WHITE & CASE

July 2010

Japan External Trade Organization

WTO and Regional Trade Agreements Monthly Report

IN THIS ISSUE

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UNITED STATES

United States Highlights

President Obama Introduces Export Council, Discusses NEI and Pending FTAs

On July 7, 2010, President Obama re-launched the President's Export Council and used the opportunity to provide a status update of the National Export Initiative (NEI). According to President Obama, the United States is on track towards doubling its exports by 2015, the central goal of the NEI. President Obama noted that the NEI is off to a "solid start," with exports in the first four months of 2010 growing almost 17 percent over the same period in 2009. The President also noted that the NEI has improved advocacy efforts on behalf of US exporters by having the Department of Commerce coordinate 18 trade missions with over 160 companies participating in 24 countries, and that the Export-Import Bank has more than doubled its loans to support US exporters.

At the White House event, the President introduced members of his Export Council, a group of government, business and labor representatives who will offer advice to the President on how to promote US exports, jobs, and growth. The Council is composed of the Secretaries of Agriculture, Commerce, Energy, Homeland Security, Labor, State and Treasury, and the United States Trade Representative (USTR), the Administrator of the US Small Business Administration (SBA) and the Chairman of the Export-Import Bank of the United States.

Senators on the Council include:

- Sen. Debbie Stabenow (D-MI);
- Sen. Sherrod Brown (D-OH);
- Sen. Ron Wyden (D-OR);
- Sen. John Cornyn (R-TX); and
- Sen. Mike Crapo (R-ID).

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House Members on the Council include:

- Rep. Dave Reichert (R-WA);
- Rep. Patrick Tiberi (R-OH);
- Rep. Linda Sanchez (D-CA);
- Rep. David Wu (D-OR); and
- Rep. Mark Schauer (D-MI).

Private sector members include:

- Jim McNerney, Boeing President and CEO (Chairman of the Export Council);
- Mary Vermeer Andringa President and Chief Executive Officer of Vermeer Corporation;
- Stephanie Burns, Chairman, President & CEO, Dow Corning Corporation;
- Scott Davis, Chairman & CEO, UPS;
- Richard Friedman, President & CEO, Carpenter & Company, Inc.;
- Gene Hale, President & Founder, G&C Equipment Corporation;
- C. Robert Henrikson, Chairman, President & CEO, MetLife, Inc.;
- Robert Iger, President and Chief Executive Officer of The Walt Disney Company;
- Charles Kaye, Co-President of Warburg Pincus;
- Jeff Kindler, Chairman and Chief Executive Officer of Pfizer;
- Robert Mandell, Chairman & CEO, Greater Properties;
- Alan Mulally, President and Chief Executive Officer of Ford Motor Company;
- Raul Pedraza, Founder & President, Magno International, L.P.;
- Ivan Seidenberg, Chairman & CEO, Verizon;
- Glenn Tilton, Chairman, President and CEO, UAL Corporation and Chairman & CEO, United Air Lines;
- James Turley, Chairman & CEO, Ernst & Young; and
- Patricia Woertz, Chairman of the Board, CEO & President, Archer Daniels Midland Company.

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The Export Council's labor representative is William Hite, General President of the United Association, AFL-CIO.

President Obama also referenced the pending Free Trade Agreements (FTAs) with Korea, Panama and Colombia, noting that USTR Ron Kirk has received instructions to begin discussions to settle issues in the KORUS FTA with Korean officials by the time President Obama visits Seoul in November. On the Panama and Colombia FTAs, President Obama stated these agreements would be submitted "as soon as possible for Congressional consideration," although he did not provide further details on the submission of these FTAs to Congress. On the stalled World Trade Organization (WTO) Doha Round, President Obama pledged to "improve those negotiations so that they have a higher level of ambition in the way that will translate directly into more opportunities for American exporters."

Observers point out that although President Obama announced the success of the NEI in increasing US exports in its first several months, they note that the first four months of 2009 (the period to which the President compared exports in 2010) represented the height of the global economic crisis, and they opine that any growth in US exports in 2010 would serve as a significant improvement over exports in 2009 when the United States and its trading partners struggled with their trade balances. In addition, observers noted that President Obama did not provide further details or timeframes for movement on the pending FTAs (apart from the November deadline for clearing the contentious issues in the KORUS FTA). Several business groups and FTA supporters opine that passage of the pending FTAs would also boost US exports and increase market access for US goods in foreign markets, which in turn could help the NEI's goal of doubling US exports over the next several years. A press conference following the President's Export Council event yielded little additional information, and when asked on the Administration's intent to move on the pending FTAs, Administration officials provided vague answers and did not discuss any timelines for Congressional consideration of the agreements. Statements on the stalled Doha Round were just as vague and echoed the President's general view that the United States remains committed to the Round. It thus appears that the Administration is focusing its public "trade focus" on the NEI, and does not appear (at least publicly) to have a set plan and timeframe for submission of the pending FTAs to Congress for its consideration.

