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THE WALL STREET JOURNAL.

Who cheats? Check out our survey on deceit

WEEKEND JOURNAL | PAGE W7

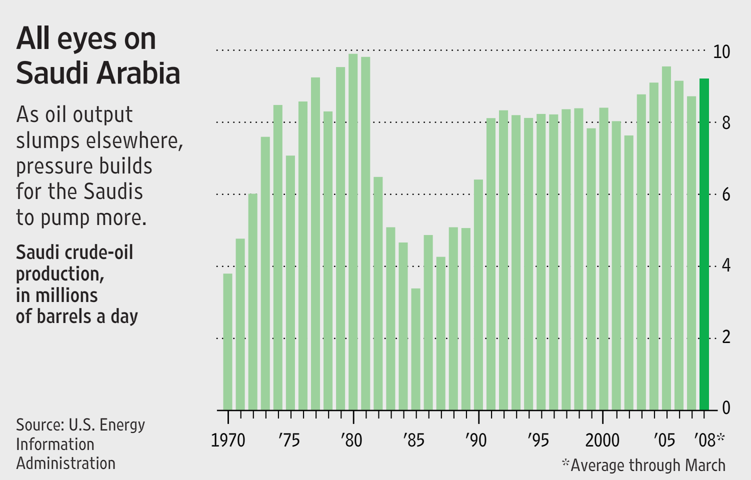
Push for air safety stalls at embattled U.S. watchdog

NEWS IN DEPTH | PAGES 12-13

Saudis debate oil supply

Optimist, pessimist over potential output worked side by side

By Neil King Jr.



Sadad al-Husseini and Nansen Saleri raced up the ranks at **Saudi Arabian Oil** Co., the world's most powerful oil company, working together for years to squeeze more crude from Saudi Arabia's massive fields. Today, the two executives have staked out opposite sides of a momentous industry debate.

Mr. Husseini, Aramco's second-in-command until 2004, says the world faces a brute reality of depleting resources and ever-rising prices. Mr. Saleri, until recently the company's oil-reservoir manager, insists that with enough ingenuity and investment, plenty more oil can be found.

With oil prices having doubled over the past year, political leaders, Wall Street investors, commuters, airlines and car makers all are scrambling to divine where prices will head next. The disparity of opinion between two of the most knowledgeable men in the industry shows how much fog hangs over the most basic question of all—whether oil can be unearthed any faster than it currently is.

At the moment, Mr. Husseini's pessimistic view is clearly ascendant. Even before this year's surge in oil prices, there were gloomy industry predictions that world oil output would soon hit a ceiling.

But Mr. Saleri isn't alone in dismissing the gloom as misplaced. Optimists, including **Exxon Mobil** Corp. and the U.S. Energy Department, argue that high prices propel companies to innovate and invest more, and as supplies rebound, prices will fall from today's levels. U.S. benchmark crude hit a record high on Thursday, closing at $139.64 a barrel, up more than threefold since 2004.

Saudi Arabia itself, producer of 12% of the world's oil, has vacillated for years over whether to try to extract oil faster than it already is. Last weekend, urged on by Saudi King Abdullah, it appeared to move

Please turn to page 27

Associated Press

U.S. Democratic presidential candidate Sen. **Barack Obama** is riding high in the polls as he speaks at an economic-competitiveness summit on Thursday.

Key battleground states favor Obama in U.S. race

By June Kronholz

The Midwest battleground states that are expected to be pivotal in deciding the outcome of November's election are trending comfortably toward Barack Obama, with independents giving him wide support over John McCain, according to a new Quinnipiac University poll conducted in partnership with The Wall Street Journal and washingtonpost.com.

The battleground surveys suggest how favorable the terrain is for Sen. Obama, the presumed Democratic nominee, at the outset of the summer general-election campaign. He is leading Sen. McCain, his apparent Republican rival, by double digits in Wisconsin and Minnesota and by smaller, but still comfortable, margins in Colorado and Michigan.

Women, younger voters and minorities, who typically trend Democratic, favor Sen. Obama in all four states. But the Illinois senator's support also seems solid among independents and among some groups, including voters older than 55 years old, that Republicans have been able to count on in the past.

Sen. Obama trails among whites in Colorado and Michigan, but leads Sen. McCain handily among whites in Minnesota and Wisconsin. No Democrat since Lyndon Johnson in 1964

Please turn to back page

In a reversal, Fortis seeks to raise funds

By Carrick Mollenkamp and Neil Shah

LONDON—After offering a rosy outlook earlier this year, Dutch-Belgian bank **Fortis** NV said Thursday it would need to raise €8.3 billion ($13.01 billion) in capital to shore up its shaky finances in a move that deals a blow to Chief Executive Jean-Paul Votron.

Fortis stock fell 19% in Amsterdam after the midsize bank unveiled a raft of measures to raise capital, including plans to issue €1.5 billion in new shares, cancel a €1.3 billion half-year dividend and sell assets. In an interview, Mr. Votron attributed the change in tack to a worsening economy, saying investors need to be assured the bank's finances are strong enough to weather problems that could extend well into 2009.

Mr. Votron said he didn't expect to share the fate of other top European and U.S. bank executives, who have been forced to step down after posting billions of dollars in write-downs on bad investments and launching capital injections. "My job is safe, otherwise I wouldn't be here," said Mr. Votron, who has headed Fortis since 2004. "I have the full support of the board for what I am doing."

The news could raise questions about Mr. Votron's decision last year to take part in the largest bank deal ever—the $100 billion acquisition of Dutch bank ABN Amro Holding NV by Fortis, **Royal Bank of**

Please turn to page 27

What's News—

Business & Finance

The Dow industrials slid 358.41 points to 11453.42 Thursday, the average's lowest level this year, amid worries over credit-related problems and the stability of U.S. auto makers. Oil prices surged to a record $139.64 a barrel. Two of the industry's greatest experts differ over whether oil can be tapped any faster. Pages 1, 15, 20

■ **European stocks tumbled**, with the Dow Jones Stoxx 600 index closing at its lowest level since October 2005. Page 15

■ **Fortis said** it needs to raise $13.01 billion in fresh capital to shore up its finances, sending the bank's stock down 19%. Page 1

■ **InBev is seeking** a legal ruling as Anheuser-Busch prepares to reject its unsolicited $46.35 billion bid. Modelo finds itself at a crossroads in the battle. Pages 2, 6

■ **UBS faces** charges of fraud and dishonest conduct in the U.S., the first allegations to come out of probes into the breakdown of the auction-rate market. Page 16

■ **The U.S. Fed is expected** this summer to make it easier for buyout firms and other outside groups to invest in banks. Page 17

■ **The EU is widening** a probe into whether drug makers used unfair tactics to block competition and prop up prices. Page 4

■ **News Corp. is considering** bids for two big satellite broadcasters, Germany's Premiere and Spain's Digital+. Page 5

■ **AstraZeneca said** the CEO and research chief of MedImmune have resigned, a year after the biotech unit was acquired. Page 6

■ **Sony set** a growth strategy centered on video-downloading services, product interconnectivity and Internet access. Page 6

■ **Air France-KLM** and three other airlines agreed to pay a total of $504 million to settle U.S. cargo-price-fixing charges. Page 7

■ **Unicredit unveiled** a three-year business plan that would cut 9% of its work force in Western Europe while expanding in Central and Eastern Europe. Page 7

Markets 4 p.m. ET

MARKET	CLOSE	NET CHG	PCT CHG
DJIA	11453.42	-358.41	-3.03
Nasdaq	2321.37	-79.89	-3.33
DJ Stoxx 600	288.48	-7.62	-2.57
FTSE 100	5518.2	-147.9	-2.61
DAX	6459.60	-158.24	-2.39
CAC 40	4426.19	-110.10	-2.43
Euro	$1.5750	+0.0180	+1.16
Nymex crude	$139.64	+5.09	+3.78

Money & Investing > Page XX

World-Wide

Election battleground states in the U.S. Midwest are trending comfortably toward Obama, with independents giving him wide support over McCain, a poll shows. The results suggest how favorable the terrain is for the presumed Democratic nominee at the outset of the summer election campaign. Pages 1, 28

■ **A suicide bomber attacked** a meeting of pro-government Sunni sheiks west of Baghdad, killing at least 23 people, including three U.S. Marines. A blast in Mosul killed at least 18 people.

■ **Iraqi and U.S. officials** don't expect to meet a July 31 deadline for a pact to establish a legal basis for a long-term U.S. military presence, but could reach an interim deal. Page 9

■ **G-8 ministers agreed** to step up efforts to secure Afghanistan's borders and stabilize food and oil prices, at a meeting in Japan.

■ **Militants attacked** coalition troops patrolling south of the Afghan capital, killing three of them and an interpreter.

■ **Zimbabwe's Mugabe said** he is open to talks with the opposition on the eve of an election that the Movement for Democratic Change is boycotting.

■ **South Africa's Mbeki** remains committed to mediation for Zimbabwe, while growing numbers of African leaders are demanding stronger action. Page 3

■ **The U.S. Supreme Court** ruled that the Constitution guarantees individuals the right to keep handguns in the home. Page 8

■ **North Korea delivered** a description of its efforts to develop nuclear weapons, after keeping the U.S. and other nations waiting for 17 months. Bush said he would remove the country from the U.S. terrorism blacklist.

■ **The U.K. outlined** proposals for a tenfold increase in renewable energy by 2020 to reduce dependence on fossil fuels.

■ **Nepal's prime minister** resigned, clearing the way for the Maoists to form a government.

■ **The Olympics is contributing** to Beijing's water crisis by increasing use of it for sports venues, researchers said. Page 25

■ **Spain's Parliament ratified** the Lisbon Treaty on EU reform.

EDITORIAL & OPINION

Tax chef

If Alain Ducasse were American, the IRS would follow him all the way to Monaco. Page 10

LEADING THE NEWS

Modelo's chief is caught in industry shift

Bid for Busch shows family-run brewers face global giants

By David Luhnow
And David Kesmodel

MEXICO CITY—Carlos Fernandez, the 41-year-old chief executive of Mexican brewer **Grupo Modelo** SA, got the top job at his company the old-fashioned way: through his family.

Mr. Fernandez's uncle ran Modelo, known for its Corona Extra beer, for three decades. And the ambitious young executive clinched his rise by marrying the daughter of another company patriarch. For the past 10 years, Mr. Fernandez has grown into his role as the king of Corona, but he and his tradition-bound company are struggling to adapt to sweeping changes in the beer industry.

Amid a frenzy of acquisitions, a few global giants are fast emerging, making family-run brewers like Modelo and its U.S. partner **Anheuser-Busch** Inc., which holds a 50% non-controlling stake in Modelo, endangered species. Now, with Belgian-Brazilian brewer **InBev** SA seeking support for its unsolicited $46.35 billion bid to buy St. Louis-based Anheuser, Modelo finds itself at a crossroads.

Anheuser appears to be opposed to the takeover, and has asked Modelo to combine forces instead. Modelo, caught off guard by the proposal, is widely expected to snub its U.S. partner in order to remain independent.

