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RESTORING OPEN SKIES: THE NEED TO ADDRESS SUBSIDIZED COMPETITION FROM STATE-OWNED AIRLINES IN QATAR AND THE UAE

> *A second challenge is posed by the role of state-owned enterprises – or "national champions". SOEs that benefit from direct and indirect subsidies as well as differences in regulatory treatment may enjoy an advantage that distorts the level playing field. Whether it's financial services, telecommunications or delivery services, SOEs are increasingly playing a significant role. This is an issue we're taking head-on in TPP….*[1]

Since 1992, the U.S. Department of Transportation (DOT) and the U.S. Department of State (the State Department) have negotiated over 100 Open Skies Agreements. Originating in response to the need to liberalize markets that had previously been restricted, Open Skies has been highly successful in opening new markets for U.S. air carriers and promoting competition and consumer choice.

From the outset, the policy was grounded on two foundational concepts: (1) promoting liberalization and removing government influence from the international aviation marketplace by persuading foreign governments to sign onto the U.S. model Open Skies agreement; and (2) ensuring that in each individual case, the bilateral agreements negotiated under the policy were consistent with U.S. interests.

As the policy gathered momentum, the United States became heavily focused on achieving the first goal, and with great success: the United States persuaded 111 foreign governments to sign Open Skies agreements. In doing so, the United States increasingly assumed that every Open Skies agreement invariably served and promoted U.S. interests by creating the conditions for market-based competition. In the overwhelming majority of cases, that assumption was true. But it is has become increasingly clear that in a few extreme cases, the valuable open skies traffic rights that the United States granted are being used in ways that are contrary to free market competition and U.S. interests.

The most extreme cases are the Gulf nations of Qatar and the United Arab Emirates (UAE). Over the past decade, the governments of Qatar, Abu Dhabi and Dubai have formulated economic development strategies that depend in large part on a massive expansion in the flow of international air passenger traffic through their hub cities. And in furtherance of these strategies, they have created vertically-integrated, wholly state-owned aviation sectors that include monopoly service providers and complex interrelationships between their government institutions, airlines, ground handlers, airports, and state-owned banks.

State-owned Qatar Airways (Qatar), Etihad Airways (Etihad) and Emirates Airline (Emirates) (collectively, the Gulf carriers) are the key instruments of these strategies, so their government owners have fueled their operations and their rapid growth with over $40 billion in subsidies and other unfair government-conferred advantages in the last decade alone. U.S. airlines are increasingly competing with these state actors as they expand the routes and services they operate to the United States.

[1] U.S. Trade Representative Michael Froman, Remarks at the Coalition of Services Industries (Jun. 14, 2014).

This white paper examines the competitive threat that U.S. carriers face as a result of this massively subsidized competition. It reaches the following conclusions:

- U.S. Open Skies policy is designed to enable U.S. carriers to compete in a global market undistorted by government actions that advantage foreign carriers. The UAE and Qatar have turned this policy on its head by pursuing aviation industrial policies that are designed to <u>distort</u> the global market <u>in favor</u> of their state-owned carriers.

- Most significantly, while they have long denied that they are subsidized, newly obtained evidence demonstrates that the Gulf carriers have collectively received over $40 billion in subsidies and other unfair advantages in the last decade alone. The subsidies are fueling a massive expansion in the Gulf carriers' fleets – and, in the case of Etihad and Qatar, their continued existence – and seriously distorting the commercial marketplace to the detriment of U.S. and third-country airlines.

- Emirates, Etihad and Qatar are among the fastest growing airlines in the world. They have ordered hundreds of new widebody aircraft, including at least 160 double-deck Airbus A380s (Emirates alone is taking nearly half of all A380s produced or under production). Emirates is now the world's largest airline measured by international passengers and capacity, and, given their current order books, the three Gulf carriers will soon have a combined widebody capacity greater than the entire U.S. commercial widebody fleet. They are increasingly deploying these aircraft on international routes to the United States.

- Unlike U.S. and third country carriers, the Gulf carriers are adding this new capacity (all of which will be deployed on international routes) at rates that substantially exceed global GDP growth, which drives growth in demand for air transport services. Therefore, in order to fill this excess capacity, they must take passengers from other countries' carriers. And because the Gulf governments' competing economic development strategies effectively force the Gulf carriers to match each other's increases in capacity, and chase the same pools of international passengers, the harm that their subsidized capacity causes is magnified.

- As the Gulf carriers continue to deploy this subsidized capacity on international routes, they take passengers and revenues from U.S. airlines. The privately-owned U.S. airlines – which must earn a sufficient return to cover their cost of capital – will be forced off those routes, or will further reduce their services on them, and U.S. workers will lose their jobs.

- U.S. carriers' international and domestic networks have a symbiotic relationship (more than half of the passengers on U.S. carrier international flights make a connection to/from a domestic flight). Thus, as the Gulf carriers force U.S. carriers to reduce, terminate or forego services on international routes, the loss of these flights from the U.S. carriers' hubs will reduce passenger flow to/from their domestic flights. Because the economic viability of many domestic routes depends critically on passengers flowing onto long haul international flights, reductions in international service will negatively impact both the size and scope of their domestic networks, including the potential loss of service to smaller communities.

- The Open Skies agreements have conferred enormous benefits on Qatar and the UAE by opening the most lucrative market in the world to their airlines, even though they provide essentially no benefits to U.S. carriers in return, given the low level of demand for travel originating or terminating in the two Gulf countries. But the governments of Qatar and the UAE must accept the obligations that come with these benefits: in this case, to reach agreement with the United States on measures to address the flow of subsidized Gulf carrier capacity to the United States.

The Obama Administration has acknowledged the trade distortions and unfair competition that state capitalism and state-owned enterprises (SOEs) are creating in other sectors of the U.S. economy, and it is taking steps to address them. It is time to do the same in this sector. The *status quo* runs absolutely counter to fundamental Open Skies policy and cannot be justified or maintained.

I. Background: U.S. Open Skies Policy and the Open Skies Agreements with Qatar and the UAE

<u>U.S. Open Skies Policy is Premised on Fair, Market-Based Competition</u>: Since 1992, the United States has pursued an "Open Skies" policy in its negotiation of air transport agreements with foreign countries. As its seminal 1995 Statement of U.S. International Air Transport Policy (the Policy) explains, a core objective of the Policy is to provide the U.S. aviation industry with "the environment and the opportunities that will enable it to grow and compete effectively in the world market,"[2] including by giving U.S. carriers "unrestricted access to as many markets and passengers as possible."[3] The Policy is based on the idea that airlines should compete in a liberalized environment that relies on "the marketplace and unrestricted, fair competition to determine the variety, quality and price of air service."[4] And because the Policy anticipates fair, market-based competition, a primary U.S. objective under the Policy is to secure unrestricted rights for carriers to operate between international gateways "by way of any point and beyond to any point, at the discretion of airline management."[5] In light of the importance of the U.S. Civil Reserve Air Fleet (CRAF) program to national defense, the Policy also seeks to "[r]ecognize the importance of military and civil airlift resources being able to meet defense mobilization and deployment requirements in support of U.S. defense and foreign policies."[6]

[2] U.S. Department of Transportation, *Statement of United States International Air Transportation Policy*, 60 Fed. Reg. 21841 (May 3, 1995) (attached as Exhibit 1).
[3] *Id.* at 21842.
[4] *Id.* at 21841.
[5] *Id.* at 21844.
[6] *Id.*

The Policy Seeks a Level Playing Field, But It Did Not Anticipate the Threat of State Capitalism: The statutory authority that underpins the U.S. Open Skies program requires DOT and the State Department to develop a negotiating policy that eliminates discrimination and unfair competitive practices facing U.S. carriers in foreign markets.[7] In line with this statutory mandate, the Policy seeks to "[e]nsure that competition is fair and the playing field is level by eliminating marketplace distortions, such as government subsidies, restrictions on carriers' ability to conduct their own operations and ground-handling, and unequal access to infrastructure, facilities, or marketing channels."[8] However, while the Policy acknowledges that some foreign governments use financial aid and ground-handling and other monopolies to distort competition in favor of their national carriers, it dismisses the long-term threat of these practices to U.S. carriers because "no individual government can control all facets of its airlines' marketplace."[9] Reflecting the state of the world in the early 1990s, the Policy asserts that state-owned airlines are less competitive than U.S. carriers and that privatization, competition and globalization are "trends fueled by economic and political forces that would ultimately prevail."[10]

Pursuant to this Policy, the United States Negotiated Open Skies Agreements with Qatar and the UAE: Between 1999 and 2002, the United States negotiated and signed Open Skies agreements with Qatar and the UAE. The U.S.-UAE Open Skies agreement applies to the Emirates of Abu Dhabi and Dubai and their respective national carriers, Etihad and Emirates, the former of which did not then exist. The U.S.-Qatar Open Skies agreement applies to Qatar Airways.[11]

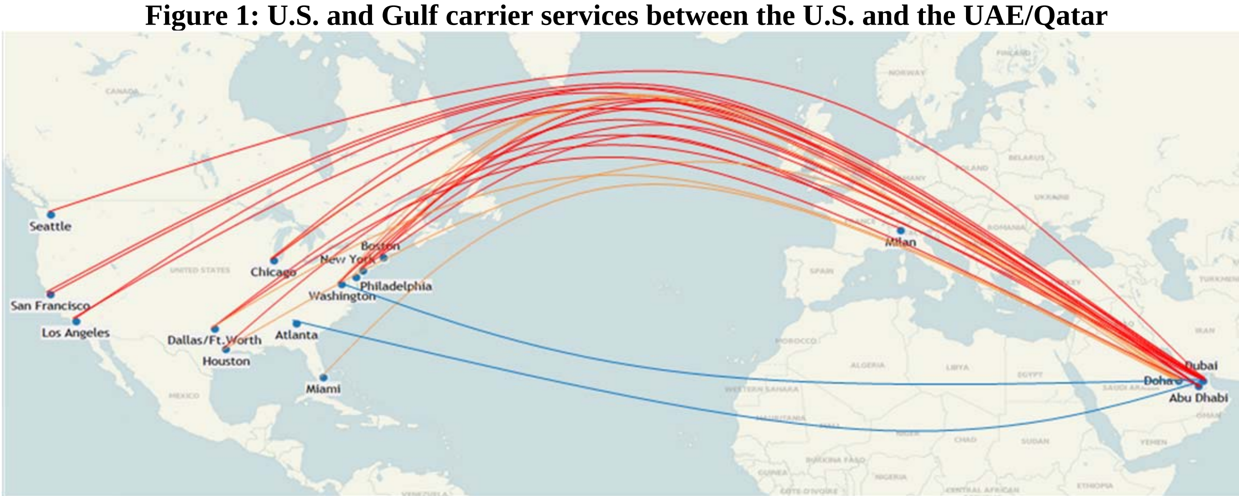
The Agreements Provide Enormous Benefits to Qatari and UAE Carriers: Consistent with U.S. negotiators' focus at the time, the Open Skies agreements with Qatar and the UAE are extremely liberal. They place no restrictions on the ability of the airlines of Qatar and the UAE to provide direct service between their home countries and the United States. They place no limitations on destinations, frequencies, routes or how airlines price their services. They also include unlimited "fifth freedom" and "sixth freedom" rights.[12] These additional rights vastly expand the value of the agreements for Qatar and the UAE, given the limited demand for air services originating or terminating in their home markets. The fifth freedom rights effectively allow Qatari and UAE airlines to provide commercial service between the United States and Europe (or the United States and Asia) as if they were U.S. or EU (or Asian) carriers. The sixth freedom rights allow them to aggregate local traffic flows from any country "behind" Qatar and the UAE, such as India or Australia, and transport them to/from the United States as if they were U.S., Indian or Australian carriers.[13]

The Gulf Carriers Operate Numerous U.S. Flights: Because the Gulf carriers are primarily transporting passengers from third countries who are using Gulf hubs as transfer points (*e.g.*,

[7] 49 U.S.C. § 40101(e)(9).
[8] 60 Fed. Reg. at 21844.
[9] *Id*.
[10] *Id.* at 21845.
[11] The U.S.-UAE Open Skies Agreement was signed on March 11, 2002, and entered into force on January 21, 2003. The U.S.-Qatar Open Skies Agreement was signed on October 3, 2001, but has not entered into force and, even today, is being applied on a provisional basis.
[12] *See* Appendix for an explanation of the so-called "freedoms of the air" (which include fifth and sixth freedoms).
[13] The two agreements also grant unlimited "seventh-freedom" cargo rights, which allow the Gulf carriers to transport cargo between the U.S. and third countries without having to include a stop in their homelands.

passengers flying Etihad from India to the United States), they operate numerous U.S. flights. Emirates currently operates ten daily flights (increasing to 11 effective March 8, 2015) from Dubai to U.S. points with service to Boston, Chicago, Dallas/Ft. Worth, Houston, Los Angeles, New York (JFK), San Francisco, Seattle, and Washington, D.C., plus a daily fifth freedom frequency between Milan, Italy and New York City.[14] Etihad currently operates an average of 6.4 daily flights from Abu Dhabi to U.S. points with service to Chicago, Dallas/Ft. Worth, Los Angeles, New York (JFK), San Francisco and Washington, D.C.[15] Qatar currently operates an average of 6.7 daily flights from Doha to U.S. points with service to Chicago, Dallas/Ft. Worth, Houston, New York (JFK), Miami, Philadelphia, and Washington, D.C.[16] By contrast, because of the low level of demand for travel originating or terminating in Qatar and the UAE, U.S. carriers operate no flights to Qatar or Abu Dhabi, and only two flights a day, collectively, to Dubai.

Figure 1: U.S. and Gulf carrier services between the U.S. and the UAE/Qatar



Source: OAG, December 2014.
Notes: Emirates and Etihad flights are shown in red; Qatar flights in orange; and U.S. airline flights in blue.

<u>Qatar and the UAE have an Obligation to Address Any Concerns that the United States Raises In Relation to the Agreements</u>: As Figure 1 illustrates, the Open Skies agreements have conferred enormous benefits on Qatar and the UAE by opening the most lucrative market in the world to their airlines. But the governments of Qatar and the UAE must accept the obligations that come with these benefits, including the obligation to allow the airlines of the other party "a fair and equal" opportunity to compete – a commitment that is inconsistent with the massive subsidies that these governments are providing to their airlines.[17] The agreements also include an obligation to engage in consultations at the request of the United States on any problems relating to the agreements, and to agree in good faith on measures to resolve them, as an alternative to the

[14] Emirates currently operates two daily round trips between Dubai and New York City with a third daily roundtrip commencing March 8, 2015; all other Emirates routes to the United States are operated once per day. Source: OAG and http://www.businesstraveller.asia/news/101015/emirates-to-fly-third-daily-a380-to-jfk.
[15] Etihad operates twice-daily service between Abu Dhabi and New York City. Etihad's service to Dallas operates three times per week and is scheduled to increase to daily service in 2016. Source: OAG, Etihad.
[16] Qatar's service to Miami is operated five times per week. Source: OAG.
[17] See U.S.-Qatar Open Skies Agreement, Art. 11 (stating that "Each Party shall allow a fair and equal opportunity for the designated airlines of both Parties to compete in providing the international air transportation governed by this Agreement"); U.S.-UAE Open Skies Agreement, Art. 11 (stating the same).

agreements' termination.[18] If either government refuses to do so, both agreements afford the United States the unilateral right to terminate the agreements with one year's notice.[19]

II. The Governments Of Abu Dhabi, Dubai And Qatar Are Using State Industrial Policy To Distort The Global Air Transport Market In Favor Of Their State-Owned Carriers

As discussed above, U.S. Open Skies policy is premised on the idea that "the marketplace and unrestricted, fair competition" should determine the variety, quality and price of air service. But over the past decade, the Governments of Abu Dhabi, Dubai and Qatar have turned this idea on its head by pursuing aviation industrial policies in which the three governments use their vertically-integrated, wholly state-owned aviation sectors to intervene in the market and give their state-owned carriers artificial competitive advantages over foreign carriers. Dubai is a case in point.

The Al Maktoum Family Runs the Emirate of Dubai: The Emirate of Dubai, one of seven emirates that together comprise the UAE, has been ruled by the Al Maktoum family since 1833. The current Ruler of Dubai is Sheikh Mohammed bin Rashid Al Maktoum; he is also the Vice President and Prime Minister of the UAE. The Crown Prince of Dubai is Sheikh Mohammed's son, Sheikh Hamdan bin Mohammed Al Maktoum. The Deputy Rulers of Dubai are Sheikh Maktoum bin Mohammed Al Maktoum, also Sheikh Mohammed's son, and Sheikh Hamdan bin Rashid Al Maktoum, Sheikh Mohammed's brother.

The Economy is Dominated by "Dubai Inc.": The economy of Dubai is dominated by "Dubai Inc.," a web of commercial corporations, financial institutions, and investment arms owned by the Dubai government and the Al Maktoum family under the umbrella of three major holding companies, Dubai Holding (owned by Sheikh Mohammed), Dubai World (owned by the government), and the government-owned Investment Corporation of Dubai (ICD).[20] Emirates is a key component of Dubai Inc. – it is 100 percent owned by the Government of Dubai through the ICD – and it derives significant benefits from its close connections with the government and other Dubai Inc. entities:

> Notwithstanding that the Group is a separate commercial enterprise operated independently of the Government of Dubai, its interests are closely aligned with the interests of the Government of Dubai and it benefits from strong relationships with regional air transportation regulators, Dubai Airports (which operates and manages both DIA [*i.e.*, Dubai International Airport (DXB)] and Al Maktoum International Airport), and Dubai Aviation City Corporation (which owns both

[18] *See* U.S.-Qatar Open Skies Agreement, Art. 13 ("Either Party may, at any time, request consultations relating to this Agreement. Such consultations shall begin at the earliest possible date, but not later than 60 days from the date the other Party receives the request unless otherwise agreed"); U.S.-UAE Open Skies Agreement, Art. 13 (stating the same).

[19] *See* U.S.-Qatar Open Skies Agreement, Art. 15 ("Either Party may, at any time, give notice in writing to the other Party of its decision to terminate this Agreement. . . . This Agreement shall terminate at midnight . . . immediately before the first anniversary of the date of receipt of the notice by the other Party, unless the notice is withdrawn by agreement of the Parties before the end of this period"); U.S.-UAE Open Skies Agreement, Art. 15 (stating the same).

[20] IMF, *United Arab Emirates: 2009 Article IV Consultation – Staff Report,* at 8.

> DIA and Al Maktoum International Airport), which is wholly-owned by the Government of Dubai."[21]

The Chairman of Emirates is Also the Chairman of Every Other Component of Dubai's Aviation Sector: The "strong relationships" between Emirates and these other parts of Dubai's aviation sector highlight a unique aspect of the Gulf aviation model: not only is virtually every supplier of goods, services and capital that the airlines need a related party, but they are almost entirely *run by the same individuals*. In the case of Dubai, the Chairman of Emirates – Sheikh Ahmed Bin Saeed Al Maktoum – is also the Chairman of Dubai Airports, the Chairman of dnata (the monopoly ground handling operation at the Dubai airports), the Chairman of Dubai Duty Free (the monopoly duty-free operator at DXB), the Chairman of Dubai Aerospace Enterprise (which leases aircraft to Emirates), the Chairman of Dubai's low-cost carrier flydubai, the Chairman of Dubai Airport Free Zone Authority, and the Chairman of Emirates NDB (the UAE's largest bank). He is also the President of the air transportation regulator (the Dubai Civil Aviation Authority (DCAA)), the Second Vice Chairman of Dubai's Executive Council (which is responsible for formulating policies and strategies for the Emirate of Dubai), a Director of Dubai Aviation City Corporation, and the Chairman of Dubai's Economic Development Committee.[22] As the son of the former ruler of Dubai, the brother of the former ruler of Dubai, and the uncle of Dubai's current ruler, he is also a member of the ruling family.[23]

Financial Transactions Within Dubai Inc. Are Highly Opaque: There is a pervasive lack of transparency in the dealings between these related entities. For example, as discussed in Section III below, Emirates' financial statements report that the airline purchased over $2 billion in goods and services from related parties in FY 2013-14, as it has in previous years. However, the financials do not disclose what types of goods and services Emirates purchased, or from whom, and they do not state that Emirates transacts with its related parties on terms equivalent to those that prevail in arm's length transactions. Indeed, because most of Emirates' related parties do not publish financial statements, it is impossible to identify and trace the financial flows between them.