Congressional Steel Caucus Requests CFIUS Investigation of Possible Chinese Investment in US Steelmaker

In a July 2, 2010 letter to Secretary of the Treasury Timothy Geithner, the Congressional Steel Caucus, a group of US lawmakers in whose constituencies steelmaking is a source of employment, requested that

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the Committee on Foreign Investment in the United States (CFIUS), an interagency body chaired by the Treasury Secretary, open an investigation into the planned joint venture (JV) agreement between Anshan Iron and Steel Group, a state-owned Chinese steelmaker, and the Steel Development Company, a Mississippi-based steelmaker. The lawmakers cited national security concerns as well as concerns over potential job losses as reasons why CFIUS should open the investigation.

Members of the Congressional Steel Caucus and those signing the letter to Secretary Geithner included Chairman Peter Visclosky (D-IN) and Vice Chairman Timothy Murphy (R-PA) along with 48 other House Representatives. In the letter sent to Secretary Geithner, the lawmakers indicated national security could be jeopardized as Anshan would have access to "information regarding American national security infrastructure projects." The lawmakers also noted in the letter that the Chinese government, through its ownership of Anshan, would have access to "new steel production technologies" developed in the United States. Additionally, the lawmakers opined that, because Anshan is controlled by China's Assets Supervision Committee of the State Council and has the backing of the Chinese government, Anshan could "easily obtain subsidized [debt] financing […] and force American Steelworkers to compete against a blank check." According to the letter, the JV deal would "allow the Chinese government to exploit the American steel market from American soil."

The Obama Administration has not commented on the letter thus far and the Treasury Department has confirmed receipt of the letter but has not given any details regarding the merits of the request made in the letter or regarding the possibility of a CFIUS investigation. President and CEO of the American Iron and Steel Institute (AISI) Thomas Gibson expressed support for the letter and stated that Anshan benefits "from massive government subsidies and other trade-distorting policies that give them an unfair advantage in international trade." Gibson has deemed appropriate a CFIUS investigation "given the economic and national security issues raised by a Chinese government investment in a US steel company." Anshan has stated that it is not concerned with the request remitted to Secretary Geithner. According to an Anshan representative, the investment would result in a non-controlling twenty-percent equity participation in the US steel rebar facility being built by Steel Development Co., and the future annual production of the facility is too small to impact the US steel market. A spokesperson for the Steel Development Co. opined that, due to Anshan's non-controlling interest in Steel Development Co., "the promotion of national security fears […] is, at best, difficult to rationalize."

The Exon-Florio Amendment to the Defense Production Act, authorizes the President, acting through CFIUS to suspend, block, or otherwise modify transactions that could result in foreign control of a firm engaged in interstate commerce in the United States if, in the President's view, the foreign interest

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exercising control over that firm might take action that threatens to impair national security. CFIUS is the investigative authority designated under the Exon-Florio Amendment. As noted, the Secretary of the Treasury chairs CFIUS. CFIUS ordinarily reviews proposed transactions covered by Exon-Florio at the request of the parties, as CFIUS clearance provides a safe harbor from the President's power to unwind completed transactions found to threaten national security. CFIUS reviews may also be initiated by CFIUS member agencies. The CFIUS review process consists of a 30-day review, followed in some cases by a 45-day investigation (such as when a foreign government-controlled party is involved or in cases where complex security issues arise). If CFIUS is unable to resolve its national security concerns, it can recommend that the President block the transaction. The President then has 15 days to take such action. The majority of transactions are cleared within 30 days.

Two notable transactions in recent years have been significantly affected by political pressure and negative public sentiment. In 2005, the Chinese National Offshore Oil Company (CNOOC) made a bid to acquire California-based oil company Unocal. CNOOC filed a voluntary notice with CFIUS, but ultimately withdrew its offer for Unocal citing "unprecedented political opposition [in the United States]" to the transaction. Also in 2005, Dubai Ports World (DPW), a United Arab Emirate (UAE) government-owned company, purchased P&O Steam Navigation Company of the United Kingdom, which operated several port terminals in the United States. CFIUS determined that the transaction did not pose a threat to national security, but DPW soon found itself under intense political pressure and media attention over the perceived threat of a UAE government entity managing US ports. In response, DPW decided in March 2006 to divest its US port operations.

USTR Announces Initiation of 2010 Annual GSP Review, Petition Deadlines

In a July 15, 2010 Federal Register (FR) notice, the Office of the United States Trade Representative (USTR) announced the initiation of the 2010 Annual Generalized System of Preferences (GSP) Product Review and the deadlines for filing petitions (75 FR 41274-41276). According to the FR notice, the deadline for submission of product petitions, other than those requesting competitive need limitation (CNL) waivers, is **August 3, 2010**. The deadline for submission of petitions requesting CNL waivers is **November 16, 2010**. Petitions submitted after the respective deadlines will not be considered for review.

The lists of product petitions accepted for review will be announced in the Federal Register at a later date. The deadline for receipt of petitions for the Country Practices Eligibility Review and related public hearing date will also be announced in the Federal Register at a later date.

