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U.S. lawmakers defeat bailout package

Vote stuns markets already in turmoil; next, a revised bill?

By Greg Hitt

WASHINGTON—The U.S. House of Representatives delivered a stunning defeat to legislation designed to rescue the nation's troubled financial system, sweeping aside a call from President George W. Bush to "send a strong signal" of confidence to markets at home and abroad.

The 228-205 vote Monday exposed deep unease among rank-and-file lawmakers in both parties with what would be an unprecedented intervention in the private sector. The vote came as turmoil in financial markets widened, prompting the Federal Reserve to inject new capital into credit markets and forcing the government-arranged sale of Wachovia Corp. to Citigroup Inc.

The Dow Jones Industrial Average was down 7% at Monday's close, while the Nasdaq Composite Index dropped 9.1% and the Standard & Poor's 500-stock index shed 8.8%.

The Bush-backed package now faces an uncertain future, though party leaders on both sides of the aisle are sure to consider revising the initiative, which Mr. Bush said Monday is needed to "keep the crisis in our financial system from spreading throughout our economy."

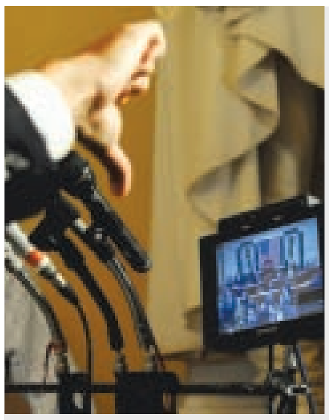
After the vote, House Minority Leader John Boehner (R., Ohio) said there would be an effort to bring back another bill, with further changes.

"We've got to find a true middle ground," he said. "We need everybody to calm down and relax and get back to work."

Ahead of the vote, Republican and Democratic leaders closed ranks around the White House, in a display of bipartisanship that further underscored the challenges facing the bill.

Mr. Boehner urged lawmakers in advance of the roll call to set aside "what's in the best interest of our party," and to instead consider the interest of the nation. "These are the votes that separate the men from the boys, and the girls from the women," said Mr. Boehner, who choked up as he spoke. Mr. Boehner also made clear the vote was going to be close, saying it "is in serious doubt."

Ahead of the vote, Mr. Bush and Vice President Dick Cheney, along with Treasury Secretary Henry Paulson, joined in lobbying for the bill, telephoning wavering rank-and file Republicans. A range of business groups, including the National Federation of Independent Businesses and the Business Roundtable, also pressed lawmakers in an effort to shore up support.

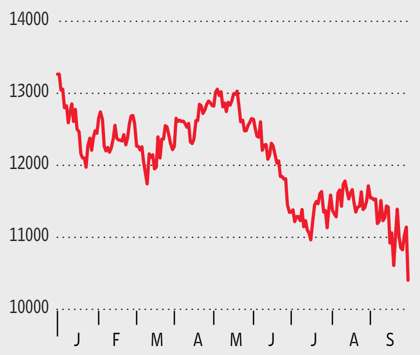


Associated Press

Reporter gives a "thumbs down" signalling that the vote on the financial bailout package failed to pass on Capitol Hill in Washington

DJIA Down

Monday's close: 10365.45, down 7%



Source: Thomson Reuters Datastream

The measure would give Treasury a $700 billion line of credit and wide authority to buy the toxic mortgages, securities and financial assets that are undermining market confidence and threatening to tilt the U.S. into recession.

Under the bill, the money would be released in installments, with $250 billion being made available to Treasury immediately, followed shortly by an additional $100 billion. The final installment would be released after the president submits a plan detailing use of the funds, and lawmakers are given 15 days to consider a resolution of disapproval. Alongside the basic bail-

Please turn to page 35

What's News—

Business & Finance

EU banking rules will be revised as the bloc struggles with its spate of bank failures. It will propose changes to include creating groups of national regulators to supervise banks doing business across national borders. **Page 1**

■ **RBS shares fell** 13% in London amid jitters that it could have a hard time swallowing its piece of ABN. **Page 3**

■ **Citigroup set a deal to buy** Wachovia's banking operations for $2.1 billion in stock. The U.S. government agreed to absorb some future losses. **Page 36**

■ **U.S. stocks plunged** 7% as the House rejected the proposed rescue plan. European shares tumbled on the wave of bank bailouts. Nymex crude oil dropped 9.8%. **Pages 19, 20**

■ **The U.S. Fed faces** further pressure to take more steps to deal with the financial crisis, following the House's rejection of a bailout plan. **Page 2**

■ **MUFG said it sealed** a deal to acquire a 21% stake in Morgan Stanley for $9 billion. **Page 2**

■ **European supermarkets** are targeting discount-hungry shoppers with store-brand groceries and special low-price stores call "hard discounters." **Page 4**

Markets 4 p.m. ET

MARKET	CLOSE	NET CHG	PCT CHG
DJIA	10394.92	-748.21	-6.71
Nasdaq	1983.73	-199.61	-9.14
DJ Stoxx 600	251.43	-14.49	-5.45
FTSE 100	4818.77	-269.70	-5.30
DAX	5807.08	-256.42	-4.23
CAC 40	3953.48	-209.90	-5.04
Euro	$1.4432	-0.0165	-1.13
Nymex crude	$96.37	-10.52	-9.84

Money & Investing > **Page 19**

World-Wide

The U.S. House dealt a stunning defeat to a $700 billion bailout bill designed to rescue the country's financial system, despite Bush's call to send a "strong signal" of confidence to markets. The package faces an uncertain future, though party leaders on both sides are sure to consider revising it. **Pages 1, 14**

■ **Eleven European tourists** and eight guides were rescued by Egyptian and Sudanese troops in an assault on kidnappers near Sudan's border with Chad. **Page 10**

■ **A car bomb hit** a military bus in Tripoli, Lebanon, killing at least five people and injuring 26, nearly all soldiers. **Page 10**

■ **The U.S. attorney general** named a prosecutor to investigate whether Bush administration officials violated law when they fired nine U.S. prosecutors.

■ **Belarus elections** that failed to elect a single opposition lawmaker "fell short" of democratic standards, observers said. **Page 9**

■ **U.S. and Syrian diplomats met** over the past week in New York, in a sign of a potential thaw between the two countries. **Page 9**

■ **U.S. warships and helicopters** circled a hijacked Ukrainian ship loaded with 33 tanks and other weapons in the Indian Ocean.

■ **Pakistani forces killed** 15 insurgents near the Afghan border. Fighting in the area has forced 20,000 people to seek refuge in Afghanistan, the U.N. said.

■ **Cadbury pulled** Chinese-made chocolate from Asian stores, and Heinz said it will no longer use Chinese milk in baby food. **Page 6**

Editorial & Opinion

Europe's turn

After gloating about U.S. financial ills, the old world learns it has its own problems. **Page 11**

Crisis deepens in bank sector across Europe

A WSJ News Roundup

A new wave of turmoil in the European banking system deepened as institutions from Belgium to Iceland succumbed to government bailouts or crises of confidence.

European governments and central banks rushed to the aid of financial institutions struggling to stay afloat amid a shutdown in the markets on which they depend to borrow money. In Germany, the government and a consortium of private banks provided a €35 billion ($51.15 billion) rescue package for big commercial lender **Hypo Real Estate Holding** AG. In Iceland, the government nationalized the country's third-largest bank, **Glitnir Banki** hf, pumping in €600 million for a 75% stake. And in Russia, Prime Minister Vladimir Putin said the government will allocate $50 billion—and more if needed—to provide banks with funds to pay back foreign loans coming due.

Meanwhile, banks' stock prices fell as investors guessed which institutions would be next to run into trouble. Shares in Belgian-French bank **Dexia SA** plunged 29% in Paris following analysts' comments that the company will need to carry out a capital increase to bolster its finances. Shares in U.K. bank **Royal Bank of Scotland Group** PLC fell 13% amid concerns the bank could face difficulties similar to that of Dutch-Belgian bank **Fortis** NV, which joined RBS last year in a consortium to buy Dutch bank ABN Amro for $101 billion. RBS declined to comment. A Dexia spokeswoman said the company has no liquidity problems, but it is closely monitor-

Please turn to page 33

EU to rewrite regulation amid latest bank failures

By **Joellen Perry** *in Frankfurt and* **Alistair MacDonald** *in London*

The European Union's top markets official is preparing new rules to overhaul banking regulation across Europe, as the Continent struggles to deal with its own spate of bank failures.

On Wednesday, Charlie McCreevy, the European Union's commissioner for internal markets, will propose changes that include creating groups of national regulators to supervise banks doing business across national borders. Such operations represent a fast-increasing share of the continent's banking business.

Mr. McCreevy also will ask for rules that force banks to set aside more capital when they sell some of the securitized credit products that were at the heart of the current crisis. In doing so, he joins a wave of European policy makers who have signaled recently they're willing to consider major supervisory and regulatory rule changes to bolster Europe's financial system against future turmoil.

