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Competing priorities shape new U.S. Congress agenda

NEWS IN DEPTH | PAGES 16-17

Morgan Stanley's CEO hunt holds key to its future

MONEY & INVESTING | PAGE 19

Russia-Ukraine dispute over gas prices intensifies

Gazprom will restart talks with Naftogaz in Moscow Thursday

A dispute between Russia and Ukraine over natural gas turned nasty on Tuesday, as gas deliveries to a swath of European countries were cut off entirely amid freezing

*By **Andrew Osborn** in Moscow, **Guy Chazan** in London and **John W. Miller** in Brussels*

winter temperatures. The escalating fight, which began last week as a commercial disagreement over pricing, evoked a similar cutoff three years ago and reignited debate across the European Union over its deep reliance on Russian energy.

As recently as Monday, European officials had been reassuring their populations that the quarrel—which began Jan. 1 when Russian gas giant OAO **Gazprom** cut deliveries meant for Ukraine's domestic consumption—didn't pose a significant threat to European Union consumers further downstream.

On Tuesday, however, gas deliveries via Ukraine dropped far more than during a similar dispute in 2006. As regional temperatures fell well below freezing, thousands of households in Bulgaria were left without heat. Po-

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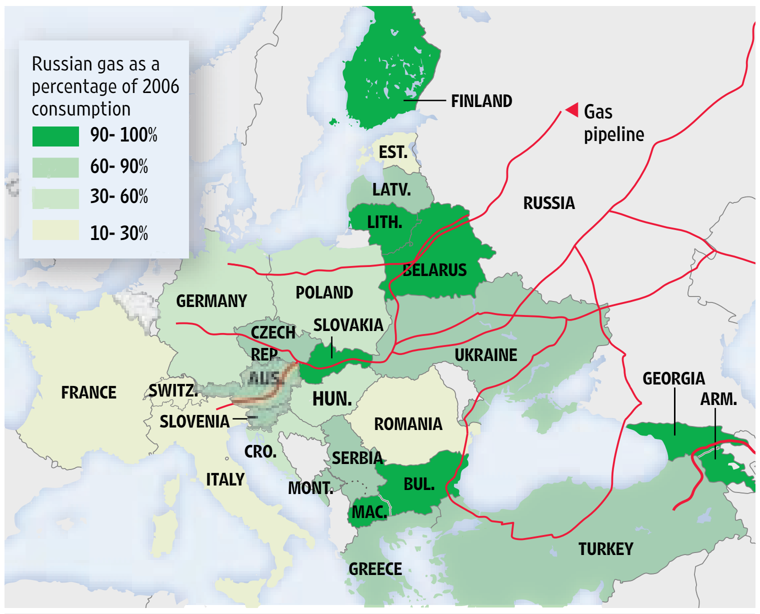

Russian gas shock

Tuesday's disruption of Russian natural gas supplies via Ukraine has revived debate in the European Union over how to reduce reliance on Europe's dominant supplier, OAO Gazprom. But countries differ widely how much gas they get from Russia, as well as in the availability of storage to cushion them against shocks.

Russian gas supplies via Ukraine halted:

- Macedonia
- Montenegro
- Bulgaria
- Turkey
- Serbia
- Croatia
- Greece
- Romania
- Ukraine (since Jan. 1)

Other significant drops:

- **Slovakia:** Down 70%
- **Austria:** OMV AG reported a 90% drop
- **Slovenia:** Geoplin registers a 90% drop
- **Poland:** 85% drop reported
- **Czech Republic:** "Significant reduction"

Sources: EIA International Energy Annual, 2007 (domestic consumption); Reuters, Associated Press, Dow Jones Newswires, and WSJ Research (Status of Russian gas supplies by country)

What's News—

Business & Finance

Russian gas supplies to a swath of Europe were cut significantly as temperatures fell across the region, raising stakes in a pricing dispute between Moscow and Kiev. The escalating fight reignited debate across the European Union over its deep reliance on Russian energy. Page 1

■ **The euro zone's falling** prices and slowing economic activity raise the chances of a big interest-rate cut. Page 2

■ **A gauge of future U.S.** home sales sank in November, and reports showed declines in both manufacturing and service-sector activity. Page 2

■ **Next and Debenhams posted** encouraging Christmas sales, as did other U.K. retailers. But the sector faces a challenge from the pound's weakness. Page 6

■ **European shares** continued to advance, led by drug companies, auto makers and metal stocks. A rally in tech stocks drove U.S. gains. Page 20

■ **Dow Chemical vowed** to pursue legal, operational and financial avenues to remake itself after a failed plastics venture. Page 8

■ **Apple will cut** the price of many songs at its iTunes Store, drop copy protection and allow iPhone 3G downloads. Page 28

■ **Steelmakers are attempting** to raise prices and reopen some closed mills in a sign the industry may have bottomed. Page 6

■ **German car sales dropped** 6.6% last month, closing out a dismal year that saw Germans buy the fewest automobiles since reunification. Page 7

■ **GM's passenger-vehicle** sales in China fell in 2008 as the country's overall sales growth slowed. Page 7

■ **Former Enron CEO** Jeff Skilling's conviction was upheld by a U.S. appeals court, but he will be resentenced. Page 4

■ **Cisco will** unveil a service for media companies to manage social networks. It also will launch a home audio system. Page 7

Markets 4 p.m. ET

MARKET	CLOSE	NET CHG	PCT CHG
DJIA	9015.10	+62.21	+0.69
Nasdaq	1652.38	+24.35	+1.50
DJ Stoxx 600	212.87	+4.18	+2.00
FTSE 100	4638.92	+59.28	+1.29
DAX	5026.31	+42.32	+0.85
CAC 40	3396.22	+36.30	+1.08
Euro	$1.3391	-0.0244	-1.79
Nymex crude	$48.58	-0.23	-0.47

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World-Wide

Israeli artillery shells struck a U.N.-run school in Gaza, killing at least 30 Palestinians who had sought shelter there, a development likely to dramatically increase international pressure for a cease-fire. Over 100 Palestinians died across Gaza, hospital officials said, pushing the war's 11-day toll to 640 Palestinians killed, and an estimated 2,960 injured. Page 3

■ **Attacks against Jews** and synagogues were reported in France, Sweden and Britain, raising concerns that the Gaza conflict may spill over into Europe. Page 31

■ **Gunmen killed** a member of Iraqi President Talabani's political party in a drive-by shooting in Kirkuk, Iraqi police said.

■ **Five Blackwater** security guards pleaded not guilty in a U.S. court to manslaughter charges in the 2007 shooting deaths of 17 Iraqi civilians.

■ **Two men shot and killed** a Muslim cleric inside a mosque in southern Afghanistan, the second such incident in the area in less than two weeks.

■ **India's prime minister** accused Pakistan of using terrorism as a policy tool and said the Mumbai attackers had official Pakistani support. Islamabad rejected the allegations. Page 11

■ **Algerian security forces** shot and killed three suspected Islamist suicide bombers in an ambush east of the capital.

■ **Sri Lanka's military said** its troops broke through the Tamil Tigers' northern defense lines, opening another active front in the war against the rebels.

■ **A Beijing woman died** of bird flu, the first human case of the virus in China since last February, putting officials on alert for a possible resurgence. Page 11

■ **The U.N. reported** a one-day jump in new cholera cases and deaths in Zimbabwe, following a week in which the epidemic had shown signs of slowing.

■ **Mauritania's coup leader** said the country will hold a presidential election May 30.

■ **Gunmen killed** a Somali aid worker, and the U.N. envoy called for a Baghdad-style Green Zone where relief workers could live.

EDITORIAL & OPINION

Plus ça change

With French President Sarkozy it seems to be the same old *politique arabe*. Page 15

German tycoon Merckle kills self as empire wavers

BY MIKE ESTERL

FRANKFURT—Adolf Merckle, one of Germany's wealthiest men, committed suicide weeks after his family business empire, spanning drugs to cement, began unraveling amid mounting debt, his family said Tuesday.

The death of the 74-year-old multibillionaire, whose holding company oversaw dozens of firms and had roughly €30 billion, or about $40 billion, in annual sales, represents one of the most tragic outcomes of the global financial crisis to date.

News of Mr. Merckle's suicide came after a consortium of about 30 creditor banks put the finishing touches on a bridge loan of roughly €400 million to the family holding company, VEM Vermögensverwaltung GmbH.

But VEM had to hand over significant collateral to the banks as a prelude to a broader restructuring in the coming months that is expected to strip the holding company of many assets, according to people familiar with the matter.

Mr. Merckle, a lawyer who shied away from the spotlight, inherited his family's pharmaceutical company in the 1960s and expanded aggressively. He eventually controlled major stakes in **Phoenix Pharmahandel**, a German pharmaceutical wholesaler with about €20 billion in revenue; publicly listed **HeidelbergCement** AG, a cement company with more than €10 billion in sales; and generic drug maker **Ratiopharm International** GmbH, which has around

Please turn to page 31

The late German billionaire Adolf Merckle, seen here in Dresden in 1996.

Israelis have front-row seats in Gaza strife

BY CHARLES LEVINSON

GAZA BORDER—Moti Danino sat Monday in a canvas lawn chair on a sandy hilltop on Gaza's border, peering through a pair of binoculars at distant plumes of smoke rising from the besieged territory.

A pious Jew and unemployed factory worker, he comes here each morning to watch Israel's assault on Hamas from what has become the war's peanut gallery—a string of dusty hilltops close to the border that offer panoramic views across northern Gaza.

