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What's News

Volkswagen said it would raise \$5.7 billion in capital to acquire a stake in the operative business of Porsche, as it fleshed out details of the highly indebted luxury sports-car maker's merger with Volkswagen. **Page 4**

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■ Fiat is setting up a joint venture with Guangzhou Automobile, its latest attempt to make inroads in China's booming auto market. **Page 4**

■ Russian hackers hijacked American identities for use in an attack on Georgian government Web sites last year, according to research from a U.S. nonprofit group. **Page 3**

■ UBS has been slapped with a complaint by Switzerland's Social Democratic party, alleging the bank "aided and abetted tax fraud." **Page 22**

■ The U.K. government is lending Airbus about \$562 million to help fund the A350 long-haul aircraft. **Page 5**

■ U.S. stocks have roared back from March lows, but some observers suggest they will be stuck in a holding pattern until 2011. **Page 19**

■ President Obama stepped up his attack on insurers as he defended his plan to overhaul U.S. health care. **Page 8**

■ U.S. industrial production rose in July for the first time in nine months, but the improving economy displayed no signs of inflation. **Page 10**

■ Protesting workers in China forced Beijing to abandon plans to privatize a steel mill, as labor activism increases. **Page 3**

■ Iran expanded its trial of opposition supporters, while Ahmadinejad said he will nominate three women to join his new cabinet. **Page 3**

■ Germany is tightening risk-management rules for banks as regulators try to prevent a repeat of the turmoil in global financial markets. **Page 32**

■ Russian officials continued to search for missing ship Arctic Sea after a report of a sighting off the West African coast couldn't be confirmed.

■ Fans protested in India after Bollywood star Shah Rukh Khan said he was held for questioning at a U.S. airport.

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John Yettaw, center, arrives at a military airport in Bangkok on Sunday, after a U.S. senator secured his release from prison in Myanmar.

U.S. senator in Myanmar

Talks with junta on Suu Kyi could presage easing of international sanctions

By WSJ STAFF REPORTERS

U.S. Sen. Jim Webb's visit to Myanmar this past weekend to meet with the reclusive leader of its military regime is casting renewed light on Washington's frustrations in dealing with a country that seldom responds to tough economic sanctions.

Sen. Webb heads a Senate subcommittee concerning U.S. policy to east Asia and is an outspoken advocate of easing sanctions on Myanmar, which is also known as Burma. He argues that curbing trade drives Myanmar into the arms of authoritarian neighbors such as China,

which has been ramping up investment in the resource-rich country in recent years.

U.S. Secretary of State Hillary Clinton, meanwhile, last month offered a carrot at a regional security conference in Thailand by saying that if Myanmar frees jailed pro-democracy leader Aung San Suu Kyi it could open the way for the U.S. to allow investments in the country, which Washington currently targets with stiff economic sanctions.

On Saturday, Sen. Webb became the first U.S. political leader to meet Senior General Than Shwe, and was also allowed to meet with

Ms. Suu Kyi to discuss the sanctions dilemma, among other topics. The moves raise tentative hopes among some exiled opposition figures that the military government may be signaling a willingness to soften its stance toward her.

At a news conference in Bangkok on Sunday, the senator said he "had a very long discussion" with Ms. Suu Kyi about when sanctions "work and when they don't work."

Sen. Webb also secured the release of a U.S. citizen, John Yettaw, who on Aug. 11 was sentenced to seven years in jail for breaking the terms of Ms. Suu Kyi's house

arrest by swimming uninvited to her lakeside mansion in Yangon, the nation's largest city. Mr. Yettaw arrived in Bangkok with Sen. Webb on Sunday and is receiving medical treatment for a series of recent seizures.

Speculation is growing among some dissidents that Ms. Suu Kyi is coming close to saying that there is a case for easing sanctions on Myanmar after years of advocating economic isolation. After realizing that sanctions have done little to dislodge the generals, "she wants to compromise," says Nyo Ohn

Please turn to page 31

Russian construction crashes to the ground

By ANDREW OSBORN

MOSCOW—Less than two years ago, Moscow's mayor, Yuri Luzhkov, called the Russia Tower skyscraper "a symbol of Russia looking upward to the future," promising completion this fall. Since then, the tower, supposed to be the tallest in Europe, hasn't risen an inch.

Its fate reflects how sharply the recession has deflated Russia's oil-fueled construction boom, delaying plans to turn Moscow into a high-rise Dubai of the East. The sudden slump in oil and commodity prices ended eight straight years of economic growth. It also clipped property developers' wings.

Shalva Chigirinsky, the oligarch bankrolling the Russia

Tower, suspended the project in November, wryly blaming former U.S. President George W. Bush for the financial crisis. Since then, Mr. Chigirinsky's problems have multiplied. The Russia Tower, Moscow officials now say, will probably never be built.

"Harsh economic conditions are forcing investors to junk the superfluous," Vladimir Resin, Moscow's first deputy mayor, told Itogi magazine. "We're ready to give up on the idea."

The \$15 billion Moscow-City business district, where the Russia Tower was meant to rise, is one of the downturn's most eye-catching victims.

Dreamt up as a rival to New York's Manhattan or London, **Page 31**

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Seeking terra firma

EMI's owner struggles with debt and nervous artists
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DJIA	9321.40	-0.82
Nasdaq	1985.52	-1.19
DJ Stoxx 600	228.77	-0.74
FTSE 100	4713.97	-0.87
DAX	5309.11	-1.70
CAC 40	3495.27	-0.83
Euro	\$1.4237	-0.41
Nymex crude	\$67.51	-4.27

Oil, gas, coal, biofuels, nuclear, wind, solar... to fuel the future we need them all.

Meeting future demand will take more than just oil. We'll need to tap every practical source of energy: from natural gas and coal to nuclear and renewables. But whatever the source, we'll need technology to help us use it as efficiently and cleanly as possible. The story continues at exxonmobil.com



ExxonMobil
Taking on the world's toughest energy challenges.

LEADING THE NEWS

U.S. airlines see pain beyond the recession

Carriers worry drop in demand will be the new normal

BY SUSAN CAREY

The recession may have bottomed out, but big U.S. airlines worry that things will never return to the way they were. They may be correct.

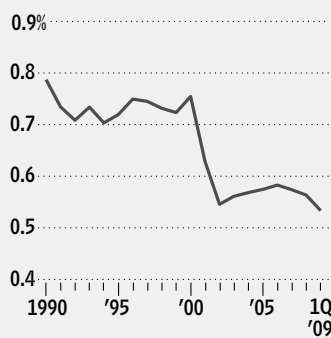
The industry has yet to recover from an across-the-board revenue drop that followed the 2001 terrorist attacks. If thrifty consumers and cost-cutting businesses are this recession's legacies, as many expect, airlines will be forced to shrink even more to balance their capacity against lesser demand.

Growing smaller means parking planes, laying off workers and dropping destinations, meaning potential customers have fewer reasons to book. Earlier this month, Delta Air Lines Inc. cited a gloomy revenue outlook for the rest of the year in its plans to cut more management jobs. If passengers don't return to the skies and fares don't rise, some airlines could run low on cash, raising the

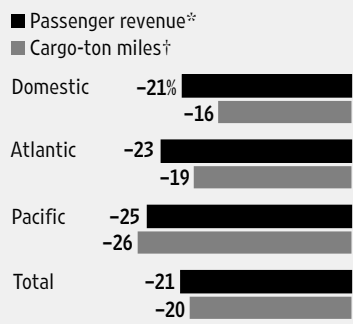
Revenue shortfall

Demand for U.S. air travel has never recovered from its post-9/11 decline.

Domestic passenger revenue, as a share of U.S. GDP



Change in demand from 2008 to 2009, January to June



*Selected airlines, includes Alaska, American, Continental, Delta, JetBlue, United and US Airways
 †Includes above airlines, in addition to FedEx, UPS, Hawaiian, Midwest and Southwest
 Source: Air Transport Association

specter of additional bankruptcies.

Like the auto, consumer-goods, packaged-food and retail industries, airlines are suffering huge revenue declines as customers put off purchases, trade down to cheaper fares and bank more personal income than at any time since 1993. Airlines fear that this behavior will stick, exacerbating the "new normal" the industry has been grappling with for the past eight years.

For decades, U.S. airlines could rely on a remarkably stable relationship between their revenue and gross domestic product. Year after year, domestic revenue came in at 0.73% of GDP on average, and total passenger revenue was equal to 0.95% of GDP. That ended after Sept. 11, as travelers stayed home because of the jitters or were put off by new airport-security measures. For the year ended March 31, domestic revenue was 0.54% of GDP, while total passenger revenue was 0.76% of GDP.

"It's not terrorism this time," said David Swierenga, an aviation economist. "It's a sea change in demand." Scott Kirby, president of US Air-

ways Group Inc., said he thinks the rapid growth of discount airlines is the main culprit behind what he calls "a long-term secular decline" in the revenue-to-GDP relationship. Since Sept. 11, low-cost airlines have grown rapidly, putting downward pressure on fares, while travelers increasingly shop for the cheapest tickets on the Internet. The Transportation Department estimates that budget airlines now account for 40% of the domestic market, up from 22% in 2001. While lower fares stimulate demand, Mr. Kirby said, airlines still wind up losing revenue overall.

As the larger carriers struggled after Sept. 11, and several went through bankruptcy-court protection, low-fare king Southwest Airlines Co. continued to expand, and upstarts such as JetBlue Airways Corp. and AirTran Holdings Inc. unleashed big flocks of new planes. Searching for greener pastures, the larger airlines added many seats on big-margin international routes.

It took a sudden and unprecedented run-up in fuel prices last year to force the industry to reverse

course and begin cutting seats and deferring new planes to address the imbalance between supply and demand. But then came the crushing recession, which hit premium cabins on international routes the hardest. Now airlines are reducing capacity on those routes as well, and putting seats on sale.

If the revenue-to-GDP ratio had stayed where it was pre-2001, the airlines would have raked in an additional \$27 billion in revenue in the year ended in March, according to the Massachusetts Institute of Technology Airline Data Project. This sum would have helped the carriers cover more of their costs and could have lifted the industry to profitability.

Trying to plug that gap, carriers are cutting costs wherever possible. They are adding fees and charges for everything from checked baggage to seats with added legroom. While this "ancillary" revenue amounts to several billion dollars a year, it isn't nearly enough.

