Economy & Politics: The U.S. has a dilemma as Iran digs in against critics

THE WALL STREET JOURNAL.

VOL. XXVII NO. 117 EUROPE TUESDAY, JULY 21, 2009

DOWJONES A NEWS CORPORATION COMPANY

europe.WSJ.com

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Switzerland SF 5 - Syria S£ 210 - Turkey TL 4.5 - U.S. Military (Eur) $2.20 – United Kingdom £1.50

What's News

Volkswagen's plan to acquire Porsche has run into fresh complications over a potential multibillion-dollar tax liability and growing tensions between the two camps. If unsolved, the tax issue could scrap the deal as currently conceived. Page 3

■ **GM received** final offers for a stake in its Opel and Vauxhall operations from three bidders. Page 3

■ **The U.K.'s FSA** pushed back at plans by the Conservative Party to abolish the financial regulator if it takes power in elections. Page 2

■ **Iran's supreme leader** warned increasingly assertive challengers to the June 12 election to tone down their complaints. Page 8

■ **U.S. stocks rose** on new economic data and bullish calls from Goldman Sachs and Bank of America. European shares gained. Page 18

■ **Italian small-business** owners plan a rally Tuesday in Rome to draw attention to their struggles. Page 3

■ **Germany's government** says the pace of the country's economic contraction slowed in the second quarter on stimulus effects. Page 10

■ **Resolution added** a cash component to its possible offer for Friends Provident, which rejected the proposal. Page 17

■ **Vivendi halted talks** to buy a majority stake in Zain's African telecom activities, easing concerns about Vivendi's credit rating. Page 5

■ **A Toyota official said** the firm's North American business could return to profitability in the next fiscal year. Page 6

■ **Halliburton's earnings** fell 48% in the second quarter, as weaker drilling activity in North America hampered the oil-services company. Page 7

■ **Wyeth holders approved** a takeover by Pfizer, setting the stage for the deal's completion by year's end. Page 6

■ **The alleged gunman** on trial for the Mumbai attacks said he is guilty. Page 9

■ **A British fighter jet** crashed inside NATO's largest base in southern Afghanistan Monday, the second crash there in two days. The two crew members ejected.

■ **Died: Frank McCourt, 78,** Pulitzer Prize-winning author of "Angela's Ashes," in New York.

EDITORIAL&OPINION

Time for reforms

East Europe's old economic growth model isn't working anymore. Page 13

Breaking news at europe.WSJ.com

CIT shares soar on rescue deal

Lender's board approves the $3 billion private-sector financing, but challenges remain

By Jeffrey McCracken And Serena Ng

CIT Group Inc.'s board has approved a $3 billion financing deal from its bondholders that should keep the commercial lender out of bankruptcy court, people familiar with the matter said Monday.

A formal announcement was expected later Monday.

The deal charges CIT high interest rates, and it doesn't permanently fix the company's long-term financing needs, said people involved in the transaction. But it buys time for the lender to restructure itself and minimizes bondholders' losses. Bondholders calculated they would lose more if CIT filed for bankruptcy and sold assets at fire-sale prices than if they offered the rescue.

Reports of the deal pushed CIT shares up 83% to $1.28 in late afternoon trade in New York.

The deal could strengthen CIT's financial position and alleviate pressure on the company to pay down $1 billion in debt that comes due in August. It may also preserve a $2.33 billion investment the U.S. Treasury made as part of the Troubled Asset Relief Program.

But analysts said the company's last-minute rescue is a bandage that will do little to stanch CIT's fundamental troubles. The company's primary challenge remains finding cheap funding to carry on making loans at a profit.

CIT "can only charge so much money to its customers for loans it makes," said Daniel Holland, an equity analyst at Morningstar in Chicago. "If it's costing them a lot to borrow that money, there's not much profit in there. There's no point in doing that business."

A CIT spokesman wasn't available for comment.

The development appeared to vindicate U.S. regulators, who balked at appeals to help CIT. And it suggested that, unlike in recent months, private capital is available to plaster over cracks in the financial system.

Still, CIT and its bondholders hope that their effort to stabilize the company will cause bank regulators to look more favorably on a CIT plan to transfer more of the company's loans from the holding company to its bank in Utah. CIT has trouble borrowing money, but its bank can finance itself by taking in deposits. To transfer more assets to the bank, however, CIT needs an exemption from the Federal Reserve and a nod from the Federal Deposit Insurance Corp.

The final term sheet still needs to be reviewed by the

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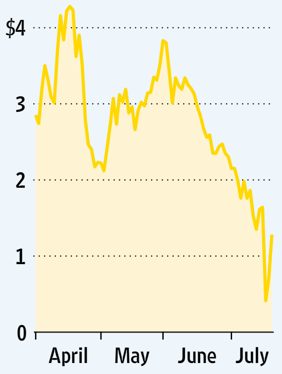
Stock surge

CIT Group's daily share price



Note: As of midafternoon Monday
Source: WSJ Market Data Group

Reuters

British Health Secretary Andy Burnham rubs disinfectant gel into his hands outside a London clinic Monday. He sought to reassure the public Britain was prepared to deal with a flu pandemic.

U.K. takes new steps to manage swine flu

By Nicholas Winning And Laurence Norman

LONDON—The U.K. government announced new measures against the swine flu as fears grow about the economic impact of the virus on a country already mired in recession.

Health Secretary Andy Burnham told Parliament on Monday the government will launch a new national service in England that will allow people who suspect they have been infected by the H1N1 virus to be diagnosed and prescribed medicine by phone or online, taking some pressure off local doctors.

"It is because we have planned carefully for this eventuality that we have large quantities of antivirals, a national pandemic flu service about to launch, and a vaccine on the way. This constitutes a solid base on which to deal with future challenges," said Mr. Burnham.

He said 26 people had died of the virus in the U.K. after the number of cases rose sharply in recent weeks. Last week saw 55,000 new cases, he said.

Mr. Burnham said the gov-

Please turn to page 31

Swiss banking fight affects U.S. clients

By Katharina Bart

ZURICH —UBS AG's high-profile spat with the U.S. Internal Revenue Service has made at least some of Switzerland's smaller banks wary of looking after U.S.-based clients. Some are stopping taking money from Americans altogether.

Spurring the moves is UBS's battle with the IRS, which wants access to 52,000 client accounts in a move aimed at rooting out possible tax fraud and, in the process, potentially breaching Switzerland's own banking secrecy laws. Analysts expect UBS to pay a hefty settlement to resolve the matter before it goes to court, which could end the case and still protect the identities of its clients.

That has made U.S.-based clients look like an expensive liability to some banks in Switzerland. At least four Swiss financial firms have put extra measures in place in dealing with clients living in the U.S. or refused American money outright.

Though these banks are relatively small compared with Switzerland's dominant private-banking giants such as Julius Baer and Credit Suisse Group—both of which refused to say if they had changed their procedures for handling U.S. clients—the moves show how UBS is undermining the main selling point of cross-border secrecy that Swiss banks of all stripes

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Cashing out

Upward mobility goes bust as Vegas's boom times sour

News In Depth, pages 14-15

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4 p.m. ET

	CLOSE	PCT CHG
DJIA	8848.15	+1.19
Nasdaq	1909.29	+1.20
DJ Stoxx 600	213.22	+1.21
FTSE 100	4443.62	+1.25
DAX	5030.15	+1.04
CAC 40	3270.94	+1.63
Euro	$1.4212	+0.71
Nymex crude	$63.98	+0.66

LEADING THE NEWS

U.K. regulator defends its role

FSA worries that Conservatives' plan undercuts mission

By Laurence Norman And Natasha Brereton

LONDON—The U.K.'s Financial Services Authority on Monday pushed back at proposals from the opposition Conservative party to scrap the agency.