He is one of dozens of Israelis who have arrived from all over Israel, some with sack lunches and portable radios tuned to the latest reports of the battle raging in front of them. Some, like Mr. Danino, are here to egg on friends and family members in the fight.

Others have made the trek, they say, to witness firsthand a military operation—so far, widely popular inside Israel—against Hamas, the militant group that controls the Gaza Strip.

Over the weekend, four teenagers sat on a hill near Mr. Danino's, oohing and aahing at the air strikes. Nadav Zebari, who studies Torah in Jerusalem, was eating a cheese

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Spain **€2.90** - Sweden **kr 27** - Switzerland **SF 4.80** - Syria **S£ 210** - Turkey **YTL 4.25** - U.S. Military (Eur) **$2** – United Kingdom **£1.40**

THE WALL STREET JOURNAL.

LEADING THE NEWS

Euro-zone activity slows

Large ECB rate cut expected after data on inflation, services

Sharply falling inflation and slowing euro-zone economic activity added to market expectations that the European Central Bank will deliver a hefty interest-rate cut next week.

Annual inflation in the 16 countries that share the euro currency fell

*By **Joellen Perry** in Frankfurt and **Nicholas Winning** and **Joe Parkinson** in London*

to 1.6% in December, the lowest in more than two years and down from 2.1% in November. Falling energy prices likely helped to pull the rate, reported Tuesday by European statistics agency Eurostat, down to a level last seen in October 2006.

Activity in the euro-zone services sector in December also shrank, at the fastest pace on record, while French consumer confidence remained in the doldrums. Companies' appetites for new hires fell in Germany, Europe's largest economy.

The dismal data suggest the euro-zone recession deepened late last year. Ben May, an economist at Capital Economics in London, said in a research note that slowing private-sector activity suggests the bloc's economy contracted by 0.8% in the fourth quarter, following 0.2% contractions in the second and third quarters.

The news pushed the euro to a low of $1.3474 against the dollar on Tuesday, as traders raised bets the ECB will cut its key rate by a half-percentage point to 2% at its meeting on Jan. 15. Lower interest rates can make a currency less attractive to investors.

The ECB's Governing Council has given no clear signal what decision it will take next week. The central bank has cut its key rate by 1.75 percentage points since October, to its current 2.5%. December's 1.6% inflation showing was below the ECB's preferred level of just below 2% for the first time since August 2007.

ECB Governing Council member Vítor Constâncio, who also heads Portugal's central bank, told reporters in Lisbon on Tuesday that "any risk of inflation consolidating far below this value [2%] should be contained preemptively with interest-rate reductions."

Other ECB policy makers, such as the central bank's chief economist Jürgen Stark, have signaled a reluctance to continue cutting aggressively, in part because continuing tension in the markets where banks lend to one another can dilute the economic impact of central-bank rate cuts.

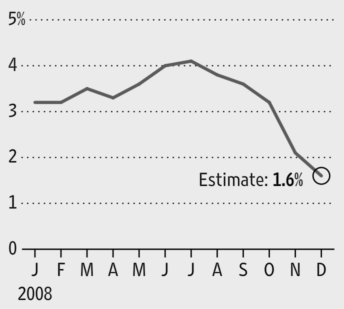
Klaus Baader, chief European economist at Merrill Lynch, said the December figures suggest euro-zone inflation could fall below zero by midyear. But the ECB and many economists maintain that deflation—a long period of falling prices—is unlikely in the euro zone.

The severity of the bloc's economic slowdown in 2008 suggests a quick recovery this year is unlikely. Markit Economics said Tuesday that the purchasing managers' index for the euro zone's services sector fell to a record low of 42.1 in December, further below the 50-point level separating expansion from contraction and down from November's 42.5 reading.

The composite measure, which includes manufacturing-sector activity, also fell to a record low of 38.2 in December from 38.9 in November.

Deceleration

Euro-zone inflation eased in Dececmber



Source: Eurostat

French national statistics office Insee said consumer confidence fell to minus 44 in December from minus 43 in November. That was better than the minus 45 expected by economists but not far off July's record low of minus 47.

In Germany, the unemployed have begun to feel the pinch from the economic slump as companies' appetite for new hires shrank in December, the country's labor office said.

Meanwhile, the U.K.'s dominant services sector contracted at a slower pace in December than it had from September to November, according to Markit Economics. But separate December data from U.K. lender Nationwide Building Society showed house prices falling at a record pace, while consumer confidence sank.

The slight uptick in service-sector activity is unlikely to dissuade the Bank of England from cutting its policy rate from the current 2% on Thursday. The U.K. central bank has cut three percentage points from its key rate since October.

Housing, manufacturing weaken further in U.S.

By Kelly Evans

The U.S. is already a year deep in the current recession, but there are fresh signs of more weakness ahead.

A gauge of future home sales sank in November, the National Association of Realtors said Tuesday, while separate reports showed declines in both manufacturing and service-sector activity.

Pending home sales, based on signed contracts that typically lead actual closings by a month or two, slumped in November after holding steady for much of 2008. The Realtors group said rising unemployment and low consumer confidence deterred buyers, and its index fell 4% to a level of 82.3, the lowest since the series began in 2001.

"In other words, there is no evidence yet of any kind of rebound in housing," said Michael Darda, chief economist at MKM Partners in Stamford, Conn., in a note to clients. He added that while mortgage rates, currently at half-century lows, are helping to stimulate refinance activity, it isn't clear whether they are doing much to boost sales.

The Realtors group is asking Congress to pass several measures to help the industry, such as a $7,500 tax credit to all home buyers and a permanent increase on loan limits to help make mortgages more affordable.

Meanwhile, woes in manufacturing—a sector that, like housing, has been struggling for several years—also worsened in recent months. New orders for manufactured goods, a key sign of health in the industry and in the U.S. economy in general, fell by 4.6% in November to $385 billion, the Commerce Department reported, following a downwardly revised 6% drop in October from the previous month.

Demand for durable goods—items such as furniture and appliances designed to last three years or more—fell by 1.5% in November to $186 billion, a larger drop than previously reported. Shipments of goods fell by 5.3%, the largest monthly drop since the series began in 1992, to $394 billion. Falling demand for goods also pushed up inventory levels, which could lead to future drops in new orders or price reductions aimed at boosting sales. A key gauge of business spending, nondefense capital-goods orders excluding aircraft, rose 3.9% after a large decline in October.

Activity in the service sector, which includes restaurant, hotel and retail jobs, and forms a larger share of U.S. jobs and production than manufacturing, continued to contract in December, the Institute for Supply Management reported, though at a slower pace than the month before. The ISM gauge of nonmanufacturing activity rose to 40.6 from 37.3 in November—levels below 50 indicate contraction—with new orders, production, employment and exports showing some improvement from low levels of activity.

"I still don't anticipate growth in this sector during the first half of the year," said Anthony Nieves, a Hilton Hotels Corp. executive and survey chairman.

China drops plans for steel hoard

By Chuin-Wei Yap

BEIJING—China has shelved a proposal to create a steel stockpile, first publicly broached in early December to help flagging mills, as consensus fell apart on how much steel to buy, an industry official said Tuesday. The government's discussions with the industry foundered on the proposed purchase volume, said Shan Shanghua, secretary-general of the China Iron and Steel Association. Beijing also faced a dilemma on whether to step in to rescue an industry that appears to be slowly mending on its own as demand recovered.

Separately, the European Commission will place temporary duties on steel wire rods from China and Moldova following complaints of dumping from EU steel companies.

INDEX TO BUSINESSES

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

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INDEX TO PEOPLE

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

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

LEADING THE NEWS

Israeli shells kill 30 at U.N. school in Gaza

Rice steps up talks to end crisis as toll of Palestinians leaps

Three Israeli artillery shells struck a United Nations-run school in Gaza on Tuesday, killing at least 30 Palestinians who had sought shelter there and stepping up international pressure for a cease-fire.

An additional 55 Palestinians were wounded when the shells

*By **Charles Levinson** on the Gaza border and **Jay Solomon** in Washington*

struck the Jabbaliya Girls Prepatory School, a little before 4 p.m., according to U.N. spokesman Chris Gunness.

The attack capped one of the bloodiest day of the Israeli blitz so far, with more than 100 Palestinians dying across Gaza, according to hospital officials. Tuesday's casualties pushed the war's 11-day toll to 640 Palestinian dead, and an estimated 2,960 injured.

Within hours of the shelling at the U.N. school, U.S. President-elect Barack Obama broke his silence on the Gaza war, calling the mounting loss of civilian life in Gaza and Israel "a source of deep concern for me."

Mr. Obama's comments could signal a tipping point in the international campaign to convince Israel to halt its attack. European and Arab leaders have pushed Israel for a quick cease-fire, but the Bush administration has refrained from condemning Israel's attack.

In Washington on Tuesday, the Bush administration stepped up diplomacy to end the crisis, sending Secretary of State Condoleezza Rice to New York to meet with Arab leaders and to take part in a United Nations Security Council meeting.

Ms. Rice was scheduled to meet with Palestinian Authority President Mahmoud Abbas, as well as senior Turkish, French and Egyptian diplomats, U.S. officials said.

Arab governments have been pushing the Security Council to pass a resolution calling for an immediate end to hostilities between Israel and Hamas. Washington so far blocked has passage of the cease-fire initiative as it seeks to put in place longer-term mechanisms to guard against the rearming of Hamas, according to U.S. officials.