Mr. McCreevy's proposed changes, long in the works, come in the wake of three dramatic weekend bank rescues that demonstrated European banks' vulnerability. The U.K. nationalized troubled mortgage lender **Bradford & Bingley** PLC. The Netherlands, Belgium and Luxembourg agreed to inject €11.2 billion into Dutch-Belgian bank **For-**

Please turn to page 35

THE FINANCIAL CRISIS

Fed pressed to take steps

U.S. ensures cash is available, joins other central banks

By Maya Jackson Randall And Jon Hilsenrath

The U.S. House of Representatives' rejection of a $700 billion financial-market bailout plan potentially puts additional pressure on the Federal Reserve to find solutions for the market's worsening crisis.

In the past year, the Fed has sharply cut interest rates, from 5.25% to 2%, to alleviate pressure on the economy. In addition, the central bank has aggressively expanded its lending powers, advancing funds to struggling financial institutions, including Bear Stearns Cos. and American International Group Inc.

If the economy worsens, the Fed could cut interest rates further, though it is too soon to say if the Fed is prepared to take that step.

Before the House vote Monday, Fed officials already had taken additional steps to ensure that financial institutions would get the cash they needed to run their operations.

The Fed said it would double the size of its so-called Term Auction Facility designed to help cash-strapped banks, to $300 billion. It will also expand its swap facilities with other central banks, aimed at sending dollars abroad, by $330 billion to $630 billion.

"The Fed is stepping in as a counterparty," said Louis Crandall, an economist with Wrightson ICAP. "They're replacing bank funding."

Interbank lending markets have been under worsening strain for weeks. For example, interest rates on three-month interbank loans have soared to more than two percentage points above the federal-funds rate, the central bank's benchmark overnight lending rate—more than twice as high as it was during the market turmoil six months ago when Bear Stearns nearly collapsed. In normal times, there is no difference between these two interest rates.

"In response to continued strains in short-term funding markets, central banks today are announcing further coordinated actions to expand significantly the capacity to provide U.S. dollar liquidity," the Fed said in a morning news release. "Central banks will continue to work together closely and are prepared to take appropriate steps as needed to address funding pressures."

The Fed said dollar funding rates abroad "have been elevated relative to dollar funding rates available in the United States." And that reflects "a structural dollar funding shortfall" outside of the U.S., it said.

The initiatives it announced Monday are aimed at boosting central banks' capacity to provide dollar funding. "This should help to improve the distribution of dollar liquidity around the globe," it said.

The Fed said it would increase the size of the 84-day Term Auction Facility auctions to $75 billion per auction from $25 billion, starting with its Oct. 6 auction. It also announced two forward TAF auctions totaling $150 billion that will be held in November. Thirdly, it announced an increase in swap authorization limits with central banks around the globe, including the Bank of Canada, Bank of England, Bank of Japan, Danmarks Nationalbank, European Central Bank, Norges Bank, Reserve Bank of Australia, Sveriges Riksbank, and Swiss National Bank.

The swap lines will now total $620 billion, compared with $290 billion previously.

Mitsubishi UFJ seals deal for Morgan Stanley stake

By Alison Tudor And Aaron Lucchetti

Mitsubishi UFJ Financial Group Inc. said it sealed a deal to acquire a 21% stake in **Morgan Stanley** for $9 billion.

The move comes at a time when the Japanese are helping to recapitalize the U.S. financial system. Last week, Japan's largest brokerage house by market capitalization, **Nomura Holdings** Inc., acquired the Asian and European operations of **Lehman Brothers Holdings** Inc., which filed for bankruptcy about two weeks ago.

In a reversal of fortunes, the Japanese banks' balance sheets are strong after years of husbanding deposits from wealthy Japanese retirees and paying down bad loans following the bursting of the stock-and-real-estate bubble in the early 1990s. But with little prospect of much growth at home, the banks are shopping abroad while prices are down and the yen is strengthening against the dollar.

Morgan Stanley is hoping the investment will boost the confidence of investors nervous about the firm's bets with borrowed money. Morgan Stanley and **Goldman Sachs Group** Inc. have both lured new capital in recent days to reduce leverage, while converting to bank holding companies.

New York-based Morgan Stanley has fought to remain independent. Morgan Stanley Chief Executive John J. Mack entered talks about a possible merger with **Wachovia** Corp. or an investment from state-owned **China Investment** Corp.

Those options were eclipsed by the idea of linking up with MUFG, the world's second-largest bank holding company, with $1.1 trillion in bank deposits. Mr. Mack visited Tokyo last week on a previously scheduled trip to Asia, where he discussed the deal's terms with MUFG management.

The companies announced plans for a broader alliance that could battle so-called universal banks, such as **Citigroup** Inc. and **J.P. Morgan Chase** & Co., that offer both commercial loans and underwriting services to large corporate clients.

MUFG, traditionally one of Japan's most conservative banks, said it expects to collaborate with Morgan Stanley in retail banking and asset management, where Morgan Stanley might aim to sell mutual funds or advisory services to MUFG customers. MUFG also said Monday it had completed a cash tender offer for the outstanding shares of San Francisco-based **UnionBanCal** Corp. that it didn't already own.The cooperation between MUFG and Morgan Stanley could eventually lead to a broader relationship, especially if Morgan Stanley is viewed as needing a stronger partner. The deal is expected to close within a few weeks, and an MUFG representative will join Morgan Stanley's board.

Investment bank **Lazard Frères** & Co. acted as financial adviser to MUFG, while **BlackRock** provided advice to MUFG on asset valuation.

Aso vows action on economy

By Takashi Nakamichi

TOKYO—Japanese Prime Minister Taro Aso said Monday he will do more to revive the country's faltering economy if needed, and hinted he might even extend the deadline for eliminating the budget deficit.

In his first keynote address to Japan's Parliament, Mr. Aso provided fresh indications of a shift in Japan's economic policy.

Amid an economic slump and ahead of general elections, Mr. Aso is moving away from the platform of former prime minister Junichiro Koizumi that focused on repairing the country's tattered finances and boosting its growth through reforms rather than fiscal spending.

An advocate of expansionary economic policy, Mr. Aso took the reins last week from his predecessor Yasuo Fukuda.

"The urgent task is to get Japan's economy back into shape," Mr. Aso said in prepared remarks for Parliament.

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

THE FINANCIAL CRISIS

Burden of ABN Amro deal weighs on RBS

Shares decline 13% after Fortis bailout causes investor jitters

BY SARA SCHAEFER MUÑOZ

LONDON—It seemed like a good idea at the time.

Royal Bank of Scotland Group PLC, **Fortis** NV, and **Banco Santander** SA may be feeling some serious buyer's remorse a year after completing the biggest banking deal ever, their $101 billion acquisition of ABN Amro Holding NV.

On Monday, almost a year to the day after the deal wrapped up, Fortis was forced to accept a government bailout that requires it to sell much of its stake in the Dutch banking giant.

RBS shares fell 13% in London Monday amid jitters that, like Fortis, it too could have a hard time swallowing its piece of ABN.

"The deal's been little short of disastrous," said Alex Potter, an analyst with the investment bank Collins Stewart. "They timed it horribly and paid too much."

At the time the deal was struck last year, just before the onset of the credit crunch, it seemed like a risky, but potentially, transformative innovation. By banding together, the three banks managed to pull off a deal none could have done on their own. They defeated **Barclays** PLC after a seven-month battle that pulled in banks in the U.S. and Asia as well as a legal dispute that went to the Dutch supreme court.

ABN Amro "will make all of our businesses stronger than they have ever been," the three banks' chief executives said in a joint statement a year ago on inking the deal.

Today, though, as they face a deepening seizure in the markets they depend on for funding, the burden of their victory weighs heavily.

Bank acquisitions are always tricky because it is hard to meld operations from people to computer systems. With ABN, it has been even trickier because the buyers needed to separate the bank first and sell some assets to comply with Dutch law.

Today, much of ABN is still operating separately, awaiting approvals on its final breakup from Dutch regulators, among other factors. That makes it easier for Fortis to sell its pieces. For RBS, that means it could take until the end of next year to integrate its ABN stake, an RBS spokeswoman says.

The only buyer to come out well is Spain's Santander. It picked up ABN units that were easier to detach, separate, and fit better with its core business. It bought ABN's Italian and Brazilian operations for €19.9 billion ($29.1 billion). The Brazilian operations more than doubled Santander's footprint there. The bank quickly sold the bulk of its Italian acquisition, Banca Antonveneta, for a profit of roughly €2.4 billion and plans to sell the rest its operations there for roughly €1 billion.

As banking shakes out globally, Santander is now considered a potential acquirer. It looked at **Wachovia** Corp. before **Citigroup** Inc. acquired assets of the troubled U.S. bank. On Monday, it agreed to buy the branches and deposits of **Bradford & Bingley** PLC as part of the U.K. government's plan to nationalize the troubled mortgage lender, adding to its recent agreement to buy U.K. bank Alliance & Leicester. Analysts say it could look at buying some of Fortis's stake in ABN.

A Santander spokesman declined to comment.

Fortis, a Dutch-Belgian bank and insurer and the smallest of the three buyers, has struggled the most. Buying ABN's private bank, Dutch retail operations and asset-management arm for €24 billion was supposed to transform Fortis from a midtier institution into one Europe's largest private banking operations.

But on Monday it said it would sell the bulk of its stake in ABN in exchange for a government bailout. The Netherlands, Belgium and Luxembourg agreed to inject €11.2 billion into the struggling bank, after potential buyers France's **BNP Paribas** SA and Dutch financial firm **ING Groep** NV walked away.