"What has become clear is there is not enough demand to satisfy the current level of supply at price levels that can sustain profit for the industry as a whole," said Darin Lee, an aviation expert at LECG LLC. He said he thinks the industry has yet to feel the full impact of U.S. unemployment at 9.4%.

Discretionary leisure trips are one focus of the new frugality, forcing airlines to counter with deep, extended fare sales to try to stimulate demand. The picture is bleaker among business travelers, who traditionally produce more revenue. Their employers are cutting travel budgets, mixing internal meetings involving travel, banning travel in first-class cabins and embracing videoconferencing.

Continental Airlines Inc. said the number of its "high yield" customers—who book costlier refundable tickets closer to their trips or have their travel arranged through corporate accounts—fell by more than one-third in February through May versus a year earlier and was down 27% in June.

Continental President Jeff

Smisek, speaking last month after announcing a second-quarter loss, said that when it comes to revenue, "we do think we have hit the bottom. But we don't know how long we will bounce along the bottom and what the rate of decline will be."

American Airlines parent AMR Corp. said it saw business travel decline more in the second quarter than its traffic overall or its unit revenue. After announcing second-quarter red ink, Chairman and CEO

Some airlines could run low on cash, raising the specter of bankruptcies.

Gerard Arpey said he has lived through several down cycles but isn't optimistic about a quick recovery this time: "Whether or not this cycle will be similar [to] the past, I don't know."

For the industry to be able to offer tickets at prices fewer consumers seem willing to pay and still turn a profit, an unimaginable amount of cost-cutting will need to occur, much more than airlines have achieved since the revenue reset that occurred in 2001.

Marketplace
Creative destruction
Scientists say blasts from asteroids fostered life on earth > Page 28

CORRECTIONS & AMPLIFICATIONS

Hedge-fund manager Dwight Anderson is 42 years old. A Money & Investing article Friday incorrectly gave his age as 41.

The global restaurant industry is roughly \$1.5 trillion, according to research firm Datamonitor Ltd. A Marketplace article Aug. 10 incorrectly identified the industry size as \$1.5 billion.

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LEADING THE NEWS

Iran widens trial of opposition supporters

Ahmadinejad will nominate women to cabinet

A WSJ NEWS ROUNDUP

Iran expanded its mass trial of opposition supporters, adding 25 more defendants, including a Jewish teenager, who are accused of involvement in unrest over the disputed presidential election.

Power challenge

■ Letter to clerics asks whether the supreme leader is fit to rule Iran.....9

The turmoil that erupted after the opposition declared the June 12 vote a fraud has weakened President Mahmoud Ahmadinejad and called his legitimacy into question. Nevertheless, he is pushing ahead with preparations for his next term by announcing he will nominate three women to join his new cabinet. If confirmed, they would be Iran's first female ministers since the 1979 Islamic Revolution.

The adding of defendants, which brought the total number to 135, defied international condemnation of the trial many view as a sham. The U.S. labeled it a "show trial" last week and President Ahmadinejad fired back with a thinly veiled criticism of President Barack Obama.

"The excellency who talks about change made a big mistake when he openly interfered in Iran's domestic issues," Mr. Ahmadinejad said Sunday, according to the semi-official Mehr news agency.

Iran accuses the U.S. and Britain of inciting postelection protests in an attempt to topple the clerical establishment. They deny the charge.

The West "should be held accountable" for its actions, Mr. Ahmadinejad said. "The Iranian nation would ... slap those with ill intentions so hard that they would lose their way home."

The defendants include a former Iranian vice president and other former senior government officials linked to the country's pro-reform movement, French and Iranian-American academics, employees of the British and French embassies, and an Iranian-Canadian reporter for Newsweek magazine. They are charged with plotting a "soft revolution" and some made public confessions that the opposition charges were coerced.

An Iranian-French employee in France's Tehran embassy was released Sunday. Clotilde Reiss, 24 years old, a French academic, was among the defendants who had made public confessions.

The prosecutor opened the third session of the trial with a general indictment of all 25 new defendants, accusing them of plotting the postelection turmoil years in advance, the state news agency reported.

One of the new defendants belongs to Iran's tiny Jewish community. Yaghoghil Shaolian, 19, was quoted by semi-official Fars news agency as saying he wasn't an activist and didn't even vote. He said he just got carried away and threw some stones at a bank branch in central Tehran, resulting in his arrest.

Iran's sole Jewish parliamentarian, Siamak Mereh Sedq, said "he is



In this photo released by the Iranian Labor News Agency, judge Abolqasem Salavati, bottom left, watches an image showing protesters during Iran's postelection turmoil, at the Revolutionary Court in Tehran on Sunday.

innocent. We hope to see his release soon based on Islamic mercy."

Mr. Ahmadinejad's announcement on female appointees to his cabinet appeared to be an attempt to enlist the support of Iranian women as he fends off criticism from the opposition and some of his own conservative supporters.

He said he will appoint Marzieh Vahid Dastgerdi, a 50-year-old gynecologist, as health minister and Fati-meh Ajorlu, a 43-year-old lawmaker, as minister of welfare and social security. Mr. Ahmadinejad now has a female vice president in charge of the environment. "At least one more will be added," he said.

Mr. Ahmadinejad has until Wednesday to present a cabinet to parliament for approval.

Opposition leader Mir Hossein Mousavi has said he will form a new political organization named "The Green Path of Hope," aimed at regaining people's constitutional rights.

Russia hackers stole identities for cyber attacks on Georgia

BY SIOBHAN GORMAN

WASHINGTON—Russian hackers hijacked American identities and U.S. software tools and used them in an attack on Georgian government Web sites during the war between Russia and Georgia last year, according to new research from a U.S. non-profit group to be released Monday.

In addition to refashioning common Microsoft Corp. software into a cyber-weapon, hackers collaborated on social-networking sites, including Twitter and Facebook Inc., to coordinate attacks on Georgian sites, the U.S. Cyber Consequences Unit found.

The cyber attacks in August

2008 significantly disrupted Georgia's communications capabilities, disabling 20 Web sites for more than a week. Among the sites taken down were those of the Georgian president and defense minister, as well as the National Bank of Georgia and major news outlets.

The institute is comprised of a group of widely recognized cybersecurity specialists who have worked for U.S. security agencies, private industry and academia. It assesses the economic and national-security implications of cybersecurity threats and briefs top U.S. officials, key industries and international institutions.

The research shows how cyberwarfare has outpaced military and

international agreements, which don't take into account the possibility of resources and civilian technology being turned into weapons.

"U.S. corporations and U.S. citizens need to understand that they can become pawns in a global cyber war," said John Bumgarner, chief technical officer at the USCCU, who wrote the report. The group plans to release a nine-page report on the attacks to the public on Monday.

The Georgian attacks, according to the group's findings, were perpetrated by Russian criminal groups and had no clear link to the Russian government. However, the timing of the attacks, just hours after the Russian military incursion began, sug-

gests that the Russian government may have at least indirectly coordinated with the cybercriminal group, Mr. Bumgarner's report concluded.

"Russian officials and the Russian military had nothing to do with the cyber attacks on the Georgian Web sites last year," said Yevgeniy Khorishko, a spokesman at the Russian Embassy in Washington.

The Russian and Turkish computer servers used in the attacks had been previously used by cybercriminal organizations, and those servers were also hosting other cyber-attack software at the time.

Some of the software used to carry out the attacks was a modified version of Microsoft code com-

monly used by network administrators to test their computer systems, Mr. Bumgarner found.

A Microsoft spokesman declined to comment on the finding because he hadn't seen the report.

After the cyber campaign was launched, Mr. Bumgarner found would-be attackers collaborating on 100 different Web forums, including Twitter and Facebook.

"It's a difficult problem to handle," said Facebook spokesman Barry Schnitt, because it is impossible to detect such collaboration without monitoring conversations. Twitter didn't respond to requests to comment.

—Jessica E. Vascellaro contributed to this article.

Worker protest pushes Beijing to halt privatization of steel mill

BY SHAI OSTER

BEIJING—Protesting steel workers in China have forced the government to abandon privatization plans for the second time in a month, in a sign of increasing labor activism.

Officials in Henan province on Sunday called off the sale of the state-owned Linzhou Iron & Steel Co. after some 3,000 workers, demonstrating since Tuesday, briefly blocked a government mediator from leaving the plant, according to the state-controlled Xinhua news agency.

The protest comes on the heels of a protest in Northeast China, dur-

ing which a manager was beaten to death when thousands of workers at the Tonghua Iron & Steel mill, afraid they would lose their jobs, held violent demonstrations.

The latest unrest comes as China is trying to force consolidation of its sprawling steel industry, the largest in the world, accounting for about 38% of global production last year. The industry is fragmented among hundreds of companies with bloated payrolls. Local governments' reliance on them for tax income and local employment have protected steel mills, allowing them to overexpand.

The protests also come at a time when China's government is em-

broiled in contentious iron-ore negotiations, which have been overshadowed by the arrest of Australian mining company Rio Tinto's chief China iron-ore team.

The central government's policy of encouraging mergers and privatizations has met heated resistance by workers afraid they will lose their jobs. But the violence—and success—of recent instances stands out.

The current labor strife is reminiscent of the disturbances China faced 10 years ago as it struggled to reform its decaying steel industry in the northeastern rust belt by dismantling the cradle-to-grave benefits that had sustained workers.

Since then, China's steel sector has boomed, thanks to a huge infrastructure building spree that has helped to change the face of China, covering it with new bridges, railroads, skyscrapers and highways as the country urbanized.

Last month, Linzhou plant was sold to Fengbao Iron & Steel Co. for 259 million yuan (\$38 million), with workers to get paid 1,090 yuan per year. The workers felt the company's new owners weren't paying them enough compensation.

According to Xinhua, about 400 employees surrounded the Linzhou offices Tuesday to block Dong Zhangyin, an official from the regional office of the State-Owned As-

sets Supervision and Administration Commission, the agency in charge of state-owned companies.

Eventually, armed police were deployed, and the workers dispersed at around 3 a.m. Saturday, according to Xinhua.

A new management has been put in charge of the factory to figure out how to restructure it.

While there are no signs of the rise of a coordinated national labor movement, worker activism has been increasing, and has won some high-profile concessions. China's workers are officially represented by the All China Federation of Trade Unions, which is controlled by the Communist Party and government.

