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Honda challenges Toyota with its new Insight hybrid

CORPORATE NEWS | PAGE 4

Ireland gets caught up in world's banking crisis

Dublin to guarantee $578 billion in debt; 'swift and decisive'

By Neil Shah And Sara Schaefer Muñoz

LONDON—Surging tensions in lending markets compelled the Irish government to take the extraordinary step of guaranteeing a wide swathe of debt issued by the country's financial institutions, underscoring the severity of the banking crisis rolling through Europe.

In the most ambitious measure taken by a sovereign state since the financial crisis began more than a year ago, Dublin said it will guarantee payments on as much as €400 billion ($578 billion) in bank debt, including deposits, securities and short-term borrowings. While small in comparison to the trillions of dollars in assets of the global banking system, the amount is more than double Ireland's annual economic output, and rivals the size of

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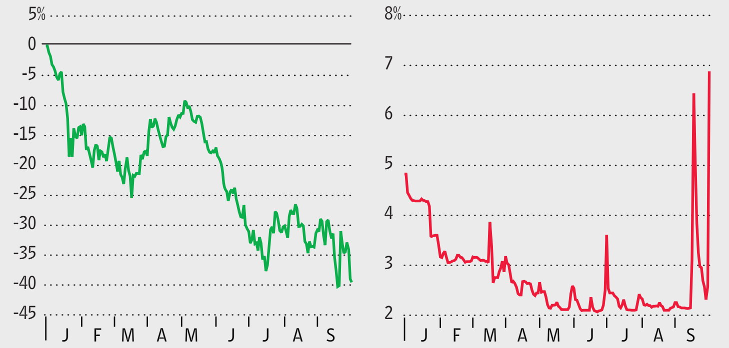

Sources: Thomson Reuters Datastream; British Bankers' Association

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Business & Finance

The Irish government took the extraordinary step of guaranteeing as much as $578 billion of debt and deposits for six big banks, an amount more than double the country's annual GDP, as credit markets tightened and Libor rose. **Page 1**

■ **Central banks** are increasingly transforming themselves from lender of last resort to lender of first resort. **Page 1**

■ **Overnight lending rates** surged around the globe. The Libor's record one-day gain underscored the fear gripping banks. **Page 17**

■ **U.S. stocks recovered** more than half the previous session's historic losses as the Dow Jones industrials jumped 4.7%. European shares rose. **Page 17**

■ **Hedge funds are taking** such drastic steps as lowering their fees as they scramble to hold on to investors. **Pages 2, 18**

■ **Consumer-price inflation** in the euro zone eased last month, fueling expectations of a shift in focus at the ECB. **Page 8**

■ **U.S. auto firms hope** a new bailout plan could stem a growing credit crisis that threatens their industry. **Page 3**

■ **Moscow wants** banking-sector weakness to spur a wave of consolidation and a huge cut in the number of lenders. **Page 3**

■ **Honda may pose** the most formidable threat to Toyota's dominance in the hybrid market when it unveils its Insight model in Paris this week. **Page 4**

■ **Tesco reported** surprisingly strong first-half earnings, in a sign that the retailer's aggressive overseas push is offsetting a slowdown in the U.K. **Page 5**

■ **Glaxo plans to cut** up to 850 research-and-development jobs on top of the 350 set for elimination earlier this year. **Page 6**

■ **Asian countries are taking** steps to boost liquidity as the global cash squeeze begins to hurt some economies. **Page 23**

Markets 4 p.m. ET

MARKET	CLOSE	NET CHG	PCT CHG
DJIA	10850.66	+485.21	+4.68
Nasdaq	2082.33	+98.60	+4.97
DJ Stoxx 600	256.05	+4.62	+1.84
FTSE 100	4902.45	83.68	+1.74
DAX	5831.02	+23.94	+0.41
CAC 40	4032.10	+78.62	+1.99
Euro	$1.4045	-0.0387	-2.68
Nymex crude	$100.64	+4.27	+4.43

Money & Investing > **Page 17**

World-Wide

American lawmakers worked to save the $700 billion financial-rescue package, after the U.S. House's rejection that initially sent global stock markets into a tailspin. Bush said his advisers will work with Congress on a new solution that could begin to move as soon as Wednesday. McCain and Obama both pressed for a deal. **Pages 1, 10, 32**

■ **At least 168 people** were killed and 100 others injured when thousands of pilgrims, panicked by false rumors of a bomb, stampeded at a Hindu temple in western India in a rush to escape.

■ **Pakistan named** Lt. Gen. Pasha chief of its main intelligence service, part of a major shake-up by army chief Gen. Kayani.

■ **Pakistan's army is backing** tribal militias that are rising to battle pro-Taliban groups in the country's northwest. **Page 8**

■ **Russia said** it won't immediately allow EU monitors preparing to deploy in Georgia to enter a buffer zone surrounding separatist South Ossetia.

■ **The leader of Bavaria's** ruling conservatives will step down Oct. 25, after a dismal state election showing for his party.

■ **The Pentagon** formally notified the U.S. Congress it wants to sell Israel up to 75 fighter jets being developed under a contract led by Lockheed. **Page 9**

■ **France and India signed** an agreement that will allow French companies to sell civilian nuclear technology to India.

■ **China aims** to launch a small space lab within four years as a stepping stone to more ambitious space feats, officials said.

■ **Parents of an infant** allegedly sickened by tainted milk powder filed suit against Sanlu, challenging Beijing's efforts to keep the scandal out of courts. **Page 9**

■ **Afghanistan's Karzai said** he asked Saudi Arabia's king to help facilitate peace talks with the Taliban and had reached out to Taliban leader Mullah Omar.

■ **Somali pirates arguing** over a hijacked cargo ship with 33 tanks engaged in a shootout, with three pirates believed dead, a U.S. official said, but a pirate spokesman denied the report.

Editorial & Opinion

Tamed tiger

Ireland's economy tries to rebound after becoming Europe's first in recession. **Page 13**

Central banks add new role, greater risk

By Joellen Perry And Sudeep Reddy

As they rush to ease deepening strains in global credit markets, central banks around the world are increasingly transforming themselves from being lenders of last resort to lenders of first resort.

With lending between financial institutions essentially frozen, the central banks have effectively taken over the role banks play in normal times—providing the day-to-day grease that allows financial markets to function.

"Banks are now on life-support systems with the central banks," said Thomas Mayer, an economist with Deutsche Bank in London.

In a crisis, deep-pocketed governments are often the only institutions left to lend to troubled financial firms, and central banks were created in part to fulfill that role. Despite central banks' ongoing efforts to keep markets flush with cash, however, banks remain exceptionally wary of lending to each other.

As a result, central banks are taking on far more risk than they would in normal times. "The central banks now act as the risk-takers of last resort," said Mr. Mayer. Banks swap collateral for central-bank funds, which is meant to cover any losses the central bank might incur if a bank defaults.

Among several indicators of money-market tension: The federal-

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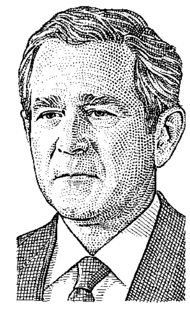
U.S. lawmakers scramble to revive bailout this week

By John D. McKinnon

American lawmakers worked to save the White House's historic $700 billion financial-rescue package, after a stunning defeat in the U.S. House of Representatives that initially sent stock markets around the world into a tailspin and added to concerns that the U.S. faces a prolonged recession if the legislation isn't revived.



George W. Bush

President George W. Bush used Monday's drop in equity markets to argue the need for quick congressional action on a rescue plan, and said his advisers will begin working with Congress on a new solution that could begin to move as soon as Wednesday. "The reality is that we're in an urgent situation," Mr. Bush said, "and consequences will grow worse each day if we do not act. If our nation continues on this course, the economic damage will be painful and lasting."

The Dow Jones Industrial Average sustained its biggest point drop in history on Monday and its biggest closing decline since the day the markets reopened after the Sept. 11, 2001, terrorist attacks.

The Dow, which had opened sharply lower on fears of more possible bank failures, finished Monday down 7%, with a 777.68 point drop to 10365.45. Losses to shares on the broader Dow Jones Wilshire 5000 index amounted, on paper, to $1.2 trillion—eclipsing the size of the proposed bailout package.

Markets began to cool early Tuesday. The DJIA recovered from some of the huge loss, closing at 10850.66, up 485.21, or 4.68%.

The White House said Mr. Bush

Please turn to page 31

THE FINANCIAL CRISIS

Hedge funds make deals to retain investors

RAB offers lower fees for 3-year lockup; side-pocket strategy

By Cassell Bryan-Low

Scrambling to hold on to investors, hedge-fund managers are taking drastic steps such as lowering their fees.

U.K. hedge fund **RAB Capital** PLC on Tuesday said it had convinced steel magnate Lakshmi Mittal and other investors to lock in their money in a flagship fund for three years in exchange for lower fees. As part of the move, it halved its annual management fee.

Increasingly, hedge funds are restructuring, changing their fees and altering how they hold investments, among other steps, in an effort to keep investors who have grown skittish at some of the funds' worst performances ever.

Tuesday was the deadline for many investors to submit requests to withdraw money at the end of the year. The industry is bracing for potentially record levels of withdrawals, following a September that many think could mark the industry's worst-ever month of performance.

Withdrawals not only hurt funds' profits but can also prompt funds to sell assets in order to pay back investors, leading to further market declines. Jean-François Vert, chief executive of money manager Allianz Alternative Asset Management expects more fund managers to try to limit withdrawals as they try to avoid selling assets.

The number of funds in operation and the amount of money they manage could both fall over the next 12 months, says Peter Astleford, a London-based partner at law firm Dechert LLP who specializes in the hedge-fund sector. "Even if that is quite modest, it will be dramatic, given the explosive growth in the industry over each of the last few years."

