Extinction Event: Subsidies Extinction in
EC–Aircraft

Subsidies have proven to be a particularly contentious area of international trade law. Disputes over trade subsidies have involved billions of dollars and implicated major industries – including the aircraft industry in particular – whose members have much riding on the outcome beyond the dollar amounts in question. This Case Note provides an overview of the economic and legal dimensions of subsidies, specific efforts to address subsidy disputes over large civil aircraft (LCAs), and World Trade Organization (WTO) case law on subsidy extinction. The piece then examines the dispute settlement bodies’ arguments over subsidies extinction in European Communities and Certain Member States – Measures Affecting Trade In Large Civil Aircraft, a landmark WTO case over European subsidies to Airbus.

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INTRODUCTION

In 2004, after a decades-long conflict over subsidies to Airbus and Boeing, the United States (U.S.) withdrew from a 12-year-old bilateral agreement on Large Civil Aircraft (LCA) with the European Communities (EC) and initiated a World Trade Organization (WTO) case challenging subsidies to Airbus, Europe’s behemoth LCA. The EC quickly responded with a case against subsidies to Boeing, the major American LCA producer. Both sides alleged the other provided WTO-inconsistent subsidies of billions of dollars to their respective LCAs. This pair of cases—against the world’s two largest aircraft manufacturers—are among the largest in the history of the WTO dispute settlement system. The WTO Appellate Body (AB) finally issued its report in the U.S.-initiated case—European Communities and Certain Member States – Measures Affecting Trade In Large Civil Aircraft (henceforth EC – Aircraft)—in 2011, finding $19.1 billion in WTO-inconsistent subsidies from the over 300 subsidies disputed.

Amid the many elements of EC – Aircraft, the AB was unable to agree upon a clear holding on the issue of subsidies extinction, the expiration of subsidy’s benefit for legal purposes—the focus of this Case Note. Instead, the AB published the three Members’ individual interpretations without prejudice for future decisions, a rare occurrence.

Cases preceding EC - Aircraft suggest that an arm’s-length
transaction extinguishes the benefits from a WTO-inconsistent subsidy, legally removing the pre-transaction subsidy benefits for the purposes of the WTO. However, in this case, the U.S. argued—and the Panel agreed—that EC – Aircraft differed from prior case law. The argument was that EC – Aircraft included instances of partial privatization, where some part of the sale failed to completely sever the connection to the government or the benefits that came before, and therefore the subsidies should not be deemed extinct. The AB reversed the Panel’s decision and found the subsidies extinct but gave no single argument for the change. The AB’s inability to settle on one justification introduced confusion into future subsidy cases.

This Case Note examines several aspects of the regulatory environment in which EC – Aircraft was decided. Section II provides a primer on subsidies law, with a focus on LCA-specific agreements. Section III details existing subsidies extinction case law. Section IV explores EC – Aircraft from the perspective of the parties and dispute settlement bodies. By highlighting areas of confusion in WTO jurisprudence around subsidies extinction, this Case Note suggests areas that would benefit from greater clarity, both in future decisions and through further academic research.

I. THE DEBATE OVER SUBSIDIES: DEFINITIONS, PURPOSES, IMPACTS

Subsidies are positive benefits generated outside of firms. The subsidies under consideration here are those established by governments to support policy decisions. However, academics and governments disagree over defining subsidies and their economic impact, an issue that has complicated international geopolitical relationships, including between the EC and the U.S. Subsidies provided by governments may include direct payments or indirect grants. Some subsidies have specific targets, while others have significantly broader effects. Traditionally, subsidies are classified as either aimed towards exports or domestically focused.

5. Id. at 261.
6. Id.
7. Id.
8. See Alan O. Sykes, The Questionable Case for Subsidies Regulation: A Comparative Perspective, 2 J. LEGAL ANALYSIS 473, 476 (2010). Export subsidies provide funds to firms in relation to their eventual export of a good. See Matsushita, Schoenbaum & Mavroidis, supra note 4, at 262. Some argue the economic distortions from export subsidies are greater than those from other subsidy types both because the goods
Some scholars have raised issues with the practical use of subsidies and with remedies used to offset subsidies, such as levying taxes—known as countervailing duties (CVD)—on exported goods in an importing country. Sykes argues that subsidies are difficult to define outside of theory. They cannot be described as any good or service offered below market price because governments also impose costs. Moreover, because there is no market equilibrium without government action, it is difficult to apply the definition of a subsidy as a government action that changes market equilibrium. Sykes suggests that any administrable rule would be over- or under-inclusive, leading to economically inefficient outcomes. In response, Mavroidis and Bagwell argue that the definitional difficulties do not remove the need for rigid remedies in response to subsidies, as they help to guard against the erosion of negotiated tariff concessions and provide parties insurance for changes made in future trade negotiations.

A. Subsidies in the Large Civil Aircraft (LCA) Context: A Brief History

The past half-century has been defined by a gradual refining of the international trade rules binding participating member states, including the U.S. and members of the EC, but cooperative efforts have also been punctuated by disputes about subsidies. The initial effort at a global agreement, 1947’s Generalized Agreement on Tariffs and Trade (GATT), contained only limited references to enter the international market and the export subsidy serves as a counterweight against tariffs at importation. See Id. However, the minority view is that export subsidies actually expand the volume of trade that would otherwise be restricted by other trade barriers. Sykes, The Questionable Case for Subsidies Regulation: A Comparative Perspective, supra, 476. On the other hand, domestic subsidies—also called production subsidies—are provided to qualifying firms irrespective of whether the firm’s goods are exported. See MATSUHITA, SCHOENBAUM & MAVROIDIS, supra note 4, at 261. The international economic impact of both production and domestic subsidies varies depending on the percent of the goods produced that enter the international market. Id.

9. MATSUHITA, SCHOENBAUM & MAVROIDIS, supra note 4, at 262.
11. Id.
12. Id. at 87.
subsidies. Multi- and plurilateral agreements in 1955 and 1979 revised these rules, though they too were incomplete. For example, the 1979 Subsidies Code lacked a specific definition of subsidies, leaving governments seeking to challenge subsidies to rely on an illustrative list of export subsidies and ambiguous language about domestic subsidies. However, the 1995 formation of the World Trade Organization brought sweeping changes to the international subsidies regime.

1. LCA Agreements

In parallel with broad efforts to expand trade rules regarding subsidies, there were two pre-WTO attempts to address European-American subsidies conflicts over LCA. In 1979, though Airbus had been in existence for fewer than 10 years, it was beginning to threaten Boeing’s position in the industry, partially due to assistance through government subsidies. That year, participating members, including the U.S. and the EC, passed the 1979 Agreement on Trade in Civil Aircraft, which had a stated goal to “eliminate adverse effects in civil aircraft resulting from governmental support in civil aircraft development, production, and marketing.” It forbade export subsidies, but allowed domestic subsidies. However, the agreement continued to promulgate a flaw seen elsewhere in international trade law agreements: it lacked a definition of a subsidy. Also, dispute resolution continued to require positive consensus, increasingly an issue of tension within the GATT, and the agreement did not provide for enforcement.

In 1984, the U.S. and the EC responded to the 1979 round’s lack of success by entering into bilateral negotiations. The pair

16. Id. at 876.
19. Id.
20. Id.
21. Id.
22. Marc C.S. Mathis, Uncivil Aviation: How the Ongoing Trade Dispute Stalemate Between Boeing and Airbus Has Undermined GATT and May Continue to Usher in an Era
sought to reach an agreement on allowable levels of government subsidization for LCA.\textsuperscript{23} Negotiations focused on eliminating Airbus’s direct subsidies and Boeing’s indirect, defense-related subsidies.\textsuperscript{24} The 1992 bilateral Agreement on Trade in Large Civil Aircraft (henceforth Bilateral Agreement) placed substantial limits on direct subsidies: it banned production subsidies and limited development subsidies to 33\% of development costs and to the form of 17-year loans.\textsuperscript{25} Furthermore, the repayment of the loans could not exceed that timeframe or have an interest rate lower than that available on the private market.\textsuperscript{26} Government subsidies were only available when Airbus and Boeing had market parity.\textsuperscript{27} Indirect subsidies were limited to 3\% of industry-wide turnover for civil aircraft and 4\% of turnover by each individual manufacturer.\textsuperscript{28} Moreover, the preamble noted that both sides expected progressive reductions in future levels of government support.\textsuperscript{29} The Bilateral Agreement required notification of subsidies—and the U.S. expected it—but the law under which Airbus was formed did not compel financial disclosure and provided an escape clause for essential security interests.\textsuperscript{30} Parties were to continue meeting on the issues biannually with the opportunity for consultations but there were no remedies available for breach beyond abrogation of the Bilateral Agreement,\textsuperscript{31} and either party could exit the agreement upon submission of a written request.\textsuperscript{32}

The Bilateral Agreement has been described as a compact between the U.S. and the EC: the U.S. would delay potential Subsidies-Code-enforcement actions in return for a European agreement to reduce support levels.\textsuperscript{33} Keeping the conflict outside...
the GATT allowed both the U.S. and the EC to avoid potential losses. The GATT system required positive consensus by the contracting parties; therefore, if the Panel were to hold against the European subsidies to Airbus, the EC would have to agree to the adoption of the report for it to have legal impact. If the EC did not, it would potentially damage the GATT’s credibility, which the U.S. also sought to avoid. The Bilateral Agreement theoretically offered both parties the opportunity to halt some of the subsidies they opposed while avoiding any legal showdown that could impact the international dispute settlement system writ large.

2. The Agreement on Subsidies and Countervailing Measures (SCM)

The formation of the WTO in 1995 and the Agreement on Subsidies and Countervailing Measures (SCM) initiated the single most significant change to international subsidies law and established the current regime. The multilateral nature of the Uruguay Round Agreement, which formed the WTO, required all signatories to be bound by the rules. It echoed previous agreements, with options for CVD application and consideration under the newly formed Dispute Settlement Understanding. Frustration towards the positive consensus under the GATT led parties, particularly the U.S., to support the adoption of negative consensus at the WTO, where any single party’s vote in favor of a dispute report’s adoption ensured its approval. This greatly increased the chances for the adoption of politically sensitive negative reports and retaliatory sanctions.

In a departure from previous agreements, the SCM defined subsidies. According to the SCM, subsidies require three elements: a financial contribution by a government, conferral of a benefit, and specificity.34 A financial contribution by a government can take numerous forms: direct transfers of funds, such as loans or equity infusions; potential transfers like loan guarantees; the government’s waiver of a firm’s requirement to pay revenue otherwise due; the provision of goods and services by the government beyond the provision of infrastructure; “payments to a funding mechanism”; or the provision of funds for payments by a third party.35 Secondly, the SCM defines a contribution as causing a benefit when the recipient receives financial contributions with better conditions than would be available in the public market.36 The SCM does not consider there to

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34. Agreement on Subsidies and Countervailing Measures art. 1.1 and 2.1, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A 1869 U.N.T.S. 14 [hereinafter SCM].
35. Id. at art. 1.1.
be a benefit if the result does not make the recipient better off, as a benefit cannot exist abstractly. Thirdly, the specificity required in Article 2 limits the SCM to subsidies where the recipients are targeted, whether that means a certain company or particular type of industry or enterprise. Moreover, the manner in which the decision was made to grant the subsidy or the geographical limitation enters into specificity. The SCM established three types of subsidies: prohibited, actionable, and non-actionable. However, only prohibited and actionable remain legal categories today. Prohibited and actionable subsidies can be challenged through the WTO dispute settlement process. Notably, there are no specific references to airline manufacturers in the SCM, despite the multiple previous agreements on LCA and the existence of an agriculture exemption.

Missing from the SCM, however, is a definition of arm’s-length transactions, though the agreement does reference them,
leaving the dispute settlement bodies to define the term in case law. The SCM addresses the issue of arm’s-length transactions once in footnote 59 to Paragraph (e) of Annex 1, which provides an illustrated list of export subsidies. SCM, paragraph (e) states that “The full or partial exemption, remission, or deferral specifically related to exports, of . . . social welfare charges paid or payable by industrial or commercial enterprises” is an export subsidy. Footnote 59 expands on this to hold that “The Members reaffirm the principle that prices for goods in transactions between exporting enterprises and foreign buyers under their or under the same control should for tax purposes be the prices which would be charged between independent enterprises acting at arm’s length.” This has been interpreted as holding that if another norm other than arm’s-length is used there may be an unlawful subsidy. In light of the absence of a clear definition in the SCM, the US – Countervailing Measures Concerning Certain Products from European Communities (US – Countervailing Measures) Compliance Panel turned to dictionary definitions. The Compliance Panel noted:

Black’s Law Dictionary defines arm’s length as “[o]f or relating to dealings between two parties who are not related or not on close terms and who are presumed to have roughly equal bargaining power; not involving a confidential relationship”. The New Shorter Oxford Dictionary defines arm’s length as “without undue familiarity; (of dealings) with neither party controlled by the other.”

The EC – Aircraft Panel Report recognized the US – Countervailing Measures Compliance Panel definitions.

43. SCM Annex 1(e) n. 59.
44. SCM Annex 1(e).
45. SCM Annex 1(e) n. 59.
46. JENS WITTENDORFF, TRANSFER PRICING AND THE ARM’S LENGTH PRINCIPLE IN INTERNATIONAL TAX LAW 286-287 (2010).
II. GETTING TO EXTINCTION: FULL PRIVATIZATION CASE LAW UNDER THE WTO

A pair of cases, the first in 2000 and the second three years later, addressed the issue of privatization and subsidies extinction under the new regime. The cases—brought by the EC against the U.S.—directly responded to decisions made by the U.S. Department of Commerce (DOC) as to whether or not subsidies provided to earlier iterations of companies survived purchase at arm’s-length. The cases established a premise that purchasers following an arm’s-length transaction receive no benefit from the subsidies pre-privatization.\(^{49}\)

The first case, *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom* (henceforth *US – Lead and Bismuth II*) addressed the extent to which subsidy benefits given to state-owned enterprises continue following privatization.\(^{50}\) The case arose out of a pre-WTO dispute and continued to consider the


survival or extinction of subsidies following change in ownership.\textsuperscript{51} The WTO case focused on equity infusions provided by the British Government to the British Steel Corporation (BSC) during the fiscal years 1977-78 to 1985-86.\textsuperscript{52} The DOC classified the infusions as non-recurring as part of the agency’s CVD calculation and spread the infusions’ effects over the useful life of steel-industry productive assets.\textsuperscript{53} The DOC agreed that the sale of the shares of the privatized BSC occurred at arm’s length and for fair market value, but held the subsidy benefit passed through to the privatized company because of the DOC’s “change-in-ownership” calculations.\textsuperscript{54} The EC challenged the U.S.’s use of pass-through methodology. Pass-through is when downstream producers receive goods from

\textsuperscript{51} DSC \textit{AB – Lead Bars}, supra note 49, at 2. In the 1994 GATT case United States - Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in France, Germany and the United Kingdom (henceforth \textit{US – Lead and Bismuth I}), the EC challenged the U.S. Department of Commerce’s (DOC) final affirmative CVD determination and asked the GATT Panel to find the duties inconsistent with the Tokyo Round Subsidies Code. The U.S. found the UK provided countervailable subsidies to United Engineering Steels Limited (UES) consisting of Regional Development, equity infusions, and loan cancellations. Report of the Panel, \textit{United States - Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in France, Germany And The United Kingdom}, SCM/185 (Nov. 15, 1994) at ¶¶ 8-9, available at http://sul-derivatives.stanford.edu/derivative?CSNID=91830022 &mediaType=application/pdf (hereinafter \textit{U.S. - Lead and Bismuth I Panel Report}). The claim of GATT-inconsistent subsidies was complicated by the fact that the alleged subsidies occurred during the 1977-78, 1980-81, 1981-82, and 1985-86 fiscal years. This was prior to the creation of the company at issue, UES, which was formed in 1986 as a joint venture between a privately-owned company and the government-owned British Steel Company (BSC). \textit{Id.} ¶ 16. The subsidies were given to BSC, but to further complicate matters, BSC was privatized in 1988, several years before the DOC initiated the investigation that led to CVD. \textit{Id.} Despite these changes, the DOC methodology found UES benefited from the earlier subsidies. The Panel decided that the DOC’s finding of subsidies from the UK that “passed through” BSC to UES was inconsistent with the GATT. \textit{Id.} ¶ 430. The Panel held the U.S. arguments were too broad, encompassing issues such as privatization not before the Panel. \textit{Id.} ¶ 417. They also questioned how the DOC limited its consideration of pass-through to the productive unit of Special Steels Business, not individual assets, and had not considered the price UES paid for the unit. \textit{Id.} ¶¶ 417, 424. This failure made the DOC’s evidence insufficient to support their finding of a subsidy, but the Panel qualified their decision as non-prejudicial to future decisions on how to find pass-through subsidies based on benefit or how to allocate the subsidies in the future. \textit{Id.} ¶ 427. This report was not adopted, therefore it did have force as a legal interpretation of GATT law and could not be used to request implementation. DSC \textit{AB – Lead Bars}, supra note 49, at 2.


\textsuperscript{54} \textit{US – Lead Bars} Panel Report ¶¶ 2.3, 2.5. 6.26.
subsidized upstream producers and the investigating authority examines if the benefits accrue downstream.\textsuperscript{55} The Panel found the imposition of CVD based on pass-through inconsistent with the SCM.\textsuperscript{56} The U.S. argued there was a financial contribution by the government and a benefit was conferred, but the Panel held and the AB agreed that the sale did not confer a benefit because the recipients paid fair market value.\textsuperscript{57} Moreover, the AB stated that the DOC should have considered whether the benefit accrued following the change in ownership.\textsuperscript{58} The AB found the U.S.’s doctrine of automatic pass-through had no validity and rejected the idea that pre-privatization subsidies passed through to the privatized company, both in this case and as a general matter.\textsuperscript{59} At most, the AB granted there could be a rebuttable presumption.\textsuperscript{60} In this case, because the shares were sold to a private company at market price, the privatization was arm’s length, and the new owners did not receive help or benefit from the former owner because the fair market value share price incorporated expected future earnings.\textsuperscript{61} Only if the shares were not purchased at fair market value could the pre-privatization benefits carry over.\textsuperscript{62}

A second case expanded on these issues: \textit{US – Countervailing Measures}. Here, the EC challenged CVD applied by the U.S. after state-owned companies were privatized.\textsuperscript{63} \textit{US – Countervailing Measures} concerned whether subsidies continued to pass through following privatization. Under the newly-revised DOC methodology, if the post-privatization entity was a new legal entity, the DOC found that a subsidy did not pass through.\textsuperscript{64} The Panel found that once a Member decided privatization occurred at arm’s length and for fair market value, it had to reach the result that no benefit accrued to the new owners.\textsuperscript{65} The U.S. argued on appeal that

\begin{itemize}
  \item \textsuperscript{56} DSC \textit{AB – Lead Bars}, supra note 49, at 3.
  \item \textsuperscript{58} DSC \textit{AB – Lead Bars}, supra note 49, at 6.
  \item \textsuperscript{59} Bhala & Gantz, \textit{WTO Case Review 2000}, supra note 50, at 67.
  \item \textsuperscript{60} \textit{Id.} at 68.
  \item \textsuperscript{61} \textit{Id.} at 69-70.
  \item \textsuperscript{62} \textit{Id.} at 70.
  \item \textsuperscript{63} DSC \textit{US – Countervailing}, supra note 49, at 2.
  \item \textsuperscript{64} \textit{Id.}
  \item \textsuperscript{65} \textit{Id.} at 7.
\end{itemize}
no matter the price paid, privatization would fail to eliminate the subsidy if the legal person continued to exist.66 The U.S.’s understanding was that the payment constituted only the avoidance of a windfall gain, not the cancellation of the benefit.67 The AB rejected both the U.S.’s arguments and the Panel decision. It held that arms-length privatization always results in no benefit: “Privatization at arm’s length and for fair market value may result in extinguishing the benefit.”68 In this regard, the Appellate Body said that there is a “rebuttable presumption that a benefit ceases to exist after such a privatization.”69 The AB did note, however, that there were situations where the market price of the assets would fail to be equivalent to the value of the benefits, and therefore “an investigating authority could legitimately find that a benefit of past non-recurring financial contribution to state-owned enterprises continue to exist beyond the time of an arm’s length privatization.”70

Commentators have challenged the economic arguments in these AB decisions. Considering US – Lead and Bismuth II, some have claimed that sale a public stock exchange should not remove a subsidy conferred and that the private owners did receive a benefit from the subsidization.71 This is because the marginal cost of production is usually lower than total cost of production: therefore, the buyer reaps a benefit if the price of steel is higher than the marginal cost of the production of steel, but too low to drive the private construction of a new plant. If the steel plant were built when the economic returns were not high enough to incentivize private construction, but high enough to incentivize the production of steel, and a private buyer purchased the plant at a price lower than the cost of construction, the WTO would hold that the subsidy was gone following this privatization.72 However, in this hypothetical, the private buyer would not have had access to the plant without the government’s subsidy because the private market would not have

67. Id. at 4
69. Id.
70. GROSSMAN & MAVROIDIS supra note 66, at 5.
72. Id.
financed its construction. For similar reasons, commentators have challenged the economic understanding present in US – Countervailing Measures because the cost of acquiring the asset does not affect the later decisions. Rather, they argue that the investigating party needs to conduct a review that considers what would have occurred but for the subsidy. These cases, and the criticism of the economics at issue in the decisions, serve as important precedents in EC – Aircraft.

III. EC – AIRCRAFT

A. Background

Since its founding, Airbus has been tied to governmental assistance. In 1969, a group of countries convened in order to create a challenger to the American aviation industry. In 1970, Airbus Industry GIE was formally established between the French Aerospatiale and West German Deutsche Airbus. Spanish CASA joined in 1974 and British Aerospace followed in 1979. It was a “loose association of fully independent cost-centered companies.”

Airbus was restructured between 2000 and 2006, as the French, German, and Spanish components merged into the European Aeronautic Defence and Space Company (EADS). All of their Airbus designs, engineering, manufacturing, production, and assets were combined into EADS in 2000. The year following the creation of EADS, and as part of an agreement, the British successor company, BAE Systems, placed their Airbus entities under common control; EADS controlled 80% of shares and BAE Systems held the remaining 20%. In 2006, when the British stake was sold, Airbus became a wholly-owned subsidiary of EADS.

73. Id.
74. GROSSMAN & MAVROIDIS supra note 66, at 6.
75. Id. at 9.
77. Kienstra, supra note 25, at 575.
79. Id.
Airbus produces a variety of aircraft for the LCA market. They originally created a series of aircraft specifically designed to compete with the LCA produced by Boeing. By 1998, the American LCA industry consolidated as the Boeing Company, as the Lockheed Corporation had left the LCA market in the 1980s and Boeing purchased McDonnell Douglas in 1996. That year Airbus achieved its goal of challenging the American industry by capturing over 50% of the LCA market.81 In 2004, Airbus announced it held 52% of market share in the prior year.82

A historical trend of aircraft-related conflicts developed between the U.S. and certain EC member states. The clashes date back to the 1970s, when Airbus entered the aircraft industry. The purchase of 23 Airbus aircraft by Eastern Airlines in 1978 led Boeing to accuse Airbus of predatory pricing.83 The 1979 Agreement on Trade in Civil Aircraft followed shortly thereafter. Conflict escalated in the 1980s after Air India cancelled an order of Boeing planes following Airbus’s offer of discounts,84 which lead in part to the Bilateral Agreement.85

The conflict at issue in this Case Note arose out of subsidies provided by European countries to Airbus for the design and construction of LCA, defined by the Panel as large, sub-sonic, “tube and wing” structured aircraft with turbo-fan engines and low-set wings that transport more than 100 passengers per flight, or an equivalent amount of cargo.86 Currently, only Airbus and Boeing construct the class of aircraft described by the Panel as LCA. The development of such planes requires extensive up-front investment and a period of design and construction exceeding three to five years before reaping any revenue from the investment, strong barriers to entry into the market.87 In October 2004, the Bilateral Agreement—

84. Chanda, supra note 83, at 4.
86. EC – Aircraft Panel Report ¶ 2.1.
87. Lester, supra note 40, at 14.
which had delayed an American suit against European subsidies—collapsed when the U.S. withdrew, citing violations by the EC. \(^{88}\) The U.S. requested consultations under the WTO Dispute Settlement Understanding on subsidies to Airbus the same day—the first step in \(EC – Aircraft\). \(^{89}\)

The U.S. alleged that the subsidies provided by the EC\(^{90}\) and certain member states were WTO-inconsistent and affected all Airbus planes (A300 through A380 series). The U.S. asserted that the challenged measures were specific subsidies under Articles 1 and 2 of the SCM, adversely affecting the U.S. in violation of Articles 5 and 6 of the SCM. \(^{91}\) The U.S. claimed subsidies to A340 and A380 aircraft were export subsidies in violation of the Article 3 prohibition. \(^{92}\)

Broadly, the Panel identified five different kinds of subsidies: launch-aid or member-state financing, design and development financing loans, infrastructure and related grants, corporate restructuring measures, and research and development funds. The Panel found cases of financial contributions that provided benefits specifically in violation of Articles 1 and 2 for launch aid and member state financing for the A300, A310, A320, A330/A340, A330-200, A340-500/600 and A380 contracts; infrastructure grants; \(^{93}\) corporate restructuring measures from German government

88. Kienstra, supra note 25, at 587.
89. Id.
90. This Case Note follows the WTO Dispute Settlement Body’s lead as to usage of the terms European Communities (EC) and European Union (EU). Prior to 2009, the EC was responsible for trade issues, reflected in the name of this case \(EC – Aircraft\) and the formal name of the Bilateral Agreement, Agreement between the European Economic Community and the Government of the United States of America concerning the application of the GATT Agreement on trade in civil aircraft on trade in large civil aircraft, for example. Following the Treaty of Lisbon, the EC was abolished in 2009 and the EU “replace[d] and succeed[ed] the European Community.” Treaty of Lisbon Amending the Treaty on European Union and the Treaty Establishing the European Community, Dec. 13, 2007, 2007 O.J. (C 306) 1, art. 2(b). While new WTO disputes filed following the change use the term EU, this case maintained its name, and the Panel Report continued to use the EC terminology because “all the arguments and presentations in this dispute, including the requests for interim review and comments thereon predate the entry into force of that treaty.” \(EC – Aircraft\) Panel Report ¶ 6.7. The AB Report, and therefore that section of this Case Note, uses the term “European Union” because it was the EU that filed the Notice of Appeal. Appellate Body Report, \(European Communities And Certain Member States – Measures Affecting Trade In Large Civil Aircraft\), ¶ 1 n. 1, WT/DS316/AB/R (May 18, 2011) [hereinafter \(EC – Aircraft\) Appellate Body Report].
91. Hahn & Mehta, supra note 2, at 141.
92. Id.
93. The WTO-inconsistent subsidies found by the Panel included Mülenberger Loch industrial site, runway improvements at the Bremen airport, and provision of the ZAC
share transfer; French government equity infusions;\textsuperscript{94} and research and technical development.\textsuperscript{95} Both the U.S. and the EC filed appeals, with the EC objecting to the conclusions on launch aid, infrastructure measures, equity infusions, and the existence of export subsidies or serious prejudice.\textsuperscript{96} The U.S. challenged the decisions on launch aid.\textsuperscript{97}

In response, the AB report generally upheld the decision that launch aid was a specific subsidy, but did not uphold the Panel finding that launch aid for A380 constituted an export subsidy.\textsuperscript{98} Certain infrastructure and research findings were overturned, but capital investments and research and development continued as specific subsidies.\textsuperscript{99} The AB completely rejected the argument by the U.S. that launch aid measures were prohibited subsidies.\textsuperscript{100} The AB recommended the EC bring its measures into compliance with the SCM.\textsuperscript{101}

\textit{B. Panel Report}

1. Parties' Arguments

At issue since the beginning of the dispute was whether the alleged subsidies continued to exist following partial privatization and private-to-private sales or if they became extinct. The EC argued that the U.S. had failed to make a case for the violation of the SCM because it did not demonstrate that benefits were incurred; they further contended that the U.S. had the burden of proving the

\textsuperscript{94} French government equity infusions include capital contributions to Aerospatiale between 1987 and 1994 and a 1998 transfer between the French government of its interest to Aerospatiale. DSC EC – Aircraft Panel Report, at 4.

\textsuperscript{95} Applicable specificity are the EC Framework Programme, French government grants, German federal grants, German sub-federal grants, UK CARAD grants, Spanish PROFIT loans, and Spanish PTA loans. DSC EC – Aircraft Panel Report, at 4.

\textsuperscript{96} Kienstra, \textit{supra} note 25, at 595-96.
continuity of benefit and establishing the benefit to producer or seller. The EC maintained that the transactions in question were at arm’s-length or transacted according to fair market value. This claim included BAE Systems’ exercise of a put option, the right to sell at a pre-set time to a pre-determined buyer a pre-established asset, and privatization of Aerospatiale. The U.S. in turn argued these transactions were not conducted at arm’s length and for fair market value. The EC countered the U.S.’s argument by asserting that prior case law should be limited to CVD. Additionally, the EC challenged the American position that the changes to Airbus were not “full privatization” by drawing attention to the lack of special rules for privatization established by the SCM. The EC cited the AB’s prior holding of a rebuttable presumption in “arm’s-length, fair market value privatization” and the AB’s reasoning “that this presumption would appear to be irrebuttable in private-to-private sales.” The EC further claimed a series of transactions extinguished or extracted benefits that could have been seen as provided to Airbus, such as the creation of EADS, which extinguished, extracted, or repaid benefits owned by the previous companies of ASM, CASA, and DASA. Similarly, the EC identified further sales of shares and IPOs that would have extracted additional benefits.

The U.S. countered that the European arguments on extinction and extraction were baseless and that the EC-identified transactions did not eliminate “all or substantially all” of the subsidized entity to private interests, and none involved relinquishment of a “controlling interest in the privatized producer.” The U.S. claimed that the EC reliance on US – Lead and Bismuth II and US – Countervailing Measures was inappropriate as those decisions were about CVD. The U.S. identified the EC extinction argument as based on: “(i) the 1999 corporate tie-up

103. *Id.* ¶ 4.9.
104. *Id.* ¶ 4.12.
105. *Id.* ¶ 4.24
106. *Id.*
107. *Id.* ¶ 4.13.
108. *Id.* ¶ 4.15.
109. *Id.*
110. *Id.* ¶¶ 4.17, 4.20.
111. *Id.* ¶ 4.21.
112. *Id.* ¶ 4.41.
113. *Id.* ¶ 4.42.
between Aérospatiale and Matra Hautes Technologies ("Matra"); (ii) the 2000 creation of EADS; (iii) the exercise by BAE of its put option in 2006; and (iv) the offerings of small portions of EADS shares between 2000 and 2007.” 114 In response, the U.S. argued those actions constituted mere restructuring and not transfers to new owners; they pointed to similar statements the EC had made to that effect in defense of EADS at the time of its creation. 115 Finally, the U.S. argued the EC failed to demonstrate that the claimed extinguished shares were sales at arm’s length and for fair market value. 116

2. Panel Holding

The Panel held that the U.S. did establish financial contributions, conferral of benefits, and specificity. Consequently, they dismissed the EC’s arguments that the subsidies were extinguished by the arm’s-length, fair-market-value transactions. 117 The Panel stated that their findings on the issue were a sufficient response to the EC’s arguments, but chose to make alternative findings on the existence of the benefit. 118 They held that, contrary to the EC’s argument, US – Lead and Bismuth II and US – Countervailing Measures did not establish a principle that “an arm’s-length, fair market value sale of all or part of a subsidized producer, whether by a government or private owner, presumptively extinguished the benefit (or a portion thereof) conferred by prior financial contributions provided to that entity.” 119 The EC – Aircraft Panel challenged the Panel and the AB’s underlying reasoning in US – Countervailing Measures, noting in particular that the manner in which the earlier case understood the concept of benefit was problematic. 120 The EC – Aircraft Panel stated that contrary to the Panel’s reasoning in US – Countervailing Measures, the entry of a previously subsidized producer into the market does not necessarily eliminate the benefits given to the producer and that the change of ownership does not incorporate the benefit into the cost of the investment. 121 The EC – Aircraft Panel claimed the previous Panel

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114.  Id. ¶ 4.48.
115.  Id. ¶¶ 4.48, 4.54.
116.  Id. ¶ 7.209.
117.  Id. ¶ 7.223.
118.  Id. ¶ 7.224.
119.  Id. ¶ 7.255.
120.  Id. ¶ 7.243.
121.  Id. ¶¶ 7.243-44.
conflated the financial contribution to the subsidized producer, the financial contribution involved with the sale, the market through which the benefit was conferred, and the market under which it was assessed. The Panel said the market for the benefit should not become the market of potential investors, and stated this approach was “at odds” with Article 14 of the SCM.

Additionally, the Panel agreed with the U.S.’s opposition to the EC’s stance and reliance on US – Countervailing Measures. The Panel expressed concern over the impact the US – Countervailing Measures principle would have on the SCM with regard to publicly traded corporations if the sale of a producer under the conditions of arm’s-length and fair market value removed the benefit. The repeated change of ownership, without change to the assets in those cases, would make it easier to subsidize without risking retaliation. Along those lines, the Panel also found the compliance proceedings for US – Countervailing Measures did not extend the alleged principle to partial sales as opposed to single sales.

The Panel argued they found nothing in the Compliance Panel’s report suggesting a government transfer of less than substantially all is presumed to extinguish the benefit. This was especially the case because the Panel’s reasoning in US – Countervailing Measures was based on the idea that purchasers paid for the subsidy’s value, which could not occur without new owners replacing the old.

The Panel refused the principle proposed by the EC because of concerns with the reasoning in US – Countervailing Measures above and the AB’s decision in that case to limit US – Countervailing Measure to the facts and circumstances of the case. The EC – Aircraft Panel limited the rebuttable presumption of subsidy extinction to situations when: “(i) benefits resulting from a prior non-recurring financial contribution, (ii) are bestowed on a state-owned enterprise, and (iii) following a privatization at arm’s length and for fair market value, (iv) the government transfers all or substantially all the property and retains no controlling interest in the privatized

122. Id. ¶ 7.244.
123. Id.
124. Id. ¶ 7.246.
125. Id.
126. Id. ¶ 7.250.
127. Id.
128. Id. ¶ 7.250 n. 2181.
129. Id. ¶ 7.239.
producer." The situation in EC – Aircraft did not match the above requirements for extinction as the transactions were neither at arm’s length, nor were they transfers by a government of all or substantially all of a state-owned producer. Indeed, some were private-to-private sales, which would undermine the SCM as addressed above. Therefore, the subsidies at issue in EC – Airbus were not extinguished by the partial privatization.

C. Appellate Body Report

1. Parties’ Arguments

The European Union (EU) requested the AB hold that the Panel had committed an error in interpreting Articles 1, 5 and 6 of the SCM because the privatization case law demonstrated a principle under the SCM of the extinction of subsidies. The EU claimed the Panel misrepresented the AB findings in US – Countervailing Measures and that, according to the AB’s prior reasoning, Members should not be able to assume that the benefit to the owners of the firm is the same as the total benefit. Similarly, the EU rejected the Panel’s finding that the EU’s theory conflated financial contributions provided to the producer and to the new owner, and contended that the holding should be invalidated. Additionally, the EU claimed that the Compliance Panel decision in US – Countervailing Measures did include the principle for partial privatization extinction and the Panel’s holding—that such a principle would damage the SCM, particularly in cases of publicly-traded corporations—failed to recognize that the publicly traded shares at issue are comparable to the sales already included as subject to extinction.

By contrast, the U.S. argued to the AB that it should uphold the Panel finding that the extinction presumption from US –

130. Id. ¶ 7.248.
131. Id. ¶ 7.249.
132. Id. ¶ 7.252.
133. EC – Aircraft Appellate Body Report ¶ 52.
134. Id. ¶ 56.
135. Id. ¶ 57.
136. Id. ¶ 57.
137. Id. ¶ 60.
Countervailing Measures did not apply to the Airbus transactions. In particular, the U.S. supported the Panel’s finding that no general principle of subsidy extinction exists following sale at arm’s length and for fair market value. The U.S. also endorsed the Panel’s acceptance of a principle that “changes in the underlying ownership of a subsidized producer automatically or presumptively eliminate the benefit conferred by prior financial contributions” would “potentially eviscerate the SCM Agreement.”

2. Appellate Body Holding

The AB began by restating the holdings from US – Lead and Bismuth II and US – Countervailing Measures as having found that the Members could treat benefits originally provided to state-owned firms as extinguished following arm’s-length, fair market value transactions with private owners. However, they noted a decision finding extinction was not inevitable, but depended on the facts of the case. The AB stated that EC – Aircraft differed from precedent because it was outside the CVD context and constituted sales of shares between private parties and partial privatization. The AB held that the elements of full privatization were missing and therefore “a fact-intensive inquiry into the circumstances surrounding the changes in ownership would be required in order to determine the extent to which there are sales at fair market value and at arm’s length, accompanied by transfers of ownership and control, and whether a prior subsidy could be deemed to have come to an end.”

The Members of the AB could find no common view of when partial privatization and private-to-private sales cause the extinction of subsidies. Rather, the AB Members presented their individual opinions without prejudice for future decisions and held that in terms of the facts of EC – Aircraft, the Panel did not consider the partial privatization transactions at issue sufficiently; for that reason, it reversed the Panel’s reasoning and findings.

138. Id. ¶ 287.
139. Id.
140. Id. ¶ 292.
141. Id. ¶ 723.
142. Id. ¶ 723.
143. Id. ¶ 724.
144. Id. ¶ 725.
145. Id. ¶ 726.
146. Id. ¶ 733.
Member A argued that the prior AB decisions finding extinction in cases of complete or substantial transfer of ownership conducted at arm’s length for fair market value should not apply to partial privatization or private-to-private sales.

Member B posited that in the context of the SCM and US–Countervailing Measures, full privatization at arm’s length for fair market value may extinguish the benefits. The AB previously agreed that privatization at arm’s length does fail to remove utility value of equipment, but that it is irrelevant for establishing the benefit under the SCM. Broadly, once the fair market value is paid, market value is achieved, and the new private owners are not benefiting from subsidies received prior to the privatization. Member B saw the full privatization rationale as applicable to partial privatization and private-to-private transactions, but dependent on a factual review of the case.

Member C affirmed the general extinction understanding, but doubted that the acquisition of shares warranted the conclusion that an extinction of benefit occurred. This Member took issue with the application because, though the shares may change hands through arm’s-length, fair market value transactions and the owner gains new rights, the company’s assets would remain unchanged. Rather, if they did change and the benefit was extinguished, then the purchaser would not receive what he or she was paying for. The benefit continues to accrue to the recipient even as the ownership changes, potentially multiple times. However, the Member held that the AB was not required to come to a final decision on the issue of extinction and, therefore, provided no further discussion.

The three AB Members were able to agree, however, on the need to reverse the EC–Aircraft Panel’s finding that the sales transactions did not extinguish the subsidies. The AB held that the

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147. The Member’s views were presented anonymously. For clarity’s sake I have assigned them letters corresponding to the paragraph of their argument, ¶ 726(a), (b), or (c) respectively.
148. Id. ¶ 726(a).
149. Id. ¶ 726(b).
150. Id.
151. Id.
152. Id. ¶ 726(c).
153. Id.
154. Id.
155. Id.
156. Id.
157. Id. ¶ 733.
Panel did not appropriately assess the extent of transfer of ownership or whether the private-to-private and partial-privatization sales were at arm’s length. In particular, the AB ruled the Panel committed errors with regard to EC statements on the arm’s-length and fair market value nature of some of their transactions, causing uncertainty about the form of the transactions. The AB also found the Panel did not sufficiently explore the legal implications of the Aérospatiale and Matra public offerings, which were not transactions where the governments had controlling interests in the privatized producer. They stated the Panel should have also spent further time and attention on how transfer of control could have been relevant to extinction.

CONCLUSION

The AB’s impact on future privatizations and Panel decisions remains to be seen. While the three separate opinions analyzed above were issued without prejudice, they may guide parties considering privatization as well as judges adjudicating future disputes. The AB members’ lack of agreement highlights the need for further scholarship on this issue. In particular, future researchers should consider economics-focused studies on the removal of subsidy benefit or lack thereof and legal examinations of how partial privatization best fits within the current trade law system.

Meanwhile, the Boeing-Airbus dispute continues. The EU announced its intention to implement the AB’s recommendations in June 2011, and reported the recommendations completed in December 2011. The U.S. requested consultations on the EU’s actions later that month, and launched additional proceedings, requesting a Compliance Panel in March 2012. The Compliance Panel’s report has been repeatedly delayed “due to the substantive and procedural complexities of this dispute” and is now due by the end of 2015. WTO observers should await the decision, but even

158. Id. ¶1 414(d)(ii).
159. Id. ¶ 730.
160. Id. ¶ 731-32.
161. Id.
163. Id.
164. In Further Delay, WTO’s Airbus Compliance Panel Expects Ruling By End-2015,
after its arrival—more than a decade since the beginning of the case—questions will remain about the long-term legacy of EC—Aircraft.

Kathleen Benner*

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* Articles Editor, Columbia Journal of Transnational Law; J.D. Candidate, Columbia Law School, 2015; B.A. Princeton University, 2010.