ING is still interested in buying Fortis's international private banking unit and its Dutch retail-banking unit, according to people familiar with the matter. Analysts expect Fortis to sell those assets at well below what it paid ABN for them.

"We still think that strategically this was a logical deal. But in hindsight, you could question the timing and the price," a Fortis spokesman said Monday.

RBS was in good shape before the deal. Hoping ABN's operations would propel its U.S. expansion, RBS Chief Executive Fred Goodwin helped pull together Santander and Fortis to bid. Instead, RBS ended up with ABN Amro's corporate bank, which has been hit hard by the credit-market turmoil. Stretched for funding, RBS was forced to raise £12 billion ($22.1 billion) in capital in June by selling shares to existing shareholders at a discount, in a so-called rights offering.

Mr. Goodwin was confident about the purchase in a statement at the bank's half-year results in early August. He said integration was ahead of schedule, and expects eventual cost-savings and revenue benefits of £1.6 billion per year. The bank has said that it is happy with the quality of the underlying ABN assets.

A spokeswoman referenced Mr. Goodwin's remarks and declined to comment further Monday.

—Dana Cimilluca contributed to this article.

CORPORATE NEWS

BREWING

InBev's shareholders approve Anheuser deal


Associated Press

INBEV SA shareholders approved the company's takeover of U.S. brewing giant **Anheuser-Busch** Cos. and a capital increase to finance the acquisition.

The $52 billion deal would create the world's largest brewer by volume and combine the Budweiser, Michelob, Stella Artois and Beck's brands.

Shareholders also approved changing the company's name to Anheuser-Busch InBev, the appointment of Anheuser-Busch Chief Executive August Busch IV to the enlarged company's board and a capital increase of as much as €10 billion, or about $15 billion. The deal is to be financed with $45 billion of debt.

—Matthew Dalton

TELECOMMUNICATIONS

Vodafone selects leaders for emerging markets

Reuters

VODAFONE Group PLC appointed heads for two new emerging-markets divisions, sealing new Chief Executive Vittorio Colao's top-management structure after a shake-up this month.

The mobile operator's former U.K. chief, Nick Read, will run the Asian-Pacific and Middle East business, while Morten Lundal, formerly head of the Middle East and Africa operations, will run Central Europe and Africa.

The move also put control of the U.K. company's U.S. joint venture Verizon Wireless in the hands of the CEO, finance chief and strategy director.

—Kathy Sandler

WSJ.com

Loans for U.S. car makers promote fuel-efficiency


Associated Press

THE U.S. government is about to offer billions of dollars to auto makers. The funds will force big changes because they are targeted to subsidize the production of cars with technology to reduce oil consumption.

That means that to get the money, Detroit's Big Three will have to stop showing off prototypes of high-technology vehicles and start building them.

They seem to be prepared to do this.

WSJ.com subscribers can read Joseph White's Eyes on the Road column at WSJ.com/Autos.

'Hard discount' stores take off

As food prices climb, more shoppers flock to cheaper groceries

EUROPEAN SHOPPERS, hit by rising prices and stagnant salaries, are hungry for cheaper groceries. Major supermarkets are responding by allocating less shelf space to international brands and more to store brands, often at half the price. Some retailers are going even further, opening no-frills "hard discount" stores that display products in their cardboard delivery boxes.

The movement is reshaping European retailing. Upscale stores such as Britain's **Marks & Spencer Group** PLC, which is a major food seller in addition to operating department stores, are losing sales. Supermarket chains, such as France's **Carrefour** SA and **Tesco** PLC in Britain, are developing cheaper product lines. And sales of major brands such as those of **Danone** SA and **Unilever** are under pressure in Europe.

By **Christina Passariello** *and* **Max Colchester** *in Paris;* **Aaron O. Patrick** *in London*

Though many American supermarkets also sell house brands, they are far more prevalent in Europe. Store brands account for some 22% of sales in Europe compared to 16% in the U.S., according to market-research firm Euromonitor International. The spread of hard discount stores is even more striking: They accounted for 10.5% of grocery distribution in Europe last year, compared to just 1.6% in North America, according to Planet Retail, another market-research firm.

The danger for international food companies is that the discounters will make European consumers expect lower prices and "fundamentally change the retail landscape," said Martin Deboo, a retail and food analyst at Investec Securities Ltd. in London.

Louise Allouche, a 42-year-old mother of three living outside Paris, said she monitors her grocery bill more carefully after a year of rising prices. One strategy: She has begun to shun some name-brand products in favor of store-label ones. "Frankly, there is little difference," she said recently outside a Carrefour supermarket. "The laundry detergent cleans the clothes and the milk tastes the same. Overall, I find supermarket brands much more price competitive."

The largest supermarkets are obliging. Carrefour and Tesco as well as **Groupe Casino** SA in France are expanding their own-brand wares, providing cut-price versions of products such as Kellogg's Corn Flakes and Heinz ketchup. In July, Carrefour Chief Executive Jose Luis Duran said the company had recently seen a "severe" drop in sales of major labels, but that "home-brand labels continued very well."

The strategy contrasts with that at most low-price U.S. retailers. **Wal-Mart Stores** Inc., for example, has a smattering of house brands in its grocery aisles but largely holds down prices for name-brand goods by driving down what it pays suppliers.

Hard-discount stores, meantime, could represent one of the biggest grocery upheavals since the rise of supermarkets decades ago. These chains offer no-frills shopping and typically just 900 to 1,600 products, which are mostly store brands. That compares with more than 20,000 products in large supermarkets. Having fewer products reduces the cost of buying, packaging, transporting and displaying the goods. The stores also charge for plastic shopping bags and keep staff numbers low.

Schwarz Group's Lidl and **Aldi Einkauf** GmbH, both German firms, pioneered the business, and have in recent years ventured across Europe, especially to France and the U.K. Aldi has 375 stores in the U.K., and plans to open 1,100 more there over the next five years. (Aldi also has expanded in the U.S., where it has more than 950 stores.)

Others are following the model. Casino has been aggressively ramping up its existing hard discount chain, Leader Price. It packages its products in more basic wrapping than international brands and doesn't advertise. "Hard discount is a well-adapted response for people who are worried about the economy," said Jean-Charles Naouri, Groupe Casino's chairman and chief executive.


Associated Press

Pricing up

Cost comparison of internationally and store-branded products, in euros

Named brand	Price	Store brand	Price
Lactel skimmed milk, 1 liter	1.10	Skimmed milk, 1 liter	0.85
Heinz tomato ketchup, 700g	2.41*	**Oak Lane** ketchup, 730g	0.75*
Danone Activia Nature, 4-pack	1.44	**Bifidus** Nature, 4-pack	0.95
Kelloggs Cornflakes, 500g	2.13*	**Country Barn** Cornflakes, 500g	0.95*
Fairy Washing Up Liquid, 500ml	1.24*	**Daisy** Washing Up Liquid, 500ml	0.75*

Sources: Tesco; WSJ research

* Converted to euros at current rate

In France, hard discount now accounts for 15% of the grocery market, up from 10% five years ago, according to banking company Investec. A new retail law in France is expected to hasten store openings by removing some of the limits on development.

The trend is producing contrasting results at retail concerns. In the U.K., Aldi's sales rose 21% in the 12 weeks ending Sept. 7 from the year-earlier period, according to research firm Taylor Nelson Sofres PLC. But the upmarket Marks & Spencer chain says its U.K. sales fell 0.5% in the 13 weeks to June 28, the latest figures available.

Tesco, preparing to do battle with hard discounters, earlier this month began selling 350 new cheap products under its own brands, including tea bags, cookies and shampoo. "If there is a war, we will win it," said Tesco's commercial director, Richard Brasher.

Though the current economic downturn is encouraging hard discount, the trend won't be fleeting, predicted Nirmalya Kumar, professor of marketing at London Business School. Having studied shopping trends in recessions, he estimates that about half of Aldi's new customers will stay even when the economy improves. "After trying Aldi and Lidl, they say: 'These people are not that bad,'" he said.

The losers could include the big international food producers, which spend billions marketing branded products that sell at higher prices. At Aldi, only 5% to 7% of products are well-known brands, retail analysts say. The proportion at Lidl is higher—25% to 35%—but it only stocks the most popular items like Unilever's Hellmann's mayonnaise and **Procter & Gamble** Co.'s Ariel laundry detergent. Casino's Leader Price's shelves feature no well-known brands.

Still, some consumers simply like particular brands, and say they'll continue to buy them. Lionel Baguudy, a 43-year-old Parisian security guard, said he buys Carrefour store-brand milk but can't resist mango-flavored Activia yogurt, made by Danone. And his three teenage children insist on pasta made by Italy's **Barilla Group**.

"The problem is that the kids love branded food," he says. "I have to feed them and they eat a lot."

Alitalia unions clear way for sale to investor group

BY LUCA DI LEO

ROME—**Alitalia** SpA got final clearance Monday for a government-engineered privatization after the last two labor unions agreed to the rescue plan.

