

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

(AB-2011-3/DS353)

ADDITIONAL WRITTEN MEMORANDUM OF THE UNITED STATES
FOLLOWING THE FIRST HEARING BEFORE THE APPELLATE BODY

September 5, 2011

SERVICE LIST

Participant

H.E. Mr. Angelos Pangratis, Permanent Mission of the European Union

Third Participants

H.E. Mr. Tim Yeend, Permanent Mission of Australia

H.E. Mr. Roberto Carvalho de Azevedo, Permanent Mission of Brazil

H.E. Mr. John Gero, Permanent Mission of Canada

H.E. Mr. Yi Xiaozhun, Permanent Mission of China

H.E. Mr. Yoichi Otabe, Permanent Mission of Japan

H.E. Mr. Park Sang-ki, Permanent Mission of Korea

INTRODUCTION

1. The United States thanks the Appellate Body for this opportunity to submit an additional written memorandum, pursuant to Rule 28 of the Working Procedures for Appellate Review, on issues that arose from lines of inquiry pursued at the first session of the oral hearing in this appeal.

2. The United States is mindful of the Appellate Body's instruction not to repeat arguments made in the written submissions. It has accordingly limited this submission to elaborating on some of the points raised by the United States at the hearing and addressing further some of the erroneous arguments raised by the European Union ("EU"). In all areas, this submission is intended as a supplement to the previous written submissions and discussions during the first hearing. Those submissions and the transcript provide a full exposition of U.S. views.

ANALYSIS

I. PURCHASES OF SERVICES ARE NOT FINANCIAL CONTRIBUTIONS FOR PURPOSES OF ARTICLE 1.1(A)(1) OF THE SCM AGREEMENT.

A. The EU has advanced no defensible basis for reading Article 1.1(a)(1) to include purchases of services in the definition of "financial contribution."

3. The text of Article 1.1(a)(1) of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement"), read in its context and in light of the object and purpose of the agreement, establishes that purchases of services are not included in the financial contribution element of the definition of a subsidy.¹ To begin, Article 1.1(a)(1) sets out a closed list of transactions that are "financial contributions."

4. The context provided by Article 14 of the SCM Agreement confirms that purchases of services are not a form of subsidy. Article 14(d), like Article 1.1(a)(1)(iii), refers explicitly to provisions of goods, provisions of services, and purchases of goods, but pointedly omits the purchase of services. The preparatory work associated with the SCM Agreement confirms this interpretation. Early drafts provided a separate category of financial contribution covering provision and purchase of goods and services, demonstrating an understanding that transactions involving goods and services were distinct from other transactions defined as financial contributions. And just as these early drafts used a specific reference to purchases of services to include them in financial contributions, the subsequent exclusion of that term from the text confirms that purchases of services are not included.

¹ U.S. Appellee Submission, paras. 154-174.

5. The EU provides no credible challenge to this analysis. It posits that the omission of “purchases of services” from Article 1.1(a)(1)(iii) of the SCM Agreement is of no consequence. It argues for a general policy favoring complaining parties that would overrule this negotiated and express omission in the language of the agreement.

6. The EU argued in its appellant submission for an expansive reading of the financial contribution categories laid out in Article 1.1(a)(1), based on the assertion that the object and purpose of the SCM Agreement is to discipline subsidies.² However, at the hearing, the EU conceded that, as the Appellate Body has found, the SCM Agreement reflects a “delicate balance” between Members seeking greater disciplines on subsidies and those seeking greater disciplines on countervailing measures. This correct understanding of the object and purpose means that interpretation of Article 1.1(a)(1) does not, as the EU asserts, lean on the side of those challenging alleged subsidies.

7. The EU also attempts to draw a parallel with the Appellate Body’s analysis of Article 3.1 of the SCM Agreement in *Canada – Autos*, asserting that “[t]he Appellate Body found that Article 3.1(b) nevertheless covers *de facto* contingency . . . despite the omission” of “the phrase ‘in law or in fact.’”³ But what the EU’s argument ignores, and the reason it fails, is that Article 1.1(a)(1)(iii) does not “omit” both purchases of goods and services, thereby leaving an open question. It includes provisions of goods, provisions of services, and purchases of goods, creating a conceptual matrix that conspicuously excludes purchases of services:

	provision of	purchase of
goods	COVERED	COVERED
services	COVERED	OUT

² EU Appellant Submission, paras. 118-119.

³ EU Opening Statement at the First Hearing, para. 17, quoting *Canada – Autos*, paras. 142-143 (footnote omitted; emphasis in original).

8. In its opening statement, the EU tried to find support for its approach in the Tokyo Round *Agreement on Government Procurement* panel report in *US – Sonar Mapping*. The U.S. appellee submission cited that report as an example of how panels routinely examine combined transactions (in that case a purchase of goods and services) based on which is the predominant element.⁴ However, the EU argues that the report is also relevant because circumvention concerns led that panel to reject the idea that an exclusion for “service contracts *per se*” also covered purchases of goods incidental to the services.⁵ The EU misunderstands the reasoning in the *US – Sonar Mapping* report. The panel found that a contract between the U.S. government and a private company was a service contract, and the purchase of services under that contract was “in principle outside the Agreement’s coverage.”⁶ The report also found the procurement of the sonar mapping system (whether or not it was formally purchased through a subcontract) was a procurement because the government paid for and took title to the sonar mapping system.⁷

9. Thus, the panel distinguished between purchases of services and purchases of goods and, despite concerns about circumvention, applied the Agreement only to the latter. The purchase of a good (the eponymous mapping system) was not excluded because “the Agreement applies to ‘any procurement of products’” and there were no other exceptions to the coverage of procurements of goods.⁸ This reasoning does not apply to the SCM Agreement, as the definition of financial contribution in Article 1.1(a)(1) is not framed as covering “any” direct transfer. The *US – Sonar Mapping* panel also noted that it interpreted the exclusion of service contracts strictly in light of “the general principle that in the interpretation of agreements, exceptions provisions should normally be construed narrowly rather than broadly.”⁹ The Appellate Body long ago rejected that principle in the interpretation of the covered agreements.¹⁰ Therefore, the *US – Sonar Mapping* report does not support the EU’s argument that the Tokyo Round panel rejected the framework that the United States proposes in this appeal.

⁴ U.S. Appellee Submission, para. 180, note 250.

⁵ EU Opening Statement at the First Hearing, paras. 27-28.

⁶ *US – Sonar Mapping*, para. 4.22.

⁷ *Id.*, paras. 4.8-4.10.

⁸ *Id.*, para. 4.19.

⁹ *Id.*, para. 4.21.

¹⁰ *EC – Hormones (AB)*, para. 104 (“merely characterizing a treaty provision as an ‘exception’ does not by itself justify a ‘stricter’ or ‘narrower’ interpretation of that provision than would be warranted by examination of the ordinary meaning of the actual treaty words, viewed in their context and in light of the treaty’s object and purpose, or, in other words, by applying the normal rules of treaty interpretation.”).

