



A power struggle heats up at a Bulgarian steel plant

NEWS IN DEPTH | PAGES 14-15

How Nintendo's president aims to step up his game

MARKETPLACE | PAGE 27

Alcatel taps Korn/Ferry to change culture at top

Global hunt is aimed at easing tensions, restoring firm hand

BY DAVID GAUTHIER-VILLARS, JOANN S. LUBLIN AND LEILA ABOUB

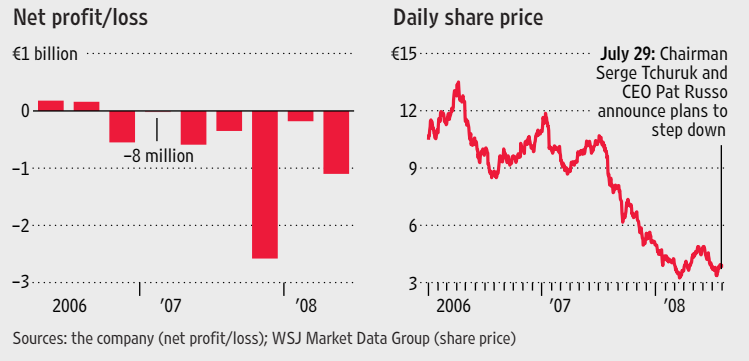
Alcatel-Lucent is kicking off a global hunt for new leadership this week, after an initial approach made a few days ago to former BT Group PLC boss Ben Verwaayen was rebuffed...

The search, to be run by executive recruiter Korn/Ferry International, is aimed at bringing a firm management hand to the big telecom-equipment maker and easing nationalistic tensions...

Details of the sudden decision are just beginning to emerge. According to people familiar with the matter, Alcatel-Lucent's board decided Ms. Russo and Mr. Tchuruk should leave after both told the board separately...

Ailing networks

Alcatel-Lucent's share price has continued to drop with big net losses.



Sources: the company (net profit/loss); WSJ Market Data Group (share price)

should leave after both told the board separately at a July 27 meeting that they could no longer work with the other. The managers have been at odds over their respective roles and strategy...

Replacements for Ms. Russo and Mr. Tchuruk aren't likely to be sought internally, and the two highest posts may also be combined into one, people familiar with the matter said.

one, people familiar with the matter said. Mr. Verwaayen, who left BT in June, declined to comment.

Among the potential candidates from outside the company, say people familiar with the board's thinking, are Thierry Breton, a former French finance minister and ex-chairman and CEO of France Télécom SA, and Philippe Germond, CEO of information-technology company Atos Origin SA.

Please turn to back page

What's News —

Business & Finance

World-Wide

Alcatel-Lucent starts a global hunt for new leadership as details emerge about the forced departures of its CEO and its chairman.

■ TNK-BP's finance chief quit amid a shareholder dispute that has thrown BP's Russian oil venture into turmoil.

■ Euro-zone producer prices hit a fresh high in June, giving the ECB more to consider at its meeting this week.

■ French prosecutors put the assistant of the man allegedly behind the \$6.99 billion trading loss at Société Générale, under formal investigation.

■ HSBC net dropped 29% to \$7.7 billion in the first half, hit by added charges of \$10.1 billion against bad loans.

■ Fortis posted a 49% decline in second-quarter net profit and gave a cautious outlook.

■ U.S. stocks finished lower as a drop in oil failed to soothe the financial worries. Mining stocks fell in Europe on concerns over demand for metals.

■ China and India are facing off on energy as they make rival bids for Imperial Energy, which produces oil in Russia.

■ UBS lawyer David Aufhauser resigned after being high-lighted, though not named, in a civil fraud complaint.

■ ArcelorMittal shrugged off U.S. recession fears with plans to build a steel mill in Mexico and buy a coke plant in Pennsylvania.

Markets 4 p.m. ET

Table with market indices: DJIA, Nasdaq, DJ Stoxx 600, FTSE 100, DAX, CAC 40, Euro, Nymex crude.

Money & Investing > Page 17

Iraq's Sadr plans to disarm his Shiite militia and turn it into a civic organization no longer guided by anti-U.S. militancy...

■ Attackers killed 16 Chinese border-patrol policemen in a largely Muslim area of northwest China, increasing security fears ahead of the Olympics.

■ The Olympics will mean hardship for many Beijing migrant workers expelled as the city has undergone a face-lift.

■ Security Council members will seek new sanctions against Iran over its nuclear program, after Tehran failed to meet a deadline for responding to an offer aimed at defusing the dispute.

■ About 150 Fatah fighters who fled to Israel to avoid capture by Gaza's Hamas rulers got asylum in the Fatah-run West Bank.

■ Afghan and NATO troops killed 17 Taliban militants in southern Afghanistan. Four police officers died in an ambush in central Ghazni province.

■ India's Singh pledged \$450 million in aid for Afghanistan as he met with Karzai in New Delhi. Both decried last month's bombing of India's embassy in Kabul.

■ Italy deployed hundreds of soldiers in cities as part of a push to fight street crime.

■ Two Dutch climbers were rescued by helicopter from K-2, the second-highest mountain, and an Italian was helped down after an avalanche that left at least 11 people presumed dead.

■ A tornado hit towns in northern France, killing three people and destroying at least 40 homes.

■ Died: Alexander Solzhenitsyn, 89, Soviet dissident writer and Nobel Prize winner in literature, in Moscow of heart failure.

EDITORIAL & OPINION

Georgia on their minds

The EU's major powers are finally getting serious about the South Caucasus.

Financial chief quits TNK-BP as spat festers

BY ANDREW OSBORN AND GUY CHAZAN

MOSCOW—TNK-BP Ltd.'s chief financial officer resigned Monday, a casualty of the bitter shareholder dispute that has convulsed Russia's No. 3 oil producer and thrown BP PLC's landmark Russian investment into turmoil.

James Owen, who had served as the company's independent financial chief since December 2005, is the most senior resignation at TNK-BP since the conflict between BP and its Russian billionaire partners erupted in the spring.

"Mr. Owen's letter states that as the current shareholder issues remain unresolved, he feels it is difficult for him to continue working independently, as his role demands," TNK-BP said in a statement.

Mr. Owen couldn't be reached for comment.

Analysts say Mr. Owen's departure leaves a key management com-

Please turn to page 3

Sadr sets plan to soften militia's role within Iraq

BY GINA CHON

BAGHDAD—Hit by a government military crackdown and dwindling popular support, anti-American Shiite cleric Muqtada al-Sadr is planning a major shift in strategy: rebranding and disarming the Mahdi Army by turning the militia into a civic and social-service organization.

In an introductory brochure reviewed by The Wall Street Journal and confirmed by Sheikh Salah al-Obeidi, Mr. Sadr's chief spokesman, the Mahdi Army will now be guided by Shiite spirituality instead of anti-American militancy. It will even get a new philosophy or guiding principle: Al-Mumahidoon, meaning for his supporters, will be the foot soldiers of the Shiites' messiah, Imam Muhammad al-Mahdi, who Shiite Muslims believe will return to rid the world of evil and injustice.

The brochure states the al-Mumahidoon office will undertake an intel-

lectual and scientific jihad that focuses on education, religion and social justice. It also says "it is not allowed to use arms at all." The al-Mumahidoon office will be divided into sections for the teachings of the faithful, religion, education and social services, as well as departments for information and administration and a follow-up section.

Posters have been put up in some areas of Baghdad saying a new direction for the Mahdi Army will be announced at this Friday's prayers. The posters also bear the name al-Mumahidoon.

Sadr officials say the transition is partly in reaction to a time horizon for withdrawal of U.S. combat troops that is expected to be part of the long-term security deal between the U.S. and Iraq, which is close to being hammered out after a few months of sometimes contentious negotiations.

The Mahdi Army had long stated

Please turn to page 3



Muqtada al-Sadr



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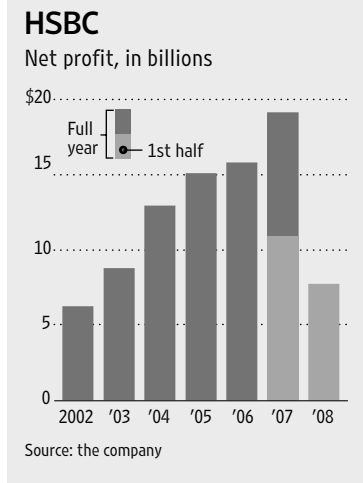
LEADING THE NEWS

# HSBC's profit falls 29%

*Impairment charges on loans hurt results in 'difficult markets'*

BY SARA SCHAEFER MUÑOZ

Global banking giant HSBC Holdings PLC posted a sharp decline in profits in the first half of this year as growth in its Asian operations failed to fully compensate for deepening losses in the U.S. mortgage market. London-based HSBC, the U.K.'s largest bank by market value, said net profit came in at \$7.7 billion, down 29% from the same period last year. The results were weighed down by \$3.9 billion in write-downs on credit investments and rising delinquencies on mortgages and other loans to U.S. consumers. The bank added \$10.1 billion to its provisions against bad loans, 58% more than in the same period last year, and said it would make further cuts in its U.S. retail-lending business.



HSBC, which was among the first banks to report problems with U.S. mortgage investments, has so far fared much better than most of its European and U.S. rivals, many of which are suffering outright losses. HSBC Chairman Stephen Green called the bank's first-half performance, which was largely in line with analysts' expectations, "resilient"

despite "the most difficult financial markets for several decades."

HSBC shares closed Monday at 828 pence on the London Stock Exchange, down 1%. The stock is down 1.7% so far this year and 7.8% from 52 weeks ago—a much better performance than its peers, some of which are down more than 40% this year.

Chief Executive Michael Geoghegan threw cold water on speculation that HSBC would expand further into investment banking by acquiring troubled Lehman Brothers Holdings Inc., saying HSBC had no interest in Lehman.

The bank, which has depended on emerging markets for an increasing share of its profits, saw strong growth from the area, although Hong Kong's pretax profit in the first half fell to \$3 billion, down 8% from the same period last year. HSBC executives said they expect business in emerging markets to keep growing, but at a slower pace as inflationary pressures and downturns in the U.S. and elsewhere take their toll.

—Carrick Mollenkamp contributed to this article.

# ImClone's Icahn spurns Bristol offer as too low

BY PETER LOFTUS

ImClone Systems Inc. Chairman Carl Icahn said he is opposed to Bristol-Myers Squibb Co.'s \$4.5 billion offer to acquire the 83% of ImClone it doesn't already own because the bid "greatly undervalues" the biotechnology company.

ImClone said its board has formed a committee to study the offer but that its preliminary view concurs with Mr. Icahn's—essentially that Bristol-Myers needs to pony up more cash.

A Bristol-Myers spokesman declined to comment.

Bristol-Myers, based in New York, announced its \$60-a-share offer for its crosstown partner last week. ImClone shares have since surged above \$60, indicating investors expect the company to sell for more.

ImClone shares were down 31 cents each at \$65.03 late Monday on the Nasdaq Stock Market, while Bristol-Myers shares were up 26 cents each, or 1.2%, at \$21.37 on the New York Stock Exchange.