LEADING THE NEWS

Fiat takes another shot at China's market

Guangzhou venture is latest attempt to make inroads

BY GILLES CASTONGUAY

MILAN—After falling out with local partners in China on two previous occasions, Fiat SpA faces what might be its last chance to expand into one of the few markets still seeing red-hot growth despite the effects of the economic downturn.

The Italian company is busy setting up a €400 million (\$570 million) joint venture with Guangzhou Automobile Group Co., its latest attempt to make inroads in a country that last month saw sales soar by more than 60% from a year earlier.

Despite fierce competition, China's market is proving irresistible for Fiat as well as other car makers. Growth rates far exceed anything other markets can offer, despite the effects of the latest slump, and China looks set to surpass the U.S. to become the world's biggest auto market as early as this year.

General Motors Corp. calls China a key growth driver; PSA Peugeot-Citroën SA has said it is open to the idea of a second joint venture with a local partner; and Nissan Motor Co. plans to build another plant with its partner.

The latest numbers reflect the market's potential. In July, vehicle sales in China rose 64% from a year earlier to 1.09 million units, making it the fifth consecutive month that they have surpassed the 1 million mark. While the numbers might be beaten by Europe, taken as a single regional market, the growth rate Europe-wide still pales by comparison to China's. Vehicle sales in Europe rose just 2.4% from a year earlier in June, according to the latest data available.

Fiat has so far had a hard time



Italian Prime Minister Silvio Berlusconi, center, meets with China President Hu Jintao, left, and Fiat CEO Sergio Marchionne in July.

finding the right local partner to help it take advantage of the opportunities offered by the market, said IHS Global Insight analyst John Zeng.

With its first partner, Nanjing Automobile Corp., Fiat couldn't agree on a licensing fee for its technology, Mr. Zeng said. Reaching out to another possible partner, Chery Automobile Co., Fiat found that the companies' respective models would be in direct competition with each other. As a result, Fiat was forced to drop a target it set three years ago to sell 300,000 cars in China by 2010.

Should it eventually fall out with Guangzhou Auto, Fiat might have to give up on China altogether, its reputation damaged beyond repair, said Nomura analyst Yankun Ho. "Nobody else will want to work with them," he said.

Fiat's reputation among Chinese drivers took a turn for the worse in the past couple of years after it pulled out of the dealership network run by former partner Nanjing in late 2007, Mr. Zeng said. "Car own-

ers [in China] were left with no warranties and found it difficult to maintain their cars," he said.

Conscious of the challenges it faces, Fiat is ready to take the time to get it right this time, a person familiar with its strategy said.

GM and Volkswagen AG, for example, took two decades to work their way to a dominant market position. Both of them have, as one of their partners, SAIC Motor Corp., the biggest car maker in China.

Given the potential size of the market, there should be enough room for Fiat to grab a share, the person familiar with Fiat's strategy said, adding that the company's aspirations were realistic. "We're not out to massacre our competitors," the person said.

Fiat is hopeful of the success of the latest joint venture, in part because it has received explicit government backing: the deal was signed in front of Chinese President Hu Jintao and Italian Prime Minister Silvio Berlusconi at a ceremony in Rome

on July 6.

"It's a reflection of the type of institutional support to this venture we will receive," Fiat Chief Executive Sergio Marchionne told analysts two weeks later.

The venture will see Fiat and Guangzhou Auto build a plant to make as many as 200,000 engines and 140,000 cars from 2011.

But some analysts, such as Philippe Houchois of UBS Warburg, wonder why Fiat is bothering. "It's marginal for Fiat," he said.

Fiat's priorities lie in Europe and the Americas, Mr. Houchois said, noting its partnership with U.S. car maker Chrysler Group LLC, in which it has taken a 20% stake, and its previous interest in GM's German unit Opel.

Brazil remains Fiat's cash cow, Mr. Houchois noted. More than 90% of the profit made by Fiat's car business still come from that country, where it has a dominant position with a 25% share of the market.

"Fiat has plenty of room to grow

in Brazil, but they have exponentially more room to grow in China," said William H. Mann, a portfolio manager at Motley Fool Asset Management.

To be sure, Fiat will need years to get the venture to make a meaningful contribution toward reaching Mr. Marchionne's production capacity target of 5.5 million to 6 million vehicles a year, deemed necessary to survive in the industry.

The number of cars Fiat expects the China venture to produce is much smaller than those from Guangzhou Auto's two other partners, Toyota Motor Corp. and Honda Motor Co. In 2008, Honda sold 473,000 units and Toyota 585,000—ranking the companies among China's top five auto makers.

Guangzhou dismisses the risk of conflict of interest, saying its three foreign partners were positioned in different market segments. Fiat, for example, was aiming for the small car segment.

Fiat's deal with Nanjing unraveled in late 2007. The partnership had been unprofitable for years and Mr. Marchionne had openly expressed his frustration with Nanjing, saying the company was distracted by the relaunch of the MG sports-car brand it had acquired.

Mr. Zeng said Nanjing was a traditional, state-owned company. "They still followed very old rules, sending government officials to run a company," he said.

By comparison, Guangzhou is much more flexible in dealing with foreign car makers, he said. One reason is because it doesn't have a brand of its own that would compete with its partners' brands.

"They are a more market-oriented entity and are quite profitable as well, so they have deeper pockets," he said. "Guangzhou Auto offers a much better partnership."

—Patricia Ho in Beijing and Kenneth Rapoza in Sao Paulo contributed to this article.

Volkswagen to raise \$5.7 billion for Porsche acquisition

BY KATHARINA BECKER AND WILLIAM LAUNDER

FRANKFURT—Volkswagen AG said Friday it would raise €4 billion (\$5.7 billion) in capital to acquire a stake in the operative business of Porsche, as it fleshed out details of the highly indebted luxury sports-car maker's merger with Volkswagen.

Volkswagen plans to acquire a 42% stake in Porsche AG, the sports-car arm and a 100% subsidiary of holding company Porsche Automobil Holding SE, for €3.3 billion by the end of 2009. A new name for the company created through a merger of Porsche and Volkswagen is yet to be decided, Volkswagen said.

Porsche said on Friday that Qatar Holding LLC will acquire 10% of the ordinary shares of the Porsche holding company from the family owners and the majority of Porsche's cash-settled options on Volkswagen shares, freeing up more than €1 billion for Porsche that is currently serving as collateral for the options structure.

Porsche added it had already decided at the end of July to write down the value of the options structure by "a considerable amount" to prepare for such a sale and therefore no further write-downs would

be necessary as a result of the deal.

If the combination with Volkswagen shouldn't take place, Qatar Holding is entitled to resell its stake in Porsche SE to the families, it added.

Volkswagen shares closed Friday in Frankfurt trading at €192.50, down 16%. One trader said the news that Qatar will acquire the majority of Porsche's options eased fears that the Volkswagen options would be thrown onto the market in a disruptive manner.

The two auto makers late Thursday said they reached a basic agreement to integrate Porsche into the

Volkswagen, which is expected to be completed during 2011. The agreement concluded a failed attempt by Porsche to take over its larger rival, which backfired as the company incurred mounting debt and was forced into the hands of VW.

The takeover of Porsche will result in total synergies of around €3 billion, Volkswagen Chief Financial Officer Hans Dieter Pötsch said Friday.

Specifically, VW's operating profit will likely increase by about €700 million each year through the synergies, Mr. Pötsch said. The synergies will include shared development and purchasing costs, shared

manufacturing platforms and revenue from Porsche sales, Mr. Pötsch said.

Through the dealings, the family owners of Porsche could maintain a 35% to 39% stake in Volkswagen, Mr. Pötsch said. The families currently own all of Porsche and slightly more than half of Volkswagen.

As such, the Porsche family owners will be the largest shareholders in the combined company, followed by the German state of Lower Saxony, with a stake of around 25%. The Emirate of Qatar is expected to become the new group's third-largest shareholder once it has exercised op-

tions to acquire VW shares from Porsche.

VW employees will have a stake of between 1% and 5% in the new company, said VW works-council chief Bernd Osterloh.

VW will reconsider making further new orders with auto-parts supplier Magna International Inc., if the company successfully acquires its rival, General Motors Co.'s Opel unit. A German spokesman said Friday that Opel bidders RHJ International SA and Magna have improved their offers for Opel.

—Erin Fines in Frankfurt contributed to this article.

GM considers producing \$4,000 compact vehicle in Asia

BY KENNETH RAPOZA

SAO PAULO—General Motors Co. is targeting the emerging ultra-low-cost car market with plans for a compact for around \$4,000, possibly producing it in Asia.

The segment is attracting increasing attention from manufacturers eager to keep sales momentum in developing markets following the sharp slide in car sales in North America and Western Europe.

"When Tata Motors in India came out with their \$2,500 Nano vehicle it put a lot of auto makers on the spot," said Nick Reilly, GM's newly installed executive vice president of international operations.

Tata started shipping the much-promoted Nano to domestic customers in July, with a base price of just under \$3,000, and executives have talked of selling versions of the car in the U.S., Europe and emerging markets.

"We are not going to make cars that cheap because that is really a specific car for a very specific market that has different emissions standards and specifications than markets like the U.S. and Brazil," Mr. Reilly said at a media briefing late Friday in Brazil, GM's third-largest market by sales after China and the U.S. "So we are looking at lower-cost vehicles, but do not know yet where it will be made or where will it be sold, though most likely in Asia."

Mr. Reilly said GM saw a market for a car that costs around \$4,000.

GM already makes micro-minivans with Chinese partners that it plans to export, and is looking to expand that product range.

"We are getting used to partnerships, and the industry as a whole will see more partnerships forming in 2009," Mr. Reilly said, adding that GM wasn't currently looking for partners in other large markets, like India.

CORPORATE NEWS

Chrysler aims to make Fiat 500 in Mexico

Another Fiat-derived car may be assembled by U.S. company, while Fiat engines could be built in Michigan

BY KATE LINEBAUGH
AND JOHN D. STOLL

DETROIT—Under the direction of Fiat SpA, Chrysler Group LLC is moving forward with plans to produce the Italian auto maker's Fiat 500 subcompact at a Chrysler plant in Mexico, according to people familiar with the matter, while considering what other Fiat models to introduce to the U.S. market.

Chrysler is also looking at making a small Fiat engine for the 500 at a Chrysler plant in Trenton, Mich., and is considering building a Fiat-derived compact car slightly larger than the 500 in the U.S., a person familiar with the plans said.

Chrysler spokesman Gualberto Ranieri declined to comment on the company's product plans, which he said will be announced at a future date.