10. At the hearing, the EU added a new theory – that Article 1.1(a)(1) cannot possibly exclude purchases of services because the EU cannot conceive of a logical basis for such an exclusion. However, the Appellate Body’s past reports provide that logic, in recognizing that the SCM Agreement as a whole, and Article 1.1(a)(1) in particular, reflects a “delicate balance” among the interests of different Members. Such compromises mediate among competing visions and objectives. Some Members took the position that the SCM Agreement should cover an expansive range of measures and others favored a shorter reach. That they were able to agree on something midway between these poles is perfectly logical.

11. Thus, the EU has failed to establish any legal basis for the Appellate Body to overturn the Panel’s finding that purchases of services are excluded from the definition of a subsidy under SCM Agreement.

B. The potential for “loopholes” and “circumvention” envisioned by the EU are illusory.

12. Instead of addressing the legal issues presented by the Panel’s analysis of Article 1.1(a)(1), the EU devoted most of its presentation at the hearing to what is essentially a policy argument – that the exclusion of purchases of services would create “loopholes” for Members seeking to circumvent the SCM Agreement. The EU has not put forward a solid factual or logical basis for this concern. Domestic administering authorities, panels, and the Appellate Body have shown a high level of capability in evaluating government contributions, understanding their nature, and assigning the proper legal consequences to them. There is no reason to consider that panels and administering authorities will be unable to detect sham transactions or choose the correct legal treatment based on the substance of the interaction between the parties. There is equally no basis to believe that authorities will allow incidental services (such as the air transportation bundled with a grant in the EU’s \$2 billion plane ride hypothetical) to distract them from properly characterizing a transaction.

13. At the hearing, a question arose regarding treatment of a transaction in which the purchase of services represented 51 percent of the value of a transaction, and the remainder was for something that, if conferred independently, would be a financial contribution. The United States expects that in evaluating any transactions, authorities will look closely at all the terms. It may well be that the elements of such a transaction are sufficiently discrete to treat them as two transactions, with one excluded and the other a financial contribution. But in the end, it would depend on the facts of a particular case, and the United States remains confident in the ability of panels and administering authorities to make appropriate characterizations.

14. It is also worth reiterating that because the SCM Agreement excludes purchases of services, there is no “loophole” in recognizing that a legitimate purchase of services is not a

financial contribution for purposes of Article 1.1(a)(1). It reflects that the scope of the agreement is not universal.

II. NASA CONTRACTS AND DOD COOPERATIVE AGREEMENTS, TIAs, AND OTAs WERE PURCHASES OF SERVICES.

A. The Panel’s “principally for the benefit and use” test is not on appeal.

15. Neither of the participants in this appeal has challenged the Panel’s finding that a legitimate purchase of research services is one in which the principal benefit and use of the research is for the purchaser. Thus, that finding is not at issue in this appeal.

16. During the hearing, the Appellate Body expressed concern regarding the principal benefit test. The lack of jurisdiction by itself precludes making a finding that the test is inconsistent with the SCM Agreement, but there is also an important practical problem with reaching any conclusions at this time. Because the participants have accepted the application of the principal benefit test to determine whether there has been a legitimate purchase of services, there have been no adversarial proceedings regarding the validity of the test itself. The Appellate Body has accordingly not had the benefit of a vigorous presentation of differing points of view and a testing of the various arguments for and against.

17. The Appellate Body asked about the consequences of a finding that the principal benefit test was inconsistent with the SCM Agreement. The United States urges the Appellate Body not to make such a finding. However, if it did, the Panel’s findings that NASA contracts and DoD cooperative agreements, TIAs, and OTAs were financial contributions would necessarily fail, as they would be based on an invalid test. As so many of the Panel’s findings were based on that test, it is difficult to envisage how the Appellate Body could complete the Panel’s analysis based on those findings while using a different legal test.

B. The Panel made a legal error when it failed to conduct the comparison necessary to evaluate whether research under the NASA contracts was principally for the benefit and use of Boeing.

18. The EU agreed at the hearing that the Panel’s principal benefit test is a legal test. Thus, whether the Panel applied that test correctly is a legal question. The EU also agreed that this test requires a comparison of two sets of facts – those showing the benefit and use of research to Boeing and those showing the benefit and use to the U.S. government and unrelated third parties. This is clearly the critical analytical step, as a valid conclusion as to which of the two sides is the “principal” beneficiary is possible only if such a comparison occurs. Whether the Panel conducted the necessary comparison and used an appropriate methodology to do so is, therefore, a legal question. In this appeal, the answer to that question is “no,” as the EU has failed to

identify any portion of the Panel Report that compares the benefit and use of NASA research to the U.S. government with the benefit and use to Boeing.

19. The EU argued at the hearing that the U.S. appeal of the Panel’s application of its principal benefit test does not raise a legal issue under Article 1.1(a)(1) of the SCM Agreement because it goes to the “weighing of the facts” or “how the Panel reasoned over disputed facts.” This is incorrect. The U.S. appeal under Article 1.1(a)(1) does not question the Panel’s factual findings, such as they are, of the benefit and use that Boeing and the U.S. government took from research under NASA contracts. It assumes, *arguendo*, that they are correct for this element of the appeal. Instead, the United States challenges whether the Panel, having considered the facts, took the analytical step of comparing the benefit and use to the U.S. government *with* the benefit and use to Boeing so that it could reach the legal conclusion as to whether the transactions were purchases of services.

20. The Appellate Body has always recognized this type of analysis – applying a legal test to the facts before it – as legal in nature. The United States has cited several reports supporting this conclusion in past submissions, and will not repeat that discussion here.¹¹ In addition, the *Brazil – Tyres* Appellate Body report, which the EU cites in its appellee submission, provides another clear example of how the EU is incorrect. In that dispute, the EU argued that the panel acted inconsistently with Article XX(b) of the GATT 1994 by failing to conduct the “weighing and balancing” of various factors needed to evaluate whether a measure was “necessary” to protect human, animal or plant life or health.¹² The Appellate Body found that “{t}he weighing and balancing is a holistic operation that involves putting all the variables of the equation together

¹¹ U.S. Other Appellant Submission, paras. 41-44; U.S. Opening Statement at the First Hearing, para. 23. *Canada – Periodicals (AB)*, p. 21; *ibid.*, p. 22 (“as a result of the lack of proper legal reasoning based on inadequate factual analysis . . . the Panel could not logically arrive at the conclusion that imported split-run periodicals and domestic non-split-run periodicals are like products”). Examples of situations in which the Appellate Body has examined the facts found by a panel and evaluated whether they establish an inconsistency with one of the covered agreements appear in *EC – Asbestos (AB)*, paras. 125-126 (“we find this insufficient to justify the conclusion that the chrysotile asbestos and PCG fibres are ‘like products’ and we, therefore, reverse the Panel’s conclusion ‘that chrysotile fibres, on the one hand, and PVA, cellulose and glass fibres, on the other, are “like products” within the meaning of Article III:4 of the GATT 1994.’”); *DR – Cigarettes (AB)*, paras. 93-99 (Appellate Body examines bonding measures to evaluate whether the Panel correctly found that they were consistent with GATT 1994 Article III:4); *US – Wheat Gluten (AB)*, para. 91; *US – FSC (AB)* (“we must compare the way the United States taxes the portion of the income covered by the measure, which it treats as foreign-source, with the way it taxes other foreign-source income under its own rules of taxation”); *US – Softwood Lumber IV (AB)*, paras. 74-75 (analyzing whether conveying rights to harvest trees constitutes a provision of goods); *Japan – DRAMs (AB)*, para. 174 (the facts cited by the panel demonstrate that it failed to assess the benefit properly for purposes of Article 1.1(b) of the SCM Agreement).

