existence of a benefit will differ from a transaction treated as a “species of joint venture.” Specifically, the evaluation will focus on the adequacy of remuneration paid by the government for what it obtained from the contractor.

53. Paragraphs 5.183 through 5.185 of the *Canada – Renewable Energy* report elaborate on the terms of this inquiry. The Appellate Body noted that “[t]he adequacy of remuneration is only one aspect of the Article 14(d) comparison, the other being the ‘prevailing market conditions’ in the country of purchase.”³⁸ If that market is distorted so that transactions do not reflect what a market would offer, “it is possible to resort to an out-of-country benchmark or to a constructed benchmark, provided that the necessary adjustments are made to reflect conditions in the market of purchase.”³⁹

54. These findings have two important implications for these proceedings. First is the focus on conditions in the market of purchase. Article 14(d) specifies that these include “price, quantity, availability, marketability, transportation and other conditions.” Given that the standard is adequate remuneration, this list suggests that the proper comparison would identify or create a benchmark similar to the government transaction in all non-price factors, and determine whether the price for that benchmark is more favorable to the recipient than the price for the government transaction. The second is that if the benchmark does not accurately reflect

³⁷ *Canada – Renewable Energy (AB)*, para. 5.130.

³⁸ *Canada – Renewable Energy (AB)*, para. 5.183 (emphasis in original).

³⁹ *Canada – Renewable Energy (AB)*, para. 5.184.

conditions in the market, it must be either adjusted or replaced by a benchmark that does reflect those conditions. The observations regarding distorted markets do not appear to be relevant, as neither party has asserted that the U.S. market for research and development services is distorted.

55. Yet the EU ignores the Appellate Body’s call for a proper comparison. Rather than providing a benchmark that is, like the transactions at issue, a purchase of services or a purchase of goods, the EU refers back to the same evidence of joint venture agreements that it submitted in the original proceeding. In essence, it asks the Panel to gloss over the significant heterogeneity among the different NASA and DoD contracts and agreements before it, and recycle a limited selection of old evidence used by the Appellate Body to address a different question. And, even in its consideration of the transactions, the EU errs in addressing only one term of the transactions – the allocation of intellectual property rights. It ignores both other conditions and the price paid and, in so doing, fails to identify and adjust for any differences.

56. Finally, in paragraph 228 of the *Canada – Renewable Energy* report, the Appellate Body discusses ways in which a panel might address “government-administered prices.” For the FIT program, these were standard prices calculated by a government agency to allow suppliers of renewable energy to recover their development costs plus a reasonable rate of return.⁴⁰ The Appellate Body found that in this situation, “a complainant would have to show that such prices do not reflect what a market outcome would be.”⁴¹ Ways to address this question might include evaluation of the methodologies used to set the price, to the extent they revealed whether remuneration was more than adequate. It might also rely on other benchmarks “found in price-discovery mechanisms such as competitive bidding or negotiated prices, which ensure that the price paid by the government is the lowest possible price offered by a willing contractor.”⁴²

57. Neither party has asserted that the prices NASA, DoD, and the FAA paid were administered in this fashion. However, the Appellate Body’s observations remain relevant to other situations in which a directly comparable benchmark is not available. For example, the procedures used to determine the price paid to a contractor could provide assurance that the remuneration was no more than adequate. In this regard, the United States notes that DoD contracts and the FAA CLEEN OTA both used a system of cost reimbursement. The DoD procurement contracts included an additional “fee”, which would provide any profit the contractor would receive. The CLEEN OTA did not. Both types of instruments were subject to competitive bidding processes. Both parties in this proceeding agree that manufacturers in the aeronautics sector decide how to use their resources based on the cost and the likely return. The Appellate Body itself has found that a bidding process is designed to achieve the lowest possible price from a willing supplier.⁴³ Therefore, the pricing methodology adopted in the DoD contract

⁴⁰ *Canada – Renewable Energy (AB)*, para. 4.23.

⁴¹ *Canada – Renewable Energy (AB)*, para. 5.228.

⁴² *Canada – Renewable Energy (AB)*, para. 5.228.

⁴³ *Canada – Renewable Energy (AB)*, para. 5.228.

and the FAA CLEEN OTA ensured that they provided no more remuneration than was adequate for the work conducted by Boeing, and the EU has never demonstrated otherwise.

58. We were surprised this morning to hear the EU's characterization of the Appellate Body's finding on this point. The Appellate Body found that: “The United States also argues that the USDoD opened each of the assistance instruments to competitive bidding and that, if Boeing had been seeking non-market terms for its participation in the research, one of the USDoD’s other suppliers of aeronautics research would have bid less. This argument, however, fails to recognize the fact that ownership of any intellectual property is not open to bidding: it is determined by US law.”⁴⁴ Thus, the Appellate Body's finding applies only to DoD assistance instruments, which were found to be “akin to a species of joint venture.” The Appellate Body did not address DoD procurement contracts – precisely the type of instrument at issue in *Canada – Renewable Energy*.

59. The United States emphasizes that the EU has failed even to address the relevant legal standard set out in Article 14(d). The benchmarks cited by the EU are not relevant to an evaluation of the other research and development contracts, as they are not sufficiently comparable to the government transactions. Therefore, the United States does not bear the burden of showing that remuneration under these transactions was no more than adequate. Nevertheless, should the Panel seek to go further, the procedures used to set the price in those instruments ensured that they did not provide more than adequate remuneration.

C. Specificity

60. The EU makes the same argument on specificity with regard to all of the research and development measures that it challenges – that because each of the issuing agencies has responsibility for a particular sector, everything they do is specific to that sector. The EU tried that argument before the original panel and the Appellate Body, and failed both times. The specificity inquiry is not confined to the particular entity issuing a measure when that entity is acting pursuant to broadly applicable legislation. That is the case with the subsidies the EU alleges to exist, which consist of entering into transactions akin to joint ventures with intellectual property provisions supposedly more favorable than a market transaction would provide. Those aspects of the transactions are governed by broader U.S. government procurement regulations, which apply over all agencies in all sectors. They are accordingly not specific.

61. To take this issue from the opposite perspective, let us assume *arguendo* that the attribution of intellectual property rights at issue in this dispute was a subsidy. The Appellate Body’s finding in *US – Large Civil Aircraft* would signify that the United States is entitled to maintain that subsidy because it is not specific. The EU’s effort to challenge provisions of that measure through the vehicle of a government contract – the vehicle specified in the laws and

⁴⁴ *US – Large Civil Aircraft (AB)*, para. 665 (footnotes omitted).

regulations that the Appellate Body found to be not specific – is nothing more than a collateral challenge to the Appellate Body’s findings.

D. Whether Procurement Contracts under the 23 Original DoD Program Elements are within the Panel’s Terms of Reference

62. Finally, the Panel asked the parties to discuss the Appellate Body’s interpretation of Article 1.1(a)(1) of the SCM Agreement and its implications for evaluating whether the terms of reference in this proceeding include procurement contracts under the 23 original DoD program elements. The Appellate Body’s findings underscore that the EU did not appeal the original panel’s finding that those measures were not inconsistent with the SCM Agreement. Therefore, the finding of the original panel was adopted by the DSB, and is not subject to re-litigation in this proceeding.

