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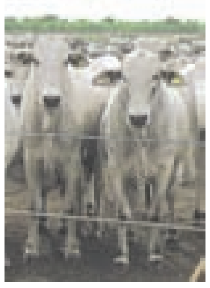

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■ **U.K. banks, battered** by the credit crunch, are battling for consumer deposits, pushing up interest rates. Page 3

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■ **BP will invest** $90 million in a U.S. producer of ethanol made from nonfood feedstocks such as plant waste. Page 5

■ **Oil was the lubricant** for U.S. and European stocks. The Dow Industrials rose 2.9% while the Dow Jones Stoxx 600 Index finished the day up 2.7%. Page 18

■ **The price of oil fell** 1.8% to $119.17 in New York. Page 19

■ **Siemens told Fujitsu** it wants to pull out of their computer venture. Page 5

■ **A Chinese court dismissed** Danone's appeal of an arbitration commission's ruling in a trademark dispute with Hangzhou Wahaha. Page 6

■ **China Development Bank** held preliminary talks with Allianz about acquiring its Dresdner Bank unit. Page 17

■ **Air France-KLM and Iberia**, hit by high jet-fuel prices, reported steep drops in profit. Page 5

■ **Google has launched** a free music-search service in China, after months of negotiations with music companies. Page 4

■ **A board member** thought to have divested himself of stock in OAO Norilsk Nickel said he planned to sell a stake he valued at $10 billion to Norilsk's largest shareholder. Page 17

Markets 4 p.m. ET

MARKET	CLOSE	NET CHG	PCT CHG
DJIA	11615.77	+331.62	+2.94
Nasdaq	2349.83	+64.27	+2.81
DJ Stoxx 600	285.01	+7.42	+2.67
FTSE 100	5454.5	+134.3	+2.52
DAX	6518.70	+168.89	+2.66
CAC 40	4386.35	+105.72	+2.47
Euro	$1.5483	-0.0133	-0.85
Nymex crude	$119.17	-2.24	-1.84

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World-Wide

Iran's nuclear program is an increasingly important issue in the race for Israel's premiership. Tough talk by candidates could further rattle oil markets and inflame regional tensions. Page 2

■ **The Iranian response** Tuesday to an offer of incentives aimed at defusing a dispute over Tehran's nuclear program is unacceptable, U.S. officials said, making new sanctions more likely.

■ **Two French agencies** proposed raising the sales tax on high-fat and high-sugar food and drinks to fight obesity. Page 2

■ **Bush was greeted** in Seoul by dueling demonstrations. About 30,000 Koreans gathered to support his visit, and later 20,000 anti-Bush protesters were hit by police water cannons as they tried to move onto a main street.

■ **Bush's visit** to Beijing this week and the new U.S. Embassy he will unveil reflect the growing importance of U.S.-China ties despite a range of disputes. Page 9

■ **Thousands of Beijing taxis** are equipped with microphones, installed for driver safety, that can be used to listen to passengers remotely and could become part of China's security campaign for the Olympics. Page 10

■ **A 6.0 quake** in China's Sichuan province Tuesday killed one person and hurt 23, in the same region as a devastating May quake.

■ **Thousands of Russians,** including Putin, paid tribute to Solzhenitsyn at a formal mourning in Moscow for the author and dissident who died Sunday.

■ **Rwanda accused** top-level French officials of involvement in the 1994 genocide that killed 800,000 people, a charge that France has repeatedly denied.

■ **Hindu and Muslim protesters** clashed with security forces in different parts of Indian Kashmir, angered at a government decision on land and a Hindu shrine.

■ **A U.S. woman received** five puppies that were cloned from her late pit bull, becoming the inaugural customer of a South Korean company, RNL Bio, that offers a dog-cloning service.

■ **Researchers discovered** more than 125,000 western lowland gorillas in the Republic of Congo, at least doubling the endangered primate's estimated numbers.

EDITORIAL & OPINION

The Italian job

Rome still has no recipe for reviving the economy after 15 years of stagnation. Page 13

Fed holds steady, leaves key rate unchanged at 2%

U.S. central bank highlights concern about weaker growth

By Sudeep Reddy

The U.S. Federal Reserve, grappling with a yearlong crisis in credit markets, held interest rates unchanged at 2% while indicating continued worries about weaker economic growth ahead.

In a statement accompanying its decision Tuesday, the Fed sought to straddle the line between continuing inflation concerns and the risk of weaker growth. "Although downside risks to growth remain, the upside risks to inflation are also of significant concern," the Fed said.

The language underscored Fed officials' continued uncertainty about the economy's course, indicating a rate increase is far from imminent.

With oil prices falling in recent weeks, the Fed noted that high inflation has been "spurred by the earlier increases" in the prices of energy and other commodities. It

Please turn to back page

Sony to buy Bertelsmann out of venture

By Ethan Smith

In a move to increase its stake in the declining music industry, **Sony** Corp. reached an agreement to buy **Bertelsmann** AG's half of Sony BMG Music Entertainment, the joint venture they formed in 2004, in a deal that values the world's No. 2 recorded-music company at $1.8 billion.

Sony is to pay Bertelsmann $600 million, according to a filing with the U.S. Securities and Exchange Commission; Bertelsmann also will receive the $600 million cash Sony BMG had on its balance sheet. The filing said that effectively meant Sony is paying a total of $900 million in the deal, as half the cash held by Sony BMG already belonged to Bertelsmann.

The move by Sony represents a significantly increased bet on recorded music at a time when sales of compact discs are in steep decline and paid digital downloading has yet to close the gap. Some executives are optimistic about novel business models such as advertising-supported music Web sites that are free for listeners, and licensing music to videogames such as Guitar Hero and Rock Band, but so far none of these have made up for the sharp drop in CD sales.

Sony BMG ranks behind **Vivendi** SA's Universal Music Group in glo-

Please turn to page 31

For just one night

The world's most expensive hotel cities. Average room rate for 2007

1. Moscow	$540
2. New York	384
3. Paris	339
4. Dubai	326
5. Milan	325
6. Stockholm	318
7. Mumbai	317
8. Bangalore	316
9. Hong Kong	306
10. London	305

Source: Hogg Robinson Group

Reuters

The Ritz-Carlton hotel near Moscow's Red Square

Moscow's pricey hotels put squeeze on visitors

By Andrew Osborn

MOSCOW—When Robert Jenkin, CEO of a multi-million-dollar property firm, travels, he stays in four- and five-star hotels in Tokyo, New York and most other major cities. In Moscow, he rents apartments, braving shabby stairwells, Soviet-era furnishings and sketchy management agencies.

The calculus is simple: A week's business here can come with a $5,000 hotel bill, while Mr. Jenkin, who lives in Sofia, Bulgaria, pays just $1,500 for an apartment. "It wouldn't make sense to rent in other parts of the world," he says. "But this is Moscow."

In Moscow, hotel rooms are among the most expensive—and hardest to find—in the world. According to corporate-services group Hogg Robinson Group, the average room rate in Moscow has risen by 93% since 2004. The average price for a business-class room in Moscow last year was $540, a survey by Hogg Robinson showed. That compared with $384 in New York.

Phone around Moscow's central hotels, though, and even $540 seems cheap. Many rooms are near or over $1,000 a night. The Baltschug Kempinski, some of whose rooms enjoy a Kremlin view, was charging a minimum of $1,600 on a recent weekday night, while the Ararat Park Hyatt, a favored spot for Western celebrities, was asking $1,300.

It's all about demand racing ahead of supply. As Russia's oil-fired economy has boomed, real-estate prices in the Russian capital have soared, inflation has ticked upward, and the rich have become richer. Hulking Soviet-era hotels

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THE WALL STREET JOURNAL.

Iran grabs focus in Israel

Nuclear program gains significance in race for premier

By Cam Simpson

JERUSALEM—Iran's nuclear program is becoming an increasingly important issue in the race for Israel's premiership, though the campaign started in earnest only last week.

The issue is certain to become more politicized with Israel's primary rapidly approaching, contributing to a climate that could further rattle global oil markets and inflame regional tensions. The Israeli campaign is heating up just as the U.S. is trying to ease anxieties over Iran and focus on diplomacy.


Shaul Mofaz

The two leading candidates to replace Israeli Prime Minister Ehud Olmert, who announced his resignation last week under a hail of corruption allegations, are already speaking loudly and sternly about Iran. Winning votes and taking a hard line on security issues are tightly intertwined in Israel, though this year's campaign could ripple beyond the Jewish state.

The Kadima party primary is slated for Sept. 17, although a subsequent runoff is possible. The winner will be empowered to form a ruling coalition, but a general election could follow if such efforts fail.

The leading Kadima contender with the most hawkish stance is Transportation Minister Shaul Mofaz. He is blamed by some oil analysts for pushing crude prices higher by his repeated statements about potential military strikes against Iran's nuclear program.

Though more reserved, front-runner Tzipi Livni, who is currently Israel's foreign minister, is also talking tough. She has hired the political team behind former Prime Minister Ariel Sharon, the man who personified iron-fisted leadership more than any other recent Israeli leader.

The bottom line is that traders and world leaders who have been nervously tracking heated Israeli rhetoric about Iran should "get ready for some more" in the next six weeks, says Reuven Hazan, a professor of political science at Hebrew University and one of Israel's leading analysts.

"If he wins, Mofaz is going to be elected based on rank-and-file voters of the Kadima party—not by oil speculators and those who hold oil stocks," says Mr. Hazan. "He's not playing in that arena."

Mr. Mofaz, whose background is in defense and security, will continue to hammer the perceived threat from Iran as he plays to his own strengths in the battle for Israeli voters, Mr. Hazan says.

Iran's nuclear program is the "800-pound gorilla...in the room all the time," Mr. Hazan says. Mr. Mofaz "is going to point at it all the time."

Mr. Mofaz, who was born into Iran's Persian-Jewish community before coming to Israel with his parents in 1958, unofficially kicked off his campaign before it was clear that Mr. Olmert would step aside.

In a long interview published in a Hebrew-language newspaper June 6, Mr. Mofaz declared that if Iran "continues with its plans to develop nuclear weapons, we will attack....There won't be any way around attacking Iran to stop the Iranian nuclear program."

That same day, crude recorded its largest price jump ever, leaping almost $11 per barrel. While a weakening dollar and jitters over the reliability of world supplies appeared to be largely to blame, some analysts also cited Mr. Mofaz.


Tzipi Livni

About a quarter of the world's crude supply is shipped through the Strait of Hormuz off the Iranian coast. Tehran has threatened to squeeze the shipping lane if attacked.

On Friday, during a forum in Washington, twice said about Iran's nuclear program that Israel "will not let the second Holocaust happen to the Jewish people once again." He said he wanted peace, but that diplomacy had limits and the window to take action against Iran was quickly closing.

On Sunday, in a speech at a local election rally in Israel, Mr. Mofaz even cited Iran in rejecting calls for new general elections. "Israel does not need general elections now, in light of the existential challenges facing us," he said, according to an aide and Israeli news reports.

Iran says its nuclear program is for strictly civilian-power purposes.