A decision to make the 500 in Toluca, Mexico, could be an early test for relations between Chrysler's new management and

two key owners, the U.S. government and the United Auto Workers union. The plant's workers are represented by a Mexican union, not the UAW.

Making the car at Toluca would preserve jobs there at a time when Chrysler is closing several plants in the U.S. and eliminating thousands of American jobs.

Chrysler was saved from collapse earlier this year when the federal government provided \$15 billion in emergency loans and brokered a rescue plan that gave Fiat management control of the company.

As part of the restructuring, a UAW health-care trust forgave \$6 billion of the \$10.6 billion it was owed by Chrysler. In exchange, the trust ended up owning 55% of the part of Chrysler that emerged from bankruptcy reorganization as well as a note for \$4.6 billion. The U.S. government holds an 8% stake.

In May, General Motors Co., which like Chrysler was restruc-

tured in bankruptcy court with billions of dollars in aid from U.S. taxpayers, came under fire from politicians and the UAW for a plan to make a new small car in China. GM eventually reversed course and decided to make the car at a Michigan plant.

"There is going to be political fall-out on anything in this kind of environment related to jobs," said David Cole, chairman of the Center for Automotive Research in Ann Arbor, Mich. "It would be a mistake to make these decisions based on emotion rather than solid business judgment."

Mr. Cole cautioned that the U.S. market for subcompacts may not be big enough to support producing a vehicle like the 500 in the U.S.

Fiat was given a 20% stake in Chrysler in exchange for providing the American auto maker with small cars, fuel-efficient engines and other technology. It wasn't required to put any cash into Chrysler.

Fiat Chief Executive Sergio Marchionne was named CEO of Chrysler in June and has been working on a plan to launch some models from the Italian company's Fiat and Alfa Romeo brands in the U.S.

As part of Fiat's agreement with the U.S. Treasury to take control of Chrysler, Fiat could increase its stake to 35%. It will be given an additional 5% stake if it introduces a vehicle in the U.S. that gets 40 miles per gallon; that's approximately the fuel-economy rating of the Fiat 500. It will be given another 5% if it begins producing fuel-efficient engines in a U.S. plant, and a further 5% for allowing Chrysler to export vehicles through Fiat's global distribution network.

The Toluca plant, which employs 2,180 workers and currently makes the Dodge Journey crossover and retro-styled PT Cruiser, is an attractive home for the 500 because some of the cars could be exported to markets in South and Cen-

tral America, where the Fiat brand is strong, people familiar with Chrysler's plans said.

Chrysler doesn't believe it could make much profit, if any, if it were to assemble the 500 in a U.S. plant, these people said.

President Obama's auto task force has promised not to interfere with the commercial operations of Chrysler and GM. Ron Bloom, the task force's new head, stressed earlier this month that the government won't micromanage decisions at either company.

"When a difficult decision has to be made on matters like where to open a new plant or what type of new car to make, the new Chrysler, not the United States government, will make that decision," said an administration official. "It's quite consistent with the plan from the start."

A UAW official speaking on the condition of anonymity said the union wasn't aware of the plans for assembling the 500.

U.K. pledges funds for Airbus jet

BY KAVERI NITHTHYANANTHAN
AND DAVID PEARSON

The U.K. government said Friday it will lend Airbus £340 million (\$562 million) to help fund development of the A350 long-haul aircraft.

The commitment, which comes as the U.K. struggles with a public debt that has ballooned in the wake of efforts to stem the financial crisis, falls well short proportionally to the amount of work that will be done in the U.K. and could leave Airbus seeking funds elsewhere.

Even so, the announcement of further government support for the wide-body plane, which will compete with Boeing Co.'s 787 Dreamliner, rekindled the dispute over aerospace subsidies.

U.K. Business Secretary Peter Mandelson said the loan will create and sustain more than 1,200 jobs at sites in Filton in southern England and Broughton in north Wales, as well as 5,000 within the supply chain across the U.K.

"It's certainly not a bailout, and it's certainly not a subsidy," said Mr. Mandelson, who announced the U.K. funding on a tour of Airbus partner GKN PLC's Filton plant. The U.K. has also committed £60 million to sup-

port GKN in designing and developing the rear spar and trailing edge of the A350.

Airbus, the commercial plane-making unit of European Aeronautic Defence & Space Co., is seeking as much as €3.67 billion (\$5.24 billion) in so-called launch aid for the A350—a third of the €11 billion the company expects it will cost to develop the more fuel efficient plane.

Partner governments traditionally have provided funding in rough proportion to the amount of work given to their countries.

France has offered €1.4 billion for the A350, reflecting its 38% share of the work. Germany has pledged €1.1 billion, a few percentage points shy of its 34% share. The U.K. will do 18% of the work—mainly building the plane's wings and landing gear—but is offering to provide only about 11% of the launch aid.

Spain, which will do about 10% of the work on the new plane, is in talks with Airbus about funding. Representatives for Airbus and the Spanish government said talks are continuing, and Spain hasn't yet decided how much it will contribute.

Even if Spain does contribute 10% of the total possible proportionally to the launch aid, the U.K.'s decision means Airbus isn't likely to get the full €3.67 billion it had sought.

Under a 1992 trans-Atlantic agreement, up to a third of the development costs of large commercial aircraft can be funded by the partner governments through repayable loans or other financial support.

Despite the agreement, the U.S. government and Airbus rival Boeing are highly critical of the loans, claiming it gives Airbus an unfair advantage in developing new commercial planes.

"Airbus has no need for cash from taxpayers," said Boeing spokesman Charlie Miller. "It should finance the A350 on its own."

"We and the U.S. government will have to study the details of this announcement," Mr. Miller said, reiterating that the company considers the loans to be "market-distorting

subsidies."

"In less than three weeks, the World Trade Organization will rule on the consistency with world trade rules of government financing for Airbus," Mr. Miller said. "Therefore, it is disappointing that Airbus member states should proceed with financing for the new A350 on the very eve of this ruling."

Airbus and EU states have long argued that Boeing also benefits from government aid, both through federal support for its military programs and state-level assistance for commercial projects. Airbus claims its rival gets a better deal because it doesn't have to repay the money, and the EU has estimated that Boeing has received \$5 billion in subsidies from the U.S. alone for its 787 Dreamliner.

It isn't clear where Airbus will find the cash to fund the remaining cost of development for the A350. Aircraft builders are increasingly leaning on their suppliers to share the burden of risk and development cost. Alternatively, Airbus could seek support from parent company EADS, which was sitting on €8.1 billion of net cash at the end of June.

EADS wasn't immediately available to comment. "The financing arrangements are still under discussion," Airbus spokesman Stefan Schaffrath said. "Nothing has been finalized."



U.K. Business Secretary Peter Mandelson, shown Friday, said the Airbus loan will create more than 1,200 jobs at sites in southern England and north Wales.

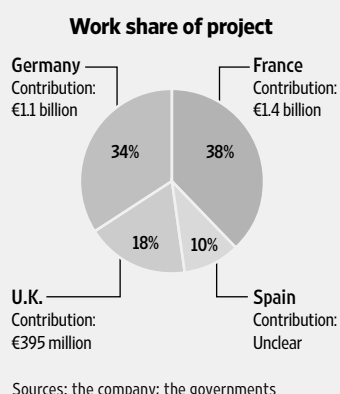
Airbus had 493 aircraft orders for the A350 from 31 customers. Virgin Atlantic Airways remains in talks to buy 50 aircraft for delivery

after 2014.

—Daniel Michaels, Jason Sinclair and Laurence Norman contributed to this article.

Aiding Airbus

European governments pledge financing to develop new Airbus jet



British Airways to put ads on boarding passes

BY KAVERI
NITHTHYANANTHAN

LONDON—British Airways PLC on Friday became the first major European scheduled airline to seek advertisers for its boarding passes, as it seeks new revenue to help reverse losses.

The airline, which posted a £106 million (\$175.7 million) net loss for the three months ended June 30, said it is now actively touting for ad-

vertisers to use space on its boarding cards and on its Web site.

Airlines around the world have seen revenues plummet as the economic downturn and credit crunch have slashed demand for air travel. BA has been hit particularly hard because its main profit driver is first- and business-class traffic across the Atlantic. Business travel has dropped sharply as companies cut costs.

To cope with the reduced de-

mand, the airline has been slashing expenses by grounding planes, cutting jobs and asking staff to take pay and bonus holidays.

The ability to advertise on boarding passes will be available from Oct. 1. Luxury auto maker Jaguar was the first company to advertise on BA's Web site—the first advertisement since the site's launch in the mid-1990s. More than 500,000 people a day visit ba.com, according to the airline.

CORPORATE NEWS

Boeing plays down jet flaw

Fuselage issue raises questions about disclosure

BY PETER SANDERS

On June 23, Boeing Co. executives confronted two problems with the much-expected but troubled 787 Dreamliner jet-development program. Boeing announced one problem where the plane's wings join the body, drawing worldwide attention. The other problem, involving the 787's composite fuselage, the company kept silent about.

When news of the second problem surfaced late Thursday on an Internet blog that follows the aviation industry, it raised new ques-

tions about Boeing's public disclosure policies on the 787 program, which is the Chicago-based aerospace company's most important development project.

Boeing on Thursday night confirmed that it had ordered some work stopped in late June at an Italian factory. Weaknesses identified on two areas of the fuselage barrels produced at the factory could cause significant damage if they weren't repaired, the company found.

Boeing and its Italian subcontractor, Finmeccanica SpA's Alenia Aeronautica, said the problem is relatively minor, and a fix is already under way.

"This has in no way affected the Dreamliner's first flight or the plane's production time or costs," Giovanni Bertolone, Alenia Aeronautica's chief executive, said in

an interview Friday.

Boeing officials say they have followed the legal and financial requirements for disclosing information about the 787 program.

Lori Gunter, a Boeing spokeswoman, defended the company's decision not to announce the fuselage problem in June. "This is fairly normal for a new development program. These issues come up and we deal with them," Ms. Gunter said.

A person familiar with Boeing's operations said stoppage orders such as the one that occurred at the Italian plant happen often and usually involve minor matters.

They represent "a daily, common occurrence at major companies," this person said. But the Italian situation "was not a safety issue [and] not a flight issue," making prompt disclosure unneces-



Boeing didn't publicly disclose a flaw with the fuselage of its 787 Dreamliner. The company said the problem is relatively minor, and a fix is already under way.

sary.