Early Monday, the Conservative party said that if it wins the next election, it would hand most of the regulator's powers to the Bank of England and set up a new agency to take over the FSA's responsibility to protect consumers.

The FSA said, "We believe that our integrated approach to understanding the whole business models of banks and other financial institutions helps to achieve that."

Explaining his proposals, Conservative party economic spokesman George Osborne said the financial crisis had shown the need to "bring together the operation of monetary policy with regulation of the banking system."

He said maintaining a system where responsibility is shared but no one is in charge invites the lack of coordination that characterized the U.K. response to the September 2007 crisis at Northern Rock PLC, which led to the bank's nationalization.

Mr. Osborne said his proposals to boost the central bank's powers work in the same direction as President Barack Obama's planned reforms to the U.S. regulatory regime.

In its response, the FSA said it recognized that it was important to cooperate closely with the Bank of England when it came to macroprudential regulation, which aims to prevent the emergence of systemic risks across the banking sector.

The Bank of England declined to comment.

There is considerable frustration within the FSA that the Conservative proposals could leave it as a "lame duck" in its dealings with banks and other regulators, and that the party hasn't acknowledged the reforms the FSA has put through since the financial crisis, a person familiar with the matter said. Some managers within the regulator think the Conservative Party could have held back until closer to the election, rather than disrupt the regulator's business now, this person said.

The FSA, which employs some 2,800 people, has plans to add 280 specialist and supervisory staff by the end of the year. The uncertainty over the agency's future could make it harder to draw top talent.

Jonathan Rogers, regulatory partner at law firm Taylor Wessing, said there was a danger of a "vacuum" being created at the heart of U.K. regulatory policy at a time when authorities are still grappling with a financial crisis. "When and if the Conservatives get into power, it could take two or possibly three years before this [reform] all comes together," Mr. Rogers said.

The Labour Party moved to put together the FSA soon after it gained power in 1997. British banking had suffered some high-profile collapses in the 1990s, including Barings, which was eventually sold to ING Groep NV, as well as Bank of Credit & Commerce International.

Under the Labour Party's changes, the Bank of England gave up its responsibility to supervise banks, while winning freedom from government interference when it came to setting interest rates.

The government's minister with responsibility for London's financial center, Paul Myners, said Monday that abolishing the FSA would severely disrupt financial services.

"The proposals would abolish an independent, expert regulator, while diverting attention from banks that took excessive risks that led to this crisis," Lord Myners told BBC television.

"The Conservatives are going to cause severe disruption if they ever get the opportunity to put into place these plans."

--Alistair MacDonald, Joe Ortiz, Matt Turner and Harry Wilson contributed to this article.

Reining the regulator | The evolution of the FSA

Britain's Conservative Party shadow Chancellor George Osborne called on Monday for Britain's Financial Services Authority regulator to be abolished.

Reuters

May 1997: Recently elected Labour government gives monetary policy independence to the Bank of England but creates a separate Financial Services Authority with powers to supervise individual instititutions and regulate markets

September 2007: After years of rapid expansion in the U.K. financial sector, mortgage lender Northern Rock comes close to collapse, leading to the first major run on a bank in more than a century and eventually forcing the nationalization in February 2008

October 2008: Following the collapse of Lehman Brothers, the U.K. government steps in to rescue a tottering banking system, spending £37 billion to inject capital into leading banks. The government ends up with a 70% stake in Royal Bank of Scotland and a 43% holding in Lloyds Banking Group

July 2009: Government proposals reaffirm the tripartite structure of U.K. regulators and lay out plans to share responsibility for systemwide financial stability between the FSA and the Bank of England. Conservative opposition party announces plans to scrap the FSA and invest its powers with the BOE and the Consumer Protection Agency

Sources: Bank of England, Financial Services Authority, Dow Jones

Iceland boosts its bank sector with bond issue

By Joel Sherwood And Terence Roth

The government of Iceland said it will recapitalize its stricken banks with a $2.1 billion government-bond issue, setting the basis for a future agreement with creditors to settle outstanding debt and restart the island nation's financial system.

The announcement marks a big step in the country's efforts to rebuild its banking system. The government said the recapitalization will leave the state with only a 13% stake in **New Kaupthing**, once Iceland's largest bank. **New Islandsbanki**, formerly named Glitnir Bank, will revert to full private ownership.

The plan was reached by negotiators from the three banks that collapsed last year, the finance ministry said. Shortly after the collapse, Iceland split each of the three big banks into a "new" bank for the small but functioning domestic operations, and an "old" bank for the moribund international operations.

Under Monday's plan, the old banks emerging from the restructuring of Kaupthing and Glitnir are required to buy majority equity stakes in the new entities, New Kaupthing and New Islandsbanki, using the money from the government-bond issue. A third bank, **Landsbanki**, was given more time to work out a new ownership structure.

The government said the recapitalization, scheduled for Aug. 14, will allow the new banks to re-enter capital markets.

Iceland's once-prosperous banking system collapsed last year in the depths of the credit crisis, which kept the banks from refinancing a heavy burden of foreign-currency debt. The government was forced to nationalize its major banks to restore stability in the financial system. The fall toppled the government and prompted a swing in popular opinion to support application for entry into the European Union.

The finance ministry didn't return calls seeking comment.

CORRECTIONS & AMPLIFICATIONS

Friends Provident Group PLC proposed an all-share deal to buy restructuring firm **Resolution** Ltd. An item in the What's News column Monday incorrectly said Friends Provident was bidding for Provident Group.

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.

THE WALL STREET JOURNAL EUROPE (ISSN 0921-99)
Boulevard Brand Whitlock 87, 1200 Brussels, Belgium
Telephone: 32 2 741 1211 Fax: 32 2 741 1600
SUBSCRIPTIONS, inquiries and address changes to:
Telephone: +44 (0) 207 309 7799
Calling time from 8am to 5.30pm GMT
E-mail: WSJUK@dowjones.com Website: www.services.wsje.com
Advertising Sales worldwide through Dow Jones International. Frankfurt: 49 69 971428 0; London: 44 207 842 9600; Paris: 33 1 40 17 17 01
Printed in Belgium by Concentra Media N.V. Printed in Germany by Dogan Media Group / Hürriyet A.S. Branch Germany. Printed in Switzerland by Zehnder Print AG Wil. Printed in the United Kingdom by Newsfax International Ltd., London. Printed in Italy by Telestampa Centro Italia s.r.l. Printed in Spain by Bermont S.A. Printed in Ireland by Midland Web Printing Ltd. Printed in Israel by The Jerusalem Post Group. Printed in Turkey by GLOBUS Dünya Basınevi.
Registered as a newspaper at the Post Office.

Editeur responsable: Patience Wheatcroft M-17936-2003

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

GM says final offers in for Opel

Beijing Automotive, Magna, RHJ likely contenders for stake

By Christoph Rauwald And Andrea Thomas

FRANKFURT—**General Motors** Corp. on Monday said it received final offers for a stake in its Opel and Vauxhall operations from three bidders, without naming them.

A person familiar with matter said **Beijing Automotive Industry Holding** Co., which is owned by the Chinese government, has submitted a final bid. Another person close to the discussions on Friday said Canadian auto-parts supplier **Magna International** Inc. and Belgian investment group **RHJ International** SA are the front-runners to clinch the deal.

Magna, which has teamed up with Russian auto maker OAO **GAZ Group** and Russian-state-controlled OAO **Sberbank**, confirmed Monday that it has submitted a slightly altered bid. Under it, Magna and Sberbank would each purchase a stake of 27.5% in Opel/Vauxhall, while previously Magna had said it would acquire a 20% stake. The bidders still seek €4.5 billion ($6.34 billion) in state loan guarantees.

