THE WALL STREET JOURNAL.

WSJ.com

DOW JONES Newswires

EUROPE

DOW JONES A News Corporation Company

VOL. XXVI NO. 119

MONDAY, JULY 21, 2008

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Business & Finance

Citigroup reported signs of progress at writing down its bad assets even as it announced a $2.5 billion quarterly loss. Citi's shares rose 7.7% as investors figured large write-downs now meant fewer surprises from U.S. financial institutions later. Page 4

■ **Roche is bringing forward** its earnings release to Monday from Thursday, an atypical move for which it didn't provide a reason. Page 8

■ **U.S. business economists** were somewhat more optimistic in a new poll but didn't see a lasting upturn soon. Page 2

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■ **U.S. borrowers are having** a tougher time getting credit, and that likely will get worse with Fannie and Freddie roiling the credit markets. Page 19

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Markets

MARKET	CLOSE	NET CHG	PCT CHG
DJIA	11496.57	+49.91	+0.44
Nasdaq	2282.78	-29.52	-1.28
DJ Stoxx 600	280.69	+4.42	+1.60
FTSE 100	5376.4	+90.1	+1.70
DAX	6382.65	+111.38	+1.78
CAC 40	4299.36	+73.37	+1.74
Euro	$1.5851	-0.0028	-0.18
Nymex crude	$128.88	-0.41	-0.32

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World-Wide

U.S. and European officials said they will intensify efforts to impose financial penalties on Iran should their diplomatic drive fail to induce Tehran to freeze its nuclear program, as the prospect of sanctions grew after talks made no progress. Solana said negotiators gave Iran two weeks to respond more concretely. Pages 1, 9

■ **Obama called** for shifting U.S. military forces from Iraq to Afghanistan, on the first stop of his weeklong foreign tour. Page 2

■ **NATO said** its forces accidentally killed at least four civilians in eastern Afghanistan, while an official in the country's west said foreign air strikes killed nine Afghan police officers.

■ **Three Germans seized** by Kurdish rebels during a climbing expedition in Turkey over a week ago were released in good condition, authorities said.

■ **European space programs** are enjoying a resurgence as officials stress the importance of pursuing efforts independent of the U.S., Russia and China. Page 1

■ **Pakistan's prime minister** tried to shift blame for the economy's woes to Musharraf's eight-year military-backed rule. Page 11

■ **Pakistan's army said** security forces killed 15 militants and detained 60, in the first major action under the new government.

■ **Iraq said** its prime minister hasn't endorsed any specific time frame, after Bush agreed to set a "general time horizon" for further troop withdrawals. Page 11

■ **Britain's Brown,** on a visit, urged Israel to stop settlement construction and offered more financial support and police training to the Palestinian government.

■ **Zimbabwe may transfer** ownership of foreign firms that support sanctions against Mugabe to locals and investors from "friendly" nations, a state newspaper said.

■ **The U.S. appears** increasingly unlikely to proceed with a planned $11 billion sale of weapons to Taiwan. Page 9

■ **Pope Benedict XVI said** a "spiritual desert" was spreading throughout the world, as he ended a visit to Australia.

■ **Padraig Harrington won** the British Open for the second year in a row, winning by four strokes.

EDITORIAL & OPINION

Focus!

Doha Round negotiators ought not be sidetracked by more short-term problems. Page 13

U.S. government agency made bad subprime loans

Predatory lending persisted after FDIC took over failed bank

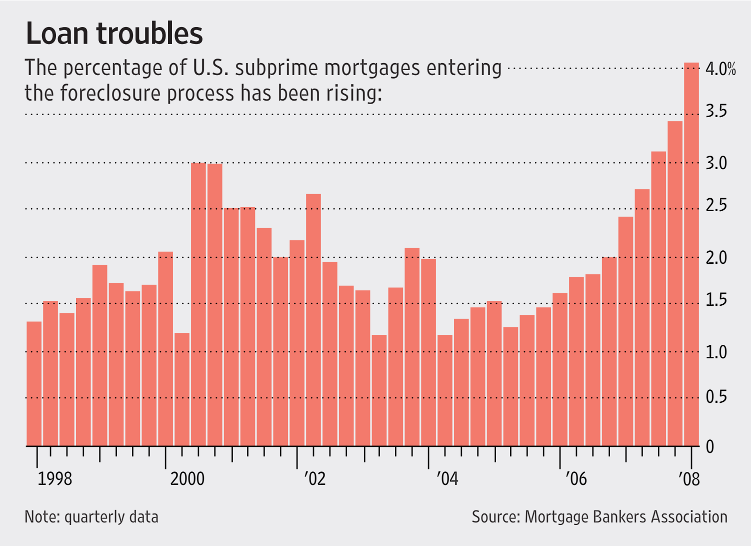
BY MARK MAREMONT

U.S. officials have heaped much of the blame for the subprime-mortgage mess on lenders, claiming they recklessly made too many high-cost home loans to borrowers who couldn't afford them.

It turns out that the U.S. government itself was one of the lenders giving out high-interest, subprime mortgages, some of them predatory, according to government documents filed in recent weeks in federal court.

The unusual situation, which is still bedeviling bank regulators, stems from the 2001 seizure by federal officials of Superior Bank FSB, then a national subprime lender based in Hinsdale, Ill. Rather than immediately shuttering or selling Superior, as it normally does with failed banks, the Federal Deposit Insurance Corp. continued to run the bank's subprime-mortgage business for months as it looked for a buyer.

Please turn to page 12



Europe grabs growing share of space sector

BY ANDY PASZTOR

LONDON—European space programs are enjoying a striking resurgence, with politicians and industry officials stressing the importance of pursuing their own scientific and military efforts independent of the U.S., Russia and China.

Louis Gallois

The European Union has made the first moves to support this ambitious undertaking, for the first time explicitly linking space endeavors to broader diplomatic and foreign-policy goals. But coming months will indicate how much support there is for taking the next big step: funding technology aimed at possible European manned missions.

After watching the U.S., Russia, China, and even India and Brazil stake out new space goals, there is a widespread feeling in Europe that it is necessary to react, according to Louis Gallois, chief executive of European Aeronautic Defence & Space Co. "I think it's very important that we reaffirm the ambition" for a strong European space vision, Mr.

Please turn to page 31

As U.S. influence wanes, Mideast nations step in

By **Jay Solomon** *in Washington,* **Cam Simpson** *in Jerusalem and* **Farnaz Fassihi** *in Beirut*

Stepping into a vacuum left by Washington's waning influence, a handful of Middle East nations and groups are pursuing talks that are dramatically shifting the region's balance of power further away from U.S. interests.

The various discussions come as the Bush administration moderates its policy of isolating the governments of Iran, Syria and their regional allies.

The talks may even be pushing Washington to reengage with Tehran and Damascus, or risk being left behind.

The U.S. State Department's point man on the Middle East is scheduled to meet Friday with a delegation of Syrian academics and lawyers. The group includes the top legal adviser to the Syrian government team involved in indirect talks recently announced with Israel, according to Syrian officials.

And over the weekend, the U.S. State Department's third-ranking official met with European diplomats and Iranian officials as part of talks to restart negotiations over Tehran's nuclear program. The weekend contact—the highest-level exchange between the two sides in years—ended inconclusively Saturday. (Please see related article on page 9.)

Tehran refused to commit to halting its uranium-enrichment program in exchange for a set of economic incentives it was offered. European Union foreign-policy chief Javier Solana said negotiators gave Tehran another two weeks to respond more concretely.

Still, the presence in Geneva of William Burns, the U.S. under-secretary of state for political affairs,

Please turn to page 31

LEADING THE NEWS

Obama pushes Afghan troop shift

On key foreign trip, Democrat promotes moving Iraq forces

By Amy Chozick And Mary Jacoby

On the first stop of his weeklong foreign tour, Sen. Barack Obama called Sunday for shifting U.S. military forces from Iraq to Afghanistan, which he called "the central front on our battle against terrorism."

"The situation is precarious and urgent here in Afghanistan," the Democratic presidential candidate said in an interview with CBS News, on the second day of a two-day visit to Afghanistan.

He is also planning to travel to Iraq as part of a congressional delegation that includes Sens. Jack Reed, a Rhode Island Democrat; and Chuck Hagel, a Nebraska Republican. In Iraq the group is to meet with Prime Minister Nouri al-Maliki, President Jalal Talabani and other key leaders in the government and parliament, said Iraqi government spokesman Ali al-Dabbagh.

The world tour is the latest of a series of efforts to burnish the junior Illinois senator's foreign-policy credentials. He met with Afghan President Hamid Karzai Sunday. He is scheduled to arrive in Jordan Monday, where he will meet with King Abdullah II. On Tuesday he plans to hold discussions with Israeli and Palestinian leaders.

Associated Press/Presidential Palace, HO

Sen. **Barack Obama**, right, walks with Afghan President **Hamid Karzai**.

While Republican presidential candidate John McCain has been generally supportive of his rival's foreign trip, he has come down hard on Sen. Obama for his calls to shift resources out of Iraq and into Afghanistan.

"Sen. Obama will tell you we can't win in Afghanistan without losing in Iraq. In fact, he has it exactly backwards," Sen. McCain said last week in response to a far-reaching foreign-policy speech Sen. Obama delivered in Washington.

Both candidates have called for boosting troop levels in Afghanistan. Sen. Obama has said he would add at least two additional combat brigades and $1 billion in annual nonmilitary assistance. Sen. McCain said he would send at least three additional brigades to Afghanistan and strengthen local tribes in border areas in Pakistan that are willing to fight foreign terrorists.

"I think that we are going to have to be vigilant in dismantling these terrorist networks" that are centered in Afghanistan and the semiautonomous tribal areas of neighboring Pakistan, Sen. Obama said Sunday.

The two presidential candidates have also sparred on Iraq. Sen. Obama, who has campaigned on his early opposition to the war, has suggested a 16-month timetable for withdrawing U.S. combat troops.

McCain foreign policy adviser Randy Scheunemann called Sen. Obama's commitment to a 16-month withdrawal plan "a strategy for defeat."

Sen. McCain has rejected a specific timetable but has said President George W. Bush's U.S. troop buildup that he supported 18 months ago has improved security on the ground enough to make a gradual withdrawal possible.

