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AIG survival in doubt as rescue bid fails

U.S. government seen as last hope to save crumbling global insurer

By **Matthew Karnitschnig**, **Sudeep Reddy**, **Jeffrey McCracken** *and* **Serena Ng**

An attempt to raise as much as $75 billion for **American International Group** Inc. from private-sector banks has failed, people familiar with the matter say, making it increasingly unlikely that the insurer will be able to survive without some government intervention.

Officials from the U.S. Treasury and Federal Reserve planned to meet with U.S. President George W. Bush on Tuesday afternoon at the White House to discuss the situation, but it remained unclear whether a government-led rescue was in the offing.

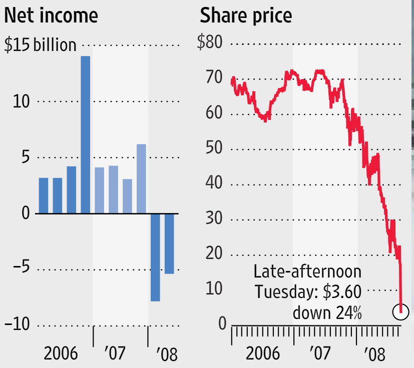
In preparation for a possible bankruptcy filing, AIG has hired New York law firm Weil Gotshal & Manges to advise it. Weil is also working for **Lehman Brothers Holdings** Inc., which filed for Chapter 11 bankruptcy protection earlier this week.

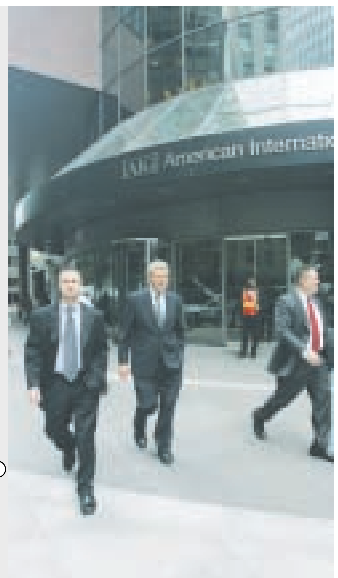
AIG's cash crisis was exacerbated Monday after ratings firms downgraded its credit ratings, forcing it to put up at least $14.5 billion

Please turn to page 31

At a loss

American International Group's New York offices Tuesday, right. Worries about the company's well-being intensified after several ratings agencies downgraded the global insurer.





Sources: the company (income); Thomson Reuters Datastream (stock). Photo: Associated Press.

Barclays to acquire some Lehman units in U.S., hire workers

By **Heidi N. Moore**, **Dana Cimilluca**, **Carrick Mollenkamp** *and* **Matthew Karnitschnig**

Barclays PLC has reached an agreement to buy the U.S. investment bank and capital-markets businesses of **Lehman Brothers Holdings** Inc. and as many as 9,000 Lehman employees will find jobs with the U.K. bank, according to people familiar with the situation. The Wall Street Journal earlier reported that Barclays would pay nearly $2 billion for a large chunk of Lehman.

The deal was to be put before a New York bankruptcy court judge for approval on Tuesday. Lehman's creditors were to meet thereafter. An official announcement wasn't expected until Wednesday morning.

The deal is expected to be structured as an asset purchase, with Barclays buying only the parts of Lehman it wants: Lehman's trading positions and any contracts that come with the business, which is likely to include pending mergers and acquisitions, as well as stock- and debt-underwriting assignments.

Barclays won't be buying any of Lehman's real estate, real-estate-backed securities, derivatives positions or over-the-counter trades. Lehman's European business will remain in bankruptcy proceedings. Lehman also is in separate talks to sell its investment-management unit to private-equity bidders.

In a twist, Lehman's much-lamented Chapter 11 bankruptcy filing may have increased the chances that the capital-markets business would be salvaged in a sale, said a person close to the deal. In weekend talks, Barclays had proposed buying all of Lehman except the investment-management business and then separating out Lehman's toxic assets along the lines of the so-called good bank/bad bank structure Lehman had been considering before the events of

Please turn to page 31

What's News—

Business & Finance

Barclays agreed to buy Lehman's U.S. investment bank and capital-markets business and hire as many as 9,000 of its employees. Meanwhile, an attempt to raise as much as $75 billion for AIG from private-sector banks apparently failed. Page 1

■ **Fed holds U.S. rates** steady but signals willingness to take action, giving it more time to weigh the effects of the latest financial turmoil. Page 1

■ **Russian share prices** plunged to their lowest levels since late 2005 amid growing fears of defaults among local banks and brokers. Page 17

■ **U.S. stocks got a boost** from talk that the government might give AIG a loan. Worries about the insurance titan had pushed European shares lower. Pages 17, 18

■ **U.S. consumer prices fell** 0.1% last month, the first decline in two years, driven by a 3.1% drop in energy prices. Page 2

■ **Goldman Sachs logged** a 70% profit drop as business slowed across the board and it posted losses on the sale of soured real-estate assets. Page 2

■ **World funding markets** ground to a halt, with short-term interest rates soaring as banks raced to ensure they had sufficient cash. Page 3

■ **Gucci chief Mark Lee** is stepping down as the fashion house struggles. Page 27

Markets 4 p.m. ET

MARKET	CLOSE	NET CHG	PCT CHG
DJIA	11059.02	+141.51	+1.30
Nasdaq	2207.90	+27.99	+1.28
DJ Stoxx 600	263.54	-7.14	-2.64
FTSE 100	5025.6	-178.6	-3.43
DAX	5965.17	-98.99	-1.63
CAC 40	4087.40	-81.57	-1.96
Euro	$1.4125	-0.0072	-0.51
Nymex crude	$91.15	-4.56	-4.76

Money & Investing > Page 17

World-Wide

Ukraine's ruling coalition collapsed, deepening a political crisis that has clouded Kiev's NATO prospects. The pro-Western alliance of President Yushchenko, who accused Russia of trying to destabilize Ukraine, and Prime Minister Tymoshenko unraveled over nine months. Page 8

■ **Pakistan said** its troops had orders to fire on U.S. soldiers if they mount raids from Afghanistan, ahead of a meeting with the top U.S. commander. Page 9

■ **Gen. Petraeus stepped aside** as Gen. Odierno became the top U.S. commander in Iraq. Page 9

■ **The U.S. coalition commander** in Afghanistan said he has too few ground troops, and even the reinforcements announced by Bush last week are insufficient.

■ **China said** further sanctions on Iran threatened by the U.S. and others won't resolve an impasse over Iran's refusal to cooperate with a U.N. nuclear probe.

■ **Pilots of a Spanair jet** that crashed last month in Madrid on takeoff, killing 154 people, failed to extend wing flaps. Page 6

■ **Bolivian soldiers arrested** an opposition governor, as the U.S. evacuated its Peace Corps volunteers amid a political crisis.

■ **Suspected drug-gang hitmen** threw two grenades into an Independence Day crowd in Mexico, killing at least eight and wounding more than 100.

■ **French troops rescued** a couple whose yacht was hijacked off Somalia Sept. 2, killing one pirate and capturing six. Page 8

■ **Cuba has accepted** conditionally the resumption of formal political dialogue with the EU.

EDITORIAL & OPINION

Tunnel vision

From Georgia to Montenegro, the European Union foreign policy is failing. Page 13

Fed stands pat on rates, signals readiness to act

By Sudeep Reddy

The Federal Reserve, faced with a series of shocks to the U.S. financial system, left interest rates unchanged Tuesday but said it is watching developments "carefully"—signaling a willingness to take action if necessary.

The U.S. central bank, in a statement after its meeting Tuesday, said "strains in financial markets have increased significantly and labor markets have weakened further."

The Fed's policy committee voted unanimously to leave the federal-funds rate, at which banks lend to each other overnight, unchanged at 2%. It was the first fully unified vote since last September.

The decision gives the Fed more time to weigh the effects of the latest round of financial turmoil on the overall economy. Officials had hoped the broader fallout from the weekend would be limited, but they are closely watching markets—and other troubled firms—to gauge whether credit would tighten as a result.

The Fed said it would "act as needed" based on economic and financial developments. Officials were already expecting economic growth to weaken later this year. In their statement, they said tight credit conditions, the housing-sector contraction and slowing export growth "are likely to weigh on economic growth over the next few quarters."

Still, the Fed said inflation and growth risks are both "of significant concern." The statement said "inflation has been high" and the inflation outlook "remains highly uncertain." But the committee still expects inflation to moderate later this year and next year.

The Fed went into this past weekend inclined to keep rates on hold for at least several months. While the U.S. economy expanded at a strong 3.3% pace in the second quarter, growth is expected to slow sharply in the coming months. At the same time, inflation worries are receding amid declines in the prices of crude oil and other commodities. After cutting rates sharply over the past year, from 5.25% last September, central-bank officials were increasingly comfortable with giving the financial system time to recover before raising rates.

Sometime next year, analysts had predicted, the Fed would finally make a move—a rate increase. But rate cuts came back on the table—with futures markets putting strong odds on a cut Tuesday—after a dramatic 10 days that threatened to topple the U.S. financial sector and exact deeper damage on the U.S. economy. In a rapid-fire series of events that began with the government takeover of mortgage giants Fannie Mae and Freddie Mac, officials have been forced to decide quickly which firms need to be saved to ensure the continued functioning of the financial system and which ones can fail without disastrous consequences for the markets and the broader economy.

Over the weekend, Fed and Treasury officials pushed for the sale of

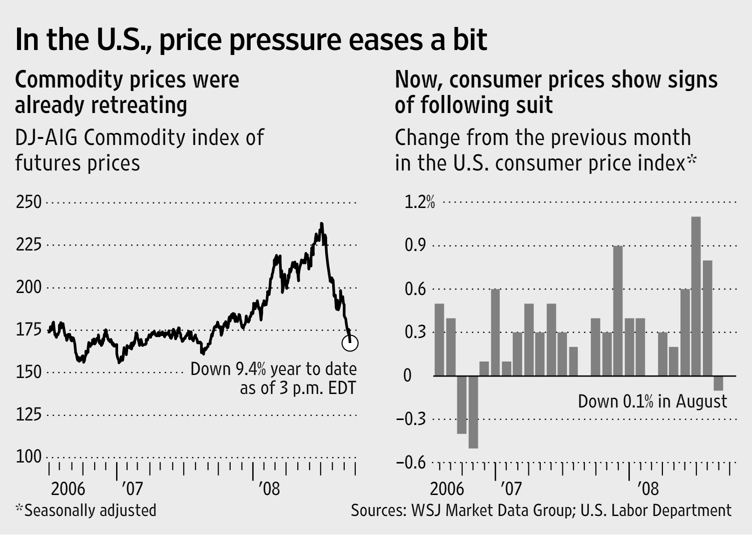
Please turn to page 30

LEADING THE NEWS

Inflation pressures ease

Oil-price drop helps give Federal Reserve more wiggle room

BY JUSTIN LAHART AND KELLY EVANS



As the credit crisis continues to wallop the economy, there is one piece of good news: Inflation is subsiding in the U.S. and many other places around the world.