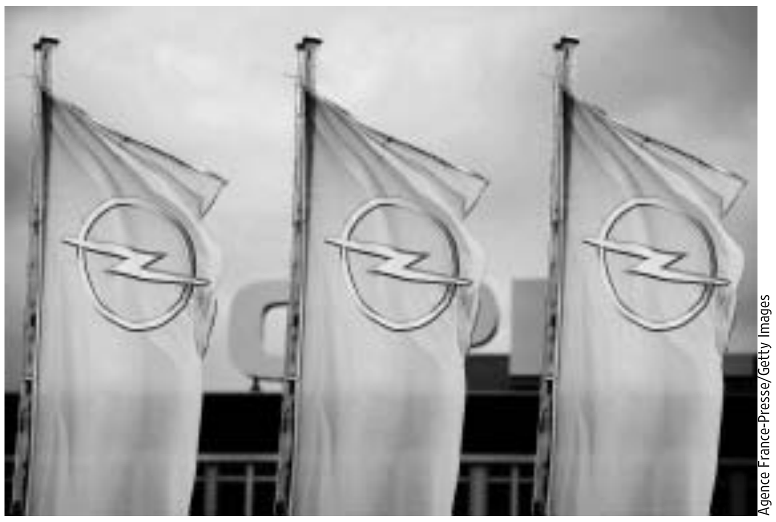
The Magna group signed a nonbinding memorandum of understanding for a deal at the end of May. Magna's bid is supported by the German government and bolstered by €1.5 billion in bridge financing provided by the German state to keep Opel afloat as GM filed for bankruptcy in the U.S.

Magna spokesman Daniel Witzani said the overall lines of the final bid haven't changed materially, only the planned ownership structure.

A spokesman for the German government, Ulrich Wilhelm, said earlier Monday that he also expected RHJ to make a final bid.

Mr. Wilhelm said the offers will be assessed "in the coming days" and then a decision will be made about further action, particularly about entering a due-diligence period. He said the government also will seek "close contact with GM Europe this week" about further steps but declined to elaborate.

GM, in a statement, said: "The final bids will now be analyzed and compared by GM. The final bids as well as GM's preliminary findings will then be reviewed with the German and other impacted governments, the EU Commission and the Opel/Vauxhall Trust Board."



Agence France-Presse/Getty Images

GM didn't name the three bidders vying for a stake in its Opel and Vauxhall operations. Above, the Opel logo on flags at a plant in Bochum, Germany, in June.

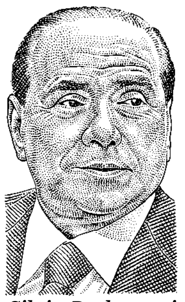
Italy's business backbone demands support

By Luca Casiraghi

MILAN—Luca Peotta has scaled down production over the past year at Reforn, the furnace maker he co-owns, and cut his work force to cope with plunging orders. Now, with no end in sight to the economic malaise, Mr. Peotta is taking to the street.

"Our politicians do not understand that this will soon turn into a social problem if the government keeps on ignoring our problems," Mr. Peotta said.

A tide of discontent is rising among the small-business owners, especially in Italy's industrial north, who have long formed the backbone of Prime Minister Silvio Berlusconi's political constituency. The Italian government, saddled with a huge public deficit, has offered little help to small businesses as they face one of the deepest recessions in decades.



Silvio Berlusconi

In late May, Mr. Peotta, whose company is based in Villafalletto, a small town near Turin, formed a protest group of 38 Italian entrepreneurs called Imprese Che Resistono—loosely translated, "Companies in the Trenches." A month later, 1,000 people gathered in Turin for a march organized by the group.

On Tuesday, Companies in the Trenches and other groups from across Italy plan to march through the streets of Rome to the offices of Economy Minister Giulio Tremonti. They plan to submit a draft of proposals to help businesses including a lower corporate tax, easier access to bank credit and a 12-month delay on tax and interest payments.

"These are concrete requests which could help the companies survive the downturn," Mr. Peotta said.

The government has acknowledged the urgency of measures to protect Italy's small and midsize companies. Earlier this month, Mr. Tremonti proposed a moratorium for payments on existing loans due to expire soon. Officials from business lobby Confindustria and the Economy Ministry started talks about the proposed moratorium last Thursday.

Small and midsize companies are key to the Italian economy: More than 99% of companies registered in the country employ fewer than 50 workers.

The number of small and midsize Italian companies at risk of collapse is worrying, observers say. Giorgio Merletti, deputy head of Confartigianato, the largest trade group representing small companies, estimated that in the region of Lombardy—which accounts for almost 30% of Italy's gross domestic product—as many as 15,000 companies could shut down by the end of this year.

Since the economic downturn began, most companies in Italy have relied on temporary layoff programs, funded by companies themselves and the government, to weather the crisis. But as the slump deepens, such costs are no longer sustainable for small players.

"We employed 12 high-skilled workers at the end of 2008, but orders have been down by 80% from then, compared to a year earlier," said Alberto Vanzini, co-owner of precision-tool maker Meccanica Fratelli Vanzini. "We have only three workers now, and to pay their salaries we don't have money left for ourselves. We can't hold on for long."

Paolo Peotta

Italian entrepreneurs came to Turin in late June for a march organized by 'Companies in the Trenches' to draw attention to the plight of small businesses.

The availability of funds for industrial activities is another crucial issue. Because few small and midsize companies are listed on stock exchanges, they depend on bank loans, which have dried up.

Bank loans to the private sector dropped 0.9% in May from a year earlier, according to the Bank of Italy. They had grown by an average of 9.6% a year in the past decade.

Small Italian companies are twice as reliant on short-term debt to finance working capital as the European average, according to a study by Italian bank Banca Monte dei Paschi di Siena SpA.

Lamberto Cardia, head of Consob, Italy's securities regulator, echoed the complaints of smaller companies about getting funds from banks. "Only larger companies manage to get fresh capital and to sell debt on the market," Mr. Cardia said at the annual meeting last week of the Milan stock exchange, Italy's primary securities market. Most small and midsize companies "are having a much harder time and could run the risk of financial asphyxiation," he said.

Marco Fortis, an economics professor at Milan's Catholic University, said there are some bright spots in the economy. "The outlook is pretty negative, especially for small companies, usually subcontractors to larger exporters—but microcompanies employing two or three workers are extremely flexible," he said. "They can easily adapt to new market conditions...and they can draw from family capital to refinance their activities."

A solution for other small and midsize companies might come in the form of temporary business associations among companies working in the same sector, as Mr. Merletti has proposed for the mechanical sector in the town of Varese. "It would help producers to be more visible on the market and to coordinate their work," he said.

Mr. Vanzini echoed that view. "Entrepreneurs working in the mechanical sector, including us, have refused to share their experiences in the past. We know how to do our job, but we lack commercial expertise to look for new customers," he said. A temporary business association would help companies survive the crisis, Mr. Vanzini said. "But we need to act fast."

Health Journal

Tome deaf

Duh! and Huh? could be the names of too many medical periodicals > **Page 27**

Porsche-VW deal hits fresh snags over tax issues

By Dana Cimilluca And Marcus Walker

Volkswagen AG's plan to acquire **Porsche Automobil Holding** SE's auto business has run into fresh complications over a potential multibillion-dollar tax liability as well as growing tensions between the two camps, according to people familiar with the matter.

The two sides tried unsuccessfully over the weekend to find a way around a tax payment that could be triggered by the sale of Porsche's sports-car operation to Volkswagen, the centerpiece of a complicated three-way deal also involving Qatar, a person familiar with the matter said.

If unsolved, the issue could scupper the deal as currently conceived, this person said, forcing Porsche to find another solution to its liquidity problems.

VW disputed the significance of the tax issue, with a spokesman calling talk of it Monday "a transparent maneuver to torpedo a sensible business idea."

Porsche's transaction with Qatar, which would hand the emirate a substantial stake in the German company, has also been cast into doubt, the people said. It is unclear whether management has enough votes on Porsche's supervisory board to win approval for the two-step deal before a planned Thursday board meeting in Stuttgart.

