THE WALL STREET JOURNAL.

WSJ.com

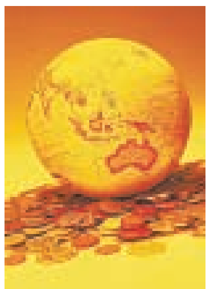
DOW JONES Newswires

EUROPE

DOW JONES A NEWS CORPORATION COMPANY

VOL. XXVI NO. 180

TUESDAY, OCTOBER 14, 2008



Global gloom: Financial crisis is all over the map

NEWS IN DEPTH | PAGES 18-19

Barclays aims to bypass the U.K. banking bailout

HEARD ON THE STREET | PAGE 22

What's News—

Business & Finance

Morgan Stanley struck a deal with Mitsubishi UFJ Financial Group, giving it the $9 billion lifeline it needed and buying the U.S. investment bank more time to make over its balance sheet. Its shares soared. Page 1

■ **European and U.S. stocks** surged on signs that governments would mount a more-coordinated effort against the credit crisis. Page 21

■ **The U.S. Treasury detailed** efforts to set its $700 billion rescue program into motion quickly. Page 3

■ **Paulson called a meeting** with top U.S. bank CEOs to discuss his plan to take equity stakes in financial firms. Page 2

■ **Google entered talks** with the U.S. Justice Department to head off any antitrust challenge to its ad pact with Yahoo. Page 9

■ **Banco Santander is in talks** to gain full control of the U.S.'s Sovereign Bancorp, which has been hurt by bad loans. Page 10

■ **The Fed began** providing dollar funding under its swap facilities with three European central banks. Qatar said it will pump capital into its banks. Pages 12, 24

■ **Waste Management dropped** its $6.7 billion bid for rival U.S. hauler Republic Services, citing market turmoil. Page 26

■ **China's import growth** slowed for a second month in September, up 21.3% from a year earlier, as commodity demand appears to wane. Page 14

■ **Catastrophe-bond** issuance has suffered amid the financial crisis, but insurers hope the complex products will be able to manage a comeback. Page 24

■ **Abbott Laboratories** joined Microsoft and H-P in announcing big stock buybacks. Page 34

■ **Telefónica will sweeten** an offer for the remaining shares of a Chilean fixed-line-telecommunications company. Page 11

Markets 4 p.m. ET

MARKET	CLOSE	NET CHG	PCT CHG
DJIA	9387.61	+936.42	+11.08
Nasdaq	1844.25	+194.74	+11.81
DJ Stoxx 600	225.37	+20.24	+9.87
FTSE 100	4256.90	324.84	+8.26
DAX	5062.45	+518.14	+11.40
CAC 40	3531.50	+355.01	+11.18
Euro	$1.3602	+0.0082	+0.61
Nymex crude	$81.19	+3.49	+4.49

Money & Investing > Page 21

World-Wide

Britain, Germany, France, Spain and Italy detailed steps to spend tens of billions of pounds and euros on stakes in struggling banks and offer hundreds of billions more in guarantees aimed at helping banks. But even as markets rallied on the news, economists fretted about the potential effect on taxpayers and budgets. Page 1

■ **North Korea lifted** its ban on U.N. inspections of a plutonium-producing plant and said it will resume disabling a linked facility, the U.N. nuclear watchdog said.

■ **Iraq opened** the doors to foreign oil-sector investment, disclosing terms for contracts in its first bidding round since the U.S.-led invasion of 2003. Page 12

■ **Obama proposed** to put home foreclosures on hold and give tax breaks to firms that create jobs, while McCain issued veiled criticism of the Bush administration.

■ **McCain and Palin rolled** into Virginia in a bid to stop the Republican ticket's slide in the state. Obama proposed new economic rescue measures. Page 35

■ **Pakistani security forces** and Taliban militants clashed near the Afghan border in fighting that killed 51 people, including 47 militants, officials said.

■ **A Christian store owner** was shot to death in Mosul, the latest in a series of killings that has caused thousands of minority Christians to flee the Iraqi city.

■ **Paul Krugman**, a Princeton scholar, New York Times columnist and Bush critic, won the Nobel Prize in economics. Page 14

■ **Zimbabwe President Mugabe** swore in two vice presidents, having said his party would control all key ministries, prompting the EU's condemnation.

■ **Iran's reformist ex-President** Khatami is hosting former U.N. chief Annan and European dignitaries to a conference on religion in a rare visit this week.

■ **Somali pirates said** they may extend a deadline to destroy a hijacked Ukrainian ship, as relatives of the ship's crew demanded Ukraine pay a ransom.

■ **Thai riot police used** a Chinese tear gas that contained a powerful explosive to disperse protesters last week, an investigator said. Three people died and 478 were injured in clashes.

EDITORIAL & OPINION

The turnaround?

We may be seeing the beginning of the end of the credit crisis. Review & Outlook. Page 15

Europe's next challenge: How to pay for bailouts

More losses could see national debts grow, credit ratings retreat

Now that governments across Europe have stepped in with bold plans to bail out their banking systems, they are facing a new challenge: How to pay for it all.

The U.K., Germany, France, Spain and Italy on Monday provided further details of measures that will see their governments spend tens of billions of pounds and euros on stakes in struggling banks and offer hundreds of billions more in guarantees aimed at helping banks borrow the money they need to do business. But even as markets rose sharply on news of the concerted efforts, economists were fretting about the potential effect on taxpayers and government finances.

*By **Marcus Walker** in Berlin, **Sara Schaefer Muñoz** in London and **David Gauthier-Villars** in Paris*

In essence, governments are making massive bets on the futures of their banking systems. If the plans work and banks do well, taxpayers could profit as the value of the government stakes rises. But if banks suffer further losses, governments could see their national debts

Please turn to page 34

Associated Press

British Prime Minister Gordon Brown, left, and Treasury chief Alistair Darling **announce their financial-rescue plan** in London on Monday.

How the U.K. rescue plan became a banking model

BY CARRICK MOLLENKAMP, DANA CIMILLUCA AND ALISTAIR MACDONALD

LONDON—The U.K. government and the country's top bankers, after a sleepless weekend in London, say they've found a way to halt the progression of the financial crisis.

The British bank bailout plan, which is becoming a model for the U.S. and the rest of Europe, is the product of an unusually close collaboration between the government and its banks.

On Monday, the U.K. government said it would invest as much as £37 billion ($63 billion) in three of the country's biggest banks, including 281-year-old **Royal Bank of Scotland Group** PLC. In one swoop, the government took controlling stakes in banks with balance sheets totaling £2.5 trillion, about 50% more than the country's gross domestic product.

Within days, the bumbling images in the public eye of Prime Minister Gordon Brown and Chancellor of the Exchequer Alistair Darling, the Treasury chief, have changed. A year ago, their missteps contributed to the U.K.'s first bank run in more than a century; a month ago, Mr. Brown had some of the lowest opinion poll ratings of any modern British prime minister. Today, their plan—which injects capital into the banks to cushion against losses while also providing more cash to the frozen bank-lending system—is being held up as an example by other governments around the globe.

On Monday, Mr. Brown invoked the July 1944 meeting at Bretton Woods, N.H.—where Western leaders met to map out a postwar financial order and established the Inter-

Please turn to page 34

Morgan Stanley, with a lifeline, vows more change

BY AARON LUCCHETTI

Morgan Stanley got the $9 billion lifeline it needed from **Mitsubishi UFJ Financial Group** Inc., buying the investment bank more time to make over its balance sheet and sending its shares soaring 85% in late trading.

But Morgan Stanley Chief Executive John Mack still has a tough job ahead of him as he looks to continue transforming his business for a difficult environment.

One of the biggest changes—the higher-risk trading businesses that carried Morgan for the past few years—are going to get smaller, and the firm is going to rely more on building market share in lower-risk sales and trading, asset management and advising individual investors, while using its new relationship with MUFG to boost its presence in commercial banking.

"We've gotten our leverage down, and it will be even lower," Mr. Mack said in an interview. "You're going to see a lot of changes."

Mr. Mack said that his firm as well as a lot of hedge funds have been shrinking businesses that use a lot of leverage, such as complex se-

Please turn to page 35

For information or to subscribe, visit www.services.wsje.com or call +44 (0) 207 309 7799 — Albania Lk 370.00 - Austria €3 - Belgium €2.90 - Croatia HRK 20 - Czech Republic Kc 110 - Denmark Dkr 22 - Finland €3.20 - France €2.90
Germany €3 - Greece €2.90 - Hungary Ft 530 - Ireland (Rep.) €2.90 - Italy €2.90 - Lebanon L£ 4000 - Luxembourg €2.90 - Morocco Dh 24 - Netherlands €2.90 - Norway Nkr 27 - Poland Zl 10.50 - Portugal €3 - Slovakia Sk 100/€3.32 - Spain €2.90
Sweden kr 27 - Switzerland SF 4.80 - Syria SE 150 - Turkey YTL 4.25 - U.S. Military (Eur) $2 - United Kingdom £1.40

THE WALL STREET JOURNAL.