U.S. consumer prices fell last month for the first time in two years, the Labor Department said Tuesday, while the consumer-price index fell 0.1% in August after rising 0.8% the previous month. A 3.1% decline in energy prices was the main force behind the overall price drop; excluding food and energy, the CPI rose 0.2%.

With price pressures easing, U.S. inflation should continue to cool in the months to come. Partly that is the result of sagging demand globally and the turnaround in the dollar, which has been climbing in value since the end of July. Damped inflation is important because it helps ease the strain of rising prices on consumer pocketbooks and company profits. It also makes it easier for the Federal Reserve to combat the weak economy by lowering interest rates.

The signs of inflation ebbing are abundant. Energy and other commodity prices were continuing to fall Tuesday, with crude oil at a seven-month low of $91.15 a barrel in late trading in New York, down from a July 3 all-time high of $145.29. Prices of imported goods slipped last month, and are expected to continue to head south.

Inflation expectations have also ratcheted lower. Households surveyed by the University of Michigan reported this month that they expect prices to advance 3.6% annually over the next five to ten years, down from the 5.1% they expected in July. When inflation expectations are lower, it becomes more difficult for companies to pass on price increases.

"Inflation, the fear seems to be passing right now," says Global Insight chief economist Nariman Behravesh. "We're going to very quickly be in a situation that it's not a problem."

The drop in price pressures has given the Federal Reserve more wiggle room on interest rates. After its meeting Tuesday, the Fed's rate-setting committee said that the inflation outlook "remains highly uncertain," but it also said it is watching the market "carefully"—signaling that it might take action if necessary.

Easing energy prices, in particular, have been a relief. Because of Hurricane Ike, gasoline prices bumped up to $3.83 a gallon in the U.S. in the week ended Monday from $3.65 a week earlier, according to the Energy Information Administration. Still, that was below the July high of $4.11. Diesel averaged $4.02 a gallon last week, down from a July high of $4.76.

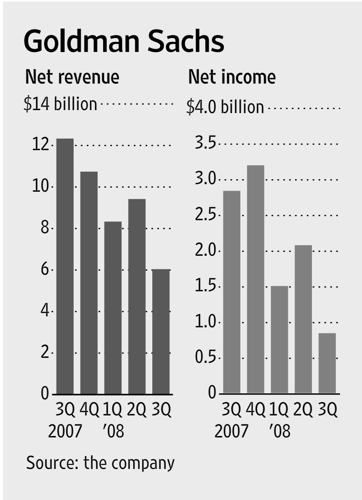
Charles Whittington, president of the trucking company **Grammer Industries** Inc. in Grammer, Ind., said he has recently reduced fuel surcharges by 10%. But he's wary of cutting more, given how volatile prices are. "Your fever has gone down from 103 to 101," Mr. Whittington said. With the recent drop, diesel is still more than $1 a gallon more than it was a year ago.

Raw-materials prices have been falling as well. Florence Wilpon, the owner of Ess-a-Bagel in New York City, who raised prices earlier this year in response to higher costs, said that a 100-pound bag of flour now costs her $46 to $47, down from $50 earlier this summer.

But a big reason for lower inflation is lower demand, so many businesses aren't celebrating the price declines. At the close of New York trading Tuesday, copper fetched $3.11 a pound, down from a July 2 high of $4.08. That's great, said Jim Bryant, owner of Vintage Copper in Salina, Okla.—but he'd much rather see orders for the custom copper cupolas and other pieces he makes for upscale homes.

Goldman feels the pinch as earnings drop by 70%

BY GREG MORCROFT AND DONNA KARDOS



Goldman Sachs Group Inc. reported a 70% decline in fiscal-third-quarter profit from a year earlier as business slowed across the board and the New York firm posted losses on the sale of soured residential and commercial real-estate assets.

Chief Executive Lloyd C. Blankfein said in a statement that Goldman "saw a marked decrease in client activity and declining asset valuations" during the quarter. The description of its business environment was a big turnaround from three months ago, when the bank said client activity was "solid" in fixed-income trading and "strong" in equities trading.

Despite tumbling markets and Wall Street turmoil that has left Goldman as one of the two remaining major independent investment banks in the U.S., Chief Financial Officer David Viniar said Goldman wouldn't change its long-term global strategy and that it has no plans to merge with or to buy a bank to expand its funding sources.

Rather, the firm would take "a more nuanced approach" in adjusting to market conditions, Mr. Viniar said in a conference call.

For the quarter ended Aug. 29, Goldman reported net income of $845 million, or $1.81 a share, down from $2.85 billion, or $6.13 a share, a year earlier. Net revenue fell 51% to $6.04 billion.

Goldman's results compared favorably with former rival **Lehman Brothers Holdings** Inc., which made a bankruptcy filing Monday. Last week, Lehman Brothers reported a fiscal third-quarter net loss of almost $4 billion after more than $5 billion of new write-downs, mostly on soured mortgage exposures.

Morgan Stanley, the other remaining large independent U.S. brokerage firm, is scheduled to report earnings Wednesday.

Goldman's investment-banking revenue slid 40%, as financial-advisory revenue dropped 56% amid a decrease in completed mergers and acquisitions. Revenue fell by two-thirds at Goldman's trading and principal-investments business and that segment's fixed-income, currencies and commodities-trading group amid weak results in credit products and mortgages. Equities revenue slumped 50%.

Meanwhile, the principal-investments group swung to a loss amid red ink from corporate and real-estate principal investments.

The asset-management and securities-services division, which includes lending and other services to hedge funds, managed to eke out a 4.3% revenue increase as a 20% jump at the securities-services segment more than offset a 5.8% decline in asset-management revenue.

CORRECTIONS & AMPLIFICATIONS

U.S. Sen. Ted Kennedy was first sworn into the Senate in November 1962 after a special election. A chart that accompanied an Aug. 26 article about Sen. Joe Biden's selection as the Democratic vice-presidential candidate incorrectly said Mr. Kennedy started his Senate career in 1963.

INDEX TO BUSINESSES

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

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INDEX TO PEOPLE

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

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

Woes pile on as funding markets freeze up

Lending rates soar; banks and insurers race to cover deposits

By Carrick Mollenkamp, Mark Whitehouse And Neil Shah

LONDON—The world's funding markets, a critical cog in the global financial system, ground to a halt Tuesday.

As banks panicked about how problems at **American International Group** Inc. and **Lehman Brothers Holdings** Inc. might affect them and their counterparts, tensions in the markets on which they depend to borrow money reached levels not seen since the credit crunch began more than a year ago. Despite concerted efforts by the world's central bankers to keep money flowing, short-term interest rates soared as banks refused to lend to one another.

In one stark sign of disappearing confidence, the overnight London interbank offered rate, or Libor, a benchmark that is supposed to reflect banks' borrowing costs, more than doubled in its sharpest spike on record. Big global banks such as **J.P. Morgan Chase** & Co., **Credit Suisse Group, UBS** AG and others reported overnight borrowing costs of 7% in dollars, compared to 3% just a day earlier. Longer-term Libor rates also rose in a move that, if sustained, will push up payments on billions of dollars in mortgage and corporate loans that are linked to Libor.

As their stock prices plunged, banks took the rare step of denying cash problems. Switzerland's UBS, refuting an analyst report and moving to counter a 17% drop in its stock price, said its total loss exposure to Lehman would be a manageable $300 million. Belgian-Dutch bank **Fortis**, which saw its shares fall nearly 11%, denied in a statement that it was seeking a capital injection. In the U.K., **HBOS** PLC, a big mortgage lender that depends heavily on market funding, said it had a strong capital position as its share price fell 22%.

The tensions reflect the vast impact that a failure of AIG, which is struggling to shore up its finances amid credit downgrades, could have on banks and financial markets. The U.S. insurer is a major player in the $62 trillion credit-default-swap market, where banks and others buy and sell insurance against defaults on corporate bonds. AIG has sold insurance on hundreds of billions of dollars in debt to European banks alone. That insurance that could prove worthless in the event of an AIG bankruptcy, precipitating billions of dollars in new losses for banks.

Because the insurance is sold in the form of private contracts, not even policy makers know exactly how much there is or who will end up taking the losses. "These things are invisible to everybody," says Howard Simons, a bond strategist at Bianco Research in Chicago. "Nobody knows what's out there."

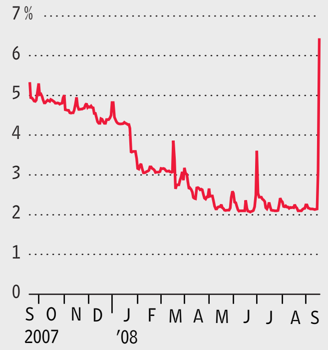
The worries about AIG are increasing the likelihood of the outcomes that markets fear most. For one, they have caused the cost of default insurance to rise sharply. That forces sellers of insurance like AIG to put up added cash as collateral to guarantee they will be able to pay in the event of a default. The added demand for cash exacerbates the money-market strains. AIG has been struggling to raise $70 billion to $75 billion from banks to help it meet obligations, according to people familiar with the matter.

The depth of the money-market problems became clear at lunchtime in London, when the British Bankers' Association published Tuesday's Libor borrowing costs. Every day, 16 banks report what it would cost them to borrow at certain maturities and currencies. The overnight dollar Libor soared to 6.4375% from 3.10625%, the largest jump on record. The three-month dollar Libor rose to 2.876% from 2.816%. One key gauge of concerns about banks' health—the difference between three-month Libor and market expectations for central-bank target rates—rose to 1.161 percentage points from 1.045 percentage points Monday.

Central bankers around the world made extraordinary efforts to ease the pain, providing tens of billions of dollars in added short-term funds to banks. The European Central Bank injected €70 billion ($99 billion) in one-day funds into euro-zone money markets, more than double its Monday injection of €30 billion. The Bank of England offered £20 billion ($36 billion) in extra two-day funds, atop Monday's £5 billion in extra three-day funds. In recent days, demand for such central-bank funds has far exceeded supply.

Off the charts

The rate banks pay to borrow dollars overnight from one another surged, a sign of little money availability.



Source: British Bankers Association

In the U.S., the Federal Reserve chose not to lower interest rates to cushion the economic impact of the latest financial-market turmoil. Before the rate decision, though, the Federal Reserve Bank of New York did inject $50 billion into the banking system early Tuesday and later added another $20 billion.