63. This Panel asked in particular for a discussion of paragraphs 590, 620, and footnotes 1297 and 1298 of the *US – Large Civil Aircraft*. In both paragraphs, the Appellate Body describes “the measures before us” or “the dispute before us” as being “NASA procurement contracts and USDOD assistance instruments.” The omission of “USDOD procurement contracts” from these descriptions of the matter signals that the Appellate Body did not consider those measures to be “before us.” The two footnotes confirm this conclusion. Footnote 1298 clarifies that the Appellate Body’s findings apply only to NASA procurement contracts and DoD assistance instruments “based on the particular characteristics of those measures.” Footnote 1297 refers to the treatment in *US – Upland Cotton* of claims under Article 6.3(d) of the SCM Agreement. Brazil sought to appeal the interpretation of Article 6.3(d). However, in light of certain other Appellate Body findings did not seek reversal of the panel’s ultimate conclusion that a measure was not inconsistent with Article 6.3(d) of the SCM Agreement. The Appellate Body declined to address the appeal because it was “unnecessary for purposes of resolving this dispute.”⁴⁵ This reference further indicates that the Appellate Body viewed the panel’s ultimate disposition regarding DoD procurement contracts as a finding the EU did not appeal and, therefore, unnecessary for purposes of resolving the dispute. Thus, the situation is markedly different from disputes in which the panel or Appellate Body makes a decision on its own not to resolve claims that the complaining party is pursuing.⁴⁶

64. As the United States has pointed out, the Appellate Body has found that a party is not entitled to use Article 21.5 to obtain an “unfair second chance” to litigate an issue already settled in the original proceeding.⁴⁷ As the original panel’s report, as modified by the Appellate Body, made no finding that DoD procurement contracts were WTO inconsistent, that issue is settled. There is an exception to this principle where the Appellate Body in the original proceeding could

⁴⁵ *US – Upland Cotton (AB)*, para .511.

⁴⁶ *E.g., EC – Bed Linens (15) (AB)*, para. 96, note 115, and *US – Oil Country Tubular Goods (21.5) (AB)*, Para. q4i\

⁴⁷ U.S. Second Written Submission, para. 22.

not complete the analysis with respect to a measure.⁴⁸ However, that exception does not apply in this case, where the Appellate Body considered that the EU had not appealed the relevant finding. Therefore, the EU is not entitled in this compliance proceeding to re-litigate its failed challenge to DoD procurement contracts under the 23 original program elements.

II. OTHER MEASURES

65. As to the EU’s remaining subsidy claims, here, too, the EU seeks to exaggerate the size of financial contributions that, if they were subsidies, would simply be too small to cause the adverse effects alleged by the EU.

66. Of these other measures, only the Washington B&O tax rate reduction is properly within the terms of reference of this proceeding and has not been withdrawn. However, the United States has taken appropriate steps to remove its adverse effects, which were found to exist only in aggregation with other subsidies that we have since withdrawn. This single measure, even according to the EU’s own flawed and inflated estimates, is simply too small to cause the adverse effects alleged by the EU. However, as with the research and development measures, the EU seeks to mask the small size of the subsidy by challenging measures that have no relation to the original measures or to the steps the United States has taken to comply with the DSB’s recommendations and rulings.

67. First, I will address the EU’s claims concerning measures that are not properly within the terms of reference of this compliance proceeding: the South Carolina measures, the Federal Aviation Administration’s CLEEN program, and each of the Washington measures *other* than the state B&O tax rate reduction. Second, I will address the EU’s claims concerning subsidies that the United States has in fact already withdrawn: the FSC/ETI tax measure and the subsidy associated with industrial revenue bonds (“IRBs”) issued by Wichita, Kansas. Afterwards, I will touch briefly on the EU’s prohibited subsidy and Article III GATT claims. The EU arguments fail with respect to all of these measures and claims.

A. Measures Not Within the Terms of Reference of This Compliance Proceeding

1. South Carolina Measures

68. The EU has now briefed the South Carolina scope issue three times since the preliminary stage of this dispute, in its two written submissions and in its supplemental scope submission. I would like to begin by observing that these three discussions do not cite any WTO panel or

⁴⁸ *US – Upland Cotton (21.5)*, para. 210.

Appellate Body reports, even in the footnotes.⁴⁹ The EU does not even cite the original panel and Appellate Body reports in its South Carolina scope discussions.⁵⁰

69. This is quite striking. It shows that the EU has not been able to find one adopted report in which the close nexus test has been applied analogously to the situation in this dispute. It shows that the EU is inviting the compliance Panel to radically depart from the approach of prior panels and the Appellate Body on close nexus. The EU interprets the close nexus test so loosely that responding Members would incur compliance obligations much broader than the measures challenged in the original dispute. In particular, the EU urges the Panel to break from past panel and Appellate Body reports in three respects: by ignoring the absence of any similarity in terms of the measures' design and architecture, by ignoring the absence of any overlap in their geographical scope, and by ignoring the absence of any link in terms of effects. I will now discuss each of these three points in greater detail.

70. The first point of divergence from adopted panel and Appellate Body reports relates to the absence of any similarity between the Washington State B&O tax rate reduction and the South Carolina measures in terms of the design and architecture of the measures – an aspect of a measure's nature. A close similarity in terms of the design and architecture of the measures has featured prominently in every past application of the close nexus test. For example, in *US – Upland Cotton*, both the original measures and the undeclared measures taken to comply were countercyclical loan and marketing loan payments, whose terms and conditions were determined by identical provisions of U.S. law.⁵¹ In *US – Zeroing (21.5 – EC)*, the undeclared measures taken to comply were all determinations relating to antidumping duties found to be WTO-inconsistent involving the same methodology, *i.e.*, zeroing. Similarly, in *US – Softwood Lumber IV (21.5)*, the original measure and the undeclared measure taken to comply were determinations in the same countervailing duty proceedings for softwood lumber, where the applicable duty rates were determined according to a particular pass-through methodology. Likewise, in *Australia – Salmon (21.5)*, the original measure and the undeclared measure taken to comply were both bans on salmon imports. Thus, in every case where a compliance panel has found a measure to constitute an undeclared measure taken to comply, that measure had a similar design and architecture as the measure at issue in the original dispute.

71. However, there is no such commonality here. The EU is challenging a hodgepodge of 14 different South Carolina measures, including:

- a sublease for damaged industrial land that Boeing assumed from Vought, a former supplier;

⁴⁹ See EU First Written Submission, paras. 50-55; EU Supplemental Scope Submission, paras. 27-33; EU Second Written Submission, paras. 147-152.

⁵⁰ See EU First Written Submission, paras. 50-55; EU Supplemental Scope Submission, paras. 27-33; EU Second Written Submission, paras. 147-152.

⁵¹ See *US – Upland Cotton* (Panel), para. 7.200.

- the alleged provision of facilities and infrastructure on that land;
- three “FILOT” agreements, which allow Boeing to pay a “fee in lieu” of property taxes through the same legal arrangement that covers the majority of industrial property in the State;
- an agreement clarifying how Boeing may apportion income for state tax purposes;
- corporate income tax credits for the creation of new jobs in any industry;
- the readySC workforce training program, which has trained employees of a wide variety South Carolina companies since 1961;
- certain sales and use tax exemptions that are available to South Carolina taxpayers in any industry;
- a property tax exemption for large cargo freighter airplanes (“LCFs”);
- a land sale that has not taken place; and
- an issuance of state economic development bonds that has also not taken place.

72. The EU alleges that all of these measures, several of which pre-date the EU’s panel request in the original proceeding, and many of which are generally available within the state, have a close nexus with Washington State’s reduction of the state-wide B&O tax rate for manufacturers of commercial airplanes or components of such airplanes. Yet none of the South Carolina measures functions like a reduction in the statewide B&O tax rate. Indeed, most of them do not affect Boeing’s tax liability at all. Even for those that do, the measures do not have a similar structure to the B&O tax rate reduction.

73. The EU does not even try to argue that they do have such a similarity individually. Rather, the EU argues that there is a similarity in terms of nature because both the South Carolina measures and the B&O tax rate reduction come in packages. In particular, the EU categorizes the South Carolina measures into three groups – Project Gemini, Project Emerald, and Phase II – and it notes that the B&O tax rate reduction was part of Project Olympus.⁵² Supposedly, this is evidence of a close nexus. Yet the EU neglects to note that “Project Olympus” was not found to be WTO-inconsistent. In fact, most parts of Project Olympus were found by the original panel and Appellate Body to be WTO-consistent. In any case, “coming in packages” is not enough of a resemblance to warrant a finding of close nexus. Likewise, “not coming in packages” is not a sufficient similarity, either. The close nexus test requires more than such a superficial similarity which says nothing about what those packages contain and whether the measures contained therein are similar in terms of their nature. Rather, it requires a resemblance in terms of design and architecture, which is absent in this case.