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Interested parties, including foreign governments, may submit petitions to:

- Designate additional articles as eligible for duty-free treatment under GSP, including to designate articles as eligible for GSP only for countries designated as least-developed beneficiary developing countries, or only for countries designated as beneficiary sub-Saharan African countries under the African Growth and Opportunity Act (AGOA);
- Withdraw, suspend or limit the application of duty-free treatment accorded under the GSP with respect to any article, either for all beneficiary developing countries, least-developed beneficiary developing countries or beneficiary sub-Saharan African countries, or for any of these countries individually;
- Waive the "competitive need limitations" for individual beneficiary developing countries with respect to specific GSP-eligible articles (these limits do not apply to either least-developed beneficiary developing countries or AGOA beneficiary sub-Saharan African countries); and
- Otherwise modify GSP coverage.

Petitions requesting CNL waivers for GSP-eligible articles from beneficiary developing countries that exceed the CNLs in 2010 must be filed in the 2010 Annual Review.

President Signs Financial Reform Bill Containing Congo "Conflict Minerals" Provisions

On July 21, 2010, President Obama signed into law the Wall Street Reform and Consumer Protection Act (H.R. 4173), a bill sponsored by Senator Christopher Dodd (D-CT) and Representative Barney Frank (D-MA) that aims to reform regulation of the US financial sector. H.R. 4173 also contains provisions requiring companies that utilize "conflict minerals" to conduct due diligence and demonstrate that their products are not fueling conflict in the Democratic Republic of the Congo (DRC). The House of Representatives passed the bill in December 2009 by a vote of 223 to 202, and the Senate passed its version of the bill on May 20, 2010 by a vote of 59 to 39. The two chambers then established a conference committee to reconcile differences between the two versions of the bill; the House of Representatives agreed to the conference report (H. Rept. 111-517) on June 30, 2010 by a vote of 237 to 192 and the Senate agreed to the conference report on July 15, 2010 by a vote of 60 to 39.

Section 1502 of H.R. 4173 ("Conflict Minerals") states that "it is the sense of Congress that the exploitation and trade of conflict minerals originating in the Democratic Republic of the Congo is helping to finance conflict characterized by extreme levels of violence in the eastern Democratic Republic of the

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Congo, particularly sexual- and gender-based violence, and contributing to an emergency humanitarian situation." The bill requires companies that file with the Securities and Exchange Commission (SEC) and use minerals originating in the DRC in manufacturing to disclose measures taken to exercise due diligence on the source and chain of custody of the materials and the products manufactured. Specifically, "not later than 270 days after the date of the enactment of this subsection, the [SEC will] promulgate regulations" requiring companies to disclose annually whether conflict minerals that are necessary for production originated in the DRC or an adjoining country. In cases in which conflict minerals did originate in any such country, companies must submit to the SEC a report that includes, with respect to the period covered by the report:

- a description of the measures taken by the company to exercise due diligence on the source and chain of custody of such minerals, "which measures shall include an independent private sector audit of such report submitted through the Commission that is conducted in accordance with standards established by the Comptroller General of the United States, in accordance with rules promulgated by the Commission, in consultation with the Secretary of State;" and
- a description of the products manufactured or contracted to be manufactured that are not DRC conflict free ("DRC conflict free" is defined to mean the products that do not contain minerals that directly or indirectly finance or benefit armed groups in the DRC or an adjoining country), the entity that conducted the independent private sector audit as required by the bill, the facilities used to process the conflict minerals, the country of origin of the conflict minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity.

In addition, companies must make available to the public on their websites the information they presented to the SEC regarding their use of conflict minerals.

The Department of Commerce can designate specific independent private sector auditors and due diligence processes as "unreliable." If, in its reporting, a company relies on a determination of an independent private sector audit or other due diligence process that is deemed "unreliable," the report does not satisfy the SEC reporting requirement.

The bill also requires the Department of State to develop a conflict map to address links between conflict minerals and armed groups (to be updated every 180 days) as well as submit to Congress a strategy to address the illicit minerals trade in the region and establish a baseline against which to judge effectiveness.

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The bill defines "conflict mineral" as columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives; or "any other mineral or its derivatives determined by the Secretary of State to be financing conflict in the Democratic Republic of the Congo or an adjoining country." Columbite-tantalite (coltan), cassiterite, gold, wolframite are commonly utilized in commercial products such as automobiles, cellular phones and airplane engines. An entity falls under the scope of this law if the company is required to file reports with the SEC and if "conflict minerals are necessary to the functionality or production of a product manufacture" by the company. The bill defines "adjoining country" as "a country that shares an internationally recognized border with the Democratic Republic of the Congo."