ImClone's skepticism appears

rooted in its exploration of breaking itself into two businesses—one for cancer drug Erbitux, ImClone's sole product, and one for its pipeline of experimental drugs, which includes a compound similar to Erbitux but whose rights are held solely by ImClone. Bristol-Myers and ImClone co-market Erbitux, which ImClone discovered.

ImClone said its board "still believes that the company's pipeline business may be extremely valuable and significantly increase stockholder value as a separate business."

On Monday, Mr. Icahn raised questions about Bristol-Myers's tactics. He said Bristol-Myers's representative on the ImClone board has been present at meetings in which the potential split of ImClone was discussed. Bristol-Myers has a representative on ImClone's board stemming from its nearly 17% ownership stake dating to 2001.

Mr. Icahn didn't identify the director who was present at the discussions of ImClone's breakup.

—Kevin Kingsbury, Ron Winslow and Sarah Rubenstein contributed to this article.

**CORRECTIONS & AMPLIFICATIONS**

**Eurex, Deutsche Börse's** derivatives business, had revenue of €233.3 million (\$362.5 million) for the second quarter. A Money & Investing article on Monday incorrectly said that the revenue came from Deutsche Börse's clearinghouse, Eurex Clearing.

**This year through Friday, Nike's** shares were down 7.5%, **McDonald's** were up 1.5%, **Time Warner's** were down 13.8% and **Target's** were down 10.6%. A chart showing price/earnings ratios and share performance of several companies that accompanied Monday's **Abreast of the Market** column reversed two sets of performance figures.

## INDEX TO BUSINESSES

This index of businesses mentioned in today's issue of The Wall Street Journal Europe is intended to include all significant references to companies. First reference to these companies appear in boldface type in all articles except those on page one and the editorial pages.

Access Industries.....3	China Merchants Group ..23	Freddie Mac.....17,18	J.Crew .....	Nike .....	Southwest Airlines .....
Advanced Micro Devices.....7	China National Offshore Oil ..6	Gazprom .....	JetBlue Airways .....	Nintendo .....	STX Pan Ocean .....
Aircell .....	China National Petroleum ..6	General Electric.....4,29	J.P. Morgan Chase .....	Nissan Motor .....	Sumitomo Mitsui Financial
Alcatel-Lucent .....	China Overseas Shipping..23	General Motors .....	Kawasaki Kisen .....	Nokia .....	Group .....
Alfa Group .....	China Petroleum & .....	GLG Partners .....	Kazakhmys .....	Nvidia .....	SVB Financial Group .....
Alliance & Leicester .....	Chemical .....	Global Infrastructure	Kirin Holdings .....	Nymex Holdings.....22	Target's .....
AMR.....4,8	China Shipping .....	Partners.....19	Korea Exchange Bank .....	Oil & Natural Gas .....	Telegraaf Media .....
Anheuser-Busch.....17	Development.....23	Goldman Sachs Group..17,21	Kremikvotzi .....	Pacific Basin Shipping .....	Tenth Street Entertainment
Apple .....	Chipotle Mexican Grill ..18	Google .....	Kyowa Hakkō Kogyo.....7	Private Bancorp.....18	.....29
ArcelorMittal .....	Chrysler .....	Grupo Modelo.....17	L'Air Liquide .....	Qualcomm.....32	Texas Instruments .....
Asciano Group .....	Cia. Vale do Rio Doce .....	Heineken .....	Lehman Brothers Holdings	QVT Financial .....	Time Warner's .....
ATA .....	Citigroup .....	Honda Motor .....	.....2,18,21	Renova .....	TNK-BP .....
Atos Origin .....	Close Brothers Group.....21	Houlihan Lokey Howard &	Lend Lease .....	Rongsheng Shipbuilding &	Toyota Motor .....
Awilco Offshore .....	Comcast Corp. ....1,32	Zukin .....	Lion Nathan.....7	Heavy Industries .....	UBS .....
Banco Santander (Spain)..18	Continental .....	HSBC Holdings .....	Lockheed Martin.....8	Rosneft .....	17,18,19,21
Bank of America .....	Crédit Agricole .....	Humana .....	Lufthansa .....	Royal Bank of Scotland PLC	Under Armour .....
Bear Stearns .....	Credit Suisse Group.....21,22	Hynix Semiconductor .....	Manitowoc .....	.....22	US Airways .....
Blackstone Group.....8	CRU International .....	Hytex Integrated .....	Mars Capital Group .....	Samsung Electronics .....	Vedanta .....
BNP Paribas .....	Daewoo Shipbuilding &	Hyundai Mipo Dockyard...23	Matsushita Electric	San Miguel .....	Vestas Wind Systems .....
Boliden .....	Marine Engineering .....	Illiad .....	Industrial .....	Sanofi-Aventis .....	Vestra .....
BP .....	Delhaize Group.....8	ImClone Systems.....2	McDonald's.....2	Sanyo Electric .....	Wachovia .....
Bristol-Myers Squibb .....	Deutsche Bank .....	Imperial Energy.....6	Merrill Lynch .....	Schaeffler Group.....20	Warner Music Group.....29
British Airways .....	Diageo .....	InBev .....	Metallinvest .....	SemGroup .....	Wells Fargo & Co. ....18
British Energy Group.....8	Dick's Sporting Goods ..18	Intel .....	Microsoft .....	Shaw Group .....	Wynn Resorts .....
Carlyle Group.....19	DreamWorks Animation	IntercontinentalExchange	Mitsui O.S.K. Lines .....	Sinotrans Shipping .....	Xstrata.....18
Centrica .....	SKG.....7	Jardine Matheson Holdings	Motorola .....	Société Générale.....19	York Capital Management.15
Cerberus Capital	Eastman Kodak .....	.....8	National Hire Group .....	Sony .....	Zentiva.....8
Management .....	Electricité de France.....8	.....8	.....19	.....7,27	.....8
Chevron .....	Enodis.....8	.....8	.....27	.....32	.....3
China Cosco Holdings .....	Exxon Mobil.....6,18	.....8	.....8	.....31	.....15
China Distance Education	Fannie Mae .....	.....8	.....8	.....23	.....19
Holdings .....	Fincantieri .....	.....17	.....8	.....6	.....7
China International Marine	Ford Motor .....	.....8	.....6	.....32	.....22
Containers .....	Fortis .....	.....6,22	.....32	.....23	.....9
China Mass Media	Fossil .....	.....6,18	.....23	.....18	.....19
International Advertising	France Télécom .....	.....18	.....23	.....4	.....6
.....23	.....1,32	.....32	.....19	.....4	.....20
.....22	.....8	.....8	.....19	.....4	.....18
.....18	.....8	.....8	.....19	.....4	.....18
.....23	.....8	.....8	.....19	.....4	.....18
.....17	.....8	.....8	.....19	.....4	.....18
.....23	.....8	.....8	.....19	.....4	.....18
.....23	.....8	.....8	.....19	.....4	.....18
.....23	.....8	.....8	.....19	.....4	.....18

## INDEX TO PEOPLE

This index lists the names of businesspeople and government regulators who receive significant mention in today's Journal.

**WSJ.com** For more people in the news, visit [CareerJournal.com/WhosNews](http://CareerJournal.com/WhosNews)

Abramovich, Roman .....	Dudley, Robert .....	Koduri, Raja .....	Pollard, Paul .....
Anderson, Richard .....	Farley, Jim .....	Kramer, Larry .....	Polovets, Stan .....
Andsimov, Vasily .....	Fordey, Euan .....	Krastev, Ivan .....	Pottier, Benoit .....
Archer, Howard .....	Fridman, Mikhail .....	Krauss, Kate .....	Rohner, Marcel .....
Astbury, Jonathan .....	Fu Shan .....	Kwon, Henry .....	Russo, Patricia .....
Aufhauser, David .....	Futterman, Donna .....	LaNeve, Mark .....	Saw, Michael .....
Baber, Anne .....	Galaev, Magomed .....	Lauer, Len .....	Schaeffer, Richard .....
Baker, Carol J. ....	Garland, Eric .....	Li, Karen .....	Schmieding, Holger .....
Bartolomeo, Eduardo .....	Geoghegan, Michael .....	Lyngen, Ian .....	Scott, David .....
Beccalli-Falco, Ferdinando	Germond, Philippe .....	Ma Boliang .....	Serra, Joe .....
.....4	Green, Stephen .....	Magomedov, Ziyavudin ..21	Sewell, Beth .....
.....4	Guild, David .....	Mapes, Tim .....	Shacknoffs, Kevin .....
.....3	Hayward, Tony .....	Milan, Liz .....	Siegel, Jill .....
Bretton, Thierry .....	Hofer, Dave .....	Mittal, Aditya .....	Soder, Dee .....
Brito, Carlos .....	Holland, Justin .....	Mittal, Lakshmi .....	Sprecher, Jeff .....
Brown, Greg .....	Icahn, Carl .....	Mittal, Pramod .....	Tamas, Tony .....
Burke, Stephen B. ....	Immelt, Jeffrey .....	Miyamoto, Shigeru .....	Tang, Osbert .....
Bush, Nathan .....	Iwata, Satoru .....	Mollenkopf, Steve .....	Tchuruk, Serge .....
Carnean, Doug .....	Jha, Sanjay .....	Mougard, Thomas .....	Tomov, Alexander .....
Carmichael-Jack, Duncan	Johansson, Jerker .....	Murray, Matthew .....	Trenchev, Konstantin ..14
.....19	Johnson, Brian .....	Natalich, Pavel .....	Usmanov, Alisher .....
.....19	Jones, Hannah .....	Newsom, Darin .....	Vekselberg, Viktor .....
Celentano, John .....	Karlsrud, Katherine .....	Norbom, Mark .....	Verwaayen, Ben .....
Coffey, Greg .....	Kato, Kazuyasu .....	Offit, Paul .....	Verwilt, Herman .....
Cox, Christopher .....	Kerviel, Jérôme .....	Owen, James .....	Wei, Jun .....
D'Alessandro, David .....	Keswick, Henry .....	Peddie, Jon .....	Williams, James .....
de Carvalho, Charlene ..17	Klemme, Josh .....	Pedley, Neil .....	Zahariev, Valentin .....
Dorman, David .....	.....29	.....19	Zhevago, Kostyantín ..15

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## LEADING THE NEWS

# Shiite cleric plans peaceful role for Iraq's Mahdi Army

*Continued from first page*  
that its principal goal was withdrawal of U.S. troops from Iraq, and since talks of a time-table have emerged the movement has tried to find itself a second life by transforming itself into a social, cultural and religious organization focused on helping Iraqi society through peaceful means, according to Mr. Obeidi.

Mr. Obeidi said that Mr. Sadr will continue to direct small, special cells for limited military operations against U.S. forces but that more details about these cells and how they can be distinguished from rogue Mahdi Army members who are disobeying a cease-fire order by Mr. Sadr will be publicized at a future date.

"All the Mahdi Army must listen to this and follow this new office, which will have the name al-Mumahidoon," Mr. Obeidi said. "Because Sayeed Muqtada al-Sadr sees that the occupation force is starting to find a formula to pull out troops from Iraq, we are also thinking that our work must focus on guiding and enlightening the people to serve Iraqi society."

This reorganization of the Mahdi Army reflects a major effort by Mr. Sadr to regain grass-roots support and weed out the criminal and extremist elements of the Mahdi Army, which moderate members of the organization believe have tarnished the movement's name. Mr. Sadr, who is believed to be studying in Iran, has expressed frustration at those who have chosen to disobey him by still fighting U.S. and Iraqi security forces, participating in smuggling and kidnapping rings, and assassinating opponents.

