

WTO Panel Report: EC – Large Civil Aircraft (Airbus)

July 2010

Summary

Decision

A WTO Panel has ruled that support provided to Airbus by the European Communities and four EU member States is inconsistent with the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement). The United States established violations under four of the five broad categories of measures it challenged:

- “Launch aid” (or “member State financing”), a form of long-term preferential financing for Airbus, which the United States argued was provided on “unsecured, back-loaded, success-dependent and below-market interest rate repayment terms”;
- Infrastructural grants, such as the provision of facilities to Airbus;
- Corporate restructurings, mainly in the form of equity infusions; and
- “Research and technological development funding” focused on aeronautics.

A fifth category of US claims – against loans provided by the European Investment Bank – failed. The Panel agreed that these loans constituted subsidies, but found that they were not “specific” to Airbus, and therefore not actionable.

Significance of Decision/Commentary

This much-anticipated Panel report is the first ruling by the WTO in the tit-for-tat aircraft subsidies row between the EC and the United States. There are only two manufacturers of large civil aircraft (LCA) left in the world, Airbus and Boeing, and competition between these

two companies is fierce. The EC has brought separate panel proceedings against what it considers to be WTO-inconsistent US subsidies to Boeing (that other Panel has yet to rule).

In the present case, the United States argued successfully that a number of support measures provided by the EC and four EU member States constituted “actionable subsidies” that caused “adverse effects” to the United States. The adverse effects found by the Panel included the displacement of Boeing imports into the European market, the displacement of Boeing’s exports into third country markets, and lost sales. It also established that certain German, Spanish and UK launch aid contracts were prohibited export subsidies.

The United States was by no means successful in all its claims. For example, the Panel rejected the US argument that Boeing had been “materially injured” by the subsidies to Airbus. Much has been made of this particular ruling in the press, although as a legal matter its significance is limited. The United States had already established that it had sustained “adverse effects” from the subsidies. As noted above, the Panel ruled that such “adverse effects” included market displacement and lost sales. Injury is another form of adverse effects, but this additional ruling would not have added substantially to the result for the United States.

A more serious matter for the United States was the Panel’s rejection of the US claim that launch aid had to be considered as a “programme”; or a distinct measure that causes adverse effects. The Panel disagreed, reasoning that the evidence and arguments “do not lead us to conclude that



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[launch aid], by definition, involves below-market financing.” This has potential consequences for the ability of the United States to use the Panel’s ruling to challenge subsidies to Airbus models that are not specifically covered in the Panel’s report. Indeed, the Panel dismissed the US claim against the Airbus A350 on the grounds that there was an only “in principle” commitment on the part of the four EC member state governments to support the development of the A350 through launch aid, since the terms and conditions of this support remained subject to negotiation. Airbus officials have been quoted in the press as saying that “the A350 is untouched by the WTO’s findings;” a point that will be strongly contested by the United States, given the Panel’s broader statements on launch aid. Thus, it seems that fights over implementation are already looming.

It is highly likely that the EC will appeal this decision and, for the reasons discussed above, the United States will probably cross-appeal. This thousand-page Panel report is very likely only the opening salvo, and not the last word, in this dispute.

Analysis

1. Challenged Measures

A. Launch aid: mixed rulings

The United States challenged launch aid provided by France, Germany, Spain and the UK from 1969 to 2006. [The EC objected to the term “launch aid” (“LA”), preferring the term “member State financing” (“MSF”). The Panel used a combined reference to “LA/MSF” throughout its report.] The United States argued that launch aid was “a particular form of long-term preferential financing granted to Airbus by the...four EC member State governments for the development of each new Airbus model of LCA on unsecured, back-loaded, success-dependent and below-market interest rate repayment terms.”

Airbus A350: US “failed to demonstrate that [launch aid] existed” at the time of panel establishment

The Panel first considered the US claim against the Airbus A350. The Panel recalled the two elements of the definition of “subsidy” under the SCM Agreement, *i.e.*, that there had to be a “financial contribution” by a government that conferred a “benefit” on the recipient. After reviewing the evidence, the Panel stated that it was “not convinced that a clear and identifiable commitment to provide LA/MSF on the terms and conditions specified by the United States existed on the date of establishment of this panel.” It found that although “an in principle commitment on the part of

the four EC member state governments to support the development of the A350 through LA/MSF did exist;” such a commitment “did not take the form of LA/MSF on backloaded, success-dependent and below market interest rate repayment terms, as the United States alleges, but rather LA/MSF on terms and conditions subject to negotiation.” The Panel concluded that “[t]he United States has therefore failed to demonstrate that the LA/MSF measure it challenges existed at the time of the establishment of this panel.” It accordingly dismissed the US complaint against the alleged launch aid for the A350.

Launch aid for other models: “direct transfers of funds” benefitted Airbus

The Panel then considered whether the individual grants of launch aid provided for other Airbus models constituted subsidies under the SCM Agreement. The Panel quickly concluded that the first element of the definition, that of “financial contribution,” had been met. Noting that all of the funds committed for the other models had already been provided to Airbus, the Panel stated that “there is no doubt that, as the United States argues, these measures involved *direct* transfers of funds, and therefore, the provision of a ‘financial contribution by a government or any public body’, within the meaning of...the SCM Agreement [original emphasis].”

Turning to the definition of “benefit,” the Panel adopted the principle set out by the Appellate Body in *Canada – Aircraft* that “a financial contribution will only confer a ‘benefit’, *i.e.*, an advantage, if it is provided on terms that are more advantageous than those that would have been available to the recipient on the market.” It similarly agreed with the Appellate Body that “the marketplace provides an appropriate basis for comparison in determining whether a ‘benefit’ has been ‘conferred’...”

Applying this test to the impugned measures, the Panel concluded that the financial contributions indeed conferred a benefit on Airbus, because the cost of the contracts to Airbus was less than the cost that Airbus would have incurred if it sought financing on the same or similar terms from “market lenders.”

The Panel also found that the launch aid subsidies were “specific,” as “[e]ach of the challenged LA/MSF contracts involves a unique transfer of funds at below-market interest rates to one particular company, Airbus.”

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Panel dismisses US claim against launch aid as a “programme”

Apart from the individual grants, the United States also challenged the “LA/MSF Programme” as a distinct measure causing adverse effects. According to the US complaint, “the governments of France, Germany, Spain and the UK...have maintained a formal and institutionalized industrial policy towards Airbus;” which entailed a “systematic and coordinated” provision of subsidies to the company.

The Panel ruled against the United States on this issue. It found that “the evidence and arguments advanced by the parties do not lead us to conclude that LA/MSF, by definition, involves below-market financing.” The Panel stated that “it cannot be concluded with the degree of certainty needed to overcome the ‘high’ evidentiary threshold that the United States must satisfy that any LA/MSF granted in the future will involve non-commercial interest rates.” The Panel thus ruled that “the totality of the evidence and arguments the United States has advanced does not demonstrate the existence of the alleged unwritten LA/MSF Programme.”

Certain EU member State launch aid contracts found to be prohibited export subsidies

Article 3.1(a) of the SCM Agreement prohibits “subsidies contingent, in law or in fact...upon export performance...” A footnote adds that “[t]his standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings.”

The EC argued that “contingency *in fact* upon *anticipated* export performance arises when the measure granting a subsidy *legally requires* the recipient to satisfy a performance condition that cannot be achieved without exports, irrespective of whether those exports (or that performance) actually takes place [original emphasis].” The Panel found that the EC interpretation “cannot be sustained.” It reasoned that “we see nothing in the ordinary meaning of the word ‘contingent’ to support the view that the required link between the anticipation of export performance and the granting of a subsidy can *only* be established by proving the existence of a *requirement* to achieve that anticipated performance [original emphasis].” It added that “limiting the scope of the prohibition on subsidies that are contingent *in fact* upon *anticipated* exportation to only those subsidies that are granted subject to the existence of a *performance obligation* that can only be achieved through export sales, would create significant potential for circumvention [original emphasis].”

According to the Panel, “[c]orrectly interpreted, the legal standard

set out in [the] footnote...indicates that a subsidy may be found to be contingent *in fact* upon *anticipated* export performance, and therefore prohibited under Article 3.1(a), when there is evidence demonstrating the existence of three distinct elements: (i) the granting of a subsidy; (ii) that is tied to; (iii) anticipated exportation or export earnings [original emphasis].” It added that “in order to qualify as a prohibited export subsidy, the grant of the subsidy must be *conditional* or *dependent upon* actual or anticipated export performance; or as we have put it above, a subsidy must be granted *because* of actual or anticipated export performance [original emphasis].”

Applying these principles to the facts of this case, the Panel found that the United States had demonstrated that the German, Spanish and UK A380 contracts amounted to prohibited export subsidies. The Panel said that such prohibited subsidies had to be withdrawn within 90 days (a period that would only start to run after the report has been adopted). However, it ruled that “the United States has not shown that the granting of the other challenged LA/MSF subsidies was contingent in fact upon anticipated export performance[.]” The Panel similarly dismissed a US claim that the launch aid measures were contingent in law on export performance.

B. European Investment Bank (EIB) loans not “specific”

The United States claimed that a number of loans provided by the EIB to Airbus entities were subsidies.

The Panel found that all of the measures at issue were “financial contributions” in the form of loans. It noted that the SCM Agreement definition of “financial contribution” included “potential direct transfers of funds or liabilities (e.g., loan guarantees).” In the Panel’s view, “the fact that a loan guarantee will confer a benefit on a recipient when it enables that recipient to obtain the guaranteed loan at a below market price implies that the benefit of a potential direct transfer of funds arises from the *mere existence* of an obligation to make a direct transfer of funds in the event of default [emphasis added].”

The Panel ruled that an EIB loan to the parent company of Airbus, the European Aeronautic Defence and Space Company (EADS), conferred a benefit, in part because the interest rate charged by the EIB was “less than what a market lender would have asked EADS to pay for comparable financing[.]” It similarly found that the Airbus companies Aérospatiale and British Aerospace benefitted from EIB loans.

However, having found that these EIB loans constituted subsidies, the US claim on this issue foundered over the Panel’s ruling that these subsidies were not “specific.”

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A subsidy will be subject to the disciplines of the SCM Agreement where it is “specific to an enterprise or industry or group of enterprises or industries.” The Agreement sets out a number of criteria to determine specificity, including “[w]here the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises....” The Panel noted that under this provision, a finding of specificity “requires the establishment of the existence of a limitation that expressly and unambiguously restricts the availability of a subsidy to ‘certain enterprises’, and thereby does not make the subsidy ‘sufficiently broadly available throughout an economy.’”

The United States argued that “EIB loans (including those to Airbus) are all one-off, discrete lending transactions and, to this extent, explicitly limited to the counterpart involved in the loan transaction.” The Panel rejected this argument, reasoning that “the wide array of economic sectors covered by the EIB’s explicit lending objectives means that its operations are expressly intended to benefit recipients well beyond a particular enterprise or industry or group of enterprises or industries.”

The United States then argued that the EIB loans were *de facto* specific. Under the SCM Agreement, a subsidy can be considered to be *de facto* specific in certain circumstances, including “the granting of disproportionately large amounts of subsidy to certain enterprises” or where there is “predominant use by certain enterprises.”

The Panel rejected the US argument that the EIB loans to EADS involved “the granting of disproportionately large amounts of subsidy to certain enterprises.” In the view of the Panel, the loan to EADS “was not disproportionately large when considered in the light of the total value of the EIB’s lending programme over a period of time that we believe is reasonable and appropriate for the purpose of conducting a disproportionality analysis.” It similarly dismissed the US “predominant use” claim.

Given its determination that the EIB loans were not “specific,” the Panel dismissed the US claims against these measures.

C. Infrastructure grants: improvements benefitted Airbus

The SCM Agreement defines a “financial contribution” to include the provision by a government of “goods or services other than general infrastructure[.]” The United States argued that infrastructural improvements undertaken by the four EU member States provided a subsidy to Airbus and could not be considered as “general.”

The Panel stated that it did “not consider that there is any form or type of infrastructure which is inherently ‘general’ *per se*. For instance, in our view, such things as railroads or electrical distribution systems do not necessarily constitute ‘general infrastructure.’” Instead, “the determination whether the provision of the good or service in question is ‘general infrastructure’ or not must be made on a case-by-case basis, taking into account the existence or absence of *de jure* or *de facto* limitations on access or use, and any other factors that tend to demonstrate that the infrastructure was or was not provided to or for the use of only a single entity or a limited group of entities.”

Applying these principles, the Panel found that a number of infrastructural improvements constituted specific subsidies to Airbus, including the provision of an industrial site, the extension of a runway, as well as regional grants. However, the Panel rejected the US claims against projects that were not of exclusive benefit to Airbus, such as the improvement of roads in France that were open to all traffic.

D. Corporate restructurings: equity infusions considered subsidies

The United States successfully challenged two transactions arising out of the German government’s restructuring of Deutsche Airbus. The German government, through its development bank *Kreditanstalt für Wiederaufbau* (KfW) made an equity infusion to Deutsche Airbus in an amount representing 20 per cent of the equity of this company. The Panel found that this acquisition by KfW of a 20 per cent equity interest constituted a subsidy in the form of a direct transfer of funds. It conferred a benefit on Deutsche Airbus because “the investment decision was inconsistent with the usual investment practice of private investors in Germany.” It was also “specific.” The later transfer by KfW of its equity interest to the parent company of Deutsche Airbus was also found to constitute a specific subsidy. The Panel made similar rulings with respect to equity infusions by the French government to Aérospatiale.

E. Research and technological development funding: a “closed system of subsidization focused on aeronautics”

The United States challenged “research and technological development funding” in the form of grants or loans provided or committed to Airbus by the EC and the member States. The Panel agreed that such direct transfers of funds or loans fell explicitly within the definition of “financial contribution” under the SCM Agreement. Such funding measures also provided a benefit to Airbus, as the company was “automatically placed in a better position than it would otherwise have been in” without measures such as the grants.

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The Panel agreed with the United States that such subsidies were “specific.” It found that the way the research programs were structured was “equivalent to setting aside a portion of a budget that is ostensibly intended to fund research activities in all sectors of the economy for the sole purpose of the research efforts of enterprises or industries active in the aeronautics sector.” Thus, “the research grants at issue could be viewed as emanating from a closed system of subsidization that focused on ‘aeronautics’ or ‘aeronautics and space.’” The Panel thus upheld the US challenge to most of these research programs.

2. Adverse Effects

Article 5 of the SCM Agreement – part of the “actionable subsidies” disciplines of the Agreement - provides in part that “[n]o Member should cause, through the use of any subsidy... adverse effects to the interests of other Members.” Adverse effects include “injury to the domestic industry of another Member” and “serious prejudice to the interests of another Member.”

Article 6 further defines when “serious prejudice” may arise, such as where the effect of the subsidy is displacement in the market of the subsidizing Member or a third country market, significant price undercutting, lost sales, price suppression or price depression. The United States invoked these disciplines as the basis for its “serious prejudice” claims.

The EC argued that “today, Boeing stands as *the* dominant player in the competitive Boeing-Airbus duopoly” and claimed that Boeing’s healthy financial and market position precluded the possibility that the United States was suffering serious prejudice caused by the subsidy [original emphasis]. However, the Panel considered the EC argument to be “inapposite, and based on a flawed understanding of the concept of serious prejudice to the interests of the complaining Member.” It stressed that “[t]here is nothing in the text of Article 6, or any other provision of the SCM Agreement, that would even suggest, much less require, consideration of the ‘state of the industry’ of the complaining Member in the context of a serious prejudice analysis.” It stated that “in our evaluation of serious prejudice...we will not, as the European Communities does, take into account improvements in the condition of Boeing.” The Panel then turned to the specific elements of the definition set out in the SCM Agreement.

Displacement of imports into the EC market

The Panel considered the evidence and found that “it is clear that Boeing’s share of LCA deliveries to the EC market declined over the [2001-2006] period [used by the Panel], while Airbus’ share of that market increased.” It concluded that “[a]s the only other competitor in the market was Airbus, it follows that the evidence

we have reviewed demonstrates that imports of United States’ LCA into the EC market were displaced by Airbus LCA over the relevant period.”

Displacement of exports from a third country markets

The Panel similarly concluded that “it is clear that in certain individual third country markets, Airbus’ market share increased significantly over the period 2001 to 2005, and even in 2006 remained higher than Boeing’s market share....” As the only other competitor in the relevant markets was Airbus, the Panel concluded that “the evidence demonstrates that Boeing’s exports of LCA were displaced from the markets of Australia and China by sales of Airbus LCA over the period we examined, and that there is a likelihood of future displacement of Boeing LCA from the Indian market.” The situation was “less compelling with respect to the markets of Brazil, Chinese Taipei, Korea, Mexico and Singapore, where sales were sporadic and volumes were relatively small, making identification of any trends more difficult.” However, the Panel again found that “any market share achieved by Airbus was at the expense of Boeing.”

Lost sales

The Panel rejected the argument that sales had to be lost only on the basis of price undercutting. It noted that “[w]hile we have concluded that significant price undercutting cannot be found on the basis of the evidence before us, this does not mean that there were not significant lost sales.” The Panel found that Boeing lost sales to Airbus in purchases by a number of airlines. It concluded that “these lost sales are significant.”

Causation: “Airbus would have been unable to bring to the market the LCA that it launched but for the specific subsidies it received”

In the final section of its report, the Panel turned to causation issues. It examined whether the “market phenomena” described above were “caused by the specific subsidies we have found were provided to Airbus.”

“Product theory of causation” upheld

The United States first advanced a “product theory of causation,” focused on launch aid. It argued that launch aid “shifts much of the commercial risk of LCA launch decisions from Airbus to the Airbus governments, thereby causing Airbus to launch aircraft models that in the absence of the subsidy would not have been launched.”

The Panel found that “the United States has demonstrated that LA/MSF shifts a significant portion of the risk of launching an aircraft from the manufacturer to the governments supplying the funding, which we recall is on non-commercial terms.” Based on

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the Panel's review of the development of successive models of Airbus LCA, it concluded that "Airbus' ability to launch, develop, and introduce to the market, each of its LCA models was dependent on subsidized LA/MSF"

The United States argued that while launch aid was the "primary subsidy" benefitting Airbus, the other subsidies had similar effects. The Panel began by recalling its key conclusion on launch aid that "LA/MSF was necessary to the launch of each successive model of Airbus LCA, and that the individual and cumulative effect of those measures was fundamental to Airbus' ability to launch the particular LCA models it launched at the time that it did. That is, but for LA/MSF, Airbus would not have been able to accomplish these successive launches." It added that this "product" effect of launch aid was "complemented and supplemented" by the other specific subsidies:

- The "equity investments and share transfer measures of the French and German governments ensured the continued existence and financial stability of the respective national entities engaged in the Airbus enterprise." These entities were "a necessary element of the overall Airbus effort, as it is clear to us that without their participation in the overall effort, Airbus would not have been able to continue to develop, launch and produce LCA in fulfillment of the goal of developing a full range of LCA for the market." The equity investments "directly supported the development of LCA in a manner that was as direct as LA/MSF"
- The "infrastructure subsidies similarly provided essential support to the development and production of Airbus LCA, relieving Airbus of significant expenses in connection with the development of facilities for the production of, most particularly, the A380, and thus enabling it to continue with the launch of successive models of LCA."
- The research and technological development funding "enabled Airbus to develop features and aspects of its LCA on a schedule that it would otherwise have been unable to accomplish."

In a key passage of the report, the Panel summarized its conclusions on causation as follows:

It is in our view clear that Airbus would have been unable to bring to the market the LCA that it launched but for the specific subsidies it received from the European Communities and the governments of France, Germany, Spain and the United Kingdom. We reiterate that we do not conclude that Airbus necessarily would not exist at all but for the subsidies, but merely that it would, at a minimum, not have been able to launch and develop the LCA models it has actually succeeded in bringing to the market. Had Airbus successfully entered the

LCA industry without subsidies, it would be a much different, and we believe, a much weaker LCA manufacturer during the period we examined, with at best a more limited offering of LCA models. Thus, under either scenario, Airbus would not have had the market presence and ability to win orders for LCA that it did have during the period 2001-2006, and the United States' LCA industry, at a minimum, would not have lost sales to Airbus and would have had a larger market share in the EC and certain third country markets than it actually did over that period. We consider that Airbus' market presence during the period 2001-2006, as reflected in its share of the EC and certain third country markets and the sales it won at Boeing's expense, is clearly an effect of the subsidies in this dispute. We therefore conclude that the displacement of United States' LCA from the EC and certain third country markets and lost sales we have found during the period 2001-2006 are an effect of the specific subsidies to Airbus that we have found.

"Price theory of causation" rejected

The United States also argued that the challenged subsidies, particularly launch aid, "provided Airbus with the financial means to be flexible with its pricing of LCA in competitions against Boeing, thereby enabling it to win sales, capture market share and significantly depress and suppress the prices of LCA between the years 2001 and 2006." The Panel rejected this part of the US claim, concluding that the United States had not demonstrated that the subsidies to Airbus "were also the cause of the significant price depression and price suppression we have observed in the period 2001 to 2006."

US injury allegations rejected: Boeing is "not...materially injured"

As noted above, the SCM Agreement defines "adverse effects" of a subsidy to include "injury to the domestic industry of another Member." The Panel rejected the US claims that its large civil aircraft industry was "injured" by the Airbus subsidies.

The Panel began its analysis of this issue by noting that Boeing constituted "the whole of the domestic industry in this dispute." Thus, it indicated it would examine the question of injury to Boeing.

The Panel rejected the EC argument that the "effect" of injury must be caused by the "use of the subsidies." The Panel said that its injury analysis should focus not on the effects of the subsidies, but rather on the effects of the subsidized imports on the US industry. It reasoned that "the question to be answered is not whether the subsidy(ies) cause injury, but whether the subsidized imports, that is, the imports of the subsidized product, do so."

It then considered the condition of Boeing, and concluded that it had not suffered material injury. After reviewing the evidence, it concluded that Boeing's performance reflects "significant improvement," and the company was "operating at levels which, in our view, do not warrant a finding that the United States' domestic industry producing LCA is materially injured." The Panel found that "following the collapse of the LCA market after the events of 9/11, Boeing has managed to successfully compete with subsidized imports and better its performance to the extent that we cannot conclude that it is materially injury [sic] as of the end of the period we examined." The Panel ruled that Boeing was "not presently materially injured" and that the United States had not established a threat of injury.

The decision of the Panel in this dispute is lengthy (1049 pages), and while this summary highlights the key points, it should not be regarded as exhaustive.

The decision of the Panel in *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft* (DS 316) was released on June 30, 2010.

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