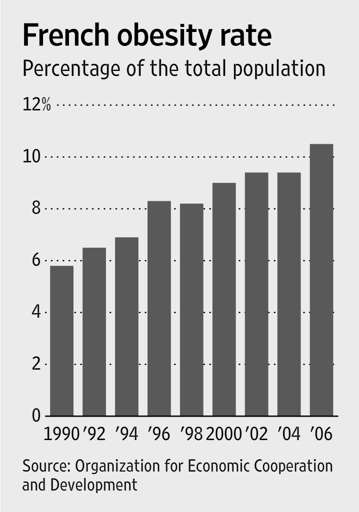
French agencies support tax rise to fight obesity

By Davide Berretta

PARIS—Two French government agencies have recommended raising the sales tax on high-fat and high-sugar food and drinks in an attempt to fight an increasing obesity problem in France.

The report, expected to go before Parliament in the fall, calls for a rise in the value-added tax to 19.6% from the current 5.5% on foods that are high in fat, sugar and salt. It also targets snack foods, such as potato chips.

The study, whose contents were reported in the French financial daily Les Echos on Tuesday and confirmed by the French Budget Ministry, comes as Europeans fret about their expanding waistlines. According to data from the Organization for Economic Cooperation and Development, obesity rates across Europe have been growing steadily over the past decade.



Source: Organization for Economic Cooperation and Development

France has long prided itself in its healthy diet and svelte physiques. Yet one in 10 people in France qualified as obese in 2006, according to the same OECD data, compared with fewer than 6% of the population in 1990. While the French are in better shape than their counterparts in Austria, Germany or Spain, the OECD says, French lawmakers have nevertheless been sounding the alarm.

"Obesity is a sizable problem of public health," Senator Janine Rozier said during a recent parliamentary debate on the issue, a transcript of which is posted on the Senate Web site. "It is rapidly spreading in our country, and increasingly it affects young people."

It is unclear what levels of fat or sugar in foods would be considered unhealthy. Yet some makers of France's famed Camembert cheeses are already turning up their nose at the idea. Taxes should be levied on foods that are "nutritionally imbalanced," Jean-Pierre Godefroy, a senator from lower Normandy, where most Camembert is produced, said in the recent parliamentary debate. But "we should leave the Camembert alone."

Laurent Flechard, commercial director at cheese producer Fromagerie Gillot, says he can't make his cheese with less fat because he has to follow specific industry rulesto make the highest-quality Camembert. "How much fat goes into our cheese is forced upon us," he says.

CORRECTIONS & AMPLIFICATIONS

Millhouse LLC is the investment vehicle of Russian oligarch Roman Abramovich. An article Tuesday on the Financial News page incorrectly called it Millhouse Capital.

The Congressional Black Caucus Foundation and the Congressional Hispanic Caucus Institute are independent groups, although their chairmen and several board members are U.S. congressmen. An Economy & Politics article Monday on lobbyists contributing to campaigns incorrectly said that both groups are controlled by members of Congress.

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.

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INDEX TO PEOPLE

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

For more people in the news, visit CareerJournal.com/WhosNews

LEADING THE NEWS

British banks battle for consumer deposits

Rivalry for funding after credit crunch pushes rates higher

By Sara Schaefer Muñoz

British banks, battered by the credit crunch and badly in need of funding, are launching a heated battle for the most old-fashioned of businesses: consumer deposits.

Giants such as **HSBC Holdings** PLC and **Barclays** PLC are pushing new products, while midsize banks such as **HBOS** PLC's Birmingham Midshires and **Bradford & Bingley** PLC are adding to their lineups and touting longer-term interest-rate guarantees. Annual compound interest rates on standard savings accounts have reached seven-year highs of more than 6%.

Adding to the competition are foreign banks opening branches in the U.K., some of which offer rates higher than 7%. "You can get some of the best rates seen in recent memory," says Alex Potter, an analyst with London investment bank Collins Stewart.

While banks have always competed for deposits, the stepped-up interest signals a shift some now expect to see across the banking landscape. Banks are focusing on bread-and-butter services now that many are unable to sell and raise money from the complex securities that exploded in recent years before collapsing in the credit crunch that began last summer.

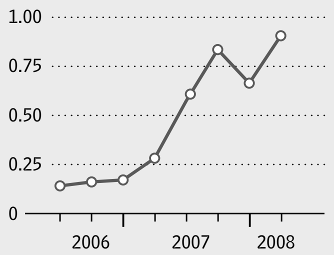
And some banks, seeking to avoid volatility from the type of savings accounts that allow consumers instant access to their money, are focusing on attracting longer-term savings deposits. HSBC, for example, is offering competitive rates on savings accounts that require customers to set aside money for a set time, such as six months or a year. "This allows us to filter out the flight money," says Stuart Gulliver, chief executive, global banking and markets at HSBC.

Increasingly, how well banks can attract money is drawing more attention than earnings growth. In a bearish report on the U.K. economy and banks last month, Citigroup Inc. said that "greater emphasis is likely to be placed on what the banks say about their respective balance sheets—from both a capital and funding perspective—on the face of a significant economic downturn and continued problems in global capital markets."

Two other big U.K. banks, Barclays and **Royal Bank of Scotland Group** PLC, are likely to update investors on their deposit levels when they report earnings Thursday and Friday, respectively.

Paying up

The difference between the interest rate paid by U.K. banks for deposits and the rate paid by the U.K. government on its debt, in percentage points



Note: Figures are based on quarterly averages of three-month deposit rates and three-month Treasury-bill yields

Source: Bank of England

Competition for deposits even in the low-rate environment of the U.S., for instance, will follow a similar trajectory, says Christopher Marinac, managing principal at FIG Partners, a research firm in Atlanta. "I wouldn't call it a price war just yet, but I could certainly envision this starting to develop" over the next few quarters.

U.S. bank executives say that while they are putting more emphasis on the retail side of the business, they note that pricing pressure has eased with the troubles at Countrywide Financial Corp., now part of **Bank of America** Corp., and **IndyMac Bancorp** Inc., both known for offering high savings rates.

Still, such moves could clip bank earnings, as the higher the rate paid for deposits, the narrower the spread to the rate charged for loans, says David Hendler, an analyst with research firm CreditSights in New York.

The war to attract more of the U.K.'s £900 billion ($1.767 trillion) retail-deposit market is the latest challenge facing U.K. banks. Building up their deposit books would help shore up capital. Deposits are a fundamental way that banks fund loans and mortgages.

The average rate for a standard, no-notice-withdrawal savings account that has a balance of £1,000, a popular account in the U.K. that gives users instant access to their money, is 3.95%, up from 2.78% in 2005, according to Moneyfacts.co.uk, which tracks rates for consumers. Rates on some such accounts have been above 6% since last year, the highest since 2001, according Moneyfacts, about a percentage point higher than the Bank of England's 5% base rate.

Banks are going after deposits as other sources of financing prove difficult. Banks have tried selling stakes and assets and selling shares to existing shareholders at a discount. The markets from which banks typically borrow have all but dried up since last August, and banks are wary of lending to each other for periods of more than a week. Worries about bank failures have caused borrowing costs to rise sharply.

Large banks are in the fight, too. HSBC recently launched an online offer of a 6.25% rate on a tax-free savings account, as well as a savings account that offers a rate of 10%, though it is for a limited amount and available only to some existing customers. The retail-banking unit of Barclays has introduced five deposit products since March, including an online savings account that offers a 5.25% rate for those months when no withdrawals are made. "We are trying to attract savers as much as the next person and expand our savings book," says Barclays spokesman Andrew McDougall.

Then there are the foreign competitors. Reykjavik, Iceland's **Kaupthing Bank** opened its online bank, Kaupthing Edge, in the U.K. in February and is pitching rates as high as 7.15% for a fixed-term savings account. The Web site of **ICICI Bank** Ltd., of Mumbai, pitches a fixed-rate account for existing U.K. customers with a rate of 7.2%.

The banks, though, will need to convince consumers to save. U.K. consumers already are more debt-laden than consumers elsewhere in Europe or in the U.S. Total consumer debt in the U.K. stood at 177% of annual disposable income at the end of 2007, by far the highest level of any developed country. In the U.S., that number was 141%, according to the Organization for Economic Cooperation and Development, of Paris.

—Carrick Mollenkamp contributed to this article.

U.K. group won't make major changes to Libor

By Laurence Norman

LONDON—After nearly two months of deliberations, the British Bankers' Association on Tuesday rejected many of the proposals aimed at addressing concerns about the accuracy of its benchmark interest rate, known as the London interbank offered rate, or Libor.

The BBA said it had decided against establishing an added dollar Libor rate to better capture the U.S. market, and would make no changes to the definition of Libor, which is supposed to reflect the short-term rates at which banks lend to one another.

The association also left in limbo a plan to expand the panels of banks that report their borrowing costs to calculate Libor every weekday morning in London.

The BBA will, however, consider setting up an additional rate designed to reflect the cost of borrowing dollars in Europe, and will move ahead with plans to better police the borrowing rates that banks contribute.

"Any changes to BBA Libor should be in response to market evolution and not as a result of a knee-jerk reaction," the BBA said in a report, which it issued following consultation with banks and Libor users such as central banks, derivatives traders and exchange operators. The BBA began the consultation in early June, when it announced its intention to find ways to boost confidence in Libor.

The decision to reject changes, the report said, stemmed in part from concerns that altering Libor could sow confusion in the market and cause legal problems, given the vast number of contracts based on the current Libor definition. Libor, which is set every day in 10 different currencies and 15 maturities, forms the basis for payments on some $350 trillion in loans and other financial instruments.

In recent months, the Libor system has come under criticism, in part because dollar Libor has risen far above the target short-term interest rate set by the U.S. Federal Reserve—a phenomenon that analysts say reflects unusual demand for the U.S. currency among European banks, which dominate the dollar Libor panel. Bankers and analysts have also expressed concern that panel banks might be understating their true borrowing costs to avoid looking desperate for cash.

The main change the BBA accepted was tighter governance of the rate-setting process. This means broadening the Foreign Exchange and Money Markets committee that oversees Libor and creating a new group that would scrutinize the data submitted by banks.

It also said that the "viability of an additional European Dollar index will be explored," but that, to avoid confusion, it would not be called a Libor rate. The BBA said it would consider expanding all the Libor panels, starting with the 16-bank dollar panel. But it said that no banks had asked to join, and that the current panels cover the "majority" of interbank lending business in London.

The BBA rejected other suggestions aimed at helping banks avoid the stigma of reporting higher borrowing rates. Those included ending the practice of publishing the rates and asking banks to estimate the borrowing costs of a hypothetical "prime" bank, instead of their own borrowing costs.

CORPORATE NEWS

AUTOMOBILES

Toyota to set aside money for losses on lease values


Shutterstock

TOYOTA Motor Corp. said it will set aside reserves in the first quarter for residual losses on automobiles leased in the U.S., because of the falling value of used cars.

"We are going to have to make large provisions," a spokesman said. He declined to say how much they will be but said Toyota will review changes to lease values every quarter.

Also on Tuesday, a production unit of Toyota said it laid off about 800 contract workers in June and August to reduce production of vehicles for export to North America. But a spokesman at the unit, Toyota Motor Kyushu Inc., said it will rehire 500 contract staff in the fall or afterward to prepare to increase output.