President Bush and Prime Minister al-Maliki agreed Friday to an unspecified "general time horizon" for withdrawing combat troops from Iraq.

"When a further conditions-based withdrawal of U.S. forces is possible, it will be because we and our Iraqi partners built on the successes of the surge strategy, which Sen. Obama opposed, predicted would fail, voted against and campaigned against in the primary," Sen. McCain said Friday.

Also Friday, the McCain campaign launched a new television ad that blasts Sen. Obama for his lack of foreign-policy experience. "He hasn't been to Iraq in years," the ad's narrator says. "Now Obama is changing himself to become president."

Senior Obama adviser Robert Gibbs rejected Republican criticism that the overseas trip—Sen. Obama's first as a presidential candidate—is a campaign ploy. "This is not a campaign trip." Mr. Gibbs said. "We'll have a series of substantive meetings to talk about the common challenges we face."

In Israel, Sen. Obama is to meet with meet Prime Minister Ehud Olmert, President Shimon Peres, Defense Minister Ehud Barak and opposition Likud Party leader Benjamin Netanyahu. He is also to meet Palestinian Authority President Mahmoud Abbas. For security reasons, his campaign declined to say whether the meeting would occur in the West Bank.

In Europe, Sen. Obama will meet with French President Nicolas Sarkozy, German Chancellor Angela Merkel and British Prime Minister Gordon Brown.

Less gloom cited on U.S. economy in latest survey

By Brian Blackstone

U.S. business economists are somewhat more optimistic about the economy than they were three months ago, but are wary of predicting a sustained upturn anytime this year, according to a newly released survey.

Members of the National Association for Business Economics polled between June 19 and July 10—before mortgage giants **Fannie Mae** and **Freddie Mac** roiled the credit markets—"were more varied than in the decidedly downbeat April survey about recent results and the next few quarters, but they were far from ebullient," said Ken Simonson, chief economist of Associated General Contractors of America, who analyzed the survey results for NABE.

The survey covered members' views on prospects in their own firms or industries in addition to the economy as a whole.

NABE members were roughly split on the outlook for U.S. gross domestic product in the second half of the year. Forty-four percent of respondents expect GDP growth of 1% or higher at an annual rate, while 45% forecast growth of less than 1% and 10% see a contraction.

Survey respondents see "cautious but still positive hiring plans" over the next six months, as well as some stabilization in housing, NABE said.

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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.

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

THE WALL STREET JOURNAL EUROPE (ISSN 0921-99)
Boulevard Brand Whitlock 87, 1200 Brussels, Belgium

Telephone: 32 2 741 1211 FAX: Business: 32 2 732 1102
News: 32 2 741 1600 Editorial Page: 32 2 735 7562

SUBSCRIPTIONS, inquiries and address changes to:
Telephone: +32 2 741 1414 International freephone: 00 800 9753 2000
E-mail: subs.wsje@dowjones.com Website: www.services.wsje.com

Advertising Sales worldwide through Dow Jones International. Frankfurt: 49 69 971428 0; London: 44 207 842 9600; Paris: 33 1 40 17 17 01

Printed in Belgium by Concentra Media N.V. Printed in Germany by Dogan Media Group / Hürriyet A.S. Branch Germany. Printed in Switzerland by Zehnder Print AG Wil. Printed in the United Kingdom by Newsfax International Ltd., London. Printed in Italy by Telestampa Centro Italia s.r.l. Printed in Spain by Bermont S.A. Printed in Ireland by Midland Web Printing Ltd. Printed in Israel by The Jerusalem Post Group. Printed in Turkey by GLOBUS Dünya Basınevi.

Registered as a newspaper at the Post Office.

Editeur responsable: Daniel Hertzberg M-17936-2003

LEADING THE NEWS

Sibling rivalry ends talks

Bad blood between two brothers derails MTN-Reliance deal

By **Jackie Range** in New Delhi
Eric Bellman in Mumbai
Dana Cimilluca in London

A bitter rivalry between two Indian billionaire brothers has scuttled negotiations to combine two of the developing world's largest mobile-phone carriers.

South Africa's **MTN Group** Ltd. and India's **Reliance Communications** Ltd. called off talks Friday over a potential multibillion-dollar deal that would have created an emerging-markets wireless giant.

Behind the collapse of the talks is the long-running feud between Mukesh and Anil Ambani, heirs to the Reliance empire of companies founded by their father. Since the father's death six years ago, the two have been trying to best each other in the highest echelons of Indian business. That rivalry catapulted the brothers into the ranks of the world's richest men.

But it also turned nasty, and ultimately doomed the merger talks between Reliance Communications, one of India's largest wireless companies, and MTN, Africa's biggest telecom company. The development is a blow to the global ambitions of Anil Ambani, the younger brother, who runs Reliance Communications.

Anil Ambani, 49 years old, was unavailable for comment, according to a spokesman. A Reliance Industries spokesman declined comment, and Mukesh Ambani, 51, couldn't be reached.

A deal between MTN and Reliance Communications would have created a company with a stock-market value of about $50 billion and 110 million customers from South Africa to India. It would have been India's largest-ever overseas deal, and established Anil as the standard bearer for India's international expansion, at a time when many Indian companies are seeking to parlay strong economic growth at home into deals abroad.

But in June, elder brother Mukesh threw in a major glitch, alleging that his Reliance Industries has the right of first refusal over any change of control in Reliance Communications. Under structures that were being discussed, Reliance Communications could have been majority acquired by MTN.

People familiar with the matter say that Mukesh's claim—and the legal uncertainty it caused—became an insurmountable stumbling block to doing a deal. Reliance Communications and MTN said Friday they had called it quits before a deadline Monday, when their exclusive talks were scheduled to expire.

Reliance Communications said in a statement: "Owing to certain legal and regulatory issues, the parties are presently unable to conclude a transaction." MTN confirmed that the talks had ended.

The collapse of the talks is likely to create uncertainty about future deals that either brother may seek to consummate abroad, if potential partners become skittish about the prospect of legal wrangling, which has been frequent between the two men. Reliance Communications' international options now appear to be much narrower, since Mukesh could attempt to wield the "right-of-first-refusal issue" over any negotiation involving a change of control in the company. Mukesh's empire includes petroleum, retail and textiles.

Thursday, Reliance Industries initiated an arbitration process against Reliance Communications relating to its right-of-first refusal claim, an event that appears to have contributed to the fate of the MTN deal.

"The personal nature of Mukesh's intervention has clearly been a great embarrassment for Anil, and has clearly triggered a political storm in India as well," said a person familiar with the matter.

— Krishna Pokharel in New Delhi contributed to this article.

Associated Press

Anil Ambani, left, and his brother, **Mukesh Ambani**, have feuded since their father's death. Mukesh scuttled Anil's deal to form an emerging-markets telecom giant.

CORPORATE NEWS

SHIPBUILDING

Norway's Aker Yards says it is reviewing bid by STX

Aker

NORWEGIAN shipbuilder **Aker Yards** ASA said Friday that it will review a mandatory offer made by South Korea's **STX Shipbuilding** Co. and will make a recommendation to its shareholders by Aug. 8.

STX offered 63 Norwegian kroner ($12.39) a share, valuing Aker at just below seven billion kroner, or about $1.4 billion. Last month, STX raised its stake in Aker to more than 40%, triggering a mandatory offer for the remainder of the big shipbuilder.

Analyst Terje Mauer of Glitnir said the offer is low, but the move may signal that STX is prepared to take some time to accumulate Aker shares.

—Elizabeth Cowley

ENERGY

Gazprom plans to cut jobs at Moscow headquarters

Associated Press

OAO GAZPROM said it will slash some of the nearly 6,000 jobs at its Moscow headquarters as part of a cost-cutting plan. Energy-industry analysts welcomed the decision of the Russian state-controlled gas-export monopoly. **Gazprom**, which employs 436,000 people, saw its payroll costs rise 25% last year when it added nearly 4,000 new jobs. Kommersant, a Russian business daily, reported Friday that Gazprom planned to cut 10% of its staff at its Moscow headquarters, where 5,770 people work. The article said Gazprom Chief Executive Alexei Miller, above, signed off on the plan last week. Gazprom confirmed there would be job cuts.

—Associated Press

BANKING

Qatar and Asian investors to close Barclays offer gap

Bloomberg News/Landov

THE QATAR Investment Authority and other Asian investors will provide the bulk of **Barclays** PLC's £4.5 billion ($8.99 billion) in fund raising after the British bank said Friday that 19% of its existing shareholders signed up to buy shares. The offer, which closed Thursday, was launched last month in an effort to shore up Barclays' balance sheet. After raising funds from major overseas investors, Barclays said existing shareholders would have the chance to buy on the same terms. That allowed them to buy shares at 282 pence each, a 9.3% discount at the time of the offer's start. Barclays said shareholders signed up to buy 267 million new shares.

—WSJ Roundup

Citi shows signs of bottoming out

Banks' write-downs reduce the chances of future surprises

By David Enrich

A ROLLER-COASTER WEEK for the American financial system ended on a relatively optimistic note Friday, as **Citigroup** Inc. reported signs of progress at writing down its pile of bad assets even as it announced a big quarterly loss.

Citigroup posted a $2.5 billion loss, which, while large, was better than analysts had been expecting. That news capped a week that began with investors being rattled by the federal seizure of **IndyMac Bank** and by the woes of mortgage titans **Fannie Mae** and **Freddie Mac**—but then saw bank stocks soar 31% from Tuesday to Friday.

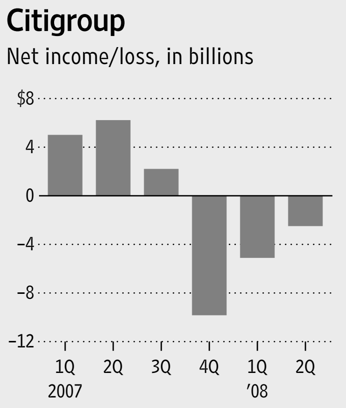
Investors were soothed by the Securities and Exchange Commission's move last Tuesday to place curbs on short selling of financial stocks. Banks such as **J.P. Morgan Chase** & Co. and **PNC Financial Services** Group Inc. also reported second-quarter earnings that were better than expected.

Still, Friday's results from Citigroup also signaled that credit problems are spreading to a wider array of loans around the world. As a result, loan losses are likely to swell for at least another year, even if financial institutions continue seeing write-downs on bad investments decline.