Some members of the family that owns the luxury sports car maker have resisted selling a stake in its holding company to Qatar, preferring instead to simply sell its options on Volkswagen stock that Porsche holds. But Qatar is insisting on a Porsche stake as part of any deal, the person said.

The discord, as well as the number of significant issues that remain to be negotiated, mean it could take months before a final deal is in place, if at all, people familiar with the matter said. VW's portion of the deal won't even be voted on Thursday, they said.

Government in U.K. reduces terror alert level

Associated Press

LONDON—The government of the United Kingdom reduced its terror-alert level to the lowest level since the July 7, 2005, bombings of London's transport system, but warned that the threat remains serious.

The government didn't explain its decision to reduce the threat from "severe," which Britain's domestic spy agency MI5 describes as a high likelihood of future terrorist attacks, to "substantial," which means such an attack remains a "strong possibility."

Bob Ayers, a London-based former U.S. intelligence officer, said officials may have reduced the threat level in an effort to show that the war in Afghanistan is helping to keep the country safe from extremists.

Paul Wilkinson, a terrorism expert at the University of St. Andrews in Scotland, rejected suggestions the move was politically inspired, saying Britons should treat the downgrade as a "very cautious" reduction that could be reversed.

CORPORATE NEWS

Korea's LG dials up cellphone growth

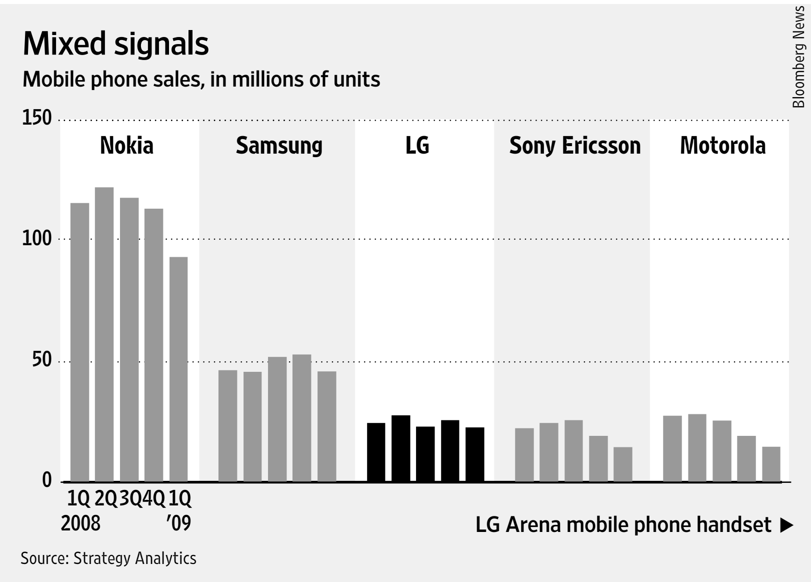
Firm gains market share on handset rivals despite slump as it gives product managers more responsibility

By Evan Ramstad

SEOUL—While the recession forces a sharp decline in global sales of mobile phones, **LG Electronics** Co. is posting some of its strongest growth ever and taking market share from cellphone rivals.

LG last year passed **Motorola** Inc. and Sony Ericsson, a joint venture of **Sony** Corp. and **Telefon AB L.M Ericsson**, to become the world's third-largest seller of cellphones, shipping just over 100 million units, or about 8.6% of the global 1.17 billion.

This year, with the overall cellphone market expected to fall more than 10%, analysts predict LG's cellphone unit shipments will jump between 10% to 20%. The division's growth is expected to help LG post a profit when it reports quarterly results Wednesday at a time when many consumer-electronics rivals are struggling with deep losses.



LG Arena mobile phone handset ▶

Bloomberg News

One of the South Korean firm's secrets: a business process in which each product has an individual responsible for it from the moment it moves out of the research lab until its last day on a store shelf.

"In the past, we didn't have people who owned the performance of a product," says Kim Myung-ho, a vice president in LG's cellphone division. "Now that we do, the number of hit phones we have is increasing."

The system allows LG, which introduces about 50 phones a year, to speedily recognize when a model is performing poorly and shorten its product life, something that happened with several camera-phones over the past two years.

"If we have 10 phones, perhaps one or two will be hits that sell millions of units, two or three more will make targets and the rest will fail," Mr. Kim says. "If a certain product is not going to be successful, we want to move on."

The system also allows product managers to quickly boost supplies and marketing in areas where a particular phone is selling well. On Monday, LG said a new phone called Cookie—touch-screen models with colorful cases for younger buyers—had shipped five million units since its release in November. LG has also been boosted by new versions of its popular Chocolate and Vu phones.

By contrast, the industry's leading seller, **Nokia** Corp., last week said it expected to lose some market share this year. And the second-biggest seller, LG's crosstown rival **Samsung Electronics** Co., forecasts marginal growth at best.

One analyst, James Kim of Nomura International Ltd. in Hong Kong, says LG is experiencing the "strongest momentum" in its history. He forecast a 6% jump in cellphone shipments in the second quarter, with bigger gains in the second half of the year. He expects LG's cellphone revenue in the quarter to jump 34% to about $4 billion due to an upward shift in average selling price.

LG laid the groundwork for the performance about two years ago when then-new Chief Executive Nam Yong restructured the electronics maker so that each product had a product business leader, a position known as the PBL within LG, responsible for it.

The position is now common in all of LG's divisions, including home appliances and consumer electronics, but the work involved in it has been refined in the cellphone business, which introduces the highest volume of products and copes with the widest mix of targets for profitability and time in the market.

Seo Hyung-won, the PBL for LG's Viewty touch-screen phone that launched in 2007 and was refreshed last month as Viewty Smart, says he updated the first product's jogwheel control and the lens cover on its camera after early customers complained about them.

But he also noted some stumbles in the process. Initially, Mr. Seo and his peers frequently traveled to gauge market response to products, which slowed their responsiveness to various factories and sales offices. "The regional offices were sometimes frustrated with absent PBLs," he says. "Now, we try to coordinate trip schedules better."

Driven by the cellphone unit's growth, LG's second-quarter performance is likely to stand out as the consumer electronics industry slogs through the current downturn. Analysts believe LG will report profit for the quarter was just slightly below, or possibly above, its year-ago level, when it had its best ever April-June period.

Part of the LG's second-quarter success is also timing. LG's appliance division, which accounts for 25% of revenue, is seasonally strongest in the second quarter. This year, LG's two other big divisions—cellphones and consumer electronics—also likely experienced better-than-usual sales and profits in the second quarter, analysts say. Typically, the fourth quarter is the strongest period for both divisions.

As well, both LG and Samsung were hurt less than rivals in other countries because they benefited from the devaluation of South Korea's currency, which made prices of the goods they shipped out of the country more competitive. Both firms recorded much smaller losses than their Japanese rivals at the end of last year.

Hotel owners focus on security but see their brands safe

Western hotel owners predict the growth of luxury brands will continue relatively undaunted in Asia despite the latest bombings at two such hotels in Indonesia.

By Kris Hudson, Tamara Audi and Patrick Barta

However, the incidents could put pressure on some hotels to beef up security measures at a tough time for the industry.

The bombings Friday in Jakarta killed nine people and injured more than 50 others at the JW Marriott and Ritz-Carlton hotels in central Jakarta. They follow others in recent years at Western-branded hotels, potentially giving pause to developers of hotels under construction in Asia.

Few brands lure travelers like Marriott, Hilton, Hyatt and other Western names, according to industry observers.

"The reality of the established brands is that they're recognized for the power of the brand," said Ed Walter, chief executive of **Host Hotels & Resorts** Inc., which owns 126 hotels around the world, a large number of which fly the Marriott flag. "I think it would take a lot to lead a developer away from these brands, especially in Asia where the population and the travelers are very brand conscious."