In another sign of policy makers' concerns about banks' access to cash, the Bank of England is expected this week to propose a new permanent emergency-financing facility for troubled banks. The facility will likely be designed to allow the central bank to secretly help banks, making short-term loans against collateral that would include hard-to-sell assets such as mortgage securities, say traders and analysts.

The banking industry is also working to create a separate, private borrowing pool, though details are still being ironed out. Under the guidance of the New York Federal Reserve, 10 of the world's biggest banks have committed to chip in $7 billion to the fund, dubbed the "Primary Dealer Liquidity Facility." Any of the member banks can borrow as much as one-third of the total fund. Banks won't actually fund the facility unless one of its 10 members needs to borrow from it.

More meetings are expected to take place in coming days. One of the outstanding goals is to enlist at least a few more banks to join the facility, which was originally intended to have about $100 billion coming from 15 different lenders.

Another less-pressing issue: A new name for the emergency fund, whose current moniker is similar to the Federal Reserve's Primary Dealer Credit Facility. "It's easily confused," said one banker involved in the talks.

—Joellen Perry, Jon Hilsenrath and David Enrich contributed to this article.

Europe worries in wake of newest U.S. troubles

By **Marcus Walker** *in Berlin,* **Joellen Perry** *in Frankfurt and* **Alistair MacDonald** *in London*

The latest turmoil in U.S. financial markets is likely to deepen Europe's already-worrisome economic downturn.

In countries where heavy borrowing fueled economic growth until this year, including the U.K. and Spain, the banking sector's worsening frailty threatens to choke off credit further, compounding slumps in consumer spending and housing markets.

Other countries, such as Germany and Italy, appear to be more insulated against the evaporation of credit because borrowers aren't as overstretched. But the global financial fallout could hurt European exports, vital to the region's growth.

European policy makers are worried. "It's clear that the financial-market crisis will have an impact on the real economy," German Finance Minister Peer Steinbrück told Germany's Parliament Tuesday.

European Central Bank officials still predict that the bloc's economy will rebound after hitting bottom in third quarter, but even before the latest upheavals, some officials were fretting publicly about the risk of a full-blown credit crunch.

The financial crisis' most obvious European casualty is the U.K., given its role as the region's financial center. When Lehman Brothers filed for U.S. Chapter 11 bankruptcy-court protection Monday, around 4,000 people in the U.K. found themselves facing unemployment. The collapse in banks' profits has hit U.K. business, from the originators of complex debt instruments to the real-estate agents who sold those bankers plush properties in London.

The cost of borrowing

Average interest rate on loans to euro-zone companies and households

Sources: ECB; Barclays Capital

The effects of more-cautious lenders, a slowing housing market, and the rising cost of living are being felt across the country. The U.K.'s annual rate of inflation hit a 16-year high of 4.7% in August, according to figures released Tuesday.

Other debt-fueled economies such as Spain and Ireland, where decade-long housing bubbles are bursting, are likely to bear the brunt if banks choke off lending. Spain's economy grew by a minimal 0.1% in the second quarter of this year. The European Commission last week forecast consecutive contractions in the third and fourth quarters.

CORPORATE NEWS

RECRUITMENT

Adecco abandons its bid for U.K. staffing specialist

Adecco

ADECCO SA, the world's largest staffing company, Tuesday abandoned its hostile bid for **Michael Page International** PLC, sending shares in the U.K. recruitment specialist down 24% in late trading.

Michael Page rejected as too low the Adecco offer, which valued it at £1.3 billion ($2.34 billion), or 400 pence a share. Switzerland-based Adecco said financial-market turmoil didn't influence its decision. Michael Page, which specializes in white-collar placements, would have helped boost Adecco's fledgling high-end-staffing business. The recruitment sector has seen consolidation this year with Randstad Holding NV's acquisition of Dutch rival Vedior NV. *—WSJ News Roundup*

MACHINERY

Sweden's Husqvarna says income to drop in quarter


Husqvarna

SWEDISH outdoor machinery maker **Husqvarna** AB Tuesday warned that its operating income for the third quarter will be "substantially lower than in the previous year" and that it will lay off about 850 employees.

It said it expects operating income for the third quarter to fall to about 300 million Swedish kronor ($44.6 million) from 553 million kronor last year.

The company, which makes such landscaping tools as chainsaws and lawn mowers, said it is suffering from lower sales of its consumer products in North America and Europe and its products aimed at the construction industry.

MEDICAL

Getinge expands in U.S. with deal for Datascope


Datascope

MEDICAL-products maker **Datascope** Corp. of the U.S. agreed to be acquired by Sweden's **Getinge** AB for $827.7 million.

Getinge, a medical-technology company operating in the cardiac- and vascular-surgery markets, will pay $53 a share, a 7.7% premium to Monday's closing price of $49.23 a share. The company has been boosting its U.S. presence, agreeing last year to buy Boston Scientific Corp.'s cardiac- and vascular-surgery businesses for $750 million.

Datascope's shares had already risen 35% this year. It was the subject of a proxy fight last year over concerns about the board's leadership. *—Shirleen Dorman*

Can Ogilvy's Young build on Asia success?

Ad firm's new chief plans to harness world-wide resources

BY GEOFFREY A. FOWLER AND SUZANNE VRANICA

Hong Kong

MILES YOUNG recently won the top job at Ogilvy Group because of his strong track record running the New York-based ad company's Asian operations. Now, the question is: Can he replicate that success in the U.S., a bigger and tougher market, and one that is going through wrenching change?

After 13 years heading Ogilvy's Asia business, the 53-year-old Englishman is packing up his Hong Kong office and moving to New York to take the reins of the **WPP Group**-owned firm, whose clients include **American Express**, **International Business Machines** and **Unilever**.

In the past five years, he doubled Ogilvy's Asian revenue to $500 million. The firm dominates the increasingly important Chinese market in terms of the size of staff and overall reputation. It hires an average 1.2 new permanent employees in China every day.

"Miles has built the best agency network in Asia," says Greg Paull, the principal of R3, a Beijing-based consulting firm that advises marketers on working with their ad agencies. "But he is going to come into his new position as a middleweight rather than a leader," he says, referring to Ogilvy's standing in the U.S. market, compared with its stronger position in Asia.

Mr. Young is taking the reins at Ogilvy at a critical juncture. The ad business in North America is on the brink of a recession—spending is expected to grow a paltry 2% this year, despite such big-league ad-spending events as the Beijing Olympics and the U.S. presidential election.

In the U.S., which still accounts for most of Ogilvy's business, revenue has been flat in recent years. Its success in picking up new business, considered a key barometer of an ad agency's health, has been disappointing. Over the past 18 months, Ogilvy has come up short in its pitches for major accounts such as phone company **Sprint Nextel** and retailer **Office Depot**.

Mr. Young says Ogilvy has already gone a long way toward fixing that problem, simply going after new accounts more aggressively. He points to the New York office's recent win of the Stolichnaya vodka account as a "kind of virility test for some of the changes that have been made in the last year."


Ogilvy

Miles Young, previously the head of Ogilvy's Asian operations, becomes its world-wide CEO as the ad agency struggles to pick up new business.

Mr. Young is largely an outsider to the New York-centered ad industry. His high-profile predecessor, Shelly Lazarus, who serves on the boards of General Electric and Merck, is one of the industry's few top executives with appeal beyond Madison Avenue. She plans to stay on as chairman of Ogilvy.

Filling big shoes won't be Mr. Young's only challenge. Madison Avenue has been turned upside down by the Web. Advertisers' shift toward more digital-ad spending presents an enormous challenge for conventional ad firms, many of which have built their reputations on television advertising.

As marketers shift their ad dollars to online, Madison Avenue is working overtime to catch up. The big companies are buying up digital-ad shops and trying to recruit digitally minded executives to fill the growing demand for more Web-focused campaigns.

Ogilvy promoted a top-notch digital creative executive to the upper echelons of its creative department several years ago. Last year it was one of the first to hire a chief digital officer.

Beyond reassessing the role of television advertising, ad agencies also have been forced to become more versatile, integrating public relations and search and direct marketing into their other offerings.

Mr. Young says he will try to better implement the cross-disciplinary approach to marketing services that was set out by his predecessor, internally dubbed "360 Degree Brand Stewardship."

Mr. Young says he'll "put a real premium on creativity," and invest in strategic planning, the consulting service that helps marketers better understand consumer mind-sets and market opportunities. "If you have those two things, those are what clients really want to pay for," he says.

He also will try to usher in a less U.S.-centered view of the marketplace. In search of growth, ad holding companies like Ogilvy parent WPP have been buying up ad shops in emerging markets such as China, India and Russia. While Ms. Lazarus did travel, Mr. Young has lived a far-flung life: He owns a cinnamon plantation in Sri Lanka and is a major collector of Asian painting and sculpture.

His Asia and Europe experience has convinced him that most management theories about international business are wrong. "Global does not mean the export of vanilla from one home base around the world. It means harnessing intelligence from all sorts of different sources and leveraging it into a solution."

Dell sees more pain; shares reach 10-year low

BY JUSTIN SCHECK

Dell Inc. said Tuesday it is seeing "further softening" in global demand, an announcement that pushed the computer maker's shares to their lowest level in 10 years.

The company has been under pressure since announcing quarterly earnings late last month that disappointed investors. While Dell's revenue showed strong growth world-wide, the company's profit declined 17% from the same period last year. Dell blamed its poor profit largely on dropping personal-computer prices.

In a news release Tuesday, Dell said it "is seeing further softening in global end-user demand in the current quarter." On Aug. 28, Dell warned "continued conservatism" in technology spending in the U.S. had spread into parts of Europe and Asia.

Dell gave few additional details and said the company "expects to incur costs as it realigns its business." Dell is in the midst of a turnaround effort that began early last year, when founder Michael Dell returned as chief executive after three years away from that position. During Mr. Dell's absence, the company fell into a slump, losing its position as the world's top PC maker to rival **Hewlett-Packard** Co. Since returning, Mr. Dell has overhauled Dell's business, which used to only sell PCs directly over the phone or Internet.


Michael Dell

Since Mr. Dell's return, the company has tried to get away from its reliance on corporate spending by developing new consumer PCs, and selling them in retail stores. Dell is also trying to sell its factories, an effort to cut costs by moving production to contract manufacturers.

Dell's shares rose after Mr. Dell came back to the company, closing at $30.60 on Oct. 31 before a subsequent fall and rebound. Inconsistent profits and shrinking margins have chipped away at investor confidence, with shares losing $1.65 to hit $16.34 in midday trading Tuesday on the Nasdaq Stock Market.

Bill Kreher, a securities analyst with Edward Jones, said he was surprised by the announcement. "The company's inconsistent performance and lack of confidence means there's a lot of uncertainty in the turnaround," he said. Further questions about Dell have also been raised by H-P's recent results.