INTERNET

Web companies create China code of conduct

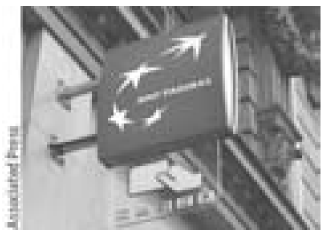

Shutterstock

MICROSOFT Corp., **Google** Inc. and **Yahoo** Inc., in negotiations with other Internet companies and human-rights groups, reached an agreement on a voluntary code of conduct for activities in China and other restrictive countries.

In letters sent to Sens. Richard Durbin (D., Ill.), and Tom Coburn (R., Okla.), the companies said the code's details are being worked out. Sens. Durbin and Coburn had asked for an update out of concern that without such a code, Internet companies could be pressured by China's government to provide information about Internet users who are in China for the Olympics. *—Fawn Johnson*

BANKING

BNP ends offer to fund Corsica real-estate buys


Associated Press

FRENCH bank **BNP Paribas** SA said it scrapped a program aimed at financing foreign citizens' real-estate purchases in Corsica, buckling to pressure from nationalist groups.

Groups seeking independence for the French island contend that foreigners' home buys fuel real-estate speculation and have staged protests at BNP branches. Demonstrations Monday in front of the bank's offices in Corsica's main cities, Ajaccio and Bastia, drew about a hundred people.

A spokesman for nationalist group Corsica Nazione Indipendente hailed the measure and warned that his group will pressure any other banks that introduce a similar offer. *—Associated Press*

British Airways vies to alter terminal views

Daily ads describe how things are going at T5 in Heathrow

BY AARON O. PATRICK
London

WHEN **British Airways**' new terminal at Heathrow Airport opened in March, it was a disaster. The airline lost thousands of bags, and flights were delayed or canceled.

Now, the airline is betting on a big and risky ad campaign to restore its battered reputation.

Every day for the next two weeks British Airways will create one new newspaper and one radio ad with a message about how well the terminal is working, based on the previous day's operations. The quick turnaround is designed to create the image that its Terminal Five, called T5, is a well-oiled machine.

ADVERTISING

The first ads appeared Tuesday. The newspaper spot showed a girl waiting happily for her sister to arrive at the terminal. Instead of a catchy slogan, the photo carried a statistic designed to convince people the problems are fixed: "Yesterday at T5 89% of flights arrived on time."

The campaign carries a risk for the airline: What if something goes wrong again? British Airways said its answer will be to fess up.

"We would use the opportunity to talk about what we are doing to resolve it," said Katherine Whitton, British Airways' general manager of global marketing communications. "We wanted to go out with a campaign that doesn't set up big emotional promises."

The airline's London ad agency, BBH, part owned by Paris-based **Publicis Groupe**, said it suggested the idea of turning around the ads in a day to its client, and the airline said they jointly agreed to do it.

The logistics are tricky. On Monday, a photographer hired by BBH arrived at the terminal at 6:30 a.m. to scout for passengers. At 1 p.m. a team at the agency's offices in London selected four of the best photos and emailed them to British Airways' Ms. Whitton to select one for the ad.

Ms. Whitton said she liked a photo of Debbie Lightstone, who was holding up a heart-shaped welcome sign for her sister flying in from New York. Ms. Lightstone signed a legal waiver allowing her image to be used, an airline spokeswoman said.

The airline crunched statistics to fit the photo. And the ad was finished by 5:30 p.m. and sent to U.K. newspapers, including the Daily Telegraph, Independent and Evening Standard. A 30-second radio spot was cut and sent to radio stations by 4:30 p.m.

Future ads will reveal the number of bags safely delivered, check-in wait times and the punctuality of departing flights, said Ms. Whitton.

British Airways has chosen a good time to be judged, said Nigel Dennis, head of the Air Transport Unit at the University of Westminster, which runs classes on airline and airport operations. Not all British Airways flights at Heathrow have moved into the new terminal, leaving it operating under full capacity, he said. The airport also is less busy during August because many business travelers are on holidays, he said. Also, the British summer offers no fog and fewer storms to disrupt flights.


BBH

British Airways' **ad campaign** seeks to repair the airline's reputation after the disastrous opening of Terminal Five.

An airline spokeswoman said the airline is "probably slightly more busy" during summer because many people go on holiday. Also, families are more likely to check in in person instead of on the Internet, putting more pressure on staff in the terminal.

As with other advertising agencies, BBH has turned around ads quickly before. When an earthquake hit Britain in February, the agency published a newspaper ad for Unilever's Lynx deodorant (known as Axe in the U.S.) the next day, saying "millions of Britons feel earth move."

British Airways and the agency rehearsed last week to make sure they could create the ads in a day. The shoot is complicated by the airline's decision that only real passengers appear in the ads. Another difficulty: getting the six-person creative team in and out of security in time to photograph in different parts of the terminal.

The new terminal opened March 27 to much fanfare. It was billed as the most advanced travel experience, boasting more shopping and restaurants than other terminals, and sleek design features such as thin television screens for advertising. Instead, there was chaos. Passengers turned up to empty check-in desks. Baggage handlers were delayed getting through security.

Amid criticism in the British media, British Airways shelved advertising by BBH to promote Terminal Five as a pleasant place to travel. That campaign didn't run but may be used at some time in the future, Ms. Whitton said.

The start-up problems weren't entirely the airline's fault. British Airways rents the building from Heathrow's owner, Spanish conglomerate **Grupo Ferrovial**, which installed computer systems which didn't work properly and took several weeks to sort out, according to a spokeswoman for Ferrovial's local unit, BAA. The computers are working now, she said: "Terminal Five continues to perform very well."

Google unveils music-search service in China

BY LORETTA CHAO

BEIJING—After months of negotiations with music companies, **Google** Inc. has launched a free music-search service in China.

Internet users in China can search for songs by singer, song or album title on Google's search page and then download licensed music files for free.

The service will be supported by advertising revenue, which will be split between Google, the music companies and a Chinese music company called **Top100.cn**, Google announced Tuesday.

If successful, the new search service could provide a way to legally monetize digital music in China, where piracy has crippled the industry, for global music labels including **Vivendi** SA's Universal Music and **EMI Group** Ltd., which have artists who are popular in China. Dozens of other foreign and domestic record labels stand to gain from the launch, as well.

Rampant piracy has long eroded profits in China for these companies; industry analysts have estimated that as many as 90% of Internet users in China—which now has the world's largest population of Internet users—download unlicensed music online everyday via search-engine services that provide links to unlicensed music downloads.

According to the International Federation of the Phonographic Industry, a music-industry association, the industry loses hundreds of millions of dollars a year because of piracy.

Google didn't specify in its announcement which of the global labels have officially signed on. But the move could also set a precedent for the music industry world-wide, which is suffering from piracy to a lesser degree than in China.

Paid download services like **Apple** Inc.'s iTunes Store have grown rapidly, but not quickly enough to offset declines in CD sales, which still account for a significant chunk of recorded-music sales.

Under the experimental business model, the companies would provide high-quality recordings of licensed music for free, which is unprecedented in China.

The search would also provide information about artists and albums from Top100.cn's database for free. Watermarking technology would be used to track downloads for meaningful statistics for use in selling advertising.

Internet users outside of China won't have access to the service, which will be limited to China.

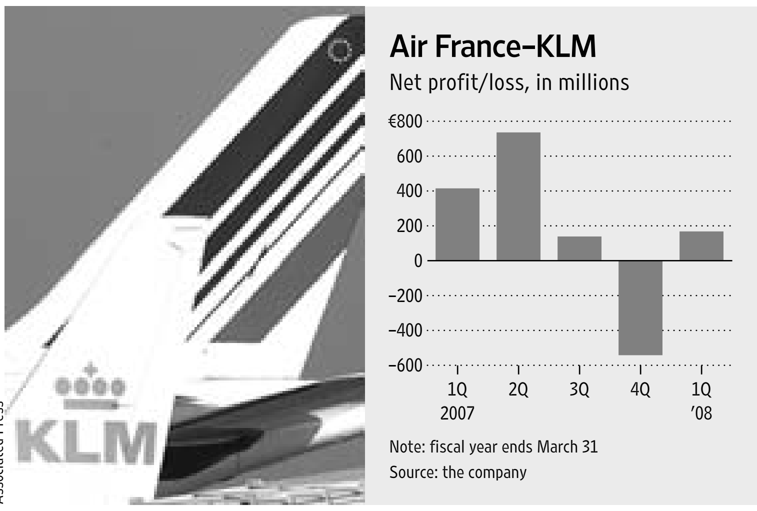
The music search could also give Google a significant boost in its struggle to gain market share in China, where its chief rival, **Baidu.com** Inc., has 64.6%, compared with Google's 26.1% as of the second quarter, according to technology-consulting firm Analysys International. Baidu, though not the only search engine in China to offer music searches and top-song charts that link to unlicensed music, has often been singled out by music-industry organizations because of its lead in the search market, which many credit to products like its music search.

CORPORATE NEWS

Jet fuel pinches, for now

As Air France, Iberia post profit declines, oil's fall boosts stocks

By Steve McGrath



LONDON—**Air France-KLM** reported a 60% drop in first-quarter net profit and Spain's **Iberia Lineas Aereas de España** SA, which is in merger talks with **British Airways** PLC, reported a 66% drop in earnings, both hurt by high jet-fuel prices.

But airline stocks rose across Europe after the oil markets gave investors some hope that pressure on airline earnings might be lifting. Oil fell 1.8% to $119.17 a barrel in New York Tuesday and is down 18% from its record on July 3. A fall in jet-fuel prices would quickly boost airline earnings, which have only been partly able to mitigate the impact through hedging, fuel surcharges or fare increases. European airlines have also been lowering winter capacity plans in expectation that slowing economies in the U.S. and Western Europe will lower demand for air travel.

Air France-KLM, the world's biggest airline by revenue, said net in the three months to June 30 fell to €168 million ($262 million) from €415 million a year earlier as its fuel bill rose 25% on the year, to €1.36 billion, although the profit figure was better than analysts had expected. The Franco-Dutch carrier estimated that its total fuel bill for the year would rise to €5.86 billion, based on a forward oil price of $126.82 a barrel and a euro/dollar exchange rate of €1.56. It said it had identified an additional €190 million of cost savings to help mitigate the impact.

Iberia, meanwhile, said net in its second quarter fell to €21.2 million from €62.6 million, as its fuel costs rose 49% to €404.6 million.

More bad news came from BA, which said traffic fell for a third consecutive month in July, and that proportionately it filled fewer seats. Traffic measured in revenue passenger kilometers fell by 3.5% from a year earlier, with total passenger numbers down 3% to three million.

"Market conditions for the industry remain very difficult on the back of high oil prices and a weak economic environment," BA said.

Air France-KLM stock rose 9.4% in Paris, British Airways rose 5% in London, and **Deutsche Lufthansa** AG rose 6.4% in Frankfurt. Budget airlines **Ryanair Holdings** PLC and **easyJet** PLC were up 15% and 12%, respectively, in Dublin and London.