Host, which doesn't own any hotels in Asia, recently formed a joint venture with a sovereign-wealth fund in Singapore to scout the Asian hotel market for purchases and investments. Host hires operating companies, such as **Marriott International** Inc. or **Hilton Hotels** Corp., to manage its hotels.

Simon Cooper, president and chief operating officer of **Ritz-Carlton Hotel** Co., noted that the attacks at luxury hotels in Mumbai in November targeted landmark properties that nonetheless didn't carry Western brands. As for any stigma for Western brands, he said, "I don't think there's any concern at all that I've heard."

Nonetheless, the latest Jakarta attacks signal that even the extensive security measures that hotels have put in place after bombings earlier this decade aren't fail-safe.

The Marriott and Ritz-Carlton in Jakarta use vehicle barriers, armed security guards and weapons-screening devices in their lobbies. "We require all of our properties to have security plans and encourage each property to reassess its own plan based on local threat conditions and the property's circumstances," Marriott spokesman Tom Marder said.

Dick Hudak, a partner in Resort Security International Inc., which advises hotels and resorts on security, said the Marriott hotels in Jakarta have better security than any property he has seen. Yet "those [bombers] got through the highest level of security," he said. "How they breached that is what we're going to have to investigate."

With the cash-strapped hotel industry already battered by a steep decline in business and leisure travel, now isn't the best time for hotels to have to spend heavily to fortify security.

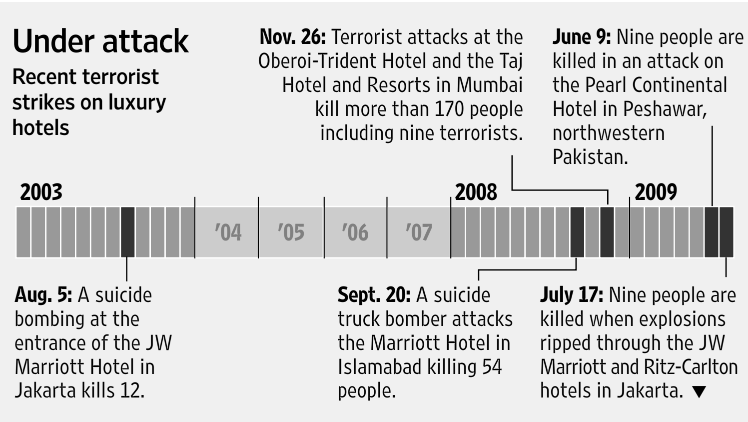
Most luxury hotels in high-risk regions such as Indonesia, parts of the Middle East and Asia already have installed pricey security features such as vehicle barriers, surveillance systems and equipment to screen for weapons, bombs and even vapors, Mr. Hudak said.

Additional actions many hotels likely will take in the wake of the bombings entail boosting their security forces' training and vigilance.

"The problem is sustained attention and guarding against a sense of complacency as you do this stuff day in, day out, and that's where things fall by the wayside," said Paul Quaglia, a security analyst in Bangkok at PSA Asia, a security-consulting and political-risk company, who previously did a security audit of the Ritz-Carlton. "Keeping a high-level sense of thoroughness 24 hours a day is hard to do, especially with a guard force that has a high level of turnover."

William Heinecke, chairman and chief executive of **Minor International**, a Bangkok-based company that owns and operates hotels in Asia, including several Marriott properties in Thailand, said his company isn't adding to security following the Jakarta bombings.

"I don't think we can add anything new; we're at the highest level that can exist," he said. He also doubts Western brands are more likely to draw terrorists than other brands are, he said. Terrorists are "looking for busy hotels," not necessarily Western ones, he said.



Indonesian forensic investigators at the JW Marriott in Jakarta last Saturday.

Associated Press

After terrorist attacks in November that killed more than 170 people, Mumbai hotels have significantly strengthened security measures.

Pakistan's hotels stepped up security considerably after a truck bomb ripped through Islamabad's Marriott hotel in September 2008, killing 54 people. Getting inside the hotels often involves passing through airport-style metal detector and X-ray setups.

Still, the Pearl Continental hotel in Peshawar, a city that abuts Pakistan's tribal badlands, was attacked in June, killing nine.

—Geeta Anand contributed to this article.

CORPORATE NEWS

FedEx, UPS cross swords over legislation

Dispute heats up over bill that affects ease of unionization

By Alex Roth

FedEx Corp. and **United Parcel Service** Inc. are intensifying a dispute over proposed U.S. legislation that could upset the balance of power in the package-delivery business by making it easier to unionize FedEx.

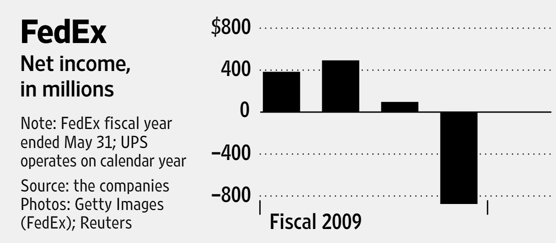
UPS is hoping Democratic control of Congress and the White House will enable it to win support for a bill that would place some of FedEx's drivers and other employees under the National Labor Relations Act, the same law that governs UPS. FedEx drivers are currently governed by a separate federal law that makes unionizing more difficult.

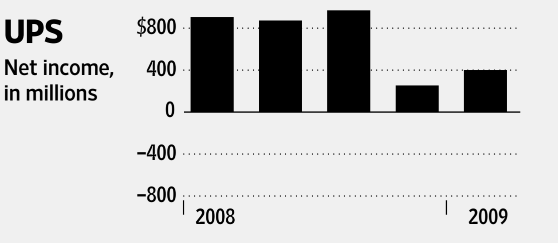
The House passed a version of the bill, called the FAA Reauthorization Act, in May. But a Senate version of that same bill doesn't contain a provision that would change FedEx's current labor status.

The chief executives of both companies have met with senators in recent months and have doubled or tripled their lobbying expenditures over the past year and a half. In June, FedEx unveiled a Web site criticizing UPS, whose workers are organized by the Teamsters, for its support of the bill. FedEx also has said the bill would put it at a competitive disadvantage and, as a result, has threatened to postpone buying billions of dollars in new planes from **Boeing** Co. if the bill becomes law.

The political calculus doesn't divide neatly along party lines. Some Republicans who normally might not support Teamster-backed bills hail from states where Atlanta-based UPS has a big presence, while some union-friendly Democrats are from states where FedEx, of Memphis, Tenn., has large facilities that could be hurt by the legislation.

The latest twist came last week, when David Keene, president of the American Conservative Union, joined several other conservative groups in signing a letter questioning FedEx's use of "bailout" to describe what UPS is seeking. In a video on FedEx's Web site, brownbailout.com, an actor alleges that UPS's opposition to the bill is tantamount to a demand for a government rescue because it would put a large competitor at a disadvantage. UPS argues that it wants the government to level the playing field.





Source: the companies
Photos: Getty Images (FedEx); Reuters

The July 15 letter signed by Mr. Keene and several other prominent conservatives noted that "FedEx's campaign is designed to capitalize on public sentiment that is angry that hundreds of billions of dollars have been wasted in the name of bailouts. But since UPS is not seeking even one dime of taxpayer money, the campaign is essentially a disinformation campaign and should be stopped."

In response to that letter, FedEx gave the Web site Politico a letter it received, dated June 30 and signed by Dennis Whitfield, the ACU's executive vice president. The letter said Mr. Keene's organization had offered to produce "op-eds and articles written by ACU's Chairman David Keene and/or other members of ACU's board of directors" in support of FedEx's position. In exchange, the group wanted FedEx to pay potentially several million dollars for the group's grass-roots efforts.