Like RAB, funds such as **BlueBay Asset Management** PLC, **Camulos Capital** LLP, and **Ore Hill Partners** LLC have asked investors to commit money for longer in return for a cut in fees.

Another strategy is to park poorly performing assets in a so-called side pocket, or separate fund, so a fund won't have to sell them, likely at a loss, to meet investor withdrawals. Hedge fund **Atticus Capital** LP put its holdings in German exchange operator **Deutsche Börse** AG in a side pocket. Deutsche Borse shares have more than halved this year.

RAB, run by well-known London fund manager Philip Richards, has faced heavy redemptions on the heels of substantial losses. Its flagship RAB Special Situations Fund Ltd., which started the year with more than $2 billion of assets, dropped 14% for the month of September through Sept. 25, and is down 55% year to date. Assets under management have shrunk to $790 million.


Philip Richards

Among its best-known bets was taking a large stake in troubled U.K. lender Northern Rock, an investment that was wiped out when the U.K. government stepped in and nationalized the bank earlier this year. Mr. Richards recently stepped down as RAB's chief executive to focus on investing.

In a last-ditch effort to save the fund, in recent weeks Michael Alen-Buckley, the firm's chairman, and RAB's head of sales, Charles Kirwan-Taylor, made their pitch to investors: a three-year lockup in exchange for a management fee of 1% of assets and performance fee of 15% of returns, instead of 2% and 20%. RAB investors previously could withdraw money on a quarterly basis but had to give 180 days' notice.

Investors figured that having the fund sell its investments now, after the markets' recent sharp falls, was less attractive than waiting to see if the fund recovers over the next three years.

One key figure was Mr. Mittal, the fund's largest investor, who also owns about a 10% stake of RAB Capital. A spokesperson for Mr. Mittal couldn't immediately be reached.

RAB needed 75% of investor votes to approve the plan, which it secured by a "considerable margin," it said. A spokesman declined to give an exact figure.

Overall, RAB—named for the last-name initials of Messrs. Richards and Alen-Buckley—has lost billions of dollars this year and now has $4.2 billion under management, down from $7.24 billion at the end of December. RAB's shares, which are listed on AIM, rose 7.7% Tuesday but are down 78% for the year.

Lehman's Europe, Asia refugees continue to land new positions

A WSJ News Roundup

Refugees from the overseas businesses of **Lehman Brothers Holdings** Inc. continued Tuesday to land new jobs in Asia and Europe.

U.S. private-equity firm **Blackstone Group** LP is hiring 12 Asia-based bankers from rivals, including a partner and two managing directors from Lehman Brothers Asia Ltd., as well as a partner and a managing director from **HSBC Holdings** PLC, Blackstone said Tuesday. It didn't disclose a further breakdown of the hires.

The poaching from Lehman is the second major raid on its bankers since **Nomura Holdings** Inc. of Japan agreed to acquire Lehman Brothers' businesses in Asia and Europe. The departures illustrate the difficulties Nomura may have in keeping top talent.

Merrill Lynch & Co. last week hired away Lehman's six-man power-sector coverage team for the region led by banker James Chapman. Nomura is offering competitive compensation to keep talent at a time of overall shrinking financial-industry pay packages.

It emerged that Nomura, while contemplating a purchase of Lehman Brothers's European equities and investment-banking business, decided not to take on the fixed-income unit as well because of regulatory capital constraints, a person familiar with the matter said Tuesday.

The Japanese bank was unable to agree to terms for the takeover of the unit by last Friday's deadline, the person said previously. The deadline wasn't extended. Earlier Tuesday, a statement from PricewaterhouseCoopers, the administrator for some of Lehman's European businesses, said Lehman was cutting 750 employees immediately. A spokesman for PWC confirmed the cuts were mainly from the fixed-income unit.

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U.S. auto makers pin hopes on rescue plan

Wall Street bailout also had provisions for soured car loans

By Aparajita Saha-Bubna

As the U.S. Congress hammers out revisions on a bailout plan for Wall Street, U.S. auto companies are hoping the new plan could stem a growing credit crisis that threatens to further crimp their industry.

The original $700 billion deal, which was rejected by the House of Representatives on Monday, included a substantial bailout for auto lenders. These companies hold a stable of bad auto loans that could shrink in value and hurt both the lenders and the vehicle makers. This bailout would have been separate from the $25 billion in low-cost loans the Big Three Detroit auto makers hope to get from Congress as early as next year.

Because of constrained capital, **GMAC** LLC, partially owned by **General Motors** Corp.; **Ford Motor** Credit; and **Chrysler** Financial have tightened lending standards in recent months. This tightening happened just as the lenders decided to pull out of the risky practice of leasing new vehicles, which had long represented about 20% of new-vehicle financing arrangements. The combination of tougher-to-get loans and absence of leasing stung auto makers during the summer selling season.

A Washington bailout of bad car loans could loosen the flow of financing for potential car buyers and spark demand for new cars and trucks. In addition, it likely would free up funds that could be invested in securities backed by auto loans, bringing down borrowing costs for auto lenders.

In August, tight credit conditions cost General Motors auto sales of roughly 10,000 to 12,000 vehicles, the car maker said. When extrapolated across the entire U.S. industry, that is the equivalent of 40,000 lost sales, or about $1 billion in revenue.

The growing credit crunch in the auto industry is expected to have wreaked havoc on September U.S. vehicle sales, which will be reported Wednesday. Research firm J.D. Power & Associates expects a 26% volume decline compared with the same month in 2007.

Associated Press

U.S. auto sales have slumped—**particularly for big vehicles** such as pickups—due to tight credit as well as higher gasoline prices.

"There are still quite a few deals getting done, but they require a lot more work and a lot more back-and-forth between the bank and the dealer," Earl Hesterberg, chief executive of dealer chain Group 1 Automotive Inc., said. "It's become significantly more difficult, particularly in the last month."

John Bergstrom, owner of the Bergstrom Automotive Group dealership chain in Wisconsin, said the buyers having the most trouble are those who have owned a car for a few years and are looking for a new one. Because they have owned their car for only a short time, they don't have much equity in their vehicle, or may even owe more than the car is worth. Banks are increasingly making these buyers produce hefty down payments.

"The challenge is affordability," Mr. Bergstrom said. "People's bills are getting higher, and then they're squeezed on gasoline and they're squeezed on milk and so forth. When they look at a car, they say they can't really afford them."

The tightening also has hit dealers as the car makers' finance arms raise the cost of the "floor plan" credit they offer dealers to buy cars for their inventory. Dealers typically repay lenders for these loans as each vehicle is sold.

Existing bonds made up of floor-plan loans of the three auto-finance arms total $25.8 billion, according to data provider ABSNet. Ford Motor Credit and GMAC lead with $12.7 billion and $10.6 billion, respectively. Both companies have had unprecedented trouble attracting investors in floor-plan assets in recent months, people familiar with the matter have said.

That has prompted the finance companies to get tougher on dealers with weak finances, raising their rates and fees for some. This makes it costlier for dealers to buy cars, eroding their margins. In addition, dealer inventories are getting leaner, meaning potential car buyers have fewer options to choose from.

And since GMAC and Chrysler Financial are both controlled by private-equity group **Cerberus Capital Management** LP, each is now being run to maximize profits, not auto sales. Last week, GM's largest Chevrolet dealer, Bill Heard Enterprises, closed all 14 of its dealerships after GMAC canceled the dealer's credit line.

—John D. Stoll and Sharon Terlep contributed to this article.

Russia seeks a shakeout in weak banking sector

By Andrew Langley And Lidia Kelly

MOSCOW—The Russian government wants the current banking-sector weakness to bring a wave of consolidation and a huge reduction in the number of lenders operating in the fragmented sector, according to people familiar with the matter.

Russian banks have recently begun to feel the strain of the financial turmoil gripping most of the world. A rout in stocks amid an exodus of foreign cash has seen banking-system liquidity dry up, forcing some institutions—like many in the U.S. and Europe—to seek fresh capital.

The developments mark a turnaround for banks, which had been enjoying a boom fueled by foreign loans and an increasingly affluent consumer. Now, what many call a long-overdue shakeout seems likely.

"The number of banks in Russia is unsustainable and unnecessary," said Aivaras Abromavicius, a partner at $4.5 billion Scandinavian investment group **East Capital**, a big investor in Russian regional banks. "In the long-term, most will cease to be around," he added.

A handful have already fallen, and market watchers say more of the country's 1,200 banks will undoubtedly follow. The government—a longtime supporter of consolidation—is inclined to encourage the trend by only offering assistance to those it wants to survive.

The central bank declined to comment for this article, but a person close to the government confirmed the existence of the initiative.

"The idea is not that the government will do this by force but that the current financial crisis is a good opportunity to let this happen in an evolutionary way," the person said.

The central bank last week briefed senior bankers on developments in the sector, with Chairman Sergei Ignatyev saying 50 to 70 banks could fall by January alone, according to a person familiar with the talks.

—Jacob Gronholt-Pedersen contributed to this article.

Housing prices decline in U.S., but consumer confidence rises

By Kelly Evans

U.S. home prices declined in July, reflecting a housing market infected by a lack of confidence now battering financial markets.

Prices fell an average 0.9% in July compared with June in the 20 U.S. metropolitan areas tracked by the S&P/Case-Shiller home-price index. The July drop ended four months of slowing price declines that analysts had hoped signaled some stabilization in the housing market.

Separately, a gauge of consumer confidence improved slightly in September, after declining in June and July amid record oil and gas prices. The Conference Board, a New York research group, said its index rose to 59.8 in September from 58.5 in August, although the latest survey period didn't fully encompass the current turmoil in financial markets and Congress's rejection of the bailout legislation.

The financial system's uncertainty is likely to hinder a housing-market recovery. While mortgage rates are lower than they were in July, buyers face tighter lending restrictions and often must make bigger down payments.