But Mr. Sadr faces many challenges in implementing his new direction. The hard-liners and Mafia-like elements of the Mahdi Army will

likely reject Mr. Sadr's new strategy, just as they have ignored his orders to freeze violent activities as part of a cease-fire. These members have also been threatening and assassinating more moderates who support the cease-fire and the move to turn the Mahdi Army into a civic organization, leaving in question whether the moderate members will proactively work to implement the new strategy or stay underground as many of them have.

A similar pattern occurred when former Sunni insurgents began forming the Awakening movement in Anbar province and turned against al Qaeda in Iraq. After joining U.S. forces to form local, informal security groups, some Awakening leaders were assassinated and many others were threatened.

"We know it will take time to get rid of these bad elements, and even some good people joined them because they fell into a trap and became mixed," said Sheikh Abu Ali, a moderate Mahdi Army leader and cleric who had his brother kidnapped by fellow Mahdi Army members because of his views. Since then he has stopped his religious work but is hoping this new strategy will make him feel safe enough to resume his teachings. "We want to go back to the army we started with, go back to our roots."

Over the past several years, the Mahdi Army had enjoyed widespread popular support in areas of Baghdad and in the southern Shiite area of Iraq because it was known to help the poor by giving them money, food and other kinds of aid. But its popularity began to wane as some members turned increasingly to criminal activity, taking control of gas stations, organizing smuggling and kidnapping rings and extorting



Mahdi Army members on a road in Basra, Iraq, in March. Anti-American Shiite cleric Muqtada al-Sadr has proposed **disarming the militia's fighters.**

money from merchants in exchange for protection.

The actions of the Mahdi Army have enormous impact on Iraq's stability, with its fighting over the past several years against U.S. and Iraqi government forces having just as much effect on the country's lack of security as attacks by al Qaeda in Iraq. Most recently, a government military crackdown on rogue members of the Mahdi Army in late March in Basra sparked fighting across southern Iraq and in Baghdad.

U.S. military spokesman Col. Jerry O'Hara said the military welcomed the news, but "the proof is always in the actions and not just the words, so we'll take a wait-and-see approach."

Tahseen al-Shaikhli, spokesman for the Baghdad security plan, said the Iraqi government is pleased to see Mr. Sadr take a rational approach

that will benefit Iraq. "We welcome any news about Iraqis laying down their arms and working to rebuild this country," Mr. Shaikhli said.

In May, Mr. Sadr and the Iraqi government worked out a truce after a government crackdown that began in Basra in late March, and many Mahdi Army members abandoned the fight, were killed, or fled to Iran. While the Mahdi Army has been weakened since those government military operations, the extremist elements are regrouping and being trained, with an estimated 5,000 members in Iran. U.S. military officials worry there is a chance that the extremists could return.

Abu Karar al-Sadri, a Mahdi Army leader in Baghdad's Rusafa neighborhood who has been against the cease fire, says he and his men will continue operations despite this new direction for the Mahdi Army.

He acknowledged that his fighters had been negatively affected by the crackdown but said they are rebuilding and continue operations. "We will continue to fight until the occupation is driven out of Iraq," he said.

Mr. Sadr began moving away from military operations when he ordered a cease-fire last August after Mahdi Army members clashed with government forces in the southern city of Karbala during a Shiite religious holiday. The fighting represented growing rivalry between Sadr followers and supporters of the main Shiite parties in government, the Islamic Supreme Council of Iraq and the Islamic Dawa Party. In February, Mr. Sadr extended the cease fire for an additional six months, saying he still wanted time to reorganize.

Since then, several moderate Sadr followers who favored the cease-fire have been killed. In April, Riyadh al-Nouri, director of Mr. Sadr's office in Najaf, was gunned down following Friday prayers after a rumor circulated that he was supporting the Americans.

Mr. Abu Ali has stopped teaching and gone underground since gunmen abducted his brother and threatened to kill him unless he stopped supporting the cease-fire and speaking out against more extremist members of the militia. Now, he is hopeful that Mr. Sadr's new direction will allow him to begin educating Mahdi Army members again.

"We want people to come back to the Sadr movement and believe in us again," the sheikh said. "We hope this new direction will allow us to rebuild our relationship with the people and make them believe we are good again."

—Iraqi staff in Baghdad contributed to this article.

## TNK-BP finance chief quits in possible win for Russian partners

*Continued from first page*  
mittee in the hands of AAR, the consortium of TNK-BP's Russian partners, marking a key tactical victory in AAR's struggle for control of TNK-BP. It comes 11 days after TNK-BP's chief executive, Robert Dudley, left Russia to manage the oil company from an undisclosed location in Central Europe, complaining of a campaign of "sustained harassment."

The conflict could be a fateful one for BP, which made a bigger bet on Russia than any of its competitors in Big Oil, and whose share price has been depressed for months by the crisis at TNK-BP. The joint venture accounts for a quarter of the British oil major's global production, and nearly a fifth of its reserves—a key focal point for investors.

TNK-BP was launched with fanfare in 2003, under the watchful gaze of then-President Vladimir Putin and British Prime Minister Tony Blair. But since then, the Russian state has gradually expanded its control of the strategic oil and gas sector at the expense of private investors and foreign oil groups, and TNK-BP, a 50-50 joint venture, has increasingly been viewed as an anomaly.

Many observers have long expected a big state-run entity such as OAO Gazprom, the natural-gas giant, or OAO Rosneft to be brought into the company as the majority shareholder.

Expectations of change grew at the end of last year when a lock-in clause keeping the Russian investors in TNK-BP expired. Shortly afterwards, the company and its employ-

ees were subject to a wave of investigations by Russian tax authorities, labor regulators and prosecutors. Those probes focused particularly on foreign nationals.

The Russian partners—Mikhail Fridman of Alfa Group, Len Blavatnik of Access Industries and Viktor Vekselberg of Renova—demanded Mr. Dudley's dismissal, complaining of mismanagement and poor performance at the oil company. BP

### A key issue is who will control TNK-BP's internal financial flows.

stood by the CEO, and accused AAR of seeking to seize control of TNK-BP.

Meanwhile, the administrative pressure built. BP was forced to withdraw from Russia 148 technical specialists it loaned to TNK-BP after they experienced visa problems. Mr. Dudley's inability to obtain a new visa triggered his decision to leave Russia last month. BP has accused AAR of orchestrating the pressure on TNK-BP's foreign staff, a charge the Russian partners deny.

Throughout the conflict, all eyes have been on Russia's new president, Dmitry Medvedev. How the TNK-BP fight plays out is seen as an indication of his attitude to foreign investment and his commitment to the rule of law.

Outwardly, the Kremlin has stayed neutral, saying it was up to the partners to patch up their differences. But some people close to TNK-BP think the kind of regulatory and bureaucratic interference the company has faced would be unthinkable without cooperation from senior Russian officials.

Hopes for a cease-fire in the increasingly acrimonious dispute were raised last week when Tony Hayward, BP's chief executive, met with Mr. Fridman in Prague for the first time in almost two months. The two drew up a list of four points of contention in need of resolution, according to people familiar with the talks. But little substantive progress was made and the two sides remain deeply distrustful of one another, analysts say.

The impasse clinched Mr. Owen's decision to leave, according to a person close to TNK-BP. "He felt that these guys were so far apart that there was no realistic chance of a resolution in the near future," this person said, adding that the financial chief felt he was less and less able to rely on data and other information provided by TNK-BP's financial department. Signing off on accounts whose integrity he couldn't vouch for opened him up to the risk of shareholder litigation, the person added.

Mr. Owen's departure will allow AAR to clinch greater control of TNK-BP and further its goal of seeking to replace Mr. Dudley, analysts say.

"For as long as BP is dragging its feet with nominating a new CEO, AAR is going to step up to the plate

and assume greater responsibilities for managing the organization," said Stan Polovets, chief executive of AAR, on Monday. "We are a 50% shareholder and it's in our interest to have the company be managed effectively and make sure nothing falls through the cracks."

Mr. Owen's resignation has left the company's core executive committee, which had five members, in the Russian shareholders' control. With CEO Mr. Dudley outside Russia and the resignation of Mr. Owen, two of the committee's three remaining members are Russian shareholders.

Others disagreed. The person close to TNK-BP said the core executive committee had no formal decision-making authority.

However, a person close to BP said it looked bad for the company, which is based in London. "This is another step in the corporate takeover," this person said. "They've got the CEO to leave the country, they've got the 148 BP specialists out, and now they've got the CFO to resign."

A key issue is who will control TNK-BP's internal financial flows. As financial chief, Mr. Owen acted as a watchdog, ensuring that money was allocated to projects agreed upon by both shareholders. Now that he is gone, that role is likely to become more opaque. The person close to TNK-BP said the shareholder dispute had already placed a serious strain on governance. "The company has a sensible management structure with fail-safe mechanisms built into it—but not for the extended absence of its CFO," this person said.

Other supervisory structures

have been weakened. A few weeks ago, a senior executive, Matthew Murray, was forced to leave Russia after his visa wasn't renewed. Mr. Dudley appointed Mr. Murray last year to work in TNK-BP's Financial Control department, with a mission to prevent potential corruption and uphold corporate-governance standards. Some officials in the company say there is a risk such scrutiny will weaken in his absence.

TNK-BP will now have to search for a replacement for Mr. Owen, and any candidate will require unanimous board approval—a tricky task with control split evenly between BP and AAR. But there are grave doubts that the company will be able to find any suitable candidates for a job that will be widely viewed in the oil industry as a poisoned chalice.

"There won't be many takers," said the person close to TNK-BP.

### Money & Investing

#### Damage control

Five fund managers discuss what went wrong this year > Page 17



## CORPORATE NEWS

## STEEL

## ArcelorMittal to build mill and buy coke plant



**A**RCELORMITTAL unveiled plans to build a \$600 million steel mill in Mexico and to buy a Pennsylvania coke plant for \$160 million, as it shrugs off U.S. recession fears by beefing up its North American presence.

The world's largest steel company by production said it was still looking at potential sites for the Mexico mill. The plant would produce carbon steel and bars to serve the construction and automotive sectors.

Separately, ArcelorMittal signed an agreement to acquire Koppers Inc.'s coke plant in Monessen, Pa. The plant produced 320,000 metric tons of metallurgical coke in 2007.

—Benoît Faucon

## AIRLINES

## Lufthansa cancels flights as pilots weigh a strike



**G**ERMANY'S pilot union, Vereinigung Cockpit, which represents around 5,000 pilots, said it expects its members at Deutsche Lufthansa AG to strike amid a wage dispute.

"There is no decision yet, but we expect warning strikes across the board, relatively soon" said a union spokesman. Pilots at Lufthansa's Cityline and Eurowing units are

asking for higher wages after six years without raises, he said.

On Friday, the airline reached a wage deal with services union Ver.di, after a six-day strike of its ground personnel. Nevertheless Lufthansa cancelled 130 domestic and long-haul flights on Monday.

—Roundup

## AUTOMOBILES

## July new-car registrations increase 2% in Germany



**N**EW-CAR registrations in Germany rose 2% in July as high fuel prices and pessimistic economic prospects weighed on Europe's biggest auto market, said the German auto-maker association VDA.