The ACU offered to "contact over 150,000 people per state multiple times at a cost of $1.39 per name or $2,147,550 to implement the entire program....If we incorporate the targeted, Senator-personalized radio effort into the plan, you can figure an additional $125,000 on average, per state."

FedEx declined the offer, and company spokesman Maury Lane accused the group of shopping its views to the highest bidder.

The conservative group released its own statement saying Mr. Keene's signature on the pro-UPS letter was "a personal decision on his part and he was not representing ACU at the time." The group said Mr. Keene hadn't received permission to use its logo on the July 15 letter and the group didn't know the letter was being sent.

The group said it continues to support FedEx's position and that its political views "have never been for sale." A spokesman declined to make Mr. Keene available for comment or to discuss the contents of the letter.

UPS spokesman Malcolm Berkely said UPS didn't pay Mr. Keene or anyone else whose name appears on the July 15 letter in return for their signature. He did acknowledge that UPS's foundation has given annual grants to Americans for Tax Reform, whose president, Grover Norquist, also signed the pro-UPS letter.

Mr. Berkely said UPS's foundation supports the organization "because of their effort to educate consumers and taxpayers about the cost of taxation, regulation and litigation." A spokesman for Americans for Tax Reform didn't respond to an email question about its financial relationship with UPS.

FedEx, the No. 2 delivery company behind UPS, worries that a Teamster-organized work force would eliminate a key competitive advantage. In past contract negotiations between the Teamsters and UPS, FedEx has played up the issue of potential "industry disruption" in attempting to capture business from some UPS customers.

In 2008, UPS more than doubled its lobbying expenditures to $5.2 million, according to Opensecrets.org, which tracks federal lobbying spending. FedEx last year spent $9.3 million on lobbying, or nearly triple its annual average in recent years, according to the Web site.

Both UPS Chairman and CEO Scott Davis and Fred Smith, FedEx's chairman and CEO, have paid visits to Sen. Mark Begich of Alaska and Sen. Johnny Isakson of Georgia, among other lawmakers, to press their cases, according to people familiar with the matter. Mr. Begich is a Democrat, but his state is home to a FedEx sorting hub. Mr. Isakson is a Republican, but his state is home to UPS headquarters.

Mr. Berkely confirmed that Mr. Davis "has made himself available to discuss this issue with members of Congress when available." FedEx also has confirmed the meetings.

Vivendi halts plan to buy stake in African business

By Ruth Bender

PARIS—**Vivendi** SA said Monday that it halted talks to buy a majority stake in the African telecommunications activities of **Mobile Telecommunications** Co., known as Zain Group, easing concerns about the impact such a deal would have had on the French media conglomerate's credit rating.

Zain's African operations, which analysts estimate could be valued at $10 billion, would have enlarged Vivendi's footprint in high-growth markets: Kuwait-based Zain is active in populous African countries where mobile-phone use is still in its infancy, such as Nigeria, Sudan and the Democratic Republic of Congo.

Vivendi already has a presence in Africa through its 53% stake in Maroc Telecom—which has operations in Morocco, Mauritania, Burkina Faso, Gabon and Mali—and Chief Executive Jean-Bernard Levy has said the company is looking to expand further in faster-growing markets. Like other European telecommunications operators, Vivendi is facing declining revenue and margins in its mature home market.

Vivendi's net debt as of March 31 totaled €8.3 billion ($11.7 billion), unchanged from a year earlier.

CORPORATE NEWS

Reuters

Demonstrators marching in Ecuador in 2003 over environmental damage they say was caused by Texaco.

1964
Ecuador grants exploration concession to a consortium of U.S. companies, with Texaco as operator

1974
State-run oil company Petroecuador acquires majority stake in consortium; Texaco remains the operator until 1990

1992
Consortium agreement expires; Texaco ends Ecuador operations

1993
Ecuadorian residents file class-action lawsuit against Texaco in New York

1996-2001
Federal court in New York dismisses lawsuit; Texaco agrees to accept Ecuadorian jurisdiction

2001
Chevron acquires Texaco

2003
Plaintiffs sue Chevron in Ecuador

2006
Rafael Correa elected president of Ecuador

2008
Court-appointed expert finds Chevron responsible for as much as $16 billion in damages; later increased to $27 billion

Chevron focuses on U.S. fight

Oil firm anticipates waging Ecuador suit in home courts

By Ben Casselman

Chevron Corp., which expects to be on the losing end of a long-running environmental lawsuit in Ecuador, is turning its attention to fighting the expected multibillion-dollar verdict in the U.S.

The plaintiffs in the case, residents of Ecuador's oil-producing Amazonian rainforest, are seeking to hold Chevron responsible for environmental contamination they say was caused by Texaco, which operated in Ecuador from 1964 to 1990 and was bought by Chevron in 2001. An expert appointed by the Ecuadorian court has recommended the judge award the plaintiffs $27 billion in damages from Chevron, which would be the biggest environmental judgment against an oil company to date.

Chevron denies the allegations, arguing that Texaco's operations in Ecuador met local and international standards, that a $40 million cleanup effort in the 1990s resolved any environmental liability the company had there, and that any remaining problems are the responsibility of **Petroecuador**, the state-run oil company that took over Texaco's operations.

The stakes are high. Damages of $27 billion would represent roughly a tenth of the company's 2008 revenue, and a record-setting judgment could tarnish Chevron's image at a time when it has been trying to establish itself as environmentally friendly.

Chevron says it has given up the prospect of winning the case because the Ecuadorian court system is heavily influenced by President Rafael Correa, who has publicly sided with the plaintiffs. The company says it plans to appeal the case in Ecuador, but has little hope of prevailing. Both sides expect a ruling in the case later this year.

Chevron itself has never operated in Ecuador, and Texaco pulled out in 1992, leaving behind almost no assets for the court to seize in case of a judgment against the company. Therefore the plaintiffs will need to try to enforce any ruling in a country where Chevron does have assets, most likely the U.S.

Chevron has been reassuring shareholders that it doesn't expect to be forced to pay any judgment imposed by Ecuador.

"We're not paying and we're going to fight this for years if not decades into the future," Chevron spokesman Don Campbell said in an interview.

To prevent enforcement of a potential judgment in the U.S., Chevron will likely need to convince a U.S. judge it didn't get a fair trial in Ecuador—something legal experts say won't be easy. "It's going to have to be pretty conclusive evidence," said Ralph Steinhardt, a law professor at George Washington University.

Complicating the matter for Chevron, after the plaintiffs originally sued Texaco in the U.S., Texaco convinced a U.S. court that the case should be heard in Ecuador, praising Ecuador's judicial system in court filings.

Chevron will likely need to convince a U.S. judge it didn't get a fair trial in Ecuador.

Texaco argued the case should be heard in Ecuador because the evidence and alleged damage were in the country. The plaintiffs argued that Ecuador wasn't equipped to deal with such a complicated case.

But Mr. Steinhardt, as well as other legal experts, said U.S. courts won't enforce a patently unjust ruling, regardless of what Texaco said during an earlier stage in the case.

Chevron has begun laying the groundwork for such an argument in court filings and letters to investors, questioning the qualifications of the court-appointed expert and arguing that recent incidents—including the adoption last fall of a new constitution that replaced Ecuador's Supreme Court with a new body—have called the entire system into question.

The plaintiffs argue Ecuador's court system has become less susceptible to corruption in recent years. Andrew Woods, a lawyer for the plaintiffs, accused Chevron of stalling. Chevron denies stalling, but has stressed to investors that any enforcement will likely take years.

The most immediate threat to Chevron, according to analysts, could be the impact a ruling would have on its reputation, particularly as the company seeks permission to drill in other developing countries.

The plaintiffs are hoping negative publicity will lead Chevron to settle the case.

Chevron has responded with its own public-relations campaign. Mr. Campbell said the company is responding to distortions from the plaintiffs.