⁵² EU First Written Submission, para. 755.

74. Second, with respect to geographical scope: unlike the South Carolina measures and the Washington State measures now before the Panel, every past application of the close nexus test has involved measures with overlapping geographical scope, which is another aspect of the nature and effects of a measure. For example, in *US – Upland Cotton (21.5)*, the compliance panel and Appellate Body considered measures which were federal-level cotton subsidies, just like the measures at issue in the original dispute. In *US – Zeroing (21.5 – EC)*, the compliance panel and Appellate Body considered federal-level antidumping duty determinations, again just like the measures at issue in the original dispute. In *Australia – Salmon (21.5)* as well, the original panel found that a nationwide salmon import ban was WTO-inconsistent, and the compliance panel found that a salmon import ban that covered the Australian province of Tasmania was within its terms of reference. Although the geographical scopes of these two import bans were not coextensive, they overlapped: the original import ban covered all of Australia, and therefore the reinstatement of an import ban in Tasmania constituted a partial survival of the original measure.

75. By contrast, in this dispute, the EU asks the compliance Panel to find a close nexus between measures with completely non-overlapping geographical scope: the alleged South Carolina measures and the Washington State measures. This is something that no panel has ever done, and the EU has not provided any basis in the text of the DSU or prior panel and Appellate Body reports for the Panel to endorse such a radical position.

76. The third break from prior applications of the “close nexus” test is that the EU asks for a close nexus finding despite its failure to establish any commonality in terms of effects, based on the facts of this dispute. The EU alleges that there is a link in terms of effects due to an alleged competition between states: supposedly, if South Carolina had not provided Project Gemini to Boeing in 2009, then Boeing would have located the second 787 assembly line in Washington State instead, leading to a higher value of Washington State subsidies. However, this argument neglects to articulate a reason why Project Emerald and Phase II should be within the Panel’s terms of reference. Moreover, even with respect to Project Gemini, there is no evidence to support the EU theory. In fact, a document reflecting the Boeing Board of Directors’ deliberations with respect to the second 787 assembly line shows that other factors were the key drivers. Boeing’s interest in adding “geographical diversity” to its supply chain; its belief that moving to South Carolina would add “important political support from a key state”; and its belief that it could achieve efficiencies and cost savings from having LCA manufacturing facilities close to Boeing’s existing suppliers, Vought and Global Aeronautica, all drove Boeing to South Carolina – not Project Gemini.⁵³ Confidential information also confirms that the South Carolina incentives did not drive the Board’s decision. Aside from third-hand press reports, the EU does not submit any evidence to support its claims, and therefore there is no factual basis for a finding of close nexus in terms of effects.

⁵³ *Gemini Update*, Boeing Board of Directors (Oct. 19, 2009) (Exhibit USA-323), p. 6; U.S. Second Written Submission, para. 91.

77. To sum up, the EU interpretation of the close nexus test implies that findings in an original dispute automatically entail compliance obligations with respect to measures that (i) have no similarity in terms of their design and architecture, (ii) cover completely separate and distinct geographical regions, and (iii) have no link in terms of effects. The implication of this interpretation is that the only necessary connection between the two measures is the identity of the private party allegedly being subsidized. Yet even the EU itself shies away from asserting that “the identity of the recipient turns all Boeing subsidies into measures taken to comply”.⁵⁴

78. Beyond these points, I would like to touch briefly on two ancillary scope arguments that the EU has made with respect to Project Emerald and the apportionment agreement. First, the EU at one point advanced a one-sentence argument that there is a close nexus between Project Emerald and the Kansas IRBs, because (and I quote): “both are subsidies for Boeing’s LCA-component manufacturing facilities and consist primarily of property tax breaks related to such facilities.”⁵⁵ Apparently, this argument is supposed to allege a similarity in terms of nature between Kansas IRBs and Project Emerald. As an initial matter, this argument ignores the fact that the Kansas IRBs and Project Emerald have no link in any respect. Furthermore, the EU argument incorrectly characterizes Project Emerald as consisting “primarily” of property tax breaks. In fact, according to the EU itself, most of the value of the alleged financial contributions under Project Emerald comes from income tax credits for the creation of new jobs, and the provision of LCA manufacturing facilities and infrastructure for Boeing’s use, neither of which affects Boeing’s property tax liability.

79. The EU also alleges a close nexus with Kansas IRBs because Project Emerald includes a fee-in-lieu of taxes (“FILOT”) agreement between Vought and South Carolina, which Boeing eventually assumed when it purchased Vought. However, the FILOT and Kansas IRBs have no connection whatsoever in terms of effects, nor does the EU allege any. Moreover, in terms of nature, the fact that one element of Project Emerald pertains to property taxes does not mean that the project has a close nexus to any other measure of another state that also pertains to property taxes. Rather, they have different granting authorities and operate through very different legal mechanisms. The original panel described the IRB as a “circular flow of money” partially reducing property *and sales* taxes on the one hand,⁵⁶ whereas, on the other hand, the FILOT is a fee-based arrangement entirely replacing Boeing’s property taxes, but not directly affecting its sales and use taxes.

80. The EU’s second ancillary scope argument is that the income allocation and apportionment agreement has a close nexus with the FSC/ETI measure, because (and I quote) it “substantially replicates the prohibited FSC/ETI subsidy on a state level”.⁵⁷ However, the EU fails to support its assertion through an examination of the design, architecture, and effects of the

⁵⁴ EU First Written Submission, para. 735 (describing a U.S. characterization of the EU’s argument).

⁵⁵ EU First Written Submission, para. 735.

⁵⁶ *US – Large Civil Aircraft (Panel)*, para. 7.658.

⁵⁷ EU First Written Submission, para. 735.

measures. Instead, the EU essentially argues that FSC/ETI and the apportionment agreement have a close nexus with each other because they are both export subsidies (at least according to the EU). For the Panel to accept this argument, it would have to resolve the EU’s claim against the apportionment agreement on the merits before addressing the question of whether the measure is within the Panel’s terms of reference. Thus, the EU argument puts the cart before the horse – the substantive question before the jurisdictional question. In fact, whether a measure is within a panel’s terms of reference cannot hinge on the outcome of the substantive analysis – rather, it should be a consequence of the design and nature of the measures at issue. The EU has not provided any analysis in this regard. In any event, even if the EU could demonstrate that the apportionment agreement is an export subsidy, the fact that two measures are export subsidies does not mean that they have a close nexus in terms of nature and effects; indeed, export subsidies come in many different forms.

81. Given that the South Carolina measures are all outside the Panel’s terms of reference, I will only briefly discuss the substance of the EU’s South Carolina claims. I would like to touch upon the four largest measures, in terms of the alleged dollar values: the Project Site Lease, the provision of facilities and infrastructure, the FILOT Agreements, and the income allocation and apportionment agreement. For all of these claims, the EU fails to demonstrate a *prima facie* case of WTO-inconsistency.

82. For the Project Site Lease and the provision of facilities and infrastructure, the EU arguments fail because, *inter alia*, the EU does not put forward any benchmark. As the Appellate Body stated: “in the absence of a market benchmark, it will not be possible to establish if a subsidy exists at all.”⁵⁸ Furthermore, in this particular case, Boeing spent considerable sums of its own money investing in the project site and the facilities and infrastructure on it.⁵⁹ Under Article 1.1(b) of the *SCM Agreement*, read in the context of Article 14(d) of that Agreement, the EU has a burden to assess whether the remuneration from Boeing to the State and its political subdivisions was adequate. The EU fails to meet this burden.

83. The EU arguments on the Project Site Lease and the Project Emerald facilities and infrastructure also fail because these measures were conferred to Vought, not Boeing. In particular, South Carolina provided these measures to Vought pursuant to the 2004 Project Emerald Agreement, and then Vought sold them to Boeing in 2009. The EU explicitly denies that any benefit passed through from Vought to Boeing.⁶⁰ Therefore, these measures did not confer a subsidy to Boeing – and it is irrelevant whether they previously conferred a subsidy to any third parties.