CORPORATE NEWS

TRUCKS

Volvo cuts output, jobs as Europe demand slows

AFP

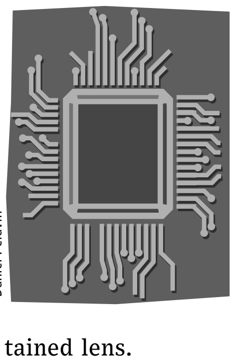
SWEDISH truck maker **Volvo** AB said Tuesday it will reduce production, cutting 1,400 jobs in Sweden and Belgium, or 20% of its truck operations' European work force of 7,000.

The move comes as the financial crisis puts a dent in demand for trucks in Europe, Volvo's biggest market. The plan is not just in response to falling demand but is also aimed at boosting efficiency and compensating for higher raw-material prices, said Staffan Jufors, head of Volvo's truck operations. Volvo said negotiations with unions will start immediately.

Rival **Scania** AB said it, too, sees demand in Europe moving into lower gear. *—Adam Ewing*

SEMICONDUCTORS

ASML begins producing new EUV chip machines



Daniel Pelavin

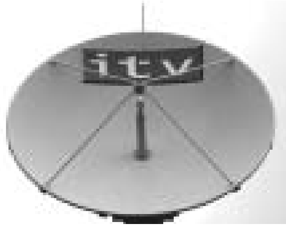
DUTCH semiconductor equipment company **ASML Holding** NV said it has begun manufacturing its next generation of chip-making machines, which use "extreme ultraviolet," or EUV, lithography.

EUV lithography systems transfer patterns on to silicon wafers by projecting extreme ultraviolet light through a vacuum-contained lens.

The company said it has five orders for its NXE systems from memory-chip and logic-chip producers and that first orders will be delivered in the beginning of 2010. It did not name the customers. *—Roberta B. Cowan*

MEDIA

ITV to cut jobs, costs amid sharp drop in ads



Reuters

BROADCASTER **ITV Group** PLC said that by early 2009 it expects to have cut 1,000 jobs, or 17% of its work force. The cuts will include 430 positions at the ITV News division, slicing the U.K. company's news staff nearly in half. The job cuts and additional major cost-cutting programs have come in response to a sharp advertising decline, which has already prompted the broadcaster to cut its dividend and lower its full-year targets.

Meanwhile, **British Sky Broadcasting** PLC was ordered by regulators Monday to reduce its 17.9% stake in ITV to below 7.5%, after BSkyB's appeal against the decision was turned down. *—Kathy Sandler*

Honda ready to invade Toyota's green turf

Auto maker betting new Insight hybrid will steal Prius fans

BY JOHN MURPHY
KATE LINEBAUGH
Tokyo

GLOBAL AUTO MAKERS are rushing to challenge the dominance of **Toyota Motor** Corp.'s Prius hybrid with a slew of eco-friendly vehicles. But **Honda Motor** Co. is likely to pose the most formidable threat to Toyota when it unveils its new Insight hybrid car Thursday at the Paris Auto Show.

Honda is betting that the five-passenger hatchback, set to go on sale next spring, will steal away Prius buyers by delivering greenness for fewer greenbacks. Honda has yet to disclose precise details about the car or its cost, and it calls the car to be shown in Paris a concept, but it says Insight "will be priced significantly lower than hybrids available today." Analysts expect the model will cost under $20,000, undercutting the current $22,000 starting price of the Prius.

"It will be the first affordable hybrid for everyone," says Tatsuo Yoshida, an analyst for UBS Securities Research in Tokyo.

New hybrid models are also on the way from **Nissan Motor** Co., **Ford Motor** Co. and **General Motors** Corp., among others. But Honda and Toyota have an advantage thanks to their substantial lead in developing hybrid technology, analysts say. Toyota, including its luxury brand Lexus, had a 79% share of the U.S. hybrid car and light-truck market in the January-August period this year, according to Autodata Corp. Honda was a distant second with 11% of the market, followed by Ford with 6%.

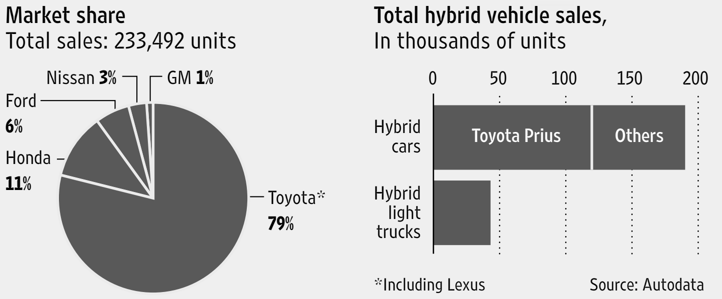
Other auto companies are also coming up with different fuel-efficient technologies, such as GM's Volt, a plug-in hybrid, and Nissan's planned pure electric vehicle. Chrysler recently announced plans to release an electric vehicle by the end of 2010. But these newer technologies are still untested, expensive and will be available only in small volumes at first, compared with the basic gas-electric hybrids like the Prius and the new Insight.

Toyota says it aims to sell about 160,000 Priuses in the U.S. this year, while Honda expects to sell about 100,000 Insights domestically in that model's first year.

Honda

Artist's rendering of the **Honda Insight**

Hybrid-vehicle market in the U.S.
January through August 2008



*Including Lexus

Source: Autodata

Toyota and Honda designed different hybrid systems, each with different strengths. Toyota's "full" hybrid setup weds a battery-powered vehicle with a gasoline engine. At slower speeds, the Prius can run on battery power alone. At higher speeds it switches mainly to gas power. In stop-and-go traffic in the city the battery power gives it better mileage than on the highway.

Honda's Insight will use a "mild" hybrid system. Its main power source will be a highly efficient, lightweight gasoline engine, but it will will be assisted by battery power. Honda hasn't released the projected mileage of the Insight, but it is expected to be higher than the Honda Civic hybrid, which gets 45 mpg on the highway and 40 mpg in the city, according to EPA ratings. The Prius also gets 45 mpg on the highway, but has a substantial edge in city driving with an EPA rating of 48 mpg.

Bruce Smith, a retired retailer in Orange County, Calif., who is a longtime owner of BMWs, drives 135 miles four times a week to look after his grandson, and wanted a fuel-efficient car. After doing research on the Prius and Honda's Civic hybrid, which uses technology similar to what will be deployed in the Insight, he opted for the Toyota because it drives on battery power more than Honda's offering.

For its part, Toyota says it welcomes the competition. "Any contribution heightening public awareness of alternative powertrains is welcome," says Paul Nolasco, a spokesman for Toyota in Tokyo.

Honda was the first auto maker to introduce a hybrid to the U.S. with a two-seater, also called the Insight, in 1999. But it didn't catch on like the four-seat Prius, and Honda eventually stopped producing the model.

Honda plans to introduce hybrid versions of other models, including a compact sporty car.

Police look for bribe evidence in case against BAE

BY DAVID CRAWFORD
AND DANIEL MICHAELS

Police searched locations in Austria last week looking for evidence of alleged bribes that they claim were paid by British defense contractor **BAE Systems** PLC to win contracts to sell military aircraft in Austria and the Czech Republic, according to court records.

Austrian prosecutor Gerhard Jarosch said police searched the home and office of Alfons Mensdorff-Pouilly, a 55-year-old Austrian count, on Sept. 24 at the request of British and Austrian investigators. The request came in connection with a continuing investigation into whether BAE unlawfully tried to influence defense procurements in a number of countries.

Mr. Mensdorff-Pouilly's wife, reached on Mr. Mensdorff-Pouilly's cellphone, referred all questions to their lawyer. Harald Schuster, lawyer for Mr. Mensdorff-Pouilly, said: "The allegations are without grounds. The English have been investigating the allegations for years without success; it will continue as such."

Britain's Serious Fraud Office has been digging into BAE's business practices since 2004, although an investigation into questions regarding funds linked to the purchase of Eurofighter Typhoon fighter jets by Saudi Arabia was halted in late 2006 by the British government. Former Prime Minister Tony Blair said he stopped the probe for national-security reasons.

The Austrian search warrant specifically excludes a search for evidence connected to the sale of BAE products to Saudi Arabia, according to the document, which was reviewed by The Wall Street Journal.

The Eurofighter is produced by a consortium including BAE, Franco-German **European Aeronautic Defense & Space** Co. and Italy's **Finmeccanica** SpA.

A BAE spokeswoman declined to discuss events in Austria. The company said in a statement that it "continues to fully co-operate with the ongoing SFO investigation."

The Austrian search warrant cites a request for legal assistance by the Serious Fraud Office, dated July 25, 2008, connected to a suspected violation of Britain's Prevention of Corruption Act 1906. The Austrian investigation has since been expanded to include suspected money laundering and bribery, Mr. Jarosch, the prosecutor, said.

According to the search warrant, dated Sept. 12, Mr. Mensdorff-Pouilly's Vienna-based company, **MPA Handelsgesellschaft** m.b.H., used its influence to prevent the Austrian air force from selecting American F-16 aircraft, built by **Lockheed Martin** Corp., by insisting that new bids needed to be filed. Austria in 2003 agreed to pay €1.79 billion ($2.58 billion) for the 18 Eurofighters.

The Austrian warrant cites a purported letter sent by Mr. Mensdorff-Pouilly to BAE in March 2003, saying the Eurofighter was selected in a second competition thanks to his efforts. Mr. Mensdorff-Pouilly said he was successful because of "aggressive payment of commissions to decision makers based on success and strong lobbying by the British, German and Italian ambassadors in support of the Eurofighter," the document says, citing a purported March 25, 2003, letter from Mr. Mensdorff-Pouilly to a BAE official.

According to the search warrant, Mr. Mensdorff-Pouilly is suspected of receiving "commission payments" from BAE as a consultant and passing some of this money as bribes to unidentified "third parties."

CORPORATE NEWS

Tesco's 1st-half net rose 11%

U.K. retailer's gains overseas help offset weak home market

By Aaron O. Patrick

LONDON—Defying tough conditions in its home market, **Tesco** PLC reported surprisingly strong first-half earnings.

Tesco, one of the world's largest retailers, is pushing aggressively beyond its home market of Britain in search of faster sales gains. In a sign that the strategy is working, overseas expansion helped offset a slowdown in the U.K., where Tesco is the largest retailer by revenue.

Sales in the U.K. rose 9.7%, compared with a 27% jump overseas, where gains were aided by favorable currency rates, strong growth in Asia and the opening of U.S. stores under the Fresh & Easy brand. The overseas business "gives us a breadth that spreads risk," Chief Executive Terry Leahy said during a news conference on Tuesday.

Net income rose 11% to £1.04 billion ($1.88 billion) in the half ended Aug. 23 from £936 million in the year-ago period. Revenue rose 13% to £25.6 billion from £22.6 billion in the year-ago period. The results exceeded analysts' expectations. Tesco shares rose 4.8% to £3.87 on the news Tuesday.

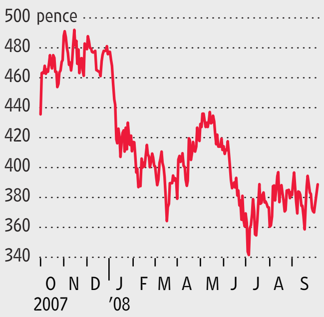
52-WEEK STOCK PERFORMANCE

Tesco

On the London Stock Exchange

Tuesday's close: 387.6 pence, up 4.8%

52-week change: down 11%



Source: Thomson Reuters Datastream

Britain's economy, like that of the U.S., is under severe strain, pushing down house prices in many areas and hurting consumer confidence. Retailers have reported that people are driving to shops less frequently and trading down to buy less expensive food and goods.Tesco has responded by creating more of its store-brand foods, promoting cheaper products and installing more self-service checkouts to cut costs.

It is also planning to expand further into financial services and might offer mortgages and current accounts—basic bank accounts with checks—in about a year, said Andrew Higginson, Tesco's director of finance and strategy.

One of Tesco's biggest expansion opportunities is the U.S. It opened the first of 90 Fresh & Easy stores late last year and plans to have 200 of the stores by the end of February, each selling mainly Tesco-brand products.

For the first time, Tesco broke out results for Fresh & Easy. Despite initial skepticism that Tesco could succeed in the tough U.S. market and on the home turf of the world's largest retailer by revenue, Wal-Mart Stores Inc., Fresh & Easy is growing quickly. Sales in the first half were £76 million on a loss of £60 million.

Growth of H&M's fast fashion succumbs to global slowdown

By Ola Kinnander

STOCKHOLM—**Hennes & Mauritz** AB posted a less-than-expected 5% rise in fiscal third-quarter net profit, as its low-price strategy appeared to succumb to the global economic downturn.

Sweden-based H&M, one of the world's biggest clothing retailers, had fared better in previous quarters, counting on price-conscious shoppers to snap up its inexpensive clothing and accessories.

Net profit in the three months ended Aug. 31 rose to 3.33 billion Swedish kronor ($489 million) from 3.17 billion kronor a year earlier. Analysts had expected net profit of 3.72 billion kronor. Revenue rose 12%, to 20.87 billion kronor from 18.71 billion kronor.

H&M shares fell 9.7% to 278 kronor on Tuesday, underperforming the broader Nordic index.

The company also reported August sales results that were significantly worse than analysts had expected. Total monthly sales grew 8% from a year earlier, while sales at stores open more than a year fell 3%. Analysts had expected total sales to rise 14% and same-store sales to increase 1.9%. H&M doesn't release monthly sales figures, only the percentage change year-to-year.

H&M, which is based in Stockholm, said last month's sales through Sept. 28—the first month of its fiscal fourth quarter—rose 9% from a year earlier.

Analysts said it appears the economic downturn has finally started to hit the fast-fashion retailer, noting that margins were squeezed by lower prices for its clothes, while production costs for its Asian suppliers and transportation costs have risen.

Chief Executive Rolf Eriksen played down the importance of high margins, telling a news conference that the company is instead focusing on continuing to sell at a brisk pace and expanding.

In an interview, Mr. Eriksen said H&M isn't being hit as hard by the downturn as its rivals are. "The pie is smaller, but H&M is gaining market share," he said.

CORPORATE NEWS

Pfizer to exit heart field

Move marks a shift in drug development; broad reshuffling

By Shirley S. Wang
And Joann S. Lublin

In a striking shift, Pfizer Inc. will abandon efforts to develop medicines for heart disease as part of a broad research reshuffling.

Pfizer will be leaving a field that includes its cholesterol-lowering drug Lipitor and other medicines that fueled the company's dominance of the pharmaceutical industry for more than a decade.

Jeffrey Kindler

The beleaguered New York pharmaceutical giant is also expected to exit therapies for obesity and bone health, to focus on more-profitable areas, such as cancer.

The move is part of a plan to reassess research productivity and to restructure into business units responsible for their own profits and losses. Job cuts and a reduction in research and development spending—which at $8.1 billion last year was the highest in the industry—are expected. Pfizer executives declined to disclose the size of any expense cuts.

"We still see the programs that we're stopping as having value," said Martin Mackay, Pfizer's head of research and development. "They're just not as valuable as other programs, like Alzheimer's or oncology." The company will seek partners to develop some of the compounds it is jettisoning. "Out-licensing will very much come to the fore," he said.

The company announced Tuesday that its late-stage development pipeline has grown to 25 compounds from 16 over the past six months. Most of these advances occurred in areas Pfizer has identified as important, including cancer, pain and Alzheimer's.

The mega-blockbusters Lipitor, the world's top selling drug with sales of $12.7 billion in 2007, and Norvasc, a blood pressure medicine with $4.7 billion in sales in 2006 before losing patent protection last year, made Pfizer in the mid-1990s the king of cardiovascular drugs.

The company had banked on another cholesterol-lowering drug, called torcetrapib, to help it maintain its leadership and provide a new source of growth after Lipitor faces generic-drug competition in 2011. But that drug failed in a major study in late 2006, and the company's prospects have been in disarray ever since.

The company will continue to develop heart medicines in late-stage testing, including an anti-clotting drug called apixaban, being co-developed with **Bristol-Myers Squibb** Co. But several other compounds, including two that were similar to torcetrapib, are being scrapped.

Pfizer sees decentralized operations as boosting pipeline prospects and efficiency. "We're running the company with a real sense of urgency and accountability," said Chief Executive Officer Jeffrey Kindler.

Drastic job cuts aren't imminent, according to two people familiar with the company's plans. But Pfizer executives expect further cost cutting before Lipitor faces generic competition, according to one informed individual. "Until 2011, It's not going to be business as usual. There will be constant belt tightening," that person said.

Glaxo plans to cut up to 850 R&D jobs

By Jeanne Whalen

Drug maker **GlaxoSmithKline** PLC Tuesday said it plans to cut as many as 850 jobs in research and development in the U.S. and Britain, the latest cuts in an industry grappling with declining profits and productivity.

The cuts, about 6% of total R&D staff, would come on top of the 350 R&D jobs Glaxo said it was eliminating earlier this year, said Claire Brough, a spokeswoman for the Brentford, U.K., company. The exact number of job cuts will be determined after consultations with employees and unions, she said.

The world's second-biggest drug maker by sales after Pfizer Inc. said that the cuts were necessary "to ensure that we can invest in key areas of future growth and evolve our business to compete effectively in what is a rapidly changing and challenging environment for pharmaceutical companies."

The drug industry has been cutting staff and costs in response to declining profits. Pfizer Inc. this week disclosed it is abandoning research into heart disease and other areas as part of a restructuring that will involve job cuts. Most big drug companies have announced layoffs over the past few years.

R&D staffs have come under particular pressure because they haven't produced enough new products to keep sales growing. Generic-drug competition is eating into profits and companies haven't launched enough new brand-name medicines to compensate.

As they cut their research staffs, drug companies are pouring investments into small, often privately-held biotech companies, which have produced some of the industry's most successful medicines in recent years.

Andrew Witty, who took over as chief executive officer of Glaxo in May, has pledged to increase Glaxo's investment in outside research. He has said that half of Glaxo's drugs in development eventually could come from partnerships with outside firms.

Mr. Witty has been scrutinizing Glaxo's own research team and making changes. Among other moves, he has set up a board that includes outside experts, such as venture capitalists, to review R&D projects and decide which to fund. He has also shut down some areas of research and focused Glaxo on eight disease areas. Glaxo has dedicated teams, known as Centres of Excellence for Drug Discovery, or CEDDs, for each disease area. The changes have caused some upheaval, with at least three CEDD leaders leaving the company in recent months.

Aviation trade group issues bleak outlook

By Kaveri Niththyananthan

In a bleak assessment of the aviation industry, the head of the International Air Transport Association called for swift action to deal with the damaging impact of the economic slowdown.

"Urgent measures are needed," said Giovanni Bisignani, the trade body's director general. "From taxation to charges and operational efficiencies, all areas impacting the business must be examined for ways to reduce costs and drive efficiencies.

"It's a matter of survival," Mr. Bisignani said. He predicted that at least 20 international airlines are at risk of bankruptcy amid financial turmoil, elevated jet-fuel prices and a slowdown in passenger growth. More than 30 have gone out of business already this year.

The warning came as IATA released international traffic data for August that showed a contraction in freight volumes for the third consecutive month as well as slowing passenger growth.

International freight traffic fell 2.7% in August from a year earlier, following drops of 1.9% in July and 0.8% in June. A 6.8% decline in freight shipped by carriers in the Asian-Pacific region in August had the greatest impact. The region represents 45% of global air cargo traffic.

The data are "a clear indication that global trade is slowing down," Mr. Bisignani said. "This shows that the impact of the financial crisis is broad geographically and will worsen before it gets better." Airlines carry 35% of the goods traded internationally, by value.