Ryanair reported a 19% rise in passenger numbers in July, but its planes were also less full as its capacity was also higher.

Last month, Ryanair said it was cutting 14% of flights this winter at Stansted, near London, citing higher fuel costs and charges imposed by British airports operator BAA. This has led to a dispute with Ryanair over those higher fees, which a BAA spokesman said occurred in April when an arrangement for Ryanair to receive what BAA called discounts expired.

Tuesday, BAA said in response to a Reuters report that it had filed a suit against Ryanair for not paying the higher fees, "this matter is in the hands of the lawyers so it is inappropriate to make any comment at this stage." Ryanair declined to comment.

Write-downs hurt Swiss Re profit

By Goran Mijuk

ZURICH—**Swiss Reinsurance** Co. said second-quarter net profit fell by more than half amid new write-downs linked to the U.S. credit crisis, but the company said its finances were sound and it will acquire Barclays Life Assurance Co., a unit of **Barclays** PLC, for £753 million ($1.48 billion).

Swiss Re, the world's largest reinsurer in terms of premium income ahead of Munich Re, said net profit fell to 564 million Swiss francs ($538.5 million) from 1.2 billion francs a year ago. The figure was less than analyst estimates of 775 million francs, as Swiss Re was bruised by a 362 million-franc write-down on arcane hedging products as well as impairments valued at 175 million francs on its investment portfolio, including bonds and stocks.

Swiss Re's gross premium income fell 20% to 6.19 billion fancs, as the company shunned underwriting less profitable business, concentrating on quality portfolios.

In Zurich trading Tuesday, Swiss Re shares were up 1.9% to 66.65 francs.

Since Swiss Re was first embroiled in the meltdown of the U.S. home-loan market last year, the company has registered mark-to-market losses of more than two billion francs on so-called structured credit-default swaps. These are hedging instruments issued by Swiss Re and designed to protect investors from falling bond prices.

With the collapse of the mortgage market, Swiss Re risks being forced to pay compensation to investors for their losses. So far, however, the actual cash-related losses to these products were limited, Chief Financial Officer George Quinn said.

Swiss Re is, however, likely to be further hurt in the third quarter, as the company warned it had to cut the value of these instruments by an additional 163 million francs in July.

"Although the write-downs were in line with what the market had expected, Swiss Re's valuation will remain low because of the risk of more impairments," said Zuercher Kantonalbank analyst Georg Marti, who rates the stock at "market weight."

Swiss Re said the acquisition of Barclays Life Assurance, which will be completed by Oct. 31 and add about £7 billion in assets under management, won't endanger the company's continuing 7.75 billion-franc share buyback. The company won't need to issue debt or raise equity to sponsor the deal.

Mr. Quinn, the finance chief, said that during the July renewals in the U.S., Swiss Re was able to grab more business, profiting from its size and financial strength, as its capital of 25.6 billion francs was nearly 15 billion francs above the regulatory solvency minimum.

Adidas profit rises 12% despite Reebok troubles

By Julia Mengewein

FRANKFURT—Sportswear and equipment maker **Adidas** AG reported a 12% rise in second-quarter net profit despite problems with its Reebok brand, helped by strong sales growth in Asia, Europe and Latin America, and a lower tax rate.

Net profit rose to €116 million ($180.8 million) from €104 million a year ago, exceeding analysts' expectations of €111 million. Its tax rate declined to 30.8% from 31.6%.

Sales rose 5% to €2.52 billion from €2.4 billion, partly hit by the strength of the euro against the dollar. On a currency neutral basis, sales grew 14%, with increases across all brands, in line with analysts' forecasts.

Adidas shares rose 7.7%, or €2.94, to €41.31 in Frankfurt.

The company's gross margin rose 2.7 percentage points to 50.1%, also reflecting continued expansion of its Adidas retail shops and increased sales in the euro zone, where the currency was strong. Sales rose 34% in Latin America, 16% in Asia and 14% in Europe, but fell 20% in North America.

Adidas slightly lifted its full-year gross margin forecast to above 48%, from between 47.5% and 48%, and said it still expects net profit growth of at least 15%, while sales should increase in a high single-digit percentage range.

Sales at the adidas brand rose 19%, currency neutral, while Reebok showed a 2% rise, and TaylorMade-adidas Golf sales increased 6%.

BP to invest $90 million in U.S. biofuels producer

By Guy Chazan

LONDON—U.K. major oil company **BP** PLC will invest $90 million in a U.S. producer of cellulosic ethanol, underscoring the growing interest in biofuels made from nonfood feedstocks such as plant waste.

So-called second-generation biofuels are garnering support amid concerns that corn-based ethanol is driving up global food prices and putting pressure on land resources. But even backers of second-generation biofuel say commercial production is a long way off.

BP's partner in the deal, **Verenium** Corp., produces cellulosic ethanol from bagasse, or sugarcane waste, and energy cane, an inedible cane-like grass.

Under an agreement to be announced Wednesday, BP will pay Verenium, of Cambridge, Mass., to access its technology platform and production facilities; BP also will co-fund Verenium's scientific initiatives. At a later stage, the two companies hope to jointly start commercial-scale production of cellulosic ethanol.

"This deal puts us at the front of the cellulosic biofuels game," said Sue Ellerbusch, president of BP Biofuels North America, in a statement.

The investment marks BP's first venture into cellulosic ethanol. Its rival, Anglo-Dutch major **Royal Dutch Shell** PLC, has built a visible presence in the sector, investing in a Canadian biotech company that makes the fuel from wheat straw and in a German firm that creates diesel fuel from wood chips. Shell is also attempting to extract biodiesel from algae.

BP previously was more focused on ethanol production. In April, it took at 50% stake in **Tropical BioEnergia** SA, which is building an ethanol refinery in Brazil.

Some countries have already moved to back the development of second-generation biofuels with legislation: the Energy Independence and Security Act of 2008 requires the U.S. to produce 21 billion gallons of advanced biofuels such as cellulosic ethanol by 2022.

Siemens wants to pull out of PC venture with Fujitsu

By Dana Cimilluca

In a move that could set the stage for the sale or dismantling of Europe's largest maker of personal computers, **Siemens** AG has informed **Fujitsu** Ltd. that it wants out of their nine-year-old joint venture, people familiar with the matter say.

Fujitsu has a right of first refusal on Siemens's 50% stake in Fujitsu Siemens Computers, though it is unclear whether it will be exercised. Kuniaki Nozoe, president of the Japanese technology titan, said at a news conference Tuesday that mobile phones are a more promising way to boost sales overseas than PCs, raising doubt about the company's commitment to the venture.

FSC, as the joint venture is known, had €6.6 billion ($10.29 billion) in sales in its latest fiscal year. However, it has failed to live up to expectations amid fierce competition from rivals such as **Dell** Inc. and **Hewlett-Packard** Co. Siemens Chief Executive Peter Löscher, who joined Siemens last year as part of a management shake-up in the wake of a bribery scandal, hasn't been happy with the performance of the venture.

Should Fujitsu waive its right, other global PC makers could look to buy out both parties and buy the venture outright. One possible buyer could be **Lenovo Group** Ltd., the Chinese company that acquired the PC division of International Business Machines Corp. in 2005. That deal was part of a wave of consolidation in the industry brought on by cutthroat pricing and shrinking margins. Still, PC shipments for many of the large producers have been growing briskly. Based upon Lenovo's current valuation, the Fujitsu Siemens venture could be worth about $4 billion.

A spokesman for Siemens, Europe's largest engineering company by revenue, declined to comment. Representatives for Fujitsu and the PC joint venture couldn't be reached.

Since 2005, Munich-based Siemens has been on an aggressive program to sell assets and raise its profitability. Last week, the company said it would sell two telecom assets including an 80% stake in its cordless-handset unit, which had about €800 million in sales last year. Siemens aims to focus on the industrial, energy and health-care segments.

Siemens recently outlined plans to cut 16,750 jobs world-wide, or about 4% of its work force, and further streamline its operations. Mr. Löscher has said the steps are necessary to bring profit margins in line with rivals and weather a slowing economy.

FSC, which also makes mainframes and servers, had a pretax profit of €105 million last year. It has forecast profit of as much as twice that this year.

The terms of the agreement between Siemens and Fujitsu call for their venture to be extended to 2014 if neither side alerts the other this year that it wants to exit.

—Mike Esterl contributed to this article.

ADM's net falls, but sales surge as prices climb

By Doug Cameron And Jennifer Hoyt

Archer-Daniels-Midland Co. reported a drop in fiscal-fourth-quarter profit, though it said sales surged on the strength of higher commodity prices.

ADM, the world's largest grain processor by revenue, insisted that global protein demand would still grow despite a recent slowdown among some of its core products.

The U.S. agribusiness group reported net income of $372 million, or 58 cents a share, down from $955 million, or $1.47 a share, a year earlier. Revenue jumped 78% to $21.78 billion.

CORPORATE NEWS

Softbank net drops 23%

Cost cuts are offset by a higher tax bill; cellphone sales fall

By Kenneth Maxwell And Juro Osawa

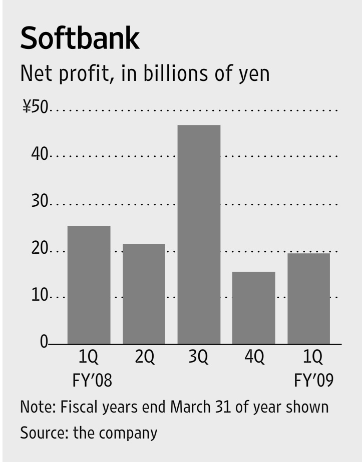
TOKYO—**Softbank** Corp. said net profit fell 23% in its first fiscal quarter on lower mobile-phone sales and as a higher tax burden blocked out efforts to cut costs.

The Japanese technology bellwether, which has a 3.9% stake in Internet firm **Yahoo** Inc., fell short of expectations even as it ramps up efforts to win customers in one of the most sophisticated—and saturated—mobile-phone markets in the world with sales of **Apple** Inc.'s iPhone.

The mobile-phone and Internet company said Tuesday that net profit for the quarter ended June 30 fell to 19.37 billion yen ($178.9 million) from 25.13 billion yen a year earlier. Softbank said that last year, net profit was boosted by one-time gains owing to the reversal of unused provisions.

But the net profit for the latest quarter was still below the 20.9 billion yen expected by the market.

Softbank said that even though subscriber numbers are rising, revenue for the quarter dropped 2.4% to 647.3 billion yen from 663.1 billion yen a year earlier. That was primarily because of lower handset sales as fewer existing clients opted to upgrade to new telephones.



With fewer phones sold, Softbank incurred fewer associated selling costs. Along with efforts to scale back other costs, that helped operating profit grow 8.1% to 85.1 billion yen in the quarter. But the company's tax bill for the quarter jumped 15% to 26.3 billion yen, more than canceling out those gains.

Still, analysts were cautiously optimistic. "The earnings result was better than I had expected," said Kenji Nishimura of Deutsche Securities. "Softbank had much lower handset sales and cellphone model upgrade rates year-on-year, but those factors didn't hurt [the company] significantly."