Emirates Plays a Key Role in the Government's Economic Development Strategy, so the Government's Aviation Policies are Designed to Ensure its Commercial Success: Given Sheikh Ahmed's control over virtually every entity in Dubai's aviation sector, his position within Dubai's royal family, and his many government roles, it is not surprising that the government's aviation policy serves Emirates' commercial interests, nor that the airline's commercial strategy

[21] Emirates, U.S.$750,000,000 4.50 per cent. Notes due 2025 (Feb. 1, 2013), at 88.
[22] Sheik Ahmed is also, *inter alia*, a Board Member of the General Civil Aviation Authority of the UAE, the Chairman of Dubai's Supreme Council for Energy, the Chairman of Dubai's Supreme Fiscal Committee, the Chairman of Dubai's Department of Oil Affairs, a member of the Board of Directors of the ICD (which owns Emirates), the Chairman of Dubai World, the Chairman of Noor Investment Group, the Vice-Chairman of the Dubai World Trade Centre, and the Chairman of Alliance Insurance Company. A schematic showing Sheik Ahmed's place in Dubai Inc. and Dubai's aviation sector is attached as Exhibit 4.
[23] The situations in Doha and Abu Dhabi are similar. Qatar's aviation sector is even more integrated than Dubai's; Qatar Aviation Services (Doha Airport's ground handling monopoly), Qatar Duty Free Company, Doha International Airport, Qatar Distribution Company, and Qatar Aircraft Catering Company are all part of the Qatar Airways Group. And Etihad – whose Chairman, Sheikh Mohamed Mubarak Al Mazrouei, is also the Undersecretary of the Crown Prince Court of Abu Dhabi – acquired Abu Dhabi Cargo Company (ADCC), Abu Dhabi In-Flight Catering (ADIFC), and the ground handling business Abu Dhabi Airport Services (ADAS) in July 2013, reorganizing them as Etihad Airport Services. It also has numerous joint ventures with other aviation sector entities.

serves the government's broader economic development objectives.[24] As Emirates has explained:

> Emirates' strategy is closely aligned with the strategic development objectives of its ultimate owner, the Government of Dubai, as set out in the Dubai Strategic Plan 2015 which envisages that economic growth in Dubai will be based, among other things, on travel and tourism, trade and transport and logistics, for all of which Emirates acts as a significant facilitator.[25]

The Government's Spending on Airports is the Most Overt Example: The most overt example of this "close alignment" is the government's spending on airports. Given Dubai's small population, the success of the government's strategic development objectives hinges on Emirates' ability to capture ever-increasing quantities of passengers from foreign carriers and flow them through Dubai. The airline's massive expansion of capacity – detailed in Section IV below – is driven by this objective. Like other airlines throughout the world, however, Emirates' ability to continue to grow depends on the existence of adequate airport infrastructure. Consequently, the government is spending tens of billions of dollars to build that infrastructure, which is grossly in excess of the capacity needed to serve Dubai's local population.[26] And as the Government of Dubai has admitted, the landing fees and other charges it imposes on airport users are far too low to cover these costs – unlike airports in Europe and North America, whose fees and charges do fully reflect such costs, and whose ability to expand is constrained by the need to recoup the costs from airport users.[27] The resulting subsidy, which amounts to hundreds

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[24] *See* Tansy Harcourt, *Miles Above the Competition*, Financial Review (July 14, 2010) (noting that "[t]he fact that the same person who rules the emirate owns the airline, the airport and most of the hotels certainly gives Emirates an advantage over many rivals. The Arab state wants to turn itself into a tourism and transport hub to compensate for dwindling oil supplies. And it's willing to use all the pricing levers it has to draw people and businesses in").

[25] Emirates Prospectus issued on June 6, 2011 for U.S.$1,000,000,000 5.125 per cent. Notes due 2016, at 60. Emirates has also described itself as:

> an integral facilitator of the DSP 2015 as it is the major carrier of airline passenger and cargo traffic to, from and through Dubai, thereby playing a central role in helping to develop Dubai's travel and tourism industry, as well as contributing significantly to the trade, transport and logistics and financial and professional services industries.

Emirates, U.S.$750,000,000 4.50 per cent. Notes due 2025 (Feb. 1, 2013), at 88.

[26] The CEO of Dubai Airports has described the airport's role in the government's strategy as follows:

> Aviation is fundamental to the ongoing prosperity and economic expansion of Dubai. My job is to make sure that the airport infrastructure grows to ensure there are no constraints. We're proactively continuing to expand at Dubai International and Dubai World Central to ensure we can accommodate the massive influx of aircraft and traffic expected to inundate both airports over the next 10 to 20 years.

Dubai Airports Strategic Plan 2020 at 7, accessible at http://www.dubaiairports.ae/docs/default-source/Publications/dubai-airports---strategic-plan-2020.pdf?sfvrsn=0.

[27] For example, in a 2004 bond prospectus, the government stated that:

> DCA [Department of Civil Aviation] revenues are sufficient to pay for its operating expenses, generating an annual cash surplus. However, the surplus cash flows are not adequate to pay for the high capital expenditure, which is incurred continually to expand and upgrade the DIA…

of millions of dollars per year, overwhelmingly benefits Emirates (which operates the vast majority of flights at DXB) and gives Emirates a significant competitive advantage over U.S. and third country carriers (this issue is discussed in greater detail in Section III below).[28]

The Government is Spending $7.8 Billion to Expand Capacity at Dubai International Airport to Accommodate Emirates' Current Growth: The government's spending on airports includes $7.8 billion to boost capacity at DXB to 90 million passengers by 2018 "to accommodate the anticipated traffic growth driven by the rapid expansion of Emirates airline and flydubai",[29] including $3.3 billion spent to construct Concourse A of Terminal 3, Emirates' new A380 hub at DXB. The facility, "built for the exclusive use of Dubai's flagship carrier Emirates,"[30] opened in January 2013.

It is Spending $32 Billion on the New Dubai World Central Airport to Accommodate Emirates' Future Growth: Furthermore, after Emirates' President Tim Clark identified capacity constraints at DXB as the biggest single threat to the airline's ability to continue its growth plans (even after the opening of Concourse A of Terminal 3),[31] the government responded with a plan to spend *$32 billion* on the *first phase* of the expansion of the new Al Maktoum International Airport at Dubai World Central (DWC), which is only 40 miles south of DXB. The ultimate goal of the DWC project is to increase the airport's capacity to 240 million passengers/year (about five times the size of Chicago O'Hare) and to make it possible for 100 A380s to operate *at any given time* – recall that Emirates has ordered a fleet of 140 A380s – although no other airline (with the exception of its JV partner Qantas) flies the double-decker aircraft to Dubai.[32] The airport's CEO has explained that they are structuring the expansion to add capacity in 20 million passenger increments to mirror Emirates' growth.[33] He has also stressed that "[w]e want this to be seamless so the growth plans of Emirates can be satisfied."[34] And when asked how the airport

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Preliminary Offering Circular (Subject to Completion) Dated 10 October 2004, Government of Dubai, Trust Certificates due 2009, at 54. Similarly, Dubai Airports has explained that its "focus on developing non-aeronautical revenue streams is fundamental to ensuring sustained corporate stability and profitability, and is vital for funding future airport development *as well as reducing dependence on government funding, while keeping aeronautical charges competitive*"). Dubai Airports, Revenue and Commercial (emphasis added), accessible at http://dubaiairportsreview.com/people/revenue-commercial (last accessed October 1, 2014).

[28] The same situation exists in Abu Dhabi and Qatar.

[29] Dubai Airports, *Biography of HH Sheikh Ahmed bin Saeed al Maktoum, Chairman of Dubai Airports; President of the Dubai Civil Aviation Authority; Chairman and CEO of Emirates Group*, http://www.dubaiairports.ae/corporate/media-centre/biographies/detail/hh-sheikh-ahmed-bin-saeed-al-maktoum.

[30] Dubai Airports Strategic Plan 2020, at 5. The Strategic Plan further notes that:

> Emirates enjoys a close and highly effective relationship with Dubai Airports, aided significantly by Emirates' Chairman and Chief Executive Sheikh Ahmed bin Saeed Al Maktoum who is also the Chairman of Dubai Airports. Accordingly, infrastructure expansion plans are the result of close stakeholder collaboration. Terminal 3 is a recent example of the benefits of that relationship.

Id. at 19.

[31] Rory Jones, *Emirates Airlines' Boss Bemoans Dubai Bottleneck*, Wall Street Journal (Jun. 2, 2014); Rory Jones, *Dubai to Invest $32 Billion in Airport to Meet Emirates Airline Growth*, Wall Street Journal (Sept. 8, 2014) (noting that Clark had "previously warned that an infrastructure bottleneck at the current airport Dubai International would impede his airline's ambitions").

[32] Dubai Airports, *Dubai Airports welcomes Sheikh Mohammed's approval of 32bn US dollars DWC airport expansion plan* (Sept. 8, 2014); OAG as of December 5, 2014 (regarding airlines flying A380s to Dubai). Qantas currently has a fleet of 4 A380s, and it has a further 8 on order.

[33] Rory Jones, *Dubai to Invest $32 Billion in Airport to Meet Emirates Airline Growth*, Wall Street Journal (Sept. 8, 2014) .

[34] *Id.*

would finance the massive project, he replied “I'm sure that the government will come up with the appropriate funding to make the project a reality.”[35]

Sheik Ahmed has described the government’s strategy in the following way:

> By 2020 some 98.5 million passengers and over four million tonnes of air freight will pass through our airports. The fleets and networks of Emirates and flydubai will grow considerably to accommodate traffic and capture market share. Similarly, our infrastructure must expand to enable this growth and facilitate the trade, tourism and commerce that in turn will support the prosperity of Dubai. This is what our Strategic Plan 2020 sets out to achieve.[36]

The Governments of Abu Dhabi and Qatar are Pursuing Similar Strategies: Abu Dhabi and Qatar are pursuing similar strategies. For example, although Abu Dhabi’s airport is only 81 miles south of DWC, the Government of Abu Dhabi is pouring billions of dollars into its own airport expansion program as part of its broader effort to expand its economy and facilitate Etihad’s growth. As an Abu Dhabi government bond offering document explains:

> Completion of Abu Dhabi’s AED 25 billion [$6.8 billion] airport expansion project, anticipated in 2015, is expected to significantly increase tourism in the emirate. The aim is to increase the annual passenger capacity to 50 million passengers in the long-term and, as part of this expansion, a new terminal, terminal 3, was completed in early 2009. Abu Dhabi-based Etihad Airways, which commenced operations in 2003, has increased the accessibility of Abu Dhabi and is a significant factor in the emirate’s tourism development planning.[37]

The CEO of Abu Dhabi Airports Company, James Bennett, has also described the government’s strategy and the key role that Etihad plays:

> Five years ago, Sheikh Khalifa bin Zayed Al Nahyan, president of the UAE and ruler of Abu Dhabi, revealed a plan for the economic development of the emirate for the next quarter of a century. Since then, the ‘Abu Dhabi Economic Vision 2030’ has been at the heart of Abu Dhabi’s development as an aviation hub. . . .
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> “The leadership recognised that connectivity to the global economy is dependent on modes of air transportation – commercial aviation, corporate aviation, cargo

[35] Adam Schreck, *Dubai's bold plan to build the world's biggest airport*, Associated Press (Sept. 10, 2014).

[36] Dubai Airports Strategic Plan 2020 at 3. The Strategic Plan itself echoes this point:

> Although DWC is the long-term solution to Dubai’s aviation needs, adequate capacity to house Emirates’ considerable operation is not expected to be in place until at least the mid-point of the next decade. Accordingly, and until such time that DWC is adequately developed, Dubai International must expand to accommodate fleet expansion and traffic growth and retain the network efficiency established by its main hub carriers.

Id. at 23.

[37] Emirate of Abu Dhabi, Waha Aerospace Bond Prospectus (July 22, 2010) at 50. According to Abu Dhabi officials, the actual cost of the airport will exceed $10 billion.

> and even maintenance services such as MRO," explains Bennett. "Aviation is clearly a key component of the [future] success of Abu Dhabi. . . ."
>
> Of course, Bennett fully appreciates the critical role that the meteoric rise of Abu Dhabi's flag carrier has played in the airport's own success. "A major contributor of the growth in Abu Dhabi has been the continued expansion and the aircraft deliveries of Etihad, our home-based airline," he says. "As the airline continues to expand its network and purchase additional aircraft, this will fuel even more growth."[38]

Finally, Qatar's Minister of Economy and Finance has stated that "[t]he government fully recognizes the importance of a healthy aviation sector. Aviation and economic growth go hand in hand – aviation is an enabler."[39] And therefore, when Qatar Airways' CEO Akbar Al Baker identified airport capacity constraints in Doha as a key factor blocking the airline's expansion,[40] the government responded with a $17 billion construction project, the new Hamad International Airport, which opened for operation in May 2014. Once fully complete, the airport will be two-thirds the size of the city of Doha (and 12 times larger than the old Doha International Airport) and have an annual capacity of 50 million passengers per year. In Al Baker's own words, the new airport has given the airline "huge space to start expansion."[41]

<u>The Gulf Carriers are a Serious Threat to U.S. Airlines</u>: An Emirates-commissioned study has predicted that the aviation sector will contribute a full 32 percent of Dubai's GDP and 22 percent of its employment by 2020.[42] This remarkable statistic explains why the Gulf carriers are such serious threats to U.S. carriers. The governments of Abu Dhabi, Dubai and Qatar are pursuing economic development strategies that depend in large part on the continued expansion of the flow of international air passenger traffic through their hubs. The success of these strategies depends on the continued rapid growth of Etihad, Emirates and Qatar. The insignificant size of the local populations in Qatar and the UAE means the airlines can continue to grow only by capturing market share from other airlines. And the governments have geared their economies to ensure that they do.

In Emirates' own words, "[t]he rapid growth of Emirates in recent years, and projected growth in future years, is in part attributable to Government policy for the development of Dubai."[43]

[38] *Interview: James Bennett, CEO, ADAC*, ArabianBusiness.com (Dec. 19, 2012). Similarly, Etihad's CEO has stated that "[o]ur mandate is to support building Abu Dhabi and bringing people into and out of Abu Dhabi, and Abu Dhabi is becoming a destination in its own right." Guilherme Lohmann, *From hub to tourist destination – An explorative study of Singapore and Dubai's aviation-based transformation*, Journal of Air Transport Management 15 (2009), at 211.
[39] Alex Lennane, *Qatar sets its sights on being a top five air cargo carrier*, The Load Star (Mar. 15, 2013).
[40] *Ready for Action – Hamad International Airport*, constructionweekonline.com (July 16, 2014).
[41] *Id.*
[42] *Explaining Dubai's Aviation Model*, Oxford Economics (June 2011), at 8.
[43] *See* Emirates Islamic bond offering prospectus from 2005 for trust certificates due 2012, at 41.

III. The Governments of Abu Dhabi, Dubai and Qatar are Fueling Their State-Owned Carriers with Massive Subsidies and Other Unfair, Government-Conferred Advantages

As the key instruments of their governments' aviation-fueled economic development strategies, the three Gulf carriers benefit from active government industrial policies that are distorting the global aviation marketplace in a way that is wholly contrary to the goals of U.S. Open Skies policy.

Most significantly, newly discovered evidence – including Etihad's and Qatar's non-public financial statements – shows that in spite of their repeated and vehement public denials, Etihad, Emirates and Qatar have collectively received over $39 billion in subsidies in the last decade alone. This massive government support has enabled the three airlines to expand their capacity and operations at a pace that would have been impossible otherwise, and, in the case of Etihad and Qatar, has kept them in business in spite of their enormous losses. According to their own financial statements, if not for the subsidies, Etihad and Qatar would not be commercially viable.

In addition to the subsidies, the three carriers also receive significant benefits from other aspects of their governments' industrial policies. Artificially low labor costs (a result of their governments' bans on unions and other well-documented labor practices), freedom from taxation, exemptions from their countries' competition laws and lack of independent regulation are only a few examples. Together with the subsidies, these government-conferred advantages artificially decrease the Gulf carriers' costs and give them significant competitive advantages over U.S. and third-country airlines.

The WTO Agreement on Subsidies and Countervailing Measures defines "subsidy" as a "financial contribution" by a government that confers a "benefit" on its recipient (*i.e.,* government support on better than commercial terms).[44] The same definition is incorporated in the U.S. countervailing duty law.[45] This white paper has used the WTO definition to evaluate the support that the Gulf carriers have received, as it has been multilaterally-agreed by all 160 WTO Members, including Qatar and the UAE.[46]

A. Etihad, Emirates and Qatar have Received Over $39 Billion in Subsidies from their Government Owners Since 2004

1. Etihad Airways: Over $17 billion in subsidies since 2004

In a 2013 submission to the U.S. Department of Transportation, Etihad flatly stated that it "operates to a commercial mandate and does not receive state subsidies."[47] Etihad's CEO James

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[44] *See* SCM Agreement, Art. 1.1. Although the SCM Agreement does not apply to air transport services, the agreement's definition of "subsidy" and its methodologies reflect a global consensus on the types of government support that are unfair, distort international commerce and harm international competitors.
[45] *See* 19 USC 1677(5)(B).
[46] The paper also uses WTO and U.S. Department of Commerce methodologies to quantify the subsidies.
[47] Motion for Leave to File and Consolidated Reply of Etihad Airways P.J.S.C., Application for Etihad Airways P.J.S.C. for a Statement of Authorization pursuant to 14 C.F.R. § 212, Docket OST-2013-0178 (Oct. 11, 2013), at 9.

Hogan has similarly claimed that "there is no form of subsidisation from the government to the airline."[48] He has made similar claims on numerous occasions in the past.[49]

But these claims are false. Etihad's audited financial statements – which Etihad refuses to publicly disclose – demonstrate that in the period from its inception to the end of 2013 (the latest information available), Etihad received over $13.5 billion in subsidies in the form of interest-free government loans, equity infusions, airport fee exemptions, and other types of government funding that have enabled the airline to continue in operation despite its $4 billion in accumulated losses.[50] The financials also show that the Government of Abu Dhabi has already committed an additional $4.2 billion in subsidies to Etihad – including $3.5 billion in 2014 – which means the total subsidy amount will exceed $17 billion.

a. $6.6 billion in subsidies from interest-free government "loans"

According to Etihad's financial statements, the Government of Abu Dhabi has granted over $6 billion in subsidies to Etihad in the form of interest-free loans. The financials show that the subsidies began at the time of the airline's inception and initially took the form of pre-delivery payments to Airbus and Boeing that the Government made on Etihad's behalf. The total amount of these payments was $491 million in 2004 and another $592 million in 2005.[51] As Figure 2 shows, Etihad's 2005 financial statements describe the transactions as "advances to suppliers":[52]

Figure 2: Excerpt from Etihad 2005 Financial Statements

9 Advances to suppliers

The Company has placed firm orders with suppliers to acquire certain aircrafts. The Government of Abu Dhabi made pre–delivery payments (PDPs) to the suppliers on behalf of the Company. These payments are included under loan from Shareholder.
As the financing arrangements were not finalised in 2005 therefore these payments have been treated as advance to supplier. Following are the details of such advances.

Aircraft	2005 AED'000	2004 AED'000	Delivery
Airbus	2,791,707	1,065,334	2006-2008
Boeing	1,187,255	739,394	2006
	3,978,962	**1,804,728**	

[48] Camilla Hall, *Etihad eyes partnership route to growth*, Fin. Times (Jan. 2, 2013).
[49] For example, in a January 2012 interview, Hogan said:

> I can assure you and everybody that Etihad does not get anything for free here. The rules are very straightforward: we don't get any form of subsidy, we get no letters of comfort or sovereign guarantees and we have to raise debt ourselves [to finance aircraft]. We go to the market as Etihad Airways.

James Hogan Etihad Airways CEO, Air Transport World (Jan. 1, 2012).
[50] Although Etihad does not publicly release its financial statements, copies of group financial accounts for the airline for the years 2004-2013 were obtained from company filings in certain third country jurisdictions.
[51] The UAE dirham (AED) is pegged to the U.S. dollar at a rate of 3.67 to 1. All AED figures in this white paper have been converted to USD using the official rate.
[52] Etihad Airways PJSC, Financial Statements (Dec. 31, 2005) at 13, Note 9 (Advances to Suppliers).

After these initial pre-delivery payments, the government shifted to providing direct loans. Etihad's financials show that it borrowed $343 million in fiscal year 2006 and $532 million in fiscal year 2007.[53] According to the 2007 financial statements, the purpose of the loans was the "partial financing of the acquisition of aircraft fleet and related assets."[54]

In 2008, the Government provided another $662 million loan, bringing the total amount at that point to $2.6 billion. The 2008 financial statements were the first to describe the loans' terms; as Figure 3 shows, they state that they were "without any interest and would be paid by the Company in accordance with a timetable to be agreed with the Shareholder such that the first installment will be paid in the year 2027."[55] The statements also explained that "[t]he Board of Directors of the Company believe that this loan be measured at cost given that it is in the nature of quasi equity and the repayment profile has not yet been agreed with the Shareholder."[56]

Figure 3: Excerpt from Etihad 2008 Financial Statements

23. Loan from the Shareholder	2008 USD '000	2007 USD '000
At 1 January	**1,989,676**	1,457,491
Borrowed during the year	**662,426**	532,185
At 31 December	**2,652,102**	1,989,676

The Company obtained subordinated loans from the Shareholder amounting to USD 3,012 million vide a decision No (17) of 2007 of the President of the Executive Council dated 9 April 2007. A further decision No (53) of 2008 of the President of the Executive Council dated 2 September 2008 increased these loans to USD 5,213 million. At 31 December 2008, an amount of USD 2,652 million was drawn down and provided by the Shareholder. The remaining loan amount is required to be utilised by the Company to finance the purchase of aircraft.

All the above loans are without any interest and would be paid by the Company in accordance with a timetable to be agreed with the Shareholder such that the first installment will be paid in the year 2027. The subordinated loans referred to in the above decisions give priority to paying off loans obtained by the Company from other institutions and sources other than that obtained from the Shareholder.

The Board of Directors of the Company believe that this loan be measured at cost given that it is in the nature of quasi equity and the repayment profile has not yet been agreed with the Shareholder.

The Government made additional loans in 2009 ($360 million), 2011 ($447 million), 2012 ($155 million), and 2013 ($1.02 billion). Like the 2008 financial statements, the 2009 statements explained that the loans were interest-free with no repayment obligation until 2027 at the earliest.[57] The repayment obligations appear to have changed in 2010, however, as the statements for that year explain that there were "no contractual obligations to repay the loans in

[53] Etihad Airways PJSC, Financial Statements (Dec. 31, 2007) at 7, 25, Note 18 (Loans and borrowings).
[54] *Id.* at 18.
[55] Etihad Airways PJSC, Consolidated financial statements (Dec. 31, 2008) at 27, Note 23 (Loan from the Shareholder). The financial statements also explain that, despite their interest-free nature, the loans are structured so that Etihad's loans from other creditors are repaid first. These extraordinarily concessional terms reflect the fact that the President of the Executive Council that granted the loans – Sheik Hamed bin Zayed Al Nahyan – was at that time also the Chairman of Etihad.
[56] *Id.*
[57] Etihad Airways PJSC, Financial Statements (Dec. 31, 2009) at 8, 28-29, Note 22 (Loan from the Shareholder).

the foreseeable future. . . . Therefore, these loans are more akin to equity instruments rather than liabilities, and accordingly have been presented within equity."[58] In other words, as of 2010, the loans were effectively forgiven.

As Figure 4 shows, the total amount of the Government's interest-free "loans" to Etihad by the end of 2013 was $4.63 billion.[59] Figure 4 also shows that the Government has authorized an additional $583 million that Etihad had not yet drawn down by the end of 2013.