¹² *Brazil – Tyres (AB)*, paras. 176 and 178.

and evaluating them in relation to each other after having examined them individually, in order to reach an overall judgment.”¹³ It then found the Panel’s “analytical process” to be consistent with this requirement, and accordingly rejected the EU’s appeal under Article XX(b). Thus, the question of whether a panel takes all of the methodological steps necessary to reach a particular legal conclusion is itself a legal question that a Member may appeal under the substantive provisions of one of the covered agreements.

21. By way of contrast, the *Brazil – Tyres* Appellate Body report also offers examples of the types of issues that *are* appeals under Article 11 of the DSU. Once the Appellate Body found that the panel had met its legal obligation of “weighing and balancing” the necessary factors, it moved on to two additional EU appeals: whether the panel “ignored substantial evidence” or failed to make an objective assessment of the facts regarding potential alternative measures.¹⁴ It addressed these questions under Article 11 of the DSU, rather than the substantive provisions of the covered agreements.

22. The parallels with this dispute are striking. The U.S. appeal under Article 1.1(a)(1) of the SCM Agreement goes to whether the Panel actually performed the kind of comparison necessary to determine whether a transaction is a purchase of services outside the scope of that provision. The U.S. appeal under Article 11 of the DSU, discussed in the following section, goes to the Panel’s failure to make an objective assessment of the facts *prior* to reaching a legal conclusion as to whether Boeing was the principal beneficiary. These are two distinct issues and, as in *Brazil – Tyres*, the appeal of one is properly under the substantive provisions of Article 1.1(a)(1) of the SCM Agreement and the appeal of the other is properly under Article 11 of the DSU.

23. As to the question of whether the Panel performed a comparison, the EU’s responses at the hearing were telling. When asked to identify where in the report such an analysis occurred, the only examples the EU could identify were in paragraph 7.1771 of the report and a few references to the use of NASA research by DoD and the Federal Aviation Administration (“FAA”). None of these references makes a comparison of the benefit and use to Boeing as against the benefit and use to the U.S. government.

24. Paragraph 7.1771 appears in the adverse effects section of the Panel Report, more than 200 pages *after* the Panel’s financial contribution analysis. The Panel itself rejected the notion that the reasoning in that paragraph was relevant to its findings of subsidization when it denied an EU request to insert a cross-reference to paragraph 7.1771 into the section on valuation of the

¹³ *Id.*, para. 182.

¹⁴ *Id.*, paras. 187 and 199.

benefit. (In the Panel’s words, “it is unclear what purpose the proposed change would serve.”¹⁵) But even if there were such a cross-reference, the discussion in the paragraph would not support the Panel’s conclusion regarding the existence of a financial contribution. Although paragraph 7.1771 addresses benefits to Boeing, the only governmental benefit it mentions is Airbus’ access to publicly disseminated NASA research. This was a small part of the governmental use that the United States demonstrated, and that the Panel identified as something Boeing had “given up” when it conducted research for NASA.¹⁶ Thus, paragraph 7.1771 does not make the comparison that the principal benefit test required between the benefit and use to Boeing against the benefit and use to the U.S. government and unrelated third parties.

25. The isolated references to the relevance of NASA research to DoD and the FAA are also insufficient. As with paragraph 7.1771, they do not contain the *comparison* that the Panel’s test required.

C. The Panel failed to make an objective assessment of the matter before it when it conducted a one-sided review of the evidence relevant to its principal benefit test.

26. The United States demonstrated in the U.S. other appellant submission and at the hearing that the Panel’s disregard for evidence demonstrating the benefit and use of NASA research to the U.S. government was inconsistent with Article 11 of the DSU.¹⁷ It will not repeat that discussion here. At the hearing, the EU did not deny that the Panel made almost no reference to evidence cited by the United States. Instead, the EU asserted that there simply was no evidence supporting the U.S. position.

27. This is incorrect. The U.S. other appellant submission cited extensive evidence demonstrating that NASA research was for the benefit and use of the U.S. government and unrelated third parties.¹⁸ Nor was this the only such evidence. Over the course of the panel proceedings, the United States cited evidence and laid out analysis describing what the government obtained from NASA research, as part of its showing that NASA research contracts were purchases of research.¹⁹ In discussing why the contracts provided a value-for-value exchange, the United States provided additional information identifying the usefulness of the

¹⁵ Panel Report, para. 6.72.

¹⁶ *Id.*, para. 7.1100.

¹⁷ U.S. Other Appellant Submission, paras. 41-60.

¹⁸ *Id.*, paras. 45-60.

¹⁹ *E.g.*, US FWS, paras. 189-194, 205-211; US SWS, paras. 62-64; US FNCOS, paras. 55-67; US RPQ 159, paras. 146-149. This evidence is in addition to what the United States has already cited.

research to the United States, which would also be relevant to the conclusion as to whether NASA contracts were purchases of services.²⁰

28. At the hearing, the EU argued that footnote 33 to paragraph 39 of the U.S. opening statement listed all of the points at which the United States cited evidence showing that NASA research was of benefit and use to the U.S. government. This is incorrect. The footnote in question lists only the references to two exhibits, to document that the United States considered these exhibits extremely important.²¹ The footnote never purported to identify *all* of the evidence cited by the United States. The U.S. other appellant submission, this submission, and the U.S. submissions to the Panel cite many other examples of evidence supporting the U.S. position.

29. Thus, it was not for want of evidence that the Panel disregarded the benefit and use that the U.S. government and unrelated third parties took from NASA research. Rather, the Panel's silence on this issue demonstrates its failure to make the objective assessment called for under Article 11 of the DSU.

D. The Panel made a legal error when it failed to address factors necessary to determine whether research under DoD cooperative agreements, TIAs, and OTAs was for the benefit and use of the U.S. government.

30. There is no question that a panel makes a legal error when it fails to address one of the factors necessary to reach a conclusion that a Member has acted inconsistently with its obligations under one of the covered agreements. For example, it would be a legal error for a panel's causation analysis under the SCM Agreement, the Antidumping Agreement, or the Safeguards Agreement to fail to address potential alternative causes of injury. More generally, it is a legal error if the facts found by a Panel do not support its finding that a Member has acted inconsistently with one of the covered agreements. That is the situation with the Panel's finding that DoD cooperative agreements, TIAs, and OTAs were principally for the benefit and use of Boeing.