American diplomats are discussing the restoration of a 2005 international agreement that allows for European Union and Palestinian Authority security officials to control the supply routes in and out of Gaza. The U.S. also wants to establish a mechanism to better monitor smuggling of weapons and other contraband into the Gaza Strip from the Sinai Peninsula.

Many moderate Arab leaders say the violence risks turning their nations against them, as they appear weak amid the Israeli operation.

"We need a cease-fire now as the violence has reached unacceptable levels," said an Arab diplomat from a U.S.-allied country. "The condition is hurting the moderates in the region."

Meanwhile European nations including France and England, worried about spillover attacks stemming from the Gaza conflict. French authorities said they fear tensions between the country's Jewish and Muslim communities may rise. In London, the Community Security Trust, a group that provides training, advice and security services for the protection of British Jews, says

Reuters

Palestinian boys stare at a house destroyed after an Israeli airstrike Tuesday at Khan Younis, in the southern Gaza Strip.

there have been around 25 incidents related to the recent action in Gaza.

Most prominent among those was an attempted arson late Sunday at a synagogue in north London, resulting in minor damage; the CST says the perpetrators tried and failed to pour flammable liquids inside the building, so instead poured gas on the door and set it on fire. Other incidents have involved graffiti with slogans like "Jihad against Israel" and "Kill the Jews."

In South America, Venezuelan President Hugo Chávez Tuesday expelled the Israeli ambassador and all embassy personnel in response to the campaign, the Associated Press reported.

Israel began an aerial bombardment of Gaza on Dec. 27 after a six-month cease-fire between Israel and Hamas, the militant group that rules Gaza, expired and Hamas resumed firing rockets at Israel. Four Israelis, three of them civilians, have been killed due to rocket attacks since the offensive began.

Past Israeli military operations have been derailed by international pressure stemming from similar missteps by the Israeli military. A missile strike against a civilian shelter, again in Qana, in 2006 killed 28 civilians and forced Israel to suspend its offensive in southern Lebanon for 48 hours.

Israel's death toll also rose on Tuesday. Four soldiers died overnight Monday in two separate friendly-fire incidents in which Israeli tank shells hit Israeli soldiers. A fifth soldier was shot dead Tuesday morning by a Palestinian militant, according to the military.

Israel said its war planes bombed 100 targets on Tuesday, as tanks took up positions on the outskirts of Gaza's second-largest city of Khan Younis in the southern part of the coastal strip.

—David Gauthier-Villars in Paris and Alistair MacDonald in London contributed to this article.

Israelis watch fighting in Gaza from atop nearby hills

Continued from first page

sandwich and sipping a Diet Coke.

"I've never watched a war before," he said. A group of police officers nearby took turns snapping pictures of one another with smoking Gaza as a backdrop. "I want to feel a part of the war," one said, before correcting himself with the official government designation for the assault. "I mean *operation*. It's not a war."

The spectators share hilltop space with an army of camera-toting Israeli and foreign journalists, who have so far been banned by the Israeli military from entering Gaza to report on the conflict.

Mr. Danino has a personal link to the fighting. His 20-year-old son Moshe is a soldier in an infantry unit fighting somewhere below his hilly perch.

From the sidelines, he is here to root for his son the soldier, he says, just as he once sat on the sidelines of soccer fields cheering for his son the high-school athlete.

"The Army took all the soldiers' cellphones away before the attack, so this is my way of staying in contact," he says.

On another hill-top overlooking Gaza, Sandra Koubi, a 43-year-old philosophy student, says seeing the violence up close "is a kind of catharsis for me, to get rid of all the anxiety we have inside us after years of rocket fire" from Hamas.

Jocelyn Znaty, a stout 60-year-old nurse for Magen David Adom, the

Charles Levinson/The Wall Street Journal

Israeli boys gather on a hilltop on Gaza's border Monday to watch Israel's offensive against Hamas. Dozens of Israeli spectators have arrived from all over Israel.

Israeli counterpart of the Red Cross, can hardly contain her glee at the site of exploding mortars below in Gaza.

"Look at that," she shouts, clapping her hands as four artillery rounds pound the territory in quick succession. "Bravo! Bravo!"

Ms. Znaty lives in Sderot, the immigrant community on Gaza's border that has long been a target for Palestinian militants inside the territory, whose rockets have frequently rained down on the town. Her daughter lives on Kibbutz Yad Mordechai, an Israeli community even closer to the Gaza Strip.

Last year, Gaza-launched rockets struck Ms. Znaty's home twice in a single week. She escaped both attacks unscathed; a simmering anger remains for those living on the other side of the Gaza fence.

She acknowledges an uncomfortable, self-conscious awareness that she is cheering on a deadly war. Israeli planes, ships and artillery have blasted the small, sealed-off territory for more than a week, killing more than 600 Palestinians and injuring more than 2,900.

The weekend ground assault has sent civilian casualties climbing, overwhelming hospitals and triggering the International Committee of the Red Cross to declare a humanitarian crisis inside the small, seaside enclave of 1.5 million.

On Tuesday, the UN said one of its schools in Gaza was hit by an Israeli strike, killing dozens of civilians who had sought refuge from the attacks.

"It's weird that we have to take lives in order to save lives," Ms. Znaty says. "But we were held hostage by Hamas while our government ignored us, and now we fight back. I am sorry, but I am happy."

War watching isn't a new phenomenon. Up until World War I, when more powerful weapons began to be used on the battlefield, it was common for civilians to perch on grassy lookouts on a battlefield's periphery to watch warring armies.

Nor is it unique to Israelis in the current conflict. On the Egyptian side of the border, across from southern Gaza, Arabs, too, were coming from far away to watch the aerial bombardment.

But at Gaza's border crossing in the dusty town of Rafah, the mood was of anger and sober resignation amid the punishing Israeli attacks. Egyptians in Rafah, and many of the Arab aid workers who have flocked here to help evacuate Gaza's wounded, share deep ethnic, family and economic ties with the territory.

Over the weekend, as ambulances ferried out bloodied Palestinian casualties, plumes of black smoke, accompanied by dull thuds and trembling earth, rose across the border, just a hundred yards across a no man's land marking the border with Egypt.

"We feel helpless. We feel like we are so close but we can't do anything," said Rami Ibrahim Shahin, a 20-year-old mechanic, whose family is originally Palestinian. His brother lives on the other side of the border, now under Israeli fire.

They talk every day, when phone connections work. After his shift ends in the evening, Mr. Shahin walks several kilometers to reach the border crossing, where he can get a better view of the attacks.

"All day long, it's like this, we see the attacks with our own eyes," shrugs Rafah resident Osama Al-Beyali, a 51-year-old porter in torn gray coveralls. As blasts ring out across the border, onlookers swear at Israel or offer prayers for victims.

A father of six, Mr. Al-Beyali says he thinks of the Palestinian children suffering in the cold, with little food or safety, under the barrage. "When I see my children, I feel ashamed and guilty. I feel like I should find a way to go over there and fight the Israelis."

"Injustice, injustice," he mumbles.

Many Israelis have come to see the early days of the Gaza offensive—where Israeli forces have suffered a handful of military deaths and three civilian casualties from rocket attacks—as a welcome change.

"I come here because our army is finally doing something, showing the world that we are not weak," says Mr. Danino, the unemployed factory worker.

—Farnaz Fassihi in Rafah, Egypt and Margaret Coker in Tel Aviv contributed to this article.

High-tech companies take up netbooks

Low-priced laptops blossom in economic downturn; new products will address flaws, provide more features

By Don Clark
And Justin Scheck

A new breed of low-priced laptops called netbooks have been thriving during the downturn—so well, in fact, that many high-tech companies are scrambling to adapt.

The responses by these high-tech companies will be a hot topic at this week's Consumer Electronics Show. They include not only new netbooks—which typically cost $300 to $500, and often use **Intel** Corp.'s Atom chip—but products that address shortcomings of the new category and other portable PCs.

Netbooks, for example, tend not to be very good at displaying graphics and playing videos. So **Hewlett-Packard** Co., on Tuesday introduced a $699 laptop that beefs up those capabilities with chips from Advanced Micro Devices Inc. H-P's new dv2 model is fewer than 2.5 centimeters thick and offers many features found in higher-end products such as **Apple** Inc.'s MacBook Air, which starts at $1,800.

Another problem with netbooks, and other laptops, is that they tend to start up too slowly and run out of power too quickly. **Phoenix Technologies** Ltd. is trying to address those issues with a downloadable layer of software, called HyperSpace, that lets users do simple chores such as calling up Web sites without waiting for an operating system to boot up.

The activity is the latest sign that technology segments are converging at an accelerating rate, driven by competitive pressures that the recession is amplifying. Companies including Phoenix are trying to help netbooks and other portables work as simply as cellphones, just as makers of those devices are improving their ability to tap into the Web.

In another tactic, **Qualcomm** Inc. and **Freescale Semiconductor** Inc., which make chips for cellphones, are discussing plans at CES to offer their technology for netbooks, too. Henri Richard, Freescale's senior vice president and chief marketing officer, predicts that new entrants such as cellphone makers will join the race to make portable computers. "Netbooks change the paradigm for how you enter the computing space," Mr. Richard says.

Hewlett-Packard

Hewlett-Packard's thin new dv2 has features of high-end laptops but a price closer to low-end netbooks

The new products, sometimes called mini-notebooks, were exemplified by the success of the Eee personal computer that Asustek Computer Inc. of Taiwan introduced in 2007. Its initial models started at $299, had a seven-inch screen, used Linux rather than Windows and had no disk drive. The portables stored a small amount of data on flash memory chips.