Treasury secretary meets with bank CEOs

One likely topic: proposal for U.S. to take equity stakes

By Deborah Solomon And Damian Paletta

U.S. Treasury Secretary Henry Paulson called top U.S. banking heads to a meeting Monday in Washington, people familiar with the matter said.

The meeting at Treasury was being held while most of the banking chiefs are in Washington for meetings of the World Bank and the International Monetary Fund. Expected to attend were chief executives Kenneth Lewis of **Bank of America** Corp., Jamie Dimon of **J.P. Morgan Chase** & Co., Lloyd Blankfein of **Goldman Sachs Group** Inc., John Mack of **Morgan Stanley**, Vikram Pandit of **Citigroup** Inc. and Robert P. Kelly of **Bank of New York Mellon** Corp.

A Treasury spokeswoman said Monday: "Treasury and the Fed are meeting today with leading financial market participants to finalize details on a financial market stabilization initiative." One person familiar with the matter said Mr. Paulson is expected to discuss details of his plan to take equity stakes in financial firms, among other points. Treasury is working to finalize details of its plans to stabilize the financial sector.

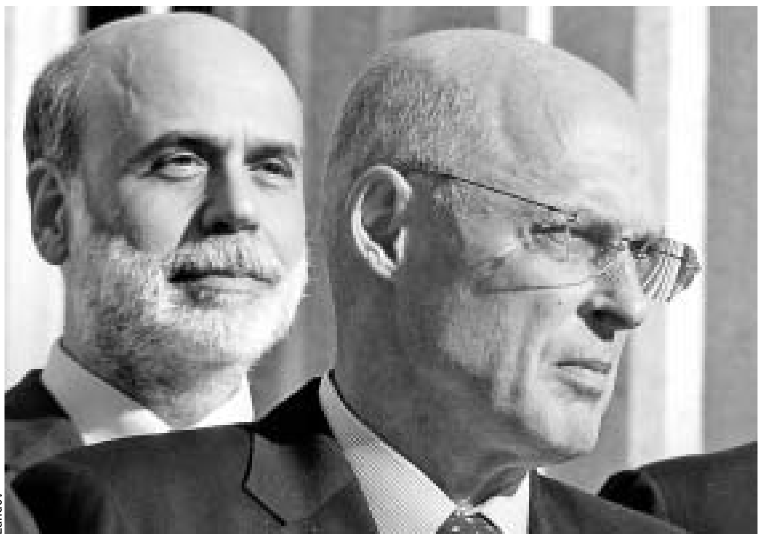
The plan likely will be designed in a way that won't wipe out existing shareholders, according to people familiar with the matter.

Such a plan would overcome a problem created by the ad-hoc nature of the government's interventions: Investors have refrained from putting capital into financial stocks in part over fears they would be hurt by future government involvement, as was the case when the government took over mortgage giants Fannie Mae and Freddie Mac and took a majority stake in insurer American International Group Inc.

The latest iteration of the Bush administration's rescue plan is fodder for a growing number of critics who say the government has sowed confusion during the fast-moving crisis by changing its mind about the best course of action. Outside economists and investors complain that neither the Treasury nor the Federal Reserve properly explained their rationale and the intended impact of their actions.

One option currently under consideration is to inject capital in banks in exchange for preferred shares, according to Wall Street executives. That would give the government a steady payment in the form of a dividend of sorts. Another would be for banks to raise some private capital in order to qualify for a government infusion.

Treasury's program would be voluntary and aimed at healthy banks, not failing institutions. While details are still being worked out, most banks likely would be able to participate in the program, though seriously troubled banks already close to failing might not be allowed to partake. The government would be a passive investor, using funds granted as part of the $700 billion bailout package. The program could be up and running shortly, according to people familiar with the matter.



Landov

U.S. Treasury Secretary **Henry Paulson**, right, and Federal Reserve Chairman **Ben Bernanke**. U.S. officials met Monday to discuss the next step for the financial crisis.

Mr. Paulson is also considering whether to implement a large-scale guarantee of bank lending similar to moves taken by the U.K., among others. The government is still proceeding with plans to buy assets from troubled banks and is expected to select asset managers this week.

Senior Federal Reserve officials, including New York Fed President Timothy Geithner and Fed Chairman Ben Bernanke, gathered at the Treasury on Sunday to discuss comprehensive approaches to the financial crisis, a move designed to forestall the need for another ad-hoc rescue.

Government officials say the U.S. was forced to take an ad-hoc approach because it lacked the tools before Congress approved the $700 billion rescue plan. They say the government will now better communicate its strategy, a process that began last week when the President's Working Group on Financial Markets outlined the steps that have been taken so far.

"We said in March we didn't have sufficient tools for the modern financial system. [House Financial Services Committee Chairman Barney] Frank said it would be next year before we got legislation and so we should make due with the tools we had and that means having to be ad hoc," said Michele Davis, a Treasury spokeswoman. Now that the administration has the tools it needs, it plans to explain to investors how it is using them, she said.

C. Fred Bergsten, a Treasury official during the Carter administration, and others argue that policy makers erred in not clearly articulating what they are doing and how they are doing it. "Even sophisticated investors need to understand basic strategy," said Mr. Bergsten, who is now director of the Peterson Institute for International Economics, a Washington think tank.

—Jon Hilsenrath, Aaron Lucchetti and Jessica Holzer contributed to this article.

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.

INDEX TO PEOPLE

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

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

THE WALL STREET JOURNAL EUROPE (ISSN 0921-99)
Boulevard Brand Whitlock 87, 1200 Brussels, Belgium
Telephone: 32 2 741 1211 FAX: Business: 32 2 732 1102
News: 32 2 741 1600 Editorial Page: 32 2 735 7562
SUBSCRIPTIONS, inquiries and address changes to:
Telephone: +44 (0) 207 309 7799 Calling time from 8am to 5.30pm GMT
E-mail: WSJUK@dowjones.com Website: www.services.wsje.com
Advertising Sales worldwide through Dow Jones International. Frankfurt: 49 69 971428 0; London: 44 207 842 9600; Paris: 33 1 40 17 17 01
Printed in Belgium by Concentra Media N.V. Printed in Germany by Dogan Media Group / Hürriyet A.S. Branch Germany. Printed in Switzerland by Zehnder Print AG Wil. Printed in the United Kingdom by Newsfax International Ltd., London. Printed in Italy by Telestampa Centro Italia s.r.l. Printed in Spain by Bermont S.A. Printed in Ireland by Midland Web Printing Ltd. Printed in Israel by The Jerusalem Post Group. Printed in Turkey by GLOBUS Dünya Basınevi.
Registered as a newspaper at the Post Office.

Editeur responsable: Daniel Hertzberg M-17936-2003

Head of U.S. rescue effort cites progress

Selection of officials, advisers helps set program in motion

By Jessica Holzer

The interim head of the U.S. government's $700 billion rescue detailed efforts to set the program in motion quickly, including officials who will help lead it and outside advisers.

Interim Assistant Secretary for Financial Stability Neel Kashkari told an international banking group that the Treasury Department tapped law firm **Simpson Thacher & Bartlett** LLP to provide advice on taking equity stakes in banks.

The Treasury is also moving forward with its authority to buy illiquid assets from financial institutions, Mr. Kashkari said, choosing consultancy **Ennis Knupp** to help select asset managers for the program.

"A program as large and complex as this would normally take months—or even years—to establish," Mr. Kashkari said. "We don't have months or years."

The public remarks were Mr. Kashkari's first since he was tapped by Treasury Secretary Henry Paulson to head the $700 billion program. A 35-year-old former Goldman Sachs Group Inc. investment banker, he was chosen last week to head the new Office of Financial Stability.

Mr. Kashkari indicated there was ample private-sector interest in assisting with the asset-purchase program. More than 200 firms have applied to manage securities or whole loans under the program, he said. The winning vendors will be chosen in the next few days.

Meanwhile, Treasury narrowed its choice of firms to serve as custodian to 10 from 70, and will make a decision within the next day.

Mr. Kashkari said Treasury was moving to recruit a permanent team, as well as interim personnel, to oversee the program.