Observers note that the aim of the legislation is not to ban the use of the named minerals if they originate from the DRC, but rather to ensure that the minerals do not come from conflict areas of the DRC or otherwise help fund the conflict. Nonetheless, some US trade groups and businesses are already criticizing the bill as being burdensome with regards to the SEC reporting requirements. Some observers opine that the new reporting requirements imply additional costs for those companies that are obliged to file the reports to the SEC, noting that the costs may come in the form of additional record-keeping requirements, compliance and due diligence with the Financial Reform Act. Jewelers of America (JA), for example, believes that the new reporting requirements could impact many retailers by "forcing" them to hire independent auditors as part of their due diligence process, and JA Chief Operating Officer Robert Headley has opined that "we cannot imagine making a disclosure to the SEC if you did not do an audit to know for a fact it would stand up." The JA also believes that the bill's "sourcing" provisions are "impractical" given "the current lack of traceability in the supply chain and the difficulties associated in tracking a particular material back to its source." Some observers even opine that supply-chains may change as companies and end-users attempt to comply with the provisions of the Financial Reform Act, and that companies and end-users may decide not to source conflict materials (as named in the bill) from entities within DRC and its surrounding countries.

The text of H.R. 4173 as signed into law is available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_reports&docid=f:hr517.111.pdf.

Former Ways and Means Chairman Rangel to Face Adjudicatory Panel Over Possible Ethics Violations

A House ethics investigative subcommittee has charged former House Ways and Means Committee Chairman Charles Rangel (D-NY) with ethics violations. Rep. Rangel will now face a trial by subcommittee on the allegations of ethics violations. On February 26, 2010, the House Committee on

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Standards of Official Conduct had admonished Rep. Rangel for violating the House gift rule by accepting corporate-sponsored trips to conferences in Antigua and Barbuda in November 2007 and St. Maarten in November 2008. The Committee claimed that it had no proof that Chairman Rangel knew that the conferences were underwritten by corporations, but stated that two members of Chairman Rangel's staff knew that corporations had underwritten at least some of the costs of the legislator's travel. Rep. Rangel was also under investigation by the Ethics Committee for failure to pay federal taxes on income from a rental in the Dominican Republic, the use of four rent-controlled apartments and his alleged role in retaining certain tax benefits for a company executive who pledged USD 1 million for the Rangel School. On March 3, 2010, Rep. Rangel announced that he would take a leave of absence as Chairman of the Ways and Means Committee. Rep. Sander Levin (D-MI), Chairman of the House Ways and Means Trade Subcommittee, then took over as Chairman of the House Ways and Means Committee.

Congressional sources note that Rep. Rangel's trial by subcommittee will begin July 29, 2010. The members of the adjudicatory panel, who by rule cannot have served on the investigative subcommittee, will "determine whether any counts in the Statement of Alleged Violation have been proved by clear and convincing evidence and to make findings of the fact." According to reports, the panel will consist of four Democrats and four Republicans. If Rep. Rangel is found guilty of violating House rules, he could face several penalties, including possible expulsion from Congress.

The last time an adjudicatory panel was convened was in 2002 when former Rep. James Traficant (D-OH) was under investigation in connection with bribery, racketeering and tax evasion. On April 15, 2002, Rep. Traficant was convicted of 10 felony counts including bribery, racketeering, and tax evasion. The House Ethics Committee then recommended that Rep. Traficant be expelled from Congress. On July 24, 2002, the House of Representatives voted 420-1 to expel Rep. Traficant.

Congressional sources note that Rep. Rangel's legal troubles likely means that Rep. Levin will remain Chairman of the House Ways and Means Committee and will no longer be considered a temporary stand-in for Rep. Rangel.

Senate Majority Leader Shifts Focus from Cap-and-Trade Bill to "Narrower" Oil Spill, Energy Bill

According to several reports, Senate Majority Leader Harry Reid (D-NV) has stated that in the short-term, he will not pursue an ambitious cap-and-trade bill that Senators have been exploring over the past several months and will instead shift his focus to a narrower bill that addresses the oil spill in the Gulf of Mexico and that includes "relatively non-contentious energy-related initiatives." According to Sen. Reid,

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Democratic Senators are ready to move on a "comprehensive bill that creates jobs, breaks our addiction to oil and curbs pollution [but] unfortunately, at this time not one Republican wants to join us in achieving this goal."

The shift in focus from a larger climate change bill to a more narrow energy bill comes after a period of intense and difficult negotiations by Democratic Senators to garner support for their cap-and-trade legislation. On May 12, 2010, Senators John Kerry (D-MA) and Joseph Lieberman (I-CT) introduced the "American Power Act" (APA), a bill that addresses climate change and greenhouse gas emissions, among other things. Sens. Kerry and Lieberman, along with Sen. Lindsey Graham (R-SC), had originally intended to introduce the APA in late April 2010. Sen. Graham had worked with the other legislators since 2009 in drafting the bill but in April 2010, he withdrew his support for the bill after Democratic leaders raised the possibility of moving an immigration bill to the floor before the climate bill. Although Sens. Kerry and Lieberman (unsuccessfully) attempted to draw Sen. Graham back to the climate change bill, the two Senators ultimately decided to introduce the bill without the support of the Republican Senator. With Sen. Graham distancing himself from the bill, many observers opined that the bill was "doomed from the start," and to date, no other Republican has stepped forward to support the bill. A June 24, 2010 meeting between Sen. Reid and other party leaders on climate change clearly showed the number of obstacles that the APA will have to go through in order to garner support and ultimately, Senate passage. Although Democrats called the June 24 climate change meeting "inspirational," "powerful" and "thrilling," Sen. Reid and others conceded that Democrats had yet to rally around any of the legislative proposals currently on the table, and they were unable to reach a decision on how to proceed with the APA.