The task of steering Modelo's course will fall to Mr. Fernandez. Like his counterpart August Busch IV at Anheuser, Mr. Fernandez was groomed for the company's top spot from an early age. When he was 12, he began tagging along to the company's flagship Mexico City brewery with his uncle, Antonino Fernandez, then chief executive.

The young Mr. Fernandez worked part time at the factory during high school, doing everything from hauling sacks of barley to learning about the fermentation process.

"Sometimes I even went on Sunday afternoon to start the bottling machines, so they could run at full-speed the next day," Mr. Fernandez said in an official company history published in 2000. "The truth is, I really liked the place, and have always found it interesting."

Carlos Fernandez

Antonino Fernandez, who was born in Spain and fought in that country's brutal civil war on the Nationalist side, had no sons of his own, and he mentored his young nephew. Carlos Fernandez rose quickly. By age 28, in 1994, he was appointed to the board of directors as vice president, the clear heir apparent. He took over as chief executive at the age of 31, even as his uncle continued to largely run things from behind the scenes until just a few years ago.

But in the years since Mr. Fernandez began his hands-on education in how to run Modelo, the role of family owners in the global beer business has steadily diminished as acquistions have yielded fewer and bigger players in the capital-intensive industry.

In 2005, for example, the Molson family of Canada and the Coors family of Colorado merged their beer companies. This year, Molson Coors Brewing Co. is combining its U.S. business with that of SABMiller PLC, further limiting the influence of the Coors family over its eponymous brewer.

Similarly, SABMiller bought Latin Ameircan brewer Bavaria, which was owned by a Colombian family, in 2005. Bavaria now is a major SABMiller shareholder.

InBev, the world's second-largest brewer by volume, has also been part of the change. The company was created by the 2004 combination of Interbrew, controlled by Belgian families, and AmBev, controlled by wealthy Brazilians. The Belgian families gave up some of their voting control to form the giant brewer; it is now increasingly run by its Brazilian holders.

Meanwhile, Anheuser and Modelo have hugged the sidelines. That's no coincidence; both brewers are famously conservative. One of the few big differences between them: The Busch family holds less than 4% of Anheuser's shares, while Modelo's voting stock is controlled by three main families.

Burned in the past by Mexico's economic upheavals, Modelo has long refused to take on a single dollar of debt, preferring to grow using its own money. Like the St. Louis brewer, it has also repeatedly turned down opportunities to buy other beer companies. And both companies are run by young chief executives burdened by the legacy of their families and the nationalism of their companies.

A spokesman for Modelo said the brewer "opted for organic growth."

Even Modelo's 1993 decision to sell a big stake to Anheuser can be seen as a conservative move. At the time, the North American Free Trade Agreement was set to kick in, and Modelo feared an invasion by the U.S. beer companies as both the U.S. and Mexico slashed import tariffs on products like beer. It preferred selling half the company and gaining the security of a big American partner, rather than open competition.

"We are a proud Mexican company," Mr. Fernandez has said of Modelo. A board member adds: "Our business is simple: We sell Mexican beers made by us in Mexico here at home and to the world."

But Modelo's fierce nationalism and conservatism has placed it in a difficult position. If InBev wins Anheuser, then Modelo ends up with a new partner—not of its own choosing and one much more aggressive than Anheuser about things like cost-cutting. Nor would InBev be likely to wait as patiently for control of Modelo as Anheuser-Busch has. Most industry analysts expect Modelo would fall into InBev's hands at some point.

"The world is changing around them," said Tom Pirko, president of California-based beverage advisory firm Bevmark. "Modelo is going to face more and more pressure to go beyond its Mexican-centric view and to really think about" expanding the global reach of its beers.

Modelo may find change difficult. The company is so insular that even as it carried out talks with Anheuser this week about its future, the board of directors was kept entirely in the dark, according to several board me

Even though the company had success abroad, Modelo doesn't view itself as a global company.

As a result, the company has regularly turned down buying opportunities.

INDEX TO BUSINESSES

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

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INDEX TO PEOPLE

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

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

LEADING THE NEWS

Mbeki unmoved by pleas for action

South African leader pushes only for talks in Zimbabwe crisis

By Sarah Childress

JOHANNESBURG—South African President Thabo Mbeki once was the voice of the continent on Zimbabwe, but these days, he mostly speaks for himself.

As the Zimbabwean government prepares to hold an election Friday that has one contesting candidate and virtually no legitimacy in the eyes of regional and international powers, Mr. Mbeki remains committed to mediation.

Western powers and growing numbers of African leaders have demanded stronger actions.

Mr. Mbeki, the heir to Nelson Mandela, was chosen in 2007 by the Southern African Development Community, the regional cooperative body, to mediate between Zimbabwean President Robert Mugabe's government and opposition leader Morgan Tsvangirai.

Since Mr. Mbeki took the role, Zimbabwe has spiraled deeper into an economic crisis that has driven at least three million refugees into his country, where they have recently been the victims of xenophobic attacks by poor, unemployed South Africans.

Mr. Mbeki's approach has so frustrated the opposition that Mr. Tsvangirai has called for him to step down from his role as mediator.

Mr. Mbeki doesn't believe in forcing regime change, either militarily or through the use of economic sanctions or border closures. His priority is "maintaining stability rather than generating any dramatic change," says Siphamandla Zondi, an Africa analyst at the Institute for Global Dialogue in South Africa.

At home, Mr. Mbeki has been the target of cartoons depicting him in outer space, or in a toga and bowing before a deified Mr. Mugabe. Abroad, he has been criticized by fellow statesmen and seems in danger of inflicting lasting damage on his legacy before he finishes his final term as president next year.

The South African leader is notoriously inscrutable, particularly on Zimbabwe. Not even his spokesman will agree to detail his thinking, saying only that the president is acting on SADC's mandate. According to analysts and others who have been made aware of his policies, Mr. Mbeki pursues this soft policy toward Mr. Mugabe because of a complex combination of his political convictions and personal history.

As the leader of southern Africa's economic engine and most influential state, Mr. Mbeki's mandate from SADC was to broker an agreement between the two camps that would allow for free and fair elections in 2008.

His critics consider the talks a failure. But in a recent meeting with Mr. Tsvangirai and other opposition members, Mr. Mbeki said he believed there had been some victories.

Negotiations, he said, allowed for the relatively peaceful first round of elections on March 29, as well as some electoral reforms, including one new requirement that local results be posted outside each polling station. That allowed for independent groups to conduct a tally that showed Mr. Tsvangirai had won—evidence that likely prevented the government from declaring Mr. Mugabe the winner, and forced Friday's runoff.

The British-educated Mr. Mbeki also believes strongly in African identity, and has accepted Mr. Mugabe's charge that Zimbabwe suffers economically largely because of Western sanctions put in place by former colonial powers who want to see a black-run Zimbabwe fail.

Part of his unwillingness to join the international community in denouncing Mr. Mugabe may also stem from what analysts say is his perception that the Western powers are critical of Zimbabwe only because white farmers have been terrorized and driven from their land by pro-Mugabe mobs. Had the victims been black, such as during the Rwandan genocide or the conflicts in the Democratic Republic of Congo, he believes, Western powers would have remained silent.

History has also shaped Mr. Mbeki's views on Zimbabwe. Messrs. Mbeki and Mugabe both fought in the struggles to free their countries from oppressive white rule. Mr. Tsvangirai didn't. He was a labor organizer, and some say Mr. Mbeki is uncomfortable with such a man running Zimbabwe.

sociated Press

South African President **Thabo Mbeki**, whose approach has caused frustration.

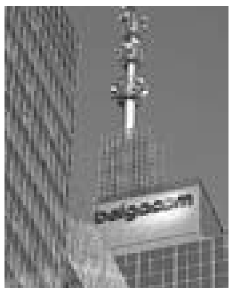
There may be one more reason Mr. Mbeki hasn't been able to get Mr. Mugabe to budge: He can't.

"I don't think [Mr. Mugabe] cares a hoot about what Mbeki or anyone else thinks," said Aubrey Matshiqi, a senior political associate at the Centre for Policy Studies in South Africa. "He's completely impervious to external opinion. The failure of quiet diplomacy is actually the failure of all forms of diplomacy."

CORPORATE NEWS

TELECOMMUNICATIONS

Tele2 sells Liechtenstein, Luxembourg operations



SWEDISH telecom operator **Tele2** AB said it was selling its operations in Luxembourg and Liechtenstein to Belgium's **Belgacom** SA for about two billion kronor, or about $330 million.

The transaction will result in a capital gain of approximately one billion kronor, Tele2 said in a statement.

Belgacom said the Luxembourg acquisition expands its footprint in that country, where the Tele2 operation will become the Belgian firm's second mobile group operating under the Tango brand name.

The acquisitions are subject to approval by antitrust authorities. *—Roundup*

AVIATION

Airbus shows off A400M, its new military transport

AIRBUS unveiled its A400M military transport in Seville, Spain, where the plane's final assembly line is located.

The airplane is designed to replace **Lockheed Martin** Corp.'s C-130 Hercules cargo aircraft as well as the retired C-160 Transall transport aircraft developed by a French and German consortium. Airbus parent **European Aeronautic Defence & Space** Co. said the new plane represents the most ambitious military procurement program ever undertaken in Europe.

The plane was developed at a cost of €20 billion ($31 billion). It has been dogged by problems in producing its turboprop engines. *—Roundup*

FINANCIAL SERVICES

Standard Chartered sees uncertainty in second half

STANDARD Chartered PLC said it has remained well capitalized in the first half of the year but faces some uncertainties as inflation hits its main markets in emerging economies.

The U.K. bank said it "had a very strong performance, building on the very good start to the year" and said it has a loan-to-deposit ratio of about 90%. Standard Chartered, which generates over 90% of its profit outside the U.K. and largely in emerging markets, said trading in its main markets has benefited from economic growth, local-currency liquidity and a sound credit environment. Standard Chartered said its net interest margins have remained broadly stable. *—Vladimir Guevarra*

U.K. DJs hope to lift some spirits

Groove Armada deal with Bacardi blends two parties' interests

By Max Colchester

WHEN GROOVE Armada's deal with a record company ended last year, the British DJ duo made an unusual move: It signed with spirit company **Bacardi**.

Under the one-year deal, unveiled earlier this year, the two DJs will be the main act at Bacardi-sponsored concerts in six venues from Miami to Athens. DJs Andy Cato and Tom Findlay will also produce records that Bacardi can use as background music for its global television ad campaigns.

ADVERTISING

For Bacardi, becoming a quasi-record label is an opportunity to boost its image among customers between the ages of 21 and 30.

Over the past 10 years, the live music scene has exploded while the record industry has suffered, says

The DJs will be allowed to keep a 100% copyright over music they create.

Natasha Kizzie, head of entertainment at the marketing company **Euro RSCG KLP**, who brokered the deal. "People's emotional attachment has shifted. It's no longer about owning music, but accessing it by going to live events."