H-P, which is less dependent on U.S. sales than Dell, has provided cautious guidance but its comments have not sounded as bearish as those of Dell.

Court allows companies to limit drug sales

Europe ruling stems the flow of medicines to be resold for profit

By Charles Forelle

BRUSSELS—European drug companies can limit but not halt supplies to wholesalers that buy drugs for sale in countries with low price caps but then re-export them to higher-priced markets for profit, Europe's highest court ruled Tuesday.

In endorsing even qualified limits on the supply of drugs to so-called parallel traders, the European Court of Justice delivered a partial victory to **GlaxoSmithKline** PLC. The U.K.-based pharmaceuticals giant has for years been trying to stop traders from buying its medicines in Greece, where Glaxo sells to wholesalers at a discount to account for the country's low price caps, and reselling the drugs elsewhere in Europe where regulated prices are higher.

The Greek decision had been hotly awaited in the drug industry, which views the gray-market trade as a threat to profits. The court is also considering a separate case involving Spanish drug sales.

"Broadly speaking, it is clear that [Glaxo] can implement a system that manages their supply and puts some restrictions on supply in a low-priced member state," said David Hull, an antitrust lawyer at Covington & Burling whose clients include drug companies, though not Glaxo.

But the court also tossed aside significant pieces of Glaxo's argument—namely that consumers don't enjoy lower prices from parallel trade—and left unclear exactly where the limits should be set, all but ensuring more litigation.

Both sides claimed success Tuesday. The ruling "invalidates a series of empty economic arguments used by the pharmaceutical industry," the trade group for parallel traders said in a statement.

"We are pleased that the [court] has confirmed that companies must be able to take reasonable and proportionate steps to protect their own commercial interests," Glaxo's statement said.

Parallel trade in drugs is especially prevalent in Europe because of the way the EU operates. The rules of the EU's common market require that goods can be traded freely between member states. At the same time, countries have the authority to set price caps for medicines, a key piece of national health plans.

Thus there is money to be made from buying drugs in low-price-cap countries—Greece is among the most attractive—and selling them elsewhere.

In one instance cited by Glaxo, the regulated price of the epilepsy drug Lamictal was 81 European cents ($1.16) per 100-milligram pill in Greece, while the German health fund paid €2.16.

The parallel traders who do this say they act as a necessary check on the market power of rapacious drug giants by bringing lower prices to patients. Drug companies say the wholesalers are greedily creaming profits that would otherwise be funneled into research.

Making the matter more complex, EU antitrust law generally forbids "dominant" companies—those with overbearing market share—from refusing to supply products in an attempt to squelch competition.

Nearly eight years ago, Glaxo for several months stopped shipping to Greek wholesalers who ordered large volumes of certain drugs—several times their normal levels, Glaxo said. The wholesalers brought claims in the Greek legal system, alleging that Glaxo was violating the EU antitrust tenets on supply to competitors. An Athens appeals court referred the question to the Court of Justice.

Tuesday, the high court said that completely stopping supply is unlawful, but that Glaxo could limit sales to "ordinary" quantities. Exactly what "ordinary" means will be up to individual countries, the court said, though it said such a determination must take into account "requirements of the market" and "previous business relations" between the drug company and the wholesaler.

Ian Forrester, a lawyer at White & Case who argued the case for Glaxo, said drug companies gather statistics from national health authorities and other sources and thus know how much of a drug is prescribed in a particular country. "It should not be at all difficult to determine" what is ordinary, he said.

Heinz Kobelt, the secretary-general of the parallel traders' trade group, said Tuesday's ruling effectively grandfathers existing parallel trade because it makes "business relations" part of the calculation to determine ordinary levels of supply. If a wholesaler has historically been exporting drugs, "that is an equally protected business relationship," said Mr. Kobelt.

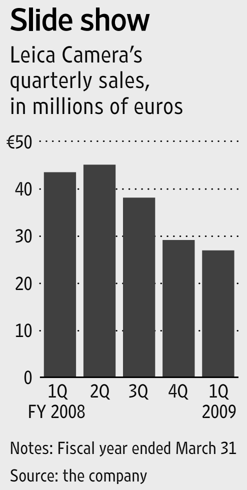
The Property Report
Silver lining
The global economic slump may boost number of REITs in Europe > Page 28

Suit shines light on Leica

CEO from the U.S. clashed with culture of fading photo icon

By Mike Esterl

Agence France-Presse/Getty Images



Leica hopes its **M8 digital** range-finder camera will revive its fortunes.

SOLMS, Germany—**Leica Camera** AG's employment dispute with fired Chief Executive Steven Lee brings to light the venerable German company's troubles moving into the digital age.

The quirky company, which helped pioneer modern photography in the early 20th century, stuck too long with film technology and now faces mounting losses and sinking sales.

Since 2006, Leica has been controlled by Andreas Kaufmann, a 54-year-old German aristocrat. A wealthy photography aficionado, he decided to buy the company to rescue it. Mr. Kaufmann imported Mr. Lee, an aggressive American executive from Best Buy Co.

As part of a turnaround effort, Mr. Lee pressed longtime employees to turn out digital products more quickly. He also tried to replace Leica's small network of specialty dealers with Internet sales and kiosks in upscale resorts.

Mr. Kaufmann eventually fired Mr. Lee after employees complained about his management and the company's sales slumped. "My mandate was not to be Mr. Nice Guy," says Mr. Lee, 54, who worked for two decades at International Business Machines Corp. before becoming a Best Buy executive. He recently moved back to Minneapolis and is suing Leica for wrongful dismissal. A German court held a hearing in June but has issued no ruling.

Andreas Kaufmann

Leica helped pioneer the 35-millimeter film format that took photography out of the studio and into the streets. The 21st century has been far less kind to the company. Leica has been awash in red ink, careening from one crisis to another. It has churned through three chief executives since 2005—most recently Mr. Lee.

Leica finds itself on the wrong side of history after the global market share for digital cameras soared from zero to 90% in about 10 years. Leica's annual revenue of about €150 million ($215 miillion) is a fraction of that of rivals such as Japan's Canon Inc. or the U.S.'s Eastman Kodak Co.

Mr. Kaufmann isn't a typical capitalist. After helping found Germany's Green party in 1979, he taught for 15 years at a Stuttgart school that follows the alternative Waldorf model. In 2004, he took a small stake in Leica, raising it in steps to 96.5%. The rest of the shares are publicly traded on the Frankfurt exchange.

He takes a long-term view. "My family owned a pulp and paper company for 101 years," says the soft-spoken Mr. Kaufmann, who now is Leica's interim CEO. Mr. Kaufmann, a German citizen who lives in Salzburg, Austria, is discreet about his finances. People close to him estimate he is worth hundreds of millions of euros and peg his investment in Leica at more than €60 million.

Leica owes much of its fame to Oskar Barnack, an engineer with asthma who began wondering a century ago whether there wasn't an easier way to take photos outdoors than carrying around the era's heavy, bulky cameras. His idea: build a small camera to house 35-mm cinematic film and enlarge the negatives back in the studio.

Other companies pursued the same concept, but Mr. Barnack's employer, the optician Ernst Leitz II, gambled more heavily by authorizing the production of 1,000 such cameras in 1925. Leica's high-quality, 35-mm models revolutionized the industry and became the gold standard for photographers on the move.

In 1996, as the digital photography revolution began, Leica brought its S1 digital camera to the market. The S1 packed 75 megapixels—several times the resolution of even today's best digital cameras—but was too large and heavy to carry around and cost about $30,000. Leica made only 146 of them.

By early 2005, banks called Leica's credit lines and the company was on the verge of bankruptcy. Emergency meetings were hosted that spring by French fashion house Hermès International SCA, which owned nearly a third of Leica and was the largest shareholder. Among those who exchanged business cards at the meetings were Mr. Kaufmann and Mr. Lee, a fellow Leica fan representing Best Buy as a potential investor.

The Minnesota-based company stayed on the sidelines, but Mr. Kaufmann became Leica's majority shareholder in early 2006. Messrs. Kaufmann and Lee met in Florida that spring to discuss the camera business. That June, Mr. Kaufmann flew to Minnesota and offered Mr. Lee the CEO job.

Mr. Lee faced immediate problems as he arrived in Solms, a sleepy town surrounded by farms about 50 miles north of Frankfurt. An important new digital camera, the M8, had to be retroactively fitted with an infrared filter to combat color distortions. Mr. Lee signed 4,000 letters of apologies to customers.

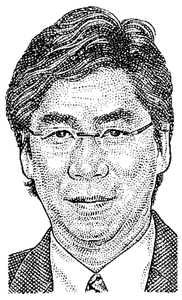
Mr. Lee threw himself into every detail, insisting on personally approving expenses above €100. He traveled to Asia to try to strike better deals with suppliers of electronic components.

To broaden the company's customer base, Mr. Lee quickly rolled out a new line of lenses called Summarit that didn't match the quality of Leica's traditional optics but—at a retail price of around €1,000—cost less than half as much. Mr. Lee also hired back production and R&D staff that had left during earlier downsizings.

But sales of the Summarit fared poorly as bargain hunters opted instead for second-hand Leica lenses sold by Leica dealers. The pipeline for other new products, including cheaper cameras manufactured with Panasonic, stalled. Mr. Lee also decided last autumn to boost the price of the M8, which had sold strongly since its 2006 launch but which he judged insufficiently profitable. He raised the suggested retail price to €4,800 from €4,200.

Customers balked. After Leica's overall sales rose sharply in late 2006 and early last year, largely on M8 sales, they fell 16% to €38.2 million in the final quarter of 2007 from the year-earlier period.

Managers said Mr. Lee set unrealistic targets and reversed course. After they told him Leica would be able to sell 5,500 Summarit lenses, Mr. Lee ordered a production run of 11,000. Leica sold only 6,000. Mr. Lee says Leica's traditional retailers didn't make enough effort to sell the new lenses.



Steven Lee

By early 2008, some managers shared their grievances with Mr. Kaufmann. They accused Mr. Lee of having belittled managers, calling them dumb farmers and other names during meetings. In late February, Mr. Kaufmann fired Mr. Lee. Employees say many managers popped champagne bottles to celebrate.

Mr. Lee acknowledges some "heated moments" during his tenure and that he occasionally uttered "insults under my breath" out of frustration. But he says he never insulted anyone personally.

Mr. Lee's supporters say he was exactly what the company needed, but that he wasn't heeded. "He had to hear, 'That's not possible,' over and over again," says one employee.

Mr. Kaufmann says the fired executive failed to win the support of most of Leica's employees, who, like other workers in Germany, hold seats on the supervisory board that vets management decisions. "Management's job is to get them behind you," says Mr. Kaufmann.