Some shareholders, however, have urged the company to settle. Mr. Campbell said Chevron is working to defend its reputation, but won't settle a case in which it has done nothing wrong. "We're not going to be bullied into a settlement," Mr. Campbell said.

Toyota lost touch in U.S., executive says

By Kate Linebaugh

Toyota Motor Corp. got "a little bit lost" in its North American strategy and fell out of touch with customers and the market, its new North American chief, Yoshimi Inaba, said Monday.

After years of growth and profits at Toyota, Mr. Inaba said elements of complacency and arrogance infiltrated the company, which prides itself on being efficient and customer-oriented as well as constantly improving.

"Our sense has been always that we listen to the market, we listen to customers, we listen to the dealer. That element is a little bit lost in the very long and good success that we have had in the last eight years," Mr. Inaba, who is president of Toyota Motor North America, told a group of reporters.

As the global vehicle market has contracted, Toyota posted its first loss in 58 years and projects to record another loss for this fiscal year.

Last month, Akio Toyoda, the great grandson of the company's founder, took over as president as the company seeks to return to profitability.

Mr. Inaba—who was dispatched by Mr. Toyoda to fix its biggest market—says Toyota's North American operations could return to profitability in the next fiscal year as he embarks on an overhaul of the business. He said he expects U.S. annual light-vehicle sales to return to about 12 million level next year, though it will take time to return to the 2007 level of 16 million.

Mr. Inaba disagreed with the contention that Toyota expanded too fast in North America. "We were having a tough time catching up with demand," he said.

Mr. Inaba stressed that the U.S. auto market "remains the most important market for Toyota."

Struggling to cope with overcapacity in its North American operations, Mr. Inaba said the company hopes to decide what to do with its California joint-venture plant with **General Motors** Co. "as quickly as possible." GM said it was exiting the 25-year partnership as part of its bankruptcy reorganization.

As part of the overall replanning process, Mr. Inaba said he is evaluating what to do with Toyota's partially built plant in Mississippi where it planned to produce its Prius hybrid.

The factory was indefinitely postponed last year. Restarting it depends on how strong demand is for the Prius and how the company reshuffles production to address overcapacity.

To assemble the Prius in the U.S., Toyota will seek to produce some of the hybrid vehicle parts locally, he said.

Mr. Inaba also said Toyota wants to grab market share that GM and **Chrysler Group** LLC lose through their restructuring process, though he conceded that **Ford Motor** Co. is best positioned to benefit from the downsizing.

"We certainly want a good chunk of it," he said. "As the dust settles down a little bit we would also like to go after any incremental volume."

Wyeth holders clear Pfizer offer to buy drug firm

By Peter Loftus

Wyeth shareholders on Monday approved a takeover by **Pfizer** Inc., helping to lay the groundwork for the deal to close this year.

About 98% of votes cast supported the deal, according to a preliminary tally announced at a shareholder meeting.

The transaction is still subject to clearance by U.S. antitrust regulators. On Friday, Pfizer said the European Commission had approved the deal, subject to the sale of certain animal-health assets in Europe. U.S. regulators also expect animal-health divestitures because Pfizer and Wyeth have overlapping businesses.

In January, Pfizer agreed to acquire Wyeth, of Madison, N.J., in a cash-and-stock deal valued at about $68 billion. New York-based Pfizer, which expects the sale to close by the end of the year, wants to diversify its business and gain access to fast-growing biotechnology drugs and vaccines as the 2011 patent expiration looms for its blockbuster cholesterol drug Lipitor. Pfizer also expects cost savings, with a 15% reduction in the combined entity's work force planned.

Wyeth Chief Executive Bernard Poussot said the combined entity will achieve more than either company could have alone. But he acknowledged "mixed feelings" and "sadness to see the company disappear as we know it today," as well as the pending job losses.

Casino revenue in Macau drops 12% on visa limits

By Jackie Cheung

HONG KONG—Macau's casino gambling revenue in the second quarter fell 12% from a year earlier to 25.62 billion patacas ($3.7 billion), and was down 2.4% from the previous quarter, the city's Gaming Inspection and Coordination Bureau said.

Analysts said visa restrictions introduced by the Chinese government have reduced the number of visitors from mainland China and hit gambling revenue in the special administrative region.

Since the middle of 2008, Beijing has tightened restrictions on visits to Macau in an apparent attempt to stop civil servants from gambling and to curb money laundering. The former Portuguese enclave returned to Chinese rule in December 1999.

Macau's casino gambling revenue fell 12.5% to 51.87 billion patacas in the first half ended June 30 from a year earlier.

The number of casino gambling tables rose to 4,390 at the end of June, from 3,998 at the end of March, the regulator said.

In 2002, Macau ended a 40-year monopoly on casino gambling in the territory enjoyed by casino businessman Stanley Ho. Since then, the territory has granted six casino licenses to casino operators, including **SJM Holdings** Ltd., controlled by Mr. Ho.

The other operators are **Las Vegas Sands** Corp., **Wynn Resorts** Ltd., **Melco Crown Entertainment** Ltd., **MGM Grand Paradise** SA and **Galaxy Entertainment Group** Ltd.

CORPORATE NEWS

Halliburton profit drops as commodity prices ebb

Drilling work falls in North America; Asia, Mideast strong

By Jason Womack
And Tess Stynes

Halliburton Co.'s second-quarter earnings fell 48% amid weak demand and lower prices, particularly in North America, where drilling activity has declined.

But relatively strong margins in international markets such as Asia and the Middle East brought in higher earnings than most analysts expected, bumping the Houston oil-services company's share price higher. Halliburton was up 3.3% to $22.08 on the New York Stock Exchange in early afternoon trading Monday.

Oil-and-gas producers are slashing spending on oil-field services as commodity prices have slumped and demand wanes. Halliburton and other companies began offering contracts tied to oil-price indexes earlier this year to keep projects afloat.

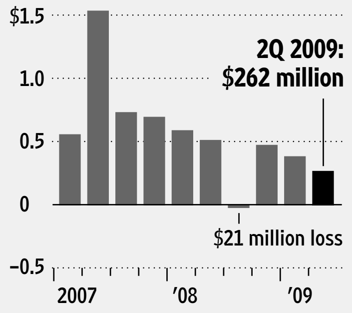
Declines in North American drilling activity weighed significantly on Halliburton's results. During a conference call, Chief Executive David Lesar said that high levels of natural-gas storage would keep North American gas-drilling activity suppressed in the near term.

"Any recovery in gas drilling is likely to be relatively modest for the rest of 2009," Mr. Lesar said.

Natural-gas storage levels have swelled despite the brisk pullback in drilling activity. Natural gas in U.S. storage for the week ending July 10 stood at 2.886 trillion cubic feet, 26% higher than a year earlier.

Another tumble

Halliburton's net income/loss, in billions



Source: the company

The U.S. gas-drilling rig count has fallen by more than half from its peak of 1,606 rigs in September.

Although the drop in onshore drilling in North America has exerted pressure on the prices Halliburton and other oil-field-services companies can charge for services, Mr. Lesar said the sector is "probably close to the bottom in terms of pricing degradation."

The company reported a profit of $262 million, or 29 cents a share, down from $504 million, or 55 cents a share, a year earlier. The latest period included a one-cent-a-share charge for job cuts, while the prior year included a 13-cent loss from discontinued operations.

Revenue fell 22% to $3.49 billion, reflecting a 37% decline in North America and a 17% drop in the Middle East and Asia.

Analysts polled by Thomson Reuters most recently were looking for earnings of 27 cents a share on revenue of $3.43 billion.