In place of the APA (or a version of the APA), Sen. Reid introduced a bill the week of July 26 that he hopes "can lay the foundation for more comprehensive energy legislation later." According to Sen. Reid, his bill would "hold BP accountable" for the oil spill in the Gulf of Mexico, to "ensure it pays to clean up its mess." Other provisions address energy-efficiency initiatives and create jobs through the proposed Homestar program that would provide rebates to consumers for energy-saving home improvements, encourage development of natural-gas powered vehicles, and invest in the federal Land and Water Conservation Fund.

In describing his shift in focus from a larger cap-and-trade bill to a narrower, less contentious bill, Sen. Reid cautioned that he was not "putting forth this bill in place of a comprehensive bill . . . but we will not pass up the opportunity to hold BP accountable, lessen our dependence on oil, create good paying American jobs and protect the environment." Nonetheless, observers are uncertain if the Senate will

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have time later this year to consider more comprehensive energy legislation. The upcoming summer recess followed by the run-up to the November election season and the subsequent lame-duck session make it unlikely that Senators will devote enough time to and vote on a cap-and-trade bill by the end of 2010. In addition, as noted, Democratic legislators have found it difficult to drum up support from Members of both parties for their climate change legislation; the tenuous support for the climate change bill consequently makes it even more unlikely that Senators will find the necessary support for the legislation by the end of year much less schedule a vote on the bill by end-2010. For now, it appears that the Senate's comprehensive climate change efforts have halted and are unlikely to pick up again until late 2010, at the earliest.

Industry Groups Submit Comments, Recommendations to DOC on NEI Goals

On July 26, 2010, industry groups submitted comments to the Department of Commerce's (DOC) Trade Promotion Coordinating Committee (TPCC) on how to achieve President Obama's National Export Initiative (NEI) and the goals under the program. Comments from interested parties varied on how the Administration can achieve its goal of doubling US exports over the next five years, although there were several commonly-shared opinions and recommendations. Many of the commenters opined that passage of the pending Free Trade Agreements with Colombia, Panama, and South Korea could help increase US market access in foreign countries, and could spur the negotiation of more US trade agreements, which in turn could translate to increased US exports. Commenting parties also noted that a reduction of nontariff barriers in the agriculture, manufacturing, and services sectors could enable increased US exports. Other recommendations to the Administration to double US exports included increased infrastructure investments and trade facilitation, a successful conclusion to the World Trade Organization (WTO) Doha Round, expansion of export promotion efforts, and improvements in export financing.

Submitted comments are available upon request.

Legislators Urge President Obama to Investigate Chinese Subsidies to Paper Producers

In a July 28, 2010 letter to President Obama, a group of legislators requested that he examine the subsidies the Chinese government provides to its paper producers. The letter, which includes the signatures of 100 Members of Congress from both the Senate and the House of Representatives, also

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urged the President to determine the extent to which these subsidies “cause or threaten to cause harm to American producers.”

The letter bases its argument on the findings of a study by the union-backed Economic Policy Institute (EPI) which estimates that subsidies provided to Chinese paper producers by the Chinese government amounted to USD 33.1 billion between 2002 and 2009 with the figure for 2008 amounting to USD 9.7 billion (these figures do not include subsidization through alleged currency manipulation). According to the EPI study, these subsidies have allowed paper production in China to triple since 2000 despite the absence of any market-based explanation for this growth. It should be noted, however, that EPI’s trade studies have received intense criticism from academics and policymakers alike for their methodological biases against open trade.

In a February 25, 2010 letter to Secretary of Commerce Gary Locke urging the Department of Commerce (DOC) to investigate China’s currency practices, 15 Senators cited Chinese subsidies to its domestic paper producers as being injurious to US paper producers. The letter alluded to a petition filed with the US International Trade Commission on September 23, 2009 by US coated paper producers and the United Steel Workers International Union (which also represents workers in the forestry and paper industries) requesting an investigation into China’s subsidization of its domestic paper producers (*Certain Coated Paper Suitable for High-Quality Print Graphics Using Sheet-Fed Presses from China and Indonesia*, case numbers 701-TA-470-471 and 731-TA-1169-1170). The Senators included China’s currency practices and alleged currency manipulation under its definition of these subsidies. According to the letter, the US industry in the coated paper case "has provided sufficient evidence such that DOC is required by law to investigate whether China's currency manipulation is a countervailable subsidy." The letter states that if DOC agrees to investigate the Chinese government's actions on currency in the paper case, the results of that investigation could then be cited in other cases alleging that currency manipulation is a subsidy which "could ultimately lead to a situation where duties are placed on a wide range of Chinese products and ultimately cause the Chinese government to reform its currency practices."