Boeing's stock price has been sensitive to developments in the 787 program. On Friday, Boeing shares fell \$1.75, or 3.8%, to \$44.87 in 4 p.m.

composite trading on the New York Stock Exchange.

—Alessandra Galloni and Joann S. Lublin contributed to this article.

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DOW JONES
A NEWS CORPORATION COMPANY

Apple's board expected to meet on Schmidt seat

BY YUKARI IWATANI KANE AND JOANN S. LUBLIN

Apple Inc.'s directors plan to meet Tuesday and are expected to discuss possible successors for the board seat recently vacated by Google Inc. Chief Executive Eric Schmidt, according to a person familiar with the matter.

Mr. Schmidt left Apple's board late last month, as the company cited potential conflicts as Apple's and Google's businesses increasingly overlap. The departure came as his membership on the two companies' boards also was being scrutinized by the U.S. Federal Trade Commission. Mr. Schmidt had been an Apple board member since 2006.

Apple's board has been criticized for a lack of independence from CEO Steve Jobs.

Apple, of Cupertino, Calif., declined to comment. According to the company's Web site, the board meets at least four times a year. Other board members besides Chief Executive Steve Jobs include Intuit Chairman Bill Campbell, former Vice President Al Gore, Avon Products CEO Andrea Jung, former Chrysler finance chief Jerome York, J. Crew Group CEO Millard Drexler and Genentech Inc. Chairman Arthur Levinson.

Apple's bylaws stipulate its board can have five to nine members; its board historically maintained between seven and eight members.

The board has been criticized for a lack of independence from Mr. Jobs. Half of Apple's six outside directors have served for at least a decade, which some governance experts say is too long to maintain independence from a CEO. "The biggest danger is that the board will be unable to truly take the perspective of the shareholder and will feel beholden to the CEO or unwilling to confront the CEO," says David Nadler, a corporate-governance specialist with Oliver Wyman Consulting.

CORPORATE NEWS

Icahn draws investor ire

Suit alleges he hurt holders by snubbing bids for telecom XO

BY RANDALL SMITH

For years, Carl Icahn has invested in companies and then publicly harangued their managers for not doing more to boost the value of their shares.

Now, Mr. Icahn finds himself the target of investor complaint. A hedge fund is alleging that Mr. Icahn—as director and majority owner of XO Holdings Inc.—hurt shareholders by snubbing three approaches to acquire the struggling telecommunications company that could have boosted the stock, according to a recently unsealed lawsuit.

In a suit filed in a New York state court, the hedge fund, R2 Investments LDC, which owns 8.8% of the Herndon, Va., company, says at least one of the bids was above the company's stock price at the time. Instead of pursuing them, Mr. Icahn opted to refinance XO's debt by purchasing \$780 million of preferred stock.

That paid off for Mr. Icahn, R2 alleges in the suit, because he could use the preferred stock to boost his stake in XO above 80%, enabling him to tap the company's previous losses for valuable offsets to taxes at his other businesses.

Meanwhile, XO's stock fell from about \$1.27 a share at the time the first bid was made to just 28 cents last month, when Mr. Icahn lodged a bid to buy the whole company.

XO has moved to dismiss the complaint. Chief Executive Carl Grivner said it would have been "a waste of time" to pursue the bids for XO or its assets, because telecom bidders at the time "couldn't get financing."

In court papers, Mr. Icahn said XO directors had no obligation to pursue the bids under the legal doc-

Do as I say

Carl Icahn prodded a number of companies to sell all or part of themselves in 2008. Now, he's being criticized for snubbing offers last year for a company he controls.

He advised these companies to sell...

YAHOO!

YAHOO
Mr. Icahn pressed the Internet company to sell itself to Microsoft Corp. When Yahoo didn't, he moved to replace the company's board.



MOTOROLA

Mr. Icahn called on the company to sell its cellphone division. Even after the company put it on the block, he launched a fight for board seats.

biogen idec

BIOGEN IDEC

Mr. Icahn pushed for a breakup or sale of the biotechnology company, and in the process made two runs at the company's board.

... and yet

XO HOLDINGS

A hedge fund accuses Mr. Icahn of letting shareholders down by not pursuing outside bids for the telecommunications company he controls.

trine of "business judgment," which gives boards discretion to pursue actions they think are in a company's best interest.

Securities lawyers say corporate executives don't have an absolute requirement to accept or disclose financial offers. But the position isn't one usually associated with Mr. Icahn, who has spent a lot of time urging executives at companies such as Kerr-McGee Corp., Blockbuster Inc., and Time Warner Inc., to sell assets or step down to boost the value of shares.

Mr. Icahn "spends so much time advocating shareholder rights" at higher-profile companies, but has taken steps to "harm shareholders" at XO, said Geoffrey Raynor, managing member of Q Investments LP, a \$1.5 billion Fort Worth, Texas, family of hedge funds that includes XO plaintiff R2.

Mr. Icahn called the statement "ludicrous." In an interview, he said his \$780 million preferred invest-

ment saved the company from the risk of insolvency at a time when "money was not available."

Mr. Icahn gained control of XO, a casualty of the technology bubble, after it sought bankruptcy protection in 2002. When XO emerged from bankruptcy proceedings in 2003, he owned 83% of its stock and 85% of its bank debt. His stake fell below 80% when XO sold shares in a rights offering, and he now owns 53%.

R2 successfully sued to block an effort by Mr. Icahn to buy XO's profitable wireline assets in late 2005.

The fund was granted the right to discovery of XO's records last November by a judge who said, referring to the 2008 preferred-stock issue, that there was a "credible basis... there might have been wrongdoing or conduct that led to an unfair transaction."

The suit by R2 didn't identify the bidders it says Mr. Icahn snubbed.

—Martin Peers
contributed to this article.

MTN urges higher bid by Bharti

BY COSTAS PARIS

SINGAPORE—South Africa's MTN Group Ltd. wants India's Bharti Airtel Ltd. to increase its offer by more than \$1 billion, if talks to combine the two telecom operators are to be successful, people familiar with the situation said Friday.

The companies have been in talks for more than two months on a complex cash-and-share swap, which they say would be worth \$23 billion, and have extended their exclusivity period until the end of August. However, a further extension may be needed to reach agreement.

"The sweetener MTN is asking

[for] is quite big. They want more cash, and although Bharti is willing to go some way to increase the offer, they may end up with no deal. I wouldn't be surprised if the talks are extended for another month," one of these people said.

Under terms proposed in May, Bharti would take a 49% stake in MTN, while the South African company would get a 36% stake in Bharti.

MTN would pay about \$2.9 billion in cash and newly issued shares for a 25% stake in the Indian company, while MTN's shareholders would hold an additional interest in Bharti to raise the overall stake to 36%.

Bharti would buy about 36% of

MTN's issued shares in cash and newly issued shares. Combined with the shares it would receive in exchange for selling a stake to MTN, Bharti would end up controlling 49% of the South African company.

Bharti hasn't announced the total cash component of its offer, but analysts estimate it at \$6.5 billion to \$7 billion. The extra \$1 billion sought by MTN is mostly cash and would represent around a 9% premium to the original Bharti offer, this person said.

A person said exchange-rate volatility was the reason for the extension in August and that volatility still posed risks to the deal.

The two companies revived talks in May after discussions last year fell apart due to differences on how to structure the deal.

South African state-owned Public Investment Corp., MTN's largest shareholder, has given its conditional approval but has said there is room for improvement on price. Other shareholders have also said they would need more cash to entice them to approve a deal with Bharti.

A combined MTN-Bharti would have operations stretching across Africa, the Middle East and southeast Asia, with revenue of more than \$20 billion a year.

—Robb M. Stewart in South Africa
contributed to this article.

Ex-Samsung chairman sentenced

ASSOCIATED PRESS

A Seoul court ruled Friday that former Samsung Group Chairman Lee Kun-hee was guilty of breach of trust and handed him a suspended prison sentence, in another legal blow to the South Korean tycoon.

The Seoul High Court sentenced Mr. Lee to three years in prison and fined him 110 billion won (\$88.7 million); he won't go to jail if he stays out of trouble for five years. The case centered on charges that he

caused damage to a Samsung company by issuing a type of bond at below-market prices.

Mr. Lee, one of South Korea's richest people, led Samsung for 20 years following the death of his father, the conglomerate's founder. He is widely credited with turning Samsung Electronics Co. into a global brand. He resigned as chairman of Samsung Electronics, the conglomerate's flagship corporation, when he was indicted in April 2007.

Swatch posts profit drop, but sees sales improving

BY ANITA GREIL

ZURICH—Swatch Group Ltd. Friday reported a 28% drop in first-half earnings as demand for watches declined markedly due to the recession, but the Swiss company said it is optimistic that sales will pick up in the second part of the year.

Swatch, whose time pieces range from the lower-priced Swatch brand to high-end watches such as the Breguet brand, said sales declined 17% from a year earlier to 2.48 billion Swiss francs (\$2.32 billion).

Yet the company was optimistic that sales would rebound somewhat in the second half, saying that—starting in May—they showed a very positive trend compared with the first four months. Swatch expects this trend to "continue in the months to come despite order cancellations for components from third-party watchmakers."

Profit in the six months to June 30 fell to 301 million Swiss francs from 418 million Swiss francs a year earlier.

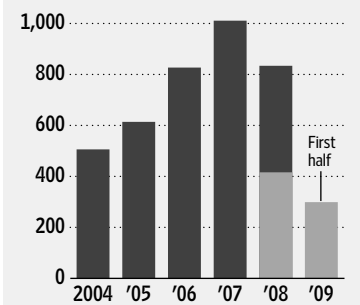
Swatch, of Biel, Switzerland, suffered a less-severe drop in sales than the Swiss watch industry as a whole, because of its portfolio of en-



Bloomberg News

Short of time

Swatch Group's net profit, in millions of Swiss francs



Source: the company

try-level and midrange watches, which have outperformed the high-end segment this year, Citigroup analyst Thomas Chauvet said in a report.

Houghton Mifflin parent reduces heavy debt load

BY JEFFREY A. TRACHTENBERG

Education Media & Publishing Group Ltd., one of the largest educational publishers, has completed a financial restructuring that will significantly reduce its \$7 billion debt load and cut its annual interest cost, the company said.

The deal gives breathing room to the Dublin company, which built up a load of debt to acquire two major educational publishers and then saw sales suffer when the recession tightened state budgets.