Tom Bloom, chief financial officer of the U.S. Comptroller of the Currency, will serve as interim chief financial officer. Jonathan Fiechter, deputy director of the International Monetary Fund's Monetary and Capital Markets Department, will serve as interim chief risk officer.

Donna Gambrell, who served as the Federal Deposit Insurance Corp.'s deputy director of consumer protection and community affairs, will serve as interim chief of homeownership preservation.

Don Hammond, a Federal Reserve deputy director and former assistant secretary at the Treasury Department, will serve as interim chief compliance officer. And Reuben Jeffrey, undersecretary of state for economic affairs and former chairman of the Commodity Futures Trading Commission, will be interim chief investment officer.

Treasury said early last week that it was seeking bids to help run the asset-purchase program, giving firms just 48 hours to apply.

Mr. Kashkari said Treasury was only considering asset managers with $100 billion of dollar-denominated fixed-income assets under management to avoid adding risk to the taxpayers.

"It would not be fiscally prudent to ask a firm that only had experience managing a few billion to manage $100 billion," he said.

Vendors, however, will be evaluated on their capacity to work with small businesses—as well as those owned by veterans, minorities and women—as subcontractors, Mr. Kashkari said.

Since the enactment of the $700 billion plan a little over a week ago, the idea of buying stakes in banks to shore up their capital has quickly gained traction.

Although the Bush administration pitched the rescue plan to lawmakers and the public as a way to unclog the financial system of its rotten mortgage assets, it has now embraced the approach of taking equity stakes in banks. Mr. Paulson and Mr. Kashkari argue that they have authority to do so under the plan.

"Treasury worked hard with Congress to build in this flexibility, because the one constant throughout the credit crisis has been its unpredictability," Mr. Kashkari said.

He said regulators were helping Treasury "to identify the quickest and most efficient method to purchase equity in financial institutions so they can resume lending."

Mr. Paulson was expected to meet with top U.S. bank officials Monday afternoon to discuss aspects of the plan.

Mr. Kashkari echoed remarks made by Mr. Paulson Friday, saying that the program to purchase equity would be standardized, voluntary and designed to reach a "broad array" of healthy financial institutions. "It will also encourage firms to raise new private capital to complement public capital," Mr. Kashkari said.

No formal request for bids was posted by Treasury to oversee such an effort. According to Mr. Kashkari, the Treasury asked six specialist law firms to advise on the equity stakes and received two proposals. It selected Simpson Thacher on Friday but didn't make the announcement until Monday.

The Treasury also asked six firms to apply to help in choosing asset managers. Ennis Knupp was selected from three firms that submitted proposals.

Mr. Kashkari said Treasury has created seven policy teams to oversee aspects of the $700 billion rescue. They include teams to implement purchasing programs for mortgage-backed securities and whole loans, as well as a program to insure financial firms' toxic assets. Other teams will oversee efforts to help homeowners stay in their homes, design executive-pay requirements for firms that participate in the program and run compliance.

Mr. Kashkari said Treasury on Friday began to solicit public comments on how to structure the insurance program. Ideas will need to be submitted within 14 days, he said.

Career Journal

Vaulting overseas

More American financial professionals are seeking jobs abroad > **Page 32**

James Bennett

THE FINANCIAL CRISIS

Act swiftly and other wisdom from Mexico

Nation's recovery after peso collapse offers lessons to U.S.

BY DAVID LUHNOW

MEXICO CITY—Talk about your role reversals. In the past few weeks, officials at the U.S. Federal Reserve have discussed the unfolding crisis with at least one central banker from a developing nation who witnessed his own country's financial system implode: Mexico's Guillermo Ortiz.

The Stanford graduate was Mexico's finance minister during the country's 1994-95 peso collapse, which led to a massive government bank bailout and Mexico's biggest economic slump since the Great Depression. The so-called Tequila Crisis, named after Mexico's national drink, is today seen as the first financial crisis of the globalized economy. The U.S. put together a massive credit line that helped Mexico emerge from the crisis and grow prosperous in its wake.

THE OUTLOOK

Last week, before the start of the International Monetary Fund's annual meeting, the Mexican central banker, who steered his nation to recovery in those dark days, met with Fed Chairman Ben Bernanke. Mr. Ortiz had previously met with some Fed officials in mid-September.

Mr. Ortiz declined to discuss details of the discussions, but the fact that officials in Washington are talking to foreign officials such as Mr. Ortiz suggests they are open to learning from other countries' experiences—even as the current crisis roils those very nations. Mexico, for its part, has had to spend about a tenth of its foreign exchange reserves defending the peso, and the cost of credit is soaring for Mexican companies, as it is for so many others.

Nonetheless, many of the lessons of the Tequila Crisis and others like it apply to the U.S.

Among the most important: Don't be ruled by ideology—stay flexible and act decisively. Help those with mortgages they can't pay. Take stakes in troubled banks. Don't expect to turn a profit on government investment.

"Do whatever it takes to restore confidence," Mr. Ortiz said in an interview. "Once you lose it, it's very difficult to get it back."

In today's globalized financial markets, once trust is blown, the markets will often overreact and the crisis will spin out of control. As a result, policy makers may need to take steps they never imagined taking. The longer they wait, the worse the pain. We are already learning this lesson the hard way.

In nearly all financial crises, the government usually reacts too slowly at first. In the case of the U.S., the Federal Reserve and Treasury tried to put out each fire as it flared, first bailing out Bear Stearns Cos., then insurance giant American International Group Inc., then lender Washington Mutual Inc.

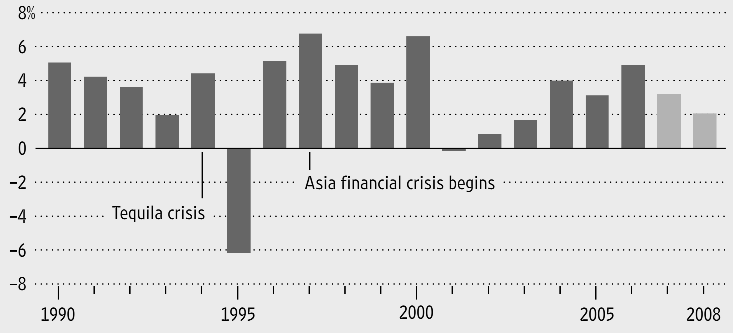
At some point, an event happens that causes the market to lose confidence. In Mexico, it was a failed attempt by the central bank to gradually devalue the peso, a move that destroyed the bank's credibility. In the U.S., it may have been letting Lehman Brothers Holdings Inc. fail, a move that created uncertainty among investors as to which financial institutions would be saved and which wouldn't.

Since then, authorities in both the U.S. and Europe have been scrambling to catch up to the crisis. "Despite all of the measures that have been taken, the authorities are now behind the curve," Mr. Ortiz said in remarks Sunday to the Institute of International Finance in Washington. "It's better to err on the side of doing too much rather than doing too little."

Learning from the 'Tequila Crisis'

Mexico's handling of its financial crisis in the 1990s may offer guidance for U.S. regulators crafting the current bailout plan

Mexico's GDP, in constant prices, change from a year earlier



Note: estimates start in 2007

Source: International Monetary Fund

In the end, Mexico acted directly to tackle the underlying problem of bad debt by launching a program to restructure mortgages, with banks, borrowers and the government all sharing loses.

The key to a mortgage restructuring: "Keep it simple," says Vicente Corta, who led Mexico's bank bailout program for several years. "We tried fancy schemes that didn't work. We ended up saying, 'OK, you pay half your mortgage, and we'll pick up the other half.' "

Mexico's bank bailout itself didn't ward off a major economic recession, although the country was also dealing with a currency crash. But within a few years, Mexican banks were healthy and the economy was growing again.

What lasted longer was political bitterness linked to the bailout, which was seen as having helped rich bankers at taxpayers' expense.

The Mexican and U.S. bank rescue plans have both involved the government taking bad loans from bank books in order to get credit flowing again. Much like Washington, the Mexican government expected to break even and possibly make some money on the bad loans that it purchased.

The reality: The government lost money—lots of it. The bailout's final price of about $75 billion was three times what the Mexican government expected. In other words, the $700 billion U.S. rescue plan could be just the beginning of the final cost.

In Mexico's bailout, banks were required to recapitalize as a condition of selling bad loans to the government. In some cases, bank owners put up new money. Banks that couldn't were forced to merge or sell to a foreign bank, or were taken over by the government.