DOC has yet to rule in the coated paper case on whether it will initiate an investigation of China’s currency practices as a countervailable subsidy. In all previous CVD cases against Chinese goods, DOC has refused to investigate China’s currency policies because the agency found that the domestic industry had failed to establish under US law that such policies met the legal definition of a subsidy. In the coated paper case, DOC announced on March 2, 2010 that it was delaying its initiation decision in order to sufficiently review the ample evidence that petitioners had provided. Analysts opined, however, that the

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delay in DOC's ruling was really intended to increase pressure on China to revalue its currency in advance of the June G-20 Summit. DOC's initiation decision is expected in August 2010; should the agency decide to initiate on the currency issue, a full investigation of whether China's currency policies provide countervailable subsidies to its domestic paper producers would then be required.

China's currency practices have drawn close scrutiny from the White House, US lawmakers and domestic industries in recent months and will continue to do so through the Fall. On September 15, 2010, the House Ways and Means Committee will hold a much anticipated hearing in which Members of the committee will hear testimony regarding whether China has made any material progress in allowing the RMB to appreciate. The Members of the committee will also consider whether Congress or the Administration needs to take action to address China's exchange rate policy.

The Treasury Department's decision to not label China a "currency manipulator" in its semi-annual report to Congress on International Economic and Exchange Rate Policies (which had been scheduled to be published in April 2010 but was delayed until July 2010), coupled with the modest appreciation of the RMB since the G-20 Summit, has caused many lawmakers and industry representatives to suggest that they will pursue other means of applying pressure on China to modify its currency practices. Senator Charles Schumer (D-NY) reaffirmed his intention to push for a vote on the Currency Exchange Rate Oversight Reform Act of 2009 (S. 1254), of which he is the sponsor, that would allow the United States to deem China's currency undervaluation a countervailable subsidy, thus subjecting all Chinese exports to potential remedial tariffs. Rep. Tim Ryan (D-OH) has also stated that he will continue to push for a vote on the Currency Reform for Fair Trade Act (HR 2378) which, similar to S. 1254, would allow the United States to deem China's currency undervaluation a countervailable subsidy. Most experts believe that the June 28 letter to President Obama is another example of such pressure, intended to push the Administration (*i.e.*, DOC) to initiate a CVD investigation of China's currency practices in the coated paper case.

House of Representatives Passes Trio of Bills Under Democrats' "Make It In America" Agenda

On July 28, 2010, the House of Representatives approved by voice vote the Emergency Trade Deficit Commission Act (H.R. 1875), a bill that forms a part of the Democrats' "Make It In America" manufacturing agenda and that would establish an emergency commission to examine and make recommendations on the US trade deficit. H.R. 1875 originally contained a provision that would have established a moratorium on the submission of free trade agreements (FTAs) to the US Congress until

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the Emergency Trade Deficit Commission issued a report and recommendations on the US trade deficit. According to Congressional sources, however, the provision was stripped from the bill the night before the vote took place; no other details on why the provisions was stripped have been provided. Upon introducing the bill, Rep. Peter DeFazio (D-OR) stated that the pending FTAs with Colombia, Panama, and South Korea opened up US markets to imports but failed to open foreign markets to US firms; consequently, Rep. DeFazio originally wanted the new emergency commission to review US trade policies and to establish a moratorium on the submission of FTAs while the review took place.

In addition to H.R. 1875, the House of Representatives passed the National Manufacturing Strategy Act (H.R. 4692) on July 28 (by a vote of 379 to 38), a bill that would require the President to publish a national manufacturing strategy every four years and to establish a National Manufacturing Strategy Board comprising federal officials and representatives of the private sector. The National Manufacturing Strategy Board would include representatives of various government agencies, two state governors of different parties, and nine members representing the private sector, selected “after consultation with industry and labor organizations.” The board would be charged with conducting a “comprehensive analysis” of the manufacturing sector, including assessments of “the current domestic and international environment” for US manufacturing, forecasts for the sector, and “matters affecting the competitiveness, growth, stability, and sustainability” of the sector, such as productivity, trade balance, job creation, and workforce development. Rep. Daniel Lipinski (D-IL) introduced the bill in February 2010. During floor debate on the bill, House Majority Leader Rep. Steny Hoyer (D-MD) noted that H.R. 4692, like H.R. 1875, is a part of Democrats' “Make It in America” agenda that would help strengthen the US manufacturing sector and its workforce.

The House of Representatives also passed on July 28 the Clean Energy Technology Manufacturing and Export Assistance Act (H.R. 5156), a bill that would direct USD 15 million in the Clean Energy Technology Manufacturing and Export Assistance Fund to pay for the development and implementation of the National Clean Energy Technology Export Strategy aimed at helping US clean technology firms increase exposure to foreign markets for their goods. The bill would also provide support for policies to reduce production costs in the clean technology sector while encouraging innovation, investment and productivity in the domestic clean technology field. Rep. Doris Matsui (D-CA) introduced H.R. 5156, also considered a part of the “Make It In America” agenda.