Since then, companies such as H-P, **Dell** Inc. and **Acer** Inc. have introduced machines with a range of features, including larger screens, disk drives and **Microsoft** Corp.'s Windows XP software.

One of the biggest cheerleaders has been Intel, which helped popularize the term netbooks and this past spring introduced the low-priced Atom chip as a calculating engine for the new devices. "Suffice it to say, demand turned out to be much larger than we anticipated," says Bill Calder, an Intel spokesman.

Gartner analyst Mika Kitagawa estimates that more than 10 million netbooks were sold in 2008, surpassing the research firm's earlier estimate of eight million—and leaping from the hundreds of thousands believed to have been sold in 2007.

Some companies initially predicted that netbooks would find their biggest audience as a first computer purchase for customers in emerging economies. Now, though, many industry executives agree that netbooks are mainly being purchased as a second or third computer in affluent households—good for quickly checking Web sites, but not powerful enough for chores such as burning DVDs.

Another issue has been whether netbooks are expanding the PC market, or taking sales from more expensive laptops.

"This is a class of PC devices that is much more incremental than it is cannibalizing," says Brad Brooks, corporate vice president of Windows consumer-product marketing.

Mr. Brooks estimates that more than 80% of netbooks now ship with Windows, compared with less than 10% when the devices first went on sale. But most run XP, and analysts say that Microsoft receives less revenue and profit from that product than the newer Windows Vista software that comes with other laptops. Intel has said its prices and profit margins on Atom also are lower than on some other chips.

Any line between netbooks and higher-end laptops stands to get even blurrier, as competition causes companies to add more features to their products. Dell, for instance, now sells a $499 netbook with a screen measuring 12 inches, essentially a scaled-up version of an earlier product with an 8.9-inch screen. H-P, in addition to its higher-priced dv2, at CES is introducing a $499 extra-durable netbook with a 10-inch screen that is aimed at business customers.

Jonathan Kaye, the marketing director for H-P's consumer-notebooks division, says that until recently, PC companies have been building machines that conform to "a fairly strict definition of what a netbook is," set largely by Intel's specifications. But, he adds, that could change as manufacturers add more sophisticated features.

Roger Kay, an analyst at Endpoint Technologies Associates, says H-P's new laptop is evidence that netbooks and the competition they have spurred are dragging down PC prices and taking sales from more-expensive models. PC makers are "eating their children," he says.

Chip makers certainly don't intend to let Intel run away with the market. **Via Technologies** Inc. is expected to discuss its competing microprocessors for netbooks at CES.

AMD, though not selling a chip for netbooks, says that most consumers will prefer machines such as the dv2 that use its microprocessors and more powerful graphics circuitry, in a combination code-named Yukon that it announced Tuesday. **Nvidia** Corp., another maker of graphics chips, wants to persuade netbook makers to use one of its graphics chips alongside Intel's Atom—providing what it estimates to be 10 times the performance of the accessory chips Intel offers with its microprocessor.

Then there is the issue of the time it takes to start Windows. Phoenix, which sells PC makers built-in programs that control the boot-up process of their systems, estimates that its HyperSpace software can let users start surfing the Web in a few seconds, save energy and avoid security problems associated with Windows. The software comes in two versions, priced at $39.95 and $59.95 for a year of use.

—Nick Wingfield contributed to this article.

Logitech to cut 5% of work force

By Hans Schoemaker

Computer-peripherals maker **Logitech International** SA abandoned its financial targets for fiscal 2009 and said it is cutting 500 jobs, or about 5% of its 9,000 employees.

Switzerland-based Logitech, which makes low-cost products ranging from mice and keyboards to Webcams and universal remote controls, has long remained relatively resilient to economic circumstances, saying most of its products fall below what it calls the "ask your spouse" level. If consumers are forced to save on big-ticket items like personal computers, they will still buy extras like a jazzy new keyboard or mouse.

Tuesday's announcement was bad news for both Logitech investors and the industry as a whole, analysts said.

"Many of Logitech's products are relatively cheap compared to household income," an analyst at Clariden Leu Investment Research wrote in a summary. "Weak sales of small-ticket items are not an encouraging sign."

Logitech isn't the first electronics maker to issue a profit warning because of the economic downturn. Motorola Inc., Sony Corp. and Philips Electronics NV have all issued similar warnings in the past two months.

Logitech didn't provide new sales or profit targets for the year ending March 31, citing continued economic uncertainty. It had previously forecast sales would increase between 6% to 8% and that operating income would rise 3% to 5% for the full year. But even those figures were trimmed: as late as October, the company had forecast both figures to rise 15%.

The computer-peripherals maker also abandoned its financial targets.

The Christmas quarter, crucial for Logitech as the quarter typically accounts for nearly a third of total revenue, marked a steep deterioration as clients sharply cut inventories, driven by lower consumer demand and retailers' expectations for a drawn-out economic crisis.

Chief Executive Gerald Quindlen said the company expects is reducing costs to cope with "what is likely to be an extended downturn."

The 500 cuts announced Tuesday are nonproduction jobs, or about 15% of its nonproduction work force.

"The magnitude of planned job cuts indicates that the situation is severe," Vontobel analyst Michael Foeth wrote in a note to investors. "Without further guidance, we assume that the company expects no growth" in fiscal 2009 and 2010.

Logitech Chairman Guerrino De Luca said he expects this year will be marked by economic crisis, much as 2008 was marked by financial crisis. But he said Logitech is in a stronger position than its competitors.

The company said it would update investors on business conditions when it reports third-quarter results Jan. 20.

Court orders resentencing of former Enron CEO Skilling

Associated Press

HOUSTON—A U.S. federal appeals court upheld the conviction of former Enron Corp. Chief Executive Officer Jeff Skilling for his role in the energy company's collapse, but vacated his 24-year prison term and ordered that he be resentenced.

A three-judge panel of the 5th U.S. Circuit Court of Appeals in New Orleans on Tuesday denied Mr. Skilling's request to overturn his convictions. Mr. Skilling and his lawyers argued his conviction was invalid because of incorrect legal theory, faulty jury instructions, a biased jury and prosecutorial misconduct, including accusations of witness intimidation and withholding evidence.

While denying those arguments, the judges said U.S. District Judge Sim Lake erred by applying guidelines that resulted in a prison term of 24 years and four months and ordered Mr. Skilling be resentenced.

Mr. Skilling is serving his time, the harshest punishment doled out in Enron's collapse, in a federal prison in Minnesota.

Mr. Skilling was convicted in May 2006 on 19 counts of fraud, conspiracy, insider trading and lying to auditors for his role in the collapse of Houston-based Enron, once the nation's seventh-largest company.

Mr. Skilling is the highest-ranking executive to be punished for the accounting tricks and shady business deals that led to the loss of thousands of jobs, more than $60 billion in Enron stock value and more than $2 billion in employee pension plans after the company imploded in 2001.

Company founder Kenneth Lay also was convicted of conspiracy, fraud and other charges, but he died less than two months later of heart disease and his convictions were vacated.

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CORPORATE NEWS

U.K. retailers face hurdle

Businesses attempt to keep costs in check amid weaker sterling

By Lilly Vitorovich

Agence France-Presse

U.K. clothing retailer Marks & Spencer is expected to issue a profit warning and cut its dividend when it releases its Christmas trading update Wednesday.

LONDON—Initial trading updates suggest many U.K. retailers did better than expected over the holidays despite the bleak economic backdrop, but all now face the task of persuading shoppers to keep spending, while keeping costs under control as sterling flounders.

Two of the country's biggest clothing chains, **Next** PLC and **Debenhams** PLC Tuesday reported encouraging Christmas sales and managed to protect margins and profit. **New Look & Fashion** Ltd., the **Co-operative Group** Ltd. and food retailer **Ocado** Ltd. also posted solid sales.

Discount retailers, online players and businesses that cater to young, financially unencumbered consumers seem to have outperformed the broader retail sector over the holidays.

While mortgage and fuel bill costs are coming down, providing some relief to shoppers, the biggest fear for consumers is unemployment, said Debenhams Chief Executive Rob Templeman.

Mr. Templeman said the sharp fall in the sterling will hurt Debenhams, but added that, thanks to hedging against currency fluctuations, the retailer was less vulnerable than many of its rivals. He said the currency's weakness might lead to some price inflation and could help offset losses triggered by the steep discounting on high street.

Next, which has a long-standing policy of not holding sales until after Christmas, said the decline of the sterling will be a "major issue" for the retail sector over the coming year. While it will have limited impact on the company's first-half performance, the retailer forecast "significant" pressure on its prices and margins later this year.

The extent of these pressures will become more apparent as its executives negotiate and resource autumn and winter stocks, said Next.

Debenhams and rival **Marks & Spencer Group** PLC, Britain's biggest clothing retailer by market value, kicked off pre-Christmas sales in November offering discounts of between 20% and 25%.

The spotlight now turns to Marks & Spencer, which is widely expected to issue a profit warning and cut its dividend when it releases its Christmas trading update Wednesday. The retailer's general merchandise division has fallen out of favor with consumers, while its food business is deemed too pricey in the current environment.

Dow Jones adds to data offerings

NEW YORK—Dow Jones & Co. bought a database of European private firms, expanding its research offerings on companies that are backed by venture-capital and private-equity investors.

Dow Jones, which is owned by **News Corp.**, publishes The Wall Street Journal.

Dow Jones bought Library House out of administration. Library House's data assets will become part of Dow Jones VentureSource, which offers research on venture-capital investments. The acquisition price wasn't disclosed.

The Library House deal continues Dow Jones's investments in businesses that offer commercial information and data services.