In recent days, the U.S. government has appeared to be moving toward a major recapitalization program, opening the door to the possibility that the U.S. government might take direct stakes in the banks.

A government stake in banks might help ease the inevitable political fallout. Mexico learned—again, the hard way—the importance of designing a bailout that gives the government, and by extension the taxpayers, some upside in an eventual recovery. Consider the case of Banamex, Mexico's biggest bank.

Banamex's owners recapitalized the bank and sold billions of dollars in bad loans to the government—which didn't take a stake in the bank. Once healthy, the bank was later sold to Citigroup for $12 billion, in a transaction in which Banamex's owners didn't pay a dime in taxes.

In Mexico, many voters felt betrayed by the bailout, which poisoned the political atmosphere for years. It was one reason why a left-wing populist candidate, Andrés Manuel Lopez Obrador, nearly won the presidency in 2006. Every year at budget time, there are still debates about spending so much money on rescuing banks, versus public schools.

Whoever wins the U.S. presidential election is bound to deal with other political fallout as well. The auto industry is already using the financial bailout to win a big loan program in Congress; expect other troubled industries to line up for rescues, too. And every time an industry gets bailed out, ordinary workers and powerful unions will expect help as well.

—Jon Hilsenrath contributed to this article.

Lear cuts outlook for its full year as demand drops

BY SHARA TIBKEN

Auto-parts maker **Lear** Corp. lowered its full-year profit and sales outlook because of "rapidly" declining North American vehicle sales.

The company, a major supplier to **General Motors** Corp., expects 2008 sales of $14 billion, down from a previous estimate of $15 billion. Analysts were expecting sales of $14.75 billion.

Lear also projected income before interest, taxes, restructuring costs and other items will be 20% below its July forecast of $550 million to $600 million.

The maker of automotive seats and electronics said declining auto sales and production in North America, as well as Europe, led to its decreased forecast.

Suppliers are taking a hit as auto makers pare down swollen inventories and try to turn around their North American operations.

Cost increases amid the economic slowdown are also hitting the suppliers' bottom lines.

In July, Lear reported an 85% drop in second-quarter net income when demand from GM declined as a result of a three-month strike at American Axle & Manufacturing Holdings Inc.

Lear's stock has plunged 82% in the past year. In afternoon trading in New York Monday, shares of Lear were down 15 cents, or 2.5%, at $5.95.

Lear still expects to generate positive free cash flow for the year.

The company plans to update its outlook when it releases its third-quarter results on Oct. 30.

Once-sheltered Latin America faces the music

BY JOHN LYONS

SÃO PAULO—In recent weeks, Latin American leaders could be heard proclaiming their region safe from the global financial crisis.

"If the crisis gets here, its going to be a ripple," President Luiz Inácio Lula da Silva of Brazil, the region's biggest economy, said on Oct. 5.

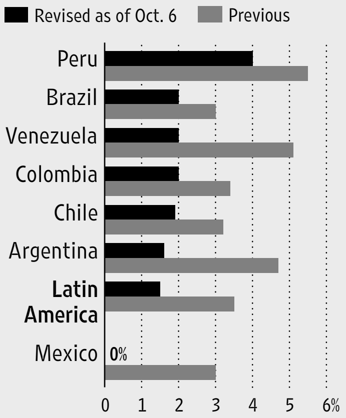
After a brutal week, the ripple is starting to look more like a tsunami. Brazil's stock market has fallen 40.9% in the past three month and its currency has suffered its deepest declines since the nation's 1999 economic meltdown as investors cashed out. Mexico burned through about 10% of its international reserves last week trying to slow a sudden drop in the peso. The currency's fall forced the nation's oldest retail chain into bankruptcy proceedings and blew holes in the balance sheets of other blue chips, such as cement giant **Cemex** SAB.

Private economists now say the global credit freeze, a possible recession in the U.S. and commodity-price declines will take a heavy toll on the resource-rich region. Several research houses cut next year's regional growth forecast to around 1.5% from around 3.5%.

"It's a global implosion that is carrying everyone and everything in its wake," says Damian Fraser, the head of Latin American equity research at UBS Pactual in Mexico City.

Facing the music

Estimated GDP growth for 2009



Source: Morgan Stanley

If Mr. da Silva and others sound like they are in a state of denial, it may be because Latin America has benefited more than any other region from a commodities boom that fueled steady growth, strengthened currencies and pushed international reserves to record levels.

The boom fostered broad optimism that a region once synonymous with currency crashes and debt defaults had matured. Until last month, some U.S. equity analysts were still telling clients that Latin America would be a "safe haven" amid global turmoil, investors say.

To be sure, Latin America is better suited to weather a downturn than it has been at any time in recent memory. Unlike at the outset of past global downturns, most of Latin America's economies are running surpluses that will protect against the sovereign debt defaults that devastated the region in the past. What's more, banks in Mexico and elsewhere, burned by risky bets in the past, largely stayed away from securities backed by risky U.S. mortgages and now boast healthy balance sheets.

Some will be hit harder than others, experts say. Argentina was struggling to stave off a debt default even before the global crisis got under way. Now, its prospects are even dimmer. In Venezuela, President Hugo Chávez will likely be forced to devalue the currency as oil prices drop; that could fuel inflation and political tensions.

It is hard to understate how much the game has changed even for the region's most stable economies. The investment-grade rated economies of Brazil, Mexico and Chile have marketed themselves to foreign investors as safe destinations for long-term investments. Mexico, for example, sold 30-year fixed-rate bonds in recent years. Many of these investors were wiped out by the recent currency crashes. That will make it more expensive for Latin companies and governments to get such financing in the future.

The reduction of economic-growth forecasts by private economists suggests much of the region's robust economic growth was related to soaring commodity prices. Unless commodity prices climb again, the region's economic surpluses may turn into deficits. That will force policy makers to make tough decisions between cutting spending, raising taxes or letting currencies weaken further.

It's far from clear how much damage the currency declines will do to big Latin companies that were betting on currency moves in the derivatives market. Already, big firms such as Brazilian pulp company **Aracruz Celulose** and Mexican retail giant **Controladora Comercial Mexicana** SAB, known as Comerci, have announced big losses. More could be in the offing.

It took us 125 years to use the first trillion barrels of oil.

We'll use the next trillion in 30.

So why should you care?

THE FINANCIAL CRISIS

Emerging economies feel effects of crisis

Consumers in Brazil, Russia, India and China are squeezed

*By **Andrew Batson** in Beijing, **Daria Solovieva** in Moscow, and **Eric Bellman** in Mumbai, India*

The global credit crisis is starting to take its toll on consumers in a group of nations that have boosted the world's economy over the past few years: the big emerging economies of China, India, Russia and Brazil.

Global growth this decade has been powered by the economies of the U.S. and these so-called BRIC countries. As a troubled financial system sidelined the U.S., hopes remained that the developing nations could pick up the slack. Instead, the economies of the big four are slowing as consumers feel the pain emanating from the West.

In Russia, easy credit that powered consumer spending is now contracting. In India, outsourced jobs from Western financial companies are dwindling. In China, the locus of world attention in recent years, a stock-market collapse and deflating property prices are causing consumers to think twice about purchases. In Brazil, the prices for the commodities it exports are falling.

Growth in these large, continental economies is still much faster than in the U.S. or Europe. But indicators suggest that their newly affluent consumers won't be holding up global growth on their own.

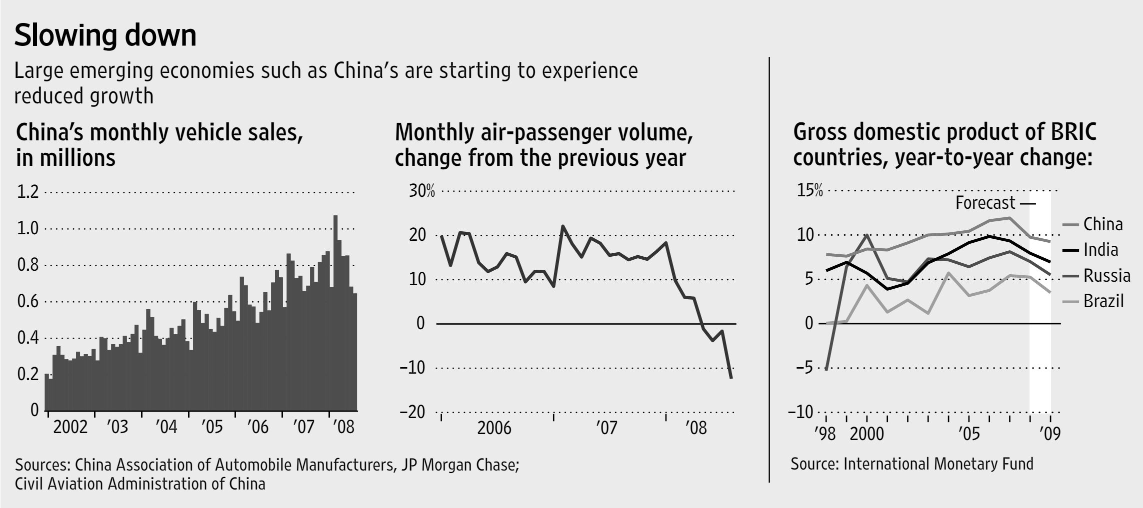
One person feeling the pain is Shanghai businessman Yan Jian. He says his business exporting toys and garments has been hurt by weakening orders from the U.S. So Mr. Yan postponed the renovation of the new apartment and is hunkering down as the economic prospects gets darker. "Things may get even worse in the near future," he says. "I have to hold back as much spending as possible."