Avia and SDL, which represent flight crew and ground staff, joined the struggling airline's seven other unions in backing a plan under which a group of domestic investors are set to invest €1 billion ($1.46 billion) for Alitalia's viable assets, including airport slots and newer planes, and merging them with Italian carrier **Air One** SpA.

The airline's key pilots union agreed to the plan last week after the investors made concessions, including on salary levels and contractual benefits.

The group of 16 investors—led by businessman Roberto Colaninno and including the Benetton family and **Intesa Sanpaolo** SpA, one of Italy's largest banks—must now pick a foreign partner for Alitalia, with attention focused on **Air France-KLM** SA or **Deutsche Lufthansa** AG.

Welfare Minister Maurizio Sacconi on Monday said the Franco-Dutch carrier and the German airline had equal chances of becoming Alitalia's partner. Alitalia is a member with Air France-KLM in the international SkyTeam marketing alliance, while Lufthansa is a partner of Air One in Star Alliance.

An Air France-KLM spokeswoman declined to comment, and Lufthansa couldn't be reached to comment.

The deal could still face scrutiny from the European Union on whether competition rules were violated and if Alitalia benefited from illegal state aid.

Mr. Colaninno and his allies are being aided by government measures that allow for Alitalia's €1.2 billion in debt to be taken on by the state and the suspension of competition rules so that Alitalia would continue to operate an effective monopoly on the lucrative Rome-Milan route.

Alitalia's future had been in doubt after unions originally rejected the rescue plan.

—Elisabetta Rovis contributed to this article.

CORPORATE NEWS

Nokia sticks to forecast despite slowdown

Mobile-phone maker expects to hit target for operating margin

BY ADAM EWING

STOCKHOLM—**Nokia** Corp. says it will hit its profit-margin targets this year, even after a third-quarter slowdown, and disclosed plans to sell a security business unit and cut about 700 software development positions.

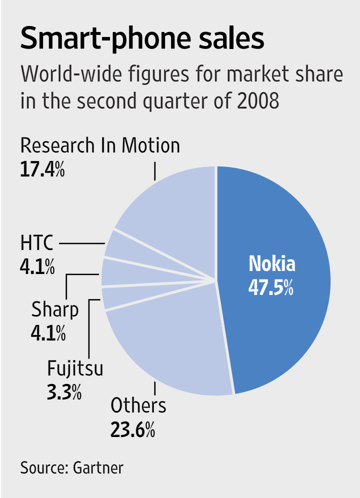
The world's largest cellphone maker by unit sales warned this month that price cutting by competitors would slightly reduce its global market share on devices during the quarter ending Sept. 30. According to research firm Gartner, Nokia had a global market share of 40% of all cellphones at the end of the second quarter of this year.

But the company renewed the goals set in late 2007 to post a near-20% operating margin in its device and services business through 2009, up from its 2006 outlook that saw its device business—its former mobile-phones and multimedia units combined—target a margin of 17% through the end of this year. It said the price cuts announced by its competitors were "unsustainable."

"Certain price action by those who don't have certain core advantages might not be as long-lasting as they By might think," Chief Financial Officer Rick Simonson said at a news conference in early September. Nokia wouldn't comment further.

But analysts say the Finland-based company will be hard-pressed to meet the optimistic projections as emerging-market and replacement sales slow. A weaker global economy, heightened competition and slowing sales of highly profitable smart phones will likely slice into earnings and force the company to scale down its outlook when it speaks to investors again on Dec. 4. "There's a disconnect," said Société Générale analyst Andy Perkins. "Market expectations of Nokia are inflated."

Nokia's shares have lost a bit more than half their value this year to hit a three-year low of €12.65 ($18.49). Over the same period, the



shares of South Korean rival **Samsung Electronics** Co. are down 7%, LG Electronics Inc. shares are 5% lower and shares of Taiwan-based **HTC** Corp. have risen nearly 17%, boosted by hype around its latest touch-screen phone, which uses Google's new Android operating system.

But a recovery in sales and profit may not be in the offing for some time, because expectations for next year don't seem to fully reflect the expected slowdown, analysts say.

Key to supporting earnings will be Nokia's ability to lift sales of smart phones—handsets that provide wireless Internet, audio and video capacity, and mapping applications. But sales of those high-tech phones aren't moving as quickly as in past quarters.

Gartner said this month that 32.2 million smart phones were sold in the second quarter, up 16% from a year earlier but much slower than the same quarter in 2007, when sales rose 55% from a year earlier.

Rival smart-phone developers, such as Apple Inc. with its iPhone, Samsung and Blackberry maker **Research In Motion** Ltd. are part of a growing challenge to Nokia, which saw its smart-phone market share slip in the second quarter to 47.5% from 50.8% the previous year, according to Gartner.

Research In Motion, of Waterloo, Ontario, last week said its second-quarter revenue rose 88% from a year earlier on strong sales.

But sales of high-tech phones hinge on consumers with ample cash to spend on luxuries in a slowing economy. J.P. Morgan Chase & Co. predicts global sales for all cellphones will fall 3.9% to 1.2 billion handsets in 2009 from projected sales this year, reflecting an expected sharp decline in global gross domestic product and an extended replacement cycle.

Many of Nokia's competitors also have suffered from the downturn, but Nokia has been largely insulated. Unlike most rivals, whose sales are concentrated in developed markets such as Western Europe, Nokia also has dominated fast-growing emerging markets such as India. But as economic problems creep into these markets, Nokia's sales growth is also likely to taper.

Nokia is working to get new smart phones to the market and recently launched its new N96 model—which features more memory and a bigger screen for music and video—and is preparing to present its first touch-screen mobile phone on Oct. 2. Nokia's Mr. Simonson said new devices released ahead of the holiday shopping season should lift its market share, supporting margins.

Sal. Oppenheim buys hefty stake in Arcandor

By Hilde Arends
And Kirsten Bienk

DAILY SHARE PRICE
Arcandor
On the Frankfurt Stock Exchange
Monday's close: **€1.87, down 2.1%**
Year-to-date change: down 88%

Source: Thomson Reuters Datastream

German retailer and tourism company **Arcandor** AG scrapped tentative plans to sell its majority stake in tour operator **Thomas Cook Group** PLC and instead opted for a capital increase—a move that produced a new major shareholder, bank **Sal. Oppenheim Jr.** & Cie.

Sal. Oppenheim said it bought a 10% stake in Arcandor for about €59 million, or about $86 million. The bank also said it agreed to buy an additional 19.5% stake from Arcandor shareholder Madeleine Schickedanz, who until now controlled a pool representing 53.3% of Arcandor's shares.

"Our shareholding in Arcandor is a business decision," Sal. Oppenheim said, adding, "We support the management board and its strategy." The bank said it considers Arcandor to be undervalued and expects the market to recognize its potential soon.

The move gives Arcandor some financial leeway, and appears to save it from being forced to sell or reduce its 52% holding in Thomas Cook, its most profitable unit.

Arcandor shares plunged last week after the company said it might cut its stake in Thomas Cook and department-store unit Karstadt in connection with a new refinancing deal with its banks. Arcandor stock plummeted 24% Friday and 30% Thursday.

The stock, which has lost more than 90% of its value in the past 12 months, closed at €1.87 ($2.73) on Monday, down 2.1% from Friday's close. While opting to keep its full stake in Thomas Cook, Arcandor said it is still reviewing its options for its Karstadt unit, which isn't profitable.

Sebastian Hein, an analyst at Bankhaus Lampe, said the capital increase buys Arcandor some time to consider how to approach its problems at Karstadt.

Thomas Cook generates about half of Arcandor's annual sales. In addition, Arcandor, formerly known as KarstadtQuelle AG, also owns mail-order business Primondo GmbH.

Separately, Thomas Cook said it abandoned talks on a possible merger of its Condor airline unit with two other German airlines: Germanwings, a low-cost affiliate of **Deutsche Lufthansa** AG, and TUIFly, a unit of rival **TUI Travel** PLC. Thomas Cook said the recent collapse of some budget carriers amid high fuel prices, in addition to other airlines grounding planes over the winter, had taken enough capacity out of the market to improve Condor's standalone prospects.

—Kaveri Niththyananthan contributed to this article.

More milk items recalled

Cadbury pulls candy from stores in Asia; Heinz drops supply

By **Aaron O. Patrick, Julie Jargon, Sky Canaves** *and* **Jason Dean**

Associated Press

British candy maker Cadbury said tests it did on products made at its Beijing plant have led to **a decision to recall** some of its items from store shelves in the region.

The Chinese milk-safety scandal exposes one of the pitfalls of a key strategy of the world's big multinational food companies: relying on local suppliers in emerging markets.

On Monday, **H.J. Heinz** Co. said it would no longer use Chinese milk in its baby food. At the same time, **Nestlé** SA, the world's biggest food company by sales, said it is examining its procedures for buying milk in China, where it depends on a network of individual dairy farmers.

Heinz and Nestlé are hoping to avoid following in the footsteps of candy maker **Cadbury** PLC, which on Monday began pulling products made at its Beijing plant from store shelves across Asia after finding traces of the industrial chemical melamine in its chocolate.

London-based Cadbury said it is recalling all 11 products made at the chocolate factory as a precaution after preliminary tests "cast doubt on the integrity of a range of our products manufactured in China." Most of the recalled candy is sold in mainland China, Hong Kong and Taiwan. One product line, Cadbury Eclairs Candy, is also marketed in Australia.