But the owners of the closely held company paid heavily for the debt relief, with their holdings diluted by about 45%. Chairman Barry O'Callaghan said that his own equity stake was reduced from about 40% of the company to about 22%.

Education Media owns Houghton Mifflin Harcourt Publishing

Co., a leading publisher of K-12 textbooks as well as a consumer publishing house. It bought Houghton Mifflin in 2006 for \$1.75 billion from private-equity groups. Soon after, it agreed to buy Harcourt for \$4 billion from Reed Elsevier.

In all, Mr. O'Callaghan said, Education Media has restructured about \$2.5 billion of its borrowings. Investors holding \$800 million in debt have agreed to exchange it for equity. In addition, lenders have agreed to let Education Media stop making interest payments on \$1.7 billion in debt in exchange for a higher payout later, cutting the company's \$500 million in annual interest payments by about a fifth.

Todd Boehly, managing partner at the investment firm Guggenheim Partners LLC, the largest single lender to Education Media through its various funds, confirmed the restructuring details.

GLOBAL BUSINESS BRIEFS

J Sainsbury PLC

Supermarket chain J Sainsbury PLC said Sunday it would fight a legal action from Diageo PLC over the drinks company's copyright on alcoholic beverage Pimm's. Diageo, the world's biggest alcoholic-drinks company by volume sold, earlier Sunday said it was suing the supermarket—one of its biggest customers in the U.K.—over its decision to launch Pitcher's, an alcoholic drink to which lemonade and fruit can be added. "We intend to vigorously defend these allegations," said a Sainsbury spokeswoman. "Our customers are savvy enough to know exactly what they're buying, the clue is in the name, and we see no basis for such a claim."

Ssangyong Motor Co.

Ssangyong Motor Co.'s second-quarter net loss widened because of a strike that slashed the auto maker's output. The South Korean company reported a net loss of 177.14 billion won (\$142.8 million) in the three months, compared with a net loss of 35.67 billion won a year earlier. Its operating loss narrowed to 27.49 billion won from 32.38 billion won, while sales fell 66% to 221.73 billion. Unionized Ssangyong workers ended a 77-day sit-in at the company's main plant on Aug. 6. The strike was staged to protest layoffs.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

Obama targets insurers in health effort

President says overhaul will help 'ordinary Americans' get coverage; White House hints public option could be dropped

BY ELIZABETH WILLIAMSON
AND AUGUST COLE

GRAND JUNCTION, Colo.—U.S. President Barack Obama got personal as he wrangled with tough questions Saturday in the latest leg of his campaign for a health-care overhaul, growing emotional when he referenced his grandmother, who died two days before he was elected.

Mr. Obama, striding across the stage with shirtsleeves rolled up, was in full campaign mode, billing the plan as aid for "ordinary Americans, no different than anyone else, held hostage by health insurance companies that deny them coverage, or drop their coverage, or charge fees that they can't afford for care they desperately need."

And the president defended a proposal for a government-run plan, saying it would help keep insurance companies "honest"—although Health and Human Services Secretary Kathleen Sebelius said Sunday that an alternative to private insurers wouldn't necessarily have to be government run.

"I think what's important is choice and competition, and I'm convinced at the end of the day, the plan will have both of those," Ms. Sebelius said Sunday morning on CNN's "State of the Union."

The issue has emerged as a political sticking point as the Obama administration intensifies its efforts to build support for overhauling the health-care system. Mr. Obama and others in the White House in the past have suggested that nothing was set in stone for an overhaul, including inclusion of a public plan. The idea has run into strong opposition from insurance companies, Republicans and others.



U.S. President Barack Obama defends his health-care overhaul at a town-hall meeting at Central High School in Colorado Saturday.

Ms. Sebelius's comments left open the possibility of having non-profit cooperatives serve as an alternative to private plans. Sen. Kent Conrad (D., N.D.) and others in the Senate have backed such an approach.

Ms. Sebelius responded to criticism that the government would be too heavily involved in coverage options by pointing out that the government already helps shape Medicare and Medicaid, the government-run plans for the elderly and disabled, and the poor, respectively. "It's really what happens in any private insurance company when they

put together a package for an employer," she said.

Mr. Obama, meanwhile, intensified his attack on the insurance industry at the Colorado forum Saturday, a theme he also deployed to great effect at a town-hall forum Friday in Belgrade, Mont.

Insurers have been slower to the negotiating table than have drug companies and hospitals as the White House tries to cut existing government costs in order to fund the plan, and insurers enjoy no special warmth among the American public.

As he works to broaden support

for the plan among the 80% of Americans who are already insured, Mr. Obama has drawn cheers in these meetings by making it clear the administration's sights are set squarely on the insurance companies.

"We're going to ban arbitrary caps on benefits. We'll place limits on how much you can be charged for out-of-pocket expenses," he said.

Mr. Obama was animated during the questioning segment of the forum. Raising his voice, he debunked a myth repeated at similar gatherings across the country about "death panels" that, opponents to the proposal allege, would decide

whether seriously ill Medicare patients would continue to receive treatment.

In a rare emotional display, Mr. Obama personalized the debate by referencing his own grandmother. "I know what it's like to watch somebody you love who's aging deteriorate, and struggle with that," he said, his voice rising. "Pulling the plug on grandma? When you start making arguments like that, that's simply dishonest."

Mr. Obama fielded some criticism during questioning from an audience of 1,600, including a college student who challenged the president to "an Oxford-style debate," adding "I don't want generalities."

"Got to have a little chutzpah," Mr. Obama responded, smiling.

Mr. Obama took questions about whether the plan would unfairly burden doctors and nurses, whether it placed sufficient cost controls on the government, and whether the public-insurance option envisioned in the proposal would put private insurers out of business.

"I understand that insurance companies need to get spanked...but how can it be considered fair competition?" asked Randall K. Pifer, president of Employee Benefits Consulting, an insurance-related firm in Grand Junction.

"Nobody's talking about a government takeover of health care," Mr. Obama responded. The overhaul, he added, is "not about eliminating private insurance."

At each stop Mr. Obama has hammered home a simplified message emphasizing the benefits of the proposal to insured and older Americans, whose support is critical if the plan—with its promise of expanding the pool of insured people—is to pass Congress by the end of this year.

U.K. health system, maligned in U.S., draws praise at home

BY CASSELL BRYAN-LOW
AND ALISTAIR MACDONALD

LONDON—The rancorous U.S. health-care debate has hopped the Atlantic, with British politicians and citizens racing to defend the honor of the country's National Health Service against perceived attacks from the Americans.

The rush is a response to claims about the alleged inefficiency and poor quality of the U.K. system made by critics of President Barack Obama's proposals on health-care reform. Opponents of the proposals claim the president intends to na-

tionalize health care and point to purported weaknesses in the U.K.'s service as a warning of what could happen in the U.S.

That has brought a fierce response from many corners of the U.K., where the U.S. health-care debate suddenly threatens to become a local political issue. Prime Minister Gordon Brown and opposition leader David Cameron each have interrupted their summer holidays to weigh in.

Mr. Brown and his wife, Sarah, rushed to defend the institution, known as the NHS, in posts on social-media site Twitter.

Mr. Cameron, meanwhile, spoke in favor of the NHS partly as an act of damage control, after a member of his own Conservative Party made harsh criticisms of U.K. health care on U.S. television.

Mr. Obama is proposing to expand health coverage to almost all Americans via new subsidies and expansion of Medicaid, the federal-state program for the poor. Still, the proposed changes would leave many of the differences between the two countries in place, with most U.S. doctors and hospitals continuing to be privately run.

The attacks have struck a nerve in Britain, where criticism of the NHS has been headline news. The front page of the Daily Telegraph newspaper Friday carried a cartoon

of a British doctor saying he preferred the U.S. health-care system because "their hospital TV dramas are so much better."

Mr. Brown joined a wave of Britons who rallied to defend the 61-year-old institution on the "welovetheNHS" stream on Twitter. "The NHS often makes the difference between pain and comfort, despair and hope, life and death," wrote Mr. Brown on Thursday.

"It's not just a health-care system; it's part of our social fabric," said Lord Ara Darzi, a surgeon and former minister in Britain's Department of Health. He defended the U.K. system as effective and comprehensive. "I don't come to work in the morning thinking if the patients are going to be able to afford the treatment I'm about to give them," Lord Darzi added.

The NHS, founded in 1948, is funded through taxes and has a budget of £105.8 billion (\$175.4 billion) for the coming year. It offers all U.K. residents free access to health care, with some exceptions such as certain dental procedures and some prescription medicines.

Many British people take the availability of free health care for granted. But national health provision remains a highly emotive issue, with many people saying the problem is that spending isn't large enough.

NHS Checkup

- **Founded:** 1948
- **Offers free access to all U.K. residents.** Exceptions include certain dental procedures and some prescription medicines.
- **Budget:** £105.8 billion (\$175.4 billion)
- **Personnel:** 1.5 million employees, including doctors, nurses and ambulance staff.
- **Public opinion:** In the past 10 years voters named NHS the most 'important' political issue, ahead of the economy and crime.

Sources: U.K. Department of Health; Ipsos Mori

One British conservative politician who has sided with Mr. Obama's critics is European parliamentary member Daniel Hannan. During a U.S. television interview Thursday, Mr. Hannan characterized the U.K. system as one with long waiting lists for operations and a lack of patient choice. It is "a relic" of wartime Britain and "puts the power of life and death in a state bureaucracy," said Mr. Hannan, during the interview on Fox News, which is owned by Wall Street Journal parent News Corp.

Despite being virtually unknown in the U.K., Mr. Hannan touched a nerve for the Conservative Party, which has sought to dispel its image as a party that wants to cut back public services such as the NHS.

The Conservative Party spent Friday distancing itself from Mr. Hannan, who is seen as a right-wing maverick in the party. Mr. Cameron went before television cameras and dismissed Mr. Hannan's views as "eccentric" and said his party "stands foursquare behind the NHS."

Mr. Hannan, reached by phone Friday, declined to comment, saying he was on holiday.

Britain's Department of Health also has rushed to the NHS's defense, supplying journalists with a three-page fact sheet to counter what it considers are misconceptions about the service. It said services are provided on the basis of clinical need, rather than age or the ability to pay, and that patients can make choices about doctors and hospitals.

The fact sheet also supplies statistics measuring Britain favorably against America, including better life expectancy rates (78 years in the U.K. versus 77 years in the U.S.) despite spending less per capita (\$2,500 a year and \$6,000 a year, respectively).