Spirits brands have long played up their party credentials by sponsoring music festivals and club nights. Putting on lavish shows with famous personalities is one way of drumming up interest via word of mouth and video-sharing Web sites.

"In such a saturated market Bacardi had to do something different to stand out," says Sarah Tinsely, who handles Bacardi's music ventures.

By signing a long-term deal with the two popular DJs—Groove Armada has sold more than three million records of dance music worldwide over the past decade—Bacardi gets unrivaled access to their fans.

As well as making and performing music at Bacardi's so-called "B-Live" concerts, Groove Armada is expected to take part in a yearlong fly-on-the-wall television documentary and produce six radio shows—all about the life and travels of Messrs. Cato and Findlay.

The programs, which will feature regular ads by Bacardi, will be syndicated by Euro RSCG KLP to television channels and radio broadcasters.

For Groove Armada, the Bacardi deal is a way to boost the duo's international standing—especially after the DJs' contract with Sony BMG's Columbia Records ended last year. The two sides agreed to part by mutual consent.

According to the terms of the deal with Bacardi, the DJs will be allowed to keep a 100% copyright over the music they create and will receive royalties for the songs they produce, says Groove Armada's manager Dan O'Neill. Bacardi will also cover recording and marketing costs of the new tracks.

"It will make people aware of what Groove Armada is and what they are offering. This is absolutely key," says Mr. O'Neill.

The deal between Bacardi and Groove Armada is a reflection of tough times in the music industry. The total value of global CD and music DVD sales fell 13% to $15.87 billion in 2007, according to the International Federation of the Phonographic Industry. While sales in downloaded music rose by more than a third last year, this hasn't been enough to offset the decline in CD and DVD sales, which still account for 82% of the music industry's revenue, the IFPI says.

As a result, musicians are increasingly seeking lucrative marketing deals outside their industries.

Household names, such as Joni Mitchell and Paul McCartney, both struck deals to sell records through coffee chain Starbucks.

Rob Loud

Derrick Santini

DJ duo Groove Armada are **Tom Findlay**, left, and **Andy Cato**, right. Performing on stage at a B-Live concert in Miami, above.

Forging partnerships between artists and consumer brands can be a painful process. Ric Salmon, the founder of London-based Harvest Entertainment who recently brokered a similar deal between boy band McFly and McDonalds, says there's bound to be a clash of interests in the long-term. Top artists teaming up with a global consumer brand sometimes also face accusations of selling out.

"Brands are interested in selling their own product; they don't necessarily care about the band they are associated with," Mr. Salmon says.

Nonetheless, a slew of other spirit companies are trying to create hype around their products by linking with famous music types.

Diageo PLC has been promoting its Smirnoff vodka brand by touring the world with a string of concerts called the "Smirnoff experience"—each featuring a different artist.

Smirnoff is focusing on creating high-profile events around the world that will be relayed over the Internet through video-sharing Web sites. Next Wednesday, for example, Smirnoff is lining up 1980s icons Duran Duran alongside music producer Mark Ronson at an event in Paris.

"I don't really care how many people come to the show because really this is about creation of content," says Philip Gladman, the global brand director for Smirnoff. "Talk of the show will be spread over the year."

Tom Middleton, a British DJ who performed at recent Smirnoff concerts in Moscow and Shanghai says allying with a major brand is a risk worth taking.

"Their resources are ridiculous," says Mr. Middleton. By signing with a drinks company, "you don't have...the record label saying: 'You can't do that because it's too expensive.'"

EU widens probe of drug makers on pricing tactics

By Jeanne Whalen And Charles Forelle

European Union investigators are widening a probe of the pharmaceutical industry as they look into whether drug companies have used unfair tactics to block competition and prop up prices.

In recent weeks, investigators have sent questionnaires to drug wholesalers and trading firms, quizzing them about pharmaceutical companies' distribution methods and other practices. The investigators asked for responses by mid-June, according to people who received the questionnaires. A spokesman said the European Commission has "sent several different sets of questionnaires to different people," but declined to comment further.

The latest round of questioning broadens an inquiry begun in January, when EU investigators visited drug-company offices unannounced and collected documents. At the time, Neelie Kroes, the EU's antitrust chief, said the investigators were looking into whether branded-drug companies were paying generic-drug makers to keep their low-cost pills off the market.

In the latest questionnaires, the EU is asking about the distribution methods drug companies use in Europe, and whether they are blocking competitors from distributing medicines.

Heinz Kobelt, secretary-general of a trade group representing drug trading companies, says EU investigators sent him a questionnaire in mid-May asking whether drug companies were using litigation or other tactics to thwart a practice called parallel trade. Mr. Kobelt heads the European Association of Euro-Pharmaceutical Companies.

Parallel trade involves wholesalers or trading companies buying drugs in a market where prices are cheap and selling them in a different country where prices are higher. Drug companies oppose parallel trade because it undercuts their direct sales, but wholesalers say it benefits consumers by lowering prices.

Associated Press

Models wear creations by Italian fashion designer **Alessandra Facchinetti** for Valentino fashion house during the showing of her ready-to-wear collection in February.

Fashion houses weather slump with IT upgrades

By Christina Passariello

MILAN—Over the past few years, top fashion labels have poured millions of euros into long-overdue overhauls of their supply chains. Now, as the global economic slump spreads to the luxury-goods industry, they're banking on the unglamorous side of their business: logistics.

During the late 1990s and early 2000s, the fashion houses grew into big corporations, with hundreds of stores around the world. But many continued to rely on outdated technology systems, causing them to regularly miss delivery deadlines at key department stores like Bergdorf Goodman in New York and Harvey Nichols in London.

The industry got away with such behavior because sales were booming. But now, with consumer demand withering, store owners have less time to sell items at full price and have become more impatient with delays. And that can cost fashion houses that deliver late. "U.S. department stores get very nervous when store sales are soft and take every chance to cancel orders," says Sanford Bernstein luxury-goods analyst Luca Solca.

When supply-chain problems backed up production of Gucci's collection earlier this year, U.S. department stores withdrew their purchases, knocking 2% off Gucci's quarterly sales growth, according to parent company **PPR** SA.

In April, Valentino risked the same fate. Sales of the label's summer collection of flower-print dresses and red tops suddenly slowed in U.S. stores as consumers felt the economic pinch. But **Valentino Fashion Group** SpA General Manager Luca Vianello says he noticed the sales decline immediately. A new technology system created by German software company **SAP** AG allows him to track store performance, manufacturing and shipping on a daily basis. Last year, Valentino Fashion Group spent some 2.5% of its €517 million ($810 million) in sales on implementing and operating its new technology.

"To have live visibility on how the business is going is relevant during this economic slowdown," Mr. Vianello said in an interview.

His solution to the April sales slump was to ship more accessories to U.S. stores. Seasonal merchandise that doesn't sell well can go on sale early to cut inventory. But accessories often last several seasons at full price and generate fatter margins, he says.

Burberry Group PLC has spent more than $100 million to overhaul the back end of its business over the past three years. It says a new information-technology system and better organization of its production allowed it to save $40 million in costs last year. And Italian jeweler **Bulgari** SpA says a recent revamping of the way the company gathers point-of-sale data lets it figure out faster how to restock jewelry cases as shoppers spend more cautiously.

The rise of technology is part of a tug-of-war that is crimping the clout of designers in the fashion world. In the past, creativity ruled, not consumer demand. Thus, creative directors dictated which items in a collection were the most important and which stores could sell them.

Now, though the technology being adopted by luxury fashion houses is standard to the retail industry, many fashion purists continue to be critical of brands that respond to consumer demand. Three years ago, for example, Gucci promoted its accessories designer Frida Giannini to creative director after her Flora line of bags became a huge hit. But critics say the brand has become more tame and has lost the cachet it had under designer Tom Ford.

Nonetheless, as high fashion comes under more pressure from mass-market retailers, luxury labels use technology to track and tweak their offerings based on what is selling.

Generational changes have also shifted power from designers to the consumer. Valentino Garavani, founder of the Valentino label, retired last year after single-handedly dictating the rules of his collections for more than four decades.

Alessandra Facchinetti, Valentino's new, 36-year-old designer, consults data on customer trends and other advice compiled by the marketing and commercial departments before creating her collections.

Valentino started the overhaul of its logistics systems in 2003. The company had expanded into a multibrand group that included the Hugo Boss label and smaller brands like M Missoni, Marlboro Classics and multiple lines under the Valentino name.

The company rolled together its financial-reporting systems, making it easier to calculate sales and earnings for the group. Then last year, thanks to a revamping of the supply-chain system, manufacturers began ordering fabric directly from Valentino's suppliers, speeding up the production process. Valentino's computer system was also hooked up to European department-store clients, so the company can track how its collection is selling.

Murdochs revisit pay TV

News Corp. weighs bids for companies in Spain, Germany

By Aaron O. Patrick

LONDON—The last time **News** Corp. spent big getting into the European pay-television market, it lost billions of dollars. Now, the media conglomerate is taking a second look.

In a move that could significantly expand the responsibilities of James Murdoch, the youngest son of Chairman Rupert Murdoch, News Corp. is considering bids for two major players in their local pay-TV markets, Germany's **Premiere** AG and Spain's Digital+, according to people familiar with the situation. The two satellite broadcasters together would likely cost more than €4 billion ($6.3 billion), analysts say.

If News Corp. goes ahead, the move would represent a significant change of tack in Europe for the New York-based company. Germany has long been a no-go zone for News Corp., which lost more than €2 billion there six years ago on its investment in Kirch Group, a media company and big pay-TV provider that went bankrupt.

James Murdoch

Now, as new digital-TV services are undermining Europe's traditional TV networks, News Corp. executives are wading back in to the Continent's huge TV market. Over the past six months, News Corp. has built a 25.01% stake in Munich-based Premiere and is considering making an offer for the whole company, according to a person familiar with the matter. Even if News Corp. doesn't make a bid, it wants to install its own managers in the company, this person said.

In Spain, media conglomerate **Prisa** SA is considering selling its Digital+ unit, one of the country's biggest satellite broadcasters. The sale process is likely to begin by the end of July, said people familiar with the situation. Other possible bidders include Paris-based **Vivendi** SA and Spanish telecom groups **Cableuropa** SAU, which operates as ONO, and **Telefónica** SA. ONO and Telefónica declined to comment.

A person close to News Corp. said no action was imminent and there is no certainty News Corp. will try to buy either company. A spokeswoman said the company doesn't comment on speculation.

If News Corp. buys Digital+ or Premiere, the acquired companies would become the responsibility of James Murdoch, the head of News Corp.'s European and Asian operations. Widely seen as his father's heir within the company, the 35-year-old Mr. Murdoch could burnish his leadership credentials by growing the businesses as he did U.K. satellite broadcaster **British Sky Broadcasting Group** PLC, which he ran from 2004 until late last year. News Corp. has a 39% stake in BSkyB.