New-car registrations in Europe tumble 16%

By Christoph Rauwald

Steep drops

Europe's new-vehicle registrations in August

Company	Units	Change from year earlier
Volkswagen	186,766	–9.5%
PSA	92,616	–18.7
Renault	72,075	–5.6
GM	71,677	–23.8
Ford	70,779	–12.6
Fiat	55,844	–11.7
Daimler	48,559	–18.2
Toyota	45,472	–23.2
BMW	42,148	–16.7
Hyundai	17,897	–12.4

Source: European Automobile Manufacturers Association

FRANKFURT—European new-passenger-car registrations fell 16% in August from a year earlier to 805,839 vehicles as weak consumer confidence and high fuel prices hurt demand, the European Automobile Manufacturers Association said Tuesday.

Over the first eight months of the year, new-car registrations—which mirror sales—were down 3.9% from a year earlier at 10.4 million, said the car makers group, known as ACEA. It noted the figures were depressed by two fewer working days this summer across the continent.

In recent months, auto makers have felt the pinch from higher costs for raw materials and sluggish car sales, especially in the U.S. and Western Europe, forcing some to revise sales targets or even issue profit warnings.

In Western Europe, new-car registrations were down 17% in August and 4.4% in the first eight months of the year.

The U.K., Italy and Spain showed particularly steep declines in August. "The British and Spanish markets are suffering from falling housing prices and the inflation rate of 4% in Italy has led to buying resistance," Commerzbank analyst Gregor Claussen said in a note.

The world's two largest auto makers by sales, Japan's **Toyota Motor** Corp. and U.S.-based **General Motors** Corp., were the worst hit last month in Europe, with slumps of 23% and 24%, respectively. GM's Opel/Vauxhall brand saw registrations fall 25% in August, while its Chevrolet brand posted a 19% decline.

For **Ford Motor** Co., registrations were down 13%, partly because of a 26% drop at its Swedish Volvo brand.

French auto maker **Renault** SA fared the best of the major auto makers, with registrations of its cars falling 5.6% in August as it introduced new models and benefited from rising demand for its low-frills Dacia brand. Peer **PSA Peugeot-Citroën** SA saw a 19% drop.

Europe's biggest auto maker by sales, **Volkswagen** AG, saw August registrations fall 9.5%. Its Audi AG premium brand and its Czech Skoda unit posted relatively stable results for the month: Audi saw a 2% drop, while Skoda posted a 0.6% decrease. But the core VW brand saw registrations fall 13% and the Spanish Seat unit recorded an 18% drop.

Italian auto maker **Fiat** SpA showed a 12% decline in August, mitigated by a solid result at the core Fiat brand.

German premium car makers **BMW** AG and **Daimler** AG saw August registrations fall 17% and 18%, respectively, in line with data the companies released earlier this month.

Flaps, alarm failure cited in deadly Spanair jet crash

By Andy Pasztor

The pilots of a Spanair passenger jet that crashed on takeoff from Madrid last month killing 154 people failed to extend wing flaps needed for extra lift, according to a preliminary report by Spanish investigators.

The investigators also determined that before the barely airborne McDonnell Douglas MD-82 slammed tail-first into the ground and burst into a fireball, it suffered a failure of an audible alarm system designed to warn pilots of improper takeoff configuration. Investigators urged U.S. and European regulators to require checks of such systems on other McDonnell Douglas MD-80-series aircraft before each flight.

The report stopped short of formally determining the probable cause for Spain's worst aviation accident in 25 years, but the language makes it clear that data and voice recorders revealed there was nothing wrong with the plane's two engines. Early press reports and comments by eyewitnesses focused on engine problems and a possible fire.

According to the report, the data recorders didn't indicate any deployment of the planes' flaps, moveable panels at the rear of each wing designed to provide extra lift during takeoff. A cockpit crew unaware of the flap problem likely would set the wrong takeoff speed and climb too steeply, according to pilots and safety experts.

The report said the aircraft climbed only 12 meters above the ground before veering off the runway and bouncing three times. "The cockpit-voice recorder registered no sound from the takeoff warning system," investigators said.

Preliminary findings from the Madrid crash indicate that Spanair's procedures require verifying proper operation of the warning system before the first flight of the day. The system isn't required to be checked prior to subsequent flights unless an entirely new cockpit crew takes over the aircraft.

A spokesman for Spanair said the company has submitted its responses to the draft report; the company had no further comment at the moment. The report could be publicly released by the government later this week.

CORPORATE NEWS

Amgen prospects firmed by new denosumab data

Study shows drug rivals top medicines to treat osteoporosis

By Thomas Gryta

Amgen Inc. released data that show its experimental bone drug denosumab is comparable to top osteoporosis treatments and will likely be a major player in a crowded market.

The study's success was reported in July but additional details were released Tuesday. The data come at a crucial time for the Thousand Oaks, Calif., drug maker because sales growth of its flagship anemia drugs evaporated last year when studies showed a link to a risk of cardiovascular disease, cancer progression and death.

Amgen shares were up 3.2% to $64.18 in Nasdaq Stock Market trading early Tuesday afternoon. The move is part of a six-month surge powered by the stabilization of sales of the beleaguered anemia drugs, cost controls and the denosumab hope.

The trial of 7,800 post-menopausal women over three years showed that denosumab reduced by 68% vertebral fractures—a key data point for potential marketing approval .

That data exceeds the approximate 50% reduction commonly seen in bisphosphonates, the class of drugs that includes **Merck & Co.**'s Fosamax and is close to the 70% reduction seen in once-yearly Reclast from **Novartis** AG. Fosamax, which went generic in February, is the most prescribed osteoporosis treatment.

"Denosumab did everything that we hoped for," said Roger Perlmutter, Amgen's executive vice president of research and development.

Amgen as well as physicians warn that clinical trials, especially multiyear studies with thousands of patients, can't be directly compared.

Side effects in the trials were comparable to placebo, alleviating worries that the drug increased the risk of infections and cancer, as was seen in some earlier small trials. Denosumab is injected under the skin twice a year.

Denosumab reduced the risk of hip fractures by 40% and nonvertebral fracture risk by 20% during the 36-month period. The hip data are key because such fractures can be fatal for older women and very expensive to treat.

Amgen is expected to use the Freedom data to file for marketing approval later this year. Estimates of denosumab's eventual annual world-wide sales vary widely on Wall Street, from $1 billion to as much as $10 billion. Amgen's 2007 total revenue was $14.8 billion.

The highest estimates include the drug's potential use in treating osteoporosis caused by cancer treatment and in helping prevent the disease's spread to the bone.

Now Amgen must face regulatory review of the drug by the U.S. Food and Drug Administration, reimbursement determinations from insurers and the crucial decision about whether Amgen should find a marketing partner.

Amgen concedes that denosumab is unlikely to unseat generic Fosamax, which costs just pennies a day, as the preferred initial therapy. After proving its effectiveness, denosumab can differentiate itself through its convenience to patients who aren't successful with Fosamax.

Fosamax suffers from poor compliance because, as with all oral bisphophenates, patients must be sitting up when they take the pills and are advised not to eat for two hours before and 30 minutes after taking the drug.

Sanofi outgoing CEO Le Fur to take half of severance pay

By Ruth Bender

PARIS—French drug maker **Sanofi-Aventis** SA's outgoing chief executive, Gerard Le Fur, will leave office with half of the severance pay to which he was originally entitled, the company said Tuesday.

Mr. Le Fur—who will be succeeded by GlaxoSmithKline PLC veteran Chris Viehbacher on Dec. 1—will be paid total severance of €2.7 million ($3.9 million), given his two years at Sanofi's helm, the company said.

"Taking into account the limited amount of time he held this office," the company said, its board decided, with Mr. Le Fur's consent, that only half of his termination benefit would be paid.

Mr. Le Fur has agreed to stay with Sanofi for a 30-month period starting Dec. 1, earning gross pay of €50,000 a month as an adviser to top management on scientific issues. He has also agreed not to join any rivals until Dec. 31, 2010, in exchange for additional monthly pay of €100,000.

Sanofi's incoming CEO, Mr. Viehbacher, will receive annual fixed compensation of €1.2 million, the company said.

The company announced earlier this month that Mr. Le Fur—whose collaboration with Sanofi Chairman Jean-François Dehecq dates back more than two decades—would be succeeded by Mr. Viehbacher, a move that was warmly welcomed by investors as a much-needed injection of fresh blood.

Sanofi shareholders had become increasingly frustrated with the company's 35% drop in stock price since Mr. Le Fur took the CEO job in January 2007. When the company on Sept. 10 confirmed the management change, first reported by Dow Jones Newswires, the stock soared to its highest level in the past six months.

Oil company **Total** SA and consumer-products maker **L'Oréal** SA, which together own about 20% of Sanofi, pressured the drug maker's board for a change in management, a person familiar with the matter said.

Total Chief Executive Christophe de Margerie said earlier this month that the company wants to keep reducing its stake in Sanofi, but smoothly, "without making waves." L'Oreal couldn't be reached for comment.

GLOBAL BUSINESS BRIEFS

Bayer AG

Direvo Biotech acquisition to boost drug portfolio

German pharmaceuticals and chemicals company **Bayer** AG said it acquired **Direvo Biotech** AG, a company that specializes in protein engineering, in a deal valued at €210 million ($300 million). Bayer said the transaction would strengthen its portfolio of biological-based drugs. Cologne-based Direvo Biotech's proprietary protein-engineering platform uses technologies for the discovery of biological-based drugs, Bayer said. The platform has been successfully applied to a wide range of proteins, including therapeutic antibodies and enzymes that will be added to the drug pipeline of Bayer Schering Pharma, Bayer said.

Ciba Holding AG

A major shareholder in **Ciba Holding** AG rejected Germany's **BASF** SE's offer of 50 Swiss francs ($45.08) a share for the ailing Swiss chemical company as too low. The rejection by Spanish fund-manager **Bestinver**, which owns 13.2% of Ciba's shares, valued at 424.3 million francs at current prices, may shake out more opposition to BASF's bid than **Golden Peaks**, an activist hedge fund with 1% of the company that on Monday slammed the offer price. "They will probably garner some support for a higher price, but I assume that BASF will succeed with the offer at 50 francs a share," Zürcher Kantonalbank analyst Martin Schreiber said. Both BASF and Ciba declined to comment on Bestinver's rejection of the offer.