Figure 4: Excerpt from Etihad 2013 Financial Statement

> The Company obtained subordinated loans from the Shareholder amounting to USD 3,012 million vide a decision No (17) of 2007 of the President of the Executive Council dated 9 April 2007. A further decision No (53) of 2008 of the President of the Executive Council dated 2 September 2008 increased these loans to USD 5,213 million. As at 31 December 2013, an amount of USD 4,630 million *(2012: USD 3,614 million)* has been drawn down and provided by the Shareholder. The loan amount is required to be utilised by the Company to finance the purchase of aircraft.
>
> As per the arrangement, there is no contractual obligation to repay the loan in the foreseeable future. In addition, the arrangement specifies that, on dissolution of the Company, the rights, benefits and obligations in the residual net assets and liabilities, attached to the loan, shall rank pari passu with those attached to the share capital of the Company. Therefore, these loans are more akin to equity instruments rather than liabilities, and accordingly have been presented within equity.

Thus, the total benefit from this single category of subsidy is at least $5.2 billion, plus another $1.38 billion in interest that would have accrued if the loans had been on commercial terms.[60]

In May 2014, information about Etihad's interest-free loans surfaced in Australia (although the press reported the loan amount as $3 billion, thus understating the true amount by half).[61] Etihad argued in response to the press reports that the loans were not subsidies because the Government expected to be paid back.[62] But Etihad's argument contradicts the international consensus on the definition of "subsidy." Loans are subsidies if they are not on commercial terms, even if they must be paid back. Interest-free loans are subsidies by definition,[63] and the other aspects of the loans – the twenty year grace period before Etihad's repayment obligation begins, the fact that they were effectively forgiven in 2010, their subordinate status – only further confirm this conclusion.

[58] Etihad Airways PJSC, Financial Statements (Dec. 31, 2010) at 29-30, Note 22 (Loan from the Shareholder).

[59] Etihad Airways PJSC, Consolidated financial statements (Dec. 31, 2013) at 42, Note 18 (Capital and reserves). In October 2013, Etihad spent approximately $350 million to purchase five Boeing 777-200LR aircraft from Air India for the express purpose of opening a new route between Abu Dhabi and Los Angeles. Thus, in this particular case, Etihad is using the subsidies specifically to target U.S. carriers. *See, e.g.,* Sharmistha Mukherjee, *Air India finalises $350-mn deal with Etihad*, Business Standard (Oct. 16, 2013).

[60] A study by the international trade and economics consulting firm Capital Trade calculated the interest subsidy that Etihad received from these loans. *See* Capital Trade Incorporated, *Evidence of Actionable Government Subsidies Received by Etihad Airways, Qatar Airways, and Emirates Airline*, at 30 (Capital Trade Study) (attached as Exhibit 2).

[61] The Australian Financial Review reported that it had obtained documents showing that Etihad had received "massive financial support from the royal family of Abu Dhabi contrary to long-standing denials." The documents described a secret, interest-free $3 billion loan that required no repayments until 2027 and a "shopping list" of other subsidies that Etihad was seeking from its government owners, including free land. The documents also indicated that the Abu Dhabi government covers the costs of Etihad's sponsorship of the English Premier League team Manchester City, which is owned by the Crown Prince's brother. Joe Aston, *Leaked report reveals Etihad's long-denied royal funding*, Australian Financial Review (May 22, 2014).

[62] *See, e.g.,* Anil Bhoyrul, *James Hogan: The facts about Etihad*, arabian business.com (June 28, 2014).

[63] *See, e.g.,* Panel Report, *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft*, WT/DS316/R, para. 7.489 (launch aid provided to Airbus at a zero rate of interest conferred a "benefit" on Airbus, and thus constituted a subsidy).

b. $6.3 billion in subsidies from government capital injections

Etihad's financials also show that in addition to the $6.6 billion in subsidized "loans," Etihad has received approximately $6.3 billion in subsidies in the form of capital injections from the Abu Dhabi government.[64] Figure 5 shows the timing and amount of the injections, which the airline has received in every year of its existence but one, including $1.2 billion in 2013.

Figure 5: Abu Dhabi government capital injections into Etihad Airways

Year	Paid up capital in USD	Accumulated
2007	1,238,977,000	1,238,977,000
2008	575,845,000	1,814,822,000
2009	330,765,000	2,145,587,000
2010	1,247,842,000	3,393,429,000
2011	438,672,000	3,832,101,000
2012	1,242,000,000	5,074,101,000
2013	1,217,000,000	6,291,101,000
Total	6,291,101,000	

Capital injections are subsidies if the recipient of the injections was not "equityworthy" at the time the government decided to inject the funding. Under the U.S. Department of Commerce's subsidy methodology, Etihad was not equityworthy at the time that the Government of Abu Dhabi committed the $6.3 billion.[65] Thus, the full $6.3 billion constitutes subsidies to Etihad.[66]

Furthermore, Etihad's financials show that Etihad has used the government's annual cash infusions to cover its substantial, ongoing operating losses. Cash infusions to cover operating losses are a particularly distortive type of subsidy.[67]

c. $751 million in subsidies from government grants

Etihad's financials further show that in addition to loan and capital subsidies, Etihad has also received at least $751 million in cash grants from its government owners. For example, as Figure 6 shows, the Abu Dhabi government gave Etihad a $111 million grant in 2008 for its "economic contribution and its role in the development of Abu Dhabi in its campaign 'Abu Dhabi to the world.'"[68]

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[64] The $6.3 billion includes $85 million that the Government had authorized but not yet disbursed as of December 31, 2013.
[65] Capital Trade Study at 18-24.
[66] In total, Etihad received $6.43 billion in equity infusions in the 2004-2013 time period. *See* Etihad Airways PJSC, Consolidated financial statements (Dec. 31, 2013) at 42, Note 18 (Capital and reserves). However, in order to be conservative, Capital Trade did not conduct a subsidy analysis for the initial start-up capital ($136 million) that the airline received in 2004-05.
[67] *See* SCM Agreement, Article 6.1(c) (stating that subsidies to cover operating losses are "deemed" to cause serious prejudice to the interests of other WTO Members). The "deemed" serious prejudice provisions are no longer in effect, however.
[68] Etihad Airways PJSC, Consolidated financial statements (Dec. 31, 2008) at 21, Note 8 (Other Income).

Figure 6: Excerpt from Etihad 2008 Financial Statements

> In view of its economic contribution and its role in the development of Abu Dhabi in its campaign "Abu Dhabi to the world", the Government of Abu Dhabi has decided to contribute for 2008 an amount of USD 111 million which has been recognised in "other income" in the consolidated income statement *(Refer Note 19)*.

Similarly, as Figure 7 shows, a leaked internal study that Booz Allen prepared for Etihad in 2010 indicates that the Executive Council of Abu Dhabi "covers" the cost of Etihad's sponsorship of the Manchester City Football Club:[69]

Figure 7: Excerpt from Booz Allen Study

> 4) Sponsorship – Ferrari ends 2010, Executive Council covers Man City

Elsewhere, it has been reported that Manchester City sold its stadium naming and jersey advertising rights to Etihad for £400 million (or $640 million, at prevailing exchange rates at the time of the announcement).[70] Thus, in "covering" this cost on Etihad's behalf, the government effectively provided Etihad a $640 million grant.

d. $501 million in subsidies from airport fee exemptions

Although UAE airports impose a passenger service charge of AED 75 ($21.78) on departing passengers, they exempt transfer traffic from payment of the charge.[71] The government's decision to forego this substantial source of revenue disproportionately benefits UAE carriers (for example, Etihad accounts for 88 percent of all connecting traffic at Abu Dhabi International) and gives them a significant competitive advantage over other international carriers. A study by Daniel Kasper of Compass Lexecon examined this practice and concluded that it has resulted in a subsidy to Etihad of at least $501 million since 2004.[72] Moreover, in addition to a subsidy, the exemption is also a *de facto* violation of the "national treatment" principle of international trade law.

e. $3.5 billion in new subsidies in 2014

Finally, in addition to the $14.2 billion in subsidized loans, capital injections and grants described above, Etihad's 2013 financial statements state that the Government of Abu Dhabi approved **another $3.504 billion** in government funding for the airline in 2014.[73] Although the financial statements do not provide any details on the precise nature of these funds, they demonstrate that the total subsidies to Etihad will exceed $17.5 billion.

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[69] The Executive Council of Abu Dhabi is the executive authority of the Emirate of Abu Dhabi. Etihad's then-Chairman, Sheikh Hamed bin Zeyed Al Nahyan, is a member of the Executive Council.
[70] *See Manchester City bank record £400m sponsorship deal with Etihad Airways*, The Guardian (July 8, 2011), available at: http://www.theguardian.com/football/2011/jul/08/manchester-city-deal-etihad-airways .
[71] *See, e.g.,* Abu Dhabi International Airport, Conditions of Use, Version 0.03 (November 2013), Schedule 5, items 1-3.
[72] Daniel Kasper, *Gulf Airport Subsidies*, at viii (Kasper Study) (attached as Exhibit 3). This issue is discussed in greater detail in subsection 3(b) below.
[73] Etihad Airways PJSC, Consolidated financial statements (Dec. 31, 2013) at 9, Note 2 (Basis of preparation).

f. Additional and Substantial Unquantified Subsidies

In addition to the subsidies quantified above, Etihad also benefits from additional subsidies that cannot be quantified, because the necessary information is not publicly available. For example:

***Purchases of Goods and Services from Other Government-owned Entities on Non-Arm's Length Terms*:** Like Emirates and Qatar, Etihad purchases significant quantities of goods and services from other government-owned entities in Abu Dhabi that are related parties. In 2013, for example, Etihad transacted with related parties for aviation fuel, aircraft maintenance services, landing and parking rights, handling services, catering services, aircraft operating leases, and airport and lounge expenses.[74] Collectively, these related party purchases represented almost 30 percent of Etihad's total operating expenses.[75] In addition, Etihad engages in substantial financial transactions with other related government entities.

While Etihad's financial statements state explicitly that Etihad purchases from government-owned *infrastructure-related* entities on an arm's length basis, it does not include a similarly straightforward statement with respect to the prices it pays its related parties for aviation fuel, in-flight catering, aircraft maintenance, handling and landing and parking, describing them instead as being "based on agreed rates."[76] This contrast in language is an indication that Etihad is not paying arm's length prices, and thus that it is receiving further subsidies through these transactions. However, the financials do not contain enough information to quantify the subsidies.

***Tax and Import Duty Exemptions*:** The government decree that established Etihad states that Etihad and "any body affiliated or dealing directly" with Etihad is exempted from all taxes and duties, including:

> "1. Income taxes and customs duties imposed on all purchases thereof including aircraft, goods, materials, equipment, machinery, devices and spare parts imported to achieve the company's purposes and all other materials necessary to the use thereof or for sale on board of its aircraft or distributed for publicity purposes whether imported in the name of the company or any affiliates, contractors or subcontractors.
>
> 2. Any taxes resulting from the sale or transfer of ownership of quotas of the company or the quotas or shares of any other affiliates.
>
> 3. Any taxes resulting from the dividends of the company's partners or the partners of any affiliate thereof."

Under U.S. and WTO rules, tax and duty exemptions are subsidies in the amount of the revenue that the company would otherwise have paid. However, the Etihad financial statements do not

[74] *See id.*, Note 22(a) at 47.
[75] *See* Capital Trade Study at 40.
[76] *See* Etihad Airways PJSC, Consolidated financial statements (Dec. 31, 2013) at 46-47, Note 22(a) (Related party transactions).

include the information that would be needed to quantify the subsidy that it is receiving as a result of these exemptions.

***Subsidies from Abu Dhabi International Airport*:** As discussed in Section II above, Etihad's hub airport is in the midst of a $6.8 billion airport expansion project that aims to increase the airport's annual passenger capacity to 50 million passengers. Despite this enormous level of expenditure, the airport charges fees that are among the lowest in the world – far too low to cover the airport's capital expenditures, unlike airports in the United States and Europe – which results in a significant subsidy to Etihad. However, the airport does not release financial statements, and there is insufficient publicly available information to determine the magnitude of the subsidy that Etihad is receiving as a result.

* * * * *

<u>The Subsidies have Funded Etihad's "Equity Alliance" Growth Strategy</u>: In recent years, Etihad has been building its network by making equity investments in failing airlines around the world. Given its extensive losses, it is clear from Etihad's financial statements that Etihad is using government money to fund this strategy, and thus that it is effectively the Government of Abu Dhabi that is making the investments. For example, Etihad's investment activity (*e.g.*, Air Berlin, Jet Airways, Virgin Australia, Air Serbia, Darwin Air) since March 31, 2013 has exceeded $1 billion, even though its 2012 financial statements reported only $576 million of cash on hand.[77] How was this possible? The answer can be found in Etihad's 2013 financials, which show that over the course of 2013, the Government of Abu Dhabi gave Etihad another $1 billion interest-free "loan", it injected $1.2 billion in additional cash, and it committed $3.5 billion in additional shareholder funds.

<u>Without the Subsidies, Etihad Would Not Be Commercially Viable</u>: Etihad's operating performance and financial condition have been so dire that the airline's auditors have been unwilling to classify the company as a "going concern" – that is, likely to remain in business in the foreseeable future – without explicit commitments by the government to continue covering Etihad's financial obligations. For example, as Figure 8 shows, Etihad's 2013 financial statements explicitly tied the going concern determination to the $3.5 billion subsidy that the Government committed in 2014.[78] Thus, without the subsidies, Etihad would not be commercially viable.

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[77] Etihad Airways PJSC, Consolidated financial statements (Dec. 31, 2012) at 28, Note 21 (Cash and cash equivalents).

[78] Etihad Airways PJSC, Consolidated financial statements (Dec. 31, 2013) at 9, Note 2 (Basis of preparation, Going concern). Similarly, Etihad's 2005 financial statements state that "[i]n view of the Company's equity stakeholder it receives diverse support from the Shareholders whereby *irrespective of its stated financial position and results*, the continuity of its operation as a going concern is secured." Etihad Airways PJSC, Financial Statements (Dec. 31, 2005) at 8, Note 2 (Basis of preparation) (emphasis added). The company's financial statements for subsequent years include similar statements.

Figure 8: Excerpt From Etihad 2013 Financial Statement

2.1 Going concern

These annual financial statements have been prepared on a going concern basis nothwithstanding the fact that the Group has accumulated losses of USD 3,763 million as at 31 December 2013. The Executive Council of the Emirate of Abu Dhabi approved in 2007 (pursuant to decision No. 17) and then in 2008 (decision No. 53) for the availability of committed funds to the Group comprising: USD 6,512 million of authorized share capital of which USD 6,427 million has been issued for cash to date and the remainder (USD 85 million) can be issued to fund future operational cash requirements (refer to note 18.1); and USD 5,213 million of shareholder loans (in substance these are equity in nature) of which USD 4,630 million has been utilized and the remainder (USD 583 million) is available for the acquisition of aircraft (refer to note 18.2).

The Group prepares rolling cash flow forecasts for a five year term. Based on their review and approval of these forecasts and USD 3,504 million available for drawdown by Etihad as approved by the Executive Council during 2014 as additional funding from the Shareholder, the Directors confirm that the Group has access to sufficient cash facilities to meet its obligations for the foreseeable future and for a period of at least 12 months from the date of approval of these annual financial statements. Accordingly, the annual financial statements have been prepared on the going concern basis.

Etihad's Recent Claims of Profitability Are Unfounded: Finally, although Etihad has boasted of its profitability in recent years, information in its financials contradict these claims. To give just one example, the 2013 financial statements show that Etihad's 2013 "Operating Profit" of $209 million and its "Profit for the year" of $62 million would not have been possible without a one-time $724 million gain from the sale of its frequent flier program. Although the financial statements do not provide much detail on the transaction, they do show that Etihad sold the program to a newly-created related party that is owned 50 percent by Etihad's wholly-owned subsidiary Etihad Airport Services and 50 percent by "Global Loyalty Company," whose ownership is unknown, but appears to be related to Etihad.[79]

Given the sale price, it appears that the related party paid twice as much for the program, on a per member basis, as other purchasers have paid in comparable transactions.[80] Furthermore, there is no evidence in the financials or public sources that the sale was actually funded. To the contrary, it appears that the sale was simply a paper transaction that was designed to allow Etihad to report a profit. Without this questionable, one-off transaction, Etihad would have incurred a net loss in the hundreds of millions of dollars in 2013.

The Government of Abu Dhabi's Subsidies to Etihad are Seriously Distorting the Market: In sum, Etihad has received a staggering amount of subsidies from its government owner that have allowed it to continue in operation in spite of its $4 billion in accumulated losses.[81] These subsidies have helped Etihad purchase a modern fleet of widebody aircraft that will give it an ongoing cost advantage over its U.S. and EU competitors. And the subsidies have enabled Etihad to grow its network and scale of operations at a pace that would have been impossible without them by funding both its fleet expansion and its equity alliance strategy. Given the

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[79] *See* Etihad Airways PJSC, Consolidated financial statements (Dec. 31, 2013) at 2, 39, Note 13.4(e) (describing the transaction). A March 2014 job posting for the position of "Head of Global Partners (Global Loyalty Company)" indicated that the position was with Etihad. *See* https://www.linkedin.com/jobs2/view/12775249.

[80] Based on the $700 million purchase price for 2.3 million members (according to an April 2, 2014 Etihad press release), the sale of Etihad's own frequent flier program implied a per-member price of approximately $300. By contrast, a recent transaction between Aeromexico and Aeroplan Aimia implied a per member price of approximately $150, and Etihad's purchases of Jet Airways' and Air Berlin's programs implied a per member price of $120-$125. Ernst & Young, Frequent Flyer Program: ready for take-off (2014), at 8.

[81] *See* Etihad Airways PJSC, Consolidated financial statements (Dec. 31, 2013) at 4.

company's dismal financial performance over the last ten years, if not for the subsidies, Etihad would have gone out of business.

2. Qatar Airways: Over $16 Billion in Subsidies Since 2004

Like Etihad, Qatar Airways has long denied that it is subsidized. In a 2006 interview, for example, Qatar's CEO Akbar Al Baker flatly stated that:

> I never borrow from the state, the state does not subsidise the airline.[82]

But its financial statements – which Qatar refuses to publicly disclose – tell a different story.[83] Like Etihad's, Qatar Airways' financials show that the Government of Qatar has been subsidizing the airline since its inception. The subsidies – over $16 billion in the past decade alone – have enabled Qatar to expand at a rate that would have been impossible otherwise and to remain in business in spite of its poor financial performance.[84] And also like Etihad, according to its own financials, without the subsidies, Qatar Airways would not be commercially viable.

a. $8.4 billion in subsidized loans and shareholder advances

Although Qatar Airways' CEO has claimed that the airline does not borrow from the state, Qatar's financial statements show that the Government of Qatar has provided subsidized loans or shareholder advances to the airline in nearly every year since 1998. The financials report that the airline received an initial loan of $19.2 million,[85] followed by another $19 million loan in 2000, a $36 million loan in 2001, a $39 million loan in 2002,[86] a $10 million loan in 2003,[87] and a $55 million loan in 2004.[88]

<u>The Subsidies Dramatically Increased in 2007</u>: In 2007, the amount of the loans dramatically increased, reaching $596 million in 2007[89] and $742 million in 2008.[90] There is no question that

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[82] *See Total Control: Interview with Qatar Airways' Akbar Al Baker*, Flightglobal.com (Mar. 2006). Similarly, in a November 2011 speech, Al Baker described the subsidy allegations as "crap" and asserted that:

> "There is a level playing field; we operate as a business the same way they operate as a business," he told Arabian Business in May. "I know they [European airlines] are always crying wolf that Gulf carriers are subsidised by the state. Subsidised no, but supported yes."

Qatar Airways CEO calls unfair subsidies talk 'crap', arabianSUPPLYCHAIN.com (Nov. 15, 2011).

[83] Like Etihad, Qatar does not publicly disclose its financial statements. However, copies of summarized versions of the airline's annual account filings were obtained from certain third country jurisdictions.

[84] The total subsidies to Qatar are even higher than $16 billion, as the airline received additional subsidies between 1998 and 2004.

[85] *See* Qatar Airways Company W.L.L., Summarized Financial Statements (Mar. 31, 1998), at 4 (listing an AED70 million "Loan from the Government of Qatar"). Although the 1998 financial statements do not describe the loan's terms, the 1997 financial statements explain that at some point during the year, the Government decided to provide Qatar a 10 year interest-free loan in order to help the airline continue as a going concern. Qatar Airways Company W.L.L., Summarized Financial Statements (Dec. 31, 1996), at 5, Note 2 (Going Concern). The Qatari Riyal is pegged to the US dollar at a fixed exchange rate of USD 1 = QAR 3.64.

[86] Qatar Airways Company W.L.L., Summarized Financial Statements (Mar. 31, 2002), at 4.

[87] Qatar Airways Company W.L.L., Summarized Financial Statements (Mar. 31, 2003), at 4.

[88] Qatar Airways Q.C.S.C., Summarised Consolidated Financial Statements (Mar. 31, 2004), at 4.

[89] Qatar Airways Q.C.S.C., Consolidated Financial Statements (Mar. 31, 2007), at 4.

[90] Qatar Airways Q.C.S.C., Consolidated Financial Statements (Mar. 31, 2008), at 4.

the loans were subsidies, as the financial statements state that they were "unsecured and interest-free with no fixed repayment schedule."[91]

<u>In 2009, the Government Forgave the "Loans"</u>: In 2009, the loans were converted to "shareholder advances" and moved to the equity portion of Qatar's balance sheet because settlement was "neither planned nor likely to occur in the foreseeable future."[92] And as Figure 9 shows, repayment was made optional, which effectively means the loans were forgiven.

Figure 9: Excerpt From Qatar Airways 2009 Financial Statement

23 SHAREHOLDER ADVANCES AND LOAN FROM THE GOVERNMENT OF QATAR

The loan from the Government of Qatar is non interest bearing as has no specific repayment terms. During the year, the loan from the Government of Qatar was converted to shareholder advances and treated as part of equity as the settlement of this amount is neither planned nor likely to occur in the foreseeable future. These shareholder advances are repayable at the option of the Company and will be converted to share capital in the long term.