International passenger traffic—measured in revenue passenger kilometers, which factor in how far passengers are flown—grew 1.3% in August, down from 1.9% growth in July and 5.4% in the first half of the year.

With capacity growth outstripping demand, passenger load factors—which measure how many of an airline's available airplane seats are filled with paying passengers—fell to 79.2% in August from 81% a year earlier.

"The contrast between the first half of the year and the last two months is stark," Mr. Bisignani said. "The slowdown has been so sudden that airlines can't adjust capacity quickly enough."

He said the figures indicate the industry still is heading for a combined loss of $5.2 billion this year and $4.1 billion in 2009.

—Vu Trong Khanh contributed to this article.

Regulators frustrate Indian drug companies

By Geeta Anand

MUMBAI—After waiting seven months for Indian regulators to approve its application for a clinical trial of a new experimental cancer drug, **Piramal Life Sciences** Ltd. this week got the green light to proceed—in Canada.

It took Health Canada, Canada's drug regulatory authority, just 28 days to approve the drug trial, the first human test of Piramal Life's new medicine.

Swati Piramal

The disparity in the approval process reflects the frustration Indian pharmaceutical companies face in trying to use their huge home market to their competitive advantage: They quickly run up against the remnants of India's arcane and plodding regulatory system, derisively known here as the "license Raj".

"Clearly, this indicates a lack of capacity and experience in approving" applications for testing new drugs, says Swati Piramal, director of the Mumbai-based Piramal Group, Piramal Life's holding company, and a major Indian generic-drug manufacturer.

Piramal Life's struggles reflect the strain between the waning bureaucracy of the license Raj—which takes its name from India's postindependence socialist era—and modern Indian businesses racing to exploit opportunities that opened up with the country's recent rapid growth. India has since ended many of the quotas and permits, helping to ignite its economic boom. Red tape, however, still trips up businesses in sectors where regulatory agencies remain powerful, despite being staffed by bureaucrats with inadequate knowledge of the areas they supervise.

Surinder Singh, the controller general of the federal-government agency that oversees drug approvals, including clinical trials, didn't respond to phone messages and faxes seeking comment for this article.

Some industry experts predict private-sector pressure will eventually force government overhauls to overcome India's regulatory system. In the case of the nation's drug companies, industry studies predict the country will become a center for conducting research and clinical trials, mainly because of its population of more than one billion people, many of whom are in need of medical care and can be quickly recruited for clinical trials.

In addition, companies would be able to recruit India's large pool of doctors and scientists, who work for a fraction of the salaries paid in Europe or the U.S. to perform the chemistry and animal experiments needed for drug development and trials.

IndiPharm, a U.S.-based clinical-research organization, predicts that 15% of all global drug trials will be conducted in India by 2011, up from just 1% in 2005. By 2010, India will command $550 million of a $24.2 billion global clinical-research market, projects Cygnus Business Consulting & Research, a Hyderabad-based business-consulting firm.

Believing in India's potential to become a huge clinical-trial center, Somesh Sharma, managing director of Piramal Life, joined the company in 2000 after working in drug development at several U.S. biotechnology companies for more than 20 years.

Piramal Group tapped Dr. Sharma to help the company develop its own original products. The company has so far developed four experimental drugs in cancer and diabetes, among other areas, executives say. "If we can do drug development in half the time at half the cost here, we can truly change the drug-development paradigm," Dr. Sharma said in a recent interview.

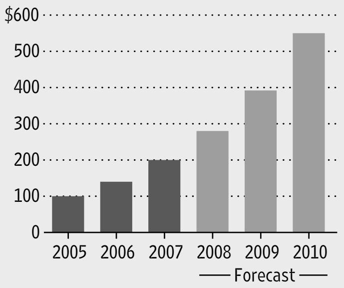
But for all India's potential, the big problem is that it still lacks the regulatory capability to quickly evaluate and approve initial clinical trials of potential new medicines in humans, Dr. Sharma and other industry executives say. Among other things, this requires regulators to understand and interpret the results of animal experiments, a skill that local agencies haven't had a chance to develop.

"The capacity still doesn't exist in India to evaluate animal studies to approve the first trials in man," says Dilip G. Shah, secretary-general of the Pharmaceutical Alliance of India, a Mumbai-based industry group.

One reason is that India didn't have strong enough patent laws in place to protect and encourage pharmaceutical innovation until 2005. As a result, no new drug developed by local or foreign pharmaceutical companies has ever been first approved in India.

Expanding business

Indian clinical research market, in millions of dollars



Source: Cygnus Business Consulting & Research

Indian pharmaceutical companies have begun pushing harder to overhaul regulatory procedures and improve training for the bureaucrats who review and rule on drug approvals and clinical trials.

Dr. Piramal, who is also vice president of the Associated Chambers of Commerce and Industry of India, a national industry group, wrote last month to Indian Prime Minister Manmohan Singh, asking him to ensure regulatory authorities will support the industry's efforts to innovate.

Among other things, she said, regulators need to set up specialized committees to review new-drug applications by therapeutic category. Dr. Piramal also urged the government to team up with foreign regulatory authorities to ensure Indian regulators get adequate training.

—Krishna Pokharel in New Delhi contributed to this article.

CORPORATE NEWS

Sentiment may hurt Disney parks

Crowds could shrink if mood of consumers darkens as expected

By Peter Sanders

Walt Disney Co.'s theme-park and resort unit has coasted through months of mounting U.S. economic woes, but an expected decline in consumer confidence could hurt even resilient vacation spots like Walt Disney World.

In late July, company officials said September bookings at Disney's U.S. resorts were on par with last year, and that bookings for the holiday season were slightly ahead.

The company hasn't provided any updated booking information since then. But analysts and other industry observers expect the global economic situation to soften demand for rooms at the company's resorts and attendance at its parks in early 2009.

So far this year, a weak dollar has succeeded in luring crowds of international visitors to Disney theme parks in Orlando, Fla., and Anaheim, Calif. During a July 30 conference call to discuss the company's fiscal third-quarter earnings, Disney executives said that while overall attendance was down slightly at both parks, the business was generally defying predictions that it would be hit hard by high gasoline prices, the U.S. housing slump and general economic malaise.

Bob Iger

"We aren't immune to the challenging economy, but we continue to be pleased with the level of business activity we've seen so far," Disney Chief Executive Bob Iger told analysts on the quarterly conference call. "The parks' performance has been particularly noteworthy."

Mr. Iger added that visits to Walt Disney World area also unlikely to be affected by a continuing reduction in airline seat capacity, noting that less than 50% of visitors to Disney World arrive by plane, and those that do tend to book their seats early when seats are plentiful.

Disney officials declined to comment on what impact economic turmoil could have on the parks operations. Disney is scheduled to report its fourth quarter and full year fiscal earnings on Nov. 6.

For the third quarter ended June 28, revenue from the parks and resorts unit rose 5% to $3.04 billion, compared with the year-earlier period. Net income for the quarter was $1.28 billion, or 66 cents a share, up from $1.18 billion, or 57 cents, a year earlier. Revenue increased 2% to $9.24 billion.

In late-afternoon New York Stock Exchange composite trading, Disney was up 93 cents, or 3.1%, at $30.66.

The company typically offers promotions and discounts during "off-peak" periods, in the early fall, for example. But in July, Mr. Iger said the company hadn't increased discounting, compared with the year earlier, and other officials said at the time that the average nightly rate at the company's hotels was "at or above" what it was in 2007.

Analysts and industry observers, meanwhile, say Disney would be better-positioned to withstand a tourist slump now than during previous recessions because the Burbank, Calif., entertainment concern has diversified enough beyond the theme-park business to reduce its exposure.

"Disney looks very different now than it did in 1991 or even after Sept. 11, [2001] because now theme parks are only about 20% of their business, whereas in 1991 it was about 50%," said Rich Greenfield, analyst a Pali Capital in New York. "But the bigger issue of what's going on in international markets certainly continues to raise concerns about sustaining attendance numbers."

Matsushita looks beyond Japan for growth

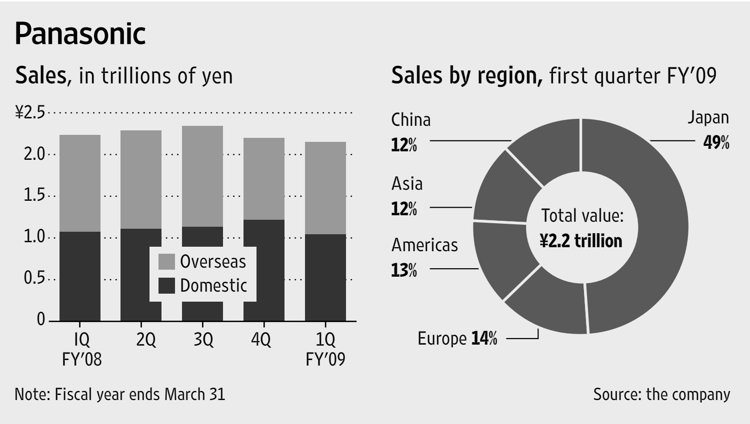
By Yukari Iwatani Kane

OSAKA—Matsushita Electric Industrial Co. discards its 90-year-old name Wednesday and recasts itself as **Panasonic** Corp., a change that comes as the electronics giant moves to lessen its reliance on the stagnant Japanese market to focus more overseas.

Matsushita's consumer electronics products, particularly its plasma televisions, are already popular throughout the world. But the company is more dependent than its rivals on the Japanese market, where the population is shrinking and growth prospects are limited. About half of its $86 billion in annual sales comes from its home market, compared with 26% for **Sony** Corp. while **Samsung Electronics** Co. gets about 20% of sales within South Korea.

"We can't compete against our rivals in growth if we stay dependent on Japan for half of our business," said Matsushita's President Fumio Ohtsubo in a rare interview. He said he embarked on the name-change project—a radical move for a company that has long revered founder Konosuke Matsushita—to emphasize a desire to change.