The problem shows how big food companies sometimes fall short in their efforts to impose Western-style food-safety standards on suppliers in the developing markets they increasingly rely on for sales growth.

"We rely on suppliers of ingredients to have their own tests," said a Cadbury spokesman in London. "Nobody can look for everything."

Since earlier this month when China's milk scandal erupted, tainted milk used to make baby formula has killed several children and made more than 54,000 others sick with kidney disease. Regulators around the world have found traces of melamine in food containing dairy products, and the U.S., European Union, India, South Korea and others have recalled or banned products.

Melamine, which is commonly used in furniture and building products, is considered so rare it isn't routinely tested for in milk. It was added to watered-down milk or milk that was protein-deficient to make its protein content appear higher.

Nestlé conducts 70 different quality tests on its milk products, but only began looking for melamine on Sept. 14, soon after the scandal became public. Nestlé recalled one product in Hong Kong, on orders from the local government, that had trace amounts of melamine and says it is reviewing its milk sourcing in China, Nestlé spokesman Robin Tickle said.

The decision by Heinz to back away from Chinese suppliers comes just days after the company began to recall 270 cases of baby food in Hong Kong as a precautionary measure. Heinz said it has begun testing all dairy ingredients in products made and sold in China for melamine, even if those ingredients don't originate in China. No one has gotten sick from consuming those Heinz products, the company said.

Heinz, the Pittsburgh ketchup giant, which sells baby food worldwide, said a number of baby-food product lines are already being made with milk from non-Chinese sources.

Over the weekend, Indonesia's Ministry of Health said its tests had found melamine in 12 types of products sold there, including M&M's and Snickers candy bars made by Mars Food Co., Beijing. In a statement Monday, **Mars** Inc. disputed the findings, saying the Indonesian results don't match tests by other Asian governments that have cleared its products.

Mars said it "remains confident that none of its chocolate or confectionery products made in China include any dairy ingredients adulterated with melamine and that all of its products are safe for consumption."

Indonesian Health Ministry officials didn't respond to requests for comment Monday.

In its statement, Cadbury said its dairy suppliers had been cleared in the recent spate of government testing, but it decided to do further tests of its Chinese products. Some of those items came back positive for traces of melamine, said Trish Fields, a spokeswoman for Cadbury Asia Pacific, though she declined to say which ones. The source of the contamination wasn't known.

Sales of Cadbury's Chinese-made chocolates account for less than half a percent of the company's world-wide chocolate sales, Ms. Fields said. In London Monday, Cadbury shares fell 2.5% to 567.50 pence ($10.45).

Cadbury is notifying retailers in China. She said Cadbury had also notified authorities in the other markets involved.

The recall came as Chinese authorities continue to detain people involved with dairy distribution, according to the official Xinhua news agency. Police in Hebei province in northern China detained 22 people involved in a network connected with making and selling melamine and tainting milk, Xinhua said. Among the detained, 19 people were managers of 17 pastures, breeding farms and milk-purchasing stations. According to police, melamine was produced in underground plants and then sold to breeding farms and purchasing stations.

"The latest developments have shown that [sourcing ingredients globally] is a challenge for many companies and it's something Mars has paid very close attention to since day one. What's critical in the case of our system is that although we use some Chinese suppliers of milk powder, they own and control the entire pipeline from milk production to milk collection to milk processing, without any interference from any traders or middlemen," says Khaled Rabbani, Mars Inc.'s director of corporate and regulatory affairs for Asia Pacific.

"That's important because we understand that melamine has been introduced into the dairy supply by unscrupulous traders that would buy it from farmers, dilute it with water and add melamine to increase the apparent protein level. One way to mitigate that risk is to have no middlemen or traders involved in your supply chain."

He says Mars sources milk powder from the U.S., New Zealand and two suppliers in China for its chocolates made in China. Mr. Rabbani says the company's Chinese suppliers undergo a rigorous vendor assurance process that entails random testing of ingredients for things like nutrient composition and Ph level. The company hadn't been testing for melamine but says it is seriously considering whether to start now.

Mr. Rabbani said that shortly after news of tainted baby formula broke, Chinese food safety authorities informed Mars that samples of the milk powder it uses were clear of melamine. To be sure, Mars also sent samples of milk powder to an independent lab in Germany, and those too were clear, Mr. Rabbani says.

Food safety regulators in Hong Kong, Korea, Malaysia, Taiwan and Thailand have tested samples of the finished products Mars sells in those countries and found them to be clear of melamine, he says. Mars also has tested its own finished products and come up with the same results.

However, Indonesia's Ministry of Health over the weekend said its tests found melamine in a dozen products sold there, including M&M's candies and Snickers chocolate bars made by Mars.

"Those results conflict with and are completely inconsistent with all the results received by Mars from both independent labs that tested milk powder and finished products and government labs that tested finished products in other countries," Mr. Rabbani says. "We want to work with the Indonesian authorities to understand how they arrived at their conclusions, because at the end of the day food safety is critical to us."

The Indonesian government also said it had found melamine in Oreo wafer sticks made by Kraft Foods Inc. Kraft spokeswoman Claire Regan said that while the Oreo wafer sticks sold in Indonesia are made in China, they do not contain any dairy ingredients sourced from China.

CORPORATE NEWS

BSkyB loses ITV appeal

U.K. court orders company to reduce stake in broadcaster

By Erica Herrero-Martinez

LONDON—A U.K. government tribunal ordered **British Sky Broadcasting** PLC to reduce its 17.9% stake in television broadcaster **ITV** PLC, rejecting the company's appeal of last year's ruling by the U.K. Competition Commission that the stake was anticompetitive.

Under the terms of the Competition Appeal Tribunal's Monday ruling, BSkyB must cut its stake in ITV to under 7.5%. BSkyB has about a month to decide whether to appeal the decision to the U.K.'s Court of Appeal.

"(BSkyB) will review and carefully decide on next steps in due course," BSkyB said in a statement. ITV said it welcomed the judgment.

Some analysts saw the investment as a way to block a potential merger between ITV and cable operator NTL Inc., now called **Virgin Media** Inc. The talks were called off after BSkyB bought its stake in 2006.

"We've consistently maintained that this undermined the plurality of the U.K.'s media and reflected a systematic effort to suppress competition," a Virgin Media spokesman said following the ruling. "We're pleased that the Competition Appeal Tribunal has rejected Sky's appeal."

The disposal could spark a full takeover bid for ITV. Analysts have suggested Israeli television and media tycoon Haim Saban, broadcaster **RTL Group** of Luxembourg and Dutch company **Endemol** NV as potential buyers. RTL declined to comment on whether it was interested in buying a stake or the whole of ITV. Spokesmen for Mr. Saban and Endemol weren't immediately available to comment. **News Corp.**, owner of The Wall Street Journal publisher Dow Jones & Co., holds a 39.1% stake in BSkyB.

EU restarts review of BHP-Rio Tinto deal

By Charles Forelle

BRUSSELS—The European Union's antitrust regulator restarted its examination of **BHP Billiton**'s proposed $130 billion hostile takeover of rival miner **Rio Tinto** and set a Jan. 15 deadline for its decision, all but assuring that a deal—if it is consummated—won't be final until next year.

The European Commission had paused its examination for about a month, citing a failure by the parties to turn over information it had requested. EU rules require the commission to render a verdict on deals within a fixed time limit, but the clock can be stopped if the regulator deems that a company hasn't complied promptly to a request for information.

Before the suspension, BHP had predicted it would overcome regulatory hurdles before the end of this year. Later, BHP's chief executive said the date could slip into early 2009. That appears almost certain: In a large and highly complex case, the EU is likely to use all its allotted time.

Hostile bidders in takeover contests regularly seek EU regulatory clearance before they have ensnared their prey, in part to remove potential antitrust worries from the target company's defensive arsenal.

There is no guarantee that BHP will be successful in securing clearance. The EU in the past has expressed concerns about concentration in the mining sector, and Europe's powerful steel industry—a buyer of the iron ore the miners pull from the earth—is lobbying heavily against the tie-up.

Man Group's shares slide 18% after fund warns fees will drop

By Marietta Cauchi

LONDON—Shares in **Man Group** PLC tumbled 18% after the publicly listed hedge-fund group said performance fees probably would fall 40% in the first half of its fiscal year, shaking investors already concerned that the $2 trillion hedge-fund industry is quickly becoming the latest casualty of the global financial crisis.

Man, one of the world's largest hedge-fund groups, said its performance fees for the six-month period ending Sept. 30 would be sharply lower because of the "extremely difficult" market conditions.

Funds under management are likely to fall 6% from March 31 to $70.3 billion, hurt by poor performance and active risk management to reduce investment exposure, the group said.

However, it estimated net inflows for the period at $4.1 billion, up 14% from the same period last year as demand for its diversified products remained steady.

On Monday, shares dropped 68.25 pence (about 98 U.S. cents) to 305.50 pence.

Analysts weren't reassured by the update, which they said confirmed concerns about weak performance and investor sentiment about the hedge-fund sector generally.

"In the near term, the share price may be held back by concerns over the performance," Numis analyst Gurjit Kambo said.