The Government then provided another $1.7 billion "shareholder advance" in 2009,[93] $1.2 billion more in 2010,[94] a further $1.2 billion in 2011,[95] another $800 million in 2012,[96] a further $280 million in 2013,[97] and another $994 million in 2014,[98] bringing the total subsidy amount through March 2014 to approximately $7.76 billion, plus $618 million in interest that would have accrued if the loans had been on commercial terms.[99]

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[91] Qatar Airways Q.C.S.C., Consolidated Financial Statements (Mar. 31, 2007), at 22, Note 22 (Loan from the Government of Qatar); Qatar Airways Q.C.S.C., Consolidated Financial Statements (Mar. 31, 2008), at 30, Note 22 (Loan from the Government of Qatar).

[92] Qatar Airways Company Q.C.S.C., Consolidated Financial Statements (Mar. 31, 2009), at 30, Note 23 (Shareholder Advances and Loan from the Government of Qatar).

[93] Qatar Airways Company Q.C.S.C., Consolidated Financial Statements (Mar. 31, 2009), at 4.

[94] Qatar Airways Q.C.S.C., Consolidated Statement of Financial Position (Mar. 31, 2010), at 5.

[95] Qatar Airways Q.C.S.C., Consolidated Statement of Financial Position (Mar. 31, 2011), at 5. In its 2011 financials, Qatar moved the $4.5 billion in shareholder advances that had accumulated through 2010 to the legal reserve, describing the transaction as a "share premium arising from conversion of shareholder advances." *Id.* at 7.

[96] Qatar Airways Q.C.S.C., Consolidated Statement of Financial Position (Mar. 31, 2012), at 5.

[97] Qatar Airways Q.C.S.C., Consolidated Statement of Financial Position (Mar. 31, 2013), at 5.

[98] The Qatar 2014 balance sheet shows the airline's share capital increasing from QR 143,800,000 at the end of FY 2013 to QR 12,077,222,000 at the end of FY 2014. A significant portion of this massive increase appears to reflect the airline's decision to reclassify its $6.78 billion (QR 8,316,722,000) in accumulated shareholder advances as capital. The remainder of the difference between the 2013 and 2014 amounts, QR 12,077,222,000 – QR 8,316,722,000 – 143,800,000, is QR 3,616,700,000 ($993.6 million), which represents new government funds injected in FY 2014. *See* Qatar Airways Q.C.S.C., Consolidated Statement of Financial Position (Mar. 31, 2014), at 5.

[99] *See* Capital Trade Study at 52, 55.

Figure 10: Shareholder loans/advances to Qatar Airways

Year	Qatar government loan/ advances in USD	Accumulated
1994	-	-
1995	-	-
1996	-	-
(15 Months) 1998	19,230,769	19,230,769
1999	-	19,230,769
2000	19,009,066	38,239,835
2001	36,171,703	74,411,538
2002	39,455,769	113,867,308
2003	9,718,407	123,585,714
2004	54,733,516	178,319,231
2005	-	178,319,231
2006	-	178,319,231
2007	595,911,813	774,231,044
2008	742,281,044	1,516,512,088
2009	1,735,193,681	3,251,705,769
2010	1,226,338,187	4,478,043,956
2011	1,193,755,769	5,671,799.725
2012	811,112,088	6,482,911,813
2013	279,884,366	6,762,796,179
2014	993,095,000	7,755,891,179

b. $6.8 billion in subsidies from government loan guarantees

The Government Guarantees Qatar Airways' Term Loans: In addition to the subsidized loans and shareholder advances, Qatar's financial statements also show that in every year since 1998, the Government of Qatar has explicitly or implicitly guaranteed the airline's term loans. Note 23 of Qatar's 2007 financial statements (the first set that disclosed any detail on the guarantees) states that most of the airline's term loans were "secured by mortgages over assets and/or guarantees given by the Government of the State of Qatar."[100] According to Qatar government bond offering documents, as of March 2010, the state was explicitly guaranteeing almost 100 percent of the company's term loans ($4.95 billion of the $5.04 billion total).[101]

In addition to these explicit loan guarantees, the government also implicitly guarantees the debt by committing to guarantee Qatar Airways as a going concern. As Figure 11 shows, this commitment includes a pledge to "continue to make funds available to the Company to allow it

[100] Note 23 in the company's 2008 financial statements, at 30, and note 24 in its 2009 financial statements repeated the same terms. *See, e.g.,* Qatar Airways Q.C.S.C., Consolidated Financial Statements (Mar. 31, 2009), at 30, Note 24 (Term Loans).

[101] *Compare* Prospectus dated July 15, 2010, US $1,000,000,000 3.50% Bonds due 2015 (July 15, 2010) at 81 (stating that "[t]he Government has also guaranteed indebtedness of certain State-owned companies, such as Qatar Airways (approximately QR18,002.3 million (US$4,945.7 million) as of March 31, 2010) . . . ") *with* Qatar Airways balance sheet (Mar. 31, 2010) at 5-6 (listing AED18.3 billion (US$5.04 billion) in term loans).

to meet its liabilities as they fall due."[102] This open-ended commitment, repeated every year in financials that potential lenders review to inform their decision whether and under what terms to extend loans or credit to Qatar Airways, amounts to an implicit guarantee of all of Qatar Airways' private debt.

Figure 11: Excerpt From Qatar Airways 2009 Financial Statement

> **2 GOING CONCERN**
>
> The Group reported a loss of QR 230,023 thousand for the year ended 31 March 2009. As a result of the current year and previous year losses, the accumulated losses as at 31 March 2009 exceed 50% of the Capital. During the year, the shareholders provided adequate financial support to continue the operations of the Group in the form of shareholder advances.
>
> Article 46 of the Articles of Association of the Company requires that the Board of Directors shall convene an Extra-Ordinary General Assembly to decide whether the situation requires dissolution of the Company or to decrease its capital or to take any other suitable measures. In the Extra-Ordinary General Assembly dated 8 September 2009, the shareholders of the Company have resolved to continue the operations of the Company as adequate financial support will be made available to enable the Company to meet its liabilities as they fall due.
>
> The consolidated financial statements have been prepared under the going concern concept due to the following facts:
>
> (a) The shareholders have resolved in the Extraordinary General Assembly to continue with the operations of the Company; and
>
> (b) The shareholders have resolved in the Extraordinary General Assembly to continue to make funds available to the Company to allow it to meet its liabilities as they fall due.

In total, the Government of Qatar guaranteed loans totaling $7.67 billion between 1998 and 2010. Under U.S. Department of Commerce subsidy valuation methodology, Qatar Airways was not "creditworthy" at the time that it received these guarantees. Consequently, in accordance with Commerce's methodology, the loan guarantees constituted subsidies – in the form of reduced interest payments – in the amount of $6.8 billion.[103]

c. $452 million in subsidies from free land

In addition to the subsidized loans, shareholder advances and loan guarantees, Qatar Airways has also received at least $452 million in subsidies from free land. For example, the airline's 2005 balance sheet reports the construction of a warehouse on a plot of land received as a grant from the government, the fair value of which was $710,000.[104] Similarly, Qatar's 2011 financials report that the government gave the airline three plots of land with a fair value of $451.6 million, which the airline disposed of in 2013, booking the $451.6 million gain.[105] Both of these land grants are subsidies, as they provided a valuable asset to the airline at no cost.

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[102] Qatar Airways Company Q.C.S.C., Consolidated Financial Statements (Mar. 31, 2009), at 9, Note 2 (Going Concern). Similar statements appear in the financial statements for other years.

[103] Capital Trade Study at 61. As the Capital Trade Study explains, the $6.8 billion constitutes only the subsidy benefits that Qatar received between 2004-2014. It does not include the additional benefits received in prior years.

[104] Qatar Airways Company Q.C.S.C., Consolidated Financial Statements (Mar. 31, 2005), at 3, 14 (QR 2,583,000 converted to USD at 3.64 QR to the dollar).

[105] Qatar Airways Q.C.S.C., Consolidated Statement of Financial Position (Mar. 31, 2011), at 25 (QR 1,643,816,000 converted to USD at 3.64 to the dollar); Qatar Airways Q.C.S.C., Consolidated Statement of Financial Position (Mar. 31, 2013), at 2, 29.

d. $616 million in subsidies from airport fee exemptions and rebates

Doha International Airport (DOH) charges a passenger fee, established by government decree, of QAR 40 ($10.98) on departing passengers. However, similar to Abu Dhabi International, Doha International exempts connecting passengers from assessment of the fee – an exemption that overwhelmingly benefits the airport's hub carrier (Qatar connects 83 percent of its passengers at DOH and accounts for 98 percent of all connecting traffic at the airport) and gives the airline a significant competitive advantage over U.S. and third country carriers.[106] A study by Daniel Kasper of Compass Lexecon examined this practice and concluded that it has resulted in a subsidy to Qatar Airways of at least $487 million since 2004.[107] In addition, the Qatar financial statements for 2007 through 2014 include an "other income" line item that is described variously as "Doha International Airport passenger tax credit" or "tax credit" or "tax release." This income item, amounting to $129 million total, appears to be a refund to Qatar of the passenger fees that are assessed on airlines using the airport, and thus an additional subsidy.[108] Therefore, the total value of the subsidies from passenger fee exemptions and rebates totals at least $616 million.

e. $215 million in subsidies from assignment of airport revenues

Since 2006, the Government of Qatar has allowed Qatar Airways to collect revenues from airport operations, including parking, facility rental income, and management fees.[109] The available financial data do not show any assumption of associated expenses, however. This assignment of airport revenue with no corresponding expenses amounts to at least $215 million in additional subsidies.

f. $22 million in subsidies from government grants

In 2013 and 2014, Qatar reported a total of $22 million in other income for "incentives and route subsidies."[110] Grants are one of the most straightforward forms of subsidy, as they are free money.

g. Additional and Substantial Unquantified Subsidies

In addition to the over $16.5 billion in subsidies quantified above, Qatar also benefits from additional subsidies that cannot be quantified, because the necessary information is not publicly available. For example:

***Granting of Monopoly Rights to Distribute Alcohol*:** The Government of Qatar has granted a division of Qatar Airlines – the Qatar Distribution Company – the sole license for the

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[106] Kasper Study at vi.
[107] *Id.* at viii. This issue is discussed in greater detail in subsection 3(b) below.
[108] *See, e.g.*, Qatar Airways Q.C.S.C., Consolidated Financial Statements (Mar. 31, 2007) at 16 (showing "Doha International Airport Passenger tax credit" granted in 2006 and 2007); Qatar Airways Q.C.S.C., Consolidated Financial Statements (Mar. 31, 2014) at 28 (showing "tax release" in 2013 and 2014).
[109] *See* Capital Trade Study at 65-68.
[110] Qatar Airways Q.C.S.C., Consolidated Financial Statements (Mar. 31, 2014), at 28, Note 6 (Other income).

legal retail sale of alcoholic beverages in Qatar.[111] Press reports indicate that alcoholic beverages in Qatar are highly priced – and thus, given the absence of multiple distribution tiers, extremely profitable to Qatar Airways.[112] While Qatar Airways enjoys the excess rents from this government-conferred monopoly, there is no evidence that it pays any fee for this right. The available evidence does not allow for the calculation of the precise benefit from this program. However, in the years between 2007 and 2009, the Qatar Airways financial statements disclosed total revenues from the sales of "Duty Free and Beverages" totaling over $500 million.[113] Assuming a profit rate of 20%, this program could have provided Qatar Airways with a benefit over three years of an additional $100 million.

***Subsidies from Hamad International Airport*:** As discussed in Section II above, the Government of Qatar recently opened the $17 billion Hamad International Airport. Landing fees at Hamad are among the lowest in the world, and far too low to cover the airport's capital expenditures. Similar to Abu Dhabi airport, the low fees in Doha indicate that the government is subsidizing the airport's infrastructure expansion, and thus subsidizing Qatar Airways, which disproportionately benefits from the low fees. However, it is not possible to determine the amount of subsidy that Qatar Airways is receiving, as the airport does not release financial statements.

***Subsidies from Qatar Aviation Lease Company*:** Qatar Airways leases a portion of its fleet from Qatar Aviation Lease Company (QALC). QALC is a Qatar Airways affiliate, which means Qatar is effectively leasing aircraft from itself. However, Qatar Airways does not disclose the terms of the leases with QALC in its financial statements, so it is not possible to determine the extent of the subsidies it is receiving from these transactions.[114]

* * * * *

<u>Without The Subsidies, Qatar Airways Would Not Be Commercially Viable</u>: In an interview in late 2013, Qatar Airways' CEO Akbar Al Baker stated that the planned initial public offering for the airline has been postponed until further notice because he prefers the airline "to remain fully under government control until its growth strategy has been fully implemented."[115] His reasoning is clear. As in Abu Dhabi, the Government of Qatar has used massive amounts of subsidies to create Qatar, keep it afloat and help it expand at a pace that would have been impossible otherwise. And as with Etihad, the subsidies have enabled Qatar to order vast numbers of new widebody aircraft and to deploy that capacity on routes without regard to profitability because it knows that – unlike private shareholders – its government owners will "continue to make funds available to the Company to allow it to meet its liabilities as they fall due", and thereby ensure its continuity as a going concern, regardless of its losses.[116] Thus,

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[111] *See:* http://www.qatarairways.com/us/en/group-companies.page
[112] *See:* http://www.qatarvisitor.com/residents/buying-alcohol
[113] CapTrade Study at 69.
[114] Furthermore, confidential sources in Doha report that the government-owned Qatar National Bank gives loans to Qatar at concessional rates, that the airline receives preferential rates on airport charges and ground handling fees from Qatar Aviation Services, and that the airline purchases jet fuel at concessional rates from the government-owned Qatar Jet Fuel Company.
[115] Jens Flottau, *Qatar CEO Interested in Concept of a Double-Stretch Airbus A350*, aviationweek.com (Oct. 30, 2013), at 4.
[116] Qatar Airways Company Q.C.S.C., Consolidated Financial Statements (Mar. 31, 2009), at 9, Note 2 (Going Concern).

while Qatar Airways claims it is not subsidized, the truth is the exact opposite: without the subsidies, the airline would not be commercially viable.

3. Emirates Airline: At Least $5 Billion in Subsidies Since 2004

Emirates Has Received At Least $5 Billion in Subsidies Since 2004: Of the three Gulf carriers, Emirates has been the most outspoken in denying that it is subsidized, and Emirates' CEO Tim Clark has said he would resign if it were ever proven that the airline has received subsidies.[117] However, although a pervasive lack of transparency in Dubai's aviation sector – in combination with Emirates' failure to release its financial statements for the first sixteen years of its existence – precludes anything near a full quantification, information from public and confidential sources indicates that Emirates has received at least $5 billion in subsidies in the last 10 years alone.

a. Between $1.6 and $4 billion in subsidies from the government's assumption of fuel hedging losses

The Government Stepped in to Shield Emirates From Massive Losses on Fuel Hedging Contracts in 2008-09: Although the description of the event is extremely vague and incomplete, Emirates' financial statements indicate that the Government of Dubai granted a multi-billion dollar subsidy to Emirates in fiscal year 2008-09 by shielding it from the impact of potentially massive losses on its fuel hedging contracts.

Oil Prices Were Extraordinarily Volatile in the 2008-09 Time Period: Oil prices were extraordinarily volatile in 2008-09, hitting a record high of $147 per barrel in July 2008, with analysts predicting that prices might ultimately exceed $200. But the analysts were wrong, and airlines that had hedged against these anticipated increases took enormous losses when prices sharply declined instead, falling below $40 by February 2009. Air France and KLM, for example, reported fuel hedging losses of €1.35 billion over the 2008-09 time period, and Delta reported over $2 billion in fuel hedging losses in the same period.

Emirates Was Exposed to Potentially Massive Losses: When Emirates' fiscal year began on April 1, 2008, it held fuel price contracts with a notional value of $4.13 billion – an enormous position, higher even than its $3 billion fuel costs for the previous year.[118] According to the financial statements, while the contracts protected the airline from increases in the cost of fuel, they leveraged the risk to Emirates in the case of oil price declines.[119] Thus, like other airlines, Emirates should have reported massive losses when prices subsequently crashed. And indeed, according to one published account, the counterparties to Emirates' hedging contracts made a massive margin call of $4 billion – a demand for additional cash from the airline – that Emirates was unable to meet.[120]

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[117] *You prove subsidy, I will resign next day: Tim Clark*, emirates24/7.com (Oct. 12, 2010).
[118] *See* The Emirates Group, Annual Report 2008-2009, at 61 (fuel costs), 103 (fuel hedging contracts).
[119] *Id.* at 108.
[120] Kate Kelly, *The Secret Club that Runs the World*, at 80 (2014). At the end of the 2007-08 fiscal year, Emirates had only $740 million in cash on hand. The Emirates Group, Annual Report 2007-2008, at 75.

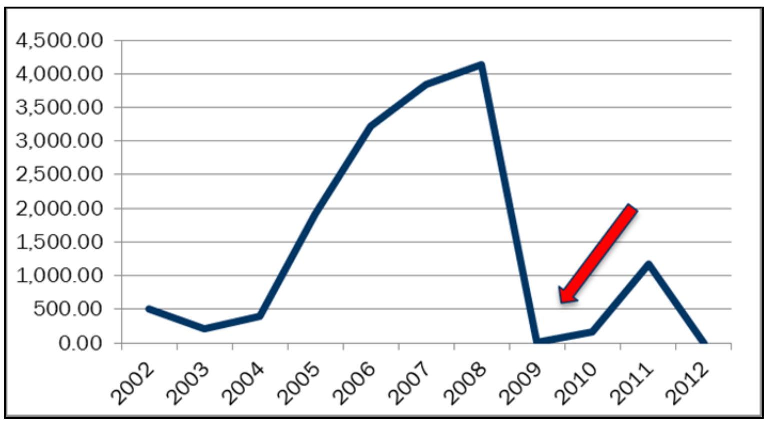
The Government of Dubai Took Over the Contracts: Instead, as Figure 12 shows, at some point during the second half of the fiscal year, Emirates novated (*i.e.*, transferred) the fuel hedging contracts to its government owner, the Investment Corporation of Dubai (ICD):[121]

Figure 12: Excerpt from Emirates 2008-09 Financial Statements

During the year, the majority of Emirates fuel hedging contracts have been novated to the parent company (Note 34).

As Figure 12 demonstrates, the financial statements provide virtually no information about the novation.[122] Among other matters, they do not even explain when or why the novation took place. It is clear, however, that the airline had already lost $428 million by the time the ICD stepped in to take over the contracts and shield Emirates from any further losses.[123] It is also clear that the value of the company's outstanding fuel hedging contracts plunged from $4.13 *billion* at the start of the fiscal year to just US$1.5 *million* at the end of the year.[124]

Figure 13: Emirates Fuel Contracts USD (000s)



The Government Also Provided $1.6 Billion in Letters of Credit: The financial statements also disclose that the ICD provided $1.6 billion in letters of credit to Emirates during the fiscal year.[125] Although the financial statements fail to explain the purpose of the letters of credit, it is likely that the ICD provided them to satisfy some portion of the $4 billion margin call discussed above. Given its limited cash on hand, Emirates could not have made the payment itself without calling into question its ability to continue as a going concern.[126]

Emirates Received Numerous Benefits as a Result of these Transactions: The novation of the contracts benefited Emirates in numerous ways. First, it relieved the airline from the need to post its own cash in response to the margin call – cash that it did not have. Second, it eliminated the need for Emirates to report a massive financial loss in its 2008-2009 financial statements that

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[121] The Emirates Group, Annual Report 2008-09, at 103 (Note 32).
[122] Although Note 32 references Note 34, there is no mention of the novation in Note 34.
[123] *Id.* at 72 and n.7 at 86.
[124] *Id.* at 103 (Note 32).
[125] *Id.* at 105 (Note 34, Related party transactions, item (vi)). The statements disclose another $250 million in letters of credit in the following fiscal year. The Emirates Group, Annual Report 2009-2010, at 84 (Note 36, Related party transactions).
[126] As noted above, Emirates had only $740 million in cash on hand at the end of the 2007-08 fiscal year, and $1.2 billion at the end of the 2008-09 fiscal year. The Emirates Group, Annual Report 2008-2009, at 75.

would have called into question its ability to continue as a going concern. Third, it shielded the airline from the losses that the ICD incurred on its behalf as the contracts came due.