Iberdrola SA

Iberdrola SA and **Electricité de France** SA reached an out-of-court settlement in a dispute that arose this year when EDF expressed an interest in entering the Spanish electricity market and possibly acquiring Iberdrola. In April, Iberdrola had filed a complaint with a court in Bilbao, Spain, saying talk of possible bids was undermining its business. The court ordered EDF to clarify its intentions, which the French utility did in August, saying it wasn't interested in buying a stake in Iberdrola. In a statement filed with the Spanish stock-market regulator Tuesday, Iberdrola didn't give any other information on its settlement with EDF. EDF said Tuesday that it "indicated publicly at the beginning of August that it doesn't have the intention of acquiring" Iberdrola.

Hewlett-Packard Co.

Hewlett-Packard Co. said it will cut 24,600 jobs as part of its plan to integrate tech-services giant **Electronic Data Systems** Corp., providing the first details of how extensive its restructuring will be. The cuts are intended to "streamline the combined company's services" businesses, H-P said in a statement, and they amount to about 7.5% of the total combined work force. Before the $13.25 billion acquisition of EDS, which was finalized last month, H-P had 178,000 employees and EDS had 142,000. The staff cuts will be spread across both companies, H-P said, with nearly half coming in the U.S. The company added that it "expects to replace roughly half of these positions over the next three years to create a global work force."

Porsche Automobil Holding SE

Porsche Automobil Holding SE raised its voting stake in **Volkswagen** AG to 35.14%, an increase of 4.89 percentage points that Porsche said gives it effective control of the largest European car maker by sales. The Germany-based sports-car maker will now have a voting majority at Volkswagen's shareholder meeting, based on the average shareholder attendance at the company's annual general meetings. "It remains our target to raise our Volkswagen stake to more than 50%," Porsche Chief Executive Wendelin Wiedeking said. Porsche spokesman Anton Hunger said the sports-car maker plans to raise its stake to that level "probably at the end of November."

Ranbaxy Inc.

The U.S. Food and Drug Administration will limit imports and sales by **Ranbaxy** Inc., India's largest drug maker and one of the worlds largest manufacturers of generic drugs. On Tuesday, the FDA issued a warning and import alert, and it imposed other sanctions, people briefed on the agency's plans said. Ranbaxy has been under investigation by the U.S. Justice Department and the FDA over whether it manufactured substandard generic drugs in one of its India plants. Among other issues, investigators were trying to determine whether it made weak or adulterated HIV drugs that were given to thousands of AIDS patients in Africa.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

FRANCE

Sarkozy urges nations to fight against piracy

FRENCH PRESIDENT Nicolas Sarkozy said the international community must join together to fight piracy on the high seas, calling it an "industry of crime."

Mr. Sarkozy's appeal came after France's army rescued two French hostages in a gun-battle with Somali pirates. The French leader said that piracy is no longer an isolated problem but has grown into an industry, and that pirates are operating farther out to sea.

He said cases of piracy off the coast of Somalia and in the Gulf of Aden have "literally exploded" this year. He said Somali pirates are still holding 150 people and at least 15 ships. *—Associated Press*

MALAYSIA

Anwar claims support to topple government

MALAYSIAN opposition leader Anwar Ibrahim said Tuesday he has more than enough pledges of support from ruling coalition lawmakers to topple the government and urged the prime minister to give up power voluntarily and peacefully.

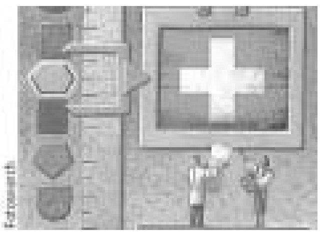
Mr. Anwar's claims—his strongest—signaled he could be on the verge of nudging the ruling National Front coalition from power.

Earlier Tuesday, Prime Minister Abdullah Ahmad Badawi brushed off Mr. Anwar's claims. "This is Anwar's mirage," he said.

Mr. Anwar said he was seeking a meeting with Mr. Abdullah. *—Associated Press*

SWITZERLAND

Industrial output soars, but gains likely won't last



SWISS industrial production grew at an unexpectedly strong pace in the second quarter, but growth rates are expected to come down sharply later this year.

Production surged 8.9% from the previous quarter and 6.1% from the second quarter of last year, the Swiss Statistics Office said. Both figures were better than expected.

Economists said production benefited from booming demand in previous quarters. Bank Sarasin chief economist Jan Poser said that "despite the positive picture, it's clear we're at the end of the cycle," noting production surpassed new-order growth, or the order backlog is shrinking. *—Martin Gelnar*

Ukraine coalition government collapses

'Orange' alliance unravels amid split over Russian policy

BY ANDREW OSBORN
Moscow

UKRAINE'S PRO-WESTERN coalition government formally collapsed, deepening a political crisis that has clouded the country's prospects of joining the NATO military alliance.

President Viktor Yushchenko and Prime Minister Yulia Tymoshenko worked together in an "Orange" coalition for nine fractious months, but their alliance gradually unraveled, not for the first time, faltering on serious policy and personality differences.

Their failure to patch up differences after a 10-day cooling-off period came as Mr. Yushchenko—whose supporters have charged Ms. Tymoshenko with collaborating with Moscow—accused Russia of trying to destabilize Ukraine.

"For some of our partners, instability in Ukraine is like bread and butter," he said in an Associated Press interview, suggesting Moscow was stirring up separatists on the volatile Crimean Peninsula, where Russia's Black Sea Fleet is based.

He said Ukraine wouldn't allow itself to be drawn into a war in the way he said Georgia had last month when Russian troops responded to a Georgian attack on South Ossetia by occupying large swaths of its territory.

"Will they [Russia] repeat the Georgian scenario?" he asked. "For sure, no."

The political turmoil sets the stage for a month of intense talks during which a new coalition must be formed. Failing that, the president has the right but not the obligation to call parliamentary elections. He has said he will call the vote, though opponents say he is bluffing, pointing to his dwindling popular support.

Russia's war against Georgia in August stoked tensions inside the Ukrainian government, driving a wedge between Mr. Yushchenko and Ms. Tymoshenko. Mr. Yushchenko favored tougher rhetoric and more immediate action, including against Russia's Black Sea Fleet. Ms. Tymoshenko backed a more cautious approach so as not to antagonize Russia, a key trading partner, her supporters say.

Some analysts say both seized the opportunity of the war to distance themselves from each other ahead of a 2010 presidential election. The other major candidate is likely to be Viktor Yanukovych, leader of the Russia-friendly Party of the Regions. Ms. Tymoshenko's Byut party teamed up with Mr. Yanukovych's party this month to vote for legislation that would seriously diminish presidential powers, infuriating Mr. Yushchenko, who accused his onetime ally of staging a "coup." He suggested she was behaving like a Kremlin agent. In an interview Tuesday, Hryorii Nemyria, a deputy prime minister and close Tymoshenko ally, called that "absurd."

The political turmoil appears certain to further cloud Ukraine's prospects of joining the North Atlantic Treaty Organization or of receiving a Membership Action Plan at an alliance meeting in December, an important first step.

Ukraine's chances are already complicated by the fact it hosts a Russian naval base and because Russian officials have made clear Moscow would be strongly opposed to NATO membership for Ukraine. The U.S. has been bullish about Ukraine joining NATO. But France and Germany—and other European members dependent on Moscow for energy supplies—are more cautious, and often struggle to find a common position on Russia.

Opinion polls show that less than one quarter of Ukrainians back joining NATO anyway. Mr. Yuschenko and Ms. Tymoshenko have both committed to conducting a national referendum on the issue.

Russia's position is that any decision to join NATO without a referendum would be unethical. "Russia will accept any decision by the Ukrainian people," said Sergei Markov, a lawmaker from the dominant United Russia Party. "But we won't accept anything else."

Moscow would regard a political decision to join NATO as "a coup d'etat," he said, adding that Russia wanted closer economic integration with Ukraine, not its territory.

Policy and personality differences led Ukraine's Yulia Tymoshenko, right, with Czech Prime Minister Mirek Topolanek, and Viktor Yushchenko to **end their coalition**.

U.K.'s inflation rate hit 4.7% in August

BY NATASHA BRERETON

LONDON—Britain's annual rate of inflation hit a 16-year high of 4.7% in August, more than double the Bank of England's 2% target, requiring the central bank's governor to explain publicly why prices are rising so fast.

In a letter to the Chancellor of the Exchequer, Bank of England Gov. Mervyn King said inflation is likely to peak soon at around 5%, but said the bank's rate-setting Monetary Policy Committee, or MPC, is committed to bringing inflation back to target in the "medium term," or in the next couple of years. The inflation rate was 4.4% in July.

"CPI inflation is likely to remain markedly above the target until well into 2009, particularly if the recent depreciation of sterling is sustained," Mr. King said.

"I continue to expect, therefore, that I will be writing further open letters to you over the next year," he said. The governor is required to write an open letter to the Chancellor of the Exchequer for every three months that the inflation rate remains above 3%.

Mr. King said he saw evidence from surveys and in financial markets that inflation expectations had risen, at least in the near term. The MPC fears that if workers expect inflation to stay high, they will seek higher wages, and set off a second round of price increases.

But he said the MPC will ensure that the current period of elevated inflation remains temporary, and said the committee was "firmer" in its belief that a period of muted economic growth was necessary to damp price and wage pressures and bring inflation back to target.

However, he also noted that the committee was also aware that the continuing slowdown in activity—if severe—could result in inflation falling below target in the medium term.

Mr. King made no attempt to guess at the damage that renewed turmoil in international financial markets will inflict on an already stagnant U.K. economy. He said the MPC would examine the latest developments, including those in the financial markets, to assess how the balance of risks is shifting at its future meetings.

The governor said he expected inflation to slow "sharply" in 2009, reaching its target "thereafter."

The relatively hawkish nature of the governor's comments suggested that a cut in rates to 4.75% in November from the current 5%, which many economists expect, isn't a foregone conclusion. The MPC next meets in early October.

In his reply to Mr. King, Chancellor of the Exchequer Alistair Darling said that the government would continue to support the MPC in its forward-looking monetary-policy stance.

U.S. has detainee doubts

Yemen is pressured on handling release from Guantanamo

By Mariam Fam

SANA'A, Yemen—U.S. Defense Secretary Robert Gates—and both presidential candidates—have said they want to shut down the Guantanamo Bay detention facility. Before that happens they will need to overcome U.S. concerns that members of the biggest block of terrorism suspects there, Yemeni nationals, won't be properly monitored if they are sent home.

In a visit to Yemen over the weekend, U.S. Assistant Secretary of Defense Michael Vickers discussed cooperation with the Yemeni government to establish a "facility" to receive released detainees, according to a news release on the Web site of the U.S. Embassy in Sana'a.


Hamoud Al-Hitar

Since the prison was established in 2002, more than 500 detainees have been released, but only about a dozen Yemenis have been let go because U.S. officials have been wary about what they might do next. About 100 Yemenis are currently detained at the U.S. installation in Cuba, out of about 255 inmates. Some Yemenis are among a group of detainees who have already been cleared for release.