Since rising mortgage defaults sparked the credit crisis last year, investment banks have racked up hundreds of billions of dollars in write-downs. Citigroup alone has suffered more than $40 billion in hits, including $7.2 billion in the second quarter, resulting from its overexposure to complex mortgage-linked securities, huge loans to finance buyout deals and other problem areas.

While Citigroup racked up its third quarterly loss in a row, some analysts and investors were encouraged that the New York financial conglomerate's write-down wasn't any steeper. One big reason: Investment banks are unloading mountains of toxic assets. While that means selling at cut-rate prices and slashing the values assigned to soured securities that no one wants, the moves reduce the odds of gigantic future write-downs.

Associated Press



Source: the company

Any new write-downs will "have to be much smaller in the future," said Tanya Azarchs, a credit analyst at ratings agency Standard & Poor's. Gary Crittenden, Citigroup's chief financial officer, said Friday that the "risk associated with the mega-markdowns is less than it was."

Citigroup shares rose 7.7%, or $1.38, to $19.35 in New York Stock Exchange composite trading at 4 p.m. Despite the rally, Citigroup stock still is down 34% so far this year.

After plunging earlier, the Dow Jones Industrial Average rebounded for a 3.6% gain for the week. On Friday, the index inched up 49.91 points, or 0.4%, to 11496.57, as investors weighed Citigroup's results against disappointing earnings from **Google** Inc. and **Microsoft** Corp.

It remains to be seen how long the sudden burst of optimism in U.S. financial institutions will last. Even if the credit crisis is starting to loosen its stranglehold on Wall Street, the outlook remains dim for commercial banks. The latest results from Citigroup and other big and small banks show that loan problems are cascading from mortgages to credit cards to commercial loans.

Citigroup recorded about $4.4 billion in loan defaults in the second quarter, while also setting aside $2.5 billion to beef up its reserves for future losses. Ominously, banks are shifting more of their concern from subprime borrowers with blemished credit to solid customers, who as a group are increasingly falling behind or defaulting on their loan payments.

The trend is a sign of the growing strain facing many consumers as the U.S. economy suffers from the brutal combination of falling home prices and sky-high fuel costs.

While subprime-mortgage defaults have been crippling and even fatal for some lenders, the pool of credit-card loans and prime mortgages is actually much deeper. Rising defaults in those areas will further drain bank profits and capital at a time when many banks already are restraining lending.

At Citigroup, about 8.5% of its subprime mortgage borrowers, which make up about 16% of the bank's total mortgage portfolio, have fallen at least 90 days behind on their loan payments, and therefore are considered at high risk of defaulting. The so-called delinquency rate is much lower for prime mortgages, but still rising. "There continues to be deterioration," Mr. Crittenden said.

A similar trend is evident in Citigroup's giant credit-card business. Defaults in North America rose in the second quarter to 6.53% of total loans from 5.81% three months earlier. That's the highest loss rate since mid-2005, when a wave of borrowers rushed to file for bankruptcy protection before a new law took effect that made it harder for them to wipe away their debts.

Mr. Crittenden warned that credit-card losses could rise "beyond their historic peaks" of about 7%, a level last seen in early 2004.

Loan defaults are spreading outside the U.S. Citigroup reported a rise in defaults on credit card loans in Brazil, Mexico and India, as well as in Japan, where huge losses have prompted Citigroup to shut down its consumer-finance business.

J.P. Morgan executives sounded a similar alarm about coming trouble in prime mortgages and credit cards when they reported results Thursday.

Despite posting net losses of more than $17 billion in the past nine months, slashing its dividend and bolstering its balance sheet with about $40 billion in outside capital, Citigroup insisted it can withstand future loan losses, assuming its current default projections prove to be accurate.

Citigroup executives touted the second-quarter performance as an early validation of new Chief Executive Vikram Pandit's strategy of slashing costs, drumming up fresh capital, shedding peripheral businesses and managing risk more wisely. Some critics have pushed unsuccessfully for a fundamental reorganization, including a breakup of the financial conglomerate created a decade ago.

Mr. Pandit, who took over in December, will have his hands full for a long time. In addition to spiraling losses in its consumer businesses, revenue is depressed in much of Citigroup's investment bank. Along with others on Wall Street, it is struggling to overcome the evaporation of some businesses since the credit crisis started. Citigroup's wealth-management division also has posted two lackluster quarters in a row.

More indications of how long it could be before the worst loan problems pass will come when **Bank of America** Corp., **Wachovia** Corp., **Washington Mutual** Inc. and other banks report second-quarter results this week.

Motorola sues former executive who joined Apple

By Sara Silver And Nick Wingfield

Motorola Inc. sued a former executive on allegations he violated a noncompete agreement by taking a job as head of global iPhone sales for **Apple** Inc. and helping Apple hire two other former Motorola employees.

The suit, which alleges breach of contract and threatened misappropriation of trade secrets, follows a deterioration in Motorola's cellphone business in the past 18 months. That has led to an exodus of employees to rivals including Apple, BlackBerry maker **Research In Motion** Ltd. and **Cisco Systems** Inc.

The suit was filed Thursday in an Illinois circuit court against Mike Fenger, who quit Motorola in March as senior vice president of mobile devices for Europe, Middle East and Africa to join Apple.

The suit alleges that Mr. Fenger agreed when he received stock options to refrain from working for a competitor for two years after leaving Motorola. It doesn't claim Mr. Fenger stole documents, but simply that Mr. Fenger learned about the communications industry through his work at Motorola. The suit didn't name the two employees he is alleged to have helped Apple recruit.

Last week, Motorola's senior vice president for supply chain, Rita Lane, became the latest executive to move to Apple. Ms. Lane, a former U.S. Air Force officer, was hired by Motorola in 2006 as chief procurement officer, after spending 14 years at International Business Machines Corp. Apple also has hired a Latin American sales executive, Ornella Indonie. Neither Ms. Lane nor Ms. Indonie returned voice mails left at their Apple phone numbers.

The lawsuit seeks to enjoin Mr. Fenger from his job until March 2010, and seeks reimbursement of millions of dollars in stock options.

Apple and Mr. Fenger declined to comment on the lawsuit. In a statement, Motorola said it "is seeking all available remedies to protect its trade secrets, confidential information, and customer relationships."


CHEVRON PRESENTS: ENERGYVILLE
An energy game developed by The Economist Group
Chevron
The Economist Group
This is your city.
How will you power it?
How do we meet growing global demand? What new kinds of fuels and power sources should we develop? And how do we safeguard the environment at the same time? These are the questions facing us all. And together, we can find the answers.
To help encourage greater understanding and discussion toward solutions, Chevron brings you Energyville, an online, interactive game that puts you in charge of meeting the energy demands of your city. It's a chance to put your theories into practice. Choose from a portfolio of energy sources to power your city today, and through 2030. Every decision you make will affect the environment, the economy, and your city's security.
After you play, share your results and challenge others. Because only when we come to understand and discuss the energy problems our planet faces, can we find the inspiration and know-how needed to solve them together.
Play it. Power it. Discuss it.
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PARKING

CORPORATE NEWS

GDF Suez's chief confident of gas supply

Energy, environment pose big challenges for new French utility

BY DAVID GAUTHIER-VILLARS AND LEILA ABBOUD

New French energy company **GDF Suez** is the world's largest utility by revenue, Europe's biggest buyer of natural gas, and an important operator in nuclear power. Created through the merger of state-controlled utility Gaz de France with electricity and natural-gas rival Suez SA, GDF Suez is also a testament to the French government's activist stance in shaping domestic industries.

Veteran Suez executive Gérard Mestrallet heads the new group. He must stitch together a company with annual revenue of €74 billion ($117 billion) and almost 200,000 employees. GDF Suez is caught up in some of the world's most pressing energy and environmental challenges: rising energy prices, global warming, and Russia's use of its energy exports to Europe as a tool of political influence.

The 59-year-old Mr. Mestrallet is an engineer by training and an avid horseman with a soft spot for Belgian beer. He's also a survivor: He steered Suez out of debt problems five years ago, and last year, when the proposed merger was on the rocks, he orchestrated compromises among bickering unions, politicians, and shareholders to ensure the deal would go ahead.

Excerpts from an interview with Mr. Mestrallet:

David Metra/VpN for The Wall Street Journal

Gérard Mestrallet, who heads GDF Suez, faces the challenge of stitching together a company with annual revenue of $117 billion and almost 200,000 employees.

WSJ: The French government orchestrated the GDF Suez merger to ensure the country can secure natural-gas supplies to heat homes and power industries. But your company has few natural-gas fields of its own, and instead buys gas from producers. How can you make sure gas keeps flowing to Europe?

Mr. Mestrallet: The security of supply does not depend on the gas you own. It comes from having diverse set of long-term contracts with gas suppliers. GDF Suez will have the largest diversified portfolio of sources of natural gas in the industry. Our gas comes from Norway, the Netherlands, Algeria, Qatar, Russia, Egypt, Libya, Yemen, Nigeria and Trinidad & Tobago. Take Yemen: We have signed a contract to buy one-third of the liquefied natural gas production of one field for 20 years. We don't need to own the gas well itself.

WSJ: Yet GDF Suez relies heavily on gas from Russia. In 2006, Russia's state-owned giant Gazprom briefly cut off deliveries to Ukraine in winter, sending a panic through European markets. How will you manage this delicate relationship with Russia?

Mr. Mestrallet: We consider Gazprom a very reliable partner; it's not a delicate relationship. It's worth noting that during the crisis in 2006, France and Belgium were the only two countries in Europe that did not suffer shortages. That's because in France we have very large underground gas-storage capacity. The storage was full at the beginning of the crisis and quite empty at the end.

WSJ: Consumers are anxious about their rising energy bills. In Europe, we've seen protests against oil companies by fishermen and truckers. Do you fear a wider backlash against energy companies?

Mr. Mestrallet: All over the world, natural-gas prices are linked to oil prices. Of course, when natural-gas prices are high, consumers are never satisfied. But it would be worse and more difficult to explain to consumers if we could not deliver adequate gas supply in winter. Our most important responsibility is to avoid shortages.