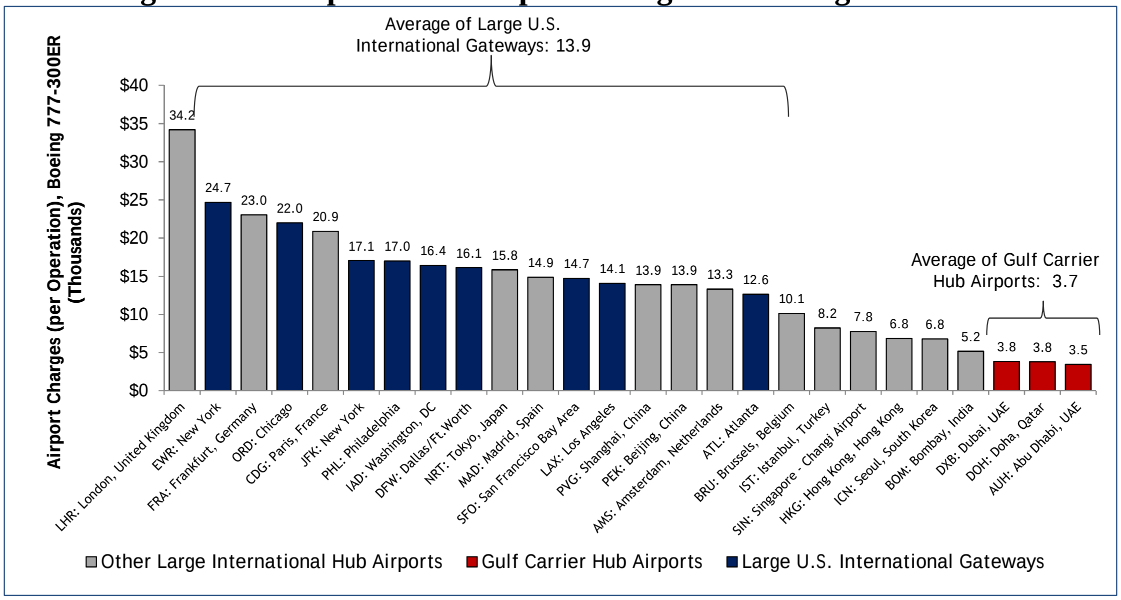
Because of the lack of disclosure in the financials, and the fact that the ICD did not publish financial statements in those years, it is not possible to precisely quantify the amount of the subsidy that Emirates received through the novation. However, a report by Capital Trade examined the transaction and, using publicly available information on the hedging losses that other airlines incurred in the same timeframe, estimated that Emirates received a subsidy of $2.4 billion.[127] The total value of the subsidy – taking into account the Government's role in keeping Emirates financially afloat – could have been much higher.

b. At least $2.3 billion in subsidies from subsidized airport infrastructure since 2004

As discussed in Section II above, the Government of Dubai is spending tens of billions in state funds to construct new, high-quality airport infrastructure to ensure that Emirates will have the airport capacity it needs to continue growing without constraint. This state of the art infrastructure confers a major competitive advantage on Emirates, not only because of the infrastructure itself, but also because – like Abu Dhabi and Doha – Dubai imposes landing fees and other charges that are far too low to recoup the money the government spends to build and operate the airports.[128] As the dominant carrier at DXB, these low fees overwhelmingly benefit Emirates and give it a major competitive advantage over U.S. carriers and their JV partners, who are based at airports whose fees do fully reflect such costs, and whose ability to expand is constrained by the need to recoup the costs from airport users. For example, as Figure 14 demonstrates, the airport charges for a 777-300ER averaged across the large U.S. international gateway airports are nearly *four times higher* than the average of Abu Dhabi, Doha, and Dubai.[129]

[127] Capital Trade Study at 79. In addition, if the hedging contracts had remained on Emirates' books, the airline would have incurred an additional $300 million in interest expense in order to finance the additional debt that would have resulted from the losses.
[128] Dubai Airports' own website acknowledges the low level of its charges, describing them as "among the lowest in the world." Dubai Airports, Revenue and Commercial, http://dubaiairportsreview.com/2012/people/revenue-commercial.
[129] Source: RDC Aviation Ltd. Assumes MTOW of 351.5 tons, seating capacity of 332, load factor of 80%, 65% connecting passengers, and 3 hours park time.

Figure 14: Comparison of Airport Charges for Boeing 777-300ER



Sources: RDC Aviation Ltd.; Emirates 2013-2014 Annual Report; OAG.
Notes: Assumes MTOW of 351.5 tons, seating capacity of 358, load factor of 80%, 65% connecting passengers, and 3 hours park time. Airport charges include: landing and runway charges, parking and ramp fees, infrastructure/passenger fees, departure and arrival taxes, security fees, APHIS fees, customs and immigration fees, and other misc. fees.

This disparity in costs and the resulting subsidization of Emirates is well-recognized in the literature. As one recent study observed:

> [i]t is considerably cheaper to land a large wide-body at Dubai than at Singapore or at London Heathrow. In the UK, British Airways, the Civil Aviation Authority and British Airports Authority are all independent organisations, whereas in the UAE, Sheikh Ahmed bin Saeed Al Maktoum controls Emirates, the airport authority and the region's aviation policy, as he is the Chairman of the airline and the minister in charge of the civil aviation department. This multifaceted management role allows for cost synergies and pressurises airports to act in the interests of airlines. The strategy of joint airline-airport ownership has forced the partnership to co-support each other's activities. In addition, Dubai airport has developed an extensive duty-free facility with sales of over $1.1 billion in 2008, which is used to cross subsidise landing and passenger charges.[130, 131]

A study by Daniel Kasper of Compass Lexecon closely examined the financing of DXB's Terminal 3 and Concourse A, which the Dubai Airports Company spent $7.8 billion to build for Emirates' exclusive use. Although the airport (like most other state-owned entities in Dubai's aviation sector) does not publish financial statements, Kasper analyzed publicly available data on the airport's revenues and costs and concluded that the airport's fees and charges appear to be far

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[130] *See* John F. O'Connell, *The rise of the Arabian Gulf carriers: An insight into the business model of Emirates Airline*, 17 Journal of Air Transport Management (2011), at 344; *see also* Tansy Harcourt, *Miles above the competition*, Austr. Financial Review (July 14, 2010) ("The fact that the same person who rules the emirate owns the airline, the airport and most of the hotels certainly gives Emirates an advantage over many rivals…. For the airline, it means advantages such as airport charges 50 per cent less than the likes of Heathrow.")
[131] An earlier version of this White Paper inadvertently misquoted this excerpt from the O'Connell study. It has been corrected.

too low to cover those costs. For 2013, Kasper estimated that the subsidy to Emirates relating to Terminal 3 and Concourse A alone was in the range of $292 to $438 million.[132] And Kasper also concluded that Emirates received an additional $94-$145 million subsidy in 2013 as a result of the government's decision to exempt transfer traffic from passenger charges – a highly unusual practice that overwhelmingly benefits Emirates, whose business model focuses primarily on flowing connecting passengers through its hub.[133] In total, the two subsidies amounted to between $437 and $532 million in 2013,[134] or between 38 and 46 percent of Emirates' 2013-2014 profits, and $2.26 billion since 2004.[135]

c. Subsidies from non-arm's length transacting with related parties

<u>In Addition, Emirates Purchases Billions in Goods and Services From Related Parties That Are Also Members of Dubai Inc.</u>: The lack of clarity surrounding Emirates' fuel hedging losses is consistent with the non-transparent approach it takes in other parts of its financial statements, particularly when it comes to its transactions with other parts of "Dubai Inc." For example, as noted in Section II above, virtually every supplier of goods, services and capital that Emirates needs is a related party (most of which do not publish financial statements). Emirates purchased over $2 billion in goods and services from such parties in fiscal year 2013-2014 (over 10 percent of its total reported operating costs), and approximately $11 billion over the past ten years.[136]

<u>Emirates Transacts with these Parties on Non-Arm's Length Terms</u>: As Figure 15 demonstrates, however, Emirates reports its related party transactions in a highly aggregated form that does not identify the specific related parties it is transacting with, or on what terms. And even more

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[132] Kasper Study at 37. Moreover, Dubai Airports has admitted that government subsidies enable it to keep its airport charges at levels that are too low to cover its costs. *See, e.g.,* Dubai Airports, Revenue and Commercial, http://dubaiairportsreview.com/people/revenue-commercial (stating that the airport's "focus on developing non-aeronautical revenue streams is fundamental to ensuring sustained corporate stability and profitability, and is vital for funding future airport development *as well as reducing dependence on government funding, while keeping aeronautical charges competitive*"); *see also* Preliminary Offering Circular (Subject to Completion) Dated 10 October 2004, Government of Dubai, Trust Certificates due 2009, at 54 (stating that "the surplus cash flows are not adequate to pay for the high capital expenditure, which is incurred continuously to expand and operate the DIA"), Government of Dubai, *Base Prospectus dated 21 January 2013, U.S.$5,000,000,000 Euro Medium Term Note Programme*, at 111 (stating that the Government's aggregate direct debt of AED 122.0 billion includes funds borrowed by the Government to finance the expansion of DXB and the first phase of the construction of Al Maktoum International Airport).

[133] Kasper Study at 37. Indeed, the primary purpose of Terminal 3 and Concourse A is to serve Emirates' connecting traffic, as the airline connects approximately 71 percent of its passengers at DXB. *Id.* at 30. By contrast, for nearly all of the other airlines operating at DXB (the primary exception being Emirates' sister company flydubai), connecting traffic constitutes a minimal percentage of their operations at DXB. *See id.* at 31. As noted above with respect to Etihad, in addition to constituting a subsidy to Emirates, this disparity in charges also constitutes a *de facto* violation of the national treatment principle of international trade law.

[134] The two categories of subsidies are related: the lower airport subsidy ($292 million) combines with the higher passenger charge subsidy ($145 million), and vice versa, which leads to the range of $437 to $532 million. *Id.* at 37.

[135] *Id.* at iv.

[136] *See* The Emirates Group, Annual Report 2013-2014, at 102, Note 37 (Related party transactions). AED 8.066 million is equivalent to $2.2 billion.

significant, like Etihad and Qatar Airways, Emirates does not assert that it transacts with those parties on terms equivalent to those that prevail in arm's length transactions.[137]

Figure 15: Excerpt from Emirates' 2013-2014 Financial Statements

37. Related party transactions

The following transactions were carried out with related parties:

	2014 AED m	2013 AED m
Trading transactions:		
(i) Sale of goods and services		
Sale of goods - Associates	58	56
Sale of goods - Companies under common control	51	11
Sale of goods - Joint ventures	29	12
Services rendered - Companies under common control	82	81
Services rendered - Joint ventures	11	11
	231	**171**
(ii) Purchase of goods and services		
Purchase of goods - Associates	208	194
Purchase of goods - Companies under common control	5,048	4,288
Services received - Companies under common control	2,810	2,472
Services received - Joint ventures	-	15
	8,066	**6,969**
Other transactions:		
(i) Finance income		
Joint ventures	5	6
Companies under common control	14	59
	19	**65**
(ii) Compensation to key management personnel		
Salaries and short term employee benefits	116	98
Post-employment benefits	14	15
Termination benefits	1	-
	131	**113**

	2014 AED m	2013 AED m
(iii) Purchase of assets		
Company under common control	80	-
Year end balances		
(i) Receivables - sale of goods and services		
Associates	28	26
Joint ventures	9	2
Companies under common control	25	79
	62	**107**
(ii) Receivables - other transactions		
Joint ventures	6	18
Companies under common control	198	488
	204	**506**
Receivable within one year	**157**	**345**
Receivable over one year (Note 15)	**47**	**161**

The amounts outstanding at year end are unsecured and will be settled in cash. No impairment charge has been recognised during the year in respect of amounts owed by related parties.

No indication the purchase of these goods and services was conducted on arm's length terms

Emirates' silence on this key point is telling, as international accounting standards state that a company should not assert that it transacts with related parties on terms equivalent to those that prevail in arm's length transactions unless it can substantiate that it does.[138] The logical inference is that Emirates does not transact with its related parties on arm's length terms, and thus that the Government is using other parts of Dubai Inc. to subsidize Emirates.[139] And the amount of the subsidy is likely significant; if Emirates is paying its related parties on average just 15 percent less than it would pay an unrelated party, it is receiving a subsidy of $330 million per year.

Furthermore, while Emirates has responded to subsidy claims in the past by pointing out that its financial statements are subject to annual audit, this proves nothing. International Standards on Auditing (ISA) 550 (Related Parties) ¶24 notes that if management has made an assertion in the financial statements to the effect that a related party transaction was conducted on terms equivalent to those prevailing in an arm's length transaction, the auditor shall obtain sufficient

[137] As previously explained, Qatar's financial statements merely state that the pricing policies and terms of related party transactions "are approved by the Group's management." *See, e.g.*, Qatar Airways Q.C.S.C., Consolidated Financial Statements (Mar. 31, 2009), at 33, Note 30 (Related Party Disclosures). Etihad's statements explain that it purchases fuel and other aviation-related goods and services from its related parties "based on agreed rates." Etihad Airways PJSC, Financial Statements (Dec. 31, 2013), at 47, Note 22 (Related party transactions and balances). By contrast, Emirates' financials are silent on this issue, presumably because Emirates – unlike Qatar and Etihad – releases its statements to the public.

[138] IAS 24, ¶23.

[139] *See, e.g.*, Ernst & Young, International GAAP 2014.

appropriate audit evidence about the assertion. In the case of Emirates, its financial statements do not make such an assertion, so there is no way to ascertain whether the auditors even looked at the issue in the course of their audit. And indeed, the available evidence supports the conclusion that the Government of Dubai uses other Dubai Inc. entities to subsidize Emirates. For example:

Emirates' Dealings with Dnata: The government of Dubai has established a monopoly for ground handling at DXB, and it has awarded the monopoly to another Dubai Inc. entity – dnata – that is also part of the Emirates Group. Emirates has stated publicly that it pays the same airport handling fees to dnata "as would a similar high-volume airline customer."[140] Inasmuch as there are no similar high volume customers at DXB – Emirates is the largest operator by a significant margin – this phrasing indicates that Emirates pays lower fees to dnata than its foreign competitors pay. And indeed, confidential sources in Dubai report that when Emirates uses dnata, it receives a discount of 15 percent. Notably, Emirates does not disclose the amounts it pays to dnata in its financial statements, and it does not assert that it transacts with dnata on arm's length terms.

Emirates' Dealings with ENOC: Various parties have alleged that the Gulf carriers benefit from subsidized aviation fuel. Emirates has claimed in response that "[t]he majority of Emirates' fuel is sourced from BP, Shell and Chevron given there is minimal jet fuel refining capacity in Dubai."[141] While it is true that Emirates sources fuel from these companies, it also sources significant quantities of fuel from the Emirates National Oil Company (ENOC), a state-owned entity that is a related party – a fact that Emirates neglects to mention.[142] As with its purchases from dnata, not only does Emirates not disclose the quantity of fuel it purchases from ENOC – indeed, it does not even mention ENOC in its financial statements – it does not assert that it transacts with ENOC on arm's length terms. ENOC does not issue financials itself.

Emirates' Dealings with Dubai Aerospace Enterprise: Emirates SkyCargo (Emirates' freight division) leases its entire fleet of freighter aircraft from a state-owned leasing company (Dubai Aerospace Enterprise (DAE)) headed by Emirates' Chairman, Sheikh Ahmed Bin Saeed Al Maktoum.[143] Emirates' financial statements do not disclose the fact that it leases its freighters from DAE, and they do not assert that Emirates transacts with DAE on arm's length terms (indeed, they disclose no information about the leases at all, and DAE does not release financial statements, which makes it impossible to determine the extent of the subsidies Emirates is receiving from below-market lease payments). However, publicly available information indicates that the freighters it leases from DAE were originally ordered by Emirates itself, and that Emirates sold the purchase rights to DAE, recording a $200 million gain.[144] Given the

[140] Emirates Airline, Airlines and subsidy: our position, at 18 ("Airlines and subsidy").
[141] *Id*. at 22.
[142] ENOC, for its part, has stated that it is the largest supplier of jet fuel to Emirates in Dubai. *ENOC welcomed on board A380* (July 31, 2008) (stating that "ENOC is the largest supplier of jet fuel to Emirates in Dubai and has been working closely with the airline ensuring that its fuel supplies and service quality continues to match the growth experienced by the airline"), http://www.enocaviation.com/enoc_aviation/News.aspx. It does not release financial statements, however, so it is not possible to determine the amount of fuel it sells to Emirates, or at what price.
[143] *See, e.g., DAE adds three new Boeing 777-200 Freighters*, Emirates247.com (Nov. 17, 2013) (stating that "DAE has placed a total of ten 777-200 freighter aircraft with Emirates' freight division, SkyCargo"); *Emirates' SkyCargo gets 3 new Boeing 777Fs*, Emirates247.com (Jan. 23, 2013) (stating that Emirates SkyCargo's freighter fleet comprises 10 aircraft).
[144] The Emirates Group, Annual Report 2007-08, at 84.

available information, the $200 million (which works out to approximately $11 million per aircraft) appears to be a subsidy to Emirates.

Emirates' Relationship with the Tax Authorities: Although customs duties constitute the overwhelming majority of Dubai's tax revenues,[145] Emirates' founding decree specifically exempts the airline from the payment of such duties "for all its imports of planes, equipment, spare parts and other materials that are necessary for its operations or to be sold on its planes or distributed for the sake of advertisement."[146] Tax exemptions are subsidies. However, Emirates does not address this issue in its financial statements, so it is not possible to determine the amount of the subsidies that it receives from these exemptions.

Emirates' Status as a GRE**:** The government of Dubai classifies Emirates as a government related entity (GRE). The Dubai government has stated that if any of its GREs are unable to pay their debts, the Government may "decide to extend such support as it may deem suitable, and based on such terms as it may deem suitable, to any such entities in order to allow them to meet their debt obligations."[147] And indeed, the government has provided "significant financial support" to "systematically and strategically important" GREs in the past.[148] Although it is not clear whether the government has provided such support to Emirates – it has not disclosed a complete list of the GREs that it has supported in this way – the airline clearly is a "systematically and strategically important" state asset. In addition to ensuring Emirates' ability to continue as a going concern – like Etihad and Qatar – this tacit support also constitutes an implicit government guarantee that ensures Emirates can obtain below-market rates on its private borrowing.[149]

d. Lack of transparency precludes evaluation of other potential subsidies

Ultimately, it is not possible to assess the full extent of the Government of Dubai's subsidization of Emirates – not only because the airline and its related parties fail to disclose much of the necessary information, but also because the information that Emirates does disclose is misleading and incomplete.

<u>Emirates Has Not Released Financial Statements For Its First 16 Years of Operation</u>: For example, Emirates has responded to claims that it is "secretly subsidized" by asserting that it has made its audited financial statements for the past two decades publicly available on the Internet.[150] In actuality, however, the earliest statements that Emirates publicly discloses are for

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[145] According to Government of Dubai bond offering documents, customs duties comprised 81.2 percent, 84.2 percent, and 86.3 percent of total taxes in 2009-2011 and were projected to comprise 83.3 percent and 84.2 percent of total taxes in 2012-13. Government of Dubai U.S.$5,000,000,000 Euro Medium Term Note Programme, Base Prospectus Dated 21 January 2013, at 98.

[146] Government of Dubai, Decree Number (2) 1985 concerning the establishment of a Corporation to be known as Emirates, Art. 9.

[147] *See, e.g.,* Government of Dubai U.S.$5,000,000,000 Euro Medium Term Note Programme, Base Prospectus Dated 21 January 2013, at 10. The government of Abu Dhabi has made similar pledges with respect to its "government-owned or systemically important companies". *See, e.g.,* Emirate of Abu Dhabi Waha Aerospace Bond Prospectus (July 22, 2010) at 4.

[148] Government of Dubai 21 January 2013 Prospectus, at 10.

[149] Simeon Kerr, *Emirates: Dubai airline's bid to be biggest takes off* , Fin. Times (Nov. 11, 2011) (stating that bankers say Emirates' "tacit sovereign backing ensures low borrowing costs").

[150] Airlines and subsidy at 10.

fiscal year 2001-02.[151] The sixteen-year gap in the public record – from the founding of Emirates in 1985 until fiscal year 2000-2001 – makes it impossible to assess the full extent of the government support that the airline has received.

Emirates Misstates the Facts: Furthermore, while the U.S. airlines have not been able to obtain most of Emirates' unpublished financial statements, the few that they have obtained demonstrate that Emirates is misstating the facts in its public statements on the issue of subsidies. For example, Emirates has repeatedly asserted that it received limited support from the Government of Dubai when it was founded in 1985, but nothing thereafter:

> In 1985 Emirates received US$10 million from the Government of Dubai in start-up capital and US$88 million invested in infrastructure, which included two Boeing 727 aircraft and the Emirates Training College building.[152]

But this is not true. In actuality, Emirates' financials for fiscal year 1996-1997 – one of the years that Emirates does not publicly disclose – show that the Government transferred the Emirates Training College to the airline in 1997, or twelve years later than Emirates claims:

Figure 16: Excerpt from Emirates 1996-97 Financial Statements[153]

> **26 Non cash transactions**
>
> The ownership of the Emirates Training College has been transferred from the Government of Dubai to the company at a value, based on its original construction cost, of Dh85 million. This amount has been credited to the capital account (Note 20).

It is unclear why Emirates has rewritten history on this issue, although the logical explanation is that the actual timing undermines its narrative that it has not received any subsidies since 1985. It is also possible that Emirates wants to conceal the fact that the Government transferred the facility at a value based on its original construction cost, as the difference between the construction cost and the market value at the time of the transfer is an additional subsidy.

Emirates Misstates the Amount of the Capital Injections it has Received: In addition, Emirates' statements on this topic also imply that the Government of Dubai has injected a maximum of $98 million into the airline (the $10 million in start-up capital plus the $88 million from the training college and the two 727s).[154] But this too is untrue. In actuality, the Government has injected at least $218 million in capital, including $137 million that the Government injected prior to 1995,[155] $7 million that it injected that fiscal year,[156] another $23 million in 1996-97 (via the

[151] *See* http://www.theemiratesgroup.com/english/facts-figures/annual-report.aspx.
[152] Airlines and subsidy at 8.
[153] Emirates, Report and financial statements for the year ended 31 March 1997, at 19.
[154] Airlines and subsidy at 8; *see also* Roger Blitz, *Tim Clark: Subsidy debate has airline boss in a spin*, Fin. Times (Nov. 5, 2010) (reporting Clark's statement that the Dubai government "gave us two 727s from the Dubai Royal Air Wing and built a training facility. In total it worked out at $50m. . . . That's all we have had. And he was absolutely clear that the Dubai government told Emirates: 'You don't come to me for money. You will buy your own aircraft.' And we have done ever since.").
[155] Emirates, Report and financial statements for the year ended 31 March 1996, at 16 (showing AED 502,214,000 ($137 million) in capital "provided by the Government of Dubai" at the start of FY 1994-1995).
[156] *Id.* (showing AED 25,000,000 ($6.8 million) injected in FY 1994-1995).

transfer of the Training College), and an additional $51 million that it injected over a five-year period from 2001-2005 (at a time that it was claiming publicly that it was not subsidized).[157]

Notably, the fact that the Government of Dubai supplied this capital is not readily discernable from Emirates' current financial statements, as Emirates has taken overt steps to hide this fact: Prior to 2009, the company's financials described the $218 million as "the permanent capital *provided by the Government of Dubai*."[158] But starting that year, Emirates changed the description to "the permanent capital of Emirates," thereby concealing its government source.[159]

B. In addition to Subsidies, the Gulf Carriers Receive Other Significant, Artificial Cost Advantages from their Government Owners

The Gulf Carriers Receive Significant Artificial Cost Advantages from Their Governments' Broader Industrial Policies: In addition to the classic subsidies discussed above, the Gulf carriers receive significant artificial cost advantages and other benefits that flow from their governments' broader industrial policies for the aviation sector. For example:

Unions are illegal in the UAE and Qatar: Under U.S. trade law, denying workers the right of association or the right to organize and bargain collectively is "unreasonable" conduct that can provide a basis for the imposition of trade sanctions.[160] Emirates, Etihad and Qatar benefit from such unreasonable conduct, as trade unions are illegal in the UAE and workers in Qatar are not allowed to unionize or strike.[161] As the International Transport Workers' Federation has observed:

> Emirates, Qatar Airways and Etihad Airways are among the fastest growing airlines in the world. They employ more than 70,000 pilots, cabin crew and ground staff between them. More than 90 percent of their employees are non-UAE/Qatari nationals – all of whom have to rely on obtaining temporary work visas under a sponsorship programme. Although these foreign workers are vital to the success of the airlines, they do not enjoy the basic labour rights (including freedom of association and the right to collective bargaining) which apply in their home countries and in virtually all the nations whose airlines compete with Emirates, Etihad and Qatar Airways.[162]

[157] *See, e.g.,* The Emirates Group, Annual Report 2002-2003, at 61, 76 (showing AED 40,000,000 ($10.9 million) in additional capital "provided by the Government of Dubai" in 2003).
[158] *See, e.g.,* The Emirates Group, Annual Report 2007-2008, at (Note 17, Capital) (emphasis added).
[159] *See, e.g.,* The Emirates Group, Annual Report 2008-2009, at 95 (Note 18, Capital).
[160] 19 U.S.C. § 2411(d)(3)(B)(iii)(I)-(II). The United States recently initiated a trade action against Bahrain for limitations the government placed on freedom of association in 2011; by contrast, the UAE and Qatar do not allow unions at all.
[161] U.S. Department of State, 2012 Human Rights Report for the United Arab Emirates, at 30; U.S. Department of State, 2012 Human Rights Report for Qatar, at 20-21; Shane McGinley, *Akbar Al Baker: No holds barred*, arabianbusiness.com (May 10, 2013) (reporting that the International Transport Workers' Federation is opposing Qatar's bid to host ICAO because "thousands of staff at Qatar Airways are denied the fundamental right to union membership enshrined by the UN").
[162] *See ITF lobbies for ICAO action on Qatar/UAE rights abuses* (Sept. 24, 2013).