Cautiously, steelmakers raise prices, reopen mills

By Robert Guy Matthews

In an early sign that some steel prices may have bottomed out, steelmakers in the U.S., China and some other countries are attempting limited price increases and reopening a handful of mills that were closed because of weak demand a few months ago.

It isn't clear whether the price increases will stick, however. Steel sellers often announce price increases or special surcharges, only to relent in the face of customer opposition or if rivals don't follow suit. Nor is it clear whether the price increases reflect more demand or lower inventories.

Troubled auto makers, contractors, appliance and equipment makers have cut back on their steel purchases. The majority of mills closed over the last few months remain shuttered and many around the world are operating below 50% of their capacity.

But steelmakers signaled cautious optimism that there is enough demand to support price increases in some parts of the world. Pittsburgh-based **Allegheny Technologies** Inc. said it would increase its surcharges on electrical steel by 55% beginning in February to $321 a short ton. (A short ton is about 0.9 metric ton.) Surcharges are tacked on to base prices, typically to account for raw-material costs, and can change monthly.

AK Steel Holding Corp., based in West Chester, Ohio, said it is raising the surcharge on February shipments of electrical steel to $165 a short ton from $10 a short ton. The percentage can't be calculated because the company doesn't reveal its base prices.

ArcelorMittal, the world's largest steelmaker by output, said it will reopen its wire rod mill in Georgetown, S.C., next Tuesday. The Luxembourg-based company on December 5 shut down much of the mill, laying off 300 workers, citing slack demand and low prices.

In China, several steel mills have announced price increases ranging from 5% to 25% for a variety of products. **Baosteel Group** Co. and **Anshan Iron & Steel Group** Corp. said that they will raise their prices for hot-rolled coil steel, a basic product that is processed into many steel applications. Baosteel also said it will increase production at some of its mills.

In Turkey, the price of domestically produced hot-rolled coil will rise about 4.5% this month to $460 a metric ton as demand for construction has begun to return. Japanese steel-industry executives said Tuesday they expect the steel market to start recovering around midyear as inventories decline and steelmakers reduce output.

Steel is a bellwether industry for the world economy because the metal is used in everything from appliances to commercial construction to bridges. The proposed price increases and isolated plant openings indicate that parts of the global industrial base might be less anemic than they were.

Steel analysts, noting that the market remains generally weak, said the proposed price increases may reflect decreased inventories rather than stronger demand. "Steel demand will likely remain weak in 2009," according to Moody's Investors Service. "We expect that the rate of downward movement will slow and that a level of stabilization should occur in the second half."

Certain European countries are further from potential recovery, analysts said. German, Ukraine and Polish mills are still scaling back production and laying off workers in an effort to bring production in line with demand.

CORPORATE NEWS

For GM, China auto market cools

Commercial vehicles buoy its total sales; Japanese fare better

By Patricia Jiayi Ho
And Norihiko Shirouzu

BEIJING—**General Motors** Corp.'s flagship passenger-vehicle venture in China posted its first decline in sales in 2008, marking a lackluster year for the U.S. auto maker's local operations as overall sales growth slowed sharply.

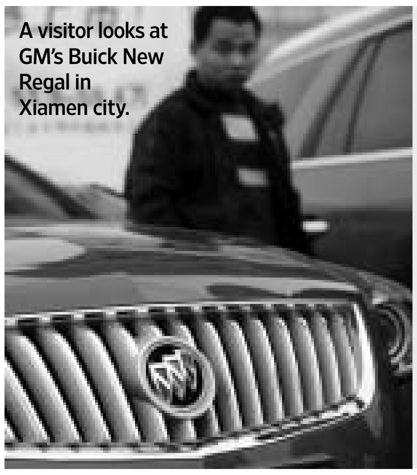
But the auto-industry picture in China wasn't uniformly bleak, as December sales for some of GM's competitors, particularly Japanese car makers, indicated an improvement after a prolonged slump.

Sales at GM's passenger-vehicle joint venture, Shanghai General Motors Corp., fell 7% to 445,709 units from 479,427 units in 2007. Shanghai General Motors is GM's 50-50 joint venture with **SAIC Motor** Corp.

"A series of natural disasters and an increase in fuel prices earlier in the year exacerbated the impact of the global economic downturn in China," Kevin Wale, president and managing director of GM in China, said in a statement.

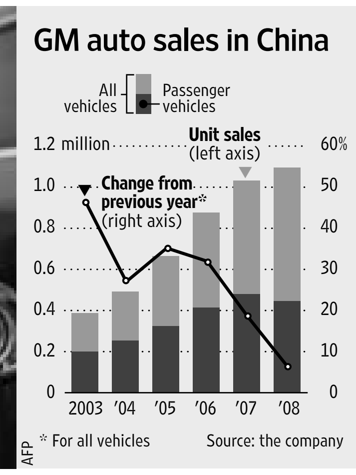
GM's total vehicle sales in China, including commercial vehicles and imports, rose 6.1% to 1,094,561 units, a record. However, growth decelerated sharply from 19% in 2007 and 32% in 2006 because of a weakening local auto industry and GM's aging models, analysts said.

The U.S. auto maker's overall sales increase was driven by its commercial-vehicle joint venture. Sales at that venture—SAIC-GM-Wuling Automobile Co.— rose 18% last year to 647,296 units from 548,945 units the year before. But GM owns only 34% of the venture and the margins on its minitruck and minibus products are relatively low. SAIC Motor Corp. owns 50% of the venture, and **Wuling Automobile** Co. owns 16%.



A visitor looks at GM's Buick New Regal in Xiamen city.

AFP



China's auto market weakened in 2008 following years of robust double-digit growth. Vehicle-sales growth slipped to 8.52% in the January-November period, when 8.63 million vehicles were sold in China, according to the China Association of Automobile Manufacturers. Vehicle sales declined in August, the first fall in more than three years.

December and full-year sales figures for the industry weren't yet available, but there were some indications of a rebound during the month. Japan's **Mazda Motor** Corp. capped 2008 with record sales in China for one of the company's top selling models. According to a senior company executive, Mazda sold about 7,000 Mazda6 midsize cars in China last month, an all-time high since the company began selling the model in 2003. For all of 2008, the company sold a total of about 67,000 Mazda6 cars, accounting for nearly half of the company's overall sales in China.

"Mazda did well in December, and sales so far this month are fairly brisk," said the executive.

People familiar with the matter at **Honda Motor** Co. and **Toyota Motor** Corp. said they also had fairly good sales in December, without elaborating.

Mazda's spokesman in Beijing, Akira Shigemasa, said the company isn't ready to disclose its sales figures for December or for the year but confirmed that December was a relatively good sales month, especially given the slowdown since August.

Banking on the Mazda6's popularity, the executive said Mazda has decided to continue to sell the current generation of the Mazda6 even after it launches the redesigned version later this year. The decision defies the industry's normal practice, but in China, more companies, including Toyota, have taken a similar approach.

Mazda's sales target for this year wasn't available. The spokesman said Mazda plans to monitor China's auto sales this month and announce its sales projection later in the first quarter.

"It's still too difficult to read where the market is going," he said.

CSM Worldwide analyst Yale Zhang said key GM models, such as the Buick LaCrosse and Excelle sedans, have reached the end of their product cycles. "You will see a recovery in 2009" with the introduction of new models, he said.

Mr. Wale said in the statement that GM will introduce several new models in China. "Over the next two to three years, we will roll out five or more new products under both of our volume brands, Buick and Chevrolet," he said. GM's four other brands in China—Cadillac, Opel, Saab and Wuling—will also introduce new and upgraded models, he said.

IHS Global Insight analyst John Zeng said the company was also hurt after GM executives lobbied the U.S. government for emergency loans to fend off bankruptcy late last year. "GM and Ford have this challenge, to defend themselves in China and improve consumer confidence," he said.

GM has said its China operations are separate and unaffected by liquidity problems in the U.S. It opened a new passenger-vehicle plant with SAIC in mid-December with an annual production capacity of 150,000 units. "While we expect vehicle sales in China to remain steady in 2009, we anticipate China remaining the world's fastest-growing major market over the next decade," Mr. Wale said.

Cisco courts entertainment and media firms

By Bobby White

Cisco Systems Inc., stepping up its effort to court media and entertainment companies, is using the Consumer Electronics Show to deliver a high-profile service to manage social networks and to show off its first home audio system.

Plans to develop Cisco's EOS offering, for entertainment operating system, were first discussed at CES a year ago. At this year's show, Cisco is expected to announce the availability of the underlying software and service, which are designed to help media companies to build online communities.

The company, known mainly for networking hardware, plans to manage EOS on its own server systems, charging companies a monthly fee and allowing them to avoid installing and managing the software. Executives at Cisco, which is based in San Jose, Calif., said the service will be particularly suited to manage social networks for consumers who favor certain musicians and watch certain television shows. It can monitor consumers as they interact in the online communities and with media, with the goal of eventually offering recommendations for other content and services, the company said.

Dan Scheinman, who heads Cisco's Media Solutions Group, said media companies are having a tough time developing business models that take advantage of the growing number of fans on the Internet. "If you're a music label or movie studio, how do you manage online content for 300 artists or 50 new movie releases?" he said.

Besides disclosing new details of EOS at this week's CES in Las Vegas, Cisco plans to disclose it has signed up **Warner Music Group** Corp. as its first user. Michael Nash, Warner's executive vice president for digital strategy and business development, said the increasing impact of technology on his company made it important to find an expert partner like Cisco to deal with the changes.