Despite the decline in handset sales, president and founder Masayoshi Son said he expects mobile-phone operations to be the driving force as the company targets profit growth for the full fiscal year.

"We are finally at a stage where we can expect stable profits," he said.

Softbank didn't issue a net-profit target for the full fiscal year through March 2009, saying the volatility of the mobile-phone market makes predictions too difficult.

Senior Vice President Kazuhiko Fujihara declined to comment on whether the iPhone can contribute to Softbank's profit this year as it invests in promoting sales. Mr. Son declined to disclose how many units of the iPhone the company has sold so far, or how many it aims to sell.

Last month, Softbank launched the iPhone 3G in Japan, hoping the product will help steal new subscribers from rival carriers.

With more than 19 million subscribers at the end of the quarter, Softbank ranks third among Japan's mobile-phone suppliers, trailing market leader **NTT DoCoMo** Inc., with about 53 million clients, and second-placed **KDDI** Corp. with around 30 million.

—Yuzo Yamaguchi and Kjell Ericson contributed to this article.

Danone appeal dismissed in China

By Michelle Ng

SHANGHAI—**Hangzhou Wahaha Group** Co. said Tuesday a Chinese court dismissed an appeal by **Groupe Danone** SA of a Chinese arbitration commission's ruling that found in favor of Wahaha in a dispute between the two firms over the ownership of the Wahaha soft-drinks trademark.

Wahaha spokesman Shan Qining said in a statement the Hangzhou Intermediate People's Court affirmed the decision of the Hangzhou Arbitration Commission, which had ruled the transfer of the trademark from Wahaha to the joint ventures between Wahaha and Danone hadn't taken place.

"We are very pleased with the ruling of the Hangzhou Intermediate People's Court, as it resolves a major source of contention between us and Danone," Mr. Shan said.

Danone said in a statement the Hangzhou Intermediate People's Court dismissed the appeal based on a procedural review only. "With respect to this ruling, Danone will report to the appropriate superior judicial authorities in the [People's Republic of China]," it said.

Mr. Shan said he believes the latest ruling will help Wahaha's case at an arbitration process in Stockholm planned for January that might determine the fate of the two companies' joint ventures. He said Danone has no other legal recourse in China over the ownership of the Wahaha trademark as the latest ruling is the final say on the matter.

Zong Qinghou

"Since it has now been settled that Hangzhou Wahaha does own the [Wahaha] trademark, Hangzhou Wahaha can give the non-joint venture companies the right to use the trademark and Danone can't dispute that," Mr. Shan said.

Danone spokesman Michael Chu said he doesn't discount the possibility of further lawsuits against Hangzhou Wahaha. "We'll try to do everything possible to protect our legal rights," he said.

Hangzhou Wahaha and Danone came together in 1996 when Wahaha founder Zong Qinghou agreed to make his Wahaha drinks in joint ventures with Danone to speed the business's expansion. Danone owned 51%, but involved itself little in Mr. Zong's operations.

Mr. Zong controls a number of Wahaha factories and a sales company outside the joint ventures, which Danone says is a breach of their original agreement. Mr. Zong has said Danone initially condoned the setup.

The dispute between the two sides broke into public view in early 2007 and legal battles have taken place between them in Los Angeles, Samoa and the British Virgin Islands, as well as China and Stockholm.

Standard Chartered earnings rise 32%

By Ragnhild Kjetland

Standard Chartered PLC reported a 32% rise in first-half net profit as the British bank continued to avoid the fallout from the credit crunch and the threat of economic decline in the West thanks to its focus on Asia, the Middle East and Africa.

Net profit rose to $1.84 billion from $1.4 billion a year earlier, while net interest income increased by 26% to $3.71 billion. As a result, Standard Chartered said it raised its interim dividend by 11% to 25.67 cents.

Since the start of the credit crunch, Standard Chartered has outperformed its peers and surpassed **Lloyds TSB** PLC and **HBOS** PLC in terms of market capitalization as its shares have lost only 5.1% in the past year. Following Tuesday's report, the bank's stock rose 8.4% to close at £15.42 ($30.27) on the London Stock Exchange.

The contribution of the wholesale-banking arm to the bank's operating income jumped 47%, while the contribution of its consumer-banking branch rose 15%. Since 2007, the units' contributions to operating income have roughly reversed, with wholesale banking now contributing 52% while consumer banking is responsible for 45%.

Strong business with companies in emerging markets helped offset a slowdown in income from consumer banking. Asia, Africa and the Middle East were responsible for all of Standard Chartered's pretax profit in the half, up from about 90% typically. The Americas, U.K. and Europe produced a pretax loss of $250 million.

The bank booked a $131 million write-down on asset-backed securities and took a $186 million charge for assets available for sale.

Procter & Gamble posts 33% jump in net profit

By Mike Barris

Procter & Gamble Co. posted a 33% jump in fiscal fourth-quarter profit as the consumer-product company's price increases and cost-savings measures offset rising commodity prices.

But the Cincinnati-based maker of Pampers diapers and Olay beauty products sees commodity costs in the new fiscal year being $3 billion higher than a year earlier, hurting profit margins.

P&G, whose proposed sale of the Folgers coffee business to J.M. Smucker Co. has been cleared by U.S. antitrust authorities, reported net income of $3.02 billion, or 92 cents a share, for the quarter ended June 30, compared with $2.27 billion, or 67 cents a share, a year earlier. The latest results included a tax gain of 12 cents a share.

Net sales rose 10% to $21.27 billion. The weaker dollar added around six percentage points to sales, while price increases added around three percentage points. Organic sales—which exclude acquisitions, divestitures and foreign-exchange impacts—rose 5%.

Gross margin fell to 49.2% from 50.8% as higher commodity and energy costs more than offset increased volume and prices.

Net sales in the beauty segment, a key driver of sales growth, climbed 11%. Investors were closely watching the category's performance, after a modest slowdown in the preceding quarter.

P&G raised the high end of its per-share earnings target for the current fiscal year by two cents and now sees earnings excluding items of $3.80 to $3.87 a share. The mean forecast by analysts surveyed by Thomson Reuters was for $3.85 on 6% revenue growth to $88.4 billion.

Shares of P&G were up 2.4%, or $1.60, to $67.42 in midday New York Stock Exchange composite trading.

P&G has been moving to shed slower-growing products so it can focus on brands with stronger prospects. In June, it agreed to sell its Folgers coffee business to Smucker for about $2.95 billion in stock. The acquisition was a departure from the plan P&G announced in January to separate Folgers into a standalone business, made necessary by Folgers' inability to keep pace with P&G's annual sales-gain target of 4% to 6%.

Consumer-product companies have been a focus of investor concern of late, not just because of the weakening economy but also as a result of higher commodity costs.

Auto makers say U.S. rules for fuel mileage too tough

By Christopher Conkey And Stephen Power

WASHINGTON—The auto industry said U.S. regulators are pushing too far, too fast in their effort to raise fuel-mileage rules. The complaints from the industry, which had voiced support for tougher standards, underscore how economic hardship is affecting a major policy debate.

Auto makers are objecting to new rules being crafted by the U.S. National Highway Traffic Safety Administration. The rules would require car makers to achieve a fleet-wide average fuel efficiency of at least 31.6 miles per gallon for cars and trucks by 2015, up from about 25 mpg today. The rules are a first step toward the U.S. Congress's goal of achieving average fuel economy of at least 35 mpg by 2020.

The agency is expected to finalize the rules this year, after considering public input and analyzing confidential product-plan submissions from manufacturers.

At a meeting with NHTSA decision makers Monday, industry officials outlined some of their objections to the rules. Advocates for more-stringent standards, on the other hand, argued that the agency needs to force auto makers to raise fuel efficiency beyond the proposed levels.

Auto makers earlier had praised the new standards. At an auto show in January, **Toyota Motor** Corp. President Katsuaki Watanabe challenged his company's engineers "to meet the new standards well in advance of 2020." In April, after the NHTSA proposed its rules, Dave McCurdy, president of the Alliance of Automobile Manufacturers, said "the industry has made a commitment to step forward and support these aggressive standards."

In May, **Ford Motor** Corp. Chief Executive Alan Mulally told industry analysts: "I think we are going to be able to satisfy those requirements."

These days, auto makers are quietly arguing that the proposed rules are simply too aggressive. They want more time to study and incorporate technologies that could lift fuel economy, fearing costly missteps could occur if they are forced to meet the NHTSA's proposed timetable. Declining sales have left them with less money for research and development.

In comments submitted to the NHTSA in late June, Ford said the proposal "goes beyond the 'maximum feasible' levels" authorized by law and that Ford "does not have adequate resources or lead time to make major product changes across most or all" of its vehicle fleet.

Toyota complained the proposed standards are "substantially front-loaded" and "increase at a rate much greater than anticipated" by the underlying law. Mr. McCurdy's Alliance said the NHTSA's timetable isn't "technologically feasible" or "economically practicable" given the challenges facing the industry.

Asked about the difference between the earlier pronouncements and the more-pessimistic view presented to the NHTSA, Ford and the Alliance said their executives continue to support the 2007 energy law that mandates a 35-mpg target by 2020, but worry that a 31.6-mpg goal by 2015 would be too hard to achieve.

A Toyota spokeswoman said the NHTSA's proposed pace "sets a much more difficult task" than envisioned. She reiterated the company's "goal has always been to meet or exceed [fuel economy] requirements, and that will not change."

CORPORATE NEWS

GM's directors continue to back CEO Wagoner

BY JOHN D. STOLL AND SHARON TERLEP

General Motors Corp.'s board of directors remains behind Chief Executive Rick Wagoner following the company's $15.5 billion loss in the second quarter, the company said Tuesday.

The auto maker's board, composed of 14 members with Mr. Wagoner as chairman, met Monday and Tuesday. The meetings were part of the annual product review the board conducts and included a Monday-night dinner and presentations from top company executives.

"The board has expressed its support for Rick Wagoner and the GM management team on several occasions, and that has not changed," said GM spokesman Steve Harris.


Rick Wagoner

One person close to the board said the board "is totally behind Rick, realizing nobody could deal with this situation any better than he." This person added that "It's a case of an excellent plan, [and] delivering on all promises."

It was unclear whether the meetings included any executive sessions, where the board holds discussions without Mr. Wagoner or other executives in attendance.

George Fisher, the company's lead independent director, through a spokesman declined to comment. Mr. Fisher in June said the board backs the executive team. Other directors didn't respond to messages seeking comment.

Mr. Wagoner has been at GM's helm as CEO since mid-2000. In recent years, the executive has cut $9 billion in structural costs, reworked the company's contract with the United Auto Workers union and accelerated growth in markets outside the core U.S. business. The UAW deal, reached last fall, could save GM $5 billion by 2011 and add needed flexibility to its manufacturing footprint.

But Mr. Wagoner has struggled to show results on the bottom line. GM reported cumulative losses of roughly $50 billion for 2005, 2006 and 2007. GM has lost more than $18 billion so far this year.

During the past two months, Mr. Wagoner has unveiled further restructuring moves. GM will close four truck plants in coming years and raise $15 billion in additional liquidity by the end of 2009, through a combination of cost cuts, asset sales and asset-backed financing.

But GM's North American operations continue to slump under Mr. Wagoner, leading to four years of financial losses and a decline in the company's share price.

GM shares were up 5.8% to $10.69 in New York Stock Exchange trading Tuesday afternoon. A decline in the price of oil has helped push GM and other stocks up in recent trading. The stock also received a boost after GM announced its liquidity plan last month.

Still, the company's market capitalization of about $6 billion is near the lowest point in five decades.

GLOBAL BUSINESS BRIEFS

GKN PLC

Earnings decline by 2%, driven by sharp tax increase

U.K. automotive and aerospace-parts maker **GKN** PLC posted a 2% drop in first-half net profit, hit by a sharp rise in taxes, but nevertheless confirmed its full-year outlook. Net profit fell to £99 million (US$194 million) from £101 million a year earlier, even as revenue rose 18% to £2.27 billion from £1.93 billion. The company said that net profit was weighed down by a sharp increase in the tax rate to 16% from 3%, higher raw-material prices and the negative impact of "difficult" North American markets on the performance of its powder-metallurgy division. However, GKN said substantial new business supports continued above-market growth, even if automotive markets soften further. It added that it expects to complete its acquisition of **Airbus**'s Filton aero-structures site before the end of the year. Shares in GKN rose 10% to close at 229 pence in London Tuesday.

Givaudan SA

Givaudan SA, the world's largest flavor and fragrances maker by market share, reported a 13% rise in first-half net profit, as higher sales in its fragrance and flavor units offset costs to integrate recent acquisition Quest and rising prices. Net profit increased to 94 million Swiss francs ($89.7 million) from 83 million francs, while sales were up 4.5% to 2.1 billion francs from 2.01 billion francs. Givaudan said it was confident it would reach savings of 200 million francs by 2010 on the integration of Quest, which it bought from Imperial Chemical Industries PLC in November 2006, against overall costs of 440 million francs. The company, which is based in Vernier, Switzerland, said it won't reach the same profit margins it had before the deal until 2010. The outlook comes against a backdrop of rising raw-material prices, which are causing trouble for many specialty chemical and fragrance makers.

Carlsberg AS

Danish brewer **Carlsberg** AS posted a 37% increase in second-quarter net profit, boosted by the recent takeover of U.K. peer Scottish & Newcastle PLC. The news lifted the company's shares 16% to 439.50 kroner ($91.81), outperforming a 0.7% gain in the broader Copenhagen market. Net profit came in at 1.42 billion kroner, up from 1.04 billion kroner a year earlier, while sales rose 39% to 17.54 billion kroner. Earlier this year, Carlsberg, together with Heineken NV, bought Scottish & Newcastle and included sales and earnings from its operations for the first time in Tuesday's report.

Legal & General Group PLC

U.K. insurer **Legal & General Group** PLC posted a 6% rise in first-half operating profit on higher new business sales, but its net profit tumbled because of weak investment markets. Operating profit on a European embedded-value basis, a measure closely watched by analysts, was £626 million ($1.2 billion), up from £589 million a year earlier. The result was higher than the £576 million average forecast from analysts. But net profit fell 89% to £69 million, reflecting the lower value of its investments. Legal & General shares rose 12% to 108.30 pence. Worldwide new life and pensions sales rose 8% to £806 million. The result was higher than the £735 million average forecast from analysts.

Beiersdorf AG

German cosmetics company **Beiersdorf** AG, the maker of Nivea lotion and Labello lip care, said its second-quarter net profit rose 58% thanks to better sales and efforts to improve its production lines. Net profit at the Hamburg-based company increased to €147 million ($229 million) from €93 million a year earlier, while sales were up 7.2% to €1.57 billion. The sales growth was led by its consumer-business segment, including a 10% gain in global sales of Nivea products used for hair care, along with deodorants and men's products. Retailers have been struggling with weakening consumer spending as economic growth deteriorates in Europe and the U.S. Beiersdorf's rival, French cosmetics group **Clarins**, last week posted a 1.8% drop in first-half sales.

Tower Group Inc.

Tower Group Inc. agreed to acquire reinsurer **CastlePoint Holdings** Ltd. in a $490 million cash-and-stock deal, the latest in the consolidating insurance industry. Shareholders of CastlePoint would get 0.47 share of Tower stock and $1.83 in cash a share, valuing CastlePoint at $12.68 a share under Monday's closing prices—a 43% premium. The value of the deal may change according to Tower's stock price in the 15 trading days prior to closing. Tower also reiterated its full-year earnings target and said second-quarter earnings would meet expectations. Meanwhile, CastlePoint projected quarterly profits three cents below analysts' mean estimate, according to Thomson Reuters. Tower, which already owns about 6.7% of CastlePoint, said the companies' combined gross premiums written would be in the range of $1.1 billion to $1.2 billion.

Molson Coors Brewing Co.

Molson Coors Brewing Co. reported a 56% drop in second-quarter profit, hurt by write-downs and merger-related expenses, as well as cost inflation. Chief Executive Peter Swinburn noted that "energy and commodity inflation has become a bigger challenge" for the company and the global beer industry. The brewer, which recently merged its American operations with those of SABMiller PLC to form MillerCoors, reported net income of $80.9 million, or 43 cents a share, down from $184.9 million, or $1.02 a share, a year earlier. Excluding items, including writing down the book value of Molson brands in the U.S., earnings fell to 93 cents a share from 97 cents. Net sales climbed 4.8% to $1.76 billion. The gross margin slid to 30.7% from 31.6% amid a 5.9% rise in the cost of goods sold per barrel.

MGM Mirage

MGM Mirage's second-quarter profit tumbled 69% amid year-earlier gains and a drop in revenue, as guests continued to visit resorts in high numbers but at lower room rates. President and Chief Operating Officer Jim Murren said results were mixed, with some properties generating increases in cash flow. "Our own forward-looking booking trends show improvement in the fourth quarter" and into next year, he said. The Las Vegas casino operator reported net income of $113.1 million, or 40 cents a share, down from $360.2 million, or $1.22 a share, in the year-earlier quarter. Net revenue slipped 2% to $1.9 billion.

Alitalia SpA

The government of Italian Prime Minister Silvio Berlusconi may agree on the state's total exit from the shareholding of **Alitalia** SpA as part of the relaunch of the airline, Minister for Relations with Parliament Elio Vito, a member of Mr. Berlusconi's cabinet, said Tuesday. Italy, which owns a 49.9% stake in the carrier, has been looking to sell Alitalia for more than 18 months. The carrier loses more than €1 million ($1.5 million) a day. With the sale of Alitalia "it may be possible that the state totally exits the capital of the company," Mr. Vito told lawmakers at a parliamentary committee in Rome. "The will of the government is that Italy has an effective and efficient flagship carrier via a solid business solution."

Marvel Entertainment Inc.

Marvel Entertainment Inc. posted a 60% increase in second-quarter profit and boosted its full-year forecast due to contributions from its films "Iron Man" and "The Incredible Hulk." The comic-book maker, which saw strong box-office sales for both films, said the quarter's figures don't include their box-office results but said media and consumer interest in the films drove strong results in the licensing division. Marvel reported net income of $46.7 million, or 59 cents a share, up from $29.1 million, or 34 cents a share, a year ago. Revenue rose 55% to $156.9 million.

Austrian Airlines AG

Austria's governing coalition partners agreed to fully privatize its 42.75% stake in troubled carrier **Austrian Airlines** AG under the condition that a blocking minority stake remains in Austrian hands, a Transportation Ministry spokeswoman said. AUA's shares surged 5.9% to €4.15 ($6.47). The state's stake, which is held through the Austrian privatization and holding company, **OIAG**, must be privatized to allow a planned majority sale of AUA, which has come under pressure from high fuel prices and deteriorating economic conditions. The spokeswoman said the coalition parties agreed to the privatization, provided a shareholder consortium, which consists of Austrian companies, is willing to increase its stake to a blocking minority. She said if the condition isn't met, the government will ensure the blocking minority by keeping 25% of the 42.75% under state control.

E.On AG

E.On Ruhrgas AG, unit of German energy company **E.On** AG, said it had decided to indefinitely postpone the construction of a liquefied-natural-gas terminal on the German North Sea coast and instead will take a stake in the planned GATE liquefied-natural-gas terminal project in Rotterdam, Netherlands. Ruhrgas said it had decided against building the Wilhelmshaven terminal because of low demand. The new deal secures a 5% equity stake in a new operating company, with Dutch companies NV **Nederlandse Gasunie** and **Vopak**, and an annual delivery of three billion cubic meters of gas. Further financial details weren't released. The GATE, which stands for Gas Access To Europe, is already under construction and should be completed in 2011. Because of E.On's inclusion in the project, its capacity is being increased to 12 billion cubic meters per year.

Lenovo Group Ltd.

Lenovo Group Ltd. said it plans to offer a low-cost "netbook" computer, priced at $399. Lenovo's decision comes after top PC makers including Hewlett-Packard Co., Dell Inc. and Acer Inc. launched notebook PCs that sell for as little as $299. The companies are hoping to tap first-time computer users in emerging markets. The IdeaPad S10, designed to be a second or an introductory computer, will perform simple tasks such as surfing the Internet, emailing, listening to music and running basic applications. The keyboard will be 85% of the size of a full-function notebook PC's keyboard. Lenovo plans to offer the IdeaPad computer in two configurations.

AXA Asia Pacific Holdings Ltd.

Australian financial-services group **AXA Asia Pacific Holdings** Ltd. said first-half net profit fell 75%, dragged lower by a 230.4 million Australian dollar (US$214.1 million) investment loss following falls in global and domestic equity markets. The life-insurance and wealth-management company, which is 53%-owned by France's **AXA** SA, said net profit fell to A$94.2 million from A$374 million a year earlier. Operating earnings, which exclude the impact of investment earnings, rose 11% to A$295 million. Chief Executive Andrew Penn said Hong Kong, where operating earnings grew 23%, remains "an important growth engine."

MGA Entertainment Inc.

A federal judge in the U.S. has denied a motion for a mistrial in a closely watched lawsuit in the toy industry. Judge Stephen G. Larson of the U.S. District Court in Riverside, Calif., rebuffed a request by **MGA Entertainment** Inc. to declare a mistrial in a case brought by rival **Mattel** Inc. involving the question of which company owns MGA's popular Bratz dolls. On July 25, a 10-member jury panel ruled that early sketches of Bratz, the doll known for its pouty lips and big head, were the property of Mattel. Bratz creator Carter Bryant was under a Mattel contract when he sold the idea to MGA Entertainment Chief Executive Isaac Larian, the jury ruled.

Quintain Estates & Development

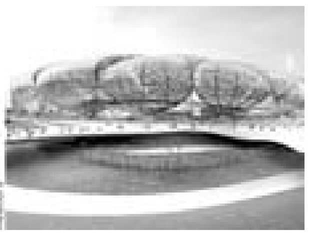
Quintain Estates & Development PLC said it would withhold its dividend as the U.K. property market looks set to worsen through the year. Initial market reaction sent shares down more than 7%, but the stock recovered to trade up 11% at 183.75 pence ($3.61). The property-development company outlined a raft of measures to preserve cash and limit risk. Quintain is looking to sell as much as £100 million in assets, starting with two properties on which it has exchanged contracts for £16.9 million. The group's risk-management strategy includes limiting exposure to the hard-hit U.K. residential market, which accounts for 29% of its land portfolio.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

U.K.