Similarly, Cranfield University's John O'Connell has observed that "Emirates has the advantage that labour laws in the UAE forbid strikes and there are no trade unions, thus ensuring smooth flight operations and continuous services."[163] O'Connell has also explained that:

> Emirates has a two-tier tax free salary system. Labour intensive tasks such as ground handling, maintenance, catering, and call centres, are sourced from the cheap labour markets of India, Pakistan, Sri Lanka, Bangladesh and Nepal . . . .[164]

The sad state of worker rights in Qatar and the UAE is widely recognized; the *New York Times*, for example, has reported that labor conditions in the UAE can resemble indentured servitude[165] and that many of the workers building Qatar's World Cup facilities will labor "under near-feudal conditions that Human Rights Watch has likened to 'forced labor.'"[166] And the Gulf carriers themselves are unapologetic about the competitive advantages they receive from their governments' restrictive labor policies. Emirates freely admits that its low labor costs give it advantages over its U.S. and European competitors, which it describes as "an undeniable fact of life."[167] And Qatar Airways' CEO Al Baker has taken it a step further, arguing that "[i]f you did not have unions you wouldn't have this jobless problem in the Western world. . . . It is caused by unions making companies and institutions uncompetitive and bringing them to a position of not being efficient."[168] Perhaps consistent with these views, the standard hiring contract at Qatar Airways reportedly requires female employees to obtain permission from the company before getting married and treats pregnancy as grounds for termination.[169]

These bans on labor rights are partially responsible for the Gulf carriers' extremely low labor costs – about half that of their U.S. competitors measured as a proportion of total costs excluding fuel – and provide them with a substantial, government-conferred advantage.

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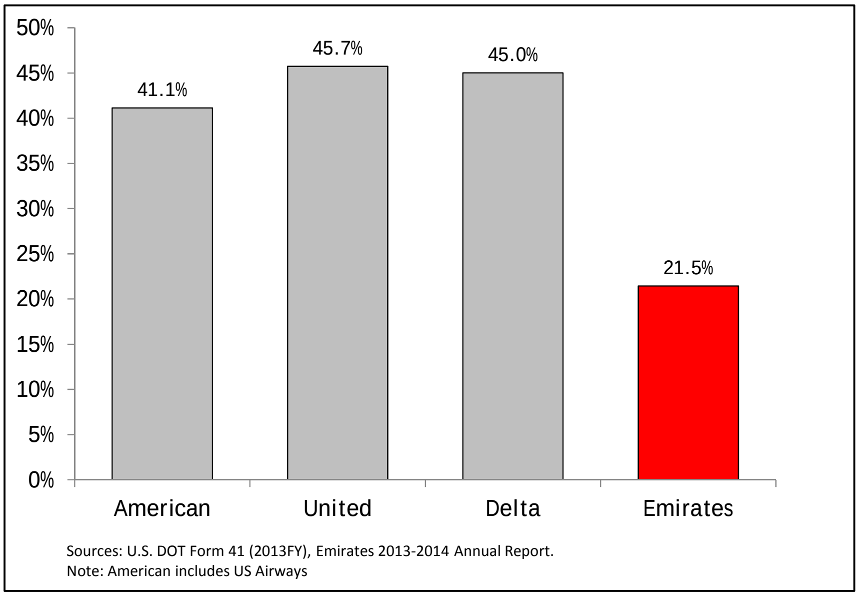
[163] John F. O'Connell, *The rise of the Arabian Gulf carriers: An insight into the business model of Emirates Airline*, 17 Journal of Air Transport Management (2011) 339-346, at 344.
[164] *Id.* at 343-44.
[165] Ariel Kaminer and Sean O'Driscoll, *Workers at N.Y.U.'s Abu Dhabi Site Faced Harsh Conditions*, NY Times (May 18, 2014).
[166] Richard Morin, *Indentured Servitude in the Persian Gulf*, N.Y. Times (Apr. 12, 2013).
[167] Airlines and subsidy at 16.
[168] Shane McGinley, *Akbar Al Baker: No Holds Barred*, arabianbusiness.com (May 10, 2013). Similarly, when Lufthansa's pilots went on strike in 2014, Al Baker said he was sure Lufthansa's CEO envied him "because we don't have to take the crap of the unions." *See, e.g.,* Richard Weiss and Hans Nichols, *Qatar Air Pities Lufthansa for Perennial Struggles with Unions*, Bloomberg (Sept. 17, 2014).
[169] Shane McGinley, *Qatar Air says female workers need permission to get married*, arabianbusiness.com (Sept. 24, 2013).

Figure 17: Labor Costs as a Proportion of Total Costs Excluding Fuel



A published empirical analysis by Stephen B. Jarrell and T.D. Stanley demonstrated that the midpoint of the gap between union and non-union wages was 11 percent.[170] Therefore, if one conservatively assumes that the Gulf carriers' annual labor costs are 11 percent lower than they would have been if their workforces were permitted to unionize, this indicates that the bans on unions have saved them approximately $3.1 billion over the past ten years.[171]

Given Emirates' claim that its labor cost advantage is "an undeniable fact of life," it is important to recognize that the low labor costs in Qatar and the UAE are not the result of a natural comparative advantage. According to IMF figures, Qatar's per capita GDP in 2013 was $98,813, the highest in the world and significantly higher than the equivalent figure for the United States.[172] The UAE's per capita GDP of $30,122 was comparable to most Western industrial countries, including such major economies as the United Kingdom, France and Spain. Thus, far from being "an undeniable fact of life," these low labor costs are the result of deliberate government policy decisions to suppress labor rights and thereby give artificial cost advantages to airlines based in some of the wealthiest countries in the world.

***The Gulf governments exempt the Gulf carriers from costly requirements imposed on their foreign competitors*:** Under national laws in the Gulf states, foreign airlines must appoint a General Sales Agent (GSA) in order to carry out commercial activities. This requirement, which does not apply to local airlines, increases ticket costs by at least three percent. The discriminatory application of this requirement unfairly increases the costs of U.S. and other foreign airlines, contrary to the "national treatment" principle of international trade law.

[170] Stephen B. Jarrell and T.D. Stanley, *A Meta-Analysis of the Union-Nonunion Wage Gap*, Industrial and Labor Relations Review (1990).
[171] Capital Trade Study at 96. Specifically, $255 million for Etihad, $984 million for Qatar, and $1.88 billion for Emirates.
[172] International Monetary Fund, "World Economic Outlook April 2014 Database." GDP is expressed in purchasing power parity ("PPP") dollars per person.

The Gulf carriers are not subject to corporate income tax or fuel tax: Although Qatar and the UAE have corporate tax regimes that require companies to pay tax on their earnings, they do not enforce the laws with respect to domestic companies. They also do not levy individual income taxes or fuel taxes. This exemption from taxation provides another significant competitive advantage to Emirates, Etihad and Qatar relative to U.S. carriers, which are subject to taxation in the United States.[173] For example, under Dubai's corporate tax regime, tax rates are calculated on a sliding scale up to a maximum of 55%. Based on Emirates' pre-tax earnings, the Government's decision not to enforce the law with respect to Emirates saved the airline as much as $523 million in Fiscal Year 2013-2014 alone, and $4.6 billion over the past 10 years.

The Gulf carriers are not subject to competition laws: Although the UAE established a competition law in 2012, it explicitly exempted government-owned entities (as well as the entire transportation sector) from its scope. The Qatar competition law includes a similar exemption. The non-applicability of these laws to the Gulf carriers explains, for example, how the Chairman of Emirates can also serve as the Chairman of the low-cost carrier flydubai and ensure that the two carriers do not compete. The wholly, vertically-integrated nature of the Gulf aviation sectors – with all of the artificial cost advantages that it confers on the Gulf carriers – would be impossible in the United States.

The Gulf carriers are not subject to independent regulatory oversight: Unlike U.S. carriers, the Gulf carriers are not subject to oversight by independent regulators in their home markets. For example, the Chairman of Emirates is also the President of the Dubai Civil Aviation Authority (DCAA) and a Director of the General Civil Aviation Authority of the UAE. Thus, it is not surprising that a recent OECD publication described the DCAA as "at least as much a support agency for Emirates as a classical regulator."[174] Similarly, the Chairman of Qatar's Civil Aviation Authority is also a Member of Qatar Airways' Board of Directors.

IV. The Gulf Carriers are Massively Expanding Their Capacity, and they are Increasingly Targeting International Routes to the United States

The subsidies and other unfair advantages that the Gulf carriers receive from their government owners created the airlines and have enabled them to expand their capacity and operations at a pace that would have been impossible otherwise. Although they are relatively new entrants to the global aviation industry, the three airlines are among the fastest-growing (and now largest) airlines in the world, having increased their combined capacity by over 1,500 percent in the years since the United States negotiated the Open Skies agreements with Qatar and the UAE.[175]

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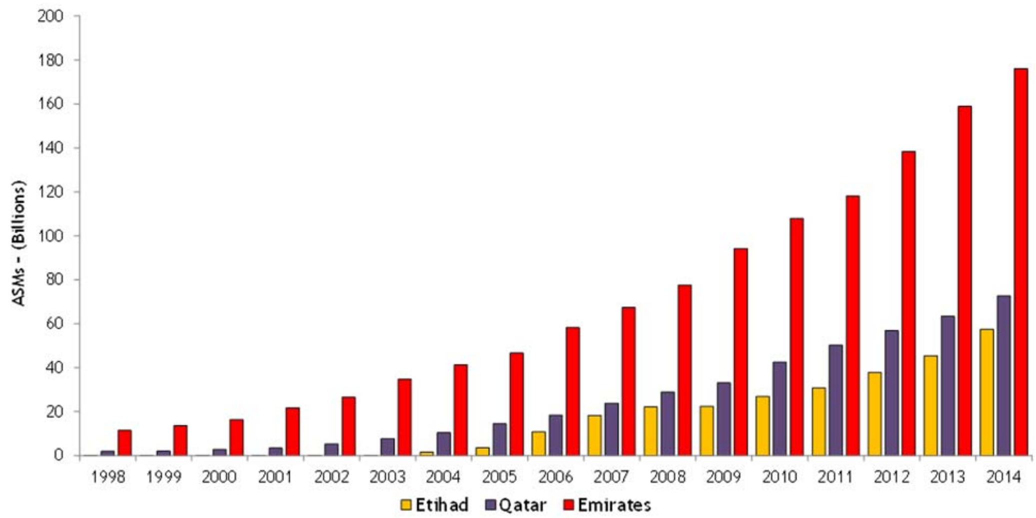
[173] According to CAPA Centre for Aviation, Emirates benefits "enormously" from the non-application of income tax rules in Dubai. CAPA Centre for Aviation, *Unit cost analysis of Emirates, IAG & Virgin* (Jan. 11, 2014).
[174] Hertog, Steffen (2012), "How the GCC did it: formal and informal governance of successful public enterprise in the Gulf Co-operation Council countries", in OECD, Towards New Arrangements for State Ownership in the Middle East and North Africa, OECD Publishing, p. 80, http://dx.doi.org/10.1787/9789264169111-5-en.
[175] Eric Amel et al., *Does the Airline Industry Suffer from Overcapacity*, Update 2014, at 13 (2014).

Figure 18: ASM Growth of Etihad Airways, Qatar Airways and Emirates Airline



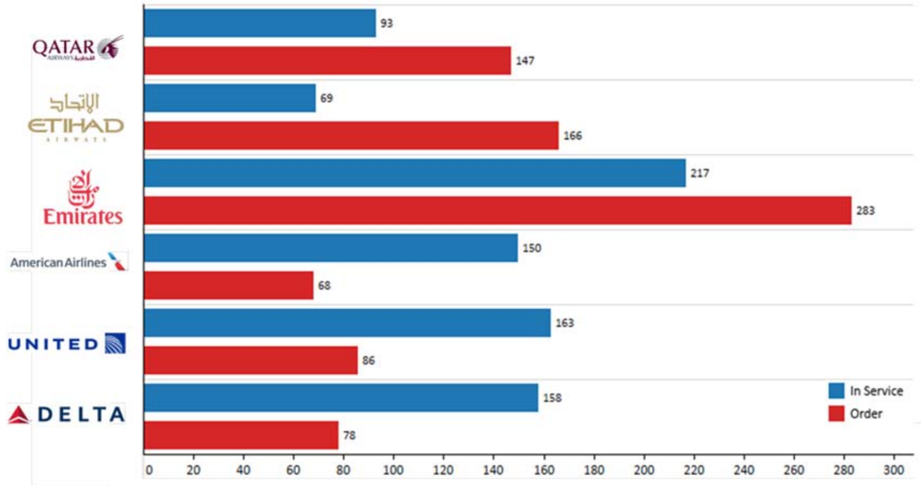
Source: OAG.

The Gulf carriers currently have a total of 363 widebody passenger aircraft in service, and that number is expected to increase by at least another 130 aircraft by 2020.[176] Including firm orders and options/letters of intent (and including aircraft scheduled for delivery after 2020), the airlines currently have a total of 818 widebody aircraft on order, a number equivalent to 24 percent of the entire global widebody fleet in 2014.[177] And because the fleets will include at least 160 Airbus A380s – the largest aircraft in the world, and the equivalent of adding almost two new aircraft in terms of capacity – the total number of orders underestimates the true impact of adding these aircraft into the marketplace.

<u>By 2020, their Combined Widebody Capacity Will Exceed the Entire U.S. Widebody Fleet</u>: To put these figures in perspective, Emirates was *already* the world's largest airline as measured by international passengers carried even *before* taking account of the 283 widebody aircraft it has on order (not including its 70 options). Its fleet of 140 A380s (including those already delivered plus orders) constitutes almost half of the entire *global* A380 fleet. And the growth plans of Etihad (69 widebodies in its fleet, 166 on order, 56 options) and Qatar (93 in its fleet, 147 on order, 96 options) are no less ambitious. Remarkably, by 2020, these three airlines – based in countries with a combined population that is less than 4 percent that of the United States – will have a total widebody capacity significantly larger than the entire U.S. commercial widebody fleet.[178]

[176] Based on firm orders net of expected aircraft retirements. Assumes retirement age is 12 years. Source: Ascend.
[177] Source: Ascend as of January 5, 2015.
[178] The relative size of the widebody fleets is even more remarkable when one considers that these population figures include the 80-90 percent of each country's population that is composed of foreigners (primarily third-world guest workers).

Figure 19: Widebody Fleet and Firm Order Books[179]

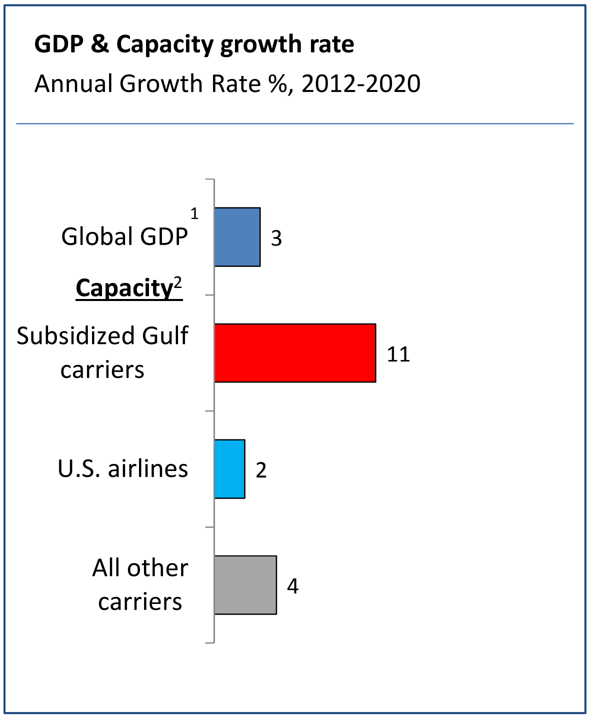


Note: Passenger aircraft only.
Source: Ascend database as of January 5, 2015.

<u>The Gulf Carriers are Adding Their New Capacity at Rates that Substantially Exceed Global GDP Growth</u>: As previously discussed, in addition to transporting local traffic between the United States and Qatar/the UAE, the Gulf carriers also (and primarily) target connecting traffic between the United States and countries and regions "behind" and "beyond" the UAE and Qatar, such as India, Southeast Asia, and Australia. The flow of this foreign passenger traffic through their hub cities is key to the economic development strategies in Abu Dhabi, Dubai and Qatar and forms the cornerstone of the Gulf carriers' existing operations.[180] Moreover, these types of operations will become even more important to the Gulf carriers in the future; as a recent MIT thesis observes, in order to maintain their <u>current</u> load factors as their new capacity comes on line, Emirates, Etihad and Qatar will need to find an additional *78 million* passengers per year, which is *almost double* their current number of passengers.[181] And because the Gulf carriers are adding this new capacity at rates that substantially exceed global GDP growth – which drives growth in demand for air transport services – the only way to accomplish this feat is to continue taking passengers from other countries' carriers.

[179] Source: Ascend as of January 5, 2015; *"Emirates finalizes $56 billion order for 150 Boeing 777X planes"*, Reuters (July 9, 2014); "Qatar Airways finalizes $19 billion Boeing 777X plane deal", Reuters (July 16, 2014).
[180] For example, connecting passengers constitute approximately 80 percent of Qatar's traffic. *See Big Three Persian Gulf Airlines Post Strong Growth on Differing Strategies*, Aviation Daily at 4, 5 (Nov. 12, 2013).
[181] Karim Al-Sayeh, *The rise of the emerging Middle East carriers : outlook and implications for the global airline industry*, Massachusetts Institute of Technology, at 140 (June 2014) (specifically, 163 million passengers by 2020, as compared to 85 million in 2013).

Figure 20: GDP versus Airline Capacity Growth Rates



The Gulf Carriers Are Increasingly Targeting Routes to the United States: Given the Gulf carriers' existing networks and their aggressive expansion plans, a significant portion of this new and subsidized capacity will target routes to the United States:

> The big three Gulf carriers are turning to expansion in North America to round out their global networks that have largely focused on Europe, Africa and Asia during the last few years. . . . Shifting their attention to the US is a natural progression for Emirates, Etihad and Qatar as the Americas are the least served regions in each carrier's network. Now that those carriers have a well-established and firm footing in other key global markets, and as they bolster their fleets with more efficient long-haul aircraft, opportunities are emerging for expansion beyond their traditional growth patterns.[182]

Qatar Has Significant U.S. Expansion Plans: As the aviation sector analysts at CAPA – Centre for Aviation have noted:

> Qatar Airways has significant expansion plans for its US operations. . . . The airline has already announced it plans to start flights to Chicago from 13-Apr-2013, and it wants to add Boston and Detroit within the next year, doubling its US network. . . . An Atlanta passenger service is also on the way. While launch dates for Atlanta, Boston and Detroit have not been announced, they are likely to come

[182] *See Gulf carriers turn their attention to the US to fuel their continued rapid growth*, CAPA Centre for Aviation (Aug. 16, 2012); *Gulf Airlines refine their respective US strategies after solid expansion during the last year*, CAPA Centre for Aviation (June 28, 2013) (stating that the U.S. market holds "huge potential" for Emirates, Etihad and Qatar and that the three airlines "are poised to shake up the US and Latin America much as they've disrupted Europe during the last few years").

> sooner rather than later. Qatar Airways' global expansion plan calls for it to roll out around 15 new destinations per year and the US is one of its prime expansion targets. The airline had hoped to open up more destinations in the US earlier than this, but a lack of aircraft has hampered its plans. . . .[183]

As Do Emirates and Etihad: Emirates' and Etihad's plans are similar. In September 2014, Emirates CEO Tim Clark said the U.S. market was "hugely important" to Emirates and that the airline was planning an expansion that would make the United States one of its three largest sources of revenue.[184] CAPA has predicted that Emirates will need to increase its U.S. capacity by 50-100 percent to meet this goal and that "[e]ven doubling U.S. capacity seems conservative."[185] Etihad's CEO has described the U.S. market as "largely untapped," and the airline added three U.S. destinations (Los Angeles, San Francisco and Dallas-Fort Worth) in 2014 alone.[186] As Figure 21 shows, the United States represents the largest untapped market for international long haul bookings for the Gulf carriers going forward.[187]

[183] *See Middle East airlines will expand into the US in 2013, further shaking up alliance structures*, CAPA Centre for Aviation (Nov. 23, 2012). Similarly:

> Qatar Airways has revealed Miami as its sixth US destination. This caps off a raft of planned new service by the three big Gulf carriers in 2014 as each airline – Emirates, Etihad and Qatar – works to increase its presence in the North American market. All are working toward feeding more North American traffic through their hubs in Dubai, Abu Dhabi and Doha and onward to points in Asia, Australasia, Africa and Europe.