In addition to developing online communities for musicians, the two companies plan to work on a variety of other services and products, Mr. Nash said.

Meanwhile, Cisco's Linksys unit, known mainly for networking gear used by homes and small businesses, at CES will announce plans to move into audio. The company is introducing a multicomponent system that it designed to send music over wireless networking connections to speakers in multiple rooms, a category already served by companies such as **Sonos** Inc.

Users of Cisco's Wireless Home Audio system can send different music selections to separate rooms, including music drawn from Apple Inc.'s iPod devices, Cisco said. A bundle of products designed to serve two rooms starts at $999.

Cisco also plans to disclose a Linksys product called the Media Hub. The system will allow consumers to access content remotely using a Web browser, Cisco said. The product line starts at $299 for a model with a disk drive with 500 gigabytes of data-storage capacity.

Toyota to extend temporary factory shutdowns

By Hiroyuki Kachi

TOKYO—**Toyota Motor** Corp. announced further cuts in domestic output, halting production for 11 days in February and March and revealing growing pessimism about flagging global auto demand.

Toyota said Tuesday it intends to suspend output at all of its 12 plants in Japan, including four that produce assembled vehicles. The company had already decided to halt production for three days at 11 of its domestic plants in January, exempting a parts plant.

The extended suspension shows the impact that plummeting auto demand and the soaring yen are having on Japan's car makers. Toyota's prominence in the global auto market could signal that Japanese rivals will follow suit.

Japan's largest car maker by volume said it will suspend production for four weekdays and two Saturdays in February. In March, it will stop production for three weekdays and two Saturdays.

"We've already informed our parts suppliers about the production halt," a Toyota spokesman said.

Toyota last month said that in the fiscal year through March it would post its first operating loss, feeling the pinch from the yen's strength and a slump in vehicle sales in key markets such as the U.S., Europe and Japan. Toyota forecast a consolidated operating loss of 150 billion yen ($1.61 billion) compared with a profit of 2.27 trillion yen in the previous fiscal year.

For calendar 2008, Toyota estimated its global sales would drop 4% from the previous year to 8.69 million vehicles. It projected world-wide production would fall 3% to 9.23 million vehicles.

German car sales decline by 6.6%; Toyota leads drop

A WSJ News Roundup

Car sales in Germany, Western Europe's largest auto market, dropped 6.6% last month, closing out a dismal 2008 that saw Germans buy the fewest cars since reunification, official statistics showed Tuesday.

Last month's poor result, the weakest on record for any December even after a 20% drop in December 2007, would have been worse had it not been for a beneficial calendar effect.

"This relatively moderate decline can also be explained by the two additional working days in December 2008 versus the same month a year earlier," the automotive industry association VDA said in a statement.

Throughout 2008, only 3.09 million new cars were registered in Germany, a 1.9% decline from a year earlier.

Industry associations like domestic lobby VDA and its rival VDIK, which represents import brands, are expecting registrations of new cars to drop 6% to 2.9 million vehicles in 2009. This would represent a third straight year of record-low market volumes for the country that was reunified in 1990.

The smallest-car segment, which includes **Daimler** AG's Smart ForTwo, **Renault** SA's Twingo and **Fiat** SpA's 500 model, bucked the trend and saw new registrations grow 18% in 2008. This helped reduce carbon-dioxide emissions of the average new car sold in Germany to 165 grams per kilometer, a decline of 2.9% from a year earlier, said Germany's motor vehicle department.

The biggest loser among car makers in Germany was **Toyota Motor** Corp., which saw new registrations halved in December and plunge 27% for the full year.

German auto makers, including Daimler, **Porsche** SE, **Volkswagen** AG and **BMW** AG, exported 223,000 cars in December, down 22% from a year earlier, VDA said. Production also fell 22% to 275,000 vehicles.

Last month's decline in production contributed to a 3% drop for the full year to 5.5 million cars—the first fall since 2002. Exports for the year were down 4% at 4.13 million cars.

Germany's bleak sales results didn't come as a surprise for an industry reeling under the combined impact of a global recession, financially overstretched consumers and frozen credit markets.

Automobile sales in both the U.S., the single largest vehicle market in the world, and Japan dropped to their lowest levels in many years, down 18% and 6.5% respectively.

The Property Report

A step forward

British property-investment duo makes first move with vulture fund > Page 29

CORPORATE NEWS

Dow Chemical sketches options

Legal action planned over recent collapse of Kuwait venture

By Ana Campoy
And Russell Gold

Dow Chemical Co. Tuesday sketched a plan to rebound from the recent collapse of a $17.4 billion dollar joint venture with a Kuwaiti-owned chemical company by seeking legal remedy, finding other partners and selling some assets.

It will likely take several months, if not years, for the plan to generate significant cash, providing Dow with little immediate help to complete the $15.3 billion acquisition of specialty-chemical maker **Rohm & Haas** Co. That deal must close by the end of this week or the price could rise.

Dow Chief Executive Andrew Liveris on Tuesday assured investors that the company will keep its investment-grade credit rating and continue to pay its dividend, which it has done for 96 years. He declined to elaborate on the status of the Rohm & Haas acquisition or confirm whether the company is ready to complete the deal.

"One should assume that Rohm & Haas is in our future," he said in an interview. "Now having said that, we've just had a material event and we're in the middle of a regulatory situation, so...I don't want to make any announcement or add to any speculation on Rohm Haas."

A Rohm & Haas spokeswoman said Tuesday that the company continues to work toward closing the deal in early 2009.

In the past, company executives have said the Rohm & Haas deal was not contingent on the cash it would have received from closing the joint venture with **Petrochemical Industries** Co., pointing to a $13 billion short-term loan Dow secured from a group of banks that would help finance the acquisition.

But the purchase threatens to leave Dow—which has a current market value of about $14.6 billion—heavily in debt at a time when the global economy has sent demand for its plastics plunging. The deal has been lambasted by critics who see it as too expensive and risky.

Dow said that it has been approached by other potential business partners and that it has been in discussions regarding some of the operations that were slated to be part of the Kuwait deal, such as the basic plastics business that was its centerpiece. It did not identify any of those involved in discussions.

Andrew Liveris

Mr. Liveris said it could take until the end of this year to bring in new partners. Addressing the collapse of the joint venture, he said, "Pursuing legal options is not a decision we take lightly." But he said Petrochemical Industries is "in breach of contract, and we must take action to protect the interests of our company and our shareholders."

The Midland, Mich., chemicals giant was notified that Petrochemical Industries was scuttling their K-Dow venture just days before its planned Jan. 2 launch. The oil company said its hand was forced when the Kuwaiti Supreme Petroleum Council withdrew support.

Dow is expected to receive at least $2 billion as a break-up fee for the failed Kuwait venture. It would be expected to pay Rohm & Haas a $750 million fee if it doesn't receive regulatory approvals by Oct. 10.

The joint venture was part of Dow Chemical's strategy to move away from commodity-chemicals business and into specialty chemicals that offer higher margins and steadier earnings. Dow on Tuesday said it remains committed to becoming an earnings-growth company instead of one tied to cyclical markets.

The scuttled joint venture came as Dow and other chemical makers are faced with slumping demand as global economic activity slows markedly. The company announced last month it would cut about 5,000 full-time jobs, or 11% of its workforce, close 20 facilities and sell several businesses as the firm looks to speed its restructuring and reduce costs.

Mr. Liveris said on Tuesday that Dow "will accelerate these actions even faster and more aggressively in 2009" as it pushes to maintain its investment-grade credit rating. The company's debt ratings are currently in below-average territory and several steps above junk.

—Christopher Hinton and Kevin Kingsbury contributed to this article.

Aer Lingus says lower fuel prices will boost cash

By Jonathan Buck

Aer Lingus Group PLC said Tuesday that an expected improvement in its 2009 financial performance would generate a significantly higher-than-expected cash balance.

The release of more financial details comes as Ireland's flagship airline continues to fend off an unsolicited €748 million ($1.02 billion) bid from **Ryanair Holdings** PLC, the second time within three years that the low-cost carrier has tried to acquire its rival. Dublin-based Ryanair owns a stake of almost 30% in Aer Lingus, a legacy of its first bid.

Aer Lingus's efforts to thwart the bid appear to be working: Ryanair on Tuesday separately said its offer had garnered the support of shareholders holding only an additional 0.01% of Aer Lingus stock.

Aer Lingus said in a statement the take-up was "pathetic" and reflected its views that Ryanair's offer significantly undervalues the company. It added that the bid couldn't be completed due to competition issues and said it regretted the "unnecessary waste of shareholder's cash" in fighting off the bid.

Investors seem to agree. Shares in Aer Lingus have traded above Ryanair's offer price for the past month.

However, Ryanair shows no sign of giving in. The airline Tuesday said it was extending the deadline for shareholders to accept the offer to Feb. 13. It also sought an extraordinary general meeting at Aer Lingus to revoke amendments that award up to €2.8 million to Chief Executive Dermot Mannion and €1.4 million to Chief Financial Officer Sean Coyle in the event of a change of control, even if they resign.

The airline also sought to censure Aer Lingus's board for breaching Irish company law by failing to seek shareholder approval for the employment-contract amendments.

Aer Lingus rejected those claims. It said the amendments were put in place two months before Ryanair's latest approach, had been initiated by the board and disclosed in Aer Lingus' defense documents.

Aer Lingus on Tuesday reiterated that it expects to be profitable in 2008 and 2009. The airline in August had forecast a net cash balance of €550 million for 2009. At that time, it anticipated a significant loss for 2009, when fuel was expected to be $117 a barrel.