If this attitude spreads, it's bad news for the global economy. Although consumers in the big four emerging economies are still much poorer than the average American or European, their growing appetite for refrigerators, cars and flat-screen televisions during the past eight years has accounted for nearly as much growth in global demand as the U.S., according to Goldman Sachs. Demand from those countries had been expected to overtake the U.S. and climb toward the total demand from the entire Group of Seven leading nations.

"These economies can no longer rely on export growth or rising commodity prices," says Fred Hu, a managing director with Goldman Sachs. "That's the biggest worry, that the crisis in the developed centers like the U.S. and Europe will have repercussions on the emerging economies."

Consumers often keep spending even as financial markets slump. But just as Wall Street's woes eventually affected Main Street, the turmoil in the large emerging economies is growing and spreading. Russia's main stock market, which had been closed since Wednesday due to a run on selling, reopened only Monday. In Brazil, the real currency has dropped dramatically in recent days, making imported items such as wine and iPods more expensive. Consumer spending in China has started to weaken in recent months.

In some of these countries, credit is contracting just as it is in the developed world. In Russia, easy credit and higher real wages have fueled a consumer boom in the past few years. But that credit is drying up fast, as cash-squeezed lenders tighten credit conditions for auto, mortgage and other loans. Sales of new cars, many of which are bought on credit, grew 22% in September—an eye-popping number but still down from consecutive months of 50% growth and the lowest monthly result since 2005.



"Russia's consumer boom was largely due to easy credit," says Alexander Potavin, a senior analyst at Moscow brokerage Antanta-Pioglobal. "Now it's really difficult to get a loan from a bank."

Retailers in India, where the stock market has also taken a beating, are bracing for tough times. This is normally a good time for sales—the run-up to Diwali, a Hindu holiday falling at the end of October this year—but consumers are expected to spend less this year. The U.S. financial sector, which is at the heart of the global turmoil, is a huge customer for India's outsourcing and call-center companies.

The pullback is already affecting Indian companies. **Build a Bear Workshop** Inc., a custom teddy bear shop from the U.S., has closed its three stores in India. One of India's biggest retailers, **Shoppers Stop** Ltd., has announced losses, while **Pantaloon Retail India** Ltd. has scaled back its plans for a nationwide rollout of shoe stores.

Leading indicators support this anecdotal evidence. India's passenger car sales, which grew an average of 20% a year over the past five years, have slowed to 8% this year.

China also has some troubling indicators. While overall retail sales have been growing quickly, by 15% to 16% in recent months, economists doubt the official numbers, especially because sales of some big-ticket items are weak. Automobile sales have fallen in August and September. And passenger traffic on Chinese airlines has declined every month since May. Some of that could be related to May's earthquake in Sichuan and travel restrictions imposed for the Olympics in August.

The two biggest weak spots in the Chinese economy appear to be export industries that sell to the U.S., and the housing market. Though few cities have had outright price declines, buyers are staying away. Macquarie Securities estimates property transactions in major Chinese cities are down by 40% to 60% in recent months.

That's affecting other industries. China sales for U.K. home-improvement retailer **Kingfisher** PLC, which runs the B&Q do-it-yourself chain, dropped 19.4% in the first half of 2008. Sales of appliances to fill up new apartments also seem to be off: U.S. electronics retailer **Best Buy** Co. said its same-stores sales in China dropped 7% in the June quarter, while local competitor **GOME Electrical Appliances Holding** Ltd. eked out a meager gain of only 0.5% in the first half.

There are even signs that spending on cheap daily necessities is slowing. This week, **Yum Brands** Inc., which operates more than 2,200 KFC restaurants in China, reported 5% growth in its same-store sales for the three months that ended Aug. 31, faster than its global average of 3%. But that was significantly slower than the 11% growth in the same period of 2007—and a sign China won't be able to bail out other countries.

Despite these worries, few think China faces a collapse in consumer spending. Mr. Hu of Goldman Sachs notes some of the slowdown came due to central government restrictions imposed to curb inflation. Policy makers in Beijing have started to reverse course, cutting interest rates twice in the past month. That parallels the response during the 1998 Asian financial crisis, when China rode out the storm with prompt pump-priming.

"The government will have to be very vigilant," says Mr. Hu. "They can't take chances in the global environment."

But persuading Chinese consumers to pare back their high rate of savings is a difficult endeavor, economists say. A lot of those savings go to pay for major education and health-care expenses that aren't covered by government programs or private insurance.

"There is no question that Beijing is promoting the role of consumption in the economy. But short of resorting to American-style 'no documentation' and 'no down payment' lending, it is difficult to see how Beijing could turn its citizens into the world's consumer of last resort," argues Andy Rothman, China strategist for CLSA, in a report this week.

—Antonio Regalado in São Paulo, Ellen Zhu in Shanghai and Ian Johnson in Beijing contributed to this article.

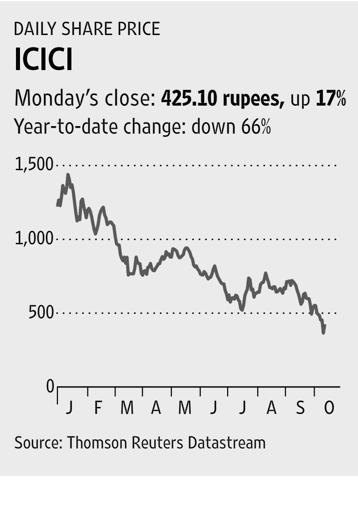
Panic and withdrawals hit India's ICICI

By Eric Bellman

MUMBAI—Global worries about the solvency of financial institutions have arrived in India, buffeting a bank that's regarded as one of the country's strongest.

In recent days, **ICICI Bank** Ltd. has taken a series of extraordinary steps to calm its depositors and reassure jittery investors. On Saturday, it sent text messages to hundreds of thousands of depositors telling them it was healthy. A central bank circular posted on its thousands of automatic teller machines said the same thing earlier in the week. On Sunday, ICICI went on the offensive, filing complaints to the police in Mumbai and elsewhere charging that some small brokers were spreading negative rumors about the bank.

Still, shares of the bank—the country's largest non-state bank and second-largest in terms of assets after the State Bank of India Ltd.—are down 66% so far this year. They lost 20% on Friday before bouncing back 17% Monday to close at 425.10 rupees ($8.79). ICICI wouldn't disclose recent withdrawal figures.



"The stock price has gone way below fundamentals," said Vaibhav Agarwal, banking analyst at Angel Broking in Mumbai.

Analysts and investors say the withdrawal worries and share pressure have a common culprit: panic. In tough times, the leading companies of the new India are viewed with caution because they are more exposed to international events than insular state-run companies.

"Not that ICICI Bank will close down or anything but I don't want to face a liquidity crisis," said P. Devarajan, a Mumbai retiree who pulled most of his savings out of its ICICI Bank this month and stuck it in a government-owned bank. "Public sector banks are better at the banking game than these high-flying newcomers."

The Indian stock market has been hit hard during the global crisis, even though there are few companies with any direct exposure to subprime lending or failed mortgages. The benchmark Bombay Stock Exchange 30-Share Sensitive Index, or Sensex, has fallen more than 40% so far this year, as increasingly risk-averse foreign investors pull out of Indian stocks. As Indian investors and depositors worry about the global problems, their attention has focused on ICICI.

India's Finance Minister P. Chidambaram tried to calm markets Monday. He said the country is putting together a plan to address the concerns of India's banking customers.

"We are working on more measures that will infuse liquidity, make credit intermediation smoother and increase the confidence of depositors and investors," he told reporters in New Delhi. "We hope to announce them shortly."