The U.S. returns detainees "when we are satisfied that the receiving country will both take adequate steps to prevent the individual from returning to the fight and will treat him humanely," said Navy Cmdr. J.D. Gordon, a Pentagon spokesman. "We have had concerns that the Yemeni [authorities] won't take the appropriate steps to mitigate the threats the detainees pose to the international community," he said. Cmdr. Gordon added in a subsequent email that the Pentagon was "optimistic" about reaching an agreement with Yemen on returning detainees.

A rehabilitation scheme in Saudi Arabia, which includes religious reeducation and psychological counseling, has won U.S. praise. More than 100 Saudis have been sent home so far.

Mohammed Albasha, a spokesman for the Yemeni Embassy in Washington, said in recent days the Yemeni and U.S. sides have made progress toward an agreement on a rehabilitation program. The Pentagon said "constructive dialogue" is continuing.

The U.S. has been demanding Yemen lock up or keep under close surveillance some of the Yemenis that Washington returns home, according to Yemeni Foreign Minister Abu-Bakr al-Qirbi. Mr. al-Qirbi said returnees will be put on trial if there is evidence that warrants it.

The impoverished country is seen by many as a fertile ground for militancy, and al Qaeda is active here. Yemen's government has sought to stamp out militants and declared itself a U.S. ally in the war on terrorism. The U.S. Embassy's Web posting said Mr. Vickers praised some recent Yemeni counterterrorism operations but said more measures were needed to "deny safe-haven in Yemen for international terrorists."

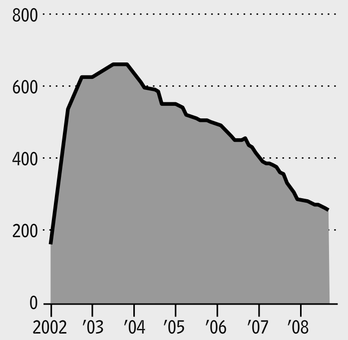
Washington is seeking the extradition of two men wanted in the U.S. on terrorism charges, but Yemen has refused.

Some of the Yemenis at Guantanamo could eventually be tried in front of military tribunals. In Guantanamo's first such trial, Salim Hamdan, a Yemeni who was Osama bin Laden's driver, was convicted of providing material support for terrorism and sentenced in August to 66 months in prison. With time served taken into account, his sentence will be up in January.

A U.S. Supreme Court ruling in June gave Guantanamo inmates the right to challenge their detention in federal courts, putting more pressure on U.S. officials to come up with solid cases against inmates or move them out. "The U.S. should not continue to warehouse...men from Yemen, simply because it doesn't fully trust [the country's] government," said Jennifer Daskal, senior counterterrorism counsel for Human Rights Watch.

Emptying out

Detainees at Guantanamo Bay



Note: Data points at irregular intervals
Sources: Defense Department; GlobalSecurity.org

U.S. and Yemeni officials say they have been discussing a possible Yemeni rehabilitation program. A Yemeni cleric and judge tried a similar idea from 2002-05 with militants in Yemeni jails. Hamoud Al-Hitar, now the country's minister of endowment and guidance, used the Quran, sayings of the Prophet Mohammed and the Yemeni constitution to try to convince inmates that a radical, violence-espousing understanding of Islam was wrong. "Jihad in Islam is there for defense and not for offensive attacks" he said he reasoned with them. He said more than 360 militants were released after going through the program, but said he doesn't follow up with all of them on "a regular basis."

U.S. officials met with Mr. Al-Hitar in July as part of discussions about how Yemen might handle Guantanamo prisoners if they are repatriated. Yemeni officials said they could incorporate Mr. Al-Hitar's program, which was touted by Yemen as a success, into a larger rehabilitation scheme.

Pakistan issues threat over raids

By Zahid Hussain

ISLAMABAD, Pakistan—On the eve of a meeting with the top U.S. military commander, Pakistan upped the ante in the standoff over U.S. troop incursions, saying its soldiers had orders to fire on American troops if they entered from Afghanistan on raids.

U.S. military officials including Adm. Mike Mullen, chairman of the Joint Chiefs of Staff, were scheduled to meet with Pakistan's top brass Wednesday in an effort to defuse tension between the two allies that has flared after a cross-border raid by U.S. Special Operations forces and an increase in drone-launched missile strikes against suspected militant sanctuaries inside Pakistan.

A Pakistani military spokesman said Tuesday that the nation's troops have been ordered to open fire if U.S. soldiers in Afghanistan launch another raid inside Pakistan, raising the prospect of a clash between Pakistani and U.S. forces on the border. Pakistani military officials have repeatedly emphasized that they consider such incursions by U.S. troops—which President George W. Bush permitted by secret orders in July—to be violations of territorial sovereignty.

"No incursion will be tolerated anymore," said Maj. Gen. Athar Abbas, chief military spokesman.

The prospect of the two allies fighting each other as they hunt down Islamist militants still appears remote, given the Pakistani government's desire to receive billions of dollars in aid from the U.S. But the repeated warnings against U.S. raids reflect the anger felt among Pakistan's senior ranks that Washington is overstepping the bounds with a close ally.


Mike Mullen

Adm. Mullen will meet with Pakistan Army Chief of Staff Gen. Ashfaq Kayani and other civil and military leaders during his one-day visit. A spokesman at the U.S. Embassy in Islamabad said that for security reasons he couldn't confirm or deny that Adm. Mullen would be visiting. Pakistani military officials said the meeting could help calm the situation. The last meeting between Gen. Kayani and Adm. Mullen took place aboard a U.S. ship Aug. 26.

Since then, the U.S. has stepped up missile attacks from Predator drones, while Special Operations forces made their first cross-border raid from Afghanistan Sept. 3. Pakistani military authorities contend that the U.S. attacks, and the civilian casualties they cause, drive people into the arms of the militants.

Drones continued to fly over the North Waziristan tribal region Tuesday, though they didn't fire any missiles. There have been more than 10 missile attacks since Aug. 20, almost all of them targeting suspected sanctuaries of Taliban militant commanders.

"The U.S. is now targeting the Taliban commanders whom it believes are spearheading the insurgency against the coalition forces in Afghanistan," said Talat Masood, a retired Pakistani general and defense analyst. "These commanders also have links with al Qaeda."

Asia inflation forecast is revised up through '09

By Karen Lane

SINGAPORE—The Asian Development Bank has sharply raised its forecast for inflation across developing Asia this year and next, warning that rising prices may be out of control in some countries.

That is likely to hurt growth in the region, which the ADB now expects to be slower through next year than it had forecast in April.

Inflation in the Manila-based multilateral development bank's 44 Asian member countries is likely to average 7.8% this year and 6% in 2009, according to the Asian Development Outlook 2008 Update. That is a big jump from the April forecast of 5.1% and 4.6%, respectively, and sharply higher than the 4.3% logged last year.

"Although central banks have begun to tighten monetary policy, some may have let the inflation genie out of the bottle by doing too little, too late, since interest rates in most countries are still lower than inflation," the ADB said Tuesday.

Rising prices and weakness in major global economies will also weigh on the developing Asian economy, which the ADB now expects to expand 7.5% this year, down a shade from its previous forecast of 7.6%, and to grow 7.2% next year. In April, it forecast 7.8% growth next year. The region's economy grew 9% in 2007.

"The downside risks to developing Asia's growth prospects are now more apparent than in April. Global conditions are more volatile—the financial crisis has not yet fully run its course," it said.

Inflation forecasts

The Asian Development Bank revised its inflation rate forecasts for 2008 sharply upwards

Source: Asian Development Outlook 2008 Update

Asia has suffered from the subprime crisis largely through a drop-off in demand for its exports.

"The risks of a second Asian crisis have abated, but not disappeared," the ADB said. It warned that a sharp deterioration in the subprime crisis could reverse capital flows to Asia. Asia's economies suffered heavily in 1997-98 in large part because of the fallout from structural weaknesses in the region's financial systems.

—Jackie Cheung in Hong Kong contributed to this article.

Iraq voter sign-up falls short

By Gina Chon And Zaineb Naji

BAGHDAD—As Iraq's Parliament haggles over an election law, election-commission officials say they are disappointed by low voter registration ahead of provincial polling that could take place later this year.

Last month, only 2.9 million out of 17 million eligible voters went to election centers during a registration drive, according to election-commission figures. That was after officials extended their deadline by a week. Meanwhile, just 100,000 of Iraq's more than two million internally displaced population applied for absentee ballots.

Iraqis who voted in the last election didn't need to re-register if their personal details hadn't changed. So, the low rate won't necessarily translate into low turnout.

Participation in the drive was seen as a gauge of voter excitement amid an improvement in security across the country. To encourage voting, Iraq's revered Shiite cleric Grand Ayatollah Ali al-Sistani urged Iraqis to participate in the drive.

"It's very disappointing," said Faraj al-Haidari, the head of Iraq's election commission.

The apathy coincides with criticism of the government for failing to take advantage of security gains to improve basic services. Unemployment is rampant, and there is little evidence of promised reconstruction in many areas.

Law could hurt chemical makers

By Matthew Dalton

The European Union's new environmental law could affect some chemical makers' sales, according to Innovest Strategic Value Advisors, a firm that advises funds on the environmental liabilities of their investments.

Ciba Specialty Chemicals Corp., **BASF** SE, **Lanxess** AG, **Clariant** AG, **Bayer** AG and **Dow Chemical** Co. are the companies most at risk from the law, known as Reach, according to an Innovest report to be released Wednesday.

Innovest based its estimate on a list that environmental groups planned to release Wednesday, detailing about 270 chemicals they say should be on a regulatory watch list. The European Chemicals Agency, which must implement the law, has yet to decide the list. Once it has, it then has to decide under what circumstances it will allow manufacturers to use the chemicals, and might ban the use of some chemicals.

If the chemicals agency aggressively limits uses of authorized chemicals, Innovest estimates that nearly 30% of Ciba's annual sales would be affected. The figure is about 26% of sales for Lanxess and BASF, 24% for Clariant, 22% for Bayer and 18% for Dow Chemical.

The report analyzed 73 chemical companies and identified 11 with 2% or more of their sales at risk. The estimates are based on the amount of dangerous chemicals a company sells into European markets.

Wall Street political donations set to slow

Industry turmoil to hit fund raising; June, July show drop

BY BRODY MULLINS AND MARY JACOBY

WASHINGTON—Barack Obama and John McCain blamed executive greed Monday for the turmoil in financial markets. But both men, and their parties, have relied heavily on Wall Street cash to fuel their campaigns, and the slowdown threatens to dry up that lucrative source of donations.