31. The United States did not appeal the Panel's findings of fact with regard to these instruments. Instead, it appealed the failure of the Panel's principal benefit analysis to take

²⁰ *E.g.*, US FWS, paras. 220-225; US SWS, paras. 64-71.

²¹ At the hearing, the EU criticized these citations as referring to the same few pieces of evidence over and over. But that was the point of the footnote – that the United States attached particular importance to Exhibits US-1140(revised) and US-1253, which were evidence that NASA articles and contractor reports were “widely cited in the worldwide scientific community.” U.S. Opening Statement at the First Hearing, para. 38. Discussions of *other* evidence appeared in *other* places.

account of two of those findings – that the nature of the research actually conducted under the instruments was “central” to the inquiry and that the U.S. ITAR (International Traffic in Arms Regulations) restrict use of DoD-funded technology on Boeing’s civil aircraft. Each of these findings pointed to a factor critical to the Panel’s evaluation, and it was a legal error for the Panel to fail to address them in its analysis.

32. At the hearing, the EU argued that it was impossible for the Panel to address the research actually conducted under DoD cooperative agreements, TIAs, and OTAs because the United States redacted information subject to ITAR controls. There is no indication that the Panel considered this to be the case, and the evidence does not support the EU assertion. Four of the documents in question were submitted by the EU, and have no redactions of any kind. Although the United States did redact ITAR-controlled information from some of the remaining documents, it provided non-controlled summaries that allow a basic understanding of the topics covered by the research. The very fact that the ITAR mandated such redactions is itself evidence of the impediments Boeing would face if it used controlled technologies on its aircraft or in its production process. Thus, the EU is incorrect in asserting that the Panel could not use the copies of cooperative agreements, TIAs, and OTAs before it.

33. The EU also tried to argue that the ITAR do not really impede Boeing’s use of weapons-related technology. However, the EU was forced to concede that the ITAR do prevent incorporation of controlled technology on exported aircraft and that the penalties for any violation are draconian. The EU was also forced to recognize the Panel’s finding that the ITAR “restrict Boeing’s ability to use certain R&D performed under DOD R&D contracts and agreements toward LCA.”²² These are compelling reasons that any benefit and use Boeing could take from DoD-funded research is less than would be the case if the ITAR were not a factor – a critical consideration in an overall evaluation.

34. Thus, the EU has done nothing to counter the U.S. demonstration that these factors were critical to a finding of the principal benefit and use from research under cooperative agreements, TIAs, and OTAs. It has also failed to show that the Panel actually considered them in its analysis. Therefore, the Panel’s analysis is insufficient to support its finding that DoD’s cooperative agreements, TIAs, and OTAs with Boeing were not purchases of services.

²² Panel Report, para. 7.1160, *quoted in* U.S. Other Appellant Submission, para. 92.

III. THE PANEL ERRONEOUSLY FOUND THAT NASA CONTRACTS AND DOD COOPERATIVE AGREEMENTS, TIAs, AND OTAs CONFERRED A BENEFIT.

A. The Panel erred in finding that NASA contracts for research that was outside of the EU claims conferred a benefit on Boeing.

35. The United States has appealed the overbreadth of the Panel’s finding that NASA research contracts conferred a benefit. Even though the EU only challenged *some* of the aeronautics research conducted by NASA in the 1989-2006 period, the Panel reached a finding with regard to *all* of the NASA research. Specifically, the Panel erroneously included in its benefit finding contracts between Boeing and NASA that covered research topics – safety, air traffic management, hypersonic flight, and others – outside the scope of the EU claims. In doing so, it acted outside its terms of reference and inconsistently with Article 1.1(b) of the SCM Agreement, which calls for a finding of benefit only with regard to transactions that are part of the financial contribution challenged by the complaining party.

36. The EU does not dispute that making a benefit finding with regard to a transaction outside of the alleged financial contribution would be inconsistent with Article 1.1(b). But it argued that the U.S. appeal is unwarranted because the Panel’s finding goes to the NASA aeronautics research programs themselves, rather than the contracts they funded. But it nevertheless argued further that if the finding did reach to the contracts, the United States failed to prove that any of the contracts called for Boeing to conduct research outside the scope of the EU claim.

37. To support its argument that the Panel’s findings applied to the programs instead of the contracts, the EU cited paragraph 7.1431(d) of the Panel Report, which states:

We have found that a number of the measures challenged by the European Communities do constitute specific subsidies:

* * * *

- (d) National Aeronautics and Space Administration (NASA)
 - (i) the payments made to Boeing pursuant to procurement contracts entered into under the eight aeronautics R&D programs at issue;
 - (ii) the access to government facilities, equipment and employees provided to Boeing pursuant to procurement contracts and Space Act Agreements entered into under the eight aeronautics R&D programmes at issue.

This finding applies to payments “pursuant to procurement contracts entered into *under* the eight aeronautics R&D programmes.” It does not cover payments under other types of instruments.²³ Thus, paragraph 7.1431 sets out findings with regard to the set of contracts “entered into” under the eight aeronautics research programs challenged by the EU. It does not make blanket findings with regard to the programs as a whole.

38. Even if the Panel’s findings could be read as covering the programs, rather than the contracts, that would not rebut the U.S. appeal. In its submissions to the Panel²⁴ and during the hearing, the EU emphasized that it did not challenge *all* NASA aeronautics research under *all* of the programs, pointing in particular to carve-outs for air traffic management and safety under the AST Program, and certain non-aeronautics computational research under the High Performance Computing and Communications Program. Thus, if the Panel made program-based findings with regard to the entirety of the eight aeronautics programs, as the EU contends, it exceeded the scope of the claims brought by the EU, which did not cover the programs as a whole. The Appellate Body should accordingly reverse the Panel’s findings even if it accepts the EU’s characterization of them.

39. The EU also argued that if the Panel’s findings cover the set of all contracts under the eight aeronautics research programs, the United States failed to properly document that any of those contracts involved research on topics outside the scope of the EU claim. This assertion is wrong on several levels. The U.S. responses to questions 179 and 188 from the Panel described in detail how NASA officials compiled the set of all NASA contracts with Boeing that called for aeronautics research, and the steps they took to winnow out contracts that were not covered by the EU claims. The United States submitted materials related to some of the excluded contracts.²⁵ It is also noteworthy that the Panel did not ask for further documentation from NASA, and expressed no doubts about the accuracy of this exercise. The EU has itself provided no basis for asserting that NASA improperly identified contracts as falling outside the EU claims, and no legal authority for arguing that the United States had to submit additional materials in support of the exclusions. Therefore, the EU arguments do not justify the Panel’s

²³ The EU stated before the Panel that its claims exclude payments under reimbursable Space Act agreements. EC RPQ 158, para. 237 (“the European Communities challenges NASA’s LCA-related non-reimbursable SAAs in their entirety; it challenges NASA’s LCA-related partially-reimbursable SAAs to the extent Boeing “pays” something other than cash for the goods and services Boeing receives; and it does not challenge any of NASA’s fully-reimbursable SAAs.”).

²⁴ EC RPQ 158, para. 237.