In the past decade, ICICI Bank has transformed itself from a stodgy, socialist-era corporate lender to one of India's most dynamic and fastest-growing retail banks. It rode a wave of middle-class consumption, coupled with high savings and new credit card use, to build new branches and thousands of ATMs across the country. It has been one of the few Indian banks to venture abroad, even investing in Lehman Brothers Holdings Inc. bonds.

Analysts say such strengths shouldn't now be viewed as signs of weakness. On Monday, Standard & Poor's reiterated its strong rating for ICICI Bank. While its U.K. subsidiary has a $3.5 billion international investment portfolio—of which around $80 million was invested Lehman Brothers—ICICI has more than enough assets to cover any future losses, the credit rating agency said in a release.

Some of the volatility of ICICI's shares is likely linked to its popularity among foreign investors, many of whom have been pulling money out of India recently. More than two-thirds of ICICI's shares are held by foreign investors, which is likely to mean more turbulent trading lay ahead. As ICICI is one of India's largest consumer lenders, its shares could also suffer from the bank's exposure to India's fast-growing middle class—and fears that credit defaults might begin roiling the Indian economy.

—Tariq Engineer contributed to this article.

CORPORATE NEWS

OIL

Det Norske field fetches hefty price from Statoil


Det Norske Oljeselskap

NORWEGIAN OIL company **Det Norske Oljeselskap** said it is selling its 15% stake in the Goliat field to **StatoilHydro** ASA for 1.3 billion Norwegian kroner ($206 million), bolstering its cash position and financial capacity. Analysts said that the price for the field, in the Barents Sea, was well above expectations, which had ranged between 800 million kroner and 900 million kroner.

Because the sale process started around four months ago, the price signals that the Norwegian oil sector has held its value throughout the recent turmoil, said DnB NOR Markets analyst Espen Hennie. *—Elizabeth Cowley*

ADVERTISING

Marketing budgets shrink in U.K. amid credit crisis


Fotosearch

MARKETING budgets in the U.K. have been cut for the fourth quarter in a row, according to an Institute of Practitioners in Advertising survey.

Business confidence has suffered record declines, and even online-ad spending is stagnating. Only 12% of companies raised their marketing budgets while 35% cut them, citing lower-than-expected sales and profits amid weaker consumer and corporate demand.

Budgets for conventional advertising, such as television and newspapers, were among the hardest hit. Internet-ad budgets have come under pressure after fast growth in previous quarters. *—Kathy Sandler*

SEMICONDUCTORS

Micron buys 35.6% stake in Taiwan chip venture

Associated Press

MICRON Technology Inc. has agreed to pay $400 million for **Qimonda** AG's stake in Taiwan-based Inotera Memories Inc. in a move to gain lower-cost production capacity.

Micron's purchase of Qimonda's 35.6% stake in Inotera will provide badly needed cash for Qimonda, which is majority-owned by **Infineon Technologies** AG and has posted big losses lately.

Inotera, which has two factories, is jointly owned by Qimonda and **Nanya Technology** Corp. Mark Durcan, Micron's president, said the deal allows his company to forgo investing $500 million in another joint venture with Nanya. *–Don Clark*

GM board was cool to a Chrysler merger

Shrinking prospects push Detroit to weigh unorthodox options

BY JOHN D. STOLL, MATTHEW DOLAN AND NEAL E. BOUDETTE

GENERAL MOTORS Corp.'s board gave a cool reception to the idea of acquiring **Chrysler** LLC after GM's top management discussed the matter at a meeting last week, people familiar with the matter said.

Despite huge losses over the past four years, a plunge in GM's stock price and growing worries about whether the auto maker has enough cash to turn itself around, GM's board has continued to support Chairman and Chief Executive Rick Wagoner. But the board's cautious reaction to the proposed merger suggests it may assert itself more than in the past if Mr. Wagoner and his team try to move ahead with a Chrysler deal.

GM recently held talks with Chrysler's majority owner—private-equity firm **Cerberus Capital Management** LP—in which Cerberus proposed swapping its 81.1% stake in Chrysler for GM's 49% stake in GMAC, a big auto and home lender. Cerberus owns the other 51% of GMAC.

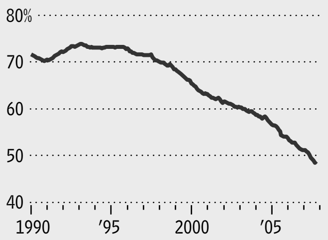
The talks—which have broken off for now but could be revived—underscore the way the crisis in financial markets is forcing Detroit's Big Three auto makers to explore once-unthinkable options as they scramble to respond to a fast-changing global economy. Squeezed by falling auto sales and limited access to new financing, they are facing a future in which they are likely to become much smaller, if they survive at all.

As yet more evidence of that, GM Monday said it will close its Janesville, Wis., truck plant on Dec. 23, rather than wait until 2010, accelerating production cuts rolled out this summer. The Janesville factory, which makes full-size SUVs such as the Chevrolet Suburban, was one of four North American factories slated to close by 2010. The Janesville plant employs about 1,200. Another SUV plant, in Moraine, Ohio, also will close Dec. 23.


Associated Press

Shrinking slice

Combined U.S. market share of the Big Three auto makers*, 12-month moving average, monthly data



*Chrysler, Ford and General Motors
Source: Autodata

For several months, GM has been considering whether to sell all or part of its minority stake in GMAC, which the most recent estimates suggest is worth roughly $6 billion to $7 billion, people familiar with the matter said.

Cerberus regards itself as one of the few potential buyers for the GMAC stake, people familiar with the negotiations said. But since last week's board discussions, GM directors and management have complained Cerberus seemed to be offering GM too little in the proposed deal.

GM's board has been meeting more often than usual in recent months due to the auto maker's deteriorating financial health. The board meets formally the first week of each month. In addition, George Fisher, GM's lead independent director, holds a weekly conference call for board members.

The idea of acquiring Chrysler was discussed at a formal meeting last week, people familiar with the matter said. The board also held a call on Friday, according to a person with knowledge of the call.

Few in the auto industry believe acquiring Chrysler would be the right move for GM. Both companies are burning billions in cash each month, and GM has confirmed only that its cash requirements are met through 2008.

This summer GM approached **Ford Motor** Co. about a possible merger, a person familiar with the matter said. Mr. Wagoner met Ford Chief Executive Alan Mulally as part of the preliminary discussions, this person said. Before the talks progressed very far, Ford concluded it should continue to go it alone, this person said.

The recent maneuvering reflects the likely shape of things to come. GM, Ford and Chrysler are "not going to dominate in the U.S. and elsewhere in the world as they have in the past," said Michael J. Jackson, chairman and CEO of **AutoNation** Inc., the auto dealership chain. "They will have to be smaller companies, and they'll have to find a piece of the pie where they can be successful and profitable," he said in an interview.

Chrysler and Ford are already shrinking. Just a few years ago, Chrysler was producing more than three million cars and trucks a year. But under Cerberus's ownership, it is trying to close plants and slash development spending in hopes of becoming smaller and profitable.

Mr. Mulally's turnaround hopes for Ford are built on shrinking the auto maker to focus its resources on its namesake brand. Ford has sold its Jaguar and Land Rover lines and has begun shopping its Volvo unit.

For much of its 100-year history, GM thrived by buying other car makers. But few in the auto industry believe acquiring Chrysler is the right move to save the company now. Both companies are burning billions in cash each month, and GM has confirmed only that its cash requirements are met through 2008.

"The last thing GM needs is more U.S. plants, more U.S. dealers, more U.S. brands," Mr. Jackson said. "I can't see the logic to it."

Friction spurred exit of Ford's finance chief

BY MATTHEW DOLAN

DETROIT—The unexpected retirement of **Ford Motor** Co.'s chief financial officer last week came after increasing friction between him and other senior executives, people familiar with the matter said.

Top executives at Ford in recent weeks spoke with Chief Executive Alan Mulally and Chairman William C. Ford Jr. about their dissatisfaction with finance chief Don Leclair, these people said. The working relationship had frayed so much that at least two high-level company officials talked openly about whether they could continue to working with Mr. Leclair serving as chief financial officer, they said.

The strained relations between Mr. Leclair and other members of the Ford's senior management team centered on whether Mr. Leclair had been too forceful in pursuing his own agenda without informing other vice presidents of his plans in a timely way, according to people familiar with the matter.