Powerhouse

If GDF Suez had existed in 2007, it would have had:

Revenue: €74.3 billion

Operating profit: €8.53 billion

Net profit: €5.57 billion

Employees: 196,560

Largest shareholders:
French state: 35.7%
Groupe Bruxelles Lambert: 5.3%

Note: €1 billion = $1.58 billion at current rate
Source: GDF Suez prospectus

WSJ: Do you fear that energy companies are seen as the corporate "bad guys" of today—like tobacco companies were a decade ago?

Mr. Mestrallet: I think we have to give people a more positive feeling about energy companies. If energy is seen only through the lens of increasing prices, that will create problems. We've created in GDF Suez a division dedicated to energy efficiency. We recently re-engineered the internal manufacturing processes at a Volvo truck plant in Belgium to help save energy.

WSJ: Europe has been a leader in the fight against global warming, yet the Continent's emissions are still growing 1% a year. What has gone wrong?

Mr. Mestrallet: It has been quite courageous and risky for Europe to make unilateral commitments to reduce emissions. But now others must follow. The United States has a special responsibility. How can you ask China and India and others to dramatically reduce their carbon dioxide emissions, which in the short term would mean reducing their growth and slowing the pace at which they eliminate poverty, while the richest country is doing nothing? I hope the U.S. authorities will decide to take action soon.

WSJ: Do you think European companies have been hurt by the region's effort to curb its greenhouse-gas emissions?

Mr. Mestrallet: There is a risk that they will be. There have to be global rules of the game. If only one region makes all the effort while the rest of the world keeps emitting carbon, it represents a big penalty for European industry.

WSJ: GDF-Suez has proposed building and operating two nuclear power plants in the United Arab Emirates. How do you manage the risk of nuclear power in volatile regions?

Mr. Mestrallet: The UAE has a very stable political environment, and the necessary legal and regulatory frameworks.

WSJ: But how will you help the United Arab Emirates and other nuclear newcomers develop a nuclear safety culture?

Mr. Mestrallet: The French state has promised to help these countries create the control and safety agencies that they'll need. The French are willing to transfer regulatory and legal know-how by signing bilateral agreements for the development of civilian nuclear programs.

WSJ: The French state has a 36% interest in your company. Who is in the driver's seat at GDF Suez, you or President Nicolas Sarkozy?

Mr. Mestrallet: More than 99% of shareholders voted in favor of the merger. So I think we have convinced them that the presence of the state will not prevent GDF Suez from growing and making money.

Big shareholder backs Yahoo in proxy fight, pressing Icahn

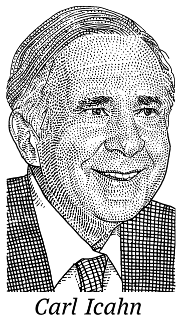
BY JESSICA E. VASCELLARO AND JOANN S. LUBLIN

Yahoo Inc.'s board received a major shareholder endorsement Friday, increasing pressure on activist investor Carl Icahn to consider a compromise in his proxy battle against the Internet company.

Legg Mason Capital Management—which owns a 4.4% stake in Yahoo—said it would support Yahoo's slate of directors at the Aug. 1 shareholder meeting.

Mr. Icahn, whose funds have a roughly 5% stake in Yahoo, is trying to replace the board in a disagreement about Yahoo's rejection of a number of offers from **Microsoft** Corp.

"We believe the current board acted with care and diligence when evaluating Microsoft's offers," Legg Mason Chairman Bill Miller said, calling the board "independent and focused on value creation for long-term shareholders."



Carl Icahn

Mr. Miller also said he would prefer that the company and Mr. Icahn reach an agreement on the board's composition to end what he called a "disruptive" proxy contest.

Mr. Miller was one of a few large shareholders who expressed his frustration with Yahoo publicly after acquisition talks with Microsoft fell apart in May. At the time, Mr. Miller suggested he would have been happy with a sale price lower than what Yahoo had demanded.

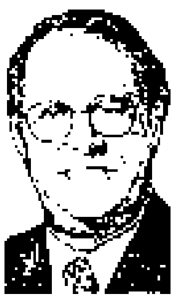
Several other large shareholders have yet to declare how they plan to vote in the election, although few seem likely to support Mr. Icahn's entire nine-person slate. Several institutional investors intend to support some but not all of his nominees, according to someone familiar with those investors. "That bodes well for a settlement—and not for Icahn getting control," this person said.

Many institutional investors will decide whether to support Mr. Icahn's slate based on a recommendation from ISS Governance Services, the biggest U.S. proxy-advisory service. The **RiskMetrics Group** Inc. unit wields tremendous clout in counseling investors about proxy fights, director elections and shareholder resolutions.

Yahoo Chief Executive Jerry Yang, three other executives and three outside directors pitched their case Thursday during a meeting at ISS headquarters in Rockville, Md., according to people familiar with the situation.

Despite persistent rumors of settlement talks, Mr. Yang and his colleagues gave no hint that they might give Mr. Icahn four board seats as a compromise, one person said. The Yahoo officials reviewed both their board and the Icahn lineup without saying whether they would find Mr. Icahn's nominees "acceptable," that person added.

For now, a compromise appears unlikely because Yahoo directors feel they "are in a pretty strong position here," a second person with knowledge of the situation said.



Bill Miller

ISS officials asked independent Yahoo directors whether they might replace Mr. Yang and other top executives, but they insisted that they still support current management's strategic plan because it "would increase value over time," recalled the first person familiar with the situation.

ISS staffers then questioned why the board would sell the company for $33 a share if the strategic plan makes sense.

Yahoo directors said they mentioned the $33 figure in order to demonstrate they were willing to sell the company at a price shareholders would support, people familiar with the matter said.

Earlier, Yahoo Chairman Roy Bostock and Mr. Yang blasted Mr. Icahn as a "corporate agitator" who wants to "get his money back quickly" as they shed slightly more detail on their plans for improving shareholder returns.

In the second letter Yahoo sent to shareholders last week, the Yahoo leaders reiterated the board's willingness to sell the Internet company for $33 a share or higher to **Microsoft** Corp. in a deal that delivers "certainty of value and closing." The board also continues to actively examine other "value-creating steps," including a potential spinoff of the company's Asian assets and a return of cash to shareholders, they wrote.

The letter struck a more conversational tone than previous missives, as it traced the history of Yahoo's proxy war with the billionaire activist. Mr. Icahn, whose funds own roughly 5% of Yahoo, is leading a campaign to take over the Yahoo board at its shareholder meeting Aug 1.

Messrs. Bostock and Yang had barbs for Microsoft, whose proposal to acquire Yahoo's search business was rejected by Yahoo. They accused the software giant of cozying up to Mr. Icahn in an "odd-couple alliance" and being interested mainly in buying Yahoo "at a bargain-basement price."

"Microsoft's flip-flops and inconsistencies over the past five months are so stupefying that one can only conclude that Microsoft was never fully committed to acquiring Yahoo," they wrote.

"They say I'm a short-term agitator, but the most money I've made are those investments that I held six, seven, eight years," said Mr. Icahn, citing various energy, railcar and casino investments. "They say I can't manage, but my modus operandi is to put good CEOs in to run my various companies and they've prospered.

"The letter they sent is like something out of 'Alice in Wonderland.' Their search business is losing share and is risky. Someone comes along, offers a guarantee of $2.3 billion a year, and they refuse to negotiate—you need the Mad Hatter to explain why."

Mr. Icahn was unavailable for comment. A Microsoft spokesman declined to comment.

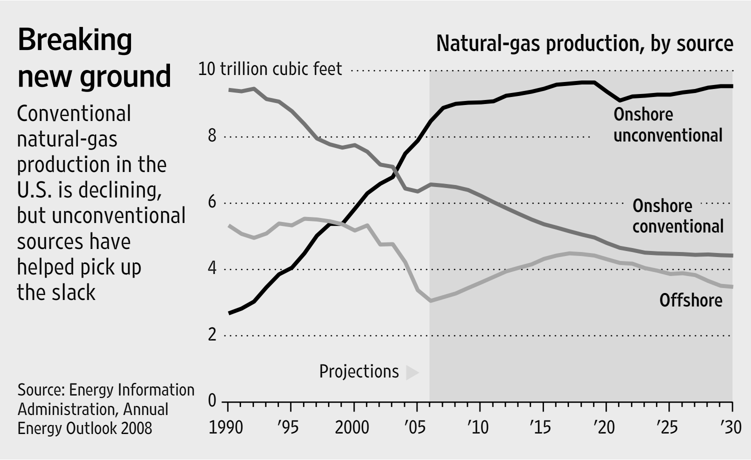
—Benjamin Pimentel and Gregory Zuckerman contributed to this article.

CORPORATE NEWS

BP buys into Oklahoma

U.S. energy reserves regain their allure; Big Oil's big shift

By Ben Casselman And Russell Gold



Oil giant **BP** PLC will pay $1.75 billion for natural-gas assets in Oklahoma, placing a big bet on North America's booming unconventional gas fields.

The deal with Oklahoma City-based **Chesapeake Energy** Corp. is the latest sign of a major shift in Big Oil's strategy. For years, the largest oil companies have all but ignored the continental U.S. in favor of huge oilfields overseas and offshore. Now, facing declining production, shrinking reserves and increasing political challenges, the companies are coming back.

They are returning to a rapidly changing North American energy scene. In recent years, smaller independent companies including Chesapeake have learned how to produce gas from unconventional reservoirs—tightly packed sands, coal beds or dense rocks called shales—that were long considered too difficult or too expensive to produce. That has led to a drilling boom in Texas, Colorado, Pennsylvania and elsewhere, spurred in part by soaring energy prices.

Global companies such as BP have largely remained on the sidelines, shunning the fields because they require hundreds of small wells managed by large numbers of employees. In years past, they sold most of their U.S. assets, arguing it was a mature region that didn't offer adequate returns.

Now that is changing as they face harsh political treatment in energy-rich nations and are losing access to the world's best remaining reserves.

BP's dive into unconventional U.S. gas is "a seminal event," said Ralph Eads, chairman of Jefferies Randall & Dewey, the energy-investment-banking arm of Jefferies & Co.

Like most big oil companies, BP has struggled recently to replace aging fields and grow production. Its oil and gas production was down 2.8% in 2007 from a year earlier.

In Thursday's deal, the company is buying natural-gas leases believed to contain two trillion cubic feet of gas, the equivalent of more than 350 million barrels of oil. Chesapeake produces about 50 million cubic feet per day production on the Oklahoma property.