²⁵ Exhibit US-1304 lists some of the contracts that were mistakenly identified at the time of the U.S. first written submission as relating to the EU claims. Materials related to those contracts appear in Exhibits US-438, US-440, US-441, US-442, US-445, US-448, US-479, US-492, US-574, US-575, US-577, and US-587.

finding of a benefit with regard to the contracts that NASA identified as outside the scope of the EU claims.

40. In conclusion, the EU was clear throughout the dispute that its claims that NASA aeronautics programs conferred a subsidy to Boeing did not apply to *all* NASA research. The United States put forward evidence that Boeing did, in fact, conduct research in excluded areas under NASA contracts. Therefore, the Panel’s subsidy findings, whether characterized as covering all of the NASA-Boeing contracts or all payments to Boeing under the eight challenged programs, were inconsistent with Article 1.1(b) of the SCM Agreement because they found a benefit for transactions that were not part of the financial contribution at issue.

B. The Panel erred in concluding that DoD cooperative agreements, TIAs, and OTAs conferred a benefit on Boeing.

41. The Panel performed its benefit analysis in the abstract, by positing a hypothetical transaction and evaluating whether a market actor would enter into such a transaction on the same terms. This approach might be appropriate, but only if the hypothetical faithfully reflected the terms of the transaction at issue, and the panel was correct in its evaluation of how market actors would behave. But in this instance, the Panel erred by constructing a hypothetical that did not reflect the facts at issue, and by providing no support for its assertion that no market actor would enter into the theoretical transaction. For that reason, the Panel’s analysis was inconsistent with Article 1.1(b).

42. The Panel’s hypothetical posited a transaction in which “one entity would pay another entity to conduct R&D . . . on the term that the entity receiving the financial contribution conduct R&D that is principally for the benefit and use of the entity receiving the payment” without “some form of royalties or repayments.”²⁶ The United States explained that this hypothetical did not reflect the terms of DoD cooperative agreements, TIAs, and OTAs, because they required a contribution from Boeing over the course of the project. The EU did not dispute that this was the case, but argued that Boeing’s contributions came during the course of the research and were therefore not the type of “royalties or repayments” that the Panel viewed as characteristic of a market transaction. In response to the U.S. observation that the difference identified by the EU was a matter of timing, rather than substance,²⁷ the EU contended that no market actor would accept an up-front contribution in lieu of an after-the-fact repayment or royalty. It provided no factual support or economic reasoning in support of this assertion. There is, in fact, none. A market actor might find it preferable to have another party contribute up front to a joint effort,

²⁶ Panel Report, para. 7.1184.

²⁷ U.S. Opening Statement at the First Hearing, para. 61.

rather than funding the whole cost, and waiting to receive royalty payments or repayments if the project is successful. As an economic matter, the time value of money and the absence of risk might provide incentives for private actors to prefer contributions. Therefore, the EU has provided no valid reason to consider that the Panel’s hypothetical addressed the facts of the case before it.

43. The EU also argued that no market actor would, under any circumstances, enter into a joint project where it paid half of the costs, but its partner enjoyed more than half of the benefit and use of the results.²⁸ Again, the EU provided neither facts nor economic reasoning in support of its assertion. There are a number of situations in which market actors enter into transactions with asymmetric benefits. For example, one of the partners may have a greater degree of market power or the partner with the lesser benefit may nonetheless expect to meet its desired rate of return, even if the benefit to the other is greater. In any event, if the contract was subject to competitive bidding, as were the DoD agreements at issue, any perceived imbalance in the benefit would nevertheless represent the best terms available to the purchaser. Thus, there is no basis to assume, as the EU would have the Appellate Body do, that no market actor would enter into a transaction on the same terms as the DoD cooperative agreements, TIAs, and OTAs with Boeing.

**IV. THE PANEL’S FINDING THAT THE WASHINGTON STATE B&O TAX ADJUSTMENT
CONSTITUTED A FINANCIAL CONTRIBUTION IS FLAWED.**

44. As the United States has explained in its written submissions and during the hearing, the Panel, when analyzing the Washington State B&O tax rate adjustment, set forth the wrong legal test for determining whether a government has foregone revenue that is otherwise due.²⁹ The Panel further erred in its application of Article 1.1(a)(1)(ii) of the SCM Agreement by failing to properly identify income that is “legitimately comparable” to income from manufacturing and selling aircraft, and by failing to properly analyze the State of Washington’s “fiscal treatment” of such income. These are legal errors and do not, as the EU repeatedly suggested during the hearing, require the Appellate Body to reassess the Panel’s findings of fact.

²⁸ EU Appellee Submission, paras. 182-183.

²⁹ See U.S. Other Appellant Submission, paras. 130-143; U.S. Opening Statement at the First Hearing, paras. 67-73; Panel Report, para. 7.120.

A. The Panel incorrectly stated the legal test to be applied under Article 1.1(a)(1)(ii) of the SCM Agreement.

45. During the hearing, the EU had little to say when directly questioned by the Appellate Body about the U.S. argument that the Panel incorrectly stated the legal test to be applied under Article 1.1(a)(1)(ii) of the SCM Agreement at paragraph 7.120 of the Panel Report. The EU simply asserted that the Panel had correctly quoted relevant passages from prior Appellate Body reports discussing Article 1.1(a)(1)(ii) in the paragraphs preceding its misstatement of the law.

46. However, in paragraph 7.119 of the Panel Report, the Panel fails to note the Appellate Body's juxtaposition of the proper legal test, described in the sentence that the Panel quoted from the Appellate Body report in *US – FSC (Article 21.5 – EC)*, with the use of a “but for” test, which the Appellate Body suggested in the preceding sentence of its report would “usually be very difficult” to apply.³⁰ This omission and the Panel's misquotation of the Appellate Body report in *US – FSC (Article 21.5 – EC)* are perhaps further explanations, but no excuse for the Panel's ultimate failure to state the legal test correctly in the following paragraph.

47. In any event, because the Panel applied the wrong legal test, as the United States has demonstrated, the Panel's finding that the Washington State B&O tax reductions constituted “revenue foregone” should be reversed.

B. The Panel's application of a “but for” test in this case is legally insufficient because the Panel failed to properly identify “legitimately comparable” income or to examine the “fiscal treatment” of the income being compared.

48. Beyond its misstatement of the law in paragraph 7.120 of the Panel Report, the Panel further erred in its application of the law to the facts. Specifically, the Panel erred in its application of the legal concepts of “legitimately comparable income” and the “fiscal treatment” of such income, on which the Appellate Body elaborated in *US – FSC (Article 21.5 – EC)*.³¹

49. As discussed in the U.S. other appellant submission, the Panel applied a “but for” test in order to determine whether the State of Washington had foregone revenue that was otherwise due within the meaning of Article 1.1(a)(1)(ii) of the SCM Agreement. The Panel mistakenly believed that a “but for” test can be used *as a substitute* for comparing the fiscal treatment of the challenged income to the fiscal treatment of legitimately comparable income. Of course, as the United States has pointed out, and as the EU appeared to agree during the hearing, the “but for”

³⁰ *US – FSC (Article 21.5 – EC) (AB)*, para. 91.

³¹ *See US – FSC (Article 21.5 – EC) (AB)*, para. 91.

test is simply one method of making the comparison required under Article 1.1(a)(1)(ii). Even when applying a “but for” test, the Panel was required to properly identify income that was “legitimately comparable,” and it was required to examine the “fiscal treatment” of such income. The Panel failed to do either.

50. In response to questions from the Appellate Body, the EU appeared to agree with the United States that if a jurisdiction has a general sales or VAT tax and every sale is subject to the tax, then everyone subject to the tax is similarly situated. That is, the income from all sales would be “legitimately comparable.” Similar to the examples suggested by the Appellate Body’s questions, per Revised Code of Washington (“RCW”) 82.04.220, the Washington State B&O tax is levied upon “every person . . . for the act or privilege of engaging in business activities.”³² Accordingly, and by logical extension from the EU’s responses to the Appellate Body’s questions, income from all business activities is “legitimately comparable” under such a system.

51. The EU, of course, does not accept this proposition, but the EU does not explain why income from certain categories of business activity in Washington State becomes not “legitimately comparable” simply because the Washington State B&O tax system imposes multiple tax rates on different categories of business activity. The Panel likewise fails to explain or even address why business activities other than those in the categories of “manufacturing,” “retailing,” and “wholesaling” are not “legitimately comparable” to aircraft manufacturing and selling. The Panel’s narrow focus on applying an oversimplified “but for” test resulted in its failure to consider this legal question.

52. Even assuming, *arguendo*, that all business activities subject to the Washington State B&O tax are not “legitimately comparable,” the Panel’s implicit finding – that “manufacturing,” “retailing,” and “wholesaling” are the *exclusive* categories of business activity that are “legitimately comparable” to aircraft manufacturing and selling – is legally insufficient. Despite noting their existence, the Panel fails to take into account, for example, other separately identified categories of business activity, such as manufacturing of semiconductor materials and manufacturing and selling of nuclear fuel processors.³³ The Panel never addresses why these other categories, each of which is taxed at a lower nominal rate than aircraft manufacturing and selling, should not be considered equally “legitimately comparable” to aircraft manufacturing and selling, if not more so than the categories utilized by the Panel for its “but for” test. Indeed, the Panel never addresses why the host of other categories of business activity separately identified in the Washington State tax code, including a variety of other manufacturing and selling activities, would or would not be “legitimately comparable” to aircraft manufacturing and

³² Exhibit EC-81.

³³ See Panel Report, paras. 7.202-203.

selling. This failure by the Panel to properly identify “legitimately comparable” income for the purpose of making the comparison required under Article 1.1(a)(1)(ii) is fatal to the Panel’s financial contribution finding.

53. Equally problematic is the Panel’s failure to examine properly the “fiscal treatment” either of income from aircraft manufacturing and selling or income from the other categories of business activity that the Panel used in the application of its “but for” test. Once again, the Panel oversimplified its task, looking only to the nominal tax rates set forth in the Washington State tax code. This was, however, a legally insufficient examination of the “fiscal treatment” of income from business activities under the Washington State B&O tax system.

54. Evidence relating to the effective tax rate is highly relevant to an understanding of the “fiscal treatment” of income from business activity under the Washington State B&O tax system.³⁴ The nominal or statutory tax rate may not fully represent the “fiscal treatment” of any particular income, because of pyramiding. As discussed during the hearing, in a VAT tax system, there is no pyramiding because the tax is applied only to the value added during a particular step of the production process. Under Washington State’s B&O tax system, the B&O tax is collected at each step in the production process and is based in each instance *on the full value of the good*. All of the B&O tax imposed on each of the steps is built into the final cost of a product, and the result is that the effective tax rate for the producer of a complex product, such as large civil aircraft, is much higher than the nominal or statutory tax rate. This outcome is reflected in tables in the Tax Structure Study Committee report that the United States put before the Panel, and which were discussed during the hearing.³⁵

55. In order to compare the “fiscal treatment” of aircraft manufacturing and selling with “legitimately comparable” income – a category the Panel did not actually identify – it was necessary for the Panel to take into account evidence related to the effective tax rate. However, the Panel did not take that evidence into account, and even deemed it “not relevant to the analysis required by the Appellate Body report in *US – FSC*.”³⁶ Because the Panel failed to examine the actual “fiscal treatment” of income from aircraft manufacturing and selling and compare it with other “legitimately comparable” income, the Appellate Body should reverse the Panel’s financial contribution finding.

³⁴ See U.S. Other Appellant Submission, paras. 157-161; U.S. Opening Statement at the First Hearing, para. 81.

³⁵ See Exhibit US-180, Table 9-7, p. 112; Exhibit US-183, Appendix C-12, Table 1, p. 41.

³⁶ Panel Report, para. 7.137.

V. THE PANEL’S FINDING THAT THE WASHINGTON STATE B&O TAX ADJUSTMENT WAS A SPECIFIC SUBSIDY IS FLAWED.

56. The United States has also explained why the Panel’s finding that the Washington State B&O tax adjustment was *de jure* specific to the aircraft industry is flawed.³⁷ The United States would like to emphasize, as we explained during the hearing, that the U.S. arguments concerning the Panel’s specificity finding are premised on an assumption that, for the purpose of argument, the Appellate Body accepts the Panel’s financial contribution findings. Of course, as explained above, the United States considers that the Panel’s financial contribution findings should be reversed. Should the Appellate Body uphold the Panel’s financial contribution findings, however, it is difficult to see how it could simultaneously uphold the Panel’s finding of *de jure* specificity.

57. The Panel made the following findings in the context of its financial contribution analysis that are relevant to the question of specificity:

{O}n its face, the Washington tax code establishes a general rule that applies to “every person engaging...in business as a manufacturer”. It also allows for *certain exceptions* {plural} to this rule, which are set out in other provisions of the same chapter. The *exceptions* {plural} include lower taxation rates for manufacturers of semiconductor materials, manufacturers of wheat into flour and manufacturers of bio-diesel and alcohol fuel, for example.³⁸

...

The effect of HB 2294 is *to include commercial aircraft manufacturing*, and the manufacturing of components for such aircraft, *within the list of activities* {plural} *that are subject to a taxation rate that differs from the rate of 0.484 per cent*. It also includes wholesale and retail sales by such manufacturers within the exceptions {plural} to the rates of 0.484 per cent and 0.471 per cent respectively.

The *terminology employed in HB 2294* provides support for the notion that there is a general taxation rate applicable to manufacturing activities and that *deviations from this* {plural} are an exception.³⁹

...

³⁷ See U.S. Other Appellant Submission, paras. 163-179, U.S. Opening Statement at the First Hearing, paras. 88-96.

³⁸ Panel Report, para. 7.123 (emphasis added).

³⁹ *Id.*, para. 7.125-126 (emphasis added).

{T}he State of Washington legislation and documents produced by State departments confirm the European Communities’ argument that there is a general or “normal” B&O tax rate of 0.484 per cent for manufacturing and wholesaling activities and that *deviations from this rate {plural} are an exception or a “preferential” rate*. Similarly, the text of the *Revised Code of Washington* and some of the other evidence surveyed in the foregoing analysis, including section 16 of HB 2294, indicate that the rate reduction from 0.471 per cent in relation to retail sales is also a “preferential rate”.⁴⁰

58. As these passages make clear, the Panel found that a “general rate” exists in the Washington tax code,⁴¹ that there are multiple “exceptions” to the “general rate” providing for lower, preferential taxation rates,⁴² and that HB 2294 added aircraft manufacturing and selling to the already existing list of “exceptions” to the “general rate.”⁴³

59. Of course, the Panel did not directly find that any taxation rate other than that for aircraft manufacturing and selling constitutes a financial contribution or a subsidy actionable under the SCM Agreement. Any such finding would have been outside the Panel’s terms of reference, as the EU’s panel request limited its challenge to alleged subsidies provided to the aircraft industry. However, neither a complaining Member nor a petitioner in a domestic proceeding can, by limiting the description of the scope of the challenged subsidy in the panel request or petition, effectively pre-determine the outcome of the specificity analysis. As the EU agreed during the hearing, the “subsidy” to which Articles 2.1 and 2.1(a) of the SCM Agreement refer is the subsidy defined by and found to exist under Article 1.1 of the SCM Agreement, and in order to determine whether such subsidy is specific, it may be necessary to look at the broader legal framework that establishes the subsidy and regulates access to it.

60. Indeed, the Panel recognized that, in this case, it was necessary to “examine the B&O taxation system as a whole, in particular the legislation and documents produced by the granting authority, in order to determine whether the subsidy in issue is explicitly limited to certain enterprises or is broadly available.”⁴⁴ However, despite recognizing the need to examine the RCW “as a whole,” the Panel made a *de jure* specificity finding that is not supported by the evidence and is premised on irrelevant considerations.

⁴⁰ *Id.*, para. 7.132 (emphasis added).

⁴¹ *Id.*, paras. 7.123, 7.126, 7.132.

⁴² *Id.*, paras. 7.123, 7.126, 7.132.

⁴³ *Id.*, para. 7.125.

⁴⁴ *Id.*, para. 7.199.

61. In explaining its specificity finding, the Panel stated that “{w}e have found that through the introduction of HB 2294 the State of Washington granted a subsidy and that on the face of HB 2294 the subsidy is limited to the aerospace industry.”⁴⁵ This statement departs from the Panel’s earlier characterization of HB 2294, and is contrary to the text of the bill. Earlier in the Panel Report, the Panel found that section 3 of HB 2294 effectuates the addition of aircraft manufacturing and selling to the existing “list of activities subject to a taxation rate that differs from” the “general rates.”⁴⁶ Additionally, section 3 of HB 2294 restates the entirety of RCW 82.04.260 and makes amendments to that provision.⁴⁷ RCW 82.04.260, as well as section 3 of HB 2294, identifies numerous activities in separately numbered subparagraphs, all of which are, as the Panel found, “exceptions” to the “general rate” that the Panel found to exist.

62. Furthermore, the Panel’s finding that the taxation rate applied to aircraft manufacturing and selling is a subsidy is premised on the relationship of that taxation rate to the “general rates,” which are set forth in other provisions of the RCW, namely RCW 82.04.220, 82.04.250, and 82.04.270.⁴⁸ If the Panel’s logic and financial contribution findings are accepted, then the taxation rates applied to the other activities separately identified in RCW 82.04.260 and section 3 of HB 2294 are simply “exceptions” to precisely the same “general rates,” and thus are the same, or part of the same subsidy. In order to discern whether access to that subsidy was explicitly limited to certain enterprises within the meaning of Article 2.1(a) of the SCM Agreement, the Panel was required to determine whether all of the industries that had been granted preferential taxation rates, taken together, would constitute “certain enterprises.” The Panel did not conduct such an analysis.

63. Instead, the Panel found that the taxation rates for other activities identified in the same provision of the RCW are not “part of a common subsidy programme” because they “were introduced at a range of different times and for a variety of different purposes.”⁴⁹ The Panel’s decision to make the timing and alleged purpose of the enactment of the various “exceptions” determinative has potentially troubling implications. Consideration of timing and purpose in a case such as this suggests that two Members with identical laws might have different obligations under the SCM Agreement where one Member enacts its law at one point in time for one, clearly stated purpose, while the other Member enacts the same law but does so through a series of amendments over time with various stated purposes. The potential that one Member might be

⁴⁵ *Id.*, para. 7.204.

⁴⁶ *See id.*, para. 7.125.

⁴⁷ *See* Exhibit EC-54.

⁴⁸ *See* Panel Report, paras. 7.122-124.

⁴⁹ *Id.*, para. 7.205.

found to have acted inconsistently with its WTO obligations while the other Member would be permitted to engage in the same behavior is an untenable result, and one that can be avoided by properly focusing on the text of the legislation as it exists rather than the purported purpose or timing of amendments to the legislation.

64. The text of the RCW demonstrates that the different taxation rates are all set forth in the same provision of the RCW, specifically RCW 82.04.260, and section 3 of HB 2294, and each is described using nearly identical language: “Upon every person engaging within this state in the business of . . . the amount of tax with respect to such {activity} shall be equal to. . . .” These or very similar words appear in nearly all of the subparagraphs of RCW 82.04.260 and section 3 of HB 2294, including the subparagraph describing the taxation rate for aircraft manufacturing and selling.

65. As the above discussion and review of the Panel Report make clear, the Panel failed to examine whether, looking at the text of the RCW as a whole, access to preferential taxation rates was explicitly limited to certain enterprises. That is, the Panel failed to examine whether all industries that were granted access to preferential taxation rates taken together constitute “certain enterprises” within the meaning of Article 2.1 of the SCM Agreement, or whether the subsidy is “sufficiently broadly available” throughout the Washington State economy so as to be non-specific.⁵⁰ Accordingly, because the Panel failed to analyze specificity properly, the Panel’s specificity finding should be reversed.

66. Additionally, the United States does not believe that it is possible for the Appellate Body to complete the analysis and determine whether the subsidy that the Panel found to exist, *i.e.*, preferential taxation rates, is *de jure* specific. While it may be possible for the Appellate Body to identify the industries that have access to a preferential taxation rate, it would not be possible to determine whether that group constitutes “certain enterprises” within the meaning of Article 2.1 of the SCM Agreement.

67. In *US – Anti-Dumping and Countervailing Duties (China)*, to which the Appellate Body referred in a question during the hearing, the Appellate Body indicated that “the term ‘certain enterprises’ refers to a single enterprise or industry or a class of enterprises or industries that are known and particularized.”⁵¹ However, the Appellate Body went on in that report to note its agreement with “the panel in *US – Upland Cotton* that any determination of whether a number of enterprises or industries constitute ‘certain enterprises’ can only be made on a case-by-case

⁵⁰ *See id.*, para. 7.191.

⁵¹ *US – Anti-Dumping and Countervailing Duties (China) (AB)*, para. 373.

basis.”⁵² In *US – Anti-Dumping and Countervailing Duties (China)*, the Appellate Body was not called upon to review a Panel determination, or a determination by an investigating authority that a number of enterprises or industries constitute “certain enterprises.” The determination under review there was more limited in nature and premised on evidence showing that access to a subsidy was limited to a particular industry.⁵³

68. Here, the Panel failed to undertake any inquiry into an analysis of whether any collection of enterprises or industries in addition to “aerospace” would constitute “certain enterprises” under the SCM Agreement. The Panel failed to make any factual findings in this regard and there simply is insufficient evidence on the record, disputed or undisputed, to enable the Appellate Body to complete the analysis, given the Appellate Body’s admonition that such a determination must be made on a “case-by-case basis.”

VI. THE PANEL ERRED IN FINDING THAT BOEING AND SPIRIT WERE GRANTED DISPROPORTIONATELY LARGE AMOUNTS OF THE WICHITA INDUSTRIAL REVENUE BONDS SUBSIDY.

69. The United States has identified numerous problems with the Panel’s consideration of the third factor in Article 2.1(c) of the SCM Agreement.⁵⁴ In light of the many serious errors in the Panel’s analysis and the Panel’s failure actually to take into account the diversification of the Wichita economy, the Panel’s conclusion that Boeing and Spirit were granted disproportionately large amounts of the Wichita industrial revenue bonds (IRBs) subsidy, and its finding that, therefore, the IRBs are *de facto* specific, should be reversed.

70. The participants and third participants have given much attention to the questions of which baseline group to use for the second ratio in the disproportionality analysis and how properly to measure a subsidy recipient’s share of economic activity. However, the fundamental flaw with the Panel’s analysis is that one cannot establish whether an amount of subsidy granted to a recipient is disproportionately large by looking at the recipient’s share of economic activity, when the subsidy is not granted to or apportioned among subsidy recipients based on their economic share. In a case such as this, economic share is not probative of the question of disproportionality.

⁵² *Id.*, para. 373.

⁵³ *See id.*, para. 395.

⁵⁴ U.S. Other Appellant Submission, paras. 180-195; U.S. Opening Statement at the First Hearing, paras. 97-106.

71. During the hearing, the United States proposed a hypothetical scenario wherein a subsidy is granted to any company that hires visually impaired workers. If a small enterprise hires significantly more visually impaired workers than any other company, and that small enterprise receives a correspondingly large amount of the subsidy, that large amount is not disproportionate simply because the small enterprise's share of economic activity is less than the proportion of the subsidy it received.

72. The converse is equally true. If a large enterprise were to receive large amounts of the same subsidy for hiring visually impaired workers, but evidence showed that the large enterprise hired fewer visually impaired workers than other companies, the Panel's analysis would nonetheless suggest that, regardless, the large amounts of subsidy received should not be considered disproportionate, so long as they are in proportion to the large enterprise's share of economic activity.

73. As the United States has explained, disproportionality should be assessed in light of the operation of the subsidy and the objective criteria or conditions for receiving the subsidy. Where there is a subsidy for construction or capital improvement (an activity that generally is performed across an economy), if the subsidy is granted to applicants in proportion to their share of eligible construction or capital improvement activity, then the amounts of subsidy each receives, even if large, should not be considered disproportionately large simply because there is no correspondence to the company's share of economic activity.

74. The question of whether a subsidy recipient's economic share should be measured against the economic share of other subsidy recipients, applicants, or eligible companies, or the entire manufacturing sector, or even the whole economy, and the question of whether a company's level of employment is a useful proxy for estimating its economic share, are secondary to the question of whether economic share is relevant to the disproportionality analysis at all. Even assuming *arguendo* that economic share is relevant, however, the United States and some of the third participants have pointed to other serious flaws in the Panel's analysis. For example, Canada noted that comparing a company's economic share to that of the whole economy, including companies not eligible to receive the subsidy, will skew the disproportionality analysis and permit a panel or investigating authority to find *de facto* specificity in virtually any situation.⁵⁵ Australia also pointed to the problems inherent in using employment level alone as a proxy for economic share, especially when looking at capital intensive industries.⁵⁶

⁵⁵ Canada Third Participant Written Submission, para. 44.

⁵⁶ Australia Third Participant Written Submission, paras. 92-95.

75. During the hearing, the EU answered the arguments set forth above by asserting that it was simply responding to the United States, which referenced Boeing’s employment level before the Panel. This is no justification for the Panel’s errors. Furthermore, it was not the responsibility of the United States to demonstrate to the EU how to show disproportionality or to make the EU’s case for it. It is also not the fault of the United States that the EU advanced a legally deficient case for showing that Boeing and Spirit were granted disproportionately large amounts of the subsidy.

76. In any event, the United States clearly explained to the EU and the Panel the pitfalls of the EU’s approach and its misguided use of employment data:

The EC {seeks} a mathematical correspondence between usage and employment numbers that is irrelevant and does not establish *de facto* specificity. The EC never explains why it is reasonable to expect a company’s share of IRBs to be the same as its share of employment – there are a variety of reasons that some businesses may use IRBs more than others, including that IRBs are more useful to companies with extensive machinery and property usage, and that some transaction costs are involved in applying for IRBs that smaller businesses may be less inclined to assume. The lack of direct mathematical correspondence between share of local employment and IRB usage does not establish *de facto* specificity here.⁵⁷

The Panel, at the EU’s urging and over the objections of the United States, made a legally deficient disproportionality finding, which should be reversed.

77. Finally, the United States notes the following statement by the Panel about its effort to take into account the diversification of economic activities in Wichita:

In determining whether the amount of subsidies granted to “certain enterprises” is lacking proportion, comparing the percentage of the subsidy received by the “certain enterprises” with their position within the entire economy, is one way in which the diversification of the economy in the jurisdiction of the granting authority can be taken into account.⁵⁸

78. This is the Panel’s only description of its effort to take into account economic diversity. However, as discussed during the hearing, comparing the percentage of the subsidy received by

⁵⁷ U.S. Opening Statement at the Second Panel Meeting, para. 118.

⁵⁸ Panel Report, para. 7.760.

“certain enterprises” with their position within the entire economy, in many cases, will provide very little information about the diversification of economic activities in a jurisdiction. It may only shed light on the relative size of the economic activities compared, but say nothing about the diversity of activity. Consequently, the Panel failed to take into account the diversification of economic activities in Wichita, as it was required to do by the last sentence of Article 2.1(c) of the SCM Agreement, and this is another legal error in the Panel’s analysis.

79. As the United States has explained, the Panel’s *de facto* specificity analysis is deeply flawed and should be reversed. Because the EU failed to adduce any evidence relevant to the question of disproportionality, there is insufficient evidence on the record to permit the Appellate Body to complete the analysis and determine whether Boeing and Spirit were granted disproportionately large amounts of the Wichita IRBs subsidy.

CONCLUSION

80. Once again, the United States appreciates the opportunity to provide these comments, which we hope will be of assistance to the Appellate Body as it considers the issues in this dispute.