Fuel prices have fallen significantly since the summer, and Aer Lingus said the continued drop has allowed it to be the first trans-Atlantic airline to eliminate fuel surcharges completely.

Aer Lingus on Dec. 8 announced that it was on track to deliver at least €50 million in annual cost savings following agreements on work-practice changes with unions' Siptu and Impact.

Ryanair in 2006 dropped a €1.48 billion bid for Aer Lingus after it failed to overcome opposition from the Irish government and European Union regulators.

Separately, Ryanair said Tuesday that in December it carried 4.37 million passengers, an 11% increase from a year earlier, but that its load factor, which measures how many of the airline's available seats it filled with paying passengers, remained unchanged at 79%.

Altria completes purchase of UST following delay

By Kerry E. Grace

Altria Group Inc. completed its $10.4 billion acquisition of **UST** Inc., after the deal for the maker of Copenhagen and Skoal smokeless tobacco was put off in October at the request of the company's lenders.

At the time, Altria said it had the deal's financing in place. Nonetheless, the postponement highlighted the effect of the credit crunch even on financially strong companies such as Altria, which generates hefty cash flow.

Holders of UST's common shares will receive $69.50 a share in cash. UST's common shares will no longer trade on the New York Stock Exchange.

Altria also will assume $1.3 billion of UST debt.

After years of merger speculation, Altria announced the deal to buy UST, which sells premium smokeless-tobacco brands such as Copenhagen and Skoal, in September, the biggest move by the maker of the Marlboro brand since it spun off Philip Morris International Inc. in March.

McGraw-Hill cuts 375 more jobs

By Kerry E. Grace

McGraw-Hill Cos. said it cut 375 jobs in the fourth quarter, primarily in its education business, putting the year's reduction at 1,045.

The textbook publisher and financial-information provider has been reporting weak results as its Standard & Poor's unit has been hurt by the credit crunch. S&P, the world's largest bond rater by revenue, has had less debt to grade as credit markets seized up amid scant investor interest. The division's growth had helped fuel strong profit increases for the company from 2004 to 2007.

The education business, McGraw-Hill's largest, also has been struggling. Its third-quarter profit slid 15% as sales declined 3.8%, hurt by budgetary pressures on school districts. At the time, Chief Executive Harold McGraw III cited particular weakness in large urban markets.

McGraw-Hill said 215 of the fourth-quarter job cuts were in the education segment. McGraw-Hill's work force is about 21,000. The latest reduction will result in a charge of $16.4 million, or five cents a share, for the period.

GLOBAL BUSINESS BRIEFS

BP PLC

New head of BP America helped end TNK-BP fight

BP PLC said Tuesday Lamar McKay, who acted as troubleshooter in last year's bitter dispute between BP and its Russian partners in **TNK-BP Holdings**, has been appointed chairman and president of BP America. Mr. McKay has led BP's special projects team since early 2008. Last summer, Mr. McKay replaced James Dupree, the head of Russia and Kazakhstan for BP, in talks with the Russian partners. The company said he played a major role in establishing the new governance model for TNK-BP that resolved the dispute. Mr. McKay is a veteran of U.S. oil company Amoco, which he joined in 1980 as a petroleum engineer. Mr. McKay succeeds Robert A. Malone, who is retiring after 34 years with the company, BP said.

Bertelsmann AG

German publishing house Gruner + Jahr, in which media conglomerate **Bertelsmann** AG holds a 74.9% stake, Tuesday named Bernd Buchholz as its new chief executive. Mr. Buchholz succeeds Bernd Kundrun, who left after a difference of opinion about the publisher's strategy. The move by Gruner + Jahr's supervisory board—headed by Hartmut Ostrowski, CEO of parent company Bertelsmann—ends a months-long conflict between Mr. Kundrun, who has headed Gruner + Jahr since 2000, and Bertelsmann. Gruner + Jahr publishes several magazines and financial daily Financial Times Deutschland. The Jahr family holds a 25.1% stake in the publisher. Mr. Buchholz has been a member of the publisher's executive board since 2004.

Anheuser-Busch InBev NV

Anheuser-Busch InBev NV said it wants to close the historic Stag brewery in London and potentially cut workers in 2010. The cuts are intended to capture savings from the $52 billion merger of InBev, maker of Stella Artois and Beck's, and Anheuser Busch, brewer of Budweiser. A-B InBev executives say they want to cut $1.5 billion in annual costs by the end of 2011. Both InBev and Anheuser have large operations in the U.K., including breweries as well as sales and marketing divisions. The Stag brewery has operated since the 15th century and now employs 182 people.

CRH PLC

Building materials company **CRH** PLC Tuesday said that it expects to report a mid-teen percentage decline in 2008 pretax profit and that the outlook for this year is difficult because of the global financial crisis. The forecast for 2008 earnings is slightly worse than the "low to mid-teen" percentage decline predicted in November, and would result in a pretax profit of around €1.6 billion ($2.17 billion), down from €1.9 billion a year earlier. The revision includes a €50 million hit from currency fluctuations. "Visibility is clouded," said Chief Executive Myles Lee, referring to 2009. The company said lower energy costs, a reduction in interest rates and a U.S. infrastructure stimulus package should help in the second half of the year.

Atos Origin

Activist funds Centaurus Capital LP and Pardus Capital Management LP have ended the shareholder pact that brought about an overhaul of information-technology services company **Atos Origin** SA's management last year. French market regulator AMF said Tuesday that the two funds informed it of the end of their 15-month-old pact Monday. Centaurus's stake in Atos has fallen to 5.01%, from 6.66% in September, while Pardus's stake remains stable at 10.04%, according to the filing. In the first half of 2008, Centaurus and Pardus engaged in a public battle, which culminated in the ouster of former Chairman Didier Cherpitel.

—Compiled from staff and wire service reports.

Deficit hawks worry about Obama plan

Republicans and some Democrats say items in stimulus package show too little concern for impact on U.S. budget

By Jonathan Weisman

Policy changes being considered as part of U.S. President-elect Barack Obama's economic-stimulus plan could carry long-term consequences for the deficit, and they are raising bipartisan concerns.

As part of his two-year stimulus plan, Mr. Obama is considering offering unemployment benefits to part-time workers and subsidizing health insurance for the laid-off, among other measures.

Republicans and even some Democrats said some of these items under consideration in the stimulus plan, which is estimated to cost $775 billion, show too little concern for the long-term impact to the U.S. deficit.

"Any additional tax cuts, where there will be pressure to make them permanent, or spending proposals that have a permanent nature to them, give me pause," said Senate Budget Committee Chairman Kent Conrad (D., N.D.). "The whole rationale for an expansion of the deficit and debt is to stimulate the economy in a time of weakness. That I support. But we will recover, and we're already in an unsustainable budget situation long-term."

Sen. Conrad said he has repeatedly raised such concerns with Obama transition aides.

Mr. Obama Tuesday said the Congressional Budget Office is expected Wednesday to forecast a deficit of about $1 trillion for fiscal 2009, even before the stimulus package is passed.

The president-elect huddled with his economic team Tuesday to discuss ways of containing the long-term deficit. Among those attending were budget director-designate Peter Orszag, Treasury Secretary-nominee Timothy Geithner and National Economic Council director-designate Lawrence Summers.

"Potentially we've got trillion-dollar deficits for years to come, even with the economic recovery that we are working on at this point," Mr. Obama said. "We're going to have to stop talking about budget reform. We're going to have to totally embrace it. It's an absolute necessity."

It wasn't immediately clear what that reform might entail.

Obama aides strongly defended two proposals that have drawn the most fire. One would extend unemployment insurance to part-time workers and revamp the program to cover workers who have long dropped through the cracks, especially working mothers. The other would offer federal subsidies to laid-off workers trying to purchase continued health insurance through the Cobra system.


Associated Press

President-elect Barack Obama met with his economic advisers at his transition office in Washington on Tuesday, including White House Chief of Staff-designate Rahm Emanuel, left, and Budget Director-designate Peter Orszag, center.

Aides said both programs would be temporary and expire with the two-year stimulus program.

Critics said turning off such programs would be difficult.

"Those aren't stimulus. Those are ideological accomplishments in the guise of economic stimulus," said Rep. Paul Ryan of Wisconsin, the ranking Republican on the House Budget Committee.

Another plan to provide a $500-per-worker tax break, effective immediately through changes in federal tax withholdings, is a down payment on a permanent tax break, the Obama team has said.

Leonard E. Burman, director of the nonpartisan Tax Policy Center, estimated that over a decade, the measure would cost $700 billion.

"Clearly, spending a trillion dollars to avert world-wide economic collapse is a worthwhile investment, but if we're not mindful of the long-term consequences, we're looking at an economic crisis that will make this one look like a blip," he said.

Deficit-minded Republicans and Democrats have asked Mr. Obama to include in his plan a bipartisan commission to tackle the swelling budget deficits. The panel would draft proposals to cut entitlement spending, reshape the tax code and trim federal programs, and then put those proposals before Congress for a straight up-or-down vote. Congress set up a similar panel to tackle the politically thorny issue of military base closings.

Some lawmakers also want the stimulus package to include rules mandating that any changes to tax policy or spending that would extend beyond 2010 be offset with explicit spending cuts or tax increases.

Tuesday, Mr. Obama committed to establishing a Recovery Oversight Board to ensure stimulus funds are spent as intended and that new programs succeed. Lawmakers wouldn't be allowed to insert pet projects into the bill, he said. And any expenditures would be listed on the Internet.