Matsushita's business is still strong: It nearly doubled profit to about $680 million in the April-June quarter. But that's mostly because of cost cuts. In the business year ended March 31, Matsushita's overseas sales were essentially flat and sales in Japan fell 3%.



The disproportionate focus on the Japanese market is one reason why Matsushita's brand recognition has been lower than those of its rivals. In addition, Matsushita has juggled three disparate brand names—Matsushita, National and Panasonic—which weakened its image further. In the latest annual survey of global brands by consultancy Interbrand, Panasonic came in at No. 78 with a brand value of $4.28 billion. That compared with Samsung at No. 21 with a value of $17.7 billion and Sony at No. 25 with a value of $13.58 billion.

Going forward, all the company's products—from DVD players to dishwashers—will carry the Panasonic brand. While Panasonic is well known globally, the company has long been known by its name Matsushita in Japan, and National is the brand it has used for its home appliances. Analysts say the change allows the company to focus its marketing efforts and save costs.

"It's good to focus management resources on the more useful brand," says Takaaki Umezawa, a managing director in Japan for A.T. Kearney.

Matsushita is launching its new global focus at a particularly challenging time. The global electronics market is increasingly crowded with new competitors, including upstarts like **Vizio** Inc., which sells cut-rate products by contracting manufacturing. What's more, global demand is slowing in the wake of the turmoil in the U.S. financial industry.

In addition to its mainstay consumer electronics business, Mr. Ohtsubo said the company expects to find potential growth globally in the home-appliances business. Though profit margins tend to be thin, Matsushita has maintained 9% profit margin in that business—the highest among all of its units—by selling compact, low-energy products. While most of its home appliance sales outside Japan has been in Asia so far, the company plans to start selling air conditioners, refrigerators, and washing machines—its three main appliance products—in Europe by March.

The 63-year-old Mr. Ohtsubo, who has spent 37 years at Matsushita and took over the top job two years ago, has already taken some steps to globalize the company. Matsushita, which only had one non-Japanese executive officer before, added two more last year. He also appointed a team of advisers from outside the company last month from the U.S., Brazil and India to provide an outside perspective on how to manage a business in different parts of the world.

On a smaller scale, Matsushita held a monthly executive meeting in China in May, its first one outside of Japan. Mr. Ohtsubo says he's also encouraging more employees to take business trips overseas. He himself takes such trips eight or nine times a year.

While these are still small steps, Mr. Ohtsubo said it is only the beginning. "We are going to change very fast," he says. "We have to."

—Miho Inada contributed to this article.

Paramount to distribute Marvel Studios films, such as 'Iron Man 2'

By Lauren A.E. Schuker

Viacom Inc.'s Paramount Pictures will test whether comic book superheroes can make up for the loss of superstar director Steven Spielberg.

Paramount announced an agreement Monday with Marvel Studios to distribute all four of its coming feature films through 2011, including "Iron Man 2," a sequel to this summer's breakout hit, as well as "The First Avenger: Captain America" and "The Avengers." The deal also includes distribution of a fifth movie, "Iron Man 3," if the studio decides to produce it.

Paramount now has room in its film slate after recently learning that Mr. Spielberg and his DreamWorks team would leave the studio to start a joint-venture with India's **Reliance ADA Group**.

Marvel Studios, which is a subsidiary of **Marvel Entertainment** Inc., only recently began producing and financing films based on its stable of comic-book superheroes. Its first effort, "Iron Man," became an overnight success, grossing more than $300 million at the U.S. box office.

The success of "Iron Man" for both parties sparked the new deal between Marvel and Paramount. To distribute that film, Paramount took a fee equivalent to 10% of the revenue.

"Our collaboration got off to a fantastic start with 'Iron Man,'" said Rob Moore, vice chairman of Paramount. The new arrangement, Mr. Moore adds, is a "great deal for Paramount as Marvel has as good a creative and commercial track record as anyone in the movie business," he added.

Under the new arrangement, Paramount will take a slightly lower fee, collecting about 8% of revenue. That is in part because Marvel's movies are in high demand as the film industry tries to cash in on films based on comic-book characters, like "The Dark Knight," which have been box-office hits.

"We had some built-in flexibility for where to distribute our feature films," said David Maisel, chairman of Marvel Studios. "So we got improved economics for this new arrangement."

GLOBAL BUSINESS BRIEFS

PepsiCo Inc.

Profits decline in quarter amid weakening economy

Pepsi Bottling Group Inc. said its fiscal third-quarter net income fell 11%, reflecting slowing demand in a weak global economy and a tax-related gain in the year-earlier period. The world's largest bottler for **PepsiCo** Inc. reported net for the quarter ended Sept. 6 of $231 million, or $1.06 a share, down from $260 million, or $1.12 a share, in the year-ago period, which included a net tax benefit of 14 cents a share. Revenue rose 2.3%, to $3.81 billion from $3.73 billion. The Somers, New York, company had predicted earnings of $1.02 to $1.06 a share on revenue growth of 3%.

OAO Polyus Gold

The board of Russian gold producer OAO **Polyus Gold** on Tuesday approved the purchase of a 50.1% stake in Kazakhstan's **KazakhGold Group** Ltd., a spokesman for the Russian company said. Polyus will offer KazakhGold 70% of the total in its shares and 30% in cash, **Onexim Group**, which owns about 30% of KazakhGold, said in a statement. Onexim, which is owned by Polyus Chairman Mikhail Prokhorov, declined to provide further details on the deal. KazakhGold said Monday that Polyus could offer about $780 million, or $14.73 a share—made up of $7.95 a share in cash and 0.298 Polyus Gold share for every KazakhGold share.

Entergy Corp.

Entergy Corp. expects storm-damage costs from Hurricane Ike to run between $525 million and $625 million, though the U.S.'s second-largest nuclear generator reiterated that its "total liquidity is sufficient to meet current obligations." The New Orleans-based company said two weeks ago that it couldn't yet determine Ike costs, though it estimated damage from Hurricane Gustav at $500 million to $600 million. Entergy reiterated that the storms will cut third-quarter revenue and that it can raise more than $6 billion to cover obligations.

Washington Post Co.

Washington Post Co. announced the acquisition of Foreign Policy, a magazine devoted to international affairs and economics, from the Carnegie Endowment for International Peace. The magazine, which has a circulation of 100,000, draws little advertising but has an influential readership in academia and policy circles. Moises Naim, the current editor and publisher, will stay on as editor in chief. Terms of the deal weren't disclosed. Foreign Policy will become part of the business unit that includes Washington Post's online magazine Slate.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

U.K.

As money is pulled out, pressure on pound grows


Shutterstock

BRITAIN'S current-account deficit doubled in the second quarter, adding pressure onto the pound and new worries for the Bank of England.

Combined with the government's deteriorating public finances, a widening current-account gap could further depress sterling. The Office for National Statistics said Britain's current account deficit widened to £11 billion ($20 billion) from £5.5 billion in the first quarter, as investors unwound stakes in the U.K. financial sector. Separate data showed U.K. economic growth ground to a halt in the second quarter, while business investment saw its second straight quarterly decline. *—Joe Parkinson*

ITALY

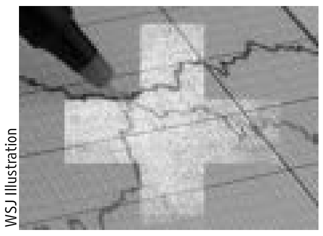
Police descend upon mob, gangland-killing suspects


AFP

ITALIAN POLICE made sweeping arrests against the mob, targeting a powerful clan as well as three suspects linked to a recent gangland-style slaying of six African immigrants near Naples. In a series of raids in Naples and surrounding areas, where the Camorra crime syndicate is based, police also seized assets valued at €100 million ($143.5 million) and weapons, police and government officials said. Interior Minister Roberto Maroni hailed the operation as a serious blow to the Camorra organization. More than 1,000 officers were involved in the arrests of 26 suspects believed to be part of a Camorra clan. *—Associated Press*

SWITZERLAND

Current-account surplus shrank in second quarter


WSJ Illustration

SWITZERLAND'S current-account surplus fell more than 50% in the second quarter from a year earlier because losses at banks' foreign subsidiaries due to financial-market turmoil led to a sharp drop in income from direct investment, the Swiss National Bank said.

At 10 billion Swiss francs ($9.19 billion), the current-account surplus was half the figure for the second quarter of 2007. The decline was due largely to investment income's dropping 13 billion francs. Trade in goods and services, by contrast, remained dynamic, with the income surplus expanding three billion francs to 16 billion francs. *—Anita Greil*

Pakistan turns to tribal militias for help

Regional fighters begin combating pro-Taliban groups

BY ZAHID HUSSAIN
Bajaur, Pakistan

THE PAKISTANI army is backing tribal militias that are rising to battle pro-Taliban groups, a development that the government hopes will turn the tide against insurgents here in the embattled northwest.

Pakistan's military and intelligence agencies say recent antigovernment violence, including Sept. 20's deadly bombing of the Marriott Hotel in Islamabad, which killed 53, is rooted in Islamist strongholds along the border with Afghanistan, in districts like Bajaur.

The militant groups here—Pakistanis allied with Taliban and al Qaeda guerrillas in Afghanistan—are trying to carve out Islamist enclaves along the border. To fight them, the government has deployed more than 8,000 troops in the Bajaur region. The army says it has killed 1,000 militants in the six weeks since the campaign started. But a steady supply of Islamist guerillas is pouring in from Pakistan and Afghanistan, and the fighting shows little sign of abating.

The tribal militias could provide a counterweight. "The tribesmen have risen against the militants. It could be a turning point in our fight against militancy," says Owais Ghani, governor of North West Frontier Province. The province is "providing them financial as well as moral support," he says.

A senior military officer calls Bajaur "the center of gravity of the militant movement." Military commanders say the struggle for control of the tribal region is crucial to containing the spread of Islamist militancy to other parts of northwestern Pakistan.

"The threat of Bajaur radiates in all directions and affects the entire region," said Maj. Gen. Tariq Khan, the commanding officer of the military campaign in the region, last week.

The army-backed militia movement has similarities with the Sunni awakening in Iraq, where U.S.-supported Arab tribesmen turned against al Qaeda fighters, says Tanveer Ahmed Khan, chairman of the Pakistan Institute of Strategic Studies.

But some analysts worry the emergence of the militias could escalate fighting in the border region into a mini-civil war, pitting pro- and anti-Taliban Pakistanis against one another.

In the past few weeks, militias have emerged in the Kurram and Khyber tribal areas along the border with Afghanistan, as well as in the Dir district in North West Frontier Province, according to residents and officials. Initially, the Lashkars, as the militias are known, were organized as indigenous resistance groups without help from local government administrations, but now

both the military and the provincial government support them.

Malik Munasib Khan, the white-bearded chieftain of the Salarzai tribe, leads one of the largest new militias. Sporting a white skullcap and toting an old Soviet-made Kalashnikov rifle, Mr. Khan exhorts villagers to fight the estimated 4,000 militants who have moved into the Bajaur district during the past year.

"They are killing our people and destroying our land," he told hundreds of men gathered at a dusty market surrounded by mud houses in the village of Raghagan last Friday.

The tribesmen—armed with machine guns and rocket launchers, some dating from the Soviet Union's occupation of Afghanistan in the 1980s—responded with shouts of "Allahu akbar!" or "God is great."

The Salarzai militia claims to have 4,000 armed fighters under its control, a figure the Pakistani military says it believes is accurate. Militia leaders say they have driven Afghan Taliban and al Qaeda fighters and other militants out of their region, torching their homes and installations. "We will not let any Taliban enter our area," says Ayaz Khan, a member of the militia.

Initially, some in the Salarzai tribe—one of five main tribes in the Bajaur district—had been sympathetic to the Islamists, who had promised to restore law and order to the loosely governed semiautonomous tribal area. But many rebelled after the militants tried to impose a harsh system of Islamic rule on the local population. "Every family was asked to give one male member for fighting. They would forcibly take people from their houses," says militia member Mr. Khan.

Euro-zone consumer-price inflation eases

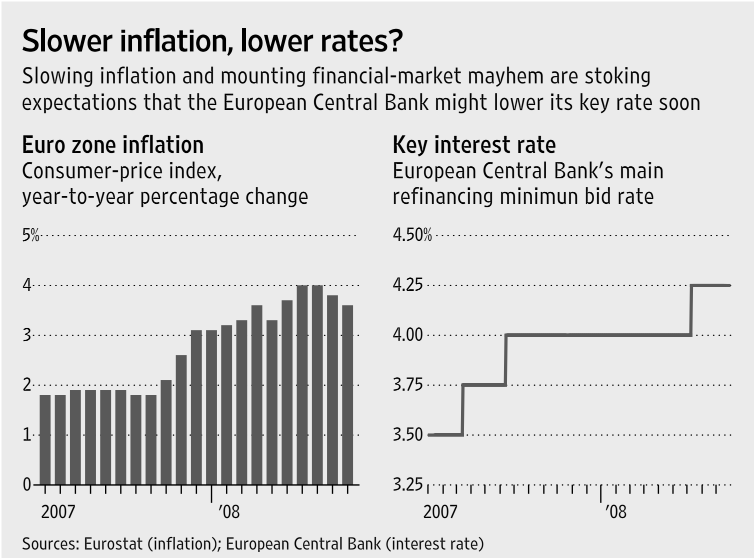
BY EMMA CHARLTON
AND JOELLEN PERRY

Euro-zone consumer-price inflation eased for the second month in September, increasing expectations the European Central Bank at its meeting Thursday will acknowledge the mounting risks to growth posed by financial-market turmoil.

The annual rate of consumer-price inflation in the 15-country area fell to 3.6% in September, down from 3.8% in August, according to European statistics agency Eurostat. Slowing inflation, the U.S. House of Representatives' rejection of the $700 billion bailout plan and the rescue of four European banks this week raised economists' expectations that ECB policy makers might cut their key rate soon.

"In the current environment, it's becoming increasingly difficult for the ECB to maintain the view that inflation remains the predominant concern," said Marco Valli, an economist at UniCredit Markets & Investment Banking. "Our projections for the euro area see consumer prices dropping below 3% early next year and bottoming out at 1.8% in July 2009."

ECB policy makers have said the euro-zone slowdown will be steeper



Sources: Eurostat (inflation); European Central Bank (interest rate)

than they had expected but have maintained inflation remains their top priority. While the U.S. Federal Reserve has cut its key rate to 2% from 5.25% in September, 2007, the ECB raised its key rate in July to a seven-year high of 4.25% to combat inflation pressures. At 3.6% in September, inflation is well above the ECB's preferred level of just below 2%.

But amid mounting financial-sector mayhem in Europe, signs inflation may have peaked could give policy makers scope to acknowledge mounting risks to euro-zone growth. In recent days, Dutch-Belgian bank **Fortis** NV, Belgium's **Dexia** SA and German commercial property lender **Hypo Real Estate Holding** AG have gotten government support. The Irish government issued sweeping deposit guarantees Tuesday to safeguard the country's banking system.

"The direct spillover from U.S. markets and rising global risk aversion is clear," said Signe Roed-Frederiksen, an economist at Danske Bank. "Global growth prospects decline every day the crisis rages on, and confidence in banks around the globe is crashing."

Interest-rate futures Tuesday suggested a 56% chance of a quarter-point cut at the ECB's meeting Thursday, but most economists in a recent Reuters survey said they believe policy makers won't lower their key rate until later this year or early next year.

Among signs of slowing prices, French producer prices fell 0.5% on the month in August after rising 0.7% on the month in July, French statistics office Insee said Tuesday.

Euro-zone money-market tensions are also worsening, which could increase pressure on policy makers to consider cutting rates. Amid fears of default, banks are making heavy use of the ECB's overnight lending and deposit facilities, rather than entrust their cash with other banks. The interest rate on the ECB's overnight dollar auction also surged to 11% from 3% on Monday, a sign banks are desperate for cash.

Parents in China file suit over tainted milk

First reported claim seeks compensation for sick 1-year-old

By Sky Canaves And Juliet Ye

HONG KONG—The parents of a 1-year-old boy allegedly sickened by tainted milk powder filed a lawsuit against the manufacturer, according to state media, in what appears to be the first challenge to official efforts to keep the scandal out of China's courts.

China's official media and the family's lawyers said the suit, filed in a court in Zhenping county in Henan province, was the first filed in relation to illness caused by milk tainted with the industrial chemical melamine. The suit was filed last week against dairy company **Shijiazhuang Sanlu Group** Co., but has yet to be accepted by the court. As is common in China, the filing isn't publicly available.

Sanlu's officials couldn't be reached for comment. China's companies and government offices are closed this week for a holiday.

The family's attorneys, Zhang Xingkuan and Ji Cheng of Beijing's Deheng Law Office, declined to disclose the names of their clients. Mr. Zhang said they are seeking compensation of 150,000 yuan ($21,900) to cover hospital fees, travel expenses, time off from work and other costs. The attorney said that the parents claim the boy developed kidney stones from drinking Sanlu, and that they had more than 90 empty bags of Sanlu milk powder their son had consumed as proof.

On Sept. 13, Chinese authorities promised free treatment to all children sickened by tainted dairy products, although detailed guidelines on eligibility for treatment haven't been made public. Some hospitals have narrowly interpreted the obligation to provide care at no cost.

For parents such as Mr. Zhang's clients, who have been paying out-of-pocket for their son's medical care since June, the government's promises haven't helped, said Mr. Zhang. He said the family was instructed by the Beijing hospital where their son was transferred to seek reimbursement back home in Henan.

The Chinese government has been struggling to contain the scandal over the contamination of dairy products, which has led to the deaths of as many as four children in China and sickened more than 54,000. On Sunday, Prime Minister Wen Jiabao said the government would fix the domestic dairy industry.

AFP

A market in Nanjing, China, makes **copies of test reports** available to customers to verify that dairy products are free of melamine contamination.

Product liability suits are rare in China's developing legal system, although the Chinese are becoming increasingly aware of their legal rights in pursuing cases.

Because courts and even private lawyers aren't independent of the government, officials often take a direct role in dealing with victims in high-profile incidents. In the aftermath of May's Sichuan earthquake, the parents of children who died in collapsed schools were dissuaded from turning to courts while the government conducted investigations.

The Sanlu lawsuit comes as some lawyers who offered to assist families of sickened children report being pressured to stay away from the issue. Beijing lawyer Li Fangping, who organized a group of over 120 volunteer lawyers around China to provide free legal advice to families affected by tainted milk, said he has received numerous calls from lawyers in the volunteer network who said they are facing pressure from local officials to refrain from getting involved.

"The situation has been very critical," said Mr. Li, "especially in Henan province." Mr. Li said he was summoned by Beijing judicial authorities on Monday to discuss his work and was instructed to await their reply on how to proceed.

The All China Lawyers Association, the official bar association that acts as an intermediary between its members and the government, couldn't be reached for comment.

Mr. Zhang said he isn't involved with the volunteers and hasn't been told to drop the case against Sanlu. "My partner and I will continue working with the parents," he said.

On Tuesday, more products with Chinese-made ingredients were recalled outside of mainland China. Unilever Hong Kong Ltd, a subsidiary of the Anglo-Dutch consumer-products giant **Unilever**, said it would recall four batches of Lipton milk tea powder sold in Hong Kong and Macau after its tests found melamine in the products. Unilever spokesman Trevor Gorin said the scope of the recall was "relatively contained."

Hong Kong authorities also said they found tainted Pocky Men's coffee-cream-coated biscuit sticks made by **Ezaki Glico** Co. of Japan, and tainted coconut and walnut cakes from **Tian Le Yuan Foods** Co. of China.