Despite poor performance and market turmoil, Man Group remained confident about demand for its products and said sales for the first six months to September are estimated to be $10 billion, up from $5 billion in the first quarter.

It expected gross management-fee income for the period to be more than 10% higher than the $983 million for the first six months last year.

"Private investor and institutional redemption rates have remained low, in line with last year's levels," the company said.

Six telecom firms complete cable across the Pacific

SEOUL—Six of the world's biggest telecommunications companies completed construction of a high-speed fiber-optic cable across the Pacific Ocean, South Korea's **KT** Corp. said Monday.

The 18,000-kilometer Trans-Pacific Express cable will link the U.S., China, South Korea and Taiwan.

The undersea cable will offer an alternative to the single low-capacity cable that provides the only direct link between mainland China and the U.S. Currently, most Web traffic between the two countries has to go through Hong Kong or Japan, at times causing delays.

—Insoo Nam

GLOBAL BUSINESS BRIEFS

BYD Co.

Berkshire unit buys stake in Chinese battery maker

Shares of Chinese battery maker **BYD** Co. surged 42% Monday after a unit of Warren Buffett's **Berkshire Hathaway** Inc. disclosed a $230 million investment. MidAmerican Energy Holdings Co., an energy services provider 87.4%-owned by Berkshire, will hold a 9.9% stake in BYD. MidAmerican Chairman David Sokol says the move reflects the emergence of Chinese companies as important research-and-development centers for technology products. Analysts said the investment by a Berkshire unit marks a vote of confidence in BYD's operations despite its weak first-half net profit, which fell 7% to 596 million yuan ($87 million) from 641 million yuan because of competitive handset and auto markets.

KazakhGold Group Ltd.

Kazakh gold miner **KazakhGold Group** Ltd. said it received a possible cash and share offer for a 50.1% stake from Russian gold producer **OAO Polyus Gold**. The potential offer values KazakhGold at about $780 million, or $14.73 a share—made up of $7.95 a share in cash and 0.298 Polyus Gold share for every KazakhGold share. Polyus shares were 4.7% higher at $26.90 in Moscow, while depositary receipts in KazakhGold were down 19%, or $2.33, at $9.67 each in London. **Gold Lion Holdings** Ltd., which owns 41.7% of KazakhGold, said it would support Polyus's offer, if one were made. KazakhGold is Kazakhstan's largest gold producer, mining 232,000 ounces in 2007.

Neptune Orient Lines Ltd.

Neptune Orient Lines Ltd. said it submitted a binding bid last week for **TUI** AG's Hapag-Lloyd container shipping business. "Any agreement would be subject to the acceptance of the bid by TUI, regulatory approvals and shareholders' approval," NOL said Monday. Apart from NOL, the Hamburg-based Albert Ballin consortium, which includes Germany's **HSH Nordbank** AG and insurer **Signal Iduna**, has submitted a bid. "Under difficult circumstances, we have made a good offer to TUI," Christian Olearius, the coordinator for the Hamburg-based consortium, said without giving the bid price. NOL is 66%-owned by Singapore state investment company **Temasek Holdings** Pte. Ltd.

OAO Gazprom

South Korea agreed to import pipeline natural gas from Russia for 30 years from 2015 as part of a $102 billion bilateral gas and chemical package deal, the Ministry of Knowledge Economy said. State-run **Korea Gas** Corp. signed a memorandum of understanding with Russia's state-controlled gas firm OAO **Gazprom** Monday to annually import 10 billion cubic meters of gas, or about 7.5 million metric tons if converted to liquefied natural gas, for 30 years from 2015, the energy ministry said. The import, the country's first pipeline natural-gas import, will be equivalent to about 20% of South Korea's gas demand in 2015.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

U.K.

Growth in mortgage loans plummeted in August


Shutterstock

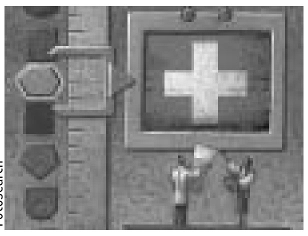
GROWTH in U.K. net mortgage lending plunged to £143 million ($263 million) in August, the lowest figure since records began in 1993, as the crisis in the global financial system led banks to further cut loans, the Bank of England said.

August's growth was far short of the downwardly revised £3 billion net lending increase in July and compared with a £9.1 billion increase in August 2007. Mortgage approvals also hit a record low, with 32,000 approvals in August, compared with 33,000 in July.

Net mortgage lending may have been harmed by uncertainty over plans for the stamp duty tax on housing transactions. *—Laurence Norman*

SWITZERLAND

Economy faces recession amid a global downturn


Fotosearch

THE KOF Economic Institute said the Swiss economy is facing a recession, predicting a contraction in the fourth quarter of 2008 and the first quarter of 2009 amid a weakening global economy.

"We are being confronted by a recession scenario—albeit a mild and short one," KOF said. It added that it expects a 2008 growth rate of 1.9%, slowing to a rise of just 0.3% in 2009.

KOF also said a spike of the Swiss franc in the wake of the financial crisis has dissipated, and said the worsening economic outlook and a drop in inflation gives the Swiss National Bank some leeway to lower interest rates. *—Hans Schoemaker*

EURO ZONE

Business confidence falls, suggesting slower growth


Imagine

BUSINESS confidence in the 15 countries that use the euro weakened in early September, pointing to a further slowdown in growth ahead. But a European Commission survey said consumer confidence was unchanged, as shoppers now expect prices to rise less rapidly over the next year than they have in recent months.

The commission noted the survey was done largely in the first two weeks of the month, and "may not capture changes in sentiment resulting from significant recent events." The commission's overall measure of economic sentiment fell to 87.7 from 88.5 in August. *—Paul Hannon*

Norway's exhausting war on emissions

Efforts to contain greenhouse gases can't stop their rise

BY LEILA ABBOUD
Oslo

IN 1991, NORWAY became one of the first countries in the world to impose a stiff tax on harmful greenhouse-gas emissions. Since then, the country's emissions should have dropped. Instead, they've risen 15%.

Although the tax forced Norway's oil and gas sector to become among the greenest in the world, soaring energy prices led to a boom in offshore production, which in turn boosted overall emissions. So did drivers. Norwegians, who already pay the equivalent of nearly $10 a gallon, took the tax in stride, buying more cars and driving them more. And numerous industries won exemptions from the tax and carried on much as before.

It wasn't supposed to be this way. By making it more expensive to pollute, carbon taxes are meant to spur companies and individuals to clean up. Yet Norway's sobering experience demonstrates how difficult it is to cut emissions in the real world, where elegant theoretical solutions sometimes get maimed by economic changes, entrenched behaviors and political realities.

Norway's policy makers say they gave exemptions to some local industries because they feared the tax would damage economic growth and hurt employment. "We had to find ways to spur environmental change without shooting ourselves in the foot," says Gro Harlem Brundtland, who devised the tax when she was Norwegian prime minister in the 1990s.

Europe struggled with a similar dilemma as it set up its "cap-and-trade" system to reduce greenhouse-gas emissions by utilities and heavy industry. But regulators cushioned industry in the early years of the system, giving them little incentive to improve. As a result, emissions have crept up 1% a year since 2005. In the U.S., the Senate voted down cap-and-trade legislation in July, won over by arguments that the system would hurt industry and boost consumer prices. But the measure could be revived since both U.S. presidential candidates support it.

A few countries have hurt emissions without injuring their economies. Sweden and Denmark, both of which introduced a carbon tax, have reduced their greenhouse-gas emissions by 14% and 8%, respectively, since 1990 while also maintaining growth. Their emission reductions can't be attributed only to the tax itself, economists say, but additional moves to encourage energy efficiency and renewable energy, which are government subsidized. And economists point out that as countries get richer, they generally spew out more carbon dioxide.

Norway's strong economic growth—gross domestic product has swelled 70% since 1990—has far outstripped its 15% rise in greenhouse-gas emissions, according to Norwegian government. Since the tax wasn't working, the country voluntarily joined the bloc's cap-and-trade system this year.

Norway's carbon tax was born when Ms. Brundtland took over as prime minister in 1990. One of her first moves was to present a plan for an across-the-board tax on carbon-dioxide emissions generated by the burning of fuels.

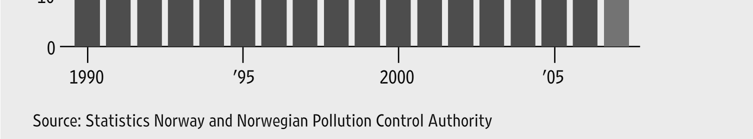
Norwegian industry balked, arguing that the levy would cripple its ability to compete internationally and threaten jobs. For some sectors, Ms. Brundtland abandoned the battle. Fishermen howled their catches of cod, herring and salmon would become unattractive if they were forced to raise prices. The fishing industry was too central to the Norwegian local economy and too potent a political symbol to threaten with a tax. It got a full exemption.

Some of the heaviest pushback came from oil and gas companies, which argued that the government risked crippling Norway's most lucrative business. Drilling on the Continental Shelf has been the primary engine of economic growth in Norway since the 1960s, generating some 24% of the country's annual GDP. Taxes on the sector account for 31% of the nation's revenues, financing a generous social-welfare system that includes universal health care and state-funded pensions.

But Ms. Brundtland didn't budge vis-a-vis Norway's oil and gas industry—the biggest polluters by far—levying on it a $65 tax per ton of carbon emitted. In contrast, the cost of a permit to emit the equivalent of one ton of carbon in Europe's current cap-and-trade system is $35.

After the tax was passed, domestic oil and gas giant **StatoilHydro** was forced to rethink nearly every aspect of its drilling cycle.

Around the time the tax was being debated, Statoil was developing a new gas field in the North Sea. At the Sleipner field, the natural gas Statoil extracts from under the sea bed contains 9% carbon dioxide. That's too high for Statoil's customers, whose power plants are designed to burn gas with only 2% carbon dioxide. Before Statoil can sell the gas, it has to separate and discard some of the carbon dioxide. Usually the excess carbon dioxide is spewed directly into the air.



Source: Statistics Norway and Norwegian Pollution Control Authority

Because of the looming carbon tax, Olav Karstaad, a chemical engineer at Statoil, got to work on another solution. Mr. Karstaad adapted technology to push carbon dioxide under the sea floor and store it there.

Statoil spent two years and some $200 million on the project, which was launched in 1996. Since then, some 10 million tons of carbon dioxide have been buried, saving Statoil about $60 million on its carbon tax bill every year. In the end, it cost Statoil less to build the carbon storage facility than what it would have spent on taxes, says Mr. Karstaad. "This is a money-saving operation for us."

As a result of that and other carbon-reducing measures, the company's carbon-dioxide emissions per ton of oil and gas it extracts are 39% of the industry average, according to the company. Nevertheless, Statoil's overall emissions have more than quadrupled since 1990 to reach 8.9 million tons annually, fueled by a huge expansion in drilling. Without the tax, the increase would have been even worse, according to Statoil and the Norwegian government.

There were other bright spots. Although the metal industry wasn't required to pay the carbon tax, the government did sign a voluntary agreement with the country's three biggest aluminum firms, including **Norsk Hydro** SA, to cut emissions 55% from 1990 levels by 2005. While there were no explicit penalties, "we would lose all credibility if we didn't do the work," says Bernt Alfred Malme, Hydro's environmental officer.

Hydro, now part of StatoilHydro, spent $45 million in new technology for four of its smelters, changing a key step in the production process during which anode gas, a harmful greenhouse gas, is created. It also spent $1.1 billion to open a new assembly line that nearly quadrupled production without increasing its emissions. Hydro also managed to reduce carbon emissions about 34% to 2.1 million tons in 2005, from 1990 levels. That, combined with reductions at the two other companies, allowed the industry to meet its 55% goal. "The voluntary agreement worked really well for us," said Mr. Malme.

Other industries that were successful in negotiating exceptions for themselves have made little progress.

Take paper manufacturers, who were given a low tax rate of between $16 and $18.40 a ton—less than a third what the oil sector pays. For the country's biggest paper company, **Norske Skog**, the carbon tax amounted to only about $200,000 a year. "It didn't have a major influence on our investments or our project decisions," says Georg Carlberg, vice president for environmental policies.

The carbon tax's most glaring failure was in the transportation sector. Norway's Post Office transports 95% of the country's mail on heavy-polluting trucks. Geir Riise, environmental officer at Norway Post, says the company is trying to modernize its fleet of trucks, train its drivers, and optimize its routes to reduce mileage. But "it's very difficult for us to reduce our emissions and still deliver the mail to every home and every village in Norway," he says.

The tax has also done little to quench Norwegians' thirst for automobiles. The number of registered cars has risen 27% in the past decade. Norwegians are used to paying high prices at the pump: a gallon of gasoline costs around $9 to $10 and about 6% of the price comes from the carbon tax. Yet since two-thirds of Norwegians live in the countryside, they pay up and keep driving.

Mathias Lund, a 37-year-old accountant from Stavanger, drives half an hour every morning from his farm. "I like the lifestyle and the outdoors, but that means I have to drive to get everywhere."

CAPITAL JOURNAL ▪ GERALD F. SEIB

Democrats want Obama to use some fighting words

IS BARACK OBAMA too cool to be elected president?

That's what some of his own supporters are wondering after the first presidential debate. We aren't talking here about the kind of cool that makes you one of the most popular kids in school.

Instead, the cool at issue here is the kind that means being low-key, a bit reserved and short on emotional displays. Desirable as such characteristics may be in some quarters of society, they are often thought to suggest something is lacking in a politician, who supposedly needs to show passion, a willingness to fight for beliefs and a burning desire to win.

The fear that Sen. Obama lacks those tendencies has been an undercurrent among Democrats for many months, and the concern has oozed to the surface since last week's debate against Republican presidential nominee John McCain. Their fear is that Sen. Obama took too many punches, delivered too few of his own, and explained more than battled.

Just one example: Lincoln Mitchell, writing on the Huffington Post blog, bemoaned the fact that Sen. Obama didn't challenge the McCain assertions during last week's debate that he was "naive" about the ways of the world. "By not fighting this label," Mr. Mitchell wrote, "Obama seemed to almost concede the point. Nobody wants a naive president; and Obama should have challenged this label—especially because it is wrong."

Moreover, Democrats are anguished that Sen. Obama acknowledged that Sen. McCain was right on some points so often that Republicans instantly put out a television ad pointing out the fact.

It's an understandable concern for Obama partisans, and perhaps Sen. Obama might be better off if he shed some of that natural cool and became more of a jouster.

BUT THAT ANALYSIS also misses an important point. It's almost always a mistake for a candidate to campaign as something other than what he really is. It's probably a particular mistake this year, given the public mood of 2008.

Consider some history on this point. There seems little doubt that the cerebral Al Gore made a mistake by trying to turn himself into a fire-breathing populist in the 2000 presidential campaign. When Michael Dukakis's 1988 campaign tried to make him appear to be the kind of hawk he wasn't by propping him up in a tank, the result was a disaster.

Ronald Reagan's friends complained regularly that he got into trouble when his handlers overscripted him and wouldn't "let Ronnie be Ronnie," and they were probably right. On the other side of this campaign, Sen. McCain, arising from the ashes after his campaign virtually collapsed in 2007, reverted to the unscripted and independent-sounding campaigner he had been.

The jury is still out on the more recent controlled version of the McCain campaign, though it's noteworthy that his late-summer surge came when he made a McCain-like unconventional decision to choose Alaska Gov. Sarah Palin as his running mate. And now that Gov. Palin's image is picking up some tarnish, there's a quiet let-Sarah-be-Sarah sentiment developing among Republicans who think she has been so tightly controlled to prevent mistakes that her natural appeal has been stifled.

WHICH BRINGS us to Sen. Obama. The fact is that he *is* a cool customer. He has been known to shoo to the back of his campaign bus his own aides when they were feverishly working their BlackBerrys and obsessing about late-breaking gossip and poll results. He tends to answer debate questions by analyzing the problem under discussion at some length before winding around to saying what he would do about it. He doesn't seem to like the close-quarters jabbing of a standard political debate, which showed whether his foe was Hillary Clinton or Sen. McCain.

Those are the characteristics that have some Democrats wondering whether they see in Sen. Obama the shadows of another Illinois politician, Adlai Stevenson, rather than the second coming of Bill Clinton. Democrats are particularly sensitive on this point because they have concluded that both Mr. Gore in 2000 and John Kerry in 2004 lost because they allowed themselves to be turned into punching bags during their campaigns.

But this is 2008, and Sen. Obama is a different candidate. From the outset, his campaign persona was built on the idea that, as a young politician and a newcomer to Washington, he stood outside the conventional politics of the past two decades. The appeal of Sen. Obama in many ways lies in the notion that he is a "postpartisan" leader who isn't held hostage by the partisan attack machines that many Americans think their country's political institutions have become.

There's reason to wonder whether Sen. Obama is as postpartisan as his rhetoric suggests, but the point is that the image has worked to his benefit. It also happens to have been the very image that helped Sen. McCain win his party's nomination this year, which tells us something about the mood of the country right now. There is palpable anger afoot in the land, and it seems to be directed at the way politics is practiced as much as anything else. Let no attack go unanswered is one rule of politics; to thine own self be true may be an equally powerful one this year.

Belarus election fails test

OSCE observers find vote-counting flaws, little improvement

BY ANDREW OSBORN

MINSK, Belarus—European observers said an election in Belarus that failed to elect a single opposition lawmaker "fell short" of democratic standards, dealing a setback to Minsk's hopes of a rapprochement with the West.

Belarus's autocratic President Alexander Lukashenko had promised Sunday's parliamentary election would be "unprecedented" in its fairness, paving the way for the lifting of Western sanctions and an end to the small country's pariah status.

But observers from the Organization for Security and Cooperation in Europe noted only "minor improvements" since the previous legislative election four years ago.

"There were efforts," said Anne-Marie Lizin, vice president of the OSCE parliamentary assembly. "But at the same time we want to say that's not enough."

Washington, which had partially suspended financial sanctions against Minsk this year, responded quickly, saying the vote fell short of international standards. EU External Relations Commissioner Benita Ferrero-Waldner, in a statement, noted "positive indications but also a number of negative elements," Reuters reported.