Construction progresses at London Olympic venue


Reuters

CONSTRUCTION of the lower-tier seating and pedestrian bridges of London's Olympic Stadium has started.

London 2012 organizers said the latest work at the stadium site in east London involved the concrete supports for the lower tiers of seating and abutments for one of the main pedestrian access bridges.

A concrete batching plant has been set up on the south of the site to cast almost 200 rakers, the structures that will support the 25,000 seats that will be a permanent feature of the stadium after the 2012 Games. *—Associated Press*

HONG KONG

China to help fund bridge to Hong Kong, Macau

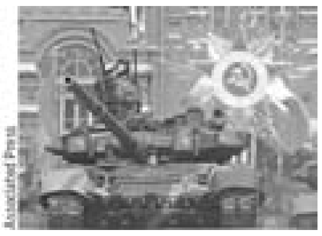

Shutterstock

A BRIDGE connecting Hong Kong with Macau and Guangdong province in mainland China will be partially funded by the Chinese central government and begin construction by 2010, Hong Kong Chief Executive Donald Tsang said.

China's central government and the Guangdong provincial government will contribute 7 billion yuan, or about $1 billion, to the estimated 37.5 billion yuan cost of building the 18-mile bridge. Hong Kong and Macau will provide 6.8 billion yuan and 1.9 billion yuan, respectively, Mr. Tsang said. The rest will be financed by loans to be repaid from toll fees, a spokesman said. *—Reuters*

RUSSIA

Arms sales are set to top $8 billion in '08, set mark


Associated Press

RUSSIAN arms sales are set to reach a post-Soviet record this year, a top official said.

Russia's weapons exports will exceed $8 billion this year, Russian news agencies quoted Mikhail Dmitriyev, head of the Federal Service for Military and Technical Cooperation, as saying.

According to the latest report by Stockholm International Peace Research Institute, Russia accounted for a quarter of global arms sales in 2003-07, coming in a close second after the U.S.

China and India have been the leading customers, but Russia recently has struck big weapons deals with Venezuela, Algeria and Iran. *—Associated Press*

No change seen for European interest rates

Slowing economies top inflation worries in central banks' eyes

By Emma Charlton And Joe Parkinson
London

THE EUROPEAN Central Bank and Bank of England are almost certain to leave interest rates on hold when they conclude their policy meetings Thursday, amid further signs that the euro-zone and British economies are slowing, economists said.

Even though inflation in the two economies continues to run at high levels, analysts say the two central banks won't want to aggravate the possible risk of recession by raising rates now, and will instead wait to see whether retreating commodities prices and the economic slowdown will tame inflation without monetary tightening.

"Despite the remarkable unraveling of euro-zone data, the ECB will likely hold rates steady at [Thursday's] meeting—inflation remains elevated and euro-zone policymakers are still very concerned about wage growth," said Matt Sharratt, an economist at Bank of America. "The rapidly weakening U.K. data will also not be enough to dissuade the BOE from sitting on their hands," he said.

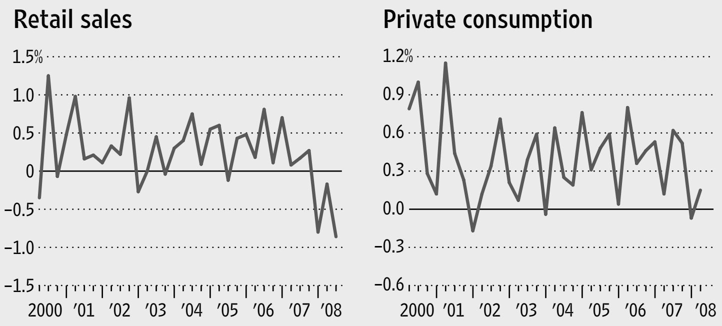
The annual rate of euro-zone inflation was 4.1% in July, up from 4.0% in June, twice as high as the ECB's target of close to but just under 2%. In the U.K., consumer prices rose 3.8% from a year earlier in June, the second consecutive month that they have been more than one percentage point above the BOE's 2.0% target.

Data released Tuesday underlined the risk of recession, showing that the U.K. economy appears increasingly likely to contract in the third quarter and the euro zone might already have gone negative in the previous period.

In the euro zone, a July survey of service-sector purchasing managers showed business contracting for a second straight month and at the fastest rate for five years. A separate report from the Eurostat statistics office showed that retail sales volumes in the 15 countries that share the euro fell at the fastest annual rate since records began in 1996.

Consumer spending slides

Euro zone retail sales and private consumption, quarter-to-quarter percentage change



Source: Eurostat

In the U.K., meanwhile, the same survey for the services sector showed that activity fell for the third straight month in July. U.K. manufacturing output and industrial production also fell unexpectedly in June.

A wait-and-see stance from the central banks would help European policymakers catch up with an abrupt economic decline. The Bank of England's key bank rate now stands at 5.0% following three cuts since December. The European Central Bank raised its rate from 4.0% to 4.25% at its July meeting.

Speaking to BBC radio on Tuesday, U.K. Chancellor of the Exchequer Alistair Darling acknowledged that the problems affecting the British economy are more acute than many had expected.

"There's no doubt that what's happening now is far more profound and will be more prolonged than people thought 12 months ago when this problem first arose," Mr. Darling said.

With manufacturing activity also contracting, economists see more trouble ahead.

Euro-zone consumers are reining in spending as higher prices for food and fuel hit incomes. Consumer pockets are also coming under pressure from tight lending conditions, higher interest rates and concerns about the economy. Economists at Citigroup calculate that retail sales in the second quarter were down 0.8% from the first three months of the year.

That is consistent with their estimate that euro-zone gross domestic product fell 0.2% during the three months to June. "Given that the surveys point to a fall in [the third quarter] too, recession risks are mounting," said Jennifer McKeown, an economist for Capital Economics.

Economists see a similar scenario for the U.K.

"The latest U.K. data suggest that the economy has ground to a halt," said Vicky Redwood, an economist for the U.K. at the same firm. "Indeed, it is quite possible that the economy has already entered a recession." A technical recession is defined as two consecutive quarters of gross-domestic-product contraction.

—Paul Hannon contributed to this article

Obama backs using U.S. strategic oil reserve

Barack Obama, unveiling a broad energy plan, said he supports tapping the U.S.'s Strategic Petroleum Reserve to drive down gasoline prices in the short term. Republicans responded by criticizing the Democratic presidential contender's apparent shift in position—and poking fun at another of his proposals to save gas: having drivers fully inflate their car tires.

During the Democratic primary, Sen. Obama argued against releasing oil from the strategic reserves, in contrast with then-rival Sen. Hillary Clinton's support for such a move. He has reiterated that position during the general election campaign against Republican Sen. John McCain.

By **Amy Chozick** *in Lansing, Mich., and* **Elizabeth Holmes** *in Rapid City, S.D.*

Sen. Obama, speaking in Lansing Monday, urged the government to sell 70 million barrels of oil from its stockpiles, suggesting that gas prices could fall within two weeks. He pledged funding to support long-term work on hybrid cars and pushed for the development of renewable energy sources.


Barack Obama

Sen. McCain opposes drawing from the strategic reserves, and his campaign criticized Sen. Obama's proposal to do so. "The strategic oil reserve exists for America's national security strategy, not Barack Obama's election strategy," McCain spokesman Tucker Bounds said in a statement.

Obama aides said the Illinois senator had met with economic advisers and business leaders in Washington last week, and they had advised him to call for tapping the government reserve. Sen. Obama had previously said that the reserves should be tapped only in an emergency.

Energy has become a pivotal issue in this increasingly competitive election, as voters fret over high gas prices, which have hovered around $4 a gallon, and their impact on food and transportation costs. Sen. McCain has successfully seized on the issue to gain ground against Sen. Obama, who continues to lead in most polls.

On Saturday, Sen. Obama backed off his opposition to offshore drilling, saying he would support expanded drilling as part of a broader bipartisan energy package to reduce dependence on foreign oil.

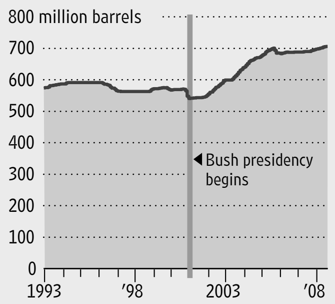
The McCain campaign Monday made light of another aspect of Sen. Obama's energy plan: urging drivers to keep their car tires fully inflated. Senior McCain aide Mark Salter handed out tire gauges labeled "Obama's Energy Plan" to the news media Monday. The campaign asked donors to shell out $25 or more to receive a commemorative gauge.

In response, the Obama campaign sent out a Nascar press release from 2006 that likens tires to the late comedian Rodney Dangerfield, since they "get no respect." The release headline read, "Tire maintenance key to safety, fuel economy."

—Stephen Power in Washington contributed to this article.

In reserve

The U.S. strategic petroleum reserve has been built up under the Bush administration



Note: Data are through July 25; final two figures are monthly averages of weekly data

Source: Energy Information Administration

Building U.S.-China ties

Bush's visit, embassy come as relationship still endures friction

By Gordon Fairclough

BEIJING—The potent symbolism of President George W. Bush's planned visit to Beijing this week—and the giant new American Embassy he will unveil—reflects the growing importance of U.S.-China relations despite disputes over a range of issues.

Mr. Bush is to arrive in the Chinese capital Thursday, then on Friday inaugurate the just-completed U.S. mission before joining Chinese President Hu Jintao and other dignitaries at the opening ceremonies of the Beijing Games, the most-expensive Olympics in history.

The $434 million embassy is "a platform appropriate for the most important bilateral relationship of the 21st century," said U.S. ambassador to China Clark T. Randt Jr.

The relationship between Washington and Beijing has grown immensely in the decades since the two sides re-established diplomatic ties in 1979. Mr. Bush, who took office with a tough stance toward China, has sought to improve relations in recent years, despite some friction on issues such as China's human-rights record and Washington's support for the government of Taiwan.

The U.S. has relied heavily on China in its diplomatic efforts to force North Korea to dismantle its nuclear-weapons program. The two countries are cooperating on environmental protection and engage in regular high-level economic consultations.

"It's a broadening, a strengthening relationship," between the U.S. and China, Mr. Bush said in an interview with China Central Television before leaving the U.S. Monday. "It's important for me to send a strong signal to the Chinese people that we respect them."

Mr. Bush arrived in South Korea Tuesday for the start of his Asian tour, which also will take him to Thailand. In Beijing Friday, which is Aug. 8, Mr. Bush is to cut a ribbon at the embassy complex at exactly 8:08 a.m., precisely 12 hours before the start time for the Olympics opening ceremony, the timing of which is based on the Chinese belief that the number eight is auspicious.

Diplomatic contacts between the U.S. and China have increased markedly under Mr. Bush. In 2001, the U.S. Embassy in Beijing had a staff of about 500 from 10 U.S. government agencies. Now it has 1,100 people from 26 agencies.