—Sara Schaefer Muñoz
and Peter Landers
contributed to this article.

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ECONOMY & POLITICS

Power challenge in Iran

Letter to clerics asks if the supreme leader is fit to rule nation

BY FARNAZ FASSIHI

BEIRUT—In a daring move, a group of former reformist lawmakers, now supporters of the opposition, have challenged whether the Islamic Republic's top man in power is fit to rule.

The unprecedented complaint against Supreme Leader Ayatollah Ali Khamenei came in a letter to one of Iran's highest clerical bodies, the Assembly of Experts, which has the power to name people to the leadership post—and to remove them. The letter marks the first time a political group has questioned the authority of the supreme leader.

The letter was addressed to Ayatollah Ali Akbar Hashemi Rafsanjani, a former president who now heads the assembly and is a critic of President Mahmoud Ahmadinejad. Mr. Rafsanjani shunned the inauguration ceremony of the president on Aug. 5, as well as Mr. Khamenei's endorsement ceremony.

The letter states that according to Iran's constitution, the supreme leader isn't above the law and that the assembly has the right to review his performance as a religious and political leader.

"We demand a legal probe on the basis of Article 111 of the Constitu-

tion, which is a responsibility of the Experts Assembly," stated the letter, which was written by the head of the organization of former reformist lawmakers. Article 111 says if the supreme leader "becomes incapable of fulfilling his constitutional duties," he will be dismissed.

The letter likely won't carry much political weight nor result in action from the Assembly because the hard-liners have marginalized the reformists. But it signals an important turning point for the reform movement.

Analysts say the reform movement has become more radical and is placing itself squarely against the regime and its top authority.

Criticizing the supreme leader was once unthinkable, and had serious repercussions. Now, demonstrators regularly chant slurs against Mr. Khamenei and write insults about him in green spray paint on walls in the capital.

Letter writing also has surged. In Iran, political discourse, even the most serious, has long been in the form of an open letter. When behind-the-scenes negotiations hit a dead end, the issues are shared with the public in print.

These letters now are a crucial communication tool for opposition leaders banned from public speaking. Opposition leaders Mir Hossein Mousavi and Mahdi Karroubi, along with former president Mohammad Khatami, all have written letters to the supreme leader and to various government bodies complaining

about election turmoil.

The reform party, the brainchild of Mr. Khatami, who ruled Iran from 1997 to 2005, had always operated on the premise that it could change the system from within the existing framework. Members criticized the rank-and-file in government, even the president, but pledged loyalty to the system and to the supreme leader. That has now changed.

"When you have nothing more to lose, when even your most basic rights are not respected, then you question the foundations of the regime and that includes the supreme leader," said Fatemeh Haghighatjoo, a former reformist lawmaker, reached by phone, who is now a visiting scholar at the University of Massachusetts in Boston.

Ms. Haghighatjoo and former lawmaker Ali Akbar Mousavi Khoeini once faced legal charges for speaking out against Mr. Khamenei in the parliament.

That taboo has been challenged in particular after Mr. Khamenei openly sided with Mr. Ahmadinejad in a Friday-prayer address to the nation one week after the disputed June 12 election, and declared that his personal views were reflected closely in Mr. Ahmadinejad's policies.

A number of high-profile open letters followed, including one Mr. Rafsanjani wrote to Mr. Khamenei asking him to order a recount of votes soon after. Mr. Rafsanjani's daughter took photos of him drafting the letter on the balcony of his residence



Worshippers in Tehran shout slogans against the West during Friday prayers. The sermon criticized the European Union for supporting recent political unrest in Iran.

and posted them online, to counter rumors that the letter was a fraud.

Perhaps the most controversial letter was one Mr. Karroubi wrote last week claiming detained protesters were raped in prison. It

prompted a furious reaction from hard-liners, who denied the allegations. "The letter played with the Islamic Republic's dignity," said cleric Ayatollah Ahmad Khatami in his Friday prayer address.

Activists demand probe of deaths

BY ZAHID HUSSAIN

ISLAMABAD—Eighteen bullet-ridden bodies of suspected Taliban insurgents were discovered Sunday in Pakistan's northwestern Swat Valley, prompting demands by human-rights activists for a probe into allegations that the killings are being done by Pakistan's military or by anti-Taliban militia backed by the military.

The corpses, many with their skulls smashed, were found in Barikot, Shamoza, Kabal and Kanju districts, a local senior government official said.

Insurgent bodies are now regularly dumped on the streets of Mingora, Swat's main town, and other towns in the valley after the army declared the area clear of militants following a weeks-long offensive. But this was the highest number of Taliban bodies recovered in one day.

It was unclear who was behind the killings. The Independent Human Rights Commission has accused the military of "custodial" killings in the area, or executing captured militants before they are turned over to the judiciary. In the past, militants turned over to the courts frequently have been released. The commission has revealed the discovery of mass insurgent graves of people allegedly killed by security forces or military-backed local militias. Many of the graves were located in an area that was considered a Taliban stronghold.

"The government should allow an independent investigation into the allegation," said Asma Jahangir, chairwoman of the commission. "It is important that the mili-

tary should come clean on the allegation of extrajudicial killings," she said.

A military spokesman denied that troops were involved in the killings. "The militants might have been killed by militias raised by the local population to fight the Taliban," Col. Mohammed Akhtar said.

He added that some reports also suggested the insurgents themselves were killing their injured colleagues before fleeing. "These mass graves may have been prepared by the militants," he said. "In some cases militants have thrown the bodies in river."

Pakistan's army launched an offensive against the Taliban this year.

Pakistan's army launched an offensive against the Taliban insurgents this year after the collapse of a controversial peace deal that had allowed the Islamic radicals to enforce their own version of strict Sharia rule in the alpine enclave. The fighting had forced some two million people to flee their homes.

The Swat operation is viewed by Pakistani and U.S. officials as a success in Pakistan's battle against Islamic militancy. Richard Holbrooke, the U.S. special envoy for Pakistan and Afghanistan, said Sunday the military operation in Swat, Buner and surrounding areas marked considerable progress. "We are very impressed with their success so far," he told reporters in

Islamabad.

He said progress in taking back key Taliban territory had given U.S.-Pakistan relations enough "breathing room" to shift to other issues such as energy and economic development.

Life is returning to normal in the Swat Valley, and hundreds of thousands of people who had fled the fighting have gone home after the military secured control of the region.

Schools are open again, and civilian administrators are back at their posts in most areas. But militants are still holding on in some remote mountainous districts where their leadership is believed to be hiding. Military officials said residents were cooperating in tracking down the remnants of the Taliban, making it more difficult for the militants to hide.

Bullet-riddled bodies of government officials, soldiers and policemen dumped on the streets used to be a common sight during Taliban control of Swat Valley. The militants also used to make videos of their beheadings and distributed them to the media as a propaganda tool.

The corpses now found on the streets are mostly of militants. There have been reports of bodies of slain militants being slung from electric poles and on bridges in recent weeks, often with notes pinned on their bodies that their deaths marked the fate of enemies of the state and Swat.

"It is important for the success of the operation against the militants that the actions of the security forces are distinguishable from the atrocities of the terrorists," Ms. Jahangir said.

Nigeria bails out banks, fires their top executives

BY WILL CONNORS

LAGOS, Nigeria—The Central Bank of Nigeria pledged to inject nearly \$2.6 billion into five troubled banks and dismissed the institutions' top executives, a dramatic move aimed at rescuing the firms from what the government said was chronic mismanagement.

Nigeria is a big petroleum exporter and Sub-Saharan Africa's second-largest economy, behind South Africa. Rising oil prices in recent years triggered a borrowing and investment bonanza in the country. Amid the boom, banks lent heavily, including to speculators in the stock market, which was on a tear.

That left many banks overexposed when commodities prices turned around, the world sank into its current economic slump and Nigerian shares fell. The Nigerian Stock Market has declined roughly 60% from its highs early last year.

On Friday, Nigeria's newly installed central-bank governor, Lamido Sanusi, cited high levels of non-performing loans discovered by audits being conducted at all 24 of Nigeria's banks. Five other banks have passed audits.

Mr. Sanusi attributed the problems at the five troubled banks to "poor corporate governance practices, lax credit administration processes and the absence or nonadherence to the bank's credit risk management practices."

The five banks had been near total collapse before the central bank's intervention, Mr. Sanusi said. He indicated the government wasn't

interested in keeping stakes taken in the banks in exchange for the recapitalization. Instead, he suggested he would encourage new investors to strengthen balance sheets further.

In addition to pledging capital, the central bank said it had removed the top executives at the affected banks: Intercontinental Bank, Union Bank of Nigeria, Oceanic International Bank, Finbank and Afriland. Though the banks are publicly traded, the central bank has the authority to make such personnel decisions in certain circumstances.

"The banks have lost their money in bad loans. We have put in money," said Mr. Sanusi during a news conference in Lagos. "We have questions about the management, so we have put in new management."

By Friday afternoon, security forces had been dispatched to the banks' headquarters, according to local reports.

The central bank said the five banks would continue to operate and depositors' money would be safe. Analysts hailed the move.

Mr. Sanusi took office in June pledging to reform the banking industry and crack down on banks with poor lending records. A former banker, he has a reputation for prudent risk management.

Separately, government troops pulled out of a key area in Nigeria's oil-rich Niger Delta region last week as part of a high-profile amnesty program for militants who have been attacking another pillar of Nigeria's economy: its oil fields.

ECONOMY & POLITICS

More evidence U.S. economy is recovering

Industrial output up, new factory orders rise and inflation at bay

BY SARA MURRAY

U.S. industry ramped up production in July for the first time in nine months, led by auto makers, but the improving economy displayed no signs of inflation.

Industrial production climbed 0.5% in July, the Federal Reserve said Friday. Excluding a hurricane-related rebound in October 2008, it was the first increase since the recession began in December 2007.

The consumer-price index, meanwhile, the most visible gauge of U.S. inflation, was unchanged between June and July. Excluding energy and food, consumer prices rose 0.1% in July, the Labor Department said. Consumer prices have plummeted 2.1% over the past year, the largest 12-month drop since January 1950. A 28.1% annual decline in oil prices offset modest increases in other prices.

The production gains added to mounting evidence that the manufacturing sector is stabilizing and the

economy is beginning, if it hasn't already begun, to recover from the long, deep recession.