In July, 262,600 new cars were registered in Germany, while for the first seven months, car sales were up 3% to 1.9 million vehicles. German car exports were down 6% at 338,100 last month, but still showed the second-best results for July, which is a seasonally weak month, VDA said. Daimler AG's compact model Smart recorded a 33% rise in sales in the first seven months of the year, while the Mini helped BMW AG generate 7% growth, according to the German Department of Motor Vehicles.

## Delta will offer Wi-Fi on its U.S. flights

September rollout is planned; access will cost \$9.95 to \$12.95

BY SCOTT MCCARTNEY

**D**ELTA AIR LINES Inc. will provide wireless Internet access throughout its entire domestic fleet, enabling travelers to work or surf at 33,000 feet.

The service, to be announced Tuesday, will be available on some planes as soon as September, starting with Delta's MD-88 jets. By the end of the year, Delta will have 75 planes outfitted, with its entire 330-plane domestic fleet up and running by next summer. While several airlines have been testing airborne wireless Internet connections, Delta is the first major carrier to commit to installing Wi-Fi on every airplane.

Airlines have debated for years over what new technology to install in planes—whether customers want satellite-television broadcasts, better movies and entertainment, wireless Internet connections or cell-phone service. The winner appears to be Internet hot spots. One factor swaying the debate: the proliferation of hand-held Internet devices, such as smartphones and iPods. Other carriers, including AMR Corp.'s American Airlines, Southwest Airlines Co. and JetBlue Airways Corp., plan to offer Internet access in their fleets well.

Beyond consumer demand, Wi-Fi works for airlines for other reasons as well. The service will be priced similar to wireless connections rates at high-end hotels—\$9.95 for flights under three hours and \$12.95 for a longer itinerary—and offers airlines a chance to earn ancillary revenue. In addition, it's easy and cheap to install. While some carriers with smaller fleets have won over customers with satellite television, older carriers with large fleets balked at the large expense of retrofitting equipment into their planes.

US Airways Group Inc. has even gone as far as deciding to remove in-flight movie systems from its domes-



tic jets to save weight and reduce fuel burn. Older systems with grainy video on small monitors have become passe now that travelers are bringing their own video players with much higher-quality screens and more entertainment options.

For travelers, having wireless Internet can be a mixed blessing. While the service allows you to stay connected to email, conduct Internet research, plug into corporate networks and stay in touch with news, it does end the isolation of an airplane flight,

one of the last refuges from the always-connected world.

For many, a long airplane flight across the country will no longer be an escape. Instead of watching a movie, reading a book or trying to sleep, passengers may feel more compelled to answer email and stay in touch with colleagues and clients.

"Time on an airplane was either time lost or time found," said Tim Mapes, Delta's vice president of marketing. "This is going to totally change the dynamics of what a busi-

ness trip is."

Delta Chief Executive Richard Anderson said his company asked 15 of its largest corporate customers if they preferred in-flight live television or in-flight Internet access. "Overwhelmingly they wanted to be more productive," Mr. Anderson said.

Travelers have grown accustomed to wireless connectivity at airports, hotels and coffee shops. Just about the only unconnected part of a trip now is during flight. "Our customers are demanding of us the same type of wireless service they have on the ground," Mr. Mapes said.

Delta's service will be provided by Aircell LLC, a closely held Colorado company that specializes in communications for private jets. Aircell paid \$31.3 million at a Federal Communications Commission auction in 2006 to take over radio frequency once used for air-phone service and reallocate it to Internet service for jets.

Aircell developed a network of 92 ground-based antennas across the U.S. The antennas work with planes as high as 45,000 feet and have a radius of about 350 miles. Hot spot antennas on planes communicate with laptops and other devices onboard, then the Aircell system sends data back and forth to the ground.

The Aircell system, called Gogo and already advertised in airports, doesn't offer connections for over-water international flights. That re-

quires satellite-based communications, which so far have proven to be slower for users, cost more and require more equipment on planes.

Gogo offers full Internet access, Aircell says, including Web, instant messaging and email, as well as access to corporate networks over a VPN connection. Any passenger with a Wi-Fi-enabled laptop—or a cell-phone with Internet capabilities—will be able to do almost everything he or she could do online on the ground: email, texting, surfing, downloading and uploading or streaming video and audio. The system will be disabled during takeoff and landing.

Gogo is a data-only network, meaning that it doesn't allow voice service over the Internet. Delta says even if a passenger hacked his or her way to a telephone connection, phone conversations would be banned in-flight.

The system requires installing antennas and wiring, but isn't very heavy so it doesn't add much weight to planes, minimizing additional fuel expense. Gogo can be installed on planes overnight by Delta mechanics, the airline said. The service could even be installed in regional jets, which were traditionally too small for in-flight entertainment systems.

The system is designed so that every person on the plane could log on at the same time, but that could slow down transmission speeds.

## GE expects more orders from 2012 Olympics

BY AARON BACK

**BEIJING**—General Electric Co., a sponsor of the Beijing Olympics, expects to receive more industrial-equipment orders for the 2012 London Olympics than it booked for this year's Games.

"We are going to sell much more than \$700 million for the London Olympics," GE International Chief Executive Ferdinando Beccalli-Falco said. GE expects around £50 billion, or roughly \$100 billion, to be spent annually until 2012 on infrastructure and other improvements around London, he said.

Beijing spent an estimated \$42

billion preparing for the Games. GE's \$700 million in industrial-equipment sales for the games ranged from security systems to medical equipment, Chief Executive Jeffrey Immelt said last month.

GE expects revenue from China this year to reach about \$5 billion, up from \$4.4 billion last year. That figure is set to double over the next three years, GE China President Mark Norbom said.

GE's growth in China fits with an ever-greater portion of its revenue coming from outside the U.S. In the

second quarter, 54% of GE's revenue came from abroad, up from 51% last year, Mr. Beccalli-Falco said. "It will be 60% within a couple of years."

Mr. Norbom said he sees huge potential for GE in China following the Games. "As China gets more serious about air-quality concerns," he said, "it's got to turn away from coal and go towards other things," including wind, clean coal, natural gas and solar power.

This year's Olympics have prepared GE to supply other major events in China, Mr. Beccalli-Falco



Jeffrey Immelt

said. "We learned how to develop major projects like the Olympic Games, which before we were not really able to do, because we had a more engineering kind of approach, to sell a specific item or a specific application," he said.

GE also will apply lessons learned in Beijing to the Shanghai World Expo and the Asian Games in Guangzhou, China, both in 2010, Mr. Norbom said. The buildup of casinos in Macau is an opportunity for GE to sell equipment for lighting, security, energy and water treatment on a grand scale, he said. Macau surpassed Las Vegas in gambling revenue in 2006.

**CHEVRON PRESENTS: ENERGYVILLE**

An energy game developed by The Economist Group

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To help encourage greater understanding and discussion toward solutions, Chevron brings you Energyville, an online, interactive game that puts you in charge of meeting the energy demands of your city. It's a chance to put your theories into practice. Choose from a portfolio of energy sources to power your city today, and through 2030. Every decision you make will affect the environment, the economy, and your city's security.

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## CORPORATE NEWS

# Crossovers come up short

Auto makers' hopes for wagon-like cars dim as sales wane

BY MATTHEW DOLAN  
AND SHARON TERLEP

Already struggling with a downturn tied to gasoline prices, auto makers have another headache to deal with—falling crossover-vehicle sales.

Crossover vehicles, car-based wagons designed to look and function like sport-utility vehicles but with modestly better fuel economy, were booming coming into 2008. But sales have dropped off as consumers have flocked to less-expensive and more-efficient passenger cars.

This is forcing auto makers to further rethink a business model largely dependent on the sales and profits of large vehicles.

Despite a flood of new models in the segment, sales of crossovers were down 11% in July compared with July 2007, according to Autodata Corp., representing the third straight month of declines amid a wider downturn in the overall market.

Even though the segment continues to outperform vehicle sales in general, and despite car companies' big hopes for crossovers, auto makers have been forced to scale back production plans as sales of crossovers have missed the mark.

Crossovers were supposed to be a cushion buffering auto makers against the SUV decline that has been picking up steam in recent years.

Designed to look like truck-based SUVs, these vehicles behave more like station wagons because they are built on lighter car chassis, with the goal of being more fuel-efficient.

Because of this, auto makers touted vehicles such as the Edge by Ford Motor Co. and General Motors Corp.'s Buick Enclave as the perfect bridge for consumers who wanted a way out of their gas guzzlers but didn't want to sacrifice size.

But instead of boosting crossover sales, demand has been crippled.

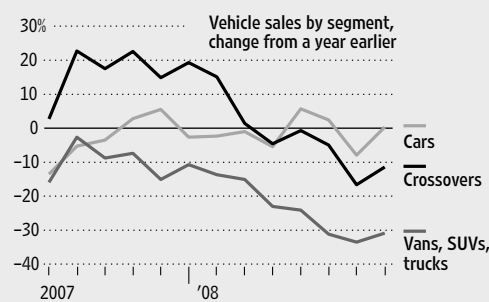
"With gas hovering around \$4 a gallon, even the crossover category continues to show signs of slowdown, as many consumers looking to replace traditional trucks are experiencing falling resale value of their old vehicles, freezing buyers out of the crossover market and



The 2008 Ford Edge is one vehicle that combines the features of SUVs and cars.

## Speed bump

Auto makers hoped that crossovers would be a cushion buffering them against declining sport-utility vehicle purchases.



Source: Autodata

pushing them to look at options such as compact and midsize cars," Lehman Brothers analyst Brian Johnson wrote last month.

"Anybody with a large SUV [is] coming in and finding out how much the market's changed," said Joe Serra, a dealer who does business in Michigan and Alabama.

Crossovers are generally costly products, meaning consumers may not be able to swallow losses on SUVs and still afford to stay in the large-vehicle market.

"They're expensive vehicles at a time when there's a lot of economic uncertainty and distress," said Mark LaNeve, North American sales chief for GM. GM's Saturn Outlook costs \$29,000, or \$13,000 more than the smaller Saturn Astra hatchback.

Ford marketing chief Jim Farley said about half of the 30,000 customers who have traded in pickup trucks in recent months have seriously considered buying a Ford Focus compact car, which has been Ford's biggest success this year.

Sales of the Focus were up 16% in July and are up 26% year to date when compared with the year-earlier periods.

The Focus may be selling well, but its margins are razor thin. As the Focus sizzles, Ford's bet on higher-margin crossovers isn't paying off as expected.

Ford is counting on crossovers

to continue gaining market share over the next five years and had intended to add a third shift of production at the Oakville, Ontario, plant where the new seven-passenger Flex wagon and other crossovers are assembled. But that plan was abruptly suspended last month.

Toyota Motor Corp. and GM are launching new crossovers later this year.

In a slide show for investors during a presentation related to the \$15.5 billion second-quarter loss announced Friday, GM pointed to only one vehicle in North America as a key upcoming product launch: a large crossover wagon called the Chevrolet Traverse.

Toyota, meanwhile, is betting on its Venza crossover, due in October, to fuel its run for more market share.