⁵⁸ *Canada – Renewable Energy (AB)*, para. 5.164.

⁵⁹ See US Second Written Submission, para. 496.

⁶⁰ See EU Second Written Submission, header before para. 722 (“The European Union does not allege that any benefits ‘passed through’ to Boeing from other firms”).

84. With respect to the three FILOT Agreements challenged by the EU – one that Boeing acquired from Vought, one that was part of Project Gemini, and one that was part of Phase II – the EU is essentially asking the Panel to find that South Carolina violated the SCM Agreement when it gave Boeing the same type of fee-based arrangement in lieu of property taxes that applies to the majority of industrial property in South Carolina. FILOT Agreements are a statewide mechanism, and the eligibility criteria for FILOT Agreements – the satisfaction of certain investment and employment criteria – are objective. Accordingly, there is no basis to find that the FILOT agreements involve revenue foregone that is otherwise due, or that any alleged benefit flowing from the agreements is specific to the aeronautical industry.

85. Finally, with respect to the apportionment agreement: this measure does not provide any subsidy to Boeing, let alone a prohibited export subsidy, as the EU alleges. The apportionment agreement clarifies existing South Carolina law. South Carolina law holds that income from “sales in this state” is apportioned to South Carolina, and therefore potentially subject to income tax, while income from other sales is not apportioned to South Carolina. “Sales in this state” are defined as goods that are “received by a purchaser” in South Carolina, “after all transportation is completed.”⁶¹ By definition, export sales are not “received by the purchaser” in South Carolina “after all transportation is completed.” Therefore, with or without the Boeing Apportionment Agreement, income from export sales is not subject to South Carolina income tax.

86. The EU fails to appreciate this point, however, due to its own confusion. In particular, the EU incorrectly believes that an LCA sale is a “sale in this state” if the “formal delivery of the aircraft to the customer” takes place in South Carolina.⁶² However, South Carolina can confirm yet again that the place of “formal delivery” is irrelevant for purposes of apportionment.⁶³ What matters is where the aircraft is received “after all transportation is completed.” Contrary to the EU’s arguments, there are no export sales that are “sales in this state.”

87. So to sum up, the EU fails to establish a *prima facie* case of WTO-inconsistency with respect to the Project Site Lease, the provision of facilities and infrastructure, the FILOT Agreements, and the apportionment agreement – as well as the other measures addressed in our written submissions. Moreover, none of the South Carolina measures challenged by the EU are within the Panel’s terms of reference.

⁶¹ S.C. Code § 12-6-2280(B) (Exhibit EU-509) (“The term ‘sales in this State’ includes sales of goods, merchandise, or property received by a purchaser in this State. The place where goods are received by the purchaser after all transportation is completed is considered the place at which the goods are received by the purchaser. Direct delivery into this State by the taxpayer to a person designated by a purchaser constitutes delivery to the purchaser in this State.”); U.S. First Written Submission, para. 604.

⁶² See EU Second Written Submission, para. 665 & note 1114.

⁶³ See US First Written Submission, para. 604.

2. FAA’s CLEEN Program

88. The EU has also sought to challenge the FAA’s Continuous Lower Energy, Emissions, and Noise (“CLEEN”) program, even though there are no DSB recommendations and rulings on this measure – and even though, by the EU’s own estimates, this measure only resulted in total outlays of roughly \$14 million from 2007 to 2012, which is significantly less than Boeing itself contributed. The EU’s claim asserts that the CLEEN program shares a close nexus to NASA R&D programs subject to the DSB’s recommendations and rulings. We’ve explained in our submissions why the EU’s assertion of a close nexus between the NASA measures and the CLEEN program fail.

89. In particular, the EU argues that there is “technological and organizational continuity” between NASA and the CLEEN program, because the CLEEN program shares common environmental goals with some NASA programs, and because FAA consulted NASA experts as it developed the CLEEN solicitation, just as it did various other experts inside and outside of the government. However, as the EU is surely aware, many government agencies include environmental goals among their priorities, and government agencies routinely consult each other in the normal course. This is part of responsible government, and it does not indicate the existence of an interagency plan to avoid the U.S. compliance obligations in this dispute.

90. Moreover, the EU ignores entirely the structure of the measure, including important differences between the CLEEN program and the NASA procurement contracts subject to the DSB’s recommendations and rulings, which reflect the inclusion of agency-specific contract terms. For example, the CLEEN OTA authorizes cost-sharing arrangements only, where the program participant must provide funding on a 1:1 basis, at a minimum. The EU also has not even attempted to explain how the NASA measures and the FAA OTA are similar in terms of effects. This again confirms the absence of any close nexus.

91. In any event, there is no evidence that the FAA OTA confers a subsidy, as discussed further in our written submission. Again, the EU declines to put forward any market benchmark – just as it does with its South Carolina claims, its claims against DoD procurement contracts, and other claims at issue in this dispute. Therefore, both on scope and on substance, the EU fails to articulate a colorable argument that the CLEEN program is inconsistent with the U.S. compliance obligations in this dispute.

3. Other Washington Measures

92. As already mentioned, the Washington B&O tax rate reduction is the only Washington measure that was subject to the DSB’s recommendations and rulings and that is properly within this compliance Panel’s terms of reference. The EU seems to recognize that the value of that measure is too small to cause any adverse effects – even under the EU’s own indefensible estimates. So instead, the EU pumps up the value of its allegations by trying to take another bite at the apple with regard to four Washington State measures that the EU unsuccessfully challenged in the original proceeding: the Washington State B&O tax credits for preproduction development and property taxes, the exemptions for computer hardware, software and

peripherals, and the City of Everett B&O tax rate reduction. The EU also attempts to expand the dispute to two other measures that were not challenged in the original proceeding and have no bearing on compliance: a higher education research program known as JCATI, and a leasehold excise tax credit that Boeing has never claimed or received.

93. None of these is a “measure taken to comply.” Several of these measures have not undergone any significant changes since the EU unsuccessfully challenged them in the original dispute. In addition, the measures that have changed – *i.e.*, the JCATI measure and the leasehold excise tax credit – have no similarity in terms of nature or effects with the Washington State B&O tax rate reduction, nor has the EU identified any. Moreover, the EU is precluded from re-litigating claims that it raised unsuccessfully in the original dispute. Again, the EU is simply trying to have a second bite at the apple.

B. Non-R&D Measures That Have Been Withdrawn

94. Next, I will discuss the United States’ compliance with the DSB’s recommendations and rulings regarding FSC/ETI and the industrial revenue bonds issued by Wichita, Kansas. The United States has withdrawn both subsidies.

1. FSC/ETI

95. The United States notified the DSB that it had enacted legislation terminating FSC/ETI tax benefits. The United States has also confirmed that Boeing has not received FSC/ETI tax benefits after 2006. Nothing has changed since the original panel considered this issue and declined to find that Boeing would receive FSC/ETI tax benefits after 2006. The EU tries to raise questions about the U.S. compliance steps, but it presents the Panel with no evidence that Boeing has actually received FSC/ETI tax benefits after 2006.

96. Instead, the EU presents the Panel with the theory that the mere availability of a tax provision constitutes a *prima facie* showing that a subsidy has been conferred. It does so, despite the fact that the only evidence bearing on this issue before the Panel – the signed affidavit of Boeing’s Vice President of Tax, James H. Zrust – confirms that Boeing did not receive tax benefits after 2006. The EU has not met its burden, nor can it. The simple fact is that the United States has withdrawn the subsidy.