GLOBAL BUSINESS BRIEFS

Renault SA

Car maker to build factories to produce ion batteries

French car maker **Renault** SA and its Japanese partner **Nissan Motor** Co. said they will build two factories in the U.K. and Portugal to produce lithium-ion batteries for future models of electric vehicles. The U.K. plant will be located at Sunderland, northeast England, where Nissan already has a vehicle assembly plant. A decision on the location of the Portuguese facility is pending. The companies are investing €250 million ($352 million) in the Portuguese plant, which will create 200 jobs. They didn't say how much they would invest in the Sunderland plant. Each plant will produce 60,000 batteries annually.

Kuehne & Nagel International

Kuehne & Nagel International AG said second-quarter net profit fell 16% amid sharp drops in demand for both sea-freight and air-freight forwarding, which the Swiss logistics company couldn't entirely offset with cost cuts. Net profit fell to 130 million Swiss francs ($120. 7 million) from 154 million francs a year earlier. Net invoiced revenue, which forwarders use to measure revenue without custom duties and levies, dropped 23% to 3.47 billion francs from 4.52 billion francs. The company said it will continue to cut costs amid dim prospects for trade picking up.

Continental AG

Auto-parts supplier and tire maker **Continental** AG said it met its second-quarter operating goals in a difficult business environment, but added that still-tight financing conditions pose a major challenge for the second half. Earnings before interest and taxes, or Ebit, remained in the black and came in at €38.8 million ($54.7 million) in the second quarter, down 92% from €455.7 million a year earlier, but exceeding first-quarter Ebit by more than €200 million. Revenue dropped 28% to €4.76 billion amid a major downturn in the global auto market.

Deutsche Lufthansa AG

The European Commission, the European Union's executive arm, said it is awaiting clarifications from German airline **Deutsche Lufthansa** AG on its planned takeover of **Austrian Airlines** AG before deciding whether to clear the deal. Commission officials held discussions with Lufthansa over the weekend, said Jonathan Todd, the panel's antitrust spokesman. EU competition commissioner Neelie Kroes offered to meet with Lufthansa's chief to discuss the matter, Mr. Todd added. A Lufthansa spokesman said the airline is working on a solution with the commission.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

U.S. confronts two timetables in Iran

With nuclear materials piling up and change in Tehran uncertain, White House keeps offer to talk on the table

By Gerald F. Seib

Two powerful forces are spinning away simultaneously in Iran: the social unrest stemming from the country's disputed presidential election, and thousands of high-tech centrifuges that are busy producing nuclear material.

The Obama administration's dilemma here is simple. Those centrifuges are likely to reach critical mass faster than the protesters in the streets. In a nutshell, that's why the administration's offer to talk with Tehran remains on the table despite the international outcry over the Iranian election outcome.

CAPITAL JOURNAL

That dilemma was put into stark relief Friday by a sermon from former Iranian President Ali Akbar Hashemi Rafsanjani, which may become a milestone in Iran's post-election unrest. Mr. Rafsanjani, an ayatollah and an iconic figure in the history of Iran's Islamic revolution, criticized both the June presidential election and the government's reaction to the ensuing protests, implying that his nation's current leaders have lost the faith of their citizens.

In one fell swoop, that kept the protest movement alive despite a police crackdown; showed that the split in Iran's clerical ranks over the supposed re-election of President Mahmoud Ahmadinejad is deep and serious; and opened the door to all sorts of intriguing regime-change possibilities. The sermon also instantly sent demonstrators back into the streets. Another flashpoint looms in early August, when Mr. Ahmadinejad is scheduled to be sworn in for his second term.

Yet from the West's perspective, the problem is that the time needed to somehow effect change in Iran's government, or even its behavior from the street up, is likely to be long—and, unfortunately, longer than the time needed to amass a worrisome amount of nuclear material.

Associated Press

Critical comments by Iran's former president over the election sent demonstrators back into the streets of Tehran last week.

The International Atomic Energy Agency last month reported that some 5,000 centrifuges now are working in Iran, churning out low-enriched nuclear fuel, while another 2,000 or so could soon join them. Those centrifuges don't produce nuclear material sufficiently enriched to produce an atomic bomb, and Iran insists the material is for civilian power production. But it can be the building block for weapons if further enriched.

The Institute for Science and International Security, a nonpartisan technical organization overseen by former IAEA inspector David Albright, estimates that at current production rates, Iran could accumulate enough low-enriched uranium to serve as feedstock for two nuclear weapons by the end of next February. It's still a leap from there to actually producing a weapon, and U.S. government specialists think Iran remains anywhere from one to three years away from being able to make a nuclear bomb.

Still, time isn't on the side of the West, and there is little reason to think political ferment in Iran will, in the short run, change the arc of its nuclear program. "The bottom line is that their [nuclear] laboratories are probably working 24/7," says Richard Haass, president of the Council on Foreign Relations, which last week hosted a major speech by U.S. Secretary of State Hillary Clinton. "So we don't have the luxury of waiting for a government we like until we approach them."

Thus, administration officials argue that if a central reason to open a dialogue with Iran was to test whether there was a way to negotiate Tehran off its current nuclear path, the need to test that hypothesis has hardly receded. If anything, the urgency has intensified.

"We remain ready to engage with Iran, but the time for action is now," Mrs. Clinton said in last week's speech. "The opportunity will not remain open indefinitely."

The danger now, though, is that a diplomatic outreach to Iran has the potential to lend Mr. Ahmadinejad and his government legitimacy at a time when it is being questioned by Iranians themselves. So the trick is to open a line to the Iranians generally without seeming to bless the besieged president.

There are a couple of ways to do that. The most likely is to talk to the Iranians within the "P5 plus one" international group—which consists of the five permanent members of the United Nations Security Council, plus Germany—rather than directly. In fact, the administration said before the Iranian election that it envisioned starting a dialogue by taking part in meetings that group might hold with Iranian officials.

One senior administration official notes that Iran has said recently that it will bring new ideas to the P5 plus one group on how to deal with its nuclear program. That hasn't happened yet, so in a sense the ball is in Iran's court.

The other option is to explicitly open channels to Iranian leaders other than Mr. Ahmadinejad. The U.S. could aim either below to the foreign minister or above to supreme leader Ayatollah Ali Khameini, the country's ultimate power source.

In any case, Mr. Haass suggests moving quickly to find out whether the Iranians will accept a "ceiling" on their nuclear activity. If the answer is no, he says, the U.S. then can move at the Security Council in September to seek tougher international sanctions on Iran. In any case, that sound diplomats will hear in the background is the whirling of Tehran's nuclear centrifuges.

Iran reformers warned to halt latest challenges

By Chip Cummins

DUBAI—Iran's supreme leader struck back Monday at a barrage of increasingly assertive challenges from reform-minded leaders, warning them to tone down complaints about the contested June 12 election and its aftermath.

Ayatollah Ali Khamenei's speech came after two former Iranian presidents appeared to directly confront him over the election. Former President Mohammad Khatami, a so-called reformist who led Iran for two terms before Mr. Ahmadinejad's first election victory in 2005, called over the weekend for a referendum on the president's re-election.

"The political elite should maintain great vigilance because they currently face a significant challenge; their failure to rise to this challenge will lead to their collapse," Iran's state-run English-language news service, Press TV, quoted Mr. Khamenei saying. He spoke as Mr. Ahmadinejad and other officials sat on the floor beside him.

The call was the latest high-profile rebuke from Mr. Khamenei, who has attempted to close debate on the subject with his endorsement of the election results weeks ago. Late last week, another former president, Akbar Hashemi Rafsanjani, in the elevated setting of Friday prayers at Tehran University, bluntly criticized the government for its handling of postelection protests.

Mr. Rafsanjani is a top cleric who helped found the Islamic Republic and enjoys his own political base apart from Mr. Khamenei. The new assertiveness by leading opposition-minded clerics could reinvigorate what appears to be a dwindling street movement.

The clerical split has been limited to a war of words. But as the rhetoric ratchets up, the stakes for both sides do, too. