LEGAL ISSUES IN THE AIRCRAFT SUBSIDIES DISPUTE

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Boeing vs. Airbus: An Examination of the Issues

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LEGAL ISSUES IN THE AIRCRAFT SUBSIDY DISPUTE

Good afternoon ladies and gentlemen. I have been asked to describe -- in general terms and quickly, so that we can get to questions -- the legal background for the aircraft subsidies cases now part-way into the WTO dispute settlement process.

You all know the basics: the United States has complained about certain European Communities ("EC") and Member State measures, and the EC has complained about certain U.S. federal and state-level measures, which are said to be "affecting trade in large civil aircraft." You also know that the complainants, if they cannot find a negotiated solution to curb future subsidies satisfactorily, will be seeking in the WTO dispute settlement process to prove that "subsidization" and resulting commercial damage already exist.

To understand the legal framework, it is best to start by looking at which provisions of the WTO *Agreement on Subsidies and Countervailing Measures* ("ASCM") each side is pleading under, and how those provisions work. I will do that briefly, and in the second part of my presentation will identify a few interesting "issues to watch" from each case.

I. PROHIBITED AND ACTIONABLE SUBSIDIES

A threshold question for the complainants is whether to allege "prohibited" or "actionable" subsidies. Prohibited subsidies, in general, are those whose bestowal is contingent on exportation or on the use of domestic inputs. Subsidies bestowed without any such contingency are actionable provided they are specific and cause adverse effects.

In both scenarios one must show that subsidies, as defined in ASCM Article 1, exist. But thereafter the legal regimes differ starkly. A prohibited subsidy claim need not include any demonstration of trade effects. An actionable subsidies claim requires such a demonstration, which as we shall see is no simple matter in a sector like commercial aircraft. Moreover, the authorized remedies differ significantly, as does the likely time limit for complying with an adverse WTO decision (much shorter for prohibited subsidies). And, as the *US – FSC* case showed, the prohibited and actionable subsidy regimes differ sharply in the magnitude of retaliation that can be authorized after a failure to implement an adverse WTO decision. (Retaliation in a prohibited subsidy case can greatly exceed demonstrable trade effects.)

A. Prohibited Subsidy Claims

Both sides have made prohibited subsidy claims, but neither side has rested solely on such claims. The most-discussed individual item in the U.S. complaint – "launch aid" – is specifically identified as a prohibited export subsidy in the U.S.

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request for consultations ("U.S. Request"). The same is true for one of the European Investment Bank loans referenced in the U.S. Request. The EC complaint does not specify which alleged U.S. subsidies the EC believes are prohibited and which actionable, except in the case of FSC benefits which have already been found to be contingent on exportation. The EC request for consultations ("EC Request") simply recites a series of alleged subsidies and then invokes both the prohibited and actionable subsidies provisions of the ASCM.

The factual basis for the U.S. depiction of launch aid as an export subsidy has not been made public, but I'm sure everyone in this room can imagine what it might include. A considerable body of WTO law has developed on the concept of *de facto* (as opposed to legally explicit) export contingency, what qualifies as an "export-oriented industry," *etc*. Some WTO Members have expressed the view that these decisions have made export contingency easier to establish than the ASCM's drafters intended.

In thinking about a long-haul large civil aircraft which repeatedly leaves and re-enters the territory where it was finally assembled, you might wonder how one can speak about that aircraft as being "exported" or about a subsidy as being "contingent on exportation." I imagine the U.S. and EC lawyers are wondering too. There are of course conventions used for purposes of data collection – we all know that aircraft have for decades been a leading category of U.S. "exports" -- but will those conventions hold in an ASCM case? Is exportation dependent on the nationality of the airline operating the aircraft? (E.g., Singapore Airlines flies an Airbus plane back and forth between Paris and Tokyo for 15 years.) What if the airline does not own the aircraft? What if the ownership is foreign but the plane itself never leaves Europe? And, what percentage of sales of a given model (say the A380) have to be "exports" -- however defined – before one can begin asking whether a subsidy attributable to that model is contingent on exportation? How can this be confidently assessed before any of the planes have entered service, and only the initial orders (many of them tentative) are available for inspection?

B. Actionable Subsidy Claims

As you can see, pleading under the prohibited subsidies regime has its share of complexities. And both sides have also invoked the ASCM's actionable subsidy provisions, suggesting there are some subsidies they believe they can prove to exist but not to be export-contingent. So, they will be seeking to demonstrate "adverse effects" in one of the forms specified in the ASCM – particularly "serious prejudice" through lost sales, price undercutting, price depression/suppression, and the like. This may be the most interesting aspect of the litigation, as the parties and panels will have to address at least three very difficult sets of questions.