Manufacturing output rose 1% in July, the largest gain since December 2006. Excluding autos and parts, it increased 0.2% as improvement emerged in areas such as metals and transportation equipment. An unusually cool summer dragged utility output down 2.4%.

"We're probably starting out on an upward path, said Nigel Gault, IHS Insight's chief U.S. economist. "It's significant that it's moving up, but it's a small step."

Programs like "cash for clunkers" will prop up the U.S. economy in the near term, but "from a longer term perspective, once the effect of inventory adjustments wears off from the manufacturing data, it will be up to final demand to carry the baton," Joshua Shapiro, MFR Inc. chief economist, wrote in a note to clients.

An increase in new orders for manufacturers in July and multiple reports that companies are drawing down inventories were welcome signals this month that the economy's downward spiral is ending. Leaner inventories prompted predictions of an increase in production, particularly among auto makers. The recession

appears to be ending even in some parts of Western Europe; Germany and France last week reported their economies grew in the second quarter, a development that economists expect in the U.S. in the current quarter.

But the economic outlook in the U.S. is clouded by doubts about the strength of consumer spending, doubts reinforced by the decline in the Reuters/University of Michigan survey of consumer sentiment. It fell 2.8 points to 63.2 in early August.

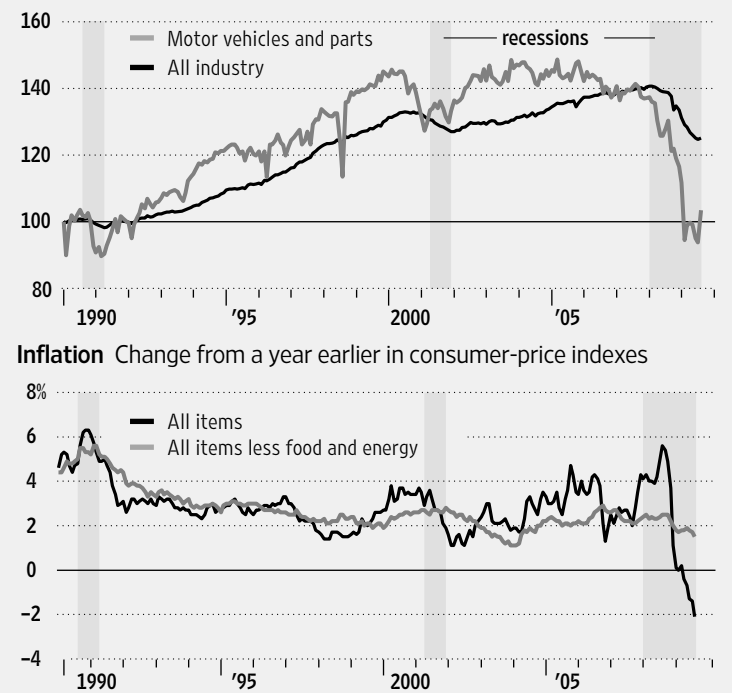
The 9.4% unemployment rate is helping to keep wages down, and in doing so, will likely continue to put a lid on inflation. Until the labor market rebounds, it will be difficult for consumer demand to pick up and spur inflationary pressures. "On the consumer side, spending doesn't look very good at the moment," Mr. Gault said. "There doesn't seem to be the demand there that would support retailers pushing through higher prices."

U.S. industry operated at 68.5% of capacity in July, up from 68.1% the previous month but well below historical norms, a factor restraining price increases.

—Karen Talley
contributed to this article.

Production turns up, prices don't

Industrial production Reindexed, December 1989=100



Note: Industrial production data are seasonally adjusted
Sources: Federal Reserve; Labor Department

Decline in euro-zone consumer prices quickened in July

BY JOE PARKINSON
AND NICHOLAS WINNING

LONDON—Consumer prices in the countries that use the euro were revised to show the fastest rate of decline on record in July, even as the return of economic growth to Germany and France is sparking hope that the deflation could end sooner than expected.

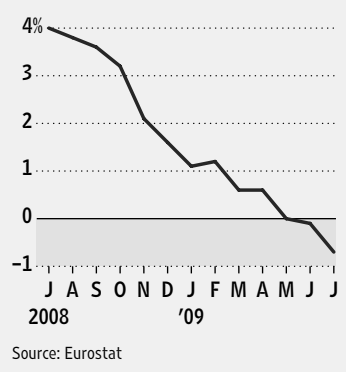
Eurostat, the European Union's official statistics agency, said Friday that the consumer-price index for the 16 countries in the euro zone fell 0.7% from a year earlier in July, wider than its earlier estimate of a 0.6% drop. In June, prices fell 0.1%, the first annual decline in the currency bloc's 10-year history.

Economists said that prices will fall even more rapidly in the months to come.

The European Central Bank's goal is to keep prices rising at an

Prices plunge

Euro zone consumer prices hit fresh low in July



Source: Eurostat

annual rate of around 2%. It has predicted that consumer prices will continue to decline for several months before beginning to increase by the

end of the year.

The decline in prices, however, could be slowed by the expansion in gross domestic product in Germany and France. Both countries reported an unexpected return to growth in the second quarter. Eurostat reported Thursday that both economies grew 0.3% in the second quarter. Those numbers ensured that total euro-zone gross domestic product in the second quarter dropped just 0.1% from the previous three months.

While the better-than-expected news from the currency bloc's two largest economies will exert upward pressure on prices, it is still too early to declare the death of deflation. Doubts remain about the sustainability of the recovery in Europe's economic heartland.

Stimulus measures including programs to swap old cars for more fuel-efficient ones will peter out soon

and European banks are still reluctant to lend as they continue to try to digest losses from the financial crisis.

Separate data Friday underscored the risks that remain for the currency bloc. The rate of decline of Spain's economic output eased in the second quarter from the first, although the year-to-year fall was the largest since 1970.

Meanwhile, the Council of Mortgage Lenders, or CML, said Friday that the number of U.K. homes that were repossessed was 11,400 in the April to June quarter, down from 12,700 in the first three months of the year. While there was a slight improvement in the repossession numbers, CML said mortgage arrears and repossessions were likely to increase this year.

"With unemployment rising and the economy still weak, the outlook will remain challenging for the rest

of this year and into 2010," said Jackie Bennett, CML's head of policy. The figures indicate the government's efforts to cushion the blow of the recession on homeowners through a variety of initiatives is having an effect.

Figures released by the Ministry of Justice in the U.K. on Friday also showed there were 21,090 bankruptcy petitions in the second quarter. That is a 1% drop from the previous quarter and up from 20,007 in the second quarter of last year.

"With the highest unemployment figures recorded since 1995, the insolvency figures will only increase," said John Bangham, director of personal insolvency at KPMG. "Along with unsecured debt, it's likely that home repossessions will also continue to increase."

—Nina Koeppen
and Ainsley Thomson
contributed to this article.

Iraqi candidates debate merits of bridging the sectarian gap

BY CHARLES LEVINSON

BAGHDAD—Iraq's politicians are furiously angling for position ahead of parliamentary elections that could redefine the country's sectarian-based political landscape.

Across Baghdad, Iraqi politicians and party bosses have been shuttling between party headquarters, parliamentary backrooms and heavily fortified residential villas to explore and seal alliances ahead of the January vote.

Politicians and others involved in the deal-making say they are wrestling with a question that could affect Iraq for years to come: Are they more likely to win by playing sectarian politics, as in the past, or by forming coalitions that reach across ethnic and sectarian divides?

"We have a window of opportunity over the next few months to cross the religious-sectarian bound-

ary in our politics," says former national-security adviser Mouafaq al-Rubaie, who will be competing for parliament as head of his own newly formed political party.

The success of nonsectarian parties in provincial elections this year suggested to many that the era of sectarian politics in Iraq may be fading.

Some leaders of the Sunni Awakening movement have said they would like to form an alliance with the Shia prime minister. Sunnis, Kurds and Shiite parties talk about building coalitions based on political issues rather than identity.

"The people sent signals in the provincial elections that they won't support sectarian lists," says Osama Nujaifi, a Sunni lawmaker who is a member of the Iraqia Party led by Ayad Allawi, a secular Shiite. Mr. Nujaifi predicts the election alliance with the broadest representation of Iraqi sects will pull in the most votes

in January.

That would be a big turnaround from Iraq's parliamentary poll in 2005. That vote pitted Sunni, Shiite and Kurd parties against each other and sharpened already-tense sectarian battle lines. "If these elections are like [those] last elections, it will solidify our sectarian divisions, and we will become a country with a de facto soft partition, like Lebanon," says Mr. al-Rubaie.

After a 2006 bombing of a Shiite mosque, sectarian violence exploded but has dropped off sharply since. But a spate of bloody attacks against Shiites and ethnic minorities in recent weeks has many here worried that extremists are set on rekindling sectarian bloodshed before the polls.

Amid that new tension, some Shiite political leaders are pushing Shiite parties to reconstitute the alliance that swept them to power in 2005, and enter January's vote as

part of a similar slate of candidate. Shiites outnumber other sects and ethnic groups in Iraq by a large margin, but before the U.S.-led invasion were largely excluded from the Sunni-dominant ruling class.

"In Iraq, sectarian politics brings votes," says Ahmed Chalabi, a Shiite politician who once enjoyed the backing of some U.S. officials. More recently, he has emerged as a vocal defender of Iran and a leading proponent of a unified Shiite alliance.

Some Iraqis fear that a reconstituted Shiite umbrella would perpetuate the sort of politics blamed for poisoning relations between sects since the 2003 invasion.

Members of the Shiite alliance deflect that criticism by pointing to a handful of Sunnis who have joined their slate. Critics counter that the Sunnis make up a marginal and largely symbolic representation.

Any final coalitions or slate of

candidates may not be finalized until an election law concerning the organization of the ballot, now stuck in parliament, is finalized. It is unclear when that will happen.

A key question is whether Prime Minister Nouri al-Maliki's Dawa Party will join the new Shiite alliance or run independently, under the steam of his newfound popular appeal. If he joins the alliance, he runs the risk of losing the nonsectarian credentials that have won him a broadened base of support in the Iraqi street. If he runs independently, he risks alienating the Shiite backers who made him prime minister in the first place.

Hassan Suneid, a senior Maliki adviser, said the prime minister, unwilling to abandon fully his Shiite base, hopes to join the Shiite coalition. "If Mr. Maliki feels the Shiite alliance has sufficiently broad representation of Iraqi ethnic groups, he'll join," says Mr. Suneid. "If not, he'll go it alone."