Making the investments work wouldn't be easy. Pay TV isn't particularly popular in Spain, and Germany is rife with satellite-TV piracy. While Europe's affluent audiences are appealing, the investments could leave News Corp. with less money to spend in faster-growing markets like India. News Corp. owns Dow Jones & Co., publisher of The Wall Street Journal.

The acquisitions would give News Corp. greater leverage in buying satellite space and negotiating movie purchases with Hollywood studios. But the big price tags could make it difficult for the company to buy both. "Both of them are great investments, but if he buys Premiere, this is money not spent on" Digital+, said Andrea Azzimondi, an analyst at research firm Pali International.

At Premiere, News Corp. has so far used its stake to appoint two of James Murdoch's lieutenants to the board this month: Sky Italia Chief Executive Tom Mockridge and Mark Williams, chief financial officer for News Corp. in Europe and Asia. It is unclear how News Corp. would get management control of Premiere. With two of the six board seats, it doesn't have the numbers to force out CEO Michael Börnicke.

"It is not possible at the moment" for News Corp. executives to run the company, said Premiere spokesman Torsten Fricke. "They don't have any members on the management board." If News Corp.'s shareholding goes above 30%, the company will be required under German law to bid for all Premiere shares.

On Wednesday, one potential obstacle to a Premiere bid fell. The European Union cleared News Corp. to buy the company on the condition that other operators are allowed to use Premiere's satellite platform.

With 2.1 million subscribers, Digital+ is one of Spain's biggest pay-TV broadcasters. But the industry is growing slowly, and most Spaniards choose not to pay for television. Walt Disney Co. recently decided to make its Disney Channel free in Spain, because it couldn't get enough viewers to pay.

A Prisa spokeswoman said the company is likely to decide in July whether to sell Digital+. Analysts value the unit at between €3 billion and €3.5 billion, although the price could be higher depending on how much debt is included. If News Corp. wants to buy, it might find itself in a bidding war. Vivendi CEO Jean-Bernard Lévy recently told French newspaper Les Echos that his company would look at Digital+ "with interest." A Vivendi spokesman said he didn't have anything to add to Mr. Lévy's comments.

News Corp. might face a bidding war if it decides to buy Digital+. Vivendi's CEO recently said his company would look at the Spanish pay-TV firm "with interest."

News Corp.'s last move into Germany ended in failure when media mogul Leo Kirch lost billions of dollars on investments in pay TV, film and broadcasting. News Corp. was a minority investor in the Kirch Group without management control, so its executives found themselves powerless to act as the company overloaded on debt and in 2002 turned into what was then the biggest corporate collapse in Germany's postwar history.

—Dana Cimilluca contributed to this article.

AP shifts frustrate some

Newspaper editors lament focus on Web amid fight for readers

By Russell Adams

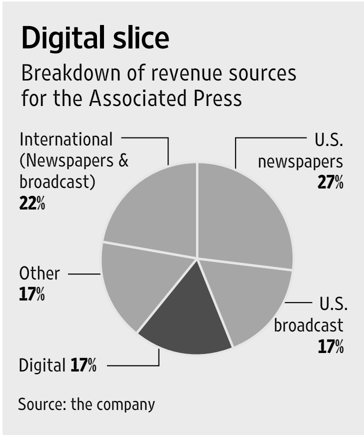
As the economic pressure on newspapers intensifies, the Associated Press, a 162-year-old newsgathering cooperative for the industry, is beginning to fracture.

Long a newspaper-centric organization, the AP has shifted its focus in recent years. With readers and advertisers migrating away from news on printed paper and toward cable TV and the Web, the AP is devoting more of its resources to producing content for other news outlets. These include the very Web portals that pose the greatest competition for newspapers, such as Yahoo and Google, which are now among the AP's biggest customers.

For some editors, the AP's strategy, coupled with its high prices, amounts to a betrayal at a time when the industry is under threat. In recent months such frustrations have sparked a bitter war of words. The editor of the Pittsburgh Post-Gazette, for example, likened AP President and Chief Executive Tom Curley to the secretary-general of the Politburo at a convention in April.

Some newspapers have attempted to reduce their reliance on the AP. This past spring, prompted by unhappiness with the AP's fees and reduced coverage of state and local news, the eight largest newspapers in Ohio created a cooperative called the Ohio News Organization, or OHNO, which allows its members to sidestep the AP by sharing stories. Five Montana newspapers owned by the newspaper concern **Lee Enterprises** have also begun sharing more content. And editors in Texas, Pennsylvania and Indiana have quietly inquired about how the Ohio cooperative works.

In some cases, newspaper editors are going up against their owners, many of whom are represented on AP's board and support the organization's initiatives. "There is a chill in the air that this is something that we can't engage our corporate owners on because they're conflicted," an editor says.



Dean Singleton, chairman of the AP's board and chief executive of newspaper publisher **MediaNews Group**, says that he welcomes a healthy debate about the AP's role in reporting and delivering the news but that the editors' complaints are misguided. "When you're faced with downsizing your news operations and making dramatic changes in how you operate, you always look for someone to blame," he says. "And AP has been a handy entity to complain about."

Rupert Murdoch, chief executive of **News Corp.**, which owns Dow Jones & Co., publisher of The Wall Street Journal, was appointed to AP's board of directors in April. In March, Dow Jones announced it wouldn't renew the news partnership between Dow Jones Newswires and the AP and had entered into a new agreement with Agence France-Presse. Dow Jones said the switch reflected its strategy to invest in global financial news.

The AP was founded in 1846 by a group of New York newspapers seeking to chronicle the U.S.-Mexican War more efficiently. Its members pay annual fees and provide their own stories to other members alongside AP-produced content. For most of its life, the organization mainly served newspapers. But that began to change in the mid-1990s, when the AP began to pump money into photo- and video-journalism operations and package the products for sale to broadcasters.

More recently, as Web portals emerged as big paying customers, the AP deepened its coverage in areas like sports, entertainment and business. Today, U.S. broadcasters and Internet companies together account for more of the AP's revenue than U.S. newspapers do. While the AP's 1,500 member newspapers still own the organization—other media outlets are associate members or have no membership stakes at all—they account for only 27% of AP revenue, down from more than 50% in the mid-1980s. The new customers have also helped nearly triple the AP's revenue over the past two decades, from about $250 million in 1987 to more than $710 million last year.

The diversification of its customer base has allowed the AP to bolster its newsgathering resources in areas like international news and finance at a time when the newspaper industry is downsizing. Over the past four years, for example, the AP has added 64 editorial positions to provide in-depth coverage of large companies and financial markets.

But for most of the AP's newspaper members, this type of expansion is of little value. Most of the stories generated by the financial group wind up on sites like Yahoo Finance, MSN Money and CNNMoney.com. Few show up in small- to midsize papers, most of which have refocused on local news, and they're not a priority at the larger metropolitan papers, which would prefer to assign such stories to their own staffs and leave local news, including legislative activities and court proceedings, to the AP.

MedImmune chief plans July exit

By Jeanne Whalen
And Jacob Goldstein

LONDON—Drug maker **AstraZeneca** PLC said the chief executive and research chief of biotech unit MedImmune have resigned from the company a year after AstraZeneca paid $15.6 billion to acquire MedImmune, underscoring the difficulty big drug companies face in trying to retain top biotech talent.

David Mott, chief executive of MedImmune, has decided to leave at the end of July, AstraZeneca said Thursday. James Young, MedImmune's president of research and development, resigned earlier this month, said AstraZeneca spokesman Chris Sampson.

The departures will deprive MedImmune of two of the top managers who helped build the company into one of the industry's more-productive developers of new medicines. Both men stayed long enough to earn a bonus equal to 25% of their base salary, which AstraZeneca had agreed to pay if they stayed for at least a year after the close of the acquisition in June 2007.

Mr. Mott is leaving because he thought it was "time for a change," not because of any conflicts with AstraZeneca management, Mr. Sampson said. Mr. Mott received a cash payout of more than $133 million when his MedImmune stock options were canceled at the time AstraZeneca acquired the company, according to a filing with the U.S. Securities and Exchange Commission.

Mr. Sampson said Mr. Mott was unavailable for comment, and Mr. Mott didn't return a phone call to his office in Gaithersburg, Maryland, where MedImmune is based.

Tony Zook, chief executive of AstraZeneca's North American business, will take over as interim head of MedImmune until a permanent successor is named, AstraZeneca said. Mr. Sampson said Dr. Young's plans to leave had been known internally for several months, and that "other senior leaders on MedImmune's management team" would take over his responsibilities. He said Dr. Young didn't immediately leave for another company. Dr. Young couldn't be reached for comment.

AstraZeneca, based in London, acquired MedImmune to strengthen its pipeline of drugs in development and boost its offerings of biotech drugs and vaccines. Big pharmaceutical companies have been keen to acquire or become partners with biotech companies, because the biotech sector has been particularly successful at discovering medicines in recent years.

But biotech scientists and managers, accustomed to the entrepreneurial spirit of their usually small companies, sometimes chafe at the bureaucracy of large drug companies. AstraZeneca offered all MedImmune employees a bonus of 15% to 25% of their base salary if they agreed to stay with AstraZeneca for at least a year after the acquisition was completed. It also agreed to allow MedImmune to continue operating as an independent unit within AstraZeneca, asking it only to coordinate its research strategy with AstraZeneca. MedImmune has about 2,500 employees, while AstraZeneca has more than 60,000.

Mr. Sampson said MedImmune has a deep bench of top managers and scientists who remain with the company. "There is a very strong leadership team that is a hallmark of MedImmune and its success, and something we're looking to use as a foundation to build upon," he said.

Mr. Mott joined MedImmune in 1992 as a vice president for business development, strategic planning and investor relations and became CEO in 2000.

InBev seeks legal ruling on Anheuser's directors

By David Kesmodel

InBev NV continued to ratchet up the pressure in its unsolicited takeover bid for **Anheuser-Busch** Cos. on Thursday, seeking a legal ruling that might help pave the way for Anheuser shareholders to remove the St. Louis icon's board.

InBev, based in Leuven, Belgium, reiterated that it wants to reach a friendly accord to acquire the Budweiser maker. But it said it filed suit in Delaware Chancery Court, seeking a judgment to confirm that shareholders acting by written consent could remove all 13 of Anheuser's directors without cause.

The move comes as Anheuser prepares its first response to InBev's offer of $46.35 billion in cash. The Wall Street Journal reported Thursday that Anheuser is prepared to reject the bid as soon as this week. The brewer is expected to argue that InBev's offer undervalues Anheuser and announce its own strategic plan to boost shareholder value, which is likely to include the sale of noncore assets, according to people familiar with the matter.

That could trigger a hostile takeover battle for the dominant U.S. beer maker. InBev, which brews Beck's and Labatt Blue, is prepared to take its offer directly to Anheuser shareholders via a tender offer, though it hasn't decided whether to pursue such a course. Its statements Thursday also indicated it might pursue a proxy fight.