Employees of **Merrill Lynch** & Co., the investment bank that agreed over the weekend to be sold to **Bank of America** Corp., have been the largest corporate givers to Sen. McCain's campaign through the end of July, according to an analysis of federal election records by the nonpartisan Center for Responsive Politics in Washington. Merrill employees have given $297,000 to the Arizona Republican and $191,000 to Sen. Obama, an Illinois Democrat.

John McCain

Investment bank **Lehman Brothers Holdings** Inc., which filed for bankruptcy-court protection early Monday, has been the eighth-largest corporate giver to Sen. Obama's campaign this election cycle, with Lehman employees donating $361,000. Lehman employees gave $117,500 to Sen. McCain's campaign.

Democrats, in particular, have become more reliant in recent years on Wall Street money. The second-largest source of donations to all Democratic candidates in the 2008 campaign has been the securities and investment industry. The industry ranks as the third-biggest giver to Sen. Obama's presidential campaign.

The securities and investment industry is also the No. 2 giver to the Republican Party and its candidates, and to Sen. McCain.

Industry employees have donated more money to Democrats than Republicans this cycle. Through June 30, Democrats had received 56% of the $101.4 million in donations from industry employees. In the 2004 campaign, Republicans took in 52% of the $97.7 million donated.

Barack Obama

Both parties can expect less going forward. "The financial community is obviously poorer than a year ago," said hedge-fund manager Orin Kramer, a top Obama fund-raiser.

From the time Sen. Obama launched his presidential campaign last year until May 30 this year, the securities and investment industry had donated $9.2 million to his campaign. In June and July, the securities and investment industry fell to the No. 6 source for giving from the No. 2 source for Sen. Obama, donating $719,000, according to the Center for Responsive Politics data.

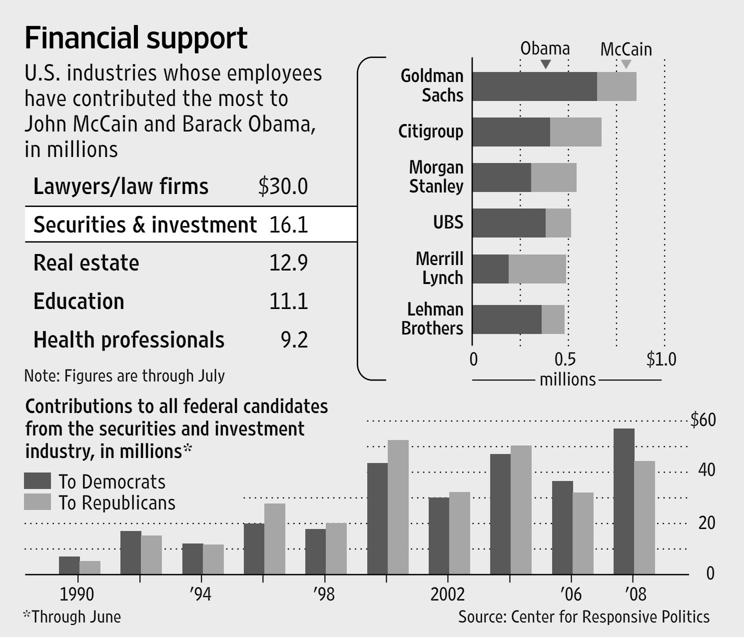
Those two months saw a significant drop in donations from several investment companies that once ranked as top givers to Sen. Obama.

From the start of the 2008 election cycle, Lehman employees donated a total of $1.9 million to candidates for president, Congress and political parties. Of that amount, nearly two-thirds went to Democrats. But in June and July, donations from Lehman fell, dropping the company off Sen. Obama's list of top campaign contributors for those months.

Lehman wasn't alone. A handful of major Wall Street firms that once ranked among the top donors in the 2008 campaign all but stopped making donations in June and July as conditions on Wall Street deteriorated. Those companies include Bear Stearns Cos., **UBS** AG, **Credit Suisse Group** and **Ernst & Young** LLP.

Trouble at several other companies could hurt fund raising for Sen. Obama and other Democrats. Employees of insurance giant **American International Group** Inc., for example, have given 66% of their $647,000 in total political donations to Democrats in the current election cycle, after favoring Republicans from the mid-1990s through early 2000s.

AIG was meeting Tuesday with Federal Reserve officials to find the cash the insurer needs to stay in business. The company's cash crisis was exacerbated late Monday after ratings firms downgraded its credit ratings.



Another victim of the credit crunch, savings-and-loan **Washington Mutual** Inc., began favoring Democrats in this election cycle after leaning toward Republicans in the 2006 elections.

Washington Mutual employees and its political action committee gave $428,000 in federal donations this election cycle, with 57% of that amount going to Democrats. In the 2006 elections, the lender's PAC and employees gave 54% of their $600,000 in federal donations to Republicans.

Sen. Obama has raised more money this campaign from employees of **Fannie Mae** than any other candidate for president or Congress, according to fund-raising reports. Sen. Obama has received more than $80,000 this election cycle in individual contributions from employees of Fannie, including many of the firm's top brass. By contrast, Sen. McCain received $6,550 from the company, $1,000 of which was given by departing Chief Executive Daniel Mudd.

Democratic fund-raisers say any donations that Sen. Obama could lose in the short term will be made up for by support and money from those who blame the sitting Republican administration for the weakness in the U.S. economy.

"I don't have to work that hard to make the case that the Bush-McCain regulatory regime has produced a failure of epic proportions," said Mr. Kramer, the Obama fund-raiser.

—Louise Radnofsky contributed to this article.

U.S. stimulus plan faces obstacles

BY GREG HITT AND SARAH LUECK

WASHINGTON—House Democratic leaders plan to push for action on a $50 billion economic-stimulus package, betting that financial-market turmoil will overcome Republican reluctance to spend more on highways and bridges.

The White House has so far resisted proposals for a second stimulus package, as have Republican congressional leaders. Democrats say the measure is needed to create jobs and bolster public confidence in the U.S. economy. The partisan divide underscores how even the turmoil on Wall Street has yet to alter the politics of gridlock on Capitol Hill.

Democratic leaders hope to move the bill to the House floor late this week or early next, after concluding action on legislation that would overhaul U.S. energy policy. The energy issue has been an election-year boon for Republicans, who have gained traction with voters by arguing that Democrats aren't doing enough to meet the nation's energy needs in an era of $4-a-gallon gas.

The biggest piece of the Democratic bill would provide funding for infrastructure projects, congressional sources said. The bill would also provide money for food stamps and help to cash-strapped states that are shouldering increased costs in Medicaid, the health program for the poor.

Still undecided is whether the bill will serve as a vehicle for $25 billion in federally backed loans for the auto industry. The loans have picked up momentum on Capitol Hill. But lawmakers may decide to attach the aid for Detroit to an end-of-session measure needed to fund the government beyond Sept. 30.

In the Senate, Democrats have been working on a similar track, saying that stimulus legislation of $50 billion to $75 billion is needed to help the struggling economy in the short-term. They, too, have backed funds for Medicaid, jobless benefits, infrastructure projects and heating assistance.

Democrats also want to use action on the stimulus package to highlight their argument that President George W. Bush is to blame for the jittery economy.

Nancy Pelosi

Speaker Nancy Pelosi, a California Democrat, said Monday that the current financial turmoil is the result of "eight years of weakened regulation" under President Bush. She urged the Bush administration to work with Democrats on an "economic package that will create jobs."

House Minority Leader John Boehner, an Ohio Republican, countered that Democrats are to blame, saying the upheaval is "another sign that the destructive tax-and-spend economic policies promoted by this Democratic Congress are failing." Mr. Boehner said lawmakers need to "get our economy moving again," but added it shouldn't be done "by growing the size of the federal government."

The sharp exchanges contrast with the cooperation displayed at the beginning of the year, when Congress and the White House rushed action on an economic-stimulus package. President Bush largely dictated terms of that bill, demanding a package of tax rebates.

In the current debate, House Minority Whip Roy Blunt has tried to stake out some middle ground. Late last week, the Missouri Republican said he expects "some things will happen in the stimulus package" and pointed to jobless benefits and home-heating assistance for the poor as two initiatives worth considering.

But for now, Democrats are pushing ahead with their own agenda, insisting on a broader package of at least $50 billion.

There's little doubt the House, where Democrats hold a significant majority, will pass a stimulus package. And some Republicans, particularly those who represent economically struggling districts in the Rust Belt, could well join in support of the plan.

On the other side of Capitol Hill, Senate Republicans, especially those in tight re-election races, will be under pressure to show they are taking action to respond in tough economic times. But with Republican leaders and the White House so far standing against another stimulus bill, the chances of the Democratic measure clearing the Senate are uncertain.

FBI struggles to fit into role as U.S. intelligence collector

BY SIOBHAN GORMAN AND EVAN PEREZ

WASHINGTON—Seven years after the 2001 terrorist attacks, the Federal Bureau of Investigation is still facing challenges in remaking itself into a domestic-intelligence organization.

Among the weak points found by an internal study: an insufficient number and quality of intelligence sources; a lack of understanding of what information should be collected; intelligence officers with limited awareness of their local areas; and quality-control problems with analysis.

FBI officials said they are implementing fixes to address the problems. According to documents reviewed by The Wall Street Journal, the study was performed last year to diagnose problems in the FBI's latest initiative to improve intelligence collection and analysis, dubbed the Strategic Execution Team.

FBI Director Robert S. Mueller III testified before Congress Tuesday, and was expected to tout the bureau's efforts in domestic intelligence. He was also going to use the hearings to defend a controversial FBI proposal to loosen restrictions on such operations, such as lowering the standards under which agents can open a preliminary case.

John Miller, the FBI's assistant director of public affairs, says hundreds of agents and analysts have gone through a new training program, which is planned for bureau-wide completion by early 2009. "The FBI's come a long way since Sept. 11," Mr. Miller said.

Several current and former intelligence and law-enforcement officials say the latest efforts still fall short of what is needed. In particular, they say, the FBI hasn't sufficiently addressed its gun-and-badge culture, which gives intelligence analysts a lesser status within the organization.

The FBI has been aggressive in establishing its National Security Branch, its main division dealing with terrorism, as well as specialized units such as one on terror financing. Such moves were recommended by post-9/11 commissions to help transform the bureau from a police agency to one focused on preempting threats.

It also has made strides in communications technology, ensuring that agents and analysts secure email accounts to link them to counterparts in other intelligence agencies.

The FBI fought to retain control over domestic intelligence, and in response to a 2005 presidential commission created the National Security Branch to house intelligence and counterterrorism activities.

"There was no pushback" from the FBI as it implemented the commission's recommendation, said Peter Ahearn, a former FBI field-office chief and former senior adviser to Director of National Intelligence Mike McConnell.