BP's announcement comes three days after rival **Royal Dutch Shell** PLC announced a 5.9 billion Canadian dollars (US$5.87 billion) takeover bid for Canadian natural-gas producer **Duvernay Oil** Corp. Shell also has partnered with **EnCana** Corp. to enter what has become the hottest new unconventional play, the Haynesville Shale in east Texas and Louisiana.

In April, Exxon Mobil Corp. bought an interest in an unconventional gas field in Hungary and has plans for gas wells in Germany also. ConocoPhillips jumped ahead of the trend in 2005 when it purchased Texas-based gas-producer Burlington Resources Inc. for $35 billion.

Unconventional oil and gas fields offer significant advantages. Not only are they in politically stable areas, they offer relatively little risk. Because each well is much like another, costs can actually go down over time, a sharp contrast to the rapidly rising costs of wells overseas.

"I think they're blown away with what the end results are," said Jefferies & Co. analyst Subash Chandra. "The resource grows over time and the costs go down."

The numbers are huge. The first major shale field to be produced—the Barnett Shale near Fort Worth, Texas—is estimated to contain 1.5 trillion cubic meters of gas, the equivalent of nearly nine billion barrels of oil, about as much as the recently discovered giant Tupi field off the coast of Brazil. Chesapeake estimates the Haynesville field could hold five times that, and other major shale fields have been found in Arkansas, Pennsylvania and British Columbia.

Chesapeake Chief Executive Aubrey McClendon said the deal with BP should highlight the importance of such fields.

"What the market should pay attention to is that a company like us has assets that have appeal to the biggest companies in the world," Mr. McClendon said.

Thursday's deal likely won't be the last of its kind. Big Oil is suddenly realizing "this wild shale mania is for real," says Art Smith, president of Triple Double Advisors LLC, a Houston-based energy investment manager.

He predicts there will be more deals as the global companies seek to build production in the stability of North America. "I absolutely see more deals coming," he said. "We've long thought they were going to regret their decision to ignore North America."

The deals highlight how attractive operating in the U.S. and other politically stable countries has become as Western oil companies find themselves increasingly boxed in by foreign governments emboldened by high oil prices.

These companies have full or partial access to only 13% of the world's oil and gas reserves, according to consultant PFC Energy, down from 19% of global reserves a decade ago and 85% in 1970.

BP made a large bet several years ago in Russia, setting up a joint venture called **TNK-BP** Ltd. But it is now in a dogfight with its Russian partners, whom it accuses of engineering a wave of police, labor and tax investigations and immigration problems for TNK-BP's foreign staff in a bid to seize control of the company. The Russian shareholders deny the claim.

Last year, Venezuela required oil companies to cede control of their interests there, forcing Exxon and ConocoPhillips to exit the country.

"The world has been getting much smaller to them for some time," said Jefferies' Mr. Chandra.

Zentiva snubs Sanofi buyout offer

By Sean Carney And Monica Mark

LONDON—Czech generic-drug maker **Zentiva** NV turned down a €1.24 billion ($1.96 billion) buyout offer from French pharmaceutical company **Sanofi-Aventis** SA, saying the bid didn't reflect its underlying value.

Sanofi, which already holds a 24.9% stake in Zentiva, offered 1,050 Czech koruna ($72.35) a share, for the rest, valuing the whole company at €1.66 billion.

The offer, which trumped a rival bid of 950 koruna a share from Czech financial company **PPF Group** NV, is subject to Sanofi acquiring more than half of Zentiva's capital and voting rights.

Zentiva has recommended that shareholders not act on either bid. Analysts predict a waiting game to see which company, if any, will make the next move.

Zentiva shares closed at 1,125 koruna each, up five koruna.

"It now depends on the commitment of the parties to finalize the transactions and go ahead and try to gain control," said Vladimira Urbankova, analyst at Erste Bank in Vienna. "The market expects something, or else the price wouldn't be above the highest bid. People are not convinced the bidders are at the top," she said.

In rejecting Sanofi's offer Friday, Zentiva said it is "well placed to participate in further expected industry consolidation and shareholders could miss out on participating in the benefits of a synergistic transaction or from receiving a premium in a change-of-control transaction."

A Sanofi spokesman said Sanofi still considers the bid to represent the fair value of the company and to be in the best interest of Zentiva's shareholders.

Milan Vanicek, head analyst at Atlantik Financial Markets in Prague, said the ball is now in PPF's court to make a counteroffer, but he added that if no new offer is made, some shareholders may take up Sanofi's offer before it expires Sept. 19 and sell to make at least some profit from the takeover attempts.

PPF wasn't available to comment Friday.

Israel's Teva to acquire Barr for $7.46 billion

By Shirley S. Wang

Teva Pharmaceutical Industries Ltd. will acquire U.S. rival **Barr Pharmaceuticals** Inc. for roughly $7.46 billion, the companies announced Friday, a move that will lift the Israeli generic-drug maker's position in emerging markets and expand its product portfolio as the sector consolidates.

Teva will assume $1.5 billion of debt as part of the deal, which is valued at $66.50 per share of Barr stock and is expected to close in late 2008. "The combination of our two companies provides an outstanding opportunity strategically and economically," said Shlomo Yanai, Teva's president and chief executive.

In making the purchase, Teva will take over the world's fourth-largest generic-drug company by sales and strengthen its position in fast-growing Central and Eastern European markets. The deal also will expand its generics business—Barr, of Woodcliff Lake, N.J., has the right to come to market with several drugs that go off-patent in coming years—and its smaller, branded pharmaceutical business, particularly with Barr's robust women's health franchise.

The price represents a hefty premium over Barr's share price, which was trading in the mid-40s before news that a deal was in the works; Barr CEO Bruce Downey called it a "very fair and generous price for the shares." His company had a sluggish first quarter, in which it failed to meet Wall Street's expectations.

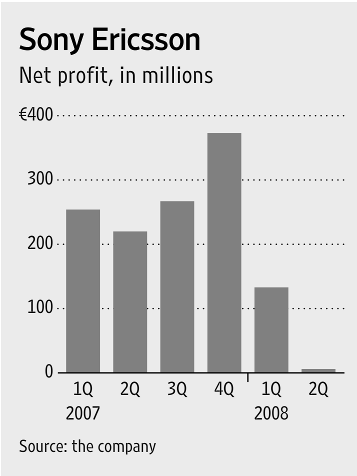
As reports of the talks surfaced Thursday, Barr's stock shot up more than 20%. On Friday, it climbed 11%, or $6.26 a share, to $63.43 in 4 p.m. New York Stock Exchange composite trading, while Teva American depositary receipts rose 4.4%, or $1.82, to $42.87, as of 4 p.m. in Nasdaq Stock Market composite trading.

In 2007, Teva had profit of $1.95 billion on revenue of $9.41 billion, while Barr's profit was $128.4 million on revenue of $2.5 billion.

"I think the market views it as a favorable transaction from both Teva's perspective and Barr's perspective," said Tim Chiang, a specialty-pharmaceutical analyst at equity-research firm FTN Midwest Securities. "Teva...was looking for another vehicle for growth with minimal overlap, geographically and in the therapeutic categories that Barr currently sells in; [Barr's portfolio] complements Teva's overall business."

Sony Ericsson profit plunges on competition, weaker sales

By Adam Ewing



STOCKHOLM—Sony Ericsson barely broke even in the second quarter amid continued weak sales of midlevel to high-end phones and heightened competition, and it said it would cut costs to boost profitability.

The mobile-phone maker, a joint venture of **Sony** Corp. of Japan and **Telefon AB L.M. Ericsson** of Sweden, said Friday that second-quarter net profit fell 97% to €6 million ($9.5 million) from €220 million a year earlier on slowing growth in mature markets, including Europe and the U.S.

Net sales fell 9.4% to €2.82 billion from €3.11 billion.

Sony Ericsson flagged the lackluster results with a profit warning in June—its second this year—when it said slower growth in Western Europe would hurt results.

Unlike Finland-based rival **Nokia** Corp., which dominates sales in fast-growing emerging markets, Sony Ericsson has only recently attempted to broaden its emerging-market portfolio, making it more susceptible to slipping demand for high-end devices in developed regions.

The company said conditions are expected to remain challenging through the second half of the year, particularly in the third quarter.

As a result, Sony Ericsson said it will cut costs by €300 million annually, with the full effect expected in a year. Restructuring charges will be at the same level as the reduction in operating expenses, the company said.

President Dick Komiyama said the company would cut about 2,000 jobs across the business, without giving further details.

"It's tough to see how the economy is going to change," Mr. Komiyama said in an interview. "Today, what we see is more competition in Europe and slowing consumer demand, even in India."

Total unit-volume growth in India was 25% to 30% last year but is now at about 17% to 18%, he said.

The company is rolling out several new products in the second half, including the XPERIA X1, a high-end device that runs on Microsoft Corp.'s Windows Mobile operating system.

Sony Ericsson shipped 24.4 million phones in the quarter, down 2% from a year earlier. However, its market share rose to 8% from 7.5% in the first quarter. The company said it still expects the global handset market to expand by about 10% in 2008, largely in fast-growing areas such as India and China.

The company slipped to the No. 5 spot globally in terms of units shipped in the first quarter—the latest available from research firm Gartner, which compiled the list—ranking behind Nokia, **Motorola** Inc., **Samsung Electronics** Co. and **LG Electronics** Inc.

The average selling price for its handsets fell to €116 from €121 in the first quarter and €125 a year earlier.

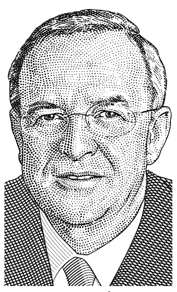
CORPORATE NEWS

VW's chief still hopeful as auto market toughens

Winterkorn touts new lines, confirms full-year targets

By Christoph Rauwald

WOLFSBURG, Germany—**Volkswagen** AG Chief Executive Martin Winterkorn said he expects his company to cope better with the difficult market environment than other auto makers and confirmed VW's full-year targets of higher revenue, operating profit and vehicle sales.



Martin Winterkorn

"We stand by what we've said," Mr. Winterkorn said. Last year, Volkswagen sold 6.2 million vehicles, raising its revenue 3.8% to €108.89 billion (US$172.49 billion) from €104.88 billion a year earlier.