Opposition activists in Belarus called on the U.S. and Europe not to recognize the vote. The overwhelmingly negative tone of the OSCE report suggested it would be hard for U.S. and European diplomats to take significant steps to improve relations with a country that has largely positioned itself as a Russian ally. The EU had said it might ease sanctions if the election was judged to be fair.

The OSCE said the greatest problem was with the vote-counting process, which it deemed "bad or very bad" in half of the country's constituencies. It also complained that around one-third of its 500 observers were barred from watching the vote count. "Where access was possible, several cases of deliberate falsification of results were observed," the OSCE said in a statement.

"The transparency of a fundamental element of the election process was compromised," said Ms. Lizin.

The OSCE also said that while the opposition was allowed to campaign, restrictions imposed by authorities meant the campaign was "barely visible."

A spokesman for the Belarusian foreign ministry said in a statement the OSCE had failed to evaluate the significance of technical measures taken to improve the election "in full measure."

He said the main point was that the observers had recognized efforts were made and that these could form a basis for future cooperation with the OSCE.

Mr. Lukashenko is trying to kick-start a moribund relationship with the West to breathe life into his country's Soviet-style economy as he comes under growing pressure from Moscow to pay substantially more for Russian natural gas. He has released political prisoners, hired a Western public-relations firm and halted systematic harassment of his opponents.

In the wake of August's conflict between Russia and Georgia, his significance as a strategic ally—both for the West and for Russia—has grown. He has resisted pressure from Moscow to recognize the Georgian breakaway territories of South Ossetia and Abkhazia, in what diplomats say appears to be a bid not to alienate the West, which strongly opposed Moscow's move to recognize them.

Both the West and Russia have indicated they are ready to improve relations, given the right conditions. Russian Prime Minister Vladimir Putin is due in Minsk next week, underlining Mr. Lukashenko's newfound popularity.

Mr. Lukashenko's political opponents say he is playing a cynical bargaining game in order to play the West off against Russia to ensure his own political survival as the Belarusian economy begins to wheeze.

"If you try to negotiate with him, he will see it as a sign of weakness," Igor Rynkevich, an opposition candidate, said in an interview. "Any concessions will come back like a boomerang."

U.S., Syria envoys step up talks

BY JAY SOLOMON

NEW YORK—Senior American and Syrian diplomats held a series of meetings over the past week here in a sign of a potential thaw between the U.S. and a country President George W. Bush has cited as one of the principal sponsors of international terrorism.

Among the key issues for the dialogue, according to participants, was Washington's support for peace talks currently being pursued by Syria and Israel over the future of the disputed Golan Heights region.

The U.S. and Syrian officials also discussed Damascus's role in promoting stabilization efforts in Iraq, Lebanon and the Palestinian territories.

"I consider this a good progress in the American position," Syrian Foreign Minister Walid Moallem said in an interview in New York Monday. "We agreed to continue this dialogue."

Mr. Moallem met Secretary of State Condoleezza Rice on the sidelines of the United Nations General Assembly Friday, according to U.S. and Syrian officials. Damascus's top diplomat then held a more detailed dialogue Monday with the State Department's Middle East point man, Assistant Secretary of State David Welch, in New York.

The issue of whether to engage Syria, in addition to Iran and North Korea, has emerged as among the most divisive foreign-policy questions facing the Bush administration, as well as America's two presidential candidates, Sens. Barack Obama and John McCain.

The White House decided to largely freeze its ties to Damascus in 2005 after the murder of former Lebanese Prime Minister Rafik Hariri, which a U.N. investigation linked to Syrian President Bashar Assad's government.

The Bush administration has also enacted a string of financial sanctions against Damascus in recent years for its support of the militant groups Hezbollah and Hamas, as well as its alleged role in facilitating the movement of foreign fighters into Iraq.

Washington's efforts to isolate Syria have largely unraveled.

Just last week, President Bush told the U.N. General Assembly that "a few nations—regimes like Syria and Iran—continue to sponsor terrorism."

Still, the Bush administration's efforts to isolate Syria have largely unraveled in recent months, as even American allies such as Israel and France said they viewed Damascus as a potential key to stabilizing the Middle East's hot spots.

Israel has engaged in indirect peace talks with Syria, brokered by Turkey, in part in a bid to woo Syria away from its alliance with Iran. French President Nicolas Sarkozy, meanwhile, visited Damascus earlier this month as part of his government's bid to win Syrian support for peace efforts in Lebanon and the Palestinian territories.

Mr. Moallem said Syria's increased engagement with Washington is a sign of Washington's recognition of Damascus's role in promoting stability in Iraq and Lebanon. "The situation in the Middle East is improving," he said in the interview.

He noted that Syria is currently in the process of sending ambassadors to Baghdad and Beirut and is seeking to enhance his country's cooperation with both countries. Mr. Moallem said he also sought enhanced counterterrorism cooperation with the U.S., particularly in light of the bombing of a Syrian military installation Saturday in Damascus, which killed 17 people.

"There are Islamic extremists coming over our border," Mr. Moallem said.

Ms. Rice on Saturday briefly discussed her meeting with Mr. Moallem, saying "it was just to talk about the regional situation and some of the emerging efforts there."

Career Journal

The waiting game

A professor suggests ways to make better use of procrastination > **Page 32**

ECONOMY & POLITICS

Bomb targets Lebanese army

Explosion kills five as period of calm marred by flare-ups

BY NADA RAAD

BEIRUT—A car bomb detonated near a military bus carrying soldiers in northern Lebanon, killing at least five people and injuring more than two dozen Monday morning, according to a Lebanese army spokesman.

The spokesman said the bomb was detonated by remote control as the bus passed. The blast, in the town of Tripoli, was the second bombing in less than two months targeting the Lebanese army.

It was the latest of several violent flare-ups in Tripoli that have marred a period of relative calm in Lebanon following a power-sharing deal this summer between the country's pro-Western government and the opposition, led by Iranian-backed Hezbollah.

In the weeks following the accord, the two sides have squabbled over cabinet posts and disarming militias. But the agreement has so far held, raising hopes of a prolonged period of political stability.

In August, a roadside bomb targeted another army bus, killing nine soldiers and several civilians. There have been no claims of responsibility for either blast, but suspicion has fallen on Islamist extremists.

In the summer of 2007, the Lebanese army fought a 15-week battle against Fatah Islam, an al Qaeda-inspired Sunni extremist group, at a Palestinian refugee camp near Tripoli. Fatah Islam was seen as badly beaten in the fighting, but it didn't disband.

The Tripoli blast follows a weekend car bombing in Damascus, the Syrian capital, that left 17 people dead. No one claimed responsibility for that blast either. Syria's state news agency SANA said Monday that investigators believe Islamist extremists from outside the country carried out that attack.

The Lebanese army has struggled to maintain security across the country following the end in 2005 of Syria's long military occupation of Lebanon. The army is one of the few Lebanese institutions that successfully distanced itself from the country's squabbling political parties. Signaling the army's popularity among Lebanese, both sides in the political standoff agreed to elevate Michel Suleiman, the former head of the army, to the presidency earlier this year.

Associated Press

A car bomb exploded near **a military bus carrying troops** in Tripoli, the second bombing in less than two months targeting the Lebanese army.

"The explosion is a campaign against the Lebanese army to say that the military cannot protect itself, and therefore is unable to protect the country," said Mosbah Ahdab, a lawmaker from Tripoli.

Tripoli has also seen its share of sectarian strife. Sunni gunmen have battled fighters of the pro-Syrian Shiite Alawite sect there.

Tour group freed in Africa, ending hostage drama

ASSOCIATED PRESS

CAIRO—Egyptian and Sudanese troops rescued a kidnapped European tour group in an assault near Sudan's border with Chad, Egyptian officials said. The 11 European tourists and their eight Egyptian guides were safe, and all returned to Cairo on Monday.

The operation ended a 10-day hostage drama that took the Europeans—five Germans, five Italians and a Romanian—and their Egyptian drivers and guides across a barren stretch of the Sahara. They were seized by gunmen on Sept. 19 while on a desert safari in a remote corner of southwestern Egypt.

Their abductors first took them to Sudan. Reports followed that they were then taken to Libya or perhaps Chad. An Egyptian security official said they were rescued in a joint operation near the Sudan-Chad border late Sunday or early Monday.

Egyptian Defense Minister Hussein Tantawi said "half the kidnappers" were killed in the rescue operation, according to state news agency MENA, but the report didn't give a precise number, or further details on the rescue.

Italian Foreign Minister Franco Frattini suggested Italian and German special forces were involved. He told the Sky TG24 television news channel that Sudan and Egypt carried out "a highly professional operation" with the "intervention of Italian intelligence and experts from the special forces" from Germany and Italy.

The break in the hunt for the tourists came Sunday, when Sudanese forces engaged a group of the kidnappers, who had been sent out to get gas and food, in a gunbattle in northwest Sudan, the Egyptian security official said. Six kidnappers were killed and two captured in that fight. The two told the authorities where the rest of the kidnappers and their captives were hiding, the official said.

The freed captives were brought by a military plane to Cairo on Monday, greeted at the airport by officials bearing bouquets of flowers. They were then taken to a military hospital for checkups.