Qatar Airways lays claim to Miami as Gulf airlines plan for a busy 2014 expansion into the US, CAPA Centre for Aviation (Oct. 23, 2013).

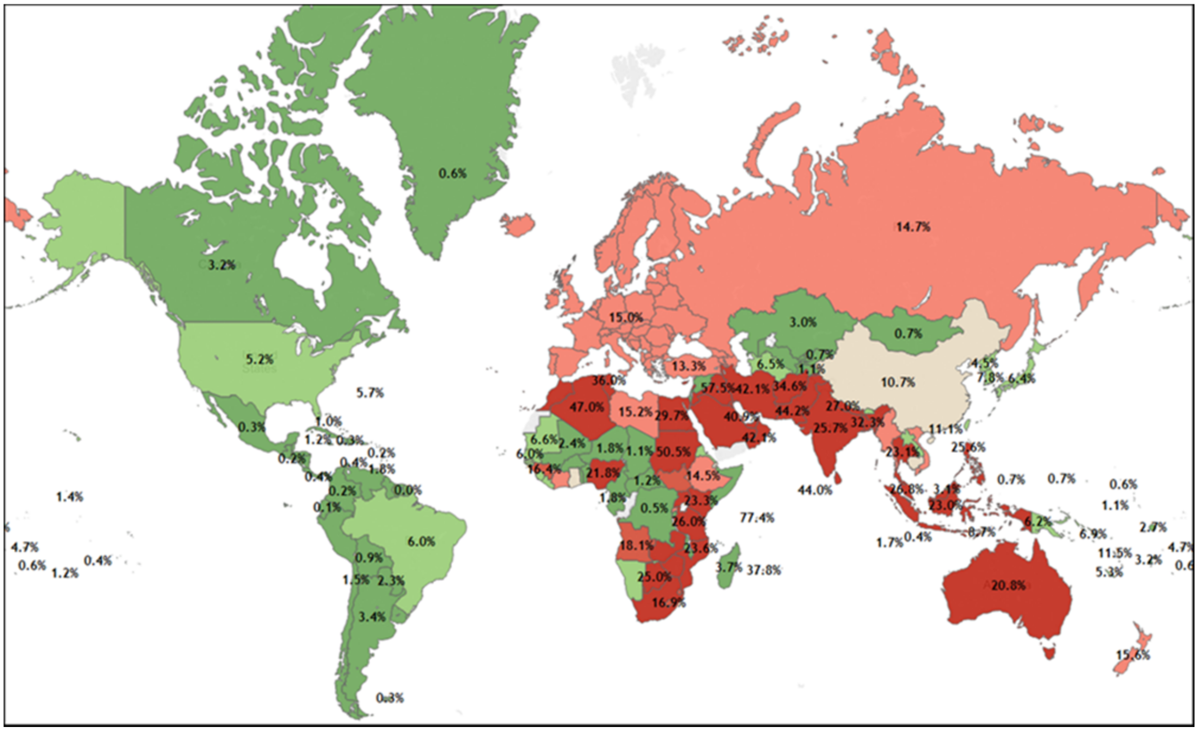
[184] Julie Johnsson, *Emirates Air Planning Expansion on U.S. Rivals' Home Turf*, Bloomberg (Sept. 21, 2014).

[185] *Emirates Airline to make the United States its third largest source of revenue*, CAPA Centre for Aviation (Oct. 29, 2014).

[186] Source: OAG. *See also* Andy Pasztor, *Etihad Airlines CEO Sketches Out Growth Plans For U.S.*, Wall Street Journal (Oct. 7, 2013) (noting that Etihad's CEO said the Los Angeles flight "will cater to business passengers, well-heeled Middle Eastern travelers and tourists seeking to use the Abu Dhabi hub to make connections to cities in Southern Europe, Asia and elsewhere").

[187] Notwithstanding their recent expansion into U.S. markets, by 2014, the Gulf carriers have only penetrated a relatively low proportion of U.S. cities that they may ultimately serve. For example, while Emirates currently serves 100 percent of the cities in Australia and New Zealand and more than 91 percent of the cities in Europe and Asia generating at least one million annual long-haul bookings, it only serves 50 percent of such cities in the United States. Likewise, Qatar currently serves 71 percent of the cities in Europe, and 93 percent of the cities in Asia generating at least one million annual long-haul bookings, compared to only 39 percent in the United States. Similarly, Etihad currently serves 67 percent of the cities in Australia and New Zealand, 54 percent of the cities in Europe, and 79 percent of the cities in Asia generating at least one million annual long-haul bookings, compared to only 33 percent in the United States. Source: MIDT and OAG.

Figure 21: Gulf Share of International Long-Haul Bookings, 2014[188]



The Gulf Governments' Competing Economic Strategies Are Causing Serious Overcapacity in the World Market: If Emirates was the only Gulf carrier targeting the U.S. market, it would still be a serious threat to U.S. airlines, given its enormous increases in capacity. But the fact that the governments of Abu Dhabi, Dubai and Qatar are simultaneously pursuing largely identical *and competing* economic strategies substantially increases the problem, as it effectively forces Emirates, Etihad and Qatar to continually match each other's increases in capacity. As Emirates acknowledged in the March 2010 edition of its "Open Sky" public affairs journal:

> The third driver creating over-capacity in some markets is government policies. Many airlines are pressurised by their governments to expand services and widen networks in support of national policies to develop incoming tourism or local business. Such airlines tend to order or operate many more aircraft than required in the markets they are serving. [This inevitably pushes down fares and cargo yields to the detriment of all airlines serving the same markets.] The most recent and vivid example of this is that of the Gulf airlines, Etihad Airways of Abu Dhabi and Qatar Airways, which have been tasked by their governments to match the worldwide network and success of their neighbouring carrier, Emirates. For these carriers profitability is seen as a long-term objective, not a short-term requirement.[189,190]

[188] Sources: MIDT, January-November. Long-haul booking defined as passengers traveling at least 2,500 miles. European countries are grouped.
[189] Emirates, Open Sky (March 2010) at 3 (Open Sky: they said it best . . .), quoting Rigas Doganis, *Flying Off Course* (4th ed. 2010), at 322.

Of course, this description applies equally to Emirates, which presumably explains why Emirates' "Open Sky" journal omitted the second half of the paragraph from the original source:

> Both these airlines have placed huge orders for aircraft, which were more than matched by earlier orders by Emirates, which included 45 Airbus A380s. In 2008 alone, in the midst of a worsening industry crisis, Etihad ordered 96 new aircraft, of which 70 were large twin-aisle jets and six were Airbus A380s. It is hardly surprising, then, that in summer 2009, when US, European and Asian airlines were cutting frequencies and capacity in response to falling demand, weekly seats offered in July 2009 on routes between the Gulf and Europe or the Gulf and Asia were some 17 per cent higher than in July 2008 (IATA, 2009)! This additional capacity would destabilize not only these two markets but was also targeting the Europe – Asia through traffic with a stop in one of the Gulf airports. Inevitably yields in all these markets would be driven down.[191]

<u>The Overcapacity Will Drive Down Yields for All Carriers, Including U.S. Carriers</u>: This is the issue that U.S. carriers are facing today. In the four years since Emirates published that edition of "Open Sky," all three Gulf carriers have continued to introduce enormous quantities of additional capacity on international routes. As noted above, all told, based only on their firm orders, the three airlines will take delivery of an additional 596 widebody aircraft – including 98 Airbus A380s.[192] The orders will nearly double their current capacity. And as the Gulf carriers continue to introduce that subsidized capacity on international routes to the United States – both direct routes to the Middle East and beyond and fifth freedom routes between the United States and Europe or Asia – inevitably, yields in those markets are driven down.[193]

To quote the analysts at CAPA – Centre for Aviation, "[t]he Gulf airlines, and particularly Emirates, have had a devastating impact on European long-haul hub carriers. The impact will be

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[190] An earlier version of this White Paper did not include the text enclosed in brackets, which does not appear in the text quoted in *Open Sky* but does appear in the original source. *See id.* It has been added in the interests of completeness.

[191] Rigas Doganis, *Flying Off Course, Airline Economics and Marketing* (4th ed. 2010), at 322. Doganis is a consultant to airlines, airports and governments and the chairman of the European Aviation Club in Brussels. He is a former Chairman/CEO of Olympic Airways and was formerly a non-executive director of easyJet and South African Airways. He is also a visiting Professor at Cranfield University. In addition to *Flying Off Course*, Doganis is the author of *The Airline Business* and *The Airport Business*.

[192] Moreover, Emirates is reportedly considering an order for 60-70 additional Airbus A380s if Airbus introduces a version with a next generation engine. *See Emirates Gives Airbus 29 Billion Reasons to Build a new Superjumbo Jet*, Business Insider (Sept. 24, 2014).

[193] A recent study of airline capacity issues reached a similar conclusion:

> The concern is that while the European and Asian carriers appear to be ordering aircraft roughly in balance with demand growth, the middle eastern carriers are adding additional capacity to the market which will upset the balance between capacity and traffic demand in the combined Europe-Middle East-Asia market. This imbalance may persist for a considerable period, given the magnitude of recent aircraft orders (and the corresponding seat capacity) by carriers in this region. Already, airfare discounting is common on flight routings via the Gulf region and is reflective of the aggressive marketing strategies these airlines have employed to fill their airplanes, in some cases diverting traffic that might otherwise have flown nonstop on Asian or European carriers, or via alternate routings (*e.g.*, New Zealand to Europe via the Middle East rather than via the traditional shorter routing over North America).

Mark Haneke, *Will there be an airplane capacity glut by 2012*, Journal of Air Transport Management 15 (2009), at 136.

different for US airlines, but despite the different geography, it will be much bigger than most expect."[194]

V. The Subsidized Gulf Carriers are Harming U.S. Interests

The Subsidies and Other Benefits Provide a Substantial, Artificial Cost Advantage That Will Force U.S. Carriers to Reduce or Forego Service on International Routes: The subsidies and other benefits that the Gulf carriers receive from their government owners provide a substantial artificial cost advantage over their U.S.-based competitors. And given the historically thin margins and highly competitive nature of the airline industry, even a small cost advantage can result in a significant shift in market share and substantial losses for the higher-cost competitor. Therefore, as the subsidized Gulf carriers increasingly deploy their new capacity on routes to the United States, basic economics suggest that prices will be driven down, and the unsubsidized U.S. carriers, constrained by the need to earn returns sufficient to cover their costs of capital, will be forced to reduce or terminate their own services on those routes and/or forego entry on routes they would otherwise have entered.[195]

Reductions in U.S. Carriers' International Services Will Negatively Impact Their Domestic Networks, Including Potential Cancellation of Services to Small and Medium-Sized Communities: Furthermore, because airlines are a network industry, U.S. carriers' international and domestic networks have a close symbiotic relationship. More than half of the passengers on U.S. carrier international flights make a connection to/from one of the carrier's domestic flights (which connect its hub to a myriad of domestic destinations in its network, including scores of small and medium-sized communities). Thus, as the Gulf carriers force U.S. carriers to reduce, terminate or forego services on international routes, the loss of these flights from the U.S. carriers' hubs will reduce passenger flow to/from their domestic flights. Because the economic viability of many domestic routes depends critically on passengers flowing onto long haul international flights, reductions in international service will negatively impact both the size and scope of their domestic networks.

The Gulf Carriers Are Displacing U.S. Carriers on Routes Beyond the Gulf: The subsidized Gulf carriers are already displacing U.S. carriers on international routes, even before the massive increase in subsidized capacity still to come. For example, the growth in Gulf carrier service from U.S. points has been most heavily concentrated to date in the Indian subcontinent, which currently accounts for 22 percent of all U.S.-Asia bookings.[196] From 2008 to 2014, annualized bookings by Gulf carriers from the United States to this region increased by nearly 2.5 million.[197]

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[194] *Why Emirates and friends will soon reshape American aviation*, CAPA Centre for Aviation (May 11, 2013).

[195] Sheik Ahmed has acknowledged Emirates' willingness to sell seats at unprofitable prices. For example:

> We expect continuing fierce competition as we defend our market share in all regions, often facing "suicidal" air fares from some of the competing airlines. This is a situation which puts pressure on all carriers but we will continue to maintain our high service standards as the fares hit levels which are unprofitable. . . .

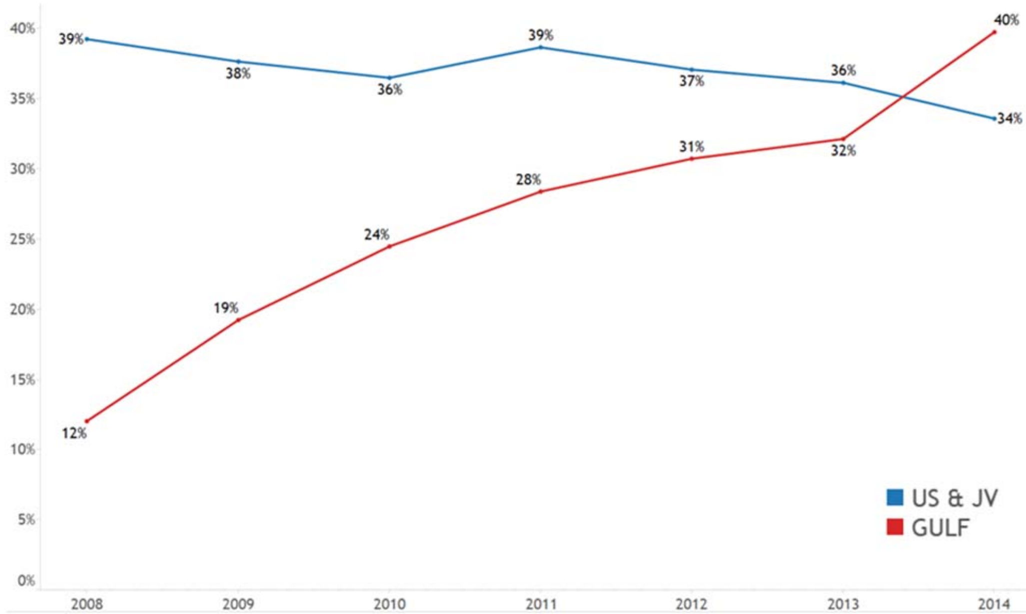
The Emirates Group, Annual Report 2008-2009, at 5.

[196] Source: MIDT. Data is for January-November. JV partners include: Delta (Air France/KLM, V-Australia, Alitalia, Virgin Atlantic), American (British Airways/Iberia, Qantas, JAL), United (Lufthansa, Swiss, Brussels, Austrian, Air Canada, ANA). Indian Subcontinent includes India, Pakistan, Bangladesh, Nepal, Sri Lanka and Maldives.

[197] Figures have been annualized for the full year based on January-November of both years.

It is no coincidence that over this same period, the Gulf carriers' share of U.S.-Indian Subcontinent bookings more than tripled (from 12.0% to 39.8%), while U.S. carriers and their JV partners lost nearly 800 bookings per day.

Figure 22: Share U.S.-Indian Subcontinent Bookings



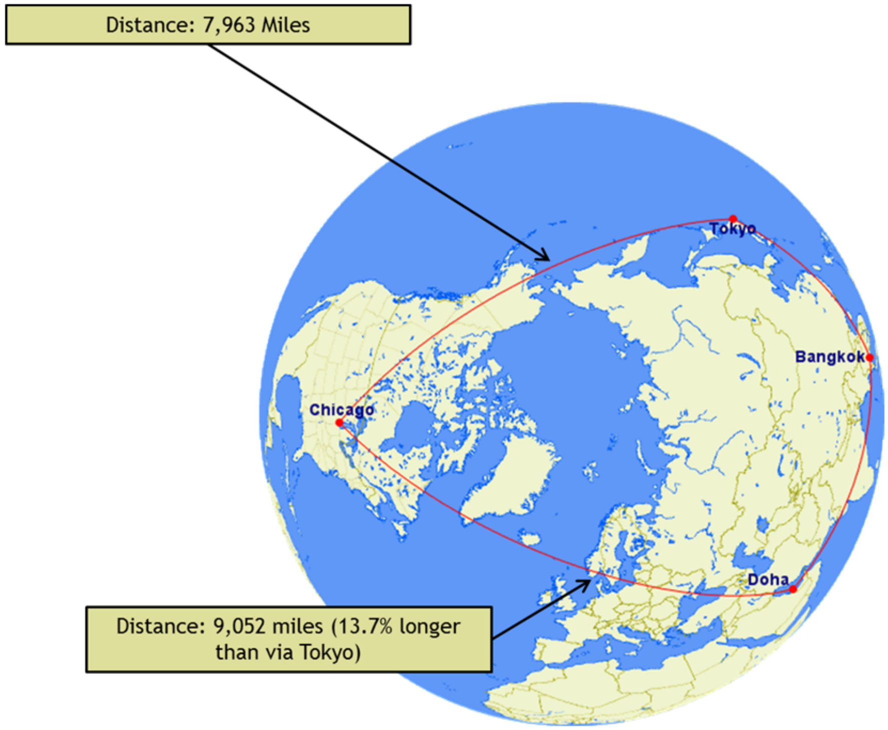
Source: MIDT (January-November of each year).
Notes: JV partners include: Delta (Air France/KLM, V-Australia, Alitalia, Virgin), American (British Airways/Iberia, Qantas, JAL), United (Lufthansa, Swiss, Brussels, Austrian, Air Canada, ANA). Indian Subcontinent includes India, Pakistan, Bangladesh, Nepal, Sri Lanka and Maldives.

These lost bookings have had a significant negative impact on U.S. carrier revenues, and if left unchecked the Gulf carriers' subsidized and significantly expanding presence on these routes will continue to erode the U.S. carrier/JV partner share in this important market and force further reductions in service.

<u>The Gulf Carriers are Also Taking Share from U.S. Carriers on Routes to SE Asia</u>: The impact of subsidized Gulf carrier competition can also be seen on routes between the United States and the emerging economies in Southeast Asia (*i.e.*, Vietnam, Thailand, Indonesia, Malaysia, and the Philippines). These routes are particularly attractive with regard to U.S. carriers' future growth, given their large populations, strong forecast GDP growth, and an emerging middle class. And as Figure 23 shows, traffic between the eastern portion of the United States and Southeast Asia is a market where U.S. carriers (and their JV partners) have a competitive advantage over the Gulf carriers owing to less circuitous routings via their west bound Asian stopover points, as compared to stopovers in the Middle East.[198]

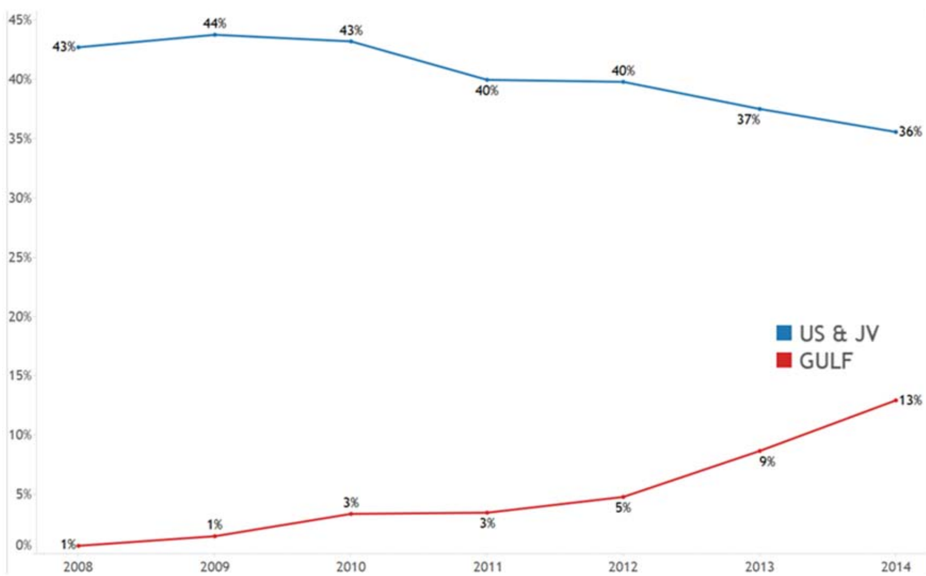
[198] The Eastern United States is defined as Alabama, Connecticut, Washington, DC, Delaware, Florida, Georgia, Massachusetts, Maryland, Maine, North Carolina, New Hampshire, New Jersey, New York, Pennsylvania, Puerto Rico, Rhode Island, South Carolina, Virginia, U.S. Virgin Islands, Vermont and West Virginia.

Figure 23: Comparative routings Eastern U.S.-Southeast Asia



Nevertheless, the Gulf carrier share on these routes has risen from one percent in 2008 to thirteen percent today, largely at the expense of U.S. carriers and their JV partners.

Figure 24: Market share Eastern U.S.-Southeast Asia (% of bookings)



Source: MIDT (January-November of each year).
Notes: JV partners include: Delta (Air France/KLM, V-Australia, Alitalia, Virgin), American (British Airways/Iberia, Qantas, JAL), United (Lufthansa, Swiss, Brussels, Austrian, Air Canada, ANA). Southeast Asia includes Indonesia, Malaysia, Vietnam, Philippines and Thailand.