Company spokesman Mark Truby declined to comment Sunday on Mr. Leclair's exit, saying that Mr. Mulally addressed the overall issue Friday. In an interview Friday, Mr. Mulally said Mr. Leclair's departure wasn't linked to a difference over Ford's direction.

Mr. Leclair, 56 years old, released a brief statement Friday, saying that "I have appreciated my time at Ford and now look forward to spending more time with my family and pursuing other interests." Through a company spokesman, Mr. Leclair declined an interview request.

Seen by supporters as a strong advocate to protect his company's bottom line, Mr. Leclair was credited with engineering a 2006 financing deal that has left Ford with a significantly larger cash cushion than either of its U.S. rivals at a time when all three Detroit auto makers are losing money and using up billions of dollars in cash each quarter.

Nevertheless, Mr. Leclair was seen as distant and rigid, people familiar with the matter said. He also didn't have the strong support of the Ford family, whose members continue to control the auto maker through a separate class of stock, they said.

Separately, Mark Fields, president of Ford's Americas operations, said Monday that news reports about the auto maker selling its controlling stake in Japan's **Mazda Motor** Co. are speculative. But Mr. Fields said the companies remain operationally independent despite joint ventures.

The possible sale was approved by Ford's board as part of an effort to bolster its finances amid a downturn in global auto sales and investor questions about the U.S. auto maker's cash reserves, according to two people familiar with the matter.

It was unclear how much of Ford's 33.4% interest in Mazda is up for grabs. But a person familiar with the matter said the company is looking at a broad range of asset sales ahead of a third-quarter report later this month that is expected to show a substantial loss.

Meanwhile, Ford's European division on Monday reported a 12% drop in September sales, selling 161,700 vehicles last month. For the first nine months of the year, European sales were down 1.3%, helped by an 18% sales increase in Russia.

—Christoph Rauwald contributed to this article.

CORPORATE NEWS

U.S. regulators, Google hold secret talks

Internet giant seeks to avoid challenge to Yahoo alliance

BY JOHN R. WILKE

WASHINGTON—**Google** Inc. has entered secret talks with the U.S. Justice Department in an effort to head off a possible antitrust challenge to its proposed advertising agreement with **Yahoo** Inc.

The settlement negotiations are at an early stage and it isn't clear whether they will resolve U.S. objections or be acceptable to the companies, lawyers close to the effort said.

Major advertisers have raised objections to the Google-Yahoo deal, which would align the two largest players in Internet ads. Advertisers have told Justice Department officials that a Google-Yahoo deal will limit competition, raise prices and reduce choices.

Under the deal, Yahoo would be able to place on its Web site certain search ads sold by Google. That would serve advertisers and users more efficiently, the companies have said. And it would bring Yahoo hundreds of millions of dollars in much-needed new revenue in its first year.

It would also create a strategic bulwark against software giant **Microsoft** Corp., which unsuccessfully bid $45 billion for Yahoo earlier this year in an effort to shore up it third-place position in online ads.

In the settlement talks with the government, the companies have discussed capping the number of Google ads Yahoo would use, assurances that Yahoo would continue to compete in search ads, and a reporting mechanism to ensure compliance, people close to the talks said. U.S. officials hope to impose measures that will ensure that prices advertisers must pay don't rise significantly after the deal.

Google and Yahoo declined to comment on a possible settlement and have said they believe the deal as currently structured is pro-competitive and good for consumers. A Justice Department spokeswoman, Gina Talamona, also declined comment, adding, "our investigation is ongoing."

The settlement talks suggest a more flexible approach by the companies. Google Chief Executive Eric Schmidt in September dismissed questions of whether Google would be willing to accept caps or other limits. He portrayed the deal as a carefully crafted "signed and binding" contract whose provisions shouldn't be tinkered with. It was "designed precisely to meet the terms of antitrust laws in the United States," he said at the time.

Reworking the deal to include a reporting mechanism, could require the companies to disclose more about the mechanics of their closely-guarded search-advertising technology than they want to. And caps on how many Google-sold ads Yahoo can display could limit Yahoo's financial gains from the agreement.

Google's critics, including Microsoft, have forcefully argued that online search advertising is too dynamic and complex to allow a settlement that could work and be effectively policed.

If the companies reach a settlement that the Justice Department believes will preserve online competition, its principles would likely be laid out in a consent decree that would be filed in court.

While that would allow the deal to proceed, it would also be a formal recognition of Google's market power. That could constrain the Mountain View, Calif., company's conduct in the future. And it might draw private antitrust suits from competitors or advertisers, if they believe that they've been mistreated by a monopolist.

Even as senior Justice Department officials weigh the companies' proposals to resolve antitrust issues, its trial staff continues to prepare a lawsuit to block the deal, according to lawyers and executives contacted as part of this effort.

In recent weeks, Justice Department officials have deposed Mr. Schmidt, the Google CEO, and other key figures in the case. Opponents, including Microsoft, have been provided documents and depositions for use in a possible lawsuit, which would begin with an application for a preliminary injunction to stop the deal, probably filed in U.S. District Court in Washington, D.C.

The government signaled its resolve by hiring a special trial counsel for the case, Sanford Litvack, a veteran litigator and former vice chairman of Walt Disney Co. That move may have caused Google and Yahoo to rethink their positions. Initially, both companies had suggested they didn't need to submit to a Justice Department review, since they viewed the deal essentially as a technology-sharing agreement, not a merger or joint venture. Mr. Schmidt has stressed that Google plans to implement the agreement in October with or without regulators' approval.

The companies have been cooperating with the Justice Department's investigation and recently agreed to delay implementing the deal until at least Oct. 22 to give federal and state antitrust officials time to complete their separate investigations.

—Jessica E. Vascellaro contributed to this article.

CORPORATE NEWS

IBM expands China R&D

Shanghai facility furthers gravitation to 'huge laboratory'

BY JAMES T. AREDDY

SHANGHAI—**International Business Machines** Corp. is opening its first research facility in about a decade, inaugurating an operation in Shanghai that will work to build new applications for the Internet and small businesses

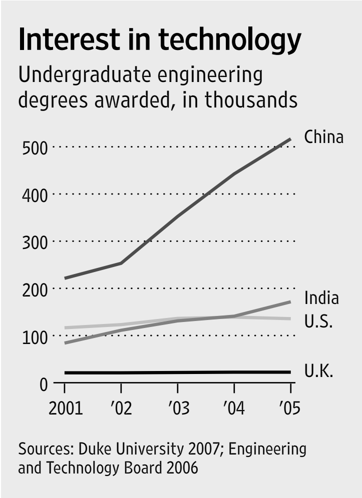
The world's biggest technology companies, including **Google** Inc. and **Microsoft** Corp., are increasingly expanding research facilities in China, which produces more than 700,000 electrical engineering graduates each year.

China's rapid growth, huge population and vast number of private businesses are enticing for research operations like the one IBM is opening, said John E. Kelly III, the Armonk, N.Y., company's director of research.

China "is a huge laboratory in which we can work," Mr. Kelly said in an interview Monday.

Hiring engineers in China tends to be cheaper than Western countries, but IBM said the increasing gravitation of its customers to China is another reason for the Shanghai lab.

IBM, which has eight R&D labs world-wide, hasn't opened a new research facility anywhere since 1998, when it opened two in India. The Shanghai lab will work as an extension of IBM's Beijing laboratory, which was opened in 1995.



Mr. Kelly said the Shanghai facility "punctuates" IBM's commitment to long-term research, where success is measured over the course of multiple years. "We're not hesitating in terms of our research," he said.

Despite growing concerns about a world-wide slowdown in capital spending by the big companies IBM serves, IBM last week told investors that it still expects global earnings to rise 22% this year.

IBM sees opportunities arising from the unprecedented turmoil in the global financial industry, Mr. Kelly said. Financial services is one of IBM's six biggest sectors, one where revenue has risen more than 10% in recent years, according to IBM's 2007 annual report.

"There's still huge opportunity to build out financial-services infrastructure," Mr. Kelly added. "The opportunities are changing but they are still enormous."

Mr. Kelly didn't make forecasts about IBM's business plans, but said the crisis may underpin demand even in hard-hit markets for stronger financial-services technologies, such as those that add transparency to transactions or improve risk management techniques, which he called "huge mathematics and analytics challenges."

Located in a sleek technology park in eastern Shanghai, the new facility will start with more than a dozen computer scientists and engineers, with plans to eventually grow toward 100. It will be overseen by Thomas Li, director of IBM China Research Laboratory.

IBM didn't disclose how much it planned to spend on the new center. Last year, IBM allocated $6.15 billion to research, development and engineering, some 6.2% of its $98.79 billion in revenue. Research spending rose 0.8% as revenue jumped about 8.1% in 2007.