Mr. Winterkorn said he is more worried about the years beyond 2008, when higher raw-material prices might translate into price increases. "We'll have to think about price hikes at some point," he said. "We can't compensate everything."

Some of the world's top auto executives have similar worries. Carlos Ghosn, who is chief executive of both **Renault** SA of France and Japan's **Nissan Motor** Co., has warned that his companies are unlikely to meet previously set sales targets because of slumping demand in markets such as Western Europe and the U.S.

On Wednesday, **Toyota Motor** Corp. said it is reviewing its global sales plan for 2008 and may downgrade targets in light of falling demand for large vehicles in the U.S. amid the jump in gasoline prices.

Mr. Winterkorn said VW's advantage is its new products, particularly the smaller, more fuel-efficient models. Those models could prove important in the U.S., where Volkswagen wants to triple annual car sales by 2018.

The CEO also said he would support a combination of Volkswagen's two suppliers, **Continental** AG and **Schaeffler Group**, but warned that a hostile takeover could have negative effects on business.

Mr. Winterkorn was reacting to Continental's rejection of an €11.2 billion takeover bid by the private German engineering company.

Roche moves up earnings report

By Anita Greil

ZURICH—Swiss pharmaceutical company **Roche Holding** AG said Sunday it will publish its first-half earnings on Monday, bringing the release forward from the originally scheduled Thursday.

Roche spokesman Daniel Piller declined to give a reason for the change.

The move was unusual for Roche, which doesn't typically change reporting dates on short notice. Even when it surprised markets a year ago by announcing that its young head of diagnostics would take over as CEO of the group, it did so along with its regular half-year earnings release.

The Basel-based company's new chief executive, Severin Schwan, has said he would continue the strategy of his predecessor, Franz Humer, of avoiding big mergers or entering the market for generic medicines. Mr. Schwan, who assumed the job in March, will be presenting the company's earnings for the first time.

Nokia to face off with Qualcomm in patents trial

By Don Clark

Are **Qualcomm** Inc.'s patent royalties an unfair tax on cellphone makers? Or have they helped the industry?

Those questions are at the heart of a high-stakes trial that begins in a U.S. courtroom in Delaware Wednesday. Cellphone giant **Nokia** Corp., which says it has paid more than $1 billion in royalties to Qualcomm since the 1990s, believes it is paying too much.

Qualcomm sells chips for cellphones, but gets more than half of its profits from patent fees. The San Diego-based company, which also reports its third-quarter results Wednesday, is battling Nokia and others in cases that cost $200 million in legal fees in its last fiscal year.

"We are winning in the marketplace, so our competitors are trying to beat us in the courtroom," said Paul Jacobs, Qualcomm's chief executive, during its annual meeting in March. "We have to continue to defend our business model."

That model has its roots in Qualcomm technology called CDMA—code division multiple access—that took a minority share in the 1990s but plays a role in all current third-generation networks. It typically charges cellphone makers close to 5% of the price of each handset to license its patents.

Nokia signed a licensing agreement with Qualcomm in 1992. They signed a revised pact in 2001 that expired in April 2007, touching off a flurry of lawsuits.

The Delaware case isn't likely to end them, but the winner could get significant leverage in negotiations over a new deal. Nokia argues that Qualcomm forfeited the right to seek injunctions in suits to enforce many patents, because it pledged a European standard-setting group to license them under fair and nondiscriminatory terms. A victory on that point would take a big legal weapon away from Qualcomm.

Nokia also contends it has a paid-up license to Qualcomm's most important patents, and that the rest are worth much less when balanced against Nokia's own patents. "Qualcomm's expectation that we would continue on those old terms relevant 15 years ago is unreasonable," a Nokia spokeswoman says.

Qualcomm says Nokia is wrong about the worth of its newer patents and its obligations to the standard-setting group. It contends that Nokia extended the 2001 pact by default—under the same licensing terms—by using Qualcomm inventions after it expired.

What opponents really don't like, Qualcomm executives say, is how it helps competing handset makers enter the market. It criticizes Nokia and five other electronics companies for simultaneously filing complaints against the company in 2005 with European antitrust authorities, under an effort code-named Project 17. "It was clearly a coordinated effort," a Qualcomm spokeswoman says.

The Nokia spokeswoman says such code names and cooperation are nothing unusual. "There is no conspiracy here," she says.

GLOBAL BUSINESS BRIEFS

Delhaize Group

Rising cost of oil and food cuts into supermarket sales

Belgian supermarket operator **Delhaize Group** Friday cut its full-year forecast, saying that higher oil and food prices are taking their toll on customer spending. The company's shares fell 18% following the announcement, but rebounded to close down 8.2%. Delhaize said net profit in 2008 is now expected to grow 15% to 20% from 2007, down from the 25% to 30% range previously expected. Sales are expected to grow 3% to 4.5%, down from a range of 4% to 5.5%. Chief Executive Pierre-Olivier Beckers said the company is taking a range of steps to ride out the slowdown. These include building up private-label products, increasing price competitiveness and adding sales promotions.

Saab AB

Saab AB posted a 21% drop in second-quarter net profit, hurt mainly by a weak dollar as well as marketing costs promoting its Gripen fighter jets. The Stockholm-based aerospace and defense company said it was pressured by high oil prices as well as delays in two aircraft projects. Net came to 341 million Swedish kronor ($57 million), down from 434 million kronor a year earlier, while sales rose slightly to six billion kronor from 5.9 billion kronor. Saab said it still expects 5% organic sales growth and an operating margin of 10% for 2008, in line with its long-term financial objectives. Chief Executive Ake Svensson said interest in its Gripen fighter jets "is greater than ever."

Atlas Copco AB

Atlas Copco AB, the world's largest maker of air compressors, said second-quarter net profit increased 3.7% thanks to strong order growth, which more than offset restructuring and currency costs. Net profit rose to 2.45 billion kronor ($410.6 million) from 2.37 billion kronor a year earlier. Sales were up 18% to 18.88 billion kronor from 15.99 billion kronor. The company said it expects demand for its products and services from most customer segments and regions to remain at a high level, primarily due to strong demand in emerging markets and the mining industry. However, it expects weakening demand related to consumer goods and residential construction in North America and Europe. Atlas Copco manufactures products in about 20 countries and had 34,458 employees at the end of June.

Schaeffler Group

Schaeffler Group said it welcomes Continental AG's willingness to enter into talks, but it still wants a stake of more than 30% in the German auto supplier and tire maker. A stake of 20% as suggested by Continental Chief Executive Manfred Wennemer "is not a strategic one and thus as a purely financial investment from Schaeffler Group not to be justified," the closely held German engineering firm said in a statement. On Wednesday, Continental rejected the €11.2 billion ($17.7 billion) takeover offer. In an interview with Frankfurter Allgemeine Sonntagszeitung, Mr. Wennemer is cited as saying the company has "good chances" of fighting off Schaeffler's bid. Schaeffler has said it holds a 2.97% stake in Continental, is entitled to own a further 4.95%, and has entered into swap transactions for about 28% of Continental's shares.

Rambler Media Ltd.

Russian Internet company **Rambler Media** Ltd. said it would sell 100% of online advertising-services company ZAO Begun to **Google** Inc. for $140 million. "This agreement means more Russian users, advertisers and partners will get better search results and more relevant advertising," said Mohammad Gawdat, Google's managing director for emerging markets. According to Rambler, Begun has more than 40,000 advertisers and its partner network includes more than 143,000 Russian-language sites. Revenue from search-related, text-based advertising on Russian-language Internet sites more than doubled last year to $225 million, Rambler said. Rambler, controlled by tycoon Vladimir Potanin's **Prof-Media** group, currently owns 50.1% of Begun but will buy the remainder ahead of the sale to Google.

China Petroleum & Chemical

China Petroleum & Chemical Corp., Asia's largest refiner by capacity, said it expects its first-half net profit to fall more than 50% from a year earlier because of surging oil costs. The profit warning from the company known as Sinopec didn't come as a surprise, because oil prices surged nearly 50% in the first six months of the year. Beijing didn't implement a long-awaited fuel-price increase of up to 18% until mid-June. Before that, the government provided subsidies and refunds on its value-added tax on oil imports, which wasn't enough to offset Sinopec's losses. Domestic gas and diesel prices remain a third below international levels. Sinopec posted a net profit of 34.93 billion yuan ($5.12 billion) in the first six months of 2007.

Nomura Holdings

Nomura Holdings said it received licenses last month from the Indian government to trade stocks, as well as stock futures and options, as it aims to tap investor demand in one of the world's fastest-growing economies. Nomura's full-scale operations will be the first in India for a Japanese firm spanning stock-trading, investment-banking and asset-management services. Due to weak demand at home, Japanese financial institutions have started increasing their overseas operations, particularly in emerging markets. Nomura's smaller rival, **Daiwa Securities Group** Inc. announced an agreement on a business alliance with Brazil's **Banco Itau Holding Financiera** SA in investment-trust products.

AMR Corp.

AMR Corp.'s American Airlines will cut 1,500 jobs in its maintenance division as it reduces its fleet of aircraft. The job reductions are part of the carrier's previously announced plans to shed 8% of its work force, or about 6,800 jobs, to cope with financial distress brought on by record fuel costs and a weakening economy. The airline told employees of the cuts in memos this week. American didn't break down the cuts by location. Besides maintaining American's jets, workers at the hubs also work on jets brought in by other carriers. American has about 14,000 employees in its maintenance division, including management and support staff. The company has said it will eliminate 900 flight attendant jobs and 200 pilot positions.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

EURO ZONE

Foreign-trade balance swung to a deficit in May

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THE EURO zone's foreign-trade balance swung to a deficit in May in a sign the euro's strength and weakening global demand are weighing on exports, Eurostat said Friday. The 15 countries that share the euro recorded a trade deficit of €4.6 billion ($7.29 billion) with the rest of the world in May, shifting from a revised €2.5 billion surplus in April. "The double whammy of a strong euro, which makes euro-zone exports less competitive, and the sharp slowdown in the U.K. and the U.S., two of the region's key export markets, is making life increasingly difficult for euro-zone exporters," said Martin van Vliet, a European economist at ING. *—Nicholas Winning*

EUROPEAN UNION

Emergency fund proposed to aid in global food crisis

Associated Press

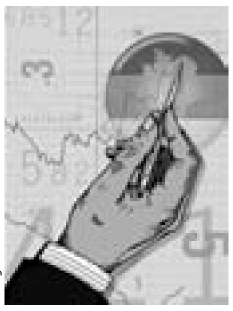
THE EUROPEAN UNION on Friday proposed a €1 billion ($1.58 billion) two-year emergency fund to help poor countries cope with the global food crisis. European Commission President José Manuel Barroso said the fund will aim to help mostly African nations, using cash that has gone unspent in this year's EU agricultural budget.