First, how can a causal connection be documented between a subsidy, on the one hand, and conditions/events observed many years after its bestowal, on the other? Consider the length of time it takes before an airframe, once "launched" at the

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R&D stage, enters service. Does a "launch" subsidy have cognizable effects in the interim? Orders may be placed sooner – closer to the year of bestowal of a subsidy -- but does losing an order constitute a "trade effect," or must one lose an actual delivery? Is the harm associated with price effects (suppression/depression) experienced when the purchase price is negotiated or at the time of delivery, perhaps many years later, or when money actually changes hands?

Second, how long do subsidies and their effects last in theory? Economists and lawyers (maybe also theologians) can have great fun with this one. If provided to help launch a particular product, does a subsidy "exist" from the moment of its bestowal until the subject product ceases to be made -- perhaps decades later? Does the answer depend on the form of the subsidy? (Since all subsidies have grant equivalents, why should the form matter?) Or, must a subsidy be allocated over time under some sort of declining-balance methodology of the type a tax accountant would use? And what about the subsidy's *effects*? How does the effect of a subsidy -- in a particular post-bestowal year -- relate to the remaining unamortized amount of the subsidy itself? If the subsidy is deemed to follow a declining-balance pattern, must the effect be assumed to follow such a pattern as well? What if the observable effects don't even begin until very little of the subsidy itself (under standard amortization techniques) is left? Or are the effects de-linked altogether, including temporally, from the subsidy itself? This would seem to be a problem, inasmuch as a complainant needs to show currently existing subsidization and currently experienced (or imminently threatened) adverse effects.

As a reminder, the question in an actionable subsidy case is not just what a subsidy enables its recipient to do (theoretically) in terms of changed price and output, but what *actually happens* as a result of the subsidy. If it is determined that a particular airframe could not have been launched without subsidies, is every later delivery of that airframe characterizable as an "adverse trade effect?" What if the evidence indicates that absent subsidies the launch would have been, not prevented, but delayed by two years? What share of the deliveries logged many years later are considered to be "adverse" effects of the subsidies in that scenario?

Third, in relation to what specific products would the various manifestations of serious prejudice be examined? For most types of serious prejudice (price suppression/depression are exceptions, at least according to the not-yet-adopted *Korea - Shipbuilding* decision), it is necessary to prove the subsidies' harmful effects vis-à-vis one's own "like products." Is there still a clearly recognizable category of "large civil aircraft" that begins at 100+ seats? What about the "regional jets" that have been encroaching upon and, in some cases, surpassing that number? And is everything above 100 seats a single like product? If not, how will the sales/pricing evidence – and the subsidies themselves – be sliced and diced? Will the parties' disagreement encompass even the definition of the "like product" categories to be examined?

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You might have expected answers this afternoon rather than so many questions. At least your admission today was free! Maybe some audience members will have proposed answers. In the meanwhile, let me mention a couple of interesting issues specific to each case – issues that bear watching, or are not being discussed accurately in the media.

II. SOME SPECIFIC ITEMS OF INTEREST

A. U.S. Complaint

Royalty-based financing ("RBF"): There has been a lot of imprecise discussion of RBF. RBF is not a loan. In its simplest form – where the investor surrenders money in exchange for the promise of a specified royalty payment per unit sold of a specified product -- it is more akin to an equity investment, with the difference being that the investor gets a share of revenues rather than a share of profits. Both equity and royalty-based investments are risky in the sense that the investor is betting on the success of the company or of a particular product line.

It is sometimes said that the absence of a clear obligation to repay the "principal" means that RBF is inherently a subsidy, but the comparison to equity purchases highlights the difficulty of that claim. RBF is used in some commercial settings, including oil exploration deals. Whether a particular government-provided RBF is a subsidy depends on two factors: (1) what a reasonable forecast indicates about likely sales volume, and (2) what the royalty formula says about the payment per unit sold. If the net present value of the expected payment stream is impressive enough – it would of course have to exceed the return available on less risky investments -- than a reasonable private investor would be willing to invest on the same terms as those extended by the government. Of course, if the upside for the RBF investor is "capped" somehow by the royalty formula, then a more certain and impressive sales forecast would be needed and probably a higher basic royalty amount (prior to the impact of the cap) as well. But the absence of an explicit "principal repayment" obligation, by itself, proves nothing.

Sometimes the legislative authority under which RBFs are provided specifies that the government can only invest where commercial capital is unavailable. The presence of such a factor would of course simplify a WTO panel's analysis.