With billions at stake, business lobbyists vie for a piece

By Elizabeth Williamson And Brody Mullins

WASHINGTON—U.S. President-elect Barack Obama's stimulus plan aims to help Main Street, but it is already sparking boom times on K Street, Washington's center of lobbying, as a host of U.S. industries seek a share of the projected $800 billion package.

Wind farms want permanent tax credits. The steel industry wants "Buy American" protection for infrastructure projects in the bill. Home builders want a national low mortgage rate, guaranteed by the government. Universities want money for campus repairs, as well as $700 more per student in federal grants.

The spending requests total many times the likely size of the package.

The spending requests total many times the likely size of the package. Environmentalists alone put together a wish list of 80 projects that add up to $405 billion.

With a fight likely over a pie that, however large, isn't big enough for all, industries are crafting creative pitches to show that assistance to them would provide the fastest, broadest or most comprehensive stimulus.

The U.S. Travel Association, which represents hotel, resort and theme-park operators, wants the stimulus package to include a measure they have pushed for years: establishing a government office to pitch American tourism to foreigners.

"When you're looking at stimulating the American economy, it doesn't get any better than bringing people into the country," said Geoff Freeman, senior vice president of the association. "They come, they leave their money, and they go home with a better impression of the United States."

Although the financial sector has received more than $1 trillion in federal rescue money over the past year, its lobbyists are pushing for more.

The Financial Services Roundtable, a coalition of the 100 largest financial-services companies, sent a letter to congressional leaders Monday asking for several tax breaks, including the doubling of the mortgage-interest deduction for first-time home buyers, and allowing companies to accelerate deductions for bad debt.

The National Association of Federal Credit Unions is looking to extend its reach with an aggressive push for Congress to lift limits on credit unions' business loans in the bill. The powerful group wants the limit raised from the current 12.25% to 20% of a credit union's total assets—or lifted entirely.

The measure, said chief lobbyist Dan Berger, is "a way to provide small businesses access to much-needed credit without costing the taxpayer a dime."

The Securities Industry and Financial Markets Association wants to exempt private-activity bonds from the alternative minimum tax, and relax rules that discourage banks from owning municipal bonds.

The U.S. Chamber of Commerce, the nation's largest business lobby, has written a letter asking for lower tax rates for companies that buy back their own debt. The National Association of Manufacturers has joined with the National Association of Home Builders in a coalition called Fix Housing First. They are pushing for an extension of home-purchase credits and a federally supported national mortgage rate of 3%.

In a conference call with Obama officials two weeks ago, executives from **International Business Machines** Corp., **Cisco Systems** Inc. and the Information Technology Industry Council outlined a six-point plan dubbed "Investing in Digital Infrastructure to Jump-start the Economy." The companies are part of a tech-industry coalition that wants to dip into the stimulus pot to upgrade and expand telephone lines for broadband Internet service, increase tax incentives for research and development and allow companies to return overseas profits to the U.S. at reduced tax rates.

At the request of Congress and the Obama transition team, the Natural Resources Defense Council has compiled a list of more than 80 projects, including $18 billion for a state energy-efficiency grant program and $6 billion for water infrastructure projects.

"It's been portrayed by some as wildly outrageous...here go the environmentalists again," said Karen Wayland, legislative director for the NRDC. "What we were suggesting are authorized programs where an injection of quick cash will create jobs."

The United States Association of Importers of Textiles and Apparel—which includes such major retailers as **Target** Corp., **J.C. Penney** Co., **Kohl's** Corp. and **Macy's** Inc.—wants a total repeal of import tariffs on clothing. The logic for tying this long-sought change to the stimulus package: The import tax falls disproportionately on those hardest hit by the downturn.

The tax makes up about $5 of the cost of shoes that retail for $15 and therefore "parents are trying to keep shoes on their children's feet and this regressive tax is making that more difficult," said Matt Rubel, the chairman and CEO of **Collective Brands** Inc., the parent company of Payless ShoeSource and several low-cost brands. "We are working very hard to make sure [that the removal of] this tax on American working families is included with the stimulus," he said.

Write-offs a boon to builders, bankers

By Jesse Drucker

The main business tax cuts proposed by President-elect Barack Obama are likely to be a windfall for two industries particularly tied to the current economic meltdown: Wall Street investment banks and home builders.

Under the proposal being crafted by the incoming Obama administration and congressional Democrats, companies would be able to use their so-called tax losses to offset taxable U.S. profits earned during the past five years.

Typically, companies can carry back such losses only two years. The Obama proposals likely would mean that companies with enormous losses from last year and this year could use the losses to help wipe out tax obligations from the previous five years and receive sizable tax-refund checks from the Treasury Department. For some firms, that would mean cash payments of billions of dollars.

Typically, such tax losses can still be taken as deductions in the future for years to come. But for companies expecting slim or nonexistent profits for the immediate future, that can mean years before they realize the full benefit of the deductions stemming from the tax losses.

The same break was included in a stimulus package enacted in 2002, and home builders had lobbied Congress for a nearly identical tax break last year—estimated to cost $6.1 billion—ultimately without success.

"I think it's ridiculous," said Dean Baker, co-director of the Center for Economic and Policy Research. "It's rewarding the people who messed up."

Fed debated whether it should set targets

Minutes suggest officials are weighing concrete guidelines

BY JON HILSENRATH

After throwing out its old rule book for managing monetary policy and the economy, the Federal Reserve is struggling to write a new one.

Fed officials debated at their December meeting whether to set explicit targets for how much money they will pump into the financial system to tame the economic crisis, according to minutes released by the central bank Tuesday.

They also considered whether to adopt a target for how much inflation they view as beneficial.

They decided against both measures. Still, the discussions over two days of intense debate were significant because they were a sign of what could come next from the fast-moving central bank, and also a sign of potential fault lines growing over its handling of the crisis.

At annual meetings of the American Economic Association this past weekend, a prominent critic of the Fed, Stanford University economist John Taylor, argued that the central bank needed to set more concrete guidelines for its actions, something the Fed minutes suggested it might do.

"Consideration will be given to whether various quantitative measures would be useful in calibrating and communicating the stance of monetary policy," the minutes said.

Fed officials went into their December meeting with a dimming view of the economic outlook. Growth, they acknowledged, was likely to fall "much more sharply" in the first half of 2009 than previously thought before a slow recovery sets in. Some officials also worried that inflation could fall below their comfort levels.

In normal times, the Fed manages the economy by increasing or reducing an overnight bank lending interest rate called the federal-funds rate. Having pushed that to near zero, however, the fed-funds rate is no longer much of a guide for monetary policy.

Instead of focusing on the interest rate, the Fed is focused on creating new lending programs and purchasing assets like mortgage-backed securities to bolster damaged markets.

Its rescue efforts have ballooned its balance sheet in the past few months, from less than $900 billion to more than $2 trillion. In the process of starting up new programs, it has pumped hundreds of billions of dollars of cash—known in central banking circles as reserves—into the financial system.

Some officials at the meeting argued that the Fed should be more specific about how much it would let these reserves grow as its rescue efforts continued. Others, however, felt that the growth of reserves shouldn't be their focus.

The debate about what the Fed should target is in some ways reminiscent of the efforts of Paul Volcker to tame inflation in the early 1980s.

Back then, the former Fed chairman stopped targeting interest rates and started targeting the growth of money in the financial system. Then the problem was the opposite of the Fed's today. Mr. Volcker was slowing money growth to break inflation while Mr. Bernanke is flooding the financial system with cash to keep inflation from getting too low.

Some regional Fed bank presidents might favor setting such growth targets. They would have a say in setting targets for money growth. But they have less say in the lending programs the Fed is creating, many of which are set by the Federal Reserve Board in Washington without the input of regional bank presidents.

The idea of an inflation target has floated around the Fed for years. Setting such a target would be a signal to the public that Fed officials don't intend to allow the economy slip to into a deflationary spiral—in which the economy sinks and consumer prices fall sharply.

Top labor priority will be put off by new Congress

BY KRIS MAHER

U.S. unions likely won't see action soon on contentious legislation making it easier to organize workers, but Democrats are moving to back a pair of less-controversial bills that would facilitate filing discrimination suits against employers.

Labor had hoped the administration of President-elect Barack Obama would take up the Employee Free Choice Act within its first 100 days. The bill would let unions sign up new members by collecting signatures on cards rather than through lengthy elections. But its enactment now appears doubtful.

The bill is strongly opposed by business. Mark McKinnon, Republican consultant and former adviser to Arizona Sen. John McCain, said support for the measure is weakening and the business lobby expects to have enough votes to block the measure with a filibuster, as it did in 2007.

William Samuel, director of government affairs for the AFL-CIO, disagreed. "We're very close to having a filibuster-proof majority in the Senate," he said.

Still, Congress seems more inclined to pursue other, less-volatile labor issues, including two this week. The Lilly Ledbetter Fair Pay Act would extend the statute of limitations under civil rights laws for bringing lawsuits against employers over pay discrimination. The Paycheck Fairness Act would strengthen remedies under the Equal Pay Act of 1963 for women who arent paid equal wages for doing the same work as men.

The business lobby opposes the measures, saying they will lead to frivolous lawsuits and saddle companies with higher legal expenses. Randel Johnson, with the U.S. Chamber of Commerce, described the bills as "a giveaway to the trial bar."

Mr. Johnson called the bills "low-hanging fruit," when compared with the Employee Free Choice Act. He said Democrats are acting too quickly on the measures and that new members of Congress won't have time to understand them.