2. Kansas IRBs

97. The United States has withdrawn the subsidy associated with the City of Wichita’s issuance of Industrial Revenue Bonds (“IRBs”) because the subsidy is no longer specific. In particular, whereas the original panel and Appellate Body found that the subsidy was specific because the City of Wichita had provided a disproportionately large number of IRBs to Boeing – *i.e.*, 69 percent – Wichita has not issued a single IRB to Boeing after 2006. In addition to withdrawing the subsidy, the United States has taken appropriate steps to remove the subsidy’s adverse effects, by ensuring that no further IRBs are issued to Boeing.

98. The EU fails to provide any alternate analysis showing that the subsidy remains specific to the aeronautical industry – and indeed, its own evidence shows that the majority of recipients after 2006 are not in the aeronautical industry at all.⁶⁴ Instead, the EU responds by focusing on the number of IRBs issued dating back to 1979. In effect, the EU is choosing to ignore the U.S. compliance steps, rather than face the fact that no IRBs have been issued to Boeing after 2006, and the true value of unwithdrawn subsidies in this dispute is miniscule in comparison to what was before the original panel and Appellate Body. Nevertheless, these compliance steps satisfy the U.S. obligations under Article 7.8 of the SCM Agreement.⁶⁵

C. Prohibited Subsidies

99. Finally, before turning to my colleague, I would like address what is perhaps the EU’s most colorful legal theory in this dispute: that “the United States has, through its sustained and repeated actions over time, used subsidies to condition Boeing’s behaviour and skew sales towards exports – as surely as a dog may be conditioned to salivate upon hearing a bell.”⁶⁶ This argument well captures the quality of argumentation put forward by the EU in this proceeding. But lest anyone doubt about the rigor of this claim, the EU explains in a footnote that “{t}his is, of course, a reference to the work of Ivan Pavlov, the Nobel prize winning founding father of the science of conditional reflex behaviour.”⁶⁷

100. One might wonder whether the EU’s arguments pay adequate tribute to the legacy of Dr. Pavlov. They are based upon data purporting to show that Boeing’s LCA sales have risen slightly over time,⁶⁸ as well as a series of “illustrative statements” such as: “The aerospace industry is a major contributor to the balance of trade and the balance of trade has an effect on the U.S. standard of living.”⁶⁹ After reflecting upon this evidence and the mechanics of canine salivation, the EU finds that every single measure being challenged in this compliance dispute – including, for example, DoD contracts requesting work product that cannot be exported without an ITAR license, the readySC employee training program in South Carolina, and grants for

⁶⁴ See *List of All City of Wichita IRBs, 1994-2012, provided by the City of Wichita* (Exhibit EU-420).

⁶⁵ See also *US – Large Civil Aircraft (Panel)*, para. 7.757 (“{W}hen a subsidy has been in operation for a long period of time, such as the IRB programme, aggregating data over the entire life of the subsidy may not always be appropriate. That may be the case where there has been a significant change in the structure of the economy and the importance of the subsidized activities in the economy over the life of the subsidy.”).

⁶⁶ EU First Written Submission, para. 759.

⁶⁷ EU First Written Submission, note 1644.

⁶⁸ See *Summary of Actual Boeing LCA Export Sales as a Percentage of Total Sales* (Exhibit EU-563). This document runs regressions on data over an arbitrary 13-year period for the share of Boeing exports as a percentage of overall sales. The coefficients for the regressions are quite low: 0.0257 for single-aisle, 0.0277 for twin-aisle, and a mere 0.0036 for very large aircraft. *Ibid.*, pp. 3-4. Moreover, the EU does not provide any analysis regarding the robustness of these regressions. Accordingly, the EU does not even succeed in the mere task of demonstrating that Boeing’s export sales (as a percentage of overall sales) have increased over time, as opposed to merely fluctuating randomly.

⁶⁹ *Illustrative Statements* (Exhibit EU-566).

Washington State’s JCATI funding for higher education – is “contingent/conditional, in fact . . . upon export performance, and {is} prohibited by Articles 3.1(a) and 3.2 and footnote 4 of the *SCM Agreement*.”⁷⁰

101. The United States disagrees that the EU has established a *de facto* tie between subsidies and export sales. In fact, it has not done anything to further explain how such a *de facto* tie would exist in this case. The United States finds equally little merit in the EU’s arguments that every single measure being challenged in this compliance dispute violates Article 3.1(b) and 3.2 of the *SCM Agreement* as a prohibited import substitution subsidy, and also violates Article III of the GATT 1994.⁷¹ If there are any questions about the basis for the U.S. position, I would be happy to address them in the question and answer session.

102. Now I will turn to my colleague Mr. Janovitz, who will discuss adverse effects.

III. ADVERSE EFFECTS

103. The EU and the United States agree that the task for this compliance Panel is to determine whether any un-withdrawn subsidies continue to cause adverse effects. The United States is confident that, on this basis, it has achieved compliance. The EU seems to have reached the same conclusion and, thus, in an effort to nevertheless obtain a finding of non-compliance, has sought to expand this compliance proceeding to the point where it would become a sprawling, unruly endeavor.

104. We have already detailed how, as part of this effort, the EU attempts to bring in subsidies that existed at the time of the original proceeding but were not challenged. For example, the EU claims that funding under DoD program elements not raised in the original proceeding nevertheless should be found to confer actionable subsidies in this compliance proceeding.⁷² The EU alleges adverse effects from new subsidies allegedly conferred by South Carolina and FAA, neither of which was involved in the original proceeding.⁷³ The EU even raises numerous arguments that were already rejected in the original proceeding.⁷⁴ In addition, the EU argues that the product markets that prevailed during the original reference period have transformed into seven markets, including four monopoly markets, and one “non-market.”⁷⁵ I will deviate a bit from the distributed version of this statement to add that, we learned this morning that nearly all alleged post-2006 R&D subsidies, unlike R&D subsidies in the original proceeding, result in lower licensing fees for Boeing. By the time the EU is done, its compliance case bears almost no

⁷⁰ EU First Written Submission, para. 763.

⁷¹ In addition, the EU prohibited subsidy and Article III GATT claims are outside the scope of this compliance dispute. See U.S. Second Written Submission, paras. 46-57.

⁷² See U.S. First Written Submission, paras. 435-437.

⁷³ See EU First Written Submission, paras. 199-232, 542-736.

⁷⁴ See, e.g., U.S. Second Written Submission, paras. 36, 58.

⁷⁵ See EU First Written Submission, paras. 894-926.

resemblance to the case it pursued in the original proceeding. And, despite that this is for all intents and purposes a new case, the EU seeks the expedited procedures of a compliance proceeding, which, among other things, would deprive the United States of a reasonable period to comply if the Panel did find any actionable subsidies.

105. The EU has a well-founded fear that an analysis based on the findings from the original proceeding – which appropriately shaped the U.S. compliance steps – would prove particularly challenging for its claims.

106. The price effects findings in the original proceeding – made only with respect to two sales campaigns in the 100-200 seat market – were driven overwhelmingly by FSC/ETI. There can be no rational disagreement about whether FSC/ETI has been withdrawn. And yet, the EU's adverse effects case never deviates from its assumption that FSC/ETI remains.

107. The technology effects findings in the original proceeding – made only with respect to the 200-300 seat market – were driven by NASA subsidies found to have accelerated the launch of the 787. My colleague has already reviewed how these subsidies, along with the smaller DoD subsidies, have been withdrawn. But assuming for the sake of argument that they are to some extent un-withdrawn, it would be extremely difficult to show that adverse effects are being caused by substantially reduced financial contributions on terms even closer to what the market offers. Unsurprisingly, the EU does not attempt to do so. Indeed, despite that NASA subsidies drove the finding in the original proceeding that U.S. R&D subsidies caused technology effects, the EU conceded this morning – as reflected in Exhibit EU-1265 – that the EU cannot show that any post-2006 NASA programs are causing technology effects.

108. In light of the overwhelming challenges the EU would face in trying to show non-compliance based on the reasoning and findings from the original proceeding, the EU instead, effectively creates a new case that it hopes will allow it to escape those overwhelming challenges. The EU distorts the finding from the original proceeding that NASA and DoD subsidies accelerated the launch and promised delivery date of the 787, and the relevance of this finding to the appropriate counterfactual, which I will address in a few minutes. The EU also attempts to inflate the amount of potential subsidies by piling additional alleged subsidies on top of those found to be actionable in the original proceeding. As my colleague has already reviewed, these include subsidies that cannot possibly provide an advantage to Boeing in the LCA marketplace, such as the P-8A program and the KC-46 program, as well as subsidies that are not properly raised because they were omitted from or resolved against the EU in the original proceeding.

109. After using these and other means of inflating the alleged subsidy amount, the EU then makes a vague allegation that – even though R&D subsidies were found only to have technology effects in the original proceeding – some of these inflated amounts now cause price effects. Although this argument is exceedingly vague, as I will address in a few minutes, it would appear to be an attempt to again avoid the consequences of the fact that 787 technology effects from the original proceeding no longer exist by contending that certain NASA and DoD measures now

only cause price effects. And again, the EU has conceded this morning that, other than a portion of FAA CLEEN and a portion of the DoD KC-46 program, the EU cannot show that any post-2006 R&D subsidies are causing technology effects.

A. Cumulation

110. Furthermore, the EU seeks to cumulate all of the subsidies in the dispute, despite that technology effects subsidies and price effects subsidies were not cumulated in the original proceeding. The EU criticizes the United States for trying to “atomize” the claims, while it is the EU that deviates from the collective assessment structure in the original proceeding. Let me make this clear: if the U.S. analysis is atomized, then the Appellate Body’s findings in the original proceeding were also atomized. Moreover, the EU ignores the Appellate Body’s guidance that effects caused genuinely but not substantially by a subsidy can only be cumulated with the effects of a subsidy already found to have a genuine and substantial relationship with the relevant market phenomena.⁷⁶

B. Product Markets

111. And if all that were not enough, the EU alleges that the markets in which adverse effects were found in the original reference period have been completely transformed, leaving seven markets and one non-market. Four of the seven are purportedly monopoly markets. And this does not include the 767, which the EU argues is in no market at all despite that it still is being produced and sold. Given the interest in the product markets issue expressed by the Panel, I will now address this in greater depth, before turning back to the EU’s efforts to pursue an effectively new case in this compliance proceeding.

112. As expressed in our written submissions, the United States believes that, even under the EU’s product market delineation, the EU has failed to demonstrate that un-withdrawn subsidies continue to cause adverse effects. But make no mistake. The EU’s proposed product markets are certainly not an accurate reflection of LCA competition.

113. It is important to note that the guidance of the Appellate Body in *EC – Large Civil Aircraft* regarding the need to perform an independent and objective assessment of the issue of product markets was provided in the context of an original proceeding. The Panel here still must make an objective assessment of the issue, but unlike in an original proceeding, the starting point in a compliance proceeding is the findings of the original panel and the Appellate Body. If a party believes that events since the original reference period have resulted in different product markets, that party bears the burden of proving as much. In the absence of such a showing, an objective assessment of the issue will maintain the market delineation from the original proceeding. This is particularly appropriate because that market definition will have informed the compliance measures taken by the responding party.

⁷⁶ See *US – Large Civil Aircraft (AB)*, para. 1282.

114. Following the original proceeding in this dispute, the DSB adopted recommendations and rulings with respect to a 100-200 seat market and a 200-300 seat market.⁷⁷ The Appellate Body also examined claims in a 300-400 seat market but did not find that subsidies caused adverse effects in this market.⁷⁸

115. During the original proceeding, the United States considered that the product markets identified by the EU (*i.e.*, 100-200, 200-300, and 300-400 seat markets) were overly narrow, but it accepted that the EU’s case could be evaluated on that basis. The original panel and the Appellate Body did so. This delineation has the virtue that it is not over-inclusive; that is, any two aircraft that fall into one of these markets do indeed compete with one another in the same market. Given that this market structure formed the basis of the adopted DSB recommendations and rulings and, therefore, informed the U.S. compliance steps, the United States has not sought to argue for a different market delineation in this compliance proceeding.

116. The EU argues that the product markets have changed since the original reference period, but it has failed to prove that there are now seven markets and one non-market for LCA. The EU’s evidence is limited to a flawed statement from Airbus’s Christophe Mourey. Before I address that statement, I would like to note the conspicuous absence of any evidence generated by Boeing, Airbus, industry observers, or anyone else that has ever analyzed LCA orders or deliveries according to the framework proposed by the EU. The EU has not explained – because there is no explanation – why, if the EU’s markets accurately reflect the contours of LCA competition, no one has ever analyzed the market in this way.

117. This is a major global industry, and both of the sophisticated participants regularly analyze data. The absence of any materials generated in the normal course of business that analyze the market based on the EU’s proposed framework is fatal to the EU’s market delineation. The implausibility of the EU’s position – that only the preparer of Exhibit EU-34(BCI) has ever understood the accurate prevailing market structure – leaves no doubt as to the inaccuracy of the EU’s position.

118. Moreover, the EU’s sole piece of evidence in support of this market structure – the Mourey Statement – is itself flawed. The Mourey Statement purports to demonstrate the contours of competition based on net present value calculations (“NPV”). The idea is that, if the difference in NPV between two aircraft models is too great to be offset by price concessions, the two aircraft do not exercise competitive constraints on one another and therefore are in separate markets. The problems with Mourey’s analysis are too numerous to list in this statement, but I will highlight a few, which without more demonstrate that this analysis is so fundamentally flawed that it offers no credibility to or valid support for the EU’s position.

119. First, Mourey provides no prices for the various aircraft he compares. Without pricing information, it is impossible to determine whether a gap in NPV can be offset by pricing

⁷⁷ See *US – Large Civil Aircraft (AB)*, para. 1350.

⁷⁸ See *US – Large Civil Aircraft (AB)*, para. 1350.

concessions. Even putting aside the absence of pricing that could be used as a benchmark, Mourey does not even identify how significant the difference between NPVs must be before he considers it too large to be offset by price concessions.

120. Second, Mourey applies his methodology to only a very limited subset of aircraft pairs, and the pairs do not seem to have been chosen by accident. For Mourey's methodology and conclusions to have any weight, its consistent application would have to not only show that certain aircraft are in separate markets, but would also have to confirm that the models placed in the same market by the EU do indeed have an NPV gap that can be overcome by price concessions. It is telling that Mourey never applies his methodology to two aircraft that he and the EU contend *do* compete in the same market. In addition, Mourey has not shown that his methodology would have yielded the product markets advocated by the EU and adopted by the panel and the Appellate Body in the original proceeding. Again, Mourey's unwillingness to demonstrate that his methodology applied consistently would support the product market structure in the original proceeding during the reference period and the EU's proposed market structure under current conditions drains the conclusions of any credibility.

121. Without getting into additional analytical flaws, these errors alone show that Mourey's conclusions are meaningless. The reason for this contorted analysis seems obvious – because nothing else would produce the EU's novel seven-market-and-one-non-market conclusion.

122. Accordingly, the EU has failed to meet its burden of demonstrating that the markets underlying the Appellate Body's findings have changed in the interim. Under this scenario, where neither party has demonstrated that changes since the reference period have resulted in different product markets, there is no basis to deviate from the market delineation relied upon by the original panel and the Appellate Body.

123. Because the EU has not proposed evidence and argumentation based on the market delineation from the original proceeding, it has failed to demonstrate adverse effects in any of these markets.

C. Causation

124. The EU's causation arguments regarding technology effects and price effects contain deep and numerous flaws, which we have addressed in our written submissions. I would like to highlight some of the most significant flaws here. With respect to technology effects, I will discuss the EU's distortion of the finding from the original proceeding that R&D subsidies *accelerated* the launch and date of promised first deliveries of the 787 and the relevance of this finding to the appropriate counterfactual question as it relates to alleged technology effects. I will then address a few of the most glaring omissions in the EU's price effects case, which leave it well short of meeting the EU's burden.

1. Alleged Technology Effects

125. The Panel has requested that we address the relevance of the original panel's conclusion that, absent the R&D subsidies, Boeing would not have been able to launch an aircraft incorporating all of the technologies that are incorporated on the 787 in 2004, with promised deliveries in 2008, for the framing of the appropriate counterfactual question to examine the technology effects of the alleged R&D subsidies. We think the finding is important, particularly in conjunction with the Appellate Body's related observations and findings.

126. Specifically, the original panel posited in paragraph 7.1775 of its report two scenarios: (1) a later launch of the 787; and (2) a launch in 2004 of a model technologically superior to the 767, but short of the 787's technological innovation.⁷⁹ The Appellate Body observed that the latter scenario had not been specifically advanced by either of the parties and was not reflected in the content of the panel's counterfactual reasoning.⁸⁰ As a result, the Appellate Body found that it could not sustain any arguments predicated on this counterfactual scenario.⁸¹ Accordingly, the Appellate Body upheld the finding that, absent the R&D subsidies, Boeing would have launched the 787 later than 2004.

127. The Panel must decide whether any un-withdrawn subsidies continue to cause adverse effects after the expiration of the reasonable period of time to comply. To properly attribute any market phenomena to the subsidies, the appropriate counterfactual inquires as to whether certain market phenomena would exist in the absence of the subsidies. Because the R&D subsidies causing technology effects were found to accelerate the launch and promised first deliveries of the 787, it is important to determine when the 787 would have been launched in the absence of the subsidies.

128. This impacts the analysis of the EU's claims in two principal ways. First, it determines the point at which the effects of the 787 in the marketplace can no longer be attributed to the subsidies. For example, in the original proceeding, where the 787 was found to have put downward pressure on A330 prices, it followed that, if the 787 had not been introduced into the marketplace, A330 prices would not have been subject to such downward pressure. Because the 787's existence in the marketplace in 2004 was found to have resulted from subsidies, the suppression of A330 prices was attributed to the subsidies.⁸²

129. But even if, in the absence of subsidies, A330 prices would have been higher during the original reference period, that would not have continued forever. The question then is when the 787 would have been launched in the absence of subsidies. At that point, the downward pressure

⁷⁹ *US – Large Civil Aircraft (Panel)*, para. 7.1775.

⁸⁰ *US – Large Civil Aircraft (AB)*, para. 1025.

⁸¹ *US – Large Civil Aircraft (AB)*, para. 1025.

⁸² *US – Large Civil Aircraft (AB)*, paras. 918-919, 1113.

on prices can no longer be attributed to the subsidies. In this way, the technology effects attributed to the subsidies in the original proceeding cease to exist.

130. Second, the EU has tried to link the impact of R&D subsidies on the 787 launch to subsequent models by arguing that knowledge from the development of technologies for the 787 has been applied in developing the 737 MAX and 777X. According to the EU, in the absence of the subsidies, Boeing would not have had the requisite knowledge to apply certain technologies on subsequent aircraft, and the launch of those aircraft would have been delayed. Boeing engineers explain the numerous inaccuracies in the EU allegations of “spillover” effects and have further conveyed why the EU’s attempted rebuttals are unsuccessful.

131. But even putting aside the factual inaccuracy of the EU’s alleged spillover effects, the EU’s argument relies on the premise that the knowledge gained in launching the 787 would have remained unknown at the time the 737 MAX and 777X were being developed. Because the 787 would have been launched even in the absence of subsidies well before significant development work started on those aircraft, the EU’s spillover effects arguments necessarily fail.

132. The EU attempts to avoid this consequence by treating the 787 technologies as if they would not exist even to this day in the absence of the R&D subsidies. The Boeing engineers provided a detailed analysis establishing that the 787 would have launched no more than two years later – around the middle of 2006.⁸³ This analysis is based on the best-available real world comparators for estimating the additional time required to launch the 787 absent the R&D subsidies: Boeing’s independent, real-world experience on early-stage, high risk R&D that is not just comparable to – but typically more complex and challenging than – work performed under the R&D programs analyzed in the original proceeding.

133. The EU counters that, absent the subsidies, it is questionable whether the 787 would have been viable at all – a position based on its failure to understand that pre-launch R&D is ignored as a sunk cost when the launch decision is made.⁸⁴ The EU then argues that, if the 787 would have been viable, it would have taken an additional 10 years to replicate development of the 787, but continues that this 10-year estimate is a gross underestimate because it assumes away Boeing’s accumulated knowledge over the years and does not take into account the additional time it would take to integrate the individual components it would develop in that time.⁸⁵ The EU does not provide an estimate that accounts for these caveats, but the 10-year delay alone would bring us to 2014. In other words, the EU contends that, as we sit here today before the Panel, not only would the 787 not yet have been launched, but there is no way it would even be launched in the next year or two.

⁸³ See EU Second Written Submission, para. 975.

⁸⁴ U.S. Second Written Submission, paras. 820-822.

⁸⁵ See EU Second Written Submission, para. 975.

134. Put differently, even though Airbus – despite a major mistake in launching the ill-fated Original A350 – was able to launch the A350 XWB in 2006, Boeing would not have been able to launch the 787 until at least a decade later. By contrast, the Boeing engineers’ estimate indicates that Boeing could have launched the 787 no later than 2006, which is, again, the year Airbus was eventually able to launch the A350 XWB, following the misstep of pursuing the Original A350. The Panel’s role is to make an objective assessment in determining when Boeing would have launched the 787 absent the R&D subsidies, and in so doing, must weigh the credibility of the competing positions taken by the United States and the EU. In this respect, the United States finds the following argument from the EU in the original proceeding particularly instructive:

Absent the knowledge, experience, and confidence provided by the US Government’s aeronautics R&D programmes, Boeing would have had to develop these technologies at its own risk and expense over a considerably longer period of time. Consequently, the 787 would have been launched at a substantially later point in time. The result would have been continued high sales at improved prices of the A330-200 and -300 models, *as well as the relatively simultaneous launch of the 787 with the comparable Airbus product.*⁸⁶

Moreover, the original panel found that Boeing would have launched a replacement for the 767 in the early- to mid- 2000s.⁸⁷ Thus, the original panel’s finding, as well as the EU’s own statement, are all consistent with the U.S. position in this compliance proceeding – that even in the absence of subsidies, Boeing would have launched the 787 no later than 2006. The extreme outlier is the EU’s current position – that the 787 would not have been launched until close to 2020 or later.

135. And I will deviate a bit from the distributed version of this statement to note that I think we learned a bit more this morning about how the EU arrived at this extreme position. The U.S. counterfactual assumes that when Boeing began significant development of the 787 in the early 2000s, had Boeing not received the R&D subsidies subject to the findings in the original proceeding, Boeing’s knowledge and experience would have been less than it was in reality, where Boeing did receive those subsidies. The EU’s counterfactual, by contrast, assumes that, absent the R&D subsidies from the original proceeding, Boeing’s knowledge and experience in the early 2000s would have been no different than it was in the late 1980s, when the R&D subsidies subjected to findings in the original proceeding were first received. This reading of the findings from the original proceeding – which shape the appropriate counterfactual – is completely untenable. There were no findings in the original proceeding that, absent the R&D subsidies, Boeing’s massive self-funded research would not have taken place, Boeing’s suppliers would have made no advancement whatsoever, and the general knowledge of the world would have remained static over that period. Simply put, the findings of the original proceeding in no way support that, absent the R&D subsidies, there would have been no advancement in

⁸⁶ EC First Written Submission, *US – Large Civil Aircraft (Panel)*, Annex C, para. 189 (Exhibit USA-293) (emphasis added).

⁸⁷ *US – Large Civil Aircraft (Panel)*, para. 7.1774.

knowledge and experience relevant to the launch of the 787 between the late 1980s and the early 2000s. The EU’s contrary assumption leads it to the extreme position that this Panel’s report would be issued before the 787 would be launched.