InBev said Anheuser's charter and Delaware law make it clear "that the eight directors elected after 2006 are subject to removal without cause through the written-consent procedure." The filing "seeks to confirm that, as InBev strongly believes, the directors elected in 2006 are also now subject to removal through that same mechanism."

Anheuser didn't immediately respond to a request for comment.

—Dana Cimilluca and Matthew Karnitschnig contributed to this article.

Sony sets Internet course in move to video downloads

By Yukari Iwatani Kane

TOKYO—After spending the past three years restructuring, **Sony** Corp. set a new growth strategy centered on video-downloading services and electronic products that can be connected to each other and to the Internet.

The Japanese electronics maker said Thursday that it plans to offer a video-downloading service through all of its key products, such as its televisions, computers, music players, and videogame devices, in the next three years.

It also plans to give 90% of its product categories network and wireless capability in the same period.

"Our mission is simply to be the leading global provider of networked consumer electronics and entertainment," Chief Executive Howard Stringer said at a news conference.

Sony said it plans to start this summer by offering movies and other video content through its PlayStation 3 videogame console's network service in the U.S.

It will begin delivering movies directly to its Internet-connected Bravia liquid-crystal-display televisions in the U.S. this autumn. Sony said it would become the first company to stream a movie directly to a television without a set-top box and without a cable or satellite television subscription.

Mr. Stringer, who was charged with turning around the struggling company when he took over in June 2005, has been slashing costs, cutting jobs, and getting rid of unprofitable businesses. With those efforts completed, the latest strategy will be a big test of whether he can also stimulate growth for the company.

As Internet connections have gotten faster and consumers are getting more of their entertainment online, analysts say that downloading services for movies and television shows could become a market worth billions of dollars in the U.S. alone.

Mr. Stringer, a former movie executive, has often talked about the importance of designing products that can be connected to each other and combined with easy-to-use software to download video, music and other content in order to compete in the fast-changing electronics industry.

Establishing a dominant position in this area is crucial for Sony after its Walkman music devices lost out to **Apple** Inc.'s iPods because the Japanese company didn't have compelling music-downloading software.

Sony, which owns a movie studio and a music company, has an advantage over rivals because it has access to both content and electronic devices and can play off the strengths of both industries. For example, the first movie it plans to offer directly to televisions is "Hancock," a Sony Pictures movie it will release before it is available on DVD.

But it is also coming in late to a market that is crowded with strong rivals. Apple, for example, offers a set-top device called Apple TV that lets users play music and video from their computer-based iTunes library. And **Microsoft** Corp.'s Xbox 360 videogame console already offers video downloading.

Also, Sony has had problems in the past getting its notoriously independent product units to work together. A previous effort to create a portable music player and online music service for the Walkman failed in part because of internal squabbling.

Still, Mr. Stringer has been laying the groundwork for making the latest effort a success. He has encouraged employees to work together and has promoted executives who understand software and content as well as Sony's traditionally strong area of hardware.

Last year, he enforced a decision to adopt certain digital-rights-management software that was key to making it possible to offer a common video-downloading service across all of Sony's products.

CORPORATE NEWS

UniCredit sets profit goal

Italian bank intends to sell noncore assets, cut jobs, shift capital

By Sabrina Cohen
And Flemming Emil Hansen

Italy's **UniCredit** SpA unveiled a three-year business plan aimed at boosting profitability by cutting 9% of its Western European work force, while expanding in Central and Eastern Europe. As part of the 2008 to 2010 plan, the bank hopes to improve earnings per share as much as 12% excluding extraordinary items, and increase revenue 6.7% a year.

UniCredit said it was cutting 9,000 of its 100,000 jobs in Germany, Austria and Italy and that 5,800 of the layoffs in Italy are in agreement with unions.

It also announced the reallocation of more capital to commercial banking by 2010, as expected. Over the next 2½ years, UniCredit wants to see capital allocation in commercial banking in Central and Eastern Europe increase to 30.4% from 18.5% in 2007.

To boost its core Tier 1 ratio, or capital held against risky assets, UniCredit said it plans to further strengthen its operations in Central and Eastern Europe by opening 1,300 branches in the region and adding 11,500 employees to its work force. This move would allow the bank to target a core Tier 1 ratio of 7.1% by the end of its three-year plan. The bank also said it sees its core Tier 1 target above 6.2% for 2008.

Federico Ghizzoni, who is responsible for the company's Central and Eastern European activities, said that the regional expansion will be focused on four markets: Russia, Ukraine, Turkey and Romania. He added that 900 of the total 1,300 branches will be opened in those markets in the next three years, while the remaining 400 will be distributed among the group's other 16 markets in the region.

In Russia, an important growth market, the bank will open 150 new branches, bringing the total number of branches in the country to 220 by the end of 2010, Mr. Ghizzoni said. He said the number of new branches could be adjusted downward if economic growth in Central and Eastern Europe should slow more than anticipated in 2008 and 2009.

"But we are optimistic," Mr. Ghizzoni said, adding that the bank sees "a clear decoupling" between Central and Eastern Europe, where economies are thriving, and Western Europe and the U.S., where growth is slowing. UniCredit has had its share of problems as a result of the credit crisis. Over the past nine months, the bank reported total credit-related write-downs and losses of €1.73 billion ($2.71 billion).

Chief Executive Alessandro Profumo said the bank will sell noncore strategic assets during the business-plan period.

In Milan, UniCredit shares fell 4.3% to €3.95 Thursday in an overall negative market.

DAILY SHARE PRICE
UniCredit SpA
On the Milan Stock Exchange
Thursday's close: **€3.95, down 4.3%**
52-week change: **down 40%**

Source: Thomson Reuters Datastream

Merck's shingles drug faces delays

By Peter Loftus

Merck & Co. is telling customers to expect shipping delays in the coming months for its Zostavax shingles vaccine because of continuing supply constraints for one of the ingredients.

Customers could face shipping delays of as many as six weeks, Merck spokeswoman Amy Rose said.

"We are continuing to accept orders for Zostavax," Ms. Rose said. "However, customers will experience shipping delays in the coming months. We will work to fill orders as product becomes available. We, of course, will continue to monitor closely the supply and demand for Zostavax and expect to provide an update to customers in coming weeks."

Zostavax is designed to prevent shingles, a painful disease caused by the reactivation of the virus that causes chickenpox in people 60 years old and above. Merck began marketing the vaccine in 2006 and last year it had sales of $236 million, making it a modest-sized product for the drug and vaccine giant.

The supply problems stem from a manufacturing snag at Merck. Last year, the company disclosed that it had made a batch of so-called bulk varicella that was less potent than required. Bulk varicella is used not only in the manufacture of Zostavax but also for Merck's chickenpox vaccine for children, Varivax. The problem led Merck, of Whitehouse Station, New Jersey, to stop filling orders for a combination vaccine called ProQuad.

Manufacturing of the bulk varicella has resumed, but the company's process improvements need to be cleared by U.S. regulators before wider use of the ingredient in finished vaccines can resume.

Meanwhile, Merck has given Varivax priority over Zostavax for use of the bulk ingredient, Ms. Rose said. Demand for Varivax increased after a national vaccine program recommended children get a second dose in 2006. Varivax sales more than doubled last year to $854.9 million.

Ms. Rose declined to say how the Zostavax shipping delays might affect full-year sales. In April, Merck said it expected total 2008 sales of certain vaccines—including Zostavax—of $2.9 billion to $3.1 billion. This forecast excludes Merck's cervical-cancer vaccine Gardasil, which is expected to have sales of $1.9 billion to $2.1 billion.

News of the Zostavax shipping delays emerged as Merck disclosed a marketing setback for Gardasil. The U.S. Food and Drug Administration declined to expand the approved population for the vaccine to women ages 27 to 45, from the currently approved group of females 9 to 26.

Airlines to plead guilty to fixing prices

By Meena Thiruvengadam

WASHINGTON—Four airline companies agreed to plead guilty and pay a combined $504 million in fines in the U.S. Justice Department's continuing investigation of collusion in air-cargo prices.

Air France, **Cathay Pacific Airways** Ltd., KLM Royal Dutch Airlines, **Martinair Holland** NV and **Scandinavian Airlines System**'s SAS Cargo Group AS are accused of holding meetings between 2001 and 2006 in which they conspired to suppress competition by fixing the cargo rates charged to customers for international air shipments.

The conspiracy raised prices on billions of dollars in consumer goods shipped by air, including produce, clothing, electronics and medicines, the government said. In some instances, the conspiracy could have added more than 10% to the cost of the goods, officials said.

Associate Attorney General Kevin O'Connor called the airlines conducted a "concerted, long-term practice" that violated the Sherman Act antitrust law. The government said the companies are cooperating with the investigation.

"The air-cargo conspirators artificially raised the prices paid to ship billions of dollars of goods," said Scott Hammond, deputy assistant attorney general for criminal enforcement in the Justice Department's antitrust division. "American businesses and consumers ended up picking up the tab."

Air France-KLM SA, which owns Air France and KLM Royal Dutch Airlines, was fined $350 million. If approved by the court, the fine would become the second-highest figure ever levied against one entity in a criminal antitrust prosecution, the Justice Department said. Cathay Pacific was fined $60 million, Martinair $42 million and SAS Cargo Group was fined $52 million.

The airlines colluded on fixing fuel surcharges, security fees and other shipping costs, focusing on lucrative cargo traffic in and out of the U.S., officials said.

If the court accepts the airlines' plea agreements, Thursday's actions would bring the total value of air-cargo and fuel-surcharge price-fixing fines assessed by the Justice Department to $1.27 billion, the highest total ever imposed in a criminal antitrust investigation, officials said.

British Airways PLC, Korean Air, Qantas Airways Ltd. and Japan Airlines Corp. previously pleaded guilty to similar charges and have been fined.

GLOBAL BUSINESS BRIEFS

Expro International PLC

Umbrellastream takeover approved by U.K. court

A U.K. court approved private-equity consortium **Umbrellastream**'s £1.8 billion ($3.6 billion) takeover of **Expro International** PLC, foiling shareholders who had hoped the court would allow rival bidder **Halliburton** Co. to return with a higher offer. The decision marks the end of a battle for the U.K. oil and services company, which has seen its shares rocket since the consortium led by **Candover**, **AlpInvest Partners** NV and **Goldman Sachs Capital Partners** made its initial approach April 17. Shares in Expro closed down 22 pence Thursday at £16.13, just below Umbrellastream's £16.15-a-share offer. The U.K. High Court had been scheduled to rule on the Umbrellastream takeover Monday, but hearings were adjourned twice to give Halliburton and shareholders a chance to weigh in.

HBOS PLC

HBOS PLC shareholders endorsed issuing £4 billion ($7.9 billion) in new shares to strengthen the bank's balance sheet. Shareholders representing 98.51% of voting rights voted in favor of the capital increase at a meeting in Edinburgh, Scotland. The additional capital will replace losses incurred on credit investments. It will also strengthen the bank's ratio of equity capital against risky assets, known as the core Tier 1 ratio, to a range of 6% to 7%, leaving a larger buffer against the 4% regulatory minimum. HBOS shares closed down 16 pence, or 5.5%, at 276.00 pence.