My own view is that *most* governmental RBFs, in the aerospace sector in Europe, have been subsidies. This view arises in part from the fact that the European Commission's Competition Directorate, when analyzing RBFs under the applicable "state aid" rules, has generally found them to be subsidies (although it has typically approved them nonetheless). The examples I have studied closely have *plainly* been subsidies. But I have never studied the RBFs provided to Airbus and its predecessors/affiliates. And there are probably few people on earth who have seen the actual RBF contracts and the business proprietary sales forecasts.

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Those items, incidentally, will presumably surface during the "Annex V"/facilitator procedure which is the data-gathering portion of an ASCM serious prejudice case (somewhat akin to "discovery" in civil litigation). It is possible that EC officials will balk at providing that sensitive material on the ground that the United States should not be able to use the serious prejudice discovery procedures to obtain information which it will then use in support of a prohibited subsidy claim. But the United States has cited the same launch aid/RBF transactions also in support of its serious prejudice claims, and in the *Korea – Shipbuilding* case, which also featured both prohibited and actionable subsidy claims, Korea tried unsuccessfully to block the use of the very same clever discovery tactic. The clever complainant in that case was the EC.

Changes in ownership: As noted above, the U.S. complaint will have to establish commercial harm being experienced today – subsidized aircraft being sold at the expense of U.S. sales and/or in a manner that negatively affects Boeing's pricing. Planes being delivered today were mainly launched long ago, which means the underlying "launch aid" subsidies (assuming they are shown to be subsidies) will be old ones. Complaining about older subsidies raises the question whether post-bestowal changes in the ownership of the recipient enterprise(s) may have extinguished the subsidies. We know from the *US - Countervailing Measures* case that some changes in ownership (privatizations) have that magical effect on some kinds of subsidies (equity subsidies and debt relief), but we do not know how broadly that concept will be held to apply. The breadth of this subsidy extinguishment concept was tested, but not extensively, in the *Korea – Shipbuilding* case where the panel seemed inclined to apply it narrowly.

B. EC Complaint

R&D aid: Of seven main categories of alleged subsidies cited in the EC Request, four appear to target R&D supports (from NASA, DoD, NIST, and in the tax code). I believe most economists would predict that, as compared with other types of subsidies, it will be harder to document a causal link running all the way from R&D assistance to commercial harm in the marketplace in the form of price suppression, displacement of competing EC products, *etc*. These difficulties will augment those arising from the pure "time lag" factor mentioned earlier.

Procurement subsidies: At least one of the main categories in the EC Request[1] involves "procurement contracts," raising the longstanding argument about whether U.S. public procurement (especially defense procurement) is conducted on overly-generous terms which provide a cross-subsidy to the participants' commercial operations. Government contractors have been known to argue that any cross-subsidy goes in the opposite direction – i.e., that technologies that are developed (and have their costs covered) on the commercial side are used in products sold to the government, giving the government a bargain. One can

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[1] The three categories not mentioned above are "state and local subsidies," FSC benefits, and "NASA Procurement Contracts."

imagine that these claims will be tested, to the fullest extent possible, in a dispute settlement proceeding.

Japanese subsidies: I was asked to say a word about subsidies reportedly made available by the Government of Japan on components or subassemblies (a current example is wings) which are to be produced in Japan and then integrated into Boeing LCA models. I don't see how those subsidies could factor in the case that has been filed against the United States; there is no mention in the EC Request of any Japanese measures, and the U.S. Government in any event cannot be expected to answer for Japanese measures, nor would any decision adopted as a result of a dispute between the EC and the United States impose some sort of "implementation" obligations on Japan.

There remains the question whether it would be possible to complain separately against Japanese subsidies. Had someone asked me last week, I would have said such a case faced a severe pleading problem. Unless characterizable as export subsidies, Japanese subsidies on components would be hard to reach because someone would have to identify, and show serious prejudice with respect to, a "like product." There would also be a problem identifying a national "market" within which serious prejudice is being experienced. Then I read the *Korea - Shipbuilding* decision, which announced that certain kinds of serious prejudice claims (those based on price depression/suppression) need not be keyed to a like product. If you focus on some "un-like" product which you make and whose prices you believe are being depressed – say a downstream product like an aircraft – your problem is purely evidentiary: how to show a causal relationship between subsidies on upstream product X and price effects on downstream product Y. A footnote in the panel report describes this as a "significant … evidentiary hurdle in respect of causation." But, the door seems – at least pending an appeal – to be open to such a claim. And serious prejudice claims of this type can focus on the "global market."

I still wouldn't bet on a claim against Japan succeeding, based on what I've seen so far.

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It was a great honor to appear here today, and I look forward to your questions.

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