Observers also note that on July 29, 2010, the House Oversight and Government Reform Committee favorably reported two bills that are considered a part of the “Make It In America” agenda: (i) the American Jobs Matter Act (H.R. 5637), a bill that allows government contractors to submit jobs impact

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statements along with proposals to win federal contracts in order to demonstrate the net employment effect that their successful bid might have; and the All American Flag Act of 2010 (H.R. 2853), a bill that would require all American flags purchased by the US government to be 100 percent made in the United States, including any article, materials or supplies used to manufacture them.

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Free Trade Agreements

Free Trade Agreements Highlights

United States Requests Consultations with Guatemala under DR-CAFTA on Apparent Violations of Labor Rights

On July 30, 2010, United States Trade Representative (USTR) Ron Kirk announced that the United States has requested consultations with Guatemala under the Dominican Republic-Central America-United States Free Trade Agreement (DR-CAFTA) regarding apparent violations of obligations on labor rights. According to USTR, this is the first labor case the United States has ever brought against a trade agreement partner. USTR Kirk announced the case during a speech to manufacturing workers in Washington, Pennsylvania on the Obama Administration's enforcement of US FTAs. According to USTR Kirk, the United States "wants to see the Government of Guatemala take specific and effective action – including, if appropriate, legislative reforms – to improve the systemic failures in enforcement of Guatemalan labor law."

USTR Kirk, along with US Secretary of Labor Hilda Solis, conveyed the United States' request for consultations with Guatemala in a July 30, 2010 letter to Guatemala's Minister of Economy Erick Haroldo Coyoy Echeverria and Guatemala's Minister of Labor and Social Protection Edgar Alfredo Rodriguez. According to the letter, USTR has "identified a significant number of failures to enforce Guatemalan labor law, constituting a sustained or recurring course of action or inaction," including:

- Ministry of Labor failures to investigate alleged labor law violations;
- Ministry of Labor failures to take enforcement action once the Ministry has identified a labor law violation;
- Court failures to enforce Labor Court orders in cases involving labor law violations;
- Responses by the Government of Guatemala to "the use and threats of violence that appear to be related to the exercise or attempted exercise of labor rights in Guatemala, including the right of association and the right to organize and bargain collectively;" and
- The failure of the Government of Guatemala to adequately protect individuals threatened with violence and apparent failures to adequately investigate and prosecute such crimes.

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USTR formulated this list of labor-related concerns following an April 2008 public submission under the DR-CAFTA from the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) and six Guatemalan unions that alleged that the Government of Guatemala is failing to effectively enforce its labor law. After receiving the submission, USTR and other government agencies "conducted an extensive examination of Guatemala's compliance with its obligations under the Labor Chapter of the DR-CAFTA," and have reviewed and analyzed Guatemala's labor laws and Guatemala's obligations under Article 16.2.1(a) of the DR-CAFTA. Article 16.2.1(a) of the DR-CAFTA states that "each Party to the agreement has committed that it will not fail to effectively enforce its labor laws, through a sustained or recurring course of action or inaction, in a manner affecting trade between the Parties." USTR believes that "based on this examination, it appears that the Government of Guatemala is failing to meet its obligations under Article 16.2.1(a) [of the DR-CAFTA], with respect to effective enforcement of Guatemalan labor laws related to the right of association, the right to organize and bargain collectively, and acceptable conditions of work."

Although US officials have been engaged in informal government-to-government discussions with the Government of Guatemala since January 2009 (when the US Department of Labor conducted a review of the 2008 submission and issued a report where it found systemic weaknesses in the Government of Guatemala's enforcement of its labor laws and raised concerns about labor-related violence), USTR believes that "to date, the Government of Guatemala has not undertaken effective steps to correct systemic failures in the enforcement of its labor laws."

In the letter to Guatemalan officials, US officials requested consultations with Guatemala under the DR-CAFTA in order to address the labor concerns that the United States listed; the United States and Guatemala will now work towards fixing a mutually convenient date to hold consultations. If the two sides cannot resolve the matter during consultations within 60 days after the delivery of the consultation request, the United States may request a meeting of the DR-CAFTA Free Trade Commission, the ministerial level body that supervises the implementation of the DR-CAFTA. If the United States and Guatemala do not resolve the matter through ministerial consultations within 30 days, the United States may request the establishment of a dispute settlement panel to consider the matter. If the panel finds that Guatemala has failed to effectively enforce its labor law, the panel may, at the request of the United States, impose an annual monetary assessment of up to USD 15 million (adjusted for inflation), if both sides are unable to reach agreement on a resolution of the matter or, after reaching agreement, the United States considers that Guatemala has failed to observe the terms of the agreement. If the panel decides that Guatemala must pay the monetary assessment, any such assessments are to be paid into a fund established by the

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trade ministers from the United States and Guatemala and expended at their direction on appropriate labor initiatives, including efforts to improve or enhance labor law enforcement in Guatemala.