In July, sales of two of the most recently redesigned crossovers plummeted. Sales of Toyota's Highlander fell 24% in July, while the Honda Pilot's slid 43%, prompting the Japanese auto makers to offer as much as \$1,000 in discounts on new models.

Toyota recently scaled back production plans for the Highlander, and Honda Motor Co. has cut Pilot output.

—Jeff Bennett  
contributed to this article.

# China, India competing to buy Imperial Energy

China and India are facing off yet again in the race to secure energy resources to fuel their economic growth, this time in Russia's Siberian oil fields.

China Petroleum & Chemical Corp., known as Sinopec, has joined

By Bruce Stanley and Nisha Gopalan in Hong Kong and Jackie Range in New Delhi

the bidding for London-listed Imperial Energy Corp., which primarily produces oil in Russia, a person familiar with the situation said Monday. India's state-owned Oil & Natural Gas Corp. has already offered about \$2.5 billion for Imperial Energy, according to another person with knowledge of that offer.

Zhang Zheng, deputy director of Sinopec's foreign affairs bureau, said he knew nothing about his company's offer for Imperial Energy and hadn't heard of the British company. Officials at ONGC weren't available for comment.

Imperial Energy confirmed in a statement Monday that it had received another approach relating to a possible cash offer, but didn't elaborate. The company said in a July 15 statement that it had received a cash offer of 1,290 pence (\$25.46) a share, but didn't name the offering company.

China and India, the world's two most populous nations, rely on energy imports and have frequently butted heads in their efforts to invest in oil assets overseas, primarily in developing nations. The Sino-Indian rivalry has helped drive up the price of oil and gas fields around the world. Chinese companies bested ONGC or one of its affiliates in energy deals in Kazakhstan and Ecuador in 2005 and in Nigeria in 2006.

"I think it's pretty clear that China wins every time the two go head to head in either buying equity stakes in oil blocks or companies. India doesn't have China's deep pockets—it's as simple as that," said Seema Desai, a London-based analyst at consulting firm Eurasia Group.

China and India have cooperated at times in their respective quests. In December 2005, a joint venture between ONGC and state-run China National Petroleum Corp. successfully bid for a stake in Petro-Canada's oil field in Syria.

China has been increasingly assertive in trying to secure energy assets. It recently put pressure on neighboring Vietnam and on Exxon Mobil Corp. over an oil-exploration project in the South China Sea.

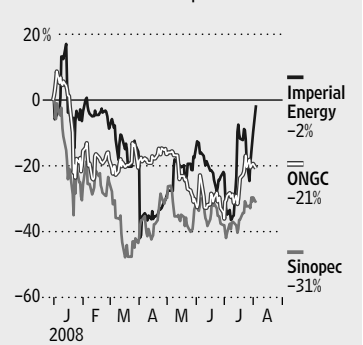
Yet China has had its share of setbacks, most notably the collapse of a \$18.5 billion bid in 2005 by China National Offshore Oil Corp., known as Cnooc, to buy Unocal Corp., in the face of U.S. political resistance. Sinopec and Cnooc also failed two years before that to acquire stakes in the enormous offshore Kashagan field in Kazakhstan.

More recently, China has succeeded in extending its reach by taking a more benign approach. Cnooc unit China Oilfield Services Ltd. last month launched a \$2.5 billion friendly takeover of a Norwegian oil-field services provider, Awilco Offshore ASA.

It wasn't immediately clear how much Sinopec or ONGC is offering for Imperial Energy. Based on Imperial Energy's closing price Friday of

## Energy race

Year-to-date stock performance



Source: Thomson Reuters Datastream

1,074 pence a share, it has a market capitalization of about £1.1 billion (\$2.2 billion). On Monday, Imperial Energy rose 8% to 1,160 pence.

"I don't know at what price Sinopec would be bidding, but it is a possibility that ONGC may revise its bid," said Sudeep Anand, a Mumbai-based associate vice president with financial-services firm Religare Securities Ltd. Imperial Energy said there could be no certainty that any offer would be made for the company.

A deal would add to either ONGC's or Sinopec's existing Russian holdings. Imperial Energy operates a cluster of oil fields in the Tomsk region of western Siberia, which it said in a filing earlier this year holds proven and probable reserves totaling 920 million barrels of oil and gas equivalent.

Imperial Energy produced an average of 10,000 barrels of oil a

## The London-listed company operates a cluster of fields in Western Siberia.

day at the end of 2007. Last year, it said it wanted to raise production to 25,000 barrels daily by the end of this year. The company's output slipped to 7,000 barrels a day in the first quarter, but it blamed "technical and logistics issues" and maintained its daily production target of 25,000 barrels by year end.

Sinopec is a minority partner with OAO Rosneft in two smaller Russian projects. The Chinese company's oil-equivalent reserves in Russia equal about 540 million barrels as of Jan. 1, 2009, said Paul Fieldsend, an analyst at energy consultancy Wood Mackenzie in Edinburgh. ONGC controls 20% of the Sakhalin-1 project led by Exxon Mobil in eastern Russia.

Russia's oil and gas fields have proved treacherous for other foreign investors. When Royal Dutch Shell PLC announced that costs at the Sakhalin-2 project had nearly doubled, Russian environmental regulators bombarded it with complaints until Shell sold a majority stake in the project to a Kremlin-run gas company in 2006. BP PLC is now embroiled in a bitter dispute with local shareholders in its largest Russian investment, a joint venture called TNK-BP Ltd.

—Aries Poon and Rick Carew in Hong Kong  
contributed to this article.

# Fortis posts 49% drop in profit

BY STEFAN KLOET

Dutch-Belgian bank and insurance company Fortis NV posted a 49% decline in second-quarter net profit and gave a cautious outlook, saying "the overall economic environment is becoming more difficult."

Net profit fell to €830 million (\$1.29 billion) from €1.62 billion last year, mainly because of a decline in the value of its loans and investment portfolio and as the company wrote off €362 million from its net thanks to the credit-market turmoil.

Fortis shares fell 3.2% in Amsterdam trading Monday.

Total income in the quarter, which includes interest income, insurance premiums, fee and commis-



Source: the company

which booked solid treasury and financial-markets results.

Profit from its banking division before divestments fell to €465 million from €1.16 billion, while profit from its insurance division edged up to €423 million from €413 million.

Fortis's interim chief executive, Herman Verwilt, said the company's businesses, including ABN Amro, performed satisfactorily "in turbulent market conditions" but added that "the credit turmoil will take us into 2009."

Analysts pointed at the group's solvency base as a key concern.

Mr. Verwilt succeeded ousted CEO Jean-Paul Votron, who on July 11 was forced to step down in the wake of mounting shareholder unrest over Fortis's €8.3 billion solvency plan.

sions and other items, rose 9.8% to €32.5 billion, boosted by the lender's merchant-banking division,

## CORPORATE NEWS

# Intel offers tech overview

*Larrabee chips aim to secure a foothold in high-end graphics*

BY DON CLARK

Intel Corp. Monday provided the first details of a chip technology that is designed to help break into new markets, starting with high-end graphics used for computer games and animation.

The company says the technology, code-named Larrabee, will be the basis for a series of chips that have far more than the two to four electronic brains found on its current microprocessors. Intel isn't being specific, but industry executives expect initial Larrabee models to have 12 to 48 calculating engines.

Dividing up computing jobs to be handled by many microprocessors isn't a new idea. Indeed, Larrabee-based chips—not slated to hit the market until late 2009 or early 2010—will be taking on two entrenched rivals that already use many special-purpose processors.

Nvidia Corp. sells a high-end chip with 240 such processors to carry out chores such as applying colors to each of the tiny dots that make up a picture on a display screen. Advanced Micro Devices Inc., which entered the field through its 2006 purchase of ATI Technologies Inc., has a model with 800 processors.

Intel is also using some special-purpose circuitry in Larrabee. But most calculating jobs will be handled by general-purpose microprocessors—known by the designation x86—that are a mainstay of personal computers.

"This is the first new architecture developed for computer graphics in the last 10 years," says Jon Peddie, who heads a firm called Jon Peddie Research that tracks the field.

Intel now offers only low-end graphics circuitry as a part of other



Intel's Larrabee technology is designed to render images in videogames, like this scene from **Gears of War 2**.

sets of accessory chips. Mr. Peddie estimates Intel could gain as much as \$4.6 billion in new revenue in 2010 if it matched Nvidia's and AMD's market shares in specialized products, known as GPUs or graphics-processing units.

That is a big "if." Nvidia and AMD executives dispute Intel's contention that Larrabee chips can surpass their products in running existing computer games. For one thing, Intel will be relying largely on software to emulate functions that are now accelerated with special-purpose GPU hardware.

"I'm sure they can make it work, but the big question is how well it will work," says Tony Tamasi, an Nvidia senior vice president.

Besides raw performance, Larrabee faces challenges in matching the power consumption and manufacturing cost of GPUs, says Raja Koduri, the chief technology officer of AMD's graphics-products group. If it isn't competitive in all three areas, "the consumer is not going to accept it," he says.

Doug Carmean, Intel's chief architect for Larrabee, says the technol-

ogy has advantages over GPUs, including a large data repository called a cache that eliminates delays associated with fetching information from separate memory chips. Processors on Larrabee chips also will communicate at very high speed, using a data pathway configured as a ring, he says.

But Larrabee's biggest selling point comes from the fact that a large number of programmers know how to exploit x86 microprocessors, which Intel expects to inspire an array of new software in fields such as oil and gas exploration and medical imaging. One potential user is DreamWorks Animation SKG Inc., which in July cited Intel's coming technology in shifting from AMD chips for servers and workstations used to make animation. Over time, Intel expects Larrabee's potential to spur faster progress in finding new ways to create programs that exploit many microprocessors.

"We see a major sea change coming, and Larrabee is one of the catalysts," says Dave Hofer, director of marketing for Intel's visual-computing group.

# Nike seeks to curb abuse of workers in Malaysia

Nike Inc. said it has taken steps to correct worker-abuse problems in a factory it uses in Malaysia, an action that the athletic-apparel giant said reflects its concerns about the country's chronic labor shortage and how it affects factory workers.

Nike on Friday alleged abuse at Hytex Integrated Bhd., a Kuala Lum-

By **Nicholas Casey** in Los Angeles and **Raphael Pura** in Kuala Lumpur, Malaysia

pur-based garment manufacturer that owns a factory producing Nike T-shirts. Nike, which is based in Beaverton, Ore., said it had completed its initial investigation into "claims of unacceptable living conditions, withholding of worker passports and garnishing of wages" that began after an Australian television report last month alleged worker mistreatment at Hytex.

In some cases, migrant workers complained that their passports were confiscated by managers, said Hannah Jones, Nike's vice president of corporate responsibility. The practice may have been used by the factory to compel workers to pay their own employment-permit fees, ordinarily paid by the company, she said. Nike said that all current employees will be reimbursed for fees associated with employment while from now on, any such fees "will be paid by the factory as a cost of doing business."

Also, Nike said it found that the majority of housing for employees was "unacceptable." It said all workers will be transferred to new Nike-inspected housing within a month.

Michael Saw, executive director of Hytex, said the company met Nike compliance officials about two weeks ago to discuss violations of Nike's code of conduct for foreign contract manufacturers and that Hytex has "rectified" the issues. "We have been working for Nike for the past 15 years," Mr. Saw said, maintaining that the allegations of abuses by the Australian reporter were "out of proportion" to the facts.

Like many businesses in Malaysia, Hytex depends on migrant labor.

The country has an estimated 2.1 million foreign workers legally employed. Estimates of illegal workers range from 500,000 to 1.2 million.

The recent issues highlight a growing concern for Nike's manufacturing operations in Malaysia, where the U.S. company focuses primarily on apparel. The country, once viewed by the industry as a possible alternative to China for manufacturing, has found itself crippled by a labor shortage as a prospering populace of 27 million shifts away from factory jobs.

That has left Malaysia dependent on workers from as far as Nepal and Pakistan, who are offered fewer rights in the country, setting the stage for the kinds of abuses that can embarrass American partners. Nike itself has battled criticism of its labor practices on and off since the 1990s.

The Malaysian government has tried, with limited success, to impose order on the migrant-worker situation. Labor officials have vowed to prosecute employers who break labor laws and have periodically announced crackdowns. But corruption, porous borders and lack of strict legal enforcement have impeded progress.

"Many Malaysian policies for bringing in migrant labor into the country are enabling some of the behavior we think is unacceptable," said Nike's Ms. Jones. "The issue of foreign migrant labor is very new to us."

Hytex's Mr. Saw said Malaysian garment operations like his company are almost completely dependent on migrants. "We have no choice," he said. "Malaysia is not a third-world country anymore ... Malaysians don't like factory work. If you ask them to do things like sewing, they're not interested."

Mr. Saw complained that the TV report alleged that Hytex and other Malaysian contract garment makers used "forced labor," a charge he disputed. He said the workers at the apparel plant—mainly from Bangladesh and Vietnam—held Malaysian work permits and were legally recruited through employment agencies.

# Sony to raise output of batteries

BY KENNETH MAXWELL

TOKYO—Sony Corp. became the latest Japanese company to step up investment in the booming business for lithium-ion batteries, saying it will pay 40 billion yen, or about \$375 million, to increase domestic output of the cells that power many consumer-electronic products.

Sony, maker of the PlayStation videogame and the Walkman music players, said the investment is part of a drive to nearly double monthly output of the cells within two years.

The rechargeable batteries are used in devices such as mobile phones, laptop computers and digital cameras.

Sony said the investment, along with plans to expand lithium-ion-battery operations in Singapore and China, should increase its monthly output capacity from the current 41 million cells a month to 74 million a month in fiscal 2010.

That should help it keep pace with rival Matsushita Electric Industrial Co., maker of the Panasonic brand of consumer electron-

ics. Matsushita recently unveiled a major drive to beef up its relatively small presence in lithium-ion-cell manufacturing, pledging 100 billion yen to build a plant in western Japan that should help it triple production to about 75 million cells a month.

In early July, Sanyo Electric Co. confirmed that it plans to invest 125 billion yen to develop its rechargeable-batteries business over the next three fiscal years in a move to increase output to about 90 million cells a month from 70 million.

# Hynix says U.S. to drop chip tariff

BY IN-SOO NAM

SEOUL—Hynix Semiconductor Inc. Monday said the U.S. Commerce Department has decided to remove a 23.78% punitive tariff on the import of its dynamic random-access memory, or DRAM, chips.

The department, in an earlier preliminary ruling, said it would lower countervailing subsidies on DRAM shipments from 2006 to 4.91%.

The preliminary ruling is expected to be finalized Nov. 20, the

company said. Should the final ruling be consistent with the preliminary ruling, Hynix would no longer face punitive duties on its DRAM shipments.

"Once finalized, we won't be obligated to deposit money for that purpose anymore. That means we'll be completely free from U.S. punitive duties," said Hynix spokeswoman Seong Ae Park.

The U.S. began imposing a countervailing tariff on the import of DRAM chips made by Hynix in 2003, alleging that the chip maker's previ-

ous bailout by government-linked creditor banks amounted to unfair subsidies.

Hynix, the world's second-largest DRAM maker by revenue after Samsung Electronics Co., said in March the countervailing duty imposed in 2005 by the U.S. on its DRAM chips was retroactively reduced to 23.78% from 44.29% earlier. As a result, Hynix will receive \$1.4 million plus accrued interest from the authorities, the company said at the time.

# Kirin earnings quadruple on stock swaps at drug unit

BY HIROYUKI KACHI

TOKYO—Kirin Holdings Co. of Japan reported that its first-half net profit soared, with contributions from group companies including drug maker Kyowa Hakko Kogyo Co. canceling out the negative effects of higher raw-materials costs.

Kirin, which holds a 46% stake in Australia-based brewer Lion Nathan Ltd. and 20% of San Miguel Corp. of the Philippines, also said it is ready to spend an additional 300 billion yen (\$2.8 billion) through 2012 on growth strategies, including mergers and acquisitions, mainly on soft-drink and alcohol beverage activities in the region.

Tokyo-based Kirin said its net profit for the half to June 30 rose more than fourfold, to 81.12 billion yen, from 16.80 billion yen a year earlier.

"We saw a changing environment, which was more rapid than we expected," stemming from higher

materials costs and a slump in domestic demand, said Kirin President Kazuyasu Kato.

But the consolidation of Kyowa Hakko that took effect in April and the strength of Lion Nathan helped boost Kirin's profitability. Kirin now has a 50.1% stake in Kyowa Hakko.

A special profit valued at 72.6 billion yen from stock swaps in the process of the Kyowa Hakko consolidation added to Kirin's net profit growth.

Kirin posted a 25% rise in interim sales, to 1.048 trillion yen from 836.02 billion yen a year earlier.

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**GLOBAL BUSINESS BRIEFS**

**L'Air Liquide SA**

**Cost savings helped net expand 8.1% in first half**

French industrial-gases company L'Air Liquide SA's said first-half net profit grew 8.1% thanks to its cost-savings and growth program and strong performance of its gas division as higher input costs were passed on to customers. Net profit in the first half rose to €601.4 million (\$934.6 million) from €556.5 million a year earlier, while revenue was up 13% to €6.37 billion from €5.63 billion. Chairman and Chief Executive Benoit Pottier said the company hadn't seen lower demand in Western Europe, North America and Japan. Air Liquide said it expects double-digit growth in full-year net profit, excluding currency fluctuations.

**Delhaize Group**

Belgian supermarket chain Delhaize Group posted a 43% rise in second-quarter net profit thanks to lower taxes and charges, but said sales were hit by a slowdown in consumer spending and a weaker U.S. dollar. The company, which operates the Food Lion, Hannaford and Sweet Bay chains in the U.S. as well as Delhaize supermarkets in Belgium, said net profit rose to €116.3 million (\$180.7 million) from €81.4 million a year earlier, when it booked a €103.8 million charge related to a debt-refinancing deal. This year's figure was also helped by a drop in the tax rate to 22.6% from 27.1%. However, sales fell 7.5% to €4.45 billion, weighed down by the slowing economy in the U.S. and Western Europe as well as the weaker dollar. Delhaize said that both in the U.S. and in Belgium the number of items purchased per visit was declining, reflecting more prudent consumer spending.

**Iliad SA**

French telecommunications and internet operator Iliad SA said its first-half revenue rose 21% as a strong performance of its broadband-services business offset a slowdown in its traditional telephony division. First-half revenue increased to €692.2 million from €574.1 million in the year-earlier period. Even though Iliad also reported a 19% increase in its second-quarter revenue to €352.2 million, its release focused on the first six months of this year. First-half revenue in Iliad's broadband-services business was up 22% to €679.6 million, while revenue in its traditional telephony division fell 34% to €12.6 million. Iliad also confirmed its full-year outlook, which targets 3.25 million broadband subscribers by the end of the year.

**Zentiva NV**

Generic drug maker Zentiva NV reported a 16% rise in second-quarter net profit, as an impairment charge dragged down a 32% sales increase. The Czech company, a takeover target of France's Sanofi-Aventis SA, said net profit rose to 363.3 million korun (\$23.6 million) from 312.4 million korun a year earlier, while revenue, which the company had reported last month, increased to 4.5 billion korun from 3.42 billion korun. Zentiva booked a 191.3 million korun impairment charge after it stopped some development projects in Turkey and Romania, saying better alternative projects are in the works. Although Zentiva posted significantly lower sales in several key markets, its Turkish unit, which was first consolidated in last year's second quarter, accounted for 1.2 billion korun in sales.

**British Airways PLC**

British Airways PLC, which is already in talks with Spain's Iberia Lineas Aéreas de España SA over a merger, hopes to seal an alliance with its U.S. partner American Airlines within weeks. BA spokesman Euan Fordyce said the carrier expected final preparations for a deal to be completed within two weeks, and an application to U.S. regulators for anti-trust immunity to be filed shortly afterward. BA and AMR Corp.'s American, the world's largest carrier by revenue passenger miles, have failed in the past to win an exemption from U.S. competition laws to work more closely together because of their dominance at London's Heathrow. However, they are expected to argue that the competitive situation has changed since the "open skies" agreement between the U.S. and the European Union came into force in March.

**Centrica PLC**

U.K. utility Centrica PLC confirmed it was in talks with a third party, widely believed to be Electricité de France SA, on taking a minority stake in U.K. nuclear generator British Energy Group PLC. The confirmation came as talks between British Energy and EDF over a takeover valued at about £12.2 billion (\$24.1 billion) stalled after shareholders rejected the French utility's offer. EDF declined to comment. Centrica, the U.K.'s largest utility by customer numbers, said that it had other alternatives if the party didn't proceed with a formal offer for British Energy or if discussions between Centrica and the third party failed. Centrica is believed to have its eye on a 25% stake in British Energy if a takeover with EDF is successful, according to people familiar with the matter.

**Lend Lease Corp.**

Lend Lease Corp., Australia's largest property developer, warned its net profit for the fiscal year that ended June 30 may fall by as much as 47%, and in the current fiscal year earnings may decline 15%. Lend Lease's net profit in 2007-08 is expected to be 265.4 million Australian dollars (US\$246.6 million), down from A\$497.5 million a year earlier. The company also cut property valuations by A\$60.2 million. Shares in Lend Lease fell 13% to A\$8.66 on the profit warning, which included a A\$121.5 million write-down of the value of real estate held by its U.K. communities business, Crosby Lend Lease. The write-down was the third for the developer of London's 2012 Olympic Village the company in the U.K. in as many years. Lend Lease will release its earnings this month.

**Metalloinvest**

Russian metal and coal company Metalloinvest, which is in merger talks with Kazakh copper miner Kazakhmys PLC, said 2007 net profit more than doubled to 29.5 billion rubles (\$1.26 billion) from 12.5 billion rubles in 2006. It was the first time that the company, co-owned by Russian billionaires Alisher Usmanov and Vasily Anisimov, reported earnings under international financial reporting standards. Revenue almost tripled to \$6.7 billion, while earnings before taxes, depreciation and amortization came to \$2.4 billion from \$849 million in 2006. Metalloinvest produces 40% of Russia's iron ore, operates the country's two largest iron mines, and holds the world's largest reserves of the steel-making raw material. It is planning an initial public offering in London this fall. Global iron-ore prices have quadrupled in the past five years.