An EU spokesman said the fund, if approved by EU governments and the European Parliament, would provide urgent funding to aid agencies to boost supplies of fertilizer and seeds to increase the planting of crops over the next two years.

—Associated Press

GERMANY

Producer prices rise 6.7%, boosting pressure on ECB



Inmagine

GERMAN producer prices surged 6.7% in June from a year earlier, their fastest annual increase since March 1982, the Federal Statistics Office said.

The bigger-than-expected increase will pose a further challenge to the European Central Bank as it struggles to contain inflation in the euro zone, which is already double the central bank's preferred target just below 2%.

Heating-oil prices jumped almost 65%, while gasoline prices leapt 11%. Electricity prices jumped 15.6%.

Excluding the energy-price increases, the index rose 3% from a year earlier.

—Nina Koeppen

Heat rises under Iran

U.S., Europe vow additional penalties if nuclear talks fail

BY JAY SOLOMON

THE U.S. is fine-tuning new financial penalties against Iran that would target everything from gasoline imports to the insurance sector, and the prospect of such sanctions grew after talks over its nuclear-fuel program this weekend made no progress.

U.S. and European officials said they will intensify efforts to impose these penalties should their diplomatic drive fail to induce Iran to freeze its nuclear program. The sanctions effort could include measures to impede Iran's shipping operations in the Persian Gulf and its banking activities in Asia and the Middle East, the officials said.

On Saturday, talks with Iran in Geneva failed to produce any progress, despite U.S. participation at the highest level since the 1979 Iranian revolution. Represented by European Union foreign-policy coordinator Javier Solana, the U.S., Russia, China, Britain, France and Germany gave Iran two weeks to respond to Mr. Solana's proposals to launch real negotiations or face further sanctions.

The five permanent members of the United Nations Security Council, plus Germany, are offering Iran economic and energy assistance, security assurances and enhanced diplomatic ties in exchange for concessions on its nuclear program.

"We have not gotten all the answers to the questions," Mr. Solana told reporters after Saturday's meeting. He said the two-week time-frame was meant to give Iran the space to come up with "the answers that will allow us to continue."

In Washington, a U.S. official was more blunt. "We hope the Iranian people understand that their leaders need to make a choice between cooperation, which would bring benefits to all, and confrontation, which can only led to further isolation," said State Department spokesman Sean McCormack.

The Security Council has demanded that Iran suspend its uranium enrichment program, which can produce civilian- or weapons-grade nuclear fuel. Iran has said repeatedly it won't do that, but there had been hopes Saturday's meeting could launch a period of preliminary talks that could start if Iran agreed temporarily to freeze its enrichment at current levels in exchange for a freeze on further sanctions.

In a sign of these hopes for progress, the U.S. sent Undersecretary of State for Political Affairs William Burns, Washington's No. 3 diplomat, an unprecedented move in the nuclear talks with Iran, which have been going since 2003. American officials said Mr. Burns's attendance would also make it easier for the U.S. to compel its negotiating partners to impose tougher measures should this "freeze-for-freeze" approach fail.

A number of Western diplomats and strategists acknowledge there is significant risk in President George W. Bush's decision to directly engage Iran on the nuclear issue. For one, they say, the Iranians could use the negotiating process as a means to divide the Europeans and Americans over sanctions while continuing to enrich uranium.

These officials also said the negotiating track could allow Tehran simply to wait out the Bush administration, while seeing if a new U.S. president takes a more conciliatory line towards Iran. Some analysts estimate that Iran could have produced enough fuel for a nuclear bomb by late next year.

"They might accept a 60-day suspension to examine the seriousness of the proposal," said David Wurmser, a former Middle East adviser to Vice President Dick Cheney. "They'll do that for 60 days and move ahead with their program."

The talks are part of a complex diplomatic game being played out in the region, the outcome of which is impossible to predict. In addition to the talks on nuclear proliferation, the Israelis are talking indirectly to the Syrians about a possible peace deal and have entered into agreements with Islamic militant groups Hamas and Hezbollah. Some senior U.S. analysts worry these overtures could be a prelude to an Israeli attack on Iran's nuclear facilities.

Still, the Bush administration has signaled it is prepared to accelerate the diplomatic embrace of Tehran if the current talks prove successful. In addition to the economic incentives outlined in Mr. Solana's proposal, U.S. officials have said they are considering opening a small diplomatic mission in Tehran in the coming months if the Iranians are receptive. And Washington has been seeking to accelerate other interpersonal exchanges between groups such as Olympic athletes, doctors and students.

Javier Solana

If Iran balks, a principal focus of any new penalties would be the country's imports of refined petroleum products, particular gasoline, said U.S. and European officials.

The Treasury Department's point man on Iran, Undersecretary for Terrorism and Financial Intelligence Stuart Levey, has been meeting government and private-sector officials in Italy, Spain and France to lobby American allies about the risks of doing business with Tehran.

Because of a lack of refining capabilities, Iran is forced to import roughly 40% of its gasoline from European, Indian and Venezuelan companies. In 2006, Iran paid roughly $5 billion for gasoline, making it the second-largest importer, after the U.S. The Iranian government was forced to ration gasoline last year due to financial and supply pressures, setting off unrest in some areas of the country.

U.K. Prime Minister Gordon Brown publicly pushed EU ministers last month to consider targeting Iran's oil and natural-gas industry, should talks stall.

U.S. weapons package for Taiwan is postponed

BY TING-I TSAI

TAIPEI—The White House appears increasingly unlikely to proceed with a planned $11 billion weapons sale to Taiwan, a decision that critics say could alter the strategic balance between the island and China and that could leave a thorny issue for the next U.S. president.

The weapons package—which includes antimissile systems sold by **Raytheon** Co. and helicopters from **United Technologies** Corp. and **Boeing** Co.—originated with an offer by U.S. President George W. Bush just months after he took office in 2001. The arms offer was the biggest for Taiwan in at least a decade, but political infighting on the island blocked allocation of funds until last December, when its legislature finally approved funding.

Since then, however, the Bush administration has yet to send formal requests to Congress that are needed for such sales, raising questions about the deal's prospects.

Then, in remarks Wednesday, the top U.S. military official in the Pacific effectively acknowledged that the Bush administration has frozen arms sales to Taiwan, at least temporarily. Adm. Timothy Keating said U.S. analysis "indicates there is no pressing, compelling need for, at this moment, arms sales to Taiwan of the systems that we're talking about."

Some proponents of the sale are now worried it won't happen before Mr. Bush finishes his term in January. "It seems reasonably clear that the [Bush] administration has decided not to sell arms to Taiwan," says Harvey Feldman, a distinguished fellow at the Heritage Foundation, a conservative think tank in Washington.

The U.S. is obligated to provide Taiwan with "arms of a defensive character" under the Taiwan Relations Act, passed in 1979 to govern relations with the island after the U.S. severed formal ties with it and recognized Beijing. China's government, which claims Taiwan as part of its rightful territory, has long demanded that the U.S. cease all weapons sales to the island.

The delay comes as relations are improving between Taiwan and China under new Taiwanese President Ma Ying-jeou, after years of tension. Officials from the Ma administration and his Nationalist Party, or Kuomintang, say the president remains determined to acquire the weapons that Taiwan needs.

Critics say Mr. Ma isn't doing enough to push for the arms package. They point out that the Kuomintang fought budgetary allocation for the weapons for years when it was the opposition party.

Observers suggest there may be less urgency in Taiwan to push for such a sale as relations with China evolve and that a deal would strain any tentative overtures. Two weeks ago the two countries began the first regularly scheduled nonstop flights between them in nearly 60 years. The two sides also agreed to a sharp rise in the number of Chinese tourists allowed to go to Taiwan.

Lawrence Walker, a spokesman for the American Institute in Taiwan, the de facto U.S. embassy in Taipei, said the U.S.'s position on arms sales to Taiwan remains unchanged.

Some analysts say Mr. Bush may only be delaying the sale until after he travels to China next month for the opening ceremony of the Beijing Olympics. "The best chance [for the sales] is right after the Olympics," said Randall Schriver, a former senior Asia official at the State Department under Mr. Bush.

The $11 billion package includes Boeing Apache Longbow attack helicopters, Sikorsky Black Hawk helicopters, Raytheon Patriot PAC-3 air-defense batteries, and designs for diesel electric submarines. For those sales to go through, the State Department must first issue formal "notifications" to Congress, but it hasn't done so.

Unless the U.S. completes legislative approval of the sales by the end of September, the package might have to be reviewed again next summer by the next administration. In addition, Taiwan's allocation for the weapons expires at the end of this year, meaning the legislature would have to approve it again.

U.K. eyes borrowing law

Possible policy shift would ease limits as finances weaken

By Laurence Norman

LONDON—The U.K.'s public finances took a sharp turn for the worse in June, in one of the clearest signs yet of the deteriorating British economy and its political fallout for Prime Minister Gordon Brown.

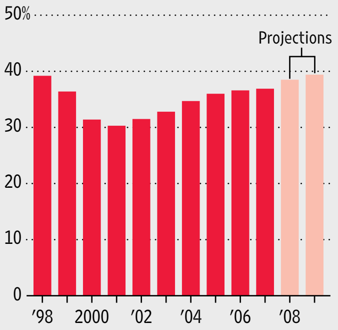
As a result, the government is considering changing its fiscal rules to make it easier to borrow—modifying a policy that was the hallmark of Mr. Brown's decade as treasury chief before he became prime minister last year.

Some economists welcomed the potential changes, saying they could help the government adapt to new economic circumstances. Other economists and some political rivals said such a move would look politically expedient, giving the economy added juice before Mr. Brown must hold an election by mid-2010.