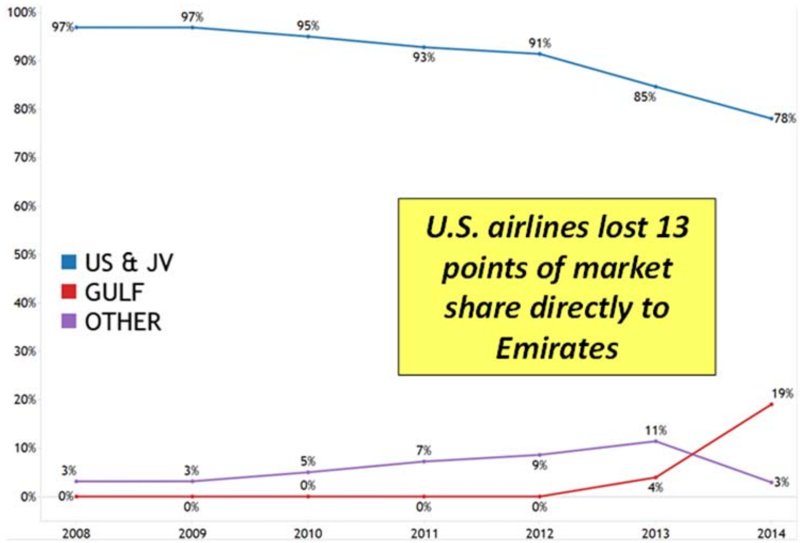
The Gulf Carriers are Taking Share Without Meaningfully Stimulating Demand: Furthermore, the Gulf carriers are taking this share without meaningfully stimulating demand – a fact that can be seen most dramatically on traffic flows between the United States and the Gulf. For example, between the end of 2007 and 2014, Emirates increased its daily seats between Dubai and the United States (excluding JFK) from approximately 250 per day to approximately 5,000. Over that same period, however, the average daily bookings between the eight U.S. cities and Dubai *decreased* by eight passengers – from 746 in 2008 to 738 in 2014.[199] Overall, nearly 11,000 daily seats have been added between the United States and Abu Dhabi, Dubai and Doha since 2008 – *95 percent of them by Gulf carriers* – but over the same period, the average daily bookings between the United States and the three Gulf hubs has increased by only <u>85 passengers</u> per day.[200]

<u>And They Are Beginning to Target Trans-Atlantic Routes Between the United States and Europe</u>: Moreover, while the Gulf carriers have primarily focused on direct flights between the United States and their respective hubs, in October 2013, Emirates launched a "fifth freedom" route between Milan and New York, and the airline is considering similar routes between the United States and other cities in Europe and Asia.[201] These types of services are particularly harmful to U.S. carriers. Although they do little to further the Gulf governments' economic development strategies – that is, flowing traffic over their hubs – they provide a means for the Gulf carriers to opportunistically plunder trans-Atlantic and trans-Pacific routes that are vital drivers for U.S. carriers' profitability. And because many of these routes are mature, growing very slowly, and already served by multiple U.S. and foreign carriers, the introduction of the new capacity will necessarily displace incumbent operators.

<u>Emirates' Route Between New York and Milan Underscores the Threat that the Gulf Carriers Pose on Trans-Atlantic and Trans-Pacific Routes</u>: Emirates' service between New York and Milan is a case in point. On October 1, 2013, Emirates launched a daily non-stop service from New York's JFK airport to Milan. Prior to this entry, American, Delta, United (from Newark), and Alitalia offered daily non-stop service for this route.[202] While total average daily bookings for the route increased after Emirates' entry as U.S. carriers attempted to defend their share, U.S. carriers have lost 13 points of market share directly to Emirates.[203]

[199] Source: MIDT and OAG. The U.S. cities include Houston (service launched in December 2007), Los Angeles (October 2008), San Francisco (December 2008), Dallas (February 2012), Seattle (March 2012), Washington (September 2012), Boston (March 2014), and Chicago (August 2014). Including New York City, which Emirates entered in 2004, average daily bookings were flat (i.e., 1,032 in 2008 versus 1,033 in 2014).
[200] Source: MIDT and OAG.
[201] *See, e.g., Gulf airlines refine their respective US strategies after solid expansion during the last* year, CAPA Centre for Aviation (June 28, 2013); Robert Wall and Chris Jasper, *Emirates Seeks Global Supremacy with A380s Flying Asia-US Routes*, Bloomberg (June 4, 2013) (quoting Emirates' CEO Tim Clark as stating that Asia-U.S. routes are "[t]he last piece of the jigsaw in the trans-Pacific" and that "[w]here we will go, when we will do it, and with what, is under plan at the moment").
[202] United and Alitalia service during the winter months was reduced to five and four times per week, respectively.
[203] Source: American, Delta, United.

Figure 25: Market Share NYC-MXP



Source: MIDT (January-November of each year).
Notes: JV partners include: Delta (Air France/KLM, V-Australia, Alitalia, Virgin), American (British Airways/Iberia, Qantas, JAL), United (Lufthansa, Swiss, Brussels, Austrian, Air Canada, ANA). Indian Subcontinent includes India, Pakistan, Bangladesh, Nepal, Sri Lanka and Maldives.

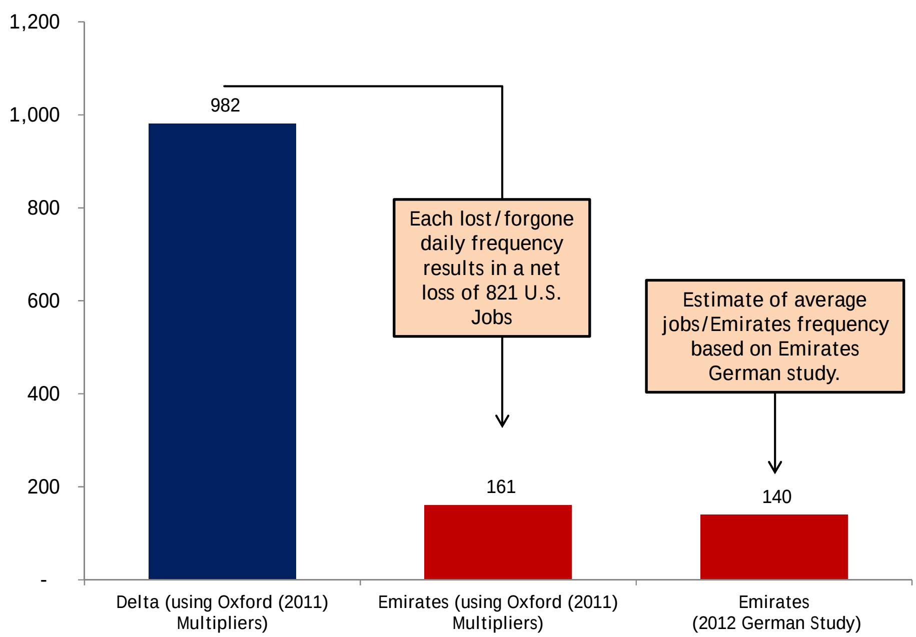
Emirates Entry Will Likely Force One or More U.S. Carriers to Exit the Route: In addition, the excess capacity on the route has driven U.S. carriers' margins to a level that is well below the industry cost of capital. The inability of U.S. carriers to cover their cost of capital on the route is unsustainable in the long run and will eventually force one or more U.S. carriers to exit the route. And as the Gulf carriers introduce similar services on other Trans-Atlantic and Trans-Pacific routes, the problem will continue to recur.

Subsidized Gulf Competition Threatens to Undermine the CRAF Program: Furthermore, subsidized Gulf carrier competition also threatens to undermine the U.S. Civil Reserve Air Fleet (CRAF) program. The voluntary program, which is managed by the Department of Defense (DOD), enables DOD to procure and deploy long-haul aircraft and crews from U.S. airlines to augment its own aircraft capabilities during national defense-related crises.[204] As subsidized Gulf competition forces U.S. carriers to reduce their long-haul international flying – and in turn, the number of widebody aircraft in their fleets – it could result in a shortfall in the aircraft available to DOD.[205] While it is unclear how DOD would deal with such a shortfall – it is unlikely in the current budgetary environment that DOD would respond by procuring additional widebody aircraft of its own – it is clear that the negative impact would directly contradict the U.S. Open Skies policy goal to "[r]ecognize the importance of military and civil airlift resources being able to meet defense mobilization and deployment requirements in support of U.S. defense and foreign policies."[206]

[204] *See* http://www.dot.gov/mission/administrations/intelligence-security-emergency-response/civil-reserve-airfleet-allocations/
[205] As of June 24, 2014, American, Delta and United account for 214 of the 236 international long-range widebody passenger aircraft in the CRAF program. *See* http://www.dot.gov/sites/dot.gov/files/docs/03%20--%20CRAF%20Tail%20Numbers%20--%20June%202014.pdf.
[206] 60 Fed. Reg. at 21844.

<u>Subsidized Gulf Competition Costs U.S. Jobs</u>: Finally, because the subsidized Gulf carriers are displacing and impeding service by U.S. carriers, U.S. employment is also suffering. Although the Gulf carrier presence in the U.S. market generates some employment, the number of positions created is far less than the job losses that U.S. carriers incur. Taking both into account, each daily widebody frequency lost or forgone due to subsidized Gulf competition results in a net loss (on average) of over 800 U.S. jobs.[207]

Figure 26: Comparison of U.S. Jobs (airline direct, indirect and induced) per Widebody Daily Frequency to/from the United States



Based on 200.4 direct airline jobs in the United States per 777 for Delta and 34 for Emirates. (Source: Delta, *The Economic Impact of Emirates Airline Flights on Greater Vienna/Austria* and *The Impact of Emirates Airline on the German Economy*). Assumes each long-haul route for U.S. carriers requires an average of 1.34 777s staffed at Delta staffing ratios. Assumes 56.7% of U.S. carrier and 20.9% of Gulf carrier passengers, respectively, make connections at U.S. gateways, resulting in 53.1 and 18.6 additional domestic U.S. airline feeder jobs, respectively. (Sources: MIDT , U.S. DOT DB1B, T100 and Form 41 data). Assumes indirect employment multiplier of 1.64 and induced employment multiplier of 0.42 (Source: *Economic Benefits from Air Transportation in the US, Oxford Economics*, 2011). Delta (Oxford Analysis) assumes routes requires 1.34 Boeing 777s staffed at Delta staffing ratios. German study estimate based on 169 direct Emirates jobs in Germany supporting 10.4 daily flights, and all indirect jobs in study excluding those related to fuel, airport charges, handling and air navigation charges. Also includes 275 induced jobs based on implicit induced multiplier in German study.

<u>The Injury to U.S. Airlines will Intensify as Gulf Carrier Fleets Continue to Grow</u>: As discussed in Section IV above, the Gulf carriers will be introducing massive quantities of additional subsidized capacity on international routes in the coming years. Qatar Airways' capacity is estimated to grow from 57 to 137 billion Available Seat Miles (ASMs) from 2012 to 2020, and

[207] One component of U.S. job losses that result from the displacement of U.S. widebody *international* services are jobs attributable to *domestic* "feed" passengers. A significant proportion of passengers traveling on long-haul international flights to/from the United States make connections at the U.S. gateway on U.S. carriers, which in turn creates demand for additional U.S. airline jobs. However, far more passengers on international flights operated by U.S. carriers make U.S. gateway connections than on flights operated by Gulf carriers, because of the convenient "behind and beyond" networks of the U.S. carriers at their hubs. Consequently, the proportion of U.S. carrier long-haul international passengers that make behind/beyond connections at U.S. gateways is—on average—2.7 times larger than that of the Gulf carriers – (i.e., 56.7% vs. 20.9%). This difference results in U.S. carriers generating approximately 35 more U.S. airline jobs than Gulf carriers per international widebody daily frequency to support domestic feed traffic. *See* Darin Lee, "Estimating Losses in U.S. Employment As a Result of the Displacement of U.S. Carrier International Services By Subsidized Gulf Carriers."

Etihad's capacity is estimated to grow from 38 to 88 billion ASMs over this same period. This represents a compound annual growth rate (CAGR) of over 11.7 percent for Qatar and 11.2 percent to Etihad. Emirates' capacity is expected to grow from 150 to 326 billion ASMs, a CAGR of 11.3 percent.[208] As previously noted, because these capacity increases significantly exceed forecast GDP and airline traffic growth rates in their home markets, or in developed or developing countries, the market will only be able to absorb this capacity if the Gulf carriers continue to take ever-increasing numbers of passengers from U.S. and other carriers.

VI. The Unique Challenges That Emirates, Etihad and Qatar Present Justify U.S. Government Intervention

<u>The Obama Administration Has Recognized the Threat That State Capitalism Poses for Other Sectors of the U.S. Economy</u>: In recent years, the Obama Administration has increasingly acknowledged the trade distortions and unfair competition associated with state capitalism:

> "[S]tate capitalism, as practiced on its current scale and using current policy approaches, is, in numerous instances, distorting trade and investment patterns in global markets; to the extent that it distorts trade and confers artificial advantages it can significantly and adversely affect important segments of our own economy, and the impact could grow over time."[209]

<u>State Capitalism is a Serious Threat in the Aviation Sector As Well</u>: This is the situation that U.S. airlines are facing in Qatar and the UAE. The governments of Abu Dhabi, Dubai and Qatar have targeted the aviation sector as a core source of their future economic growth. They have created state-owned, vertically-integrated aviation sectors that are geared to the success of their SOE carriers, which are the primary instruments of this growth. And they have fueled their carriers' expansion with over $39 billion in subsidies and other benefits that are distorting trade and conferring significant artificial cost advantages on their operations.

<u>The Open Skies Agreements with Qatar and the UAE are Facilitating Subsidized Gulf Competition</u>: In their current form, the Open Skies agreements with Qatar and the UAE facilitate this subsidized Gulf competition, which is antithetical to the underlying assumption of U.S. Open Skies policy that carriers compete on a level playing field without the distorting effect of government actions favoring one carrier in the market over its competitors. The *status quo* runs absolutely counter to fundamental Open Skies policy and cannot be justified or maintained.

<u>The Open Skies Agreements Are Inconsistent With DOT's Statutory Mandate to Strengthen the Competitive Position of U.S. Carriers:</u> The statutory authority that underpins the U.S. Open Skies program requires DOT and the State Department to develop a negotiating policy that "strengthen[s] the competitive position of air carriers to ensure at least equality with foreign air

[208] Source: OAG and A4A.

[209] Robert Hormats, Ensuring a Sound Basis for Global Competition: Competitive Neutrality (May 5, 2011); *see also* The President's 2013 Trade Policy Agenda at 6-7 (stating that "President Obama is determined to ensure that U.S. trade policy helps American companies and workers compete in global markets . . . . That is why the Administration is tackling emerging problems that increasingly affect trade in the 21st century. In the TPP and TTIP trade negotiations, for example, the United States is seeking new disciplines to address trade distortions and unfair competition associated with the increasing engagement of large, State-owned enterprises in international trade. . . .").

carriers, including the attainment of the opportunity for air carriers to maintain and increase their profitability in foreign air transportation."[210] The Open Skies agreements with Qatar and the UAE are inconsistent with this statutory mandate, as they allow the governments of Abu Dhabi, Dubai and Qatar to distort the marketplace in favor of their SOE carriers, thereby weakening the competitive position of U.S. carriers and undermining their profitability.

The Agreements Are Also Inconsistent With DOT's Statutory Mandate to Ensure Equivalent Benefits for U.S. Carriers: Furthermore, U.S. law also requires DOT and State to pursue an aviation negotiating policy that affords opportunities for foreign carriers to increase their access to the United States "if exchanged for benefits of similar magnitude for U.S. carriers or the traveling public with permanent linkage between the rights granted and rights given away."[211] The agreements with Qatar and the UAE are inconsistent with this statutory mandate as well, as they allow the Gulf carriers to flow unlimited quantities of passengers from third country markets through their hubs to a U.S. market of 300 million and provide essentially no benefits to U.S. carriers in return. And they exacerbate this imbalance by allowing unlimited "fifth freedom" traffic rights that are without value to U.S. carriers, due to the low level of demand for service terminating in Qatar and the UAE.

The Gulf Carriers Are Abusing the Agreements: Moreover, the Gulf carriers are abusing these rights: Emirates' service between New York and Milan, for example, is purely opportunistic, since the carrier was already offering two daily non-stop services between Dubai and New York City *before it launched the Milan-New York City service*. The route does nothing to further the government of Dubai's strategy of flowing traffic through Dubai; it is purely about finding opportunistic uses for an ever-expanding fleet. And if those uses undermine the profitability of U.S. and EU carriers in their home markets, so much the better. These services, which have only an incidental connection to the UAE and Qatar, are targeted at capturing seventh freedom traffic.[212] Seventh freedom passenger services are not provided for under the U.S.-UAE and U.S.-Qatar Open Skies agreements.

The Agreements Are Premised on Outdated Assumptions: At root, the agreements are a function of their time. When the United States commenced its negotiations with the UAE and Qatar in 1999 (and when it signed the agreements in 2001-02), the governments of Abu Dhabi, Dubai and Qatar had not yet developed their aviation industrial policies. Etihad did not exist, and Emirates and Qatar were a fraction of their current size and did not serve the United States.[213] DXB – which recently passed Heathrow to become the world's busiest airport for international passenger traffic – was not in the top 20 of airports worldwide. And even then, Emirates was denying that it was subsidized. It is understandable that U.S. negotiators failed to foresee the

[210] 49 U.S.C. § 40101(e)(1).
[211] 49 U.S.C. § 40101(e)(8).
[212] *See, e.g.,* http://www.emirates.com/us/english/offers/1297081/New-York-to-Milan-non-stop?intcid=offers-637518-1297081 (stating that "[f]rom October 1, 2013, you can enjoy more convenient connections between the US and Europe with the launch of non-stop flights from New York (JFK) to Milan (MXP)"); Robert Wall and Chris Jasper, *Emirates Seeks Global Supremacy With A380s Flying Asia-US Routes*, Bloomberg (June 4, 2013). The "seventh freedom" is the right to carry traffic between third countries without a stop in the home country. *See* Appendix.
[213] Emirates had 38 aircraft in its fleet in 2002; Qatar had just 13 aircraft in its fleet that same year. The Emirates Group, Annual Report 2001-2002, at 65; Qatar Airways Q.C.S.C., Summarized Financial Statements (Mar. 31, 2003), at 11; *see also* O'Connell at 340 (Figure 1), 341 (Table 2) (showing lack of service to the United States).

extent of the unfair competitive threat or the lack of balance in the benefits that would accrue to each side. But the threat – and the imbalance – is clear today.

Gulf Subsidies are Fundamentally Incompatible with U.S. Open Skies Policy: As previously discussed, a primary objective of U.S. Open Skies policy is to "[e]nsure that competition is fair and the playing field is level by eliminating marketplace distortions, such as government subsidies . . . ."[214] The aviation industrial policies of Qatar and the UAE are fundamentally incompatible with this objective. The Policy also states that "[i]f aviation partners fail to observe existing U.S. bilateral rights, or discriminate against U.S. airlines, we will act vigorously, through all appropriate means, to defend our rights and protect our airlines."[215] The subsidies and other aspects of state capitalism practiced in Qatar and the UAE are having adverse, discriminatory effects on U.S. carriers, thereby justifying action by the U.S. government to curtail the ability of the state-owned Gulf carriers to engage in unfair competition through a combination of subsidies and other artificial advantages from their own governments and the privileges of "open skies" traffic rights granted by the United States.

The U.S. Government Should Take Steps To Address the Flow of Subsidized Gulf Carrier Capacity to the United States: The Open Skies agreements conferred enormous benefits on Qatar and the UAE by opening the most lucrative market in the world to their airlines even though they provide essentially no benefits to U.S. carriers in return. But the governments of Qatar and the UAE must accept the obligations that come with those benefits: in this case, a willingness to reach agreement with the United States on measures to address the flow of subsidized Gulf carrier capacity to the United States. To this end, both agreements permit the United States to request consultations relating to the agreements at any time. The U.S. government should exercise this right to raise its concerns with the governments of each country and to negotiate new arrangements. If Qatar and the UAE refuse to do so, both agreements afford the United States the unilateral right to provide written notice of its intent to terminate the agreements at any time. Upon termination, the United States would be in a position to apply principles of comity and reciprocity as a basis for determining whether to grant traffic rights to the Gulf carriers on an extra-bilateral basis.

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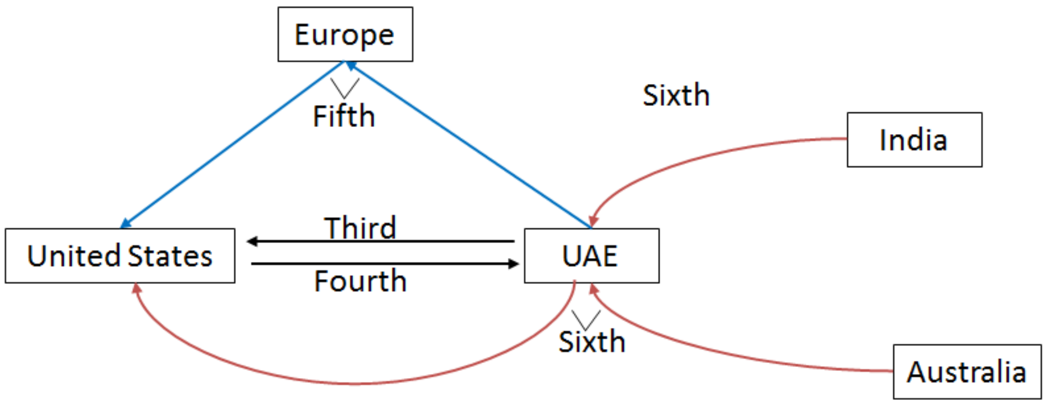
[214] 60 Fed. Reg. at 21844.
[215] *Id.*

Appendix 1: The Freedoms of the Air

Governments negotiate air service agreements within the framework of the so-called "freedoms of the air." The first freedom addresses overflying rights; the second, the right to land in a country for technical reasons; the third and fourth, the right to carry traffic to and from an airline's home country; the fifth, the right to carry local traffic to and from a third country on flights that are en route to/from a carrier's home country; the sixth, the right to flow traffic from "behind" the airline's home country through its hub; and the seventh, the right to carry traffic between third countries without a stop in the home country.[216] The following table illustrates the operation of third, fourth, fifth and sixth freedom traffic rights from the perspective of the UAE.



[216] *See, e.g.*, Pat Hanlon, Global Airlines (3rd ed. 2007), at 129-137.