**Blackstone Group LP**

U.S. private-equity firm Blackstone Group LP, in which China's sovereign-wealth fund holds a stake, has opened an office in Beijing in an effort to expand its business in the world's most populous country. Blackstone appointed Fu Shan to head the office. Mr. Fu is the former vice president of Shenzhen-listed real-estate-investment firm Beijing Mainstreets Investment Group Corp. Before that, he worked for several government agencies, including the National Development and Reform Commission. The Beijing office is Blackstone's first in mainland China; it already had an office in Hong Kong. The firm hasn't been operating in China as long as other private-equity firms such as the Carlyle Group, but it has been active the past two years.

**Fincantieri SpA**

Italian shipbuilder Fincantieri SpA signed a definitive agreement to buy Manitowoc Marine Group, a shipbuilding unit of Manitowoc Co., for \$120 million. The marine business, which has facilities in Wisconsin and Ohio, builds, repairs and converts ships. Lockheed Martin Corp. has agreed to become a minority investor, Fincantieri said. Fincantieri has been working with Lockheed Martin, building Italy's first Littoral Combat Ship. Fincantieri, which is owned by the Italian government but doesn't receive state subsidies, builds both cruise and military ships. Manitowoc said the sale will allow it to focus on its crane and food-service businesses. The company intends to use proceeds for general corporate purposes, which include paying down debt from the pending acquisition of Enodis PLC.

**Cia. Vale do Rio Doce**

Brazil's Cia. Vale do Rio Doce said it signed a \$1.6 billion shipbuilding contract with China's Rongsheng Shipbuilding & Heavy Industries Co. Rongsheng will build 12 iron-ore carriers for Vale, each with a capacity of 400,000 deadweight tons. The first of the vessels is expected to be delivered in early 2011, and the order is expected to be completed in 2012. "We're very, very optimistic about the iron-ore trade market," said Eduardo Bartolomeo, Vale's executive director of logistics. The addition of the 12 largest ore carriers to be built in the world will help Vale, the world's biggest iron-ore producer, cut the utilization rates of its vessels, Mr. Bartolomeo said. The fleet will have an estimated capacity of 30.2 million metric tons of iron ore a year from Brazil to Asia.

**Jardine Matheson Holdings Ltd.**

Jardine Matheson Holdings Ltd. said first-half net profit rose 28% on strong growth in its Indonesian auto unit and buoyant property rental markets in Hong Kong and Singapore. The Singapore- and London-listed conglomerate, which gets most of its earnings from Southeast Asia and greater China, expects inflation and rising interest rates to make trading conditions challenging. Jardine said net was \$1.02 billion, up from \$793 million a year earlier. Revenue rose 25% to \$11.47 billion. "After a good start to the year, the current momentum should carry forward to a satisfactory result for 2008, despite some slowing in the second half," Chairman Henry Keswick said.

—Compiled from staff and wire service reports.



## ECONOMY &amp; POLITICS

## ITALY

## Soldiers deployed in cities as counter to street crime



HUNDREDS of soldiers were deployed in cities across Italy on Monday as part of government measures to fight street crime.

In Rome, an initial 400 men and women were stationed at subway and railway stations and at an immigrant center, the Defense Ministry said. They were not expected to be deployed immediately in the capital's historic center. In Milan, some 150 soldiers were patrolling the Duomo cathedral and sensitive sites such as the U.S. consulate and the city's synagogue. Soldiers were also deployed in Naples, Bologna and Palermo, Italian reports said.

—Associated Press

## EURO ZONE

## IMF sees inflation falling below 2% mark next year



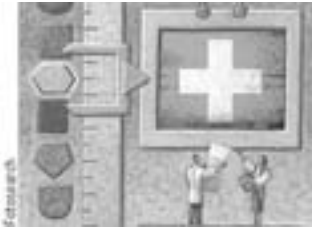
THE EURO zone's annual inflation rate should fall sharply next year to below 2%, bringing it in line with the European Central Bank's target, the International Monetary Fund said.

In its annual review of the 15-nation euro-zone economy, the fund said its executive board is divided about whether the ECB should raise its key interest rate again but that fund economists believe the rate should be unchanged. "Underlying inflation and labor costs have been well contained thus far," the IMF said.

Some members of the IMF's executive board said the ECB should be prepared to raise rates if there are signs wage increases are picking up. —Paul Hannon

## SWITZERLAND

## Purchasing index remains above critical threshold



THE SWISS purchasing managers index edged lower in July, but remained above a critical mark, data showed.

The index dropped to 54.1 from 54.9 in June, slightly above economists' expectations of a 53.7 reading. It was the first time the PMI has fallen below its long-term average of 54.5 since mid-2005, Credit Suisse said, which calculates the index with the Association of Purchasing and Materials Management.

However, July's figure remains above the boom-or-bust threshold of 50 points for the 41st consecutive month, signaling a soft landing for Switzerland's industrial sector, Credit Suisse said. —Martin Gelnar

## Olympic cleanup sends migrants packing

## As Beijing celebrates, closed shops usher in economic hardship

BY SKY CANAVES  
Beijing

NEW WALLS have already been built around much of the nameless shop on Baoshi Street, a small lane near Tiananmen Square, though there's still just enough room for customers to come and go. Inside, Wang Binjiang is holding a closeout sale.

For the past seven years, Mr. Wang has worked for his cousin selling luggage, pajamas and small tools in this neighborhood along with two other men from the same small town in Zhejiang province, on China's east coast. Each night, the three men roll out their mats and sleep on the floor of the 200-square-foot shop. Now the building that houses the shop is due to be knocked down, and without permanent-residence status in Beijing, the men aren't eligible for assistance from the local government.

"August 6 will be our last day," says Mr. Wang, 28 years old. "We must shut before the Olympics."

The Olympic Games are an occasion of celebration for many Beijing residents, whose city has been undergoing a major face-lift ahead of the Games, which start Friday. But for Mr. Wang and many others, the Games are a harbinger of economic hardship. The expulsions seem to strike a backward note for a country out to stage an Olympics worthy of its remarkable rise on the global stage.

"There are countries that are more repressive than China, but those are closed systems where the mobility of people is more limited, such as North Korea and Burma," Nicholas Bequelin, China research director for the New York-based activist group Human Rights Watch, says of the displacement.

Chinese authorities have defended the practices as meeting the demands of development and social stability and have strongly denied abuses. The central government has cautioned local officials against being overzealous. Local government

officials didn't respond to requests for comment.

Many migrant workers left in late July, when the city imposed a two-month shutdown on the construction projects that employ many of them. Others were swept out in a pre-Games crackdown on unregistered residents. Mr. Wang and his co-workers are among those who are holding out.

"We won't go back home. There's nothing to do, no money to be made there, and our plot of farmland is too small," says Mr. Wang, who earns 800 yuan, or about \$115, a month working at his cousin's pajamas and luggage store.

Homeless Beijing residents have been sent to relief centers in the outskirts of the city, while countless others have been forced to temporarily close businesses deemed "undesirable," which can include anything from roadside food vendors to massage parlors.

Wang Xijing is among the Beijing natives who have found themselves on the losing end of the Games. Mr. Wang (no relation to the store employee) used to run a supermarket in the middle of a lively street market in the eastern part of town. The whole



Passersby peer into Qianmen Street, from which some former residents complain they were forced to move before the Olympics without adequate compensation.

market was closed "for the Olympics," he says. He relocated his store to what used to be his warehouse—under a footbridge. But most of his customers were migrant workers, so now his business is down by 40%.

While a permanent return to the routine authoritarianism of pre-reform China would likely be impossible, in the short term, and for the Games, citizens such as Mr. Wang face must resign themselves to their

fate. "What can be done?" he says. "It is the Olympics, and we must do what the government says."

Protests are rare and quickly put down. On Monday, around 20 residents briefly gathered near Tiananmen Square to protest their eviction from the Qianmen area without adequate compensation, the Associated Press reported. But they were soon forced to disband by members of the local neighborhood committee as police surrounded the area. Most of the Qing Dynasty buildings in Qianmen have been demolished to make way for a shopping area scheduled to open Thursday, just in time for the Olympics.

As the capital, Beijing serves as a last resort for citizens from all over the country who are unable to resolve their problems at the local level. But in preparing for the Olympics, the city began demolishing the low-rent neighborhoods near long-distance train stations where petitioners typically lived while pursuing their cases. Today, over 90% of the petitioners, who used to number in the tens of thousands, are gone. Of the 3,000 to 4,000 petitioners who remain, many are in hiding, says Liu Anjun, a Beijing-based advocate for petitioners.

## Euro-zone producer prices climb

BY EMMA CHARLTON

LONDON—Euro-zone producer prices hit a new high in June, giving the European Central Bank more to think about at its Thursday policy meeting when it will balance soaring inflation against a steepening economic downturn.

Prices of goods leaving factory gates in the 15 countries sharing the euro rose 0.9% from May and 8.0% in the year to June, above market expectations for a 0.8% rise from May and a 7.9% annual gain, data from European Union statistics agency Eurostat showed. The June annual rise in the producer-price index was the highest since records began in January 1990.

Fears that commodities-driven inflation would push domestically set prices higher prompted the European Central Bank to raise interest

rates by a quarter of a percentage point to 4.25% at its July meeting, despite indications that the economy is set for a slowdown.

Signs of such spillovers appeared in Monday's data, with core producer prices—that is, prices stripped of energy and construction—rising 4.0% in June compared with last year and up from May's 3.8% annual rise.

That acceleration will worry the ECB, said Howard Archer, an economist at Global Insight in London. The central bank is concerned that producers and business owners will try to pass on the higher costs they are incurring to consumers, who in turn will push for higher wages, which could bolster inflationary pressures even further.

"This will reinforce the ECB's concerns that inflationary pres-

ures are potent down the supply chain, and second-round effects from elevated energy and food prices may be increasingly occurring," Mr. Archer said.

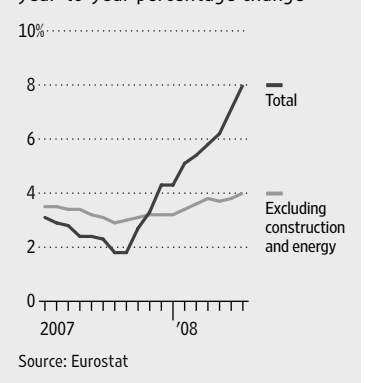
Most economists expect the central bank to leave the key rate unchanged at Thursday's meeting. They argue that the ECB is beginning to register the growing recession risk and will wait for inflation to cool naturally, especially if commodities prices continue to retreat.

But there is broad disagreement over whether the ECB would continue to hold back rate increases if the inflation rate moves further away from its medium-term goal of just less than 2%. ECB President Jean-Claude Trichet's choice of words at Thursday's news conference could provide more clues.

"We look for [Mr.] Trichet to con-

## Surging prices

Euro zone's producer-price index, year-to-year percentage change



Source: Eurostat

firm again that the ECB has 'no bias,' as he did after the July hike," said Holger Schmieding of Bank of America. "If so, this would signal that the bank will almost certainly be on hold again in September."

## ECONOMY &amp; POLITICS

# Attack in China kills 16

## Terrorism suspected in Muslim region fuels Games anxiety

Attackers killed 16 Chinese paramilitary police officers in a raid with a dump truck and grenades that also injured more than a dozen other officers in a predominantly Muslim part of northwest China Monday, highlighting security risks ahead of the Beijing Olympics.