U.K. net borrowing in June rose to £9.2 billion (US$18.4 billion) from £6.3 billion a year earlier, as government spending outstripped revenue growth, the Office for National Statistics said Friday. A closely watched measure of the health of the government's finances, net debt to gross domestic product, rose to 38.3%, the highest since July 1999 and close to the government's 40% ceiling.

Prudence index

U.K. Prime Minister Gordon Brown aims to keep net debt below 40% of Gross Domestic Product



Sources: U.K. Office of National Statistics; U.K. Treasury for projections

The rival Conservative Party, which has a 22-point lead over Mr. Brown's Labour Party in recent opinion polls, attacked Mr. Brown. George Osborne, the Conservative Party's leading voice on economic policy, said that during periods of economic growth the government had failed to put aside money for an eventual economic downturn, when revenue falls as spending rises.

"Now we've reached those bad years, the public finances are in a mess and the rules are being ditched," Mr. Osborne said.

Finance Minister Alistair Darling said in an interview on BBC radio that the U.K.'s 40% debt-to-GDP ratio actually compares quite well with that of many other developed economies.

The fiscal framework, which the government could change in the fall, was established in 1998, early into Mr. Brown's decade-longtenure as finance minister. It was a centerpiece of the Labour government's efforts to show it could be trusted with the economy, and placed Mr. Brown's stamp on fiscal policy. Under the policy, the government must balance the budget, excluding investment, over the economic cycle, and its debt must not exceed 40% of gross domestic product.

Charles Davis, an economist at the Center for Economics and Business Research, said a problem with the current system is that the Treasury decides when the economic cycle starts and ends. In the past several years, by allowing the cycle to stretch on, the government has been able to offset its extra recent borrowing against the strict fiscal discipline it applied in its early years. Mr. Davis advocates setting up a committee with the power to make this decision, decide when the economic cycle starts and ends,an idea with broad support.

"The government has too much discretion in deciding the timing of the cycle," said Peter Newland, U.K. economist at Lehman Brothers. "If it's done by a third party or [a group] that is independent of government, that would add credibility to the fiscal framework."

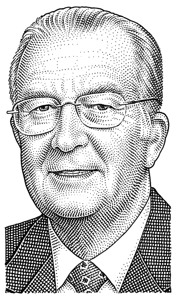
Other economists suggest removing the 40% net debt ceiling and allowing the government to borrow more in harsher conditions.

Belgium works to clear stalemate

By John W. Miller

BRUSSELS—A team appointed by Belgium's King Albert II started work Friday to resolve a stalemate between the nation's French and Dutch speakers. At stake is not whether Belgium falls apart, but whether it becomes more like Switzerland.

Ever since elections in June 2007, Belgium has been in trouble. It took nine months to form a government. Belgian newspapers ran alarming headlines warning of the nation's possible breakup. Last Monday, the prime minister, Yves Leterme, offered to resign.



King Albert II

But while the glue that holds together this fragile nation of 10.5 million is slowly coming unstuck, it's likely to endure at least another generation, say political leaders and analysts.

None of the mainstream Flemish parties favor independence for Flanders—a reflection of Belgium's battered but tenacious national identity, along with the costs and complications of divorce, and the gnarly question of who gets Brussels, the wealthy capital city and seat of the European Union.

Now, it looks increasingly like Belgium will have a constitutional convention to work out changes that would give more autonomy to Belgium's regions, making the country's political structure look more like confederal Switzerland.

Late Thursday night, King Albert said he was rejecting Mr. Leterme's resignation, and he gave three respected figures from outside the political fray until the end of the month to find a compromise that the country's French speakers, who think Belgium is too loose a federation already, are willing to accept.

Previous Belgium's Flemish majority has been restless ever since the country was formed in 1830, when French-speaking aristocrats, merchants and bankers set up Belgium as a unified, monolingual state. Even today, Brussels is a predominantly French-speaking island in the Dutch-speaking North.

constitutional shifts in 1970, 1980, 1988 and 1993 have since transformed Belgium into a Balkanized federal state with seven parliaments and some 60 cabinet-level ministers. The major political parties have split into separate French- and Dutch-speaking versions.

Now, Belgium's Flemish majority, numbering six million, is pushing for further constitutional change, driven not least by resentment at the large annual transfers of their tax money to French-speaking Wallonia, in the south. The transfers amount to between $3 billion and $6 billion a year, according to a 2006 study commissioned jointly by the regional governments of Flanders and Wallonia.

Flemish political parties also want each language-based region to run its own health care, unemployment insurance (unemployment is 15% in Wallonia, 7% in Flanders), courts and other functions. And they want the multilingual suburbs around Brussels to vote for candidates in Flanders. They vote in the capital now—a boost for French-speaking parties.

When Mr. Leterme threw in the towel last week, he told reporters: "The federal consensus model has reached its limits."

Even if King Albert's task force fails to reach an accord between the two sides, analysts say a decision to split up and create separate nations of Flanders and Wallonia—as the Czechs and Slovaks did in dissolving Czechoslovakia in 1992—is unlikely, barring a calamity such as a severe economic depression, or assassination.

Dependent on Belgium for identity and in recent years solvency, Wallonia is fiercely attached to the state. "An independent Wallonia would not make historical or economic sense," says Pascal Delwit of the Free University of Brussels. "And there is a Belgian identity," he adds. "It's by default: We're not French, and we're not Dutch."

Flanders prides itself on a rich history as an economic and military power during the Middle Ages. Flemings still celebrate the Battle of the Golden Spurs in 1302, when a Flemish militia from Bruges defeated the army of a French king. Around half of Belgium's Dutch speakers would like to see a Republic of Flanders, according to some opinion polls.

Yet, "no political party except the extremists supports a split," says Vincent Van Quickenborne, Belgium's economy minister and a Flemish conservative. Vlaams Belang (Flemish Interest), a far-right party that does advocate independence, generally polls a quarter of the vote in Flanders.

That is partly a bottom-line issue. Belgium's national debt is more than $400 billion, or 85% of gross domestic product. French-speaking leaders say they would require Flanders to pay it all off.

THE OUTLOOK ▪ By Jon Hilsenrath

Markets police themselves poorly, but regulation also has its flaws

THE EVENTS of the past few weeks leave U.S. policy makers at a crossroads in a long-running debate about how to police financial markets.

For much of the past quarter-century, policy has tilted away from strict regulation and toward relying on market discipline to keep the financial system on an even keel. Market players, the thinking went, had an incentive not to push themselves or their counterparties too far, because they had too much to lose if they did.

This approach has failed, but finding a workable alternative won't be easy.

Carmen Reinhart, a University of Maryland economist who has studied centuries of financial crises, concludes that blowups happen almost inevitably after financial markets are liberalized or some innovation allows capital to flow more freely.

She and fellow researcher Kenneth Rogoff found that during the loosely regulated 1980s and '90s there were 137 banking crises around the globe, compared with a total of nine during the more tightly regulated '50s, '60s and '70s. Deregulation of interest rates on deposits at U.S. thrifts in the early 1990s, for example, led to a wave of risk-taking and the savings-and-loan crisis.

"Market discipline exists in theory, but in practice, ahead of each crisis, what we see is quite the opposite," Ms. Reinhart says.

Such discipline clearly broke down at places like **Citigroup** and **Merrill Lynch**, which in the past nine months have written down more than $80 billion combined on bad investments. They took too many risks on complex mortgage investments that they created but didn't adequately understand. More broadly, Wall Street's version of market discipline produced the worst housing crisis since the Great Depression—just a few years after a burst bubble in Internet stocks.

Yet in recent days, the alternative to market discipline—regulation—hasn't stood up very well to scrutiny either. IndyMac Bank, the mortgage specialist that collapsed earlier this month, was a federally regulated bank. The failure of the **IndyMac Bancorp** unit could cost American taxpayers as much as $8 billion.

Ms. Reinhart likens the hodgepodge of state and federal bank supervisors to a "banana republic" of regulation.

FANNIE MAE and **Freddie Mac**, the troubled U.S. mortgage giants, are another example of regulation gone awry. They have their own regulator, the Office of Federal Housing Enterprise Oversight, whose main mission is to ensure they have enough capital. Despite the oversight, they might need capital injections from the U.S. Treasury amid mounting mortgage losses.

Unlike other areas of the economy, the Bush administration has been trying for years to sharpen oversight of the two companies. Congress is finally near completion of legislation that would create a stronger regulator to watch over Fannie and Freddie. But that comes too late for the current foreclosure crisis, which has shown that their capital requirements were too low.

Ironically, hedge funds—which are largely unregulated, and where market discipline remains the government's main policy tool—haven't produced a major blowup this cycle. The Federal Reserve has pushed investment banks to ensure that their hedge-fund clients don't borrow too much and get overextended.

So far, it seems to be working. With the exception of two funds run by **Bear Stearns**, no major hedge-fund players have collapsed during the current credit crunch. However, the hedge funds did play an important role in fueling the credit boom that preceded the current crunch—by funding and trading many of the complex debt instruments that have quickly unwound.

COLLATERALIZED debt obligations and credit-default swaps, two kinds of debt instruments that played a starring role in Bear Stearns' troubles, were the playground of many hedge funds. John Paulson, the billionaire hedge-fund manager, made his fortune by using these markets to bet against housing.

"The enormous losses and write-downs taken at financial institutions around the world since August, as well as the run on Bear Stearns, show that, in this episode, neither market discipline nor regulatory oversight succeeded," Fed Chairman Ben Bernanke said in a major address on regulation earlier this month.

The conclusion is humbling. Policy makers need to fix a broken financial system with policy levers they know are damaged, too. The pendulum between market forces and regulation has no reassuring place to swing, though in the short-run, it is surely swinging toward regulation.

Unlike his predecessor, Alan Greenspan, a strong advocate of letting the market discipline itself, Mr. Bernanke has been pushed into the role of Mr. Fixit, forced to strike some new balance with more regulation.

That will mean tinkering with everything from the way that credit-derivatives trades are settled to the way investment banks manage their short-term funding in "repo" markets, where they use securities as collateral for short-term loans. It will also mean broadening the Fed's powers to oversee investment banks and possibly others.

Some economists look upon this shift with trepidation.

"What we have is obviously very dynamic markets that have the ability to run circles around regulators and they have an incentive to exploit every possible opening there is for regulatory arbitrage," says Raghuram Rajan, a University of Chicago economist who sounded alarms about the excesses building up in the financial system back in 2005.