Mr. Kelly said the Shanghai team will work in close collaboration with other facilities and develop "next generation" Internet platforms, including text to speech applications and translation software.

Monday in Shanghai, IBM researchers were preparing demonstrations of programs already developed in China, such as one that helps retailers decide where to locate stores and another for fact-checking potential clients. Another tool, dubbed "Scissorhands," would help users extract data and services from up to 30 billion Internet pages and make that information reusable somewhere else.

Philips plans to cut jobs as its profit rises 7.9%

BY ROBERTA B. COWAN

AMSTERDAM—**Philips Electronics** NV posted a 7.9% rise in third-quarter net profit, boosted by a gain, and announced plans to cut an unspecified number of jobs as demand in Europe and emerging markets slows down.

Philips Electronics Monday also unveiled plans to ease its share-buyback program.

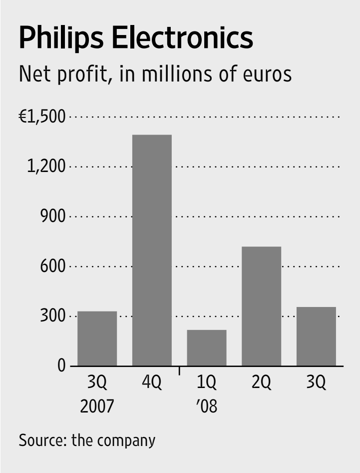
Chief Financial Officer Pierre-Jean Sivignon said that reaching the company's target of 6% annual sales growth between 2008 and 2010 is also "getting tough."

With that backdrop,The Amsterdam-based maker of shavers, televisions, lighting and high-end medical equipment said it will cut costs and jobs, booking €230 million ($308.5 million) in fourth-quarter charges. It also plans to shift more investment to emerging markets.Mr. Sivignon declined to comment on the number of layoffs, but he said the cuts would be made across all units.

Monday, shares of Philips fell 50 euro cents, or 3.2%, to €15.28 in an overall higher AEX market.

In the third quarter, Net profit rose to €357 million from €331 million a year earlier. The latest results benefited from a gain of €302 million on the August sale of Philips's remaining stake in Taiwan Semiconductor Manufacturing Co.

Sales slipped 2% to €6.33 billion from €6.47 billion. The decline is a result of a dramatic deterioration in consumer demand, with sales at Philips's consumer-lifestyle unit down 8% from a year earlier and European sales down 9%. In emerging markets, sales increased 6% in the third quarter from the year-earlier quarter, but were down 16% from the second quarter.



Results at the health-care business, which is one of the world's top hospital-equipment makers and is seen as a key growth driver for the company, were hurt by lower volumes and margin pressure in imaging systems. Analysts said the division performed worse than expected in terms of both sales and profit margins.

Earnings before interest, taxes and amortization, or Ebita, dropped to €128 million from €444 million a year earlier, dragged down by pretax charges of €241 million tied to the settlement of asbestos-related claims, and restructuring-and-acquisition-related charges of €89 million.

ING analyst Marcel Achterberg said overall the results were disappointing, citing the slowdown in consumer sales and emerging markets, deteriorating health-care margins and the slowdown in the share-buyback program.

Santander in talks for Sovereign

BY MATTHEW KARNITSCHNIG, ROBIN SIDEL AND DAVID ENRICH

Spain's **Banco Santander** SA confirmed Monday it is in talks to acquire full control of **Sovereign Bancorp** Inc., a large U.S. thrift-holding company hobbled by souring loans.

In a brief statement filed with Spain's stock market regulator, Santander said it had yet to reach an agreement to take over the Philadelphia-based lender.

Sovereign also released a statement Monday confirming talks with Santander "regarding a possible business combination involving the two companies."

"It is not possible currently to know whether such conversations will lead to an agreement or not," Sovereign said.

People familiar with the matter said Sunday that the two sides hoped to complete a deal by Monday.

Details of the transaction weren't clear, but Santander was expected to pay roughly Sovereign's stock price of $3.81, where it closed Friday in 4 p.m. New York Stock Exchange composite trading. That would value the company at about $2.53 billion. Sovereign approached Santander late last week, according to a person familiar with the matter.

As banks around the world suffer, Santander has held up well, partly because of its minimal exposure to U.S. mortgages and risky trading businesses. The Madrid bank's Abbey National PLC unit in the U.K. has said it doesn't need to tap the British government's recapitalization effort. Given its resilience, Santander is interested in turning the industry's woes to its advantage, also taking a look at **Washington Mutual** Inc. and **Wachovia** Corp. in recent weeks.

Santander and large Spanish rival **Banco Bilbao Vizcaya Argentaria**, or BBVA, have been hunting for acquisitions in the U.S. because it is seen as a higher growth market than Western Europe, despite the possibility of a U.S. recession. BBVA has been particularly aggressive, buying two Texas banks in 2006 and Compass Bancshares Inc., a Birmingham, Ala., bank with about 400 branches from Florida to Arizona, last year.

Santander has been considered a potential buyer of Sovereign, which has $79 billion in assets and 750 branches in the northeastern U.S., ever since the Spanish bank got a 24.9% stake in Sovereign three years ago and three seats on its board.

Under terms of that agreement, Santander was entitled to bid for Sovereign after May 31 of this year, but the Spanish bank had to offer at least $40 a share. That provision was later amended to $38 a share. With Sovereign's stock price down by more than 60% this year, the company's directors appear likely to waive those conditions, people close to the talks said.

It was unclear what role federal regulators have played in the talks. Santander agreed as a condition of its initial investment in Sovereign to act as a "source of strength" if the company ran into trouble. That agreement may have put pressure on the Spanish bank to step in.

The talks come just days after Sovereign named a new top executive in an attempt to restore investor confidence. Paul A. Perrault was named president and chief executive, effective in January, succeeding Joseph Campanelli, who ran Sovereign following the ouster of Jay Sidhu, Sovereign's longtime boss.

It isn't clear whether Mr. Perrault will stay on in the top role if the Santander deal is completed. "They have big ambitions in the U.S. and want to find the right person to build that around," said a person familiar with the situation, referring to Santander.

The Sovereign deal, if carried out, would launch a big project for Santander's management at a time when the bank is preparing to integrate a slew of other recently acquired assets.

"Making an acquisition of this size in a market where Santander has no presence, at the same time as integration efforts are being made in three different markets might lead to some further dispersion of management attentions, increasing integration risks," said Carlos Peixoto of Portuguese brokerage BPI.

Later this month, bank executives are set to unveil integration plans for Brazil's Banco Real, the unit of ABN Amro Santander bought for roughly €10 billion ($13.4 billion) last year.

—Christopher Bjork contributed to this article.

Boeing, machinists return to talks, with a mediator

BY J. LYNN LUNSFORD

Boeing Co. and its machinists union spent the weekend at the bargaining table with the assistance of a federal mediator, their first negotiations since a strike idled the company's commercial airplane production lines in early September.

Both sides agreed to keep details of the talks secret. A person familiar with the situation said Sunday that the two sides were "showing signs of making progress," but they remained apart on some key issues, making timing of resolution a new three-year agreement uncertain.

Almost 27,000 members of the International Association of Machinists and Aerospace Workers walked off the job on Sept. 6 after overwhelmingly rejecting a proposed contract that would have given them an additional $34,000 in wages over the life of the contract but fell short of meeting the union's demands in other areas.

According to people familiar with the situation, federal mediators shuttled between the two parties as they attempted to work through a number of touchy issues, including language that would balance the company's insistence on having the final say on manufacturing decisions while giving the union more of a say in what types of work can be outsourced.

Boeing and the union have had an uneasy relationship for almost a decade as the company has made sweeping changes to the way it makes airplanes, including using suppliers to build bigger and bigger pieces of each jetliner. At the same time, Boeing has pushed to phase out traditional pension compensation and health-insurance plans in favor of having its employees pay a greater share of their medical expenses.

The union has been successful so far in fending off huge changes to workers' pension and insurance plans. But Boeing has won revisions allowing contractors to do a larger share of fabrication work once done by company machinists. The company said it needs such flexibility in order to stay competitive, particularly as countries such as Japan, China, Brazil and Russia are working to develop the capability to build large jetliners.

Company officials have said they are eager to resolve the strike, but not at the expense of a contract that delivers pay plans or other concessions that could eventually put Boeing in the same position as the three major U.S. automobile companies. Union officials say workers are entitled to a greater share of Boeing's profits because they have played a key role in increasing productivity.