Police said they suspect that the assault was a terror attack, accord-

By **Gordon Fairclough** in Beijing and **James T. Areddy** in Urumchi, China

ing to the state-run Xinhua news agency. If so, it would be one of the deadliest terrorist acts in China in years—and one carried out despite a massive nationwide effort to boost security for the Games. Two attackers were arrested.

The morning attack took place about 4,800 kilometers from Beijing in Kashgar, a city close to China's borders with the Central Asian countries of Tajikistan and Kyrgyzstan, as well as with Afghanistan and Pakistan. The area is predominantly populated by Turkic-speaking Muslim Uighurs.

It came days before the arrival of more than 80 world leaders in Beijing for the Games—double the number who attended the 2004 Olympics in Athens. They include U.S. President George W. Bush, who is expected to attend the opening ceremonies Friday evening in a crowd of tens of thousands of athletes, politicians, business executives and other spectators.

Though the incident was widely reported in Xinjiang, the region in which Kashgar is located, it didn't appear to generate widespread news alerts. In Urumchi, the provincial capital, passengers boarded planes as usual and downtown was devoid of a notable police presence.

China says it has assembled a force of more than 100,000, including more than 30,000 People's Liberation Army soldiers, and deployed anti-aircraft missiles—including a battery near the National Stadium where the opening ceremony is going to be held—and sophisticated surveillance equipment to safeguard the Games, an important symbol of China's emergence as a global power.

A spokesman for Beijing's Olympic organizing committee, Sun Weide, said Games security officials are gathering information about the Kashgar attack. "We are well prepared to deal with all kinds of security threats," he said.

Some Uighurs—seeking independence from China—have waged sporadic and at-times violent campaigns against the government. One group, the East Turkestan Islamic Movement has been labeled an international terrorist organization by China and the U.S.

Chinese officials have repeatedly said the ETIM, which is believed to have bases in Pakistan, and Uighur (pronounced WEE-ger) separatists generally pose the most serious security threat to the Olympics.

In the run-up to the Games, Chinese authorities, looking to head off troubles, say they have stepped up antiseperatist activities. In March, the governor of Xinjiang announced a "strike-hard, high-pressure" campaign of "preventive strikes" on terrorists, separatists and religious extremism.



China's tough approach has drawn criticism from human-rights activists who say China has raised the specter of attacks as an excuse to stifle dissent and justify crackdowns on antigovernment protests. Now, the attacks are likely to strengthen China's hand in dealing with its critics.

One of the biggest questions about the latest incident is whether the plot was homegrown or whether the assailants had assistance from abroad. A Uighur woman arrested in connection with an alleged plot to down a Chinese airliner in March was carrying a Pakistani passport. Police haven't disclosed information about the men arrested Monday.

In the late 1990s—after the collapse of the Soviet Union and an easing of travel between Xinjiang and Central Asia, there was an escalation in violence by separatist groups in the strategically important region, which accounts for one-sixth of Chinese territory and is rich in oil and other resources.

In Monday's attack, two men in a dump truck slammed into a squad of border-patrol police on the street in front of their barracks, according to the Xinhua report. Xinhua said that after the truck hit a utility pole, the men tossed grenades into a police compound and attacked officers with knives.

Police officials in Kashgar, reached by phone, confirmed the attack, but declined to provide details, saying the matter was under investigation.

Since early this year, Chinese police have stepped up efforts to disrupt what they consider to be Uighur separatist organizations—killing and arresting dozens of Uighur suspects. In April, police arrested 35 people in connection with what they said was a plot by Uighur separatists to disrupt the Games.

At the time, the authorities said members of the group were planning, among other things, to kidnap athletes, journalists and tourists during the Games. Police said they found bomb-making materials and leaflets calling for "holy war" during raids on the group.

A group that identified itself as a Uighur separatist group named the Turkestan Islamic Party, released online a video dated July 23 that said the group planned to "target the most critical points related to the Olympics."

The group also claimed responsibility for bus explosions that killed two people in southwest China last month and killed three people in Shanghai in May. But Chinese police discounted the claim, saying there was no evidence that the bus blasts were terrorist attacks.

In July, U.S. Secretary of State Condoleezza Rice urged China not to let security concerns become an excuse

for attacking political dissent. "Of course, security threats have to be dealt with," Ms. Rice said. "But security should not become a cover to deal with dissent."

President Bush met last week with one of the most prominent exiled Uighur leaders, Rebiya Kadeer, president of the Uyghur American Association, a Washington-based advocacy group, along with four other Chinese dissidents, in order to send a message to Beijing on human rights.

Alim Seytoff, the general secretary of the Uyghur American Association, said the group "has no idea" who is behind the attacks, which he said "will certainly not help what we are doing peacefully to promote human rights, democracy and religious freedom for the Uighur people." Mr. Seytoff said the attack will provide fodder for Beijing "to deceive the Chinese people and the international community and portray all Uighurs as terrorists," adding, "It is extremely frustrating. We are absolutely opposed to terror and violence."

China has also devoted considerable effort to stifling embarrassing demonstrations against government policies by Chinese citizens or foreign activists intent on drawing attention to causes ranging from human rights for Tibetans to Chinese support for the governments in Sudan and Myanmar.

Also Monday, police quickly surrounded about 20 people who had gathered in a residential neighborhood near Tiananmen Square in the heart of Beijing to protest their eviction from their homes to make way for redevelopment.

The demonstrators scuffled with people in civilian clothes and were led away, according to the Associated Press, which reported that it wasn't clear where they were taken or if they were detained.

Many Uighurs chafe at Chinese rule in Xinjiang and object to government restrictions on civil liberties and religious practices. Many also resent what they see as economic discrimination by China's majority Han Chinese who have migrated to Xinjiang in growing numbers.

Instead of publicly acknowledging these complaints, the Chinese government tends to ascribe any opposition to government policies in Xinjiang to "evil forces"—without distinguishing people who adopt peaceful methods of protest from those who resort to violence.

"The reality is, you have both," said Nicholas Bequelin, a Hong Kong researcher for Human Rights Watch, a U.S.-based advocacy group. "And the Chinese government conflates violent and nonviolent positions and exaggerates certain aspects to justify its crackdown." Mr. Bequelin said that "when people have no legitimate political or legal avenues to express themselves, it does radicalize them." Still, he said, "there is no evidence of widespread support" in Xinjiang for international jihadist groups.

Large-scale rioting broke out in a Xinjiang city in early 1997 and led to a harsh crackdown by authorities. That was followed by a series of bus explosions in the Xinjiang capital of Urumqi, as well as Beijing, in which at least nine people were killed.

The violence led to general tightening of government and Communist Party control in Xinjiang. The influence of ethnic Han Chinese cadres, deemed more trustworthy by the central authorities, became more widespread. The government also tightened the reins on religion, requiring imams to gain state approval annually in order to conduct religious affairs.

## CAPITAL JOURNAL ■ GERALD F. SEIB

## Kansas governor's experiences could be of value to Obama

FOR A sparsely populated state that's often a political afterthought, Kansas has something close to a starring role in this year's presidential drama. Consider:

Kansas Sen. Sam Brownback ran for the Republican presidential nomination. Meanwhile, the Democratic presidential contender, Sen. Barack Obama, makes much of the fact that his mother and grandparents hailed from Kansas, and he lauds the Kansas "values" they gave him.

Now Sen. Obama is weighing as his running mate the governor of Kansas, Kathleen Sebelius, as well as Virginia Gov. Tim Kaine, who grew up in Kansas and whose mother happens to be from the same small town as Sen. Obama's mother.

What to make of this Kansas overdose? It's tempting, as a native son of Kansas myself, to say it's a product of the state's wisdom and character. In truth, of course, much of it is coincidence, fueled by a combination of Sen. Obama's unusual personal background and the fact that he has developed a strong liking for two fresh-faced governors who happen to share Kansas backgrounds.

Yet this prominence isn't all coincidence. Kansas has played out a fascinating political drama in recent years, and the rest of the U.S. can learn a few things from its experience. As it happens, Kansas has been through an extreme version of national political trends: a rise of social conservatives; a searing internal Republican debate; and a bit of a Democratic resurgence. It isn't mere happenstance that it has emerged as a state that is still reliably Republican yet with a highly popular Democratic governor.

FROM A DISTANCE, Kansas may not look quite that interesting. It has gone Republican in every presidential election since 1964 and hasn't elected a Democrat to the U.S. Senate in 78 years. But looks are a bit deceiving. Historically, Kansas has carried a wide streak of progressive activism and populist sentiment alongside its reliable Republicanism. Early in the 20th century, it was ahead of its time—and other states—in advancing workers' compensation and the right of women to vote. The state's legendary small-town newspaper editor, William Allen White, was a national cheerleader for the progressive Republican politics of his friend, Theodore Roosevelt.

More recently, its citizens have shown an unusually high propensity to cross party lines to balance power between the parties. Even as Republicans have dominated overall, the state has had a Democratic governor for 29 of the past 50 years.

The politics of the past two decades, though, have been particularly raucous. In the 1990s, the Kansas Republican Party, long run by traditional Main Street fiscal conservatives, came to be dominated by social conservatives who rode the waves of

the Reagan and Gingrich revolutions into power. They made the state known as not just anti-abortion but ground zero in a national effort to shut down abortion clinics and doctors who staff them. The movement to allow concealed weapons gained a big foothold. And, famously, the conservative-dominated state school board sought to block the uncritical teaching of evolution in its schools.

For a while, this social conservative wave worked well for Republicans. In 1996, the state's governor and entire congressional delegation were Republican. Ultimately, though, many Republicans came to fear that their party was coming to be seen as not just conservative but extreme. Business conservatives pushed back against social conservatives, and a civil war erupted. Some prominent Republicans, including the state's current lieutenant governor, became Democrats.

OUT OF THIS maelstrom emerged Gov. Sebelius, who benefited from the Republican civil war in winning her first term in 2002 and re-election in 2006. Even before becoming governor, she had appealed to the state's populist streak when, as a pro-consumer insurance commissioner, she blocked the merger of the Kansas Blue Cross and Blue Shield health program with an out-of-state firm.

More important, since taking office, she has proved skillful at working the political middle. Kansas today has essentially three political parties—social conservative Republicans, moderate Republicans and Democrats—and Gov. Sebelius has succeeded by binding together the latter two groups against the former.

Thus, while the libertarian Cato Institute gave her a "D" grade after her first term largely for proposing tax increases, she worked with moderate Republicans to clean up a fiscal and education-funding mess. She has developed a reputation as a generally pro-business Democrat. Meanwhile, she has pleased her party's liberal base—and gotten in trouble with leaders of her Catholic Church—by supporting abortion rights.

Democrats in general have benefited. Two of the state's four House members now are Democrats.

Liberal author Thomas Frank, a Kansas native, argues that navigating the middle ground has left Kansas Democrats with some unique skills. "The state's particularly intense version of the culture wars, plus the savage infighting of the state's [Republicans], has produced Democrats who know both how to speak to populist impulses and how to exploit the Republicans' own fragmentation," says Mr. Frank, who now writes a column for The Wall Street Journal.

The partisan minefields of Topeka, the state capital, aren't all that different from those of the nation's capital. The Sebelius experience in navigating them may be the example of Kansas values Sen. Obama finds most useful.