In late July, China opened a large new embassy in Washington. China's foreign minister, Yang Jiechi, said the new mission shows not only the sound state of China's relations with the U.S. but also highlights their "broad and beautiful prospects" for the future.

This celebratory rhetoric is fueled by the deep economic ties between the two countries. China, with its decades of rapid economic growth, is the second-largest trading partner of the U.S., after Canada. China said the U.S. is its second-largest trading partner, after the European Union.

According to U.S. figures released in 2007, China was also the second-biggest holder of U.S. government-issued Treasury bills after Japan, and therefore a key creditor of the indebted U.S. government.

Despite pressure on Mr. Bush to raise human-rights concerns with Chinese leaders, the U.S. president isn't expected to speak out loudly. White House officials say he will discuss China's treatment of Tibetans, Muslim Uighurs and other issues in private meetings. He is expected to make some public remarks on religious freedom after attending a Sunday service at a state-sanctioned Christian church.

Despite the recent rosy oratory, there is evidence that both countries have adopted hedging strategies—engaging with the other in the hopes of remaining on good terms, while at the same time preparing, especially in military terms, in case relations sour.

China is investing in a bigger navy, so it can protect its increasingly global economic interests and ensure a steady supply of fuel for its booming economy. At least partly in response, that is encouraging the U.S. military to redeploy resources in Asia.

Officials giving reporters a tour of the new U.S. Embassy in Beijing Tuesday were eager to point out that roughly 10,000 Chinese construction workers and tradespeople were involved in the construction.

Don Q. Washington, a senior embassy public-affairs officer, said the joint construction of the ambitiously designed embassy compound showed "Chinese and American cooperation can produce not just peace and security but art and culture."

But when it came time to build the eight-story chancery building that is the heart of the embassy—home to the ambassador's office and site of other sensitive diplomatic and intelligence operations—Chinese workers were barred from the site. Only American workers with security clearances and building supplies imported from the U.S. were employed, which are standard procedures in such situations.

U.S. Department of State

President George W. Bush is to cut a ribbon Friday at the new **U.S. Embassy** in Beijing, precisely 12 hours before the start of the Games opening.

FOCUS ON CHINA

Shai Oster/WSJ (1) Associated Press (2)

A **small microphone** inside a Beijing taxi, circled at left, and a GPS system allow authorities to know taxis' locations and eavesdrop. The listening devices have been installed in almost all of the city's 70,000 taxis. The system can even remotely shut off an engine.

Cabs have ears in Beijing

Microphones in taxis may help security for Olympic Games

BY SHAI OSTER
AND GORDON FAIRCLOUGH

BEIJING—Tens of thousands of taxi drivers in Beijing have a tool that could become part of China's all-out security campaign for the Olympic Games. Their vehicles have microphones—installed for driver safety—that can be used to listen to passengers remotely.

The tiny listening devices, which are connected to a global positioning system able to track a cab's location by satellite, have been installed in almost all of the city's 70,000 taxis over the past three years, say taxi drivers and industry officials.

As with digital cameras used in cities such as London, Sydney or New York, the stated purpose of the microphones is to protect the driver. But whereas other countries can only record images, Beijing taxis can be remotely activated without the driver's knowledge to eavesdrop on passengers, according to drivers and **Yaxon Networks** Co., a Chinese company that makes some of the systems used in Beijing. The machines can even remotely shut off an engine.

Whether these microphones are used to spy on riders is unclear. Asked if police could listen in on conversations in taxis, a Beijing police official declined to comment, saying that such matters were "confidential" and that they were "not supposed to release such details to the public."

China has launched a massive operation to protect the Games. Monday's deadly attack in Xinjiang on a police station underscored Beijing's worries that terrorists will attack the Olympics. The government says it has deployed about 110,000 police, troops and volunteers in Beijing to ensure security.

But Chinese authorities are also determined to thwart protesters or human-rights activists who might try to embarrass the government. Taxi drivers have been told to watch for suspicious behavior and odd packages.

Security experts say there is little likelihood that all conversations in taxis are monitored. But the presence of microphones in a place most would consider private is a reminder that there are many ways for Chinese authorities to monitor people they are concerned about.

The U.S. State Department has warned visitors to the Olympics that no place is safe from eavesdropping. "All visitors should be aware that they have no reasonable expectation of privacy in public or private locations," the department said on March 20.

The State Department notice explains that all hotel rooms and offices "are considered to be subject to on-site or remote technical monitoring at all times. Hotel rooms, residences and offices may be accessed at any time without the occupant's consent or knowledge."

Security experts say that all phones in China can be tapped, including cellphones, which send out signals that can be used to track location. That capability can be crippled only by removing the battery. Ahead of the Games, Beijing has also been blanketed by surveillance video cameras, while neighborhood committees—residents' representatives to the government—have also been called in for the effort.

Similar GPS systems with microphones have been rolled out in other parts of China, where taxi drivers have been recruited in the broader security effort.

The U.S. has warned visitors to the Games that no place is safe from eavesdropping.

In the northeastern city of Shenyang, site for some Olympic soccer matches, police have recruited 38,000 taxi drivers as "intelligence agents," according to China's Xinhua news agency. Their cooperation is important because drivers travel widely and meet many people, said Liu Juntao, an official with Shenyang's transportation department, according to Xinhua. Police there are offering citizens a reward of 500,000 yuan, or roughly $73,000, for valid tips about any potential terror plots or planned sabotage by dissidents.

Several Beijing taxi companies declined to comment on the security aspect but said that the GPS helps track taxis and that the two-way microphones will be used for translating services. About a dozen taxi drivers said the microphones were installed about three years ago, when newer cabs were built without protective metal cages around the drivers. Cabbies can turn on the system and alert their dispatch center by touching a discreet button near the steering wheel.

Human-rights activists say they are concerned about the ability to listen to conversations with the devices, which appear unique to China.

"This seems to suggest an effort by the police or other security forces to eavesdrop on conversations of passengers, rather than for the immediate safety and security of the taxi driver. It's not as if thieves outline plans to rob someone right before they do it," said Phelim Kine of Human Rights Watch.

One Beijing taxi driver said he would be uncomfortable if the device in his vehicle could snap pictures of the riders. "I wouldn't want to take a photo of my passengers without their knowledge," said the driver, wearing the new shirt and tie the drivers are required to don during the Olympics. "Wouldn't that violate their human rights?"

Yaxon Networks, based in Xiamen in Fujian province, says on its Web site that its GPS devices allow the police or a service center to "judge if the driver is in danger" through remote surveillance or wiretapping. If it is necessary, the service center can immobilize a taxi remotely by "cutting off the oil or electric supply," the company adds.

As part of its security mobilization, China's military has deployed 34,000 soldiers in Beijing and other cities hosting Olympic events, Senior Col. Tian Yixiang, a senior official at the Olympic security command center told reporters Friday. The military says it has deployed antiaircraft missiles near Games venues and has dedicated 74 jets, 47 helicopters and 33 ships to Olympic security duties.

"Generally speaking, Chinese strengths really lie in pre-empting threats rather than in crisis management or emergency response in the event that there really are any incidents," said Bonnie S. Glaser, an expert on Chinese security at the Center for Strategic and International Studies, a private Washington think tank. She mentioned China's use of the microphones in taxis at a news conference in Washington in advance of President George W. Bush's arrival in Beijing on Thursday.

China says terrorists pose small-scale threat

BY JAMES T. AREDDY

KASHGAR, China—A senior Chinese official described an assault that killed 16 policemen here as part of a continuing "jihad" aimed at disrupting the Beijing Olympics, but he added the attackers' use of relatively simple weapons suggests that terrorists pose a mainly small-scale threat.

Shi Dagang, the Communist party secretary of Kashgar in the western Chinese territory of Xinjiang, cautioned in a news conference Tuesday that more attacks are possible as the Games approach. Though he wasn't specific, Mr. Shi repeatedly mentioned a group hoping to wrest Xinjiang from Chinese rule called the East Turkistan Islamic Movement, which both Beijing and Washington have labeled a terrorist organization.

"I know those people won't lose their momentum," said Mr. Shi, who is the city's most senior official. But, he said, their methods are limited to "tricks."

The attack Monday morning on a group of jogging paramilitary policemen left 16 dead and injured another 16, two of them critically. Two local men, a 28-year-old grocer and a 33-year-old taxi driver, both now in custody, confessed to a plot that involved one person waiting on the roadside until the joggers were in position and directing the other to drive into the police with a stolen truck, according to Chinese authorities. The two then lobbed incendiary devices at police and tried to stab them with daggers.

Kashgar, about 3,600 kilometers from Beijing, is a transit point on the Silk Road and is far closer to the borders of five Central Asian states than it is to the Chinese capital. The remote western city has long been a flashpoint of ethnic tension between its predominantly Turkic-speaking Muslim Uighurs and China's main ethnic group, the Han Chinese.

Mr. Shi said authorities have evidence that the men had scoped the attack area for weeks, and that the action was carefully plotted from "both home and abroad" over the Internet. More broadly, he said 18 foreign terrorists had been detained in China, although he didn't say when or offer other details. He said the government has gathered evidence that a terrorist *jihad*, or holy war, has been launched with the goal of disrupting the Olympics with monthly attacks this year. The terrorists, he added, are using "very simple means to attack the Chinese government, and turn 2008 into a year of mourning."

June Teufel Dreyer, a political-science professor at the University of Miami, expressed skepticism about the claim that Monday's attack appeared coordinated from overseas. "This doesn't sound like a carefully orchestrated, premeditated attack," she said.

In the lead-up to the Olympic Games, which open Friday evening, China's government has issued security threats and enacted a sweeping nationwide clampdown. It has reported a number of terrorist attacks this year, including a plot foiled in midair in March to bring down an airliner, which authorities attributed to a Pakistani passport holder who set off from Xinjiang.

Even so, officials Tuesday were eager to play down worries about safety at the Games, offering foreign journalists wide latitude to cover the news, reducing security forces on the streets and saying that China's economic success and ethnic inclusiveness have virtually collapsed opposition to its policies.

Mr. Shi likened the remaining anti-China terrorists, including people working for the independence of Xinjiang, to "eggs" unable to hurt the "stone" of the Chinese government. He said such groups are still able to launch small "tricks" that might "smear the stone."

AFP

Communist Party Secretary of Kashgar **Shi Dagang** at Tuesday's news conference.

Authorities said the men apprehended in Monday's plot managed to ignite only two of their nine explosive devices, and also carried knives and a homemade gun, which wasn't used. The incident followed other recent, relatively small-scale attacks, including deadly explosions and fires in public buses in cities including Kunming and Shanghai that authorities described as deliberate.

Kashgar appeared calm Tuesday. But hours before a contingent of foreign reporters descended on the city, authorities detained and roughed up two Japanese journalists trying to photograph the scene of Monday's attack. The incident prompted an official protest from Tokyo and an expression of regret from Chinese authorities.

Little indication of the attack was apparent Tuesday aside from a bent utility pole that authorities said sent the assailants' truck toppling over, as well as a section of burnt grass. Several Kashgar residents declined requests to comment to a foreign reporter.