Porsche AG

Porsche AG said it will end a production partnership with Finland's **Valmet Automotive** Oy in 2012 and switch to working with **Magna Steyr Fahrzeugtechnik** AG of Austria. Valmet produces Boxster and Cayman models for the German sports-car maker, which said it would fulfill its contractual obligations by maintaining the partnership for the next four years. It said Magna Steyr was chosen as Porsche's future contract manufacturer in a tender. The company "secured the contract because it submitted the most financially attractive offer, and because it is in a position to take on development tasks for Porsche sports cars," Porsche said. It gave no financial details. Magna Steyr will take on production of Boxsters, which, for capacity reasons, can't be assembled at Porsche's Zuffenhausen plant in Germany.

Volkswagen AG

Volkswagen AG said May deliveries rose 2% from a year earlier to 553,400 vehicles. Deliveries for the first five months of the year rose 6.6% to 2.7 million vehicles, a company record, the German auto maker said. Volkswagen delivered 1.6 million vehicles in Europe in the first five months, a 2% increase, with German consumers buying 432,700 vehicles, a 4% increase. In Western Europe excluding Germany, the company delivered 886,000 vehicles, a decrease of 2.5%. In Central and Eastern Europe, the company saw a near 20% increase in deliveries to 230,000 vehicles. Volkswagen, Europe's largest car maker by sales, didn't release figures for North America or the rest of the world.

Iberdrola Renovables SA

Iberdrola Renovables SA pledged to invest €18.8 billion ($29.47 billion) and forecast rapid profit growth through 2012. The Spanish renewable-energy company, controlled by utility giant **Iberdrola** SA, said its net profit should rise to €400 million this year from €117.5 million last year. Renovables forecast net profit of €800 million in 2010 and €1 billion in 2012. "The guidance for 2008 is ahead of our numbers and we have been positively surprised by the aggressive targets for 2012," Dresdner Kleinwort said in a note to investors. The company said that most of the investment pledged through 2012 is earmarked to finance foreign expansion. Half of the €18.8 billion will be spent in the U.S. Renovables shares closed up €0.07, or 1.5%, at €4.79

Tata Steel Ltd.

Tata Steel Ltd., the world's sixth-largest steelmaker by capacity, posted consolidated net profit of 123.50 billion rupees ($2.90 billion) for the year ended March 31, boosted by the acquisition of Anglo-Dutch steel producer Corus and a one-time gain. Mumbai-based Tata Steel had net of 41.66 billion rupees a year earlier. The numbers aren't comparable as the company completed the purchase of Corus in April 2007. Shares of Tata Steel gained 1.9% to 757.10 rupees on the Bombay Stock Exchange on Thursday. The results were declared after trading closed. The shares have declined 19% since Jan. 1, against a 29% drop in the benchmark index.

Google Inc.

Google Inc. named Bell Canada executive Patrick Pichette its chief financial officer, succeeding George Reyes, who had announced he will retire. Mr. Pichette most recently was president of operations at Bell Canada, a unit of BCE Inc., Google said. He was finance chief from 2002 to 2003 during his seven-year stint with the Canadian communications company. His appointment at Google is effective Aug.12. "Patrick brings the expertise and track record of a successful CFO, along with the hands-on business experience of a seasoned operations executive," Google Chief Executive Eric Schmidt wrote in a news release. Google announced last year that Mr. Reyes planned to retire from the Internet company in what was one of the first departures from its top executive ranks.

Carrefour SA

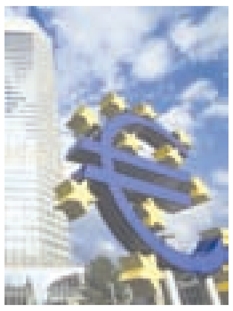
French grocery giant **Carrefour** SA has cut its 2008 operating-profit outloo. The world's second-largest retailer by market value, after Wal-Mart Stores Inc., said it expects operating profit to increase "at around the same rate as sales," having said as recently as May that its profit would rise faster than sales. Carrefour issued the statement Thursday after its shares tumbled 8.8%, to €37.88 ($59.38), the second-biggest decline in France's benchmark CAC-40 index. The drop came after Chief Executive Jose Luis Duran declined to comment late Wednesday on the group's 2008 forecast. Carrefour didn't give reasons for the lower profit outlook but said it had released the warning "in light of the share-price reaction today."

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

GERMANY

June inflation data reflect increasing price pressure



GERMANY'S preliminary June inflation figure looks likely to confirm fears of increasing price pressures after three states released consumer-price data.

German prices are expected to rise 0.3% from May and 3.2% from June of last year, accelerating from 3% year-to-year in May, according to a Dow Jones Newswires survey of analysts. The data from Europe's largest economy could push euro-zone inflation to 3.9%, said Dirk Schumacher, Goldman Sachs's senior European economist. The June inflation estimate for Germany is expected to be released Friday, while the euro-zone measure is expected Monday. *—Roman Kessler*

EUROPEAN UNION

Proposal aims to reduce mobile-phone charges

THE EUROPEAN Union unveiled plans to cut mobile-phone charges by regulating the tariffs for calls between networks.

The tariffs, known as "voice call termination rates," are currently regulated by national authorities, resulting in major differences in the charges passed on to consumers. According to figures from the European Commission, the charges range from two European cents (3 U.S. cents) per minute in Cyprus to 18 European cents per minute in Bulgaria.

The EU's top telecom official, Viviane Reding, is proposing regulation to harmonize rates across Europe over the next three years. *—Associated Press*

ROMANIA

Spurred by rising prices, central bank lifts rates

ROMANIA'S central bank lifted interest rates by a quarter of a percentage point to 10%, becoming the latest central bank on the fringes of Europe to take action against rising inflation and soaring food and fuel prices by tightening credit.

Romanian wages and retail sales are both rising by more than 25% a year, and gross domestic product expanded 8.2% in the first quarter. Inflation ran at 8.5% in May and is expected to come within a hair of 10% this summer, bringing it to more than double the central bank's target ceiling. This month, the central banks of Poland, Russia, Israel and South Africa have raised rates. *—Christopher Emsden*

Gun-rights advocates score a win in U.S.

Supreme Court rules individuals can bear arms in households

BY JESS BRAVIN AND SUSAN DAVIS
Washington

THE U.S. SUPREME Court ruled that the Constitution guarantees individuals the right to keep handguns in the home, ending an age-old debate over the elusive vocabulary of the Second Amendment while opening a new era in the nation's approach to fighting crime and preventing violence.

Delivered on the last day of the Supreme Court's term, the 5-4 decision underscored the central place the court plays in the nation's politics and culture, as well as its law.

For the third time this month, a major constitutional issue was decided by a single vote—that of Justice Anthony Kennedy, the maverick conservative who has sided with the court's liberals to extend habeas corpus rights to Guantanamo Bay prison detainees and bar the execution of child rapists. Thursday, he lined up on the right to hold that each household may arm itself with deadly weapons to fend off intruders.

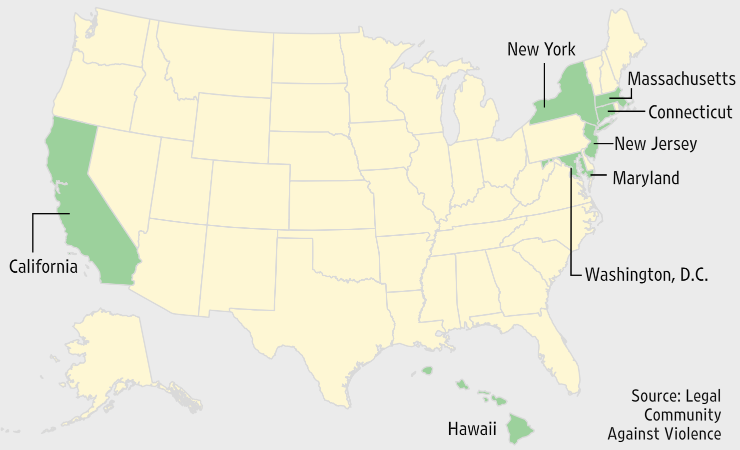
It was Justice Antonin Scalia, the blazing intellectual force of conservative jurisprudence, who wrote the opinion. The 64-page tour covers the obscure origins of gun rights in the fratricidal wars of 17th century England, the violent struggles that defined America in its colonial revolt against the British crown, its division over slavery and the subsequent repression of freed blacks, through to the modern era, where battles against foreign invasion and between internal factions have given way to urban crime.

"By the time of the founding [of the U.S.], the right to have arms had become fundamental for English subjects," Justice Scalia wrote, in an opinion joined by Chief Justice John Roberts and Justices Kennedy, Clarence Thomas and Samuel Alito. "The Second Amendment, like the First and Fourth Amendments, codified a pre-existing right."

The Second Amendment, in its entirety, reads: "A well regulated Militia, being necessary to the security of a free State, the right of the people to keep and bear Arms, shall not be infringed."

That phrasing has led to countless debates over what precisely is being protected—a right of states and their citizens to organize militias, obviating the need for a standing army; a right of individuals to arm themselves in case they may someday need to form a militia; or some other construction involving either or both personal and collective rights.

Gun laws in the U.S.
Places that prohibit some classes of weapons



Source: Legal Community Against Violence

The court decision, arising from a challenge to the ban of handguns in Washington, D.C., is the latest in a string of wins for the gun-rights lobby. In 2004, at the urging of the National Rifle Association, Congress allowed the ban on assault weapons to lapse when no legislation was produced to extend it, although U.S. President George W. Bush had said he would have signed such a measure.

In another reversal of the gun-control lobby's heyday, the amount of time the Federal Bureau of Investigation can hold records of gun sales was reduced to 24 hours from three days. Even protests from the FBI that it should be allowed to hold the records 72 hours to ensure that gun dealers and buyers hadn't found a way to circumvent the system were rejected.

In a landmark win for the firearms industry, the House and Senate passed a law limiting the ability of municipalities and cities to hold the industry liable for some acts of violence. The lobby's power also has moved into appropriations language. Riders have been attached to appropriations for the Bureau of Alcohol, Tobacco, Firearms and Explosives budget since 2003 preventing the agency from releasing firearms-tracing data collected by various law-enforcement agencies.

Much of the lobby's support has come in swing states where candidates remember that the backlash over the 1994 assault-weapons ban played a role in defeating several Democratic members of Congress that year. Gun control hasn't figured prominently in the Democratic platform since then.

Among Democrats who won the NRA's endorsement for elections in 2006 were Nebraska Sen. Ben Nelson, Oklahoma Rep. Dan Boren, Tennessee Rep. John Tanner and West Virginia Rep. Alan Mollohan, among others. In gubernatorial races, the NRA has endorsed Democrats in Oklahoma, Tennessee and Wyoming, and Bill Richardson, the former Clinton administration energy secretary and cabinet member, in New Mexico.

John Snyder, spokesman for the Citizens Committee for the Right to Keep and Bear Arms, a gun-rights group, said the consensus in the gun-rights community has been that the next challenge would be over forcing Washington to actually allow a gun dealer to locate in the city.

Mr. Snyder said the District will have a short amount of time to come up with a law that will pass Supreme Court muster. "I would imagine they would do everything they can to make it difficult for people to acquire handguns," he said. "The easiest way to do that is to restrict the presence of gun dealers. They can create a de facto gun ban by prohibiting gun dealers from being involved in commerce."

Wayne LaPierre, head of the NRA, said his group plans to immediately issue challenges to handgun bans in San Francisco and Oak Park, Wilmette and Morton Grove in Illinois and was considering bringing a case against Chicago.

He said the case had been narrow in the issues it considered, but "once you get an individual rights decision, all kinds of things flow from it."

"What this does is it puts the Second Amendment individual right as a permanent, real part of American constitutional law." Mr. LaPierre added that the NRA would try to use the decision to overturn licensing and registration requirements and bans on other kinds of weapons.

In Chicago, the City Corporation said it was expecting a challenge but would continue to enforce its handgun ban because it hadn't been invalidated by the decision.

—Gary Fields and Louise Radnofsky contributed to this article.

Nepal's prime minister resigns

BY KRISHNA POKHAREL

Nepal's prime minister resigned Thursday, yielding to pressure from the Maoists and their allies who have emerged as the most powerful political force in the Himalayan nation almost three months after elections.

The resignation of Girija Prasad Koirala will make way for Pushpa Kamal Dahal, chairman of the Communist Party of Nepal (Maoist), to form a new government. Other leftist parties are likely to back Mr. Dahal, though his party falls short of a simple majority in the 601-member Parliament.

Mr. Koirala's departure follows a fight among the seven political parties, including the Maoists, that have run a coalition government since April 2006. The Maoist members of the coalition resigned from the government June 20, accusing Mr. Koirala and his Nepali Congress Party of obstructing them from forming the next government under the premiership of Mr. Dahal.

Nepal's king has stepped down, but building a republic has been difficult.

Announcing his resignation at the Parliament Thursday, Mr. Koirala said: "There are both challenges and opportunities facing the country now. We should be able to get over the challenges and use the opportunities for the good of the people and the nation."

Nepal recently became a republic after its last monarch relinquished the throne. But its transition has been rocky. The 25 political parties in Parliament have yet to elect a president to replace the king as head of state. That left no one for Mr. Koirala to present his resignation to.

The Nepali Congress Party had proposed that Mr. Koirala, 83 years old, be installed as president, but the Maoists rejected that idea. The new Maoist-led government will face skyrocketing inflation and a food shortage.

Iraq, U.S. may miss troops-pact deadline

Interim deal weighed on military presence; stalled on immunity

By Gina Chon

BAGHDAD—Iraqi and U.S. officials may not meet a July 31 deadline for a pact to establish a legal basis for a long-term U.S. military presence here, but an interim deal could be reached allowing military maneuvers as talks on a permanent agreement continue, according to people familiar with the talks.

In addition, the two sides have made progress in talks in recent days on an agreement on their political, economic, educational and cultural relationships, which they expect to reach by the deadline.

For the past several days, leaders and representatives of Iraq's five main political parties have been meeting individually with U.S. officials in Baghdad to try to work out a compromise on the Status of Forces Agreement, which is needed to establish a legal basis for American military operations in Iraq after a United Nations mandate expires at the end of this year. Because each leader represents different political factions among Shiites, Sunnis and Kurds, reaching a consensus is a complex process. The two sides are hoping that soon the entire group can meet to move the talks forward.

The biggest points of contention in reaching a permanent agreement is whether the U.S. military could arrest Iraqi civilians and keep them in U.S. detention facilities and whether U.S. troops will be immune from prosecution under Iraqi law.

If a deal doesn't come by July 31, the two sides may agree that the U.S. will consult with and coordinate with the Iraqi government on military maneuvers in Iraq as a temporary measure, according to people familiar with the talks. That is essentially how U.S. troops already operate in Iraq and may be enough to provide a legal basis for the U.S. military here until a comprehensive agreement is established.

U.S. President George W. Bush discussed the security agreement with Iraqi President Jalal Talabani in Washington on Wednesday. Both leaders expressed cautious optimism. "We have very good, important steps toward reaching to finalize this agreement," Mr. Talabani said Wednesday. Mr. Bush said the U.S. wants an agreement that "suits" the Iraqi government.

The U.S. has dropped several conditions, most notably immunity for security contractors, which has allowed the talks to move forward after several Iraqi politicians, including Prime Minister Nouri al-Maliki, said the negotiations had reached a dead end. Immunity for private contractors has been a sensitive issue since 17 Iraqis were killed by **Blackwater Worldwide** guards in Baghdad last September. Blackwater said it was acting in self-defense.

Photos: Associated Press

U.S. soldiers in South Korea, the Philippines and Iraq

Global presence

Crucial differences remain between the U.S. and Iraqi goverments over the Status of Forces Agreement that will determine the scope of U.S. troops' presence in Iraq. A look at how long it took for other agreements to be approved:

- **World War II ended 1945**
  Agreement with NATO countries approved in 1951
  A supplementary agreement for Germany approved in 1959
  Agreement with Japan approved in 1960
- **Korean War ended 1953**
  Agreement with South Korea approved in 1966
- **Agreement with East Timor** approved in 2002, fighting ended in 1999
- **Agreement with the Philippines** called Visiting Forces Agreement, approved in 1999

Immunity for U.S. troops remains a stumbling block. The U.S. says eliminating immunity for troops in combat situations is unacceptable, while the Iraqis say it is an important condition to uphold Iraqi sovereignty.

"These talks are an important part of the normalization of relations between the U.S. and Iraq as things improve there," said retired Army Lt. Col. Nathan Freier, a senior fellow at the Center for Strategic and International Studies. "The Iraqi government is taking on more responsibilities, but given the politicization and immaturity of the Iraqi judicial system, American soldiers would be at risk if immunity is dropped."

Security agreements such as this usually take several years to negotiate and are worked out with countries that are at peace, which makes the talks with Iraq an unusual case.

Although overall violence has gone down in Iraq, there has been a spike of attacks in the last week. At least 10 American soldiers and dozens of Iraqis have been killed in Baghdad's Sadr City, Baqubah in Diyala province, Mosul in northern Iraq and other areas. On Thursday, about 40 people were killed in bombings in an area west of Baghdad and in Mosul.

The U.S. position when talks began last fall has led to a backlash in Iraq, making the job of selling the deal to the Iraqi general public even more difficult.

For the past several Friday prayers in many mosques across Iraq, including in the holy Shiite city of Karbala and the Sadr City area of Baghdad, imams have spoken out against the security pact. Followers of anti-American Shiite cleric Muqtada al-Sadr have been protesting against the talks following the prayers. During prayers in the southern city of Kufa last week, Sheikh Asad al-Nassiri, a Sadr supporter, said the security pact would "humiliate Iraqis" and "give the occupier the advantage."

Iraqi politicians—some possibly looking ahead to provincial elections scheduled for October—also have increased nationalist rhetoric about the Status of Forces Agreement.

"Any discussions with the U.S. must contain a program for the U.S. troop withdrawal from Iraq," said Sheikh Hamam Hammoudi, a lawmaker and leader in the Islamic Supreme Council of Iraq, the most powerful Shiite political party here. "Achieving full sovereignty is the most important goal."

U.S. GDP revised higher as growth jitters remain

By Kelly Evans

The U.S. economy grew slightly more in the first quarter than previously estimated, and home sales rose in May, but concerns are rising about potential threats to growth in coming months.

"For the balance of this year, it looks like the economy is trapped in a subpar growth pace but not a recession," said Stephen Stanley, chief economist with RBS Greenwich Capital in Stamford, Connecticut.

The Commerce Department said U.S. gross domestic product rose at an annual rate of 1% during the first three months of the year, up from its previous estimate of 0.9%. The economy grew at a 0.6% pace in the final quarter of last year. Stronger consumer spending and export growth helped boost growth in the first quarter; inflation rates also were revised higher.

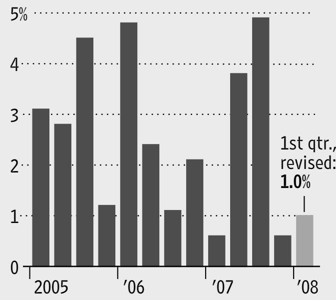
The price index for personal consumption expenditures excluding energy and food—a gauge of inflation watched closely by the U.S. Federal Reserve—rose at a 2.3% pace, above the 1.5%-to-2% range that the Fed considers price stability.

Sales of previously owned houses, meanwhile, rose 2% last month after declining in the previous two months, according to the National Association of Realtors. Still, the sales pace of existing homes, which make up about 85% of the U.S. market, is down about 16% from May 2007.

Sales of existing single-family homes rose 1.6% last month to a 4.4 million rate but are down about 15% from a year earlier. The monthly rise was likely fueled by declining prices.

Choppy growth

Quarterly change in inflation-adjusted GDP in the U.S.*



*At a seasonally adjusted annual rate

Source: U.S. Commerce Department

On GDP, analysts expect a similar performance for the April-through-June period, as government economic-stimulus checks provide some relief to consumers. Rising exports also continue to buoy growth.

Of concern now is how the economy will fare later this year and early next year, as the impact of the stimulus checks fades. U.S. consumer confidence plummeted this month as a result of labor-market worries and soaring prices for oil, fuel and other commodities.

Meanwhile, newly filed claims for unemployment benefits last week totaled 384,000, unchanged from the week before, the Labor Department said. The number of Americans who continue to claim unemployment benefits rose by 82,000 in the week ended June 14, to 3.14 million.

BOE chief cites economic risks of rate increases

By Laurence Norman And Paul Hannon

LONDON—The Bank of England won't raise interest rates just to gain credibility and must avoid an economic slowdown that is sharp enough to pull inflation below target, the central bank's governor, Mervyn King, said.

In comments that suggest the U.K. central bank is unlikely to raise rates rapidly to tame higher prices, Mr. King said "we need to avoid a slowdown that is so pronounced that it would pull inflation down, not just to the target, but below."

Mervyn King

In remarks to the Treasury Select Committee, Mr. King said that if the central bank's Monetary Policy Committee tries to get inflation down to the target level in six months, there would be a "deep recession." The MPC will set rates "at whatever level is needed in order to get inflation back to target, but I don't know what" level that is, Mr. King said.

The consumer-price index rose 3.3% in May from a year earlier, the highest annual increase in more than a decade. The BOE targets a 2% medium-term inflation rate.

The BOE has cut its benchmark interest rate three times since December but held rates steady at 5% at the May and June meetings. Last week, Mr. King warned that inflation would likely rise above 4% later this year.

U.S. pursues faster delivery of high-tech war equipment

By August Cole And Yochi J. Dreazen

WASHINGTON—The Army is set to announce a significant reshaping of its biggest and perhaps most contentious acquisitions program in an effort to speed the delivery of high-tech equipment to forces in Iraq and Afghanistan, according to senior military officials.

The Army will detail the planned changes to its $160 billion Future Combat Systems initiative Thursday, the officials said. Army officials say the revisions could push the program's total price tag even higher, lifting the fortunes of the effort's two main contractors, **Boeing** Co. and **SAIC** Inc.

The moves will shift the focus of the overall FCS effort to infantry brigades instead of armored units. The Army will also work to get large numbers of robots and miniature aerial drones—both of which are designed for use in crowded urban areas—out to forces in Iraq and Afghanistan by late 2010, instead of in 2015 or 2016 as initially planned.

"The idea here is to accelerate as much of the effort as possible," one senior Army official said.

The revisions underscore the Army's fears about the FCS effort, which has been dogged by questions about its high cost, uncertain technology and questionable relevance to the manpower-intensive ground wars in Iraq and Afghanistan.

The Army is counting on the FCS effort to increase its networking and communications abilities, as well as to provide soldiers with more-sophisticated vehicles and heavier firepower. The program has 14 components, including remotely controlled aerial and ground vehicles as well as sensors capable of detecting when intruders enter a building.

But skepticism about the program has been building within the Pentagon and on Capitol Hill. The House Armed Services Committee wants to slice about $200 million from the program, and some leading Democrats want the Army to focus more on the immediate needs of the wars in Iraq and Afghanistan.

Defense Secretary Robert Gates, who clashed publicly with the Air Force leadership over the expensive and costly F-22 jet, has also raised doubts about the FCS program. In a speech in May, Mr. Gates said that FCS "must continue to demonstrate its value for the types of irregular challenges we will face, as well as for full-spectrum warfare."

The comments alarmed many Army officials, who fear that Mr. Gates may eventually decide to sharply curtail the FCS initiative, just as he did with the F-22 program.

During the F-22 fight, Mr. Gates and his top aides began to criticize the Air Force's attraction to expensive, state-of-the-art fighters as "next-waritis." Two Army officials said Wednesday they were hoping that their changes to the FCS program would ensure that Mr. Gates didn't use the same term to describe the Army.

It is clear that senior Defense Department officials are growing concerned about FCS. The Pentagon's top weapons buyer, John Young, recently held a sweeping Saturday review of the program. Mr. Young said that he was taking a close look at the individual components of FCS to ensure that each can "stand on its own."

REVIEW & OUTLOOK

The Fed at Ease

The Federal Reserve stayed true to its recent news leaks Wednesday and held its target interest rate at 2%. In lieu of action, Chairman Ben Bernanke and his mates decided merely to *talk* tougher about inflation, signaling that they may lack the will to tighten money in an election year.

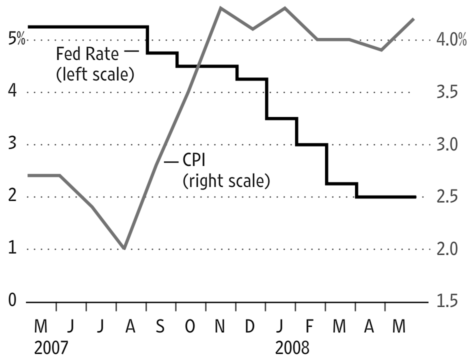
As the nearby chart shows, the Fed continues to run a highly accommodative monetary policy. The consumer price index is rising at a rate roughly double the fed funds rate, and the CPI is a lagging indicator. Producer prices in May were up 7.2% on an annual basis, and that's before soaring oil and food prices have made their way through the economy. The dollar remains weak against gold, oil, the euro, you name it.

Every American who drives or shops for groceries understands this, except at the Fed, where they bow before something called "core inflation." This is a way of measuring prices without including food and energy, and so we are supposed to take comfort that "core inflation" is rising at only a 2.3% annual rate. Yet it is the Fed-induced price spike in food and energy since last August that has Americans in an uproar and Congress in a panic that may yet produce major policy blunders.

But don't worry: Wednesday's Fed statement averred that it "expects inflation to moderate later this year and next year." That's good to know, though the Fed Governors will have to do some evangelizing because this isn't what the public thinks. According to the Conference Board's June survey of consumer sentiment, Americans believe inflation over the next 12 months will be 7.7%. That's up from 6.8% in April, 5.4% in February, 5% last September, and the highest in the last 20 years.

Negative Real Interest Rate

Federal funds target rate vs. CPI 12-month percentage change, May 2007-May 2008



Source: Federal Reserve Board, Bureau of Labor Statistics

It was only a couple of months ago that Frederic Mishkin, Donald Kohn and other Fed Governors were asserting that "inflationary expectations" were "anchored." In fact, those expectations are soaring, which means that they will soon begin to show up in wage demands and price increases throughout the economy. The more deeply those expectations become embedded, the harder they are to change and the more the Fed will have to tighten money to uproot them.

Meanwhile, inflation continues to rise around the world, especially in what the Paul Volcker Fed understood was the "dollar bloc." Headlines like this one have become routine: "Chinese agree [to] 96% rise in iron ore prices." Mexico's CPI has leapt above 5%, and Brazil's overall inflation rate is nearly 6%.

All of this is evidence that the Bernanke Fed has failed in its main responsibility of maintaining price stability and a stable dollar. In its defense, the Governors would say they have acted to prevent the credit crisis from becoming a global recession. But in the process they have ignited a global spike in commodity prices that amounts to a huge tax increase on much of the world. It is crushing the airlines, may break the U.S. car companies that rely on SUVs for their profits, and is sapping the purchasing power of the American middle class.

It has been an historic blunder, and the damage will only increase the longer the Fed takes to correct it.

Monsieur Obama's Tax Rates

Celebrity chef Alain Ducasse insists that his change of citizenship this week from high-tax France to no-income-tax Monaco wasn't a financial decision but an "affair of the heart." Right. But even if he's being sincere, plenty of other Frenchmen have moved abroad to escape their country's confiscatory taxes.

Americans should be so lucky: Theirs is the only industrialized country that taxes its people even if they live overseas. That hasn't been a big problem as long as U.S. tax rates have been relatively low. But with Barack Obama promising to lift rates to French-like levels, this taxman-cometh policy could turn Americans into the world's foremost fiscal prisoners.

And make no mistake, taxes under a President Obama could be truly *à la française*. The top marginal tax rate, including federal, state and local levies, could approach 60% for self-employed New Yorkers and Californians. Not even France's taxes are that high now that President Nicolas Sarkozy has capped the total that high-earning Frenchmen like Mr. Ducasse can pay in income, social and wealth taxes at 50% of earnings.

Mr. Sarkozy set this "fiscal shield" because he knows that tax rates affect behavior. When he visited London this year, he observed that the British capital is now home to so many French bankers and other professionals seeking tax relief that it's the seventh-largest French city. Those expatriates choose not to use their creativity and investment capital to benefit France and its economy.

Senator Obama's plans to raise income, Social Security and capital-gains taxes amount to a belief that people don't react to punitive tax rates. If so, he needn't worry about people leaving the country and could let them pay taxes in whichever part of the globe they choose to live in. Once Americans are paying French-style tax rates, they ought to have the same freedom to move as Alain Ducasse.

The Price of Justice

The Khmer Rouge war-crimes tribunal released its budget wish list Tuesday, and it isn't petty cash. The court is asking for $86 million to stay in business through December 2010 and possibly more if the trials take longer. That's less than they were asking for in February, when an earlier version of the budget stood at $114 million. But donors should still be wary.

The tribunal, run jointly by the United Nations and the Cambodian government, wants typical Turtle Bay flab: a built-in 15% contingency fund that amounts to $11 million over the next 2 1/2 years. Donors are balking, and so far only Japan and Cambodia have pitched in a meager $4 million. As we went to press the steering committee was debating whether to scale the contingency fund back to 7.5% of the budget.

Cambodia's tribunal isn't cheap—but it may be worth it.

The war-crimes tribunal's money troubles this year have been tranformative. As the reserves dwindled, the tribunal started petitioning donors for money and the biggest lenders pressed the tribunal to slim down and be more transparent.

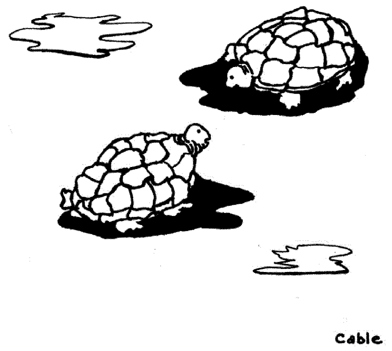
The pressure seems to be working. Over the past six months, the tribunal has made audits public, slimmed down its operations and shortened its proposed timeline. An infusion of new management has also helped. In April, Deloitte reviewed the tribunal's human-resources management and found its practices "robust" and "ready to take on the next phase of operations." The team of reviewers said five employees were underqualified for their jobs. They were fired.

There's still a way to go. Some of Deloitte's simplest recommendations, such as strengthening the code of conduct, have yet to be implemented. Deloitte suggested that the code include a pledge to report violations and not to offer or accept gifts or money. (Currently, only *accepting* gifts is forbidden). More seriously, past allegations of kickbacks have yet to be investigated.

The best thing about the new budget is that it will keep the court accountable to donors by asking for money in phases, instead of receiving a lump sum. The first phase ends in December 2009, at which point the court will have its hand out again. That will give donors the opportunity to examine the court's progess and its use of taxpayers' funds—and ask tough questions. As well they should.

Pepper . . . and Salt

THE WALL STREET JOURNAL



"I've got all of mine in a target 2085-3000 fund."

Tokyo Credit Crunch

Shares of Japanese consumer-finance firms took a beating this week as investors ratcheted down their revenue projections. Little wonder: This is an industry with a dismal future.

The sell-off was sparked by a Lehman Brothers report highlighting the shrinking loan book at Aiful, a big lender. But the pain is everywhere.

This is a crisis made entirely in Japan. When Tokyo in 2006 decided to unify two laws that capped lenders' interest rates at different levels, policy makers left lenders open to lawsuits for charging rates in the "gray zone"—the difference between the two rates. Lawyers, sniffing business, piled in. The lenders' bottom lines are also suffering from the caps on interest rates.

Instead of fixing these problems, Yasuo Fukuda's government has suggested setting up a consumer agency to handle complaints. That would conveniently distance the government from its role in creating the fiasco in the first place—and leave the lenders open to more litigation.

Worse, lenders can't bulk up through consolidation because it's hard to value a target's potential legal liabilities. So they're scaling back. In normal years, consumer-finance companies approve around half of all loan applications. Now most are approving around 20%.

The Japanese economy is slowing, credit is tight and borrowers need more sources of lending, not fewer. It would be far better for the government to be encouraging more consumer-finance companies to set up shop in Japan, not driving the existing businesses into the ground.

On Taste

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■ **Anyone who sees** the movie "Crossing" will not soon forget the terrible suffering of the people in North Korean, writes Melanie Kirkpatrick.