South Korean health authorities said they found melamine in Ritz cheese sandwich crackers made by Nabisco. A spokesman for **Kraft Foods** Inc., which owns Nabisco, said that the Ritz crackers in question were made in China and sold only in South Korea.

—Aaron O. Patrick in London contributed to this article.

U.S. Pentagon seeks to sell new fighter jets to Israel

By August Cole

The U.S. Defense Department formally notified Congress that it wants to sell Israel as many as 75 of the latest model fighter jet, which is being developed under a contract led by **Lockheed Martin** Corp.

A sale could be worth as much as $15 billion. It would mark the first order from outside the original team of countries working on the F-35 Lightning II, also known as the Joint Strike Fighter.

The aircraft is designed to replace an array of fighter and attack jets in the American arsenal. Many foreign buyers use those same planes and also are seeking to upgrade. Lockheed is the lead contractor, and the engines for the jets will come from either **United Technologies** Corp.'s Pratt & Whitney unit or **General Electric** Co.

According to the Pentagon, the F-35 program will cost almost $300 billion to develop and buy about 2,400 planes, including different versions of the aircraft for the Air Force, Navy and Marines.

Israel has indicated that it wants at least 25 jets based on the Air Force version. It may buy an additional 50 jets, which could include a model being developed for the Marines that is capable of short takeoffs and vertical landings. The deal includes spare parts and services.

In its announcement, the Pentagon's Defense Security Cooperation Agency said it told Congress last week about the possible sale. For Israel, the agency said, the planes will "enhance its air-to-air and air-to-ground self-defense capacity." Such a deal won't "affect the basic military balance in the region," according to the agency.

A Lockheed spokesman said the sale "would be an important first step in expanding interest in the Joint Strike Fighter beyond the U.S. government and eight international F-35 partner nations."

Foreign sales of the F-35 are key for Lockheed and the Pentagon, which hopes to keep costs down by spreading them out over more planes. Eight U.S. allies, including the U.K. and Australia, are involved in developing the plane and likely will buy jets as well.

The U.S. is expected to get the first deliveries in 2010. Other countries would receive them in batches in subsequent years.

The announcement marks the latest in a series of significant U.S. arms sales to the region. Iraq is interested in advanced tanks, fighters and helicopters and has more than $10 billion of U.S. weapons deals lined up. The United Arab Emirates is set to get sophisticated antimissile systems worth more than $7 billion.

If Israel gets F-35s, its air force will operate the most advanced planes in the region.

Corporate News

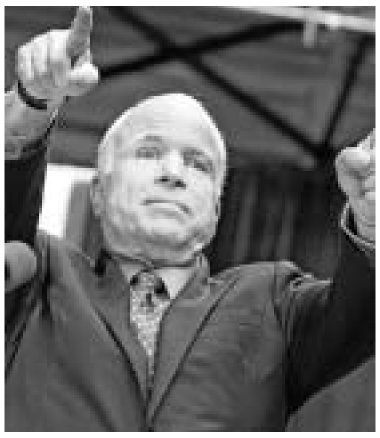
New moniker

Matsushita renames itself Panasonic as it shifts focus outside Japan > **Page 7**

ECONOMY & POLITICS

Rivals try to skirt fallout

Both U.S. candidates had offered support for bailout package

Associated Press

Sen. Barack Obama, left, and Sen. John McCain **each blamed the other** for the House of Representatives' vote against the financial rescue package on Monday.

By **Amy Chozick** *in Westminster, Colo., and* **Elizabeth Holmes** *in West Des Moines, Iowa*

John McCain and Barack Obama struggled to mitigate the political damage of the U.S. House of Representatives' rejection of the financial rescue package for a second day Tuesday, but it was unclear whether either would gain an edge in the finger-pointing.

Both men had tepidly supported the plan Sunday, saying it was an unpleasant package but necessary for the health of the economy. Now, both face difficult political choices, as they try to balance appeals to the widespread anger over the "bailout"—and the fear of letting markets continue to sink if it fails. Sen. McCain arguably has more to lose, after inserting himself into the negotiations late last week with a dramatic move to suspend his campaign.

Sen. McCain on Monday blamed the Democrat-led Congress for failing to pass the measure. Democrats blamed the Republican standard-bearer for failing to rally more members of his party, especially after a boast at a campaign event Monday morning that he had saved the measure, before it became clear the package would fail.

"Sen. Obama and his allies in Congress infused unnecessary partisanship into the process," Sen. McCain said at a stop in Iowa on Monday.

Democrats were noted that while a majority of House Democrats backed the bill, only a third of House Republicans did. And while Sen. Obama has been largely hands-off as Congress wrestled with the package, Sen. McCain has tried to be more directly involved in the negotiations, and connected himself with the results.

Sen. Obama offered his strongest support yet of the package on Tuesday, saying he planned to talk to members of Congress and "urge them to act without delay to pass a rescue plan."

Sen. McCain had worked the phones all weekend, which his aides say helped bring the more than 60 House Republican votes in favor of the bill. Yet four of the 11 members he talked to didn't vote in favor it.

At a campaign rally in Ohio Monday morning, the Arizona lawmaker claimed credit for what, at the time, seemed like the successful completion of the bill. "I put my campaign on hold for a couple of days last week," he said, "to fight for a rescue plan that puts you and your economic security and your family and working Americans first."

Minutes after news broke of the failed bailout bill, Sen. Obama took the stage at a rally and attacked Republican leadership and the underlying problems that led to the crisis.

CAPITAL JOURNAL ▪ GERALD F. SEIB

Dysfunction in Washington exacts a heavy price

THE U.S. has learned in recent weeks the price of financial failure. Now it will learn the price of political failure.

The collapse of the financial-rescue package in the House on Monday may well be reversed, at some point. Discouraged House leaders sounded as if they hoped the Senate could lead Congress back out of the wilderness in the next few days, giving the plan a second crack at passage.

But even if senators manage to revive the bailout plan, a great deal of damage already has been done:

American voters, who didn't like the plan in the first place, will like even less the discovery that Washington's response to their concerns was to collapse into genuine dysfunction. Three-quarters of Americans already think the country is on the wrong track, and the same share disapproves of the job Congress is doing. Before Monday, it seemed unlikely those numbers could go much higher. They can, and now probably will.

Beyond that, the hope that Washington had gotten the message in this campaign year that Americans were yearning for an end to gridlock and partisan warfare has been shattered. There will be plenty of blame to go around. House Republicans demanded changes in the plan last week, got some of them, and yesterday delivered just 65 votes—a third of their members—for a rescue package that their party's president, their party's Treasury Secretary and their party's House and Senate leadership all called vital to the nation.

Then on Monday, it was Democratic House Speaker Nancy Pelosi's turn to hurt the effort. She chimed in with a bizarrely timed and distinctly partisan floor speech blaming Republicans for the market mess, minutes before her party needed scores of Republican votes to make the bailout work. Whether she turned votes against the plan, or gave Republicans a convenient excuse to vote against it, was being debated in the Capitol Monday. Either way, the atmosphere is even more sour as a result.

AS IT HAPPENS, Democratic leaders also failed to convince 95 of their members to back the plan, showing that the splintering of support was widespread in the halls of Congress.

Now, though, the consequences of simultaneous political and economic breakdown ripple beyond Wall Street and Washington. The effects could be global.

The U.S.—meaning both parties and the public and private sectors—has to worry about what global investors make of the picture of disarray they now see in the U.S. That's a crucial consideration because the U.S. now depends on foreign capital to finance both a trade deficit of more than $700 billion and a $400 billion federal budget deficit. Today, foreign lenders hold about half of America's public debt, and the nation relies on them to finance more than 70% of its new debt, the nonpartisan Peter G. Peterson Foundation estimates.

The reason foreign investors have been willing to pony up this cash has been their longstanding belief that the U.S. system—financial and political—makes America the ultimate safe haven.

At what point does that basic belief start to erode? And what are the consequences of that possibly happening? The question is even more acute because of the likelihood that even more foreign capital will be needed, at least in the short term, to help the government finance the very bailout now being debated.

The more immediate question is what happens now. In the House, many of the Republicans who voted against the rescue bill actually sounded more eager afterward to get something done than they did beforehand.

But the atmosphere now is somewhere between tense and toxic. House Republican leader John Boehner said Rep. Pelosi's speech, in which she blamed the "right-wing ideology of anything goes" for bringing about the market crisis, had "poisoned" the atmosphere among his troops.

DEMOCRATIC CAUCUS leader Rahm Emanuel countered that such a charge masked a more basic Republican failure to deliver the votes needed for a measure that failed 228 to 205. Democrats "delivered 140 votes; we were supposed to deliver 125," Rep. Emanuel said. "They were supposed to deliver 100 votes. They delivered 65."

In normal times, the burden of picking up the pieces would fall on the president and his Treasury secretary. But President George W. Bush is mired in lame-duck status and has shown little ability to move House Republicans, except perhaps for the chamber's leaders. And in the aftermath of the House revolt Monday, rank-and-file Republicans didn't voice much more respect for Treasury Secretary Henry Paulson, architect of the rescue plan, than they did for their Democratic foes.

Now the hopes for action shift to the Senate, where support for the Paulson approach is far stronger. The bill the House defeated likely could pass the Senate with some votes to spare. But that isn't enough; the need is to adjust that plan in a way to attract House Republicans. That might be done by playing up provisions House rebels prefer, such as greater reliance on insurance of bad debt rather than government assumption of such debt, and changes in accounting rules that will limit the hit financial firms have to take on their balance sheets if they choose to hang onto shaky debts.

Starting now, though, another highly unusual dynamic comes into play. Both of the major-party presidential nominees are members of the Senate, where the fate of the bailout may well be determined. It isn't unreasonable to expect them to show some presidential-caliber leadership. It's an unusual role for presidential candidates to play, but the times are unusual indeed.