Several Members of the US Congress reacted positively to USTR's news of the consultations with Guatemala. House Ways and Means Committee Chairman Sander Levin (D-MI) and Trade Subcommittee Chairman John Tanner (D-TN) noted that "this is the first-ever labor case brought under any free trade agreement, and the significance of that should not be understated," adding that they welcomed the Obama Administration's "decision to address failures by Guatemala, or any other CAFTA country, to meet the standards incorporated in the CAFTA."

Although the US case against Guatemala on labor is the first of its kind under US trade agreements, observers note that since the start of the Obama Administration, US officials have stated that enforcement of trade agreements, including labor provisions, will serve as a priority, and that USTR and other agencies will strengthen their monitoring of trading partners' compliance with US FTA provisions. The consultation request indicates that the Administration intends to pursue this enhanced monitoring of compliance. Observers are especially interested how Guatemala will respond to the consultation request and how the two sides will approach and negotiate US labor concerns in Guatemala, including what steps (if any) Guatemala will take in responding to the US labor findings.

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Customs

Customs Highlights

Congress Passes US Manufacturing Enhancement Act of 2010

On July 27, 2010, the Senate approved the US Manufacturing Enhancement Act of 2010 (H.R. 4380, previously known as the Miscellaneous Tariff Bill (MTB)) by voice vote. The House of Representatives had approved H.R. 4380 on July 21, 2010 by a vote of 378 to 43 under suspension of the rules. Senate passage of H.R. 4380 clears the bill for the President's signature.

H.R. 4380 contains tariff suspensions that expired in December 2009. The bill suspends US tariffs for a broad array of inputs into the US manufacturing process that are not produced in the United States such as certain reusable grocery bags, synthetic staple fibers, various chemical compounds, certain air pressure distillation columns, certain microwaves, cellular plastic sheets for filters, certain yarns, certain laundry work surfaces, and stainless steel single-piece exhaust gas manifolds, among other things. Congress passed the last MTB in 2006 but since its expiry on December 31, 2009, US manufacturers have faced higher tariffs on inputs into their manufacturing process since January 1, 2010; H.R. 4380 enables a company affected by an expired suspension to petition Customs and Border Protection (CBP) for a refund of duties paid out.

House passage of the bill proved contentious, and House Members passed the bill even though Republican leaders voiced opposition to it under the argument that the bill was covered by the one-year moratorium on earmarks established by the House Republican Conference. On March 11, 2010, the House Republican Conference established a one-year moratorium on earmarks; House Rules defined the targeted tariff suspensions (in MTBs) as earmarks, and consequently, House Republican leaders felt it was necessary to oppose H.R. 4380 in accordance with the agreed-upon moratorium on earmarks. Nonetheless, a large number of Republican Members disagreed with the definition of tariff suspensions as earmarks and voted in favor of the bill. Although Republican leaders worked towards garnering opposition to the bill, 129 House Republicans voted in favor of H.R. 4380.

US business groups lauded passage of H.R. 4380. The American Apparel & Footwear Association (AAFA) noted that passage of H.R. 4380 was positive and urged Members of Congress to move on a second MTB that contains new duty suspensions before the current Congress ends its session at the end of the year. The National Association of Manufacturers (NAM) and the American Manufacturing Trade Action Coalition (AMTAC) also lauded passage of the bill and noted that H.R. 4380 would "support US

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jobs by driving down the cost to US manufacturing businesses." Separately, House Ways and Means Trade Subcommittee Ranking Member Kevin Brady (R-TX) used House passage of H.R. 4380 as an opportunity to urge Democratic Members to move forward on other pending trade votes. In a written statement, Rep. Brady noted that "the Democrats have proved they can support a pro-trade bill, [and] I look forward to working with my colleagues to move forward with pending trade agreements with Colombia, Panama, and South Korea."

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Petitions and Investigations

337 Complaint on Flat Panel Digital Televisions and Components Thereof

The following 337 Complaint was filed at the International Trade Commission on July 16, 2010:

Docket No: 2746

Document Type: 337 Complaint

Filed By: Blaney Harper

Firm/Org: Jones Day

Behalf Of: Vizio Inc.

Date Received: July 16, 2010

Confidential: Yes

Commodity: Flat Panel Digital Televisions and Components Thereof

Country: None

Description: Letter to Marilyn R. Abbott, Secretary, USITC, requesting that the Commission conduct an investigation under section 337 of the Tariff Act of 1930, as amended regarding Certain Flat Panel Digital Televisions Components thereof. The proposed respondents are: LG Electronics Inc. and LG Electronics USA Inc.

Status: Pending Institution

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MULTILATERAL

WTO Panel Releases Decision in European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft (DS316)

Summary

Decision: A World Trade Organization (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 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.

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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 [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. <u>Launch aid: mixed rulings</u>

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

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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'…."

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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.”

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 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*

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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. <u>European Investment Bank (EIB) loans not “specific”</u>

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.

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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."

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. <u>Infrastructure grants: improvements benefitted Airbus</u>

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."

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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.

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

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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."

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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 the Panel’s review of the development of successive

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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 fulfilment 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

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> 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 the 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'

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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 the summary above 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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