2. *Alleged Price Effects*

136. The EU’s price effects case similarly falls short. The EU has not even attempted to analyze the nature and magnitude of the alleged price effects subsidies. With respect to nature, the United States has explained why, absent significant capital constraints, there is no reason to assume that Boeing would price its aircraft differently as a result of receiving untied subsidies. In the original proceeding, the EU attempted to prove the opposite. Toward that end, it introduced the Cabral Report, which concluded that 46 cents of every untied subsidy would be allocated to more aggressive pricing to overcome switching costs and 12 cents would be allocated to more aggressive pricing to advance down the learning curve.⁸⁸ The Cabral Report then attempted to translate this into a per-aircraft subsidy amount – *i.e.*, price effect. The original panel rejected the Cabral Report.⁸⁹

137. Instead of attempting to correct for the errors in the Cabral Report, the EU simply alleges that untied subsidies have price effects without providing a shred of supporting economic analysis or quantifying the impact of the subsidies at issue in this proceeding. As a result, the EU has failed to meet its burden of showing that the untied miscellaneous subsidies – even if erroneously aggregated – can cause price effects.

138. As with the miscellaneous subsidies, the EU refrains from quantifying the price effects of tied tax subsidies. The EU instead relies on vague and unsupported statements, such as its assertion that they are “large by any reasonable measure, and sufficient to cause the adverse effects at issue.”⁹⁰ It is simply not true that they are large by any reasonable measure. As the United States has shown, measured against the average net prices of the aircraft at issue and in the context of lost sales campaigns identified by the EU, the subsidy amounts – even assuming they are used in their entirety to lower prices exclusively in the lost sales campaigns alleged by the EU – are not large; rather they are miniscule.⁹¹ When properly measured against all Boeing aircraft sales, the per-plane value of alleged subsidies is smaller still. The EU has not shown, and cannot show, that such tiny price decreases would change the outcome of sales campaigns or lead to significant price suppression.

139. The EU further relies on the Appellate Body’s guidance that precise quantification is not an indispensable part of a serious prejudice analysis, a point the United States fully accepts.⁹²

⁸⁸ *US – Large Civil Aircraft (AB)*, note 2374.

⁸⁹ *US – Large Civil Aircraft (AB)*, note 2385.

⁹⁰ EU Second Written Submission, para. 1155.

⁹¹ See Compilation of Number of Boeing Aircraft Sold in Alleged Lost Sales Campaigns and Related Calculations, p. 3 (Exhibit USA-295(HSBI)).

⁹² See EU Second Written Submission, para. 1156 (quoting *US – Large Civil Aircraft (AB)*, para. 1006).

But just because *precise* quantification is not *indispensable*, does not mean that quantification of any sort is completely unnecessary. In fact, in quoting the Appellate Body, the EU omits the portion stating that “the magnitude of subsidies is important.”⁹³ Particularly here, where the EU’s theory is based on price reductions from subsidies causing Airbus to lower its prices and lose sales, the magnitude must be shown to be sufficient on a per-aircraft basis to plausibly be a genuine and substantial cause of these phenomena. Taking a very conservative approach, the United States did just this and proved that the subsidies are not, as the EU alleges, a genuine and substantial cause of the alleged market phenomena.

140. Finally, the EU alleges that R&D subsidies fall into two mutually exclusive groups, one of which causes technology effects and one of which causes price effects. Of course, this too deviates from the findings in the original proceeding, where R&D subsidies were found to cause technology effects, but not price effects. The technology effects resulted from the subsidies allowing research to go forward in the face of the disincentives found to accompany early stage, risky research. The EU conceded this morning that, with the exception of a portion of FAA CLEEN and a portion of the DoD KC-46 program, it cannot show that any post-2006 subsidies are causing technology effects. This is staggering. The EU now clarifies that alleged post-2006 subsidies go toward research that would be conducted regardless of the subsidies, meaning that no additional knowledge or experience is gained, and no future aircraft launches will be accelerated. Instead we are now told, this research would go forward in the absence of subsidies, but Boeing would pay licensing fees it does not have to pay. In this way, the EU alleges, R&D subsidies now cause price effects – that is, they cause lower Boeing pricing of LCA. Well that prompts the critical question of why Boeing would need to pay licensing fees, a question the EU has failed to address.

141. Thus, the EU has not identified which R&D subsidies cause technology effects and which cause price effects, nor has it demonstrated that any R&D subsidies are capable of causing price effects, and even if they were, the extent of such price effects. In other words, not only does the EU effectively pursue a new case in this compliance proceeding, but it has failed to even adequately explain what its new case alleges. It is not for the Panel to cobble together a coherent case out of the vague allegations put forth by the EU; in fact, the Panel is not permitted to do so.⁹⁴ It is also entirely unfair for the United States to have to guess at what the EU is alleging.

142. Indeed, in its September 25 communication, the Panel requested that the parties address “{t}he basis that the Panel should use to distinguish aeronautics R&D subsidies that potentially operate through a ‘technology effect’ from aeronautics R&D subsidies that potentially operate through a ‘price effect’.”⁹⁵ The Panel should not be put in a position of having to find a basis to distinguish between the two. It was incumbent upon the EU to distinguish clearly between the two so that both the Panel and the United States have a firm understanding of what the EU is

⁹³ *US – Large Civil Aircraft (AB)*, para. 1006.

⁹⁴ *See EC – Fasteners (AB)*, para. 566.

⁹⁵ Communication from the Panel (Sept. 25, 2013).

alleging. In other words, the only basis for distinguishing between the two should have been a clear identification by the EU of which subsidies it alleges to be causing which effects. The fact that each party has submitted two written submissions, we are here for the panel meeting, and the Panel and the United States must still be inquiring about what the EU is alleging is totally unacceptable. And even with the clarification made this morning about nearly all post-2006 R&D subsidies being alleged to exclusively cause price effects, uncertainties still remain, including what the EU is alleging in terms of licensing fees.

D. Alleged Significant Lost Sales, Displacement and Impedance, and Significant Price Suppression

143. The United States has demonstrated that the EU’s claims of present adverse effects are flawed in myriad ways beyond core causation issues. Because the various sales campaigns and market share and pricing data are quite fact-specific and incorporate a substantial volume of BCI and HSBI, and in the interest of brevity, I will not catalogue those errors yet again, but it is worth noting the lengths to which the EU will go in its attempts to show non-compliance where it does not exist. For example, the EU re-argues lost sales in campaigns such as ANA and Continental where the original panel rejected those arguments and the EU did not appeal. Pervasive overreaching of this type throughout the EU’s submissions reflects that legitimate claims of adverse effects do not exist.

E. Conclusion

144. In conclusion, the United States emphasizes the need to remember that this is a compliance proceeding. The EU should not be permitted to re-litigate resolved issues or raise unrelated measures and measures that existed at the time of the original proceeding but were not challenged at that time. The EU should not be permitted to ignore the finding in the original proceeding that R&D subsidies *accelerated* the 787 launch, but did not make an otherwise unviable aircraft possible. The EU should not be permitted to assume that subsidies cause adverse effects through price effects when the sole subsidy found to be a genuine and substantial cause of such effects in the original proceeding – FSC/ETI – has unquestionably been withdrawn. The EU should not be permitted to twist the product market delineation despite the absence of any credible evidence that there are seven LCA markets, four of which are monopoly markets, and one non-market. And the EU certainly should not be permitted to engage in obfuscation to the detriment of the U.S. ability to defend itself through a fair process and the Panel’s ability to reach an objective assessment of the matter. A proper analysis will reveal that the United States has complied with the DSB’s recommendations and rulings.

145. I will be pleased to answer any questions the Panel may have about these or other issues related to alleged adverse effects.

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146. We have not attempted to address every single issue in this oral statement, as we know the Panel is familiar with the points we made in our written submissions. Rather, we have

focused on the issues that we thought warranted further discussion today. Therefore, to the extent this statement is silent on one of the many issues in contention, please refer to our written submissions.

147. Thank you for your time and attention. We look forward to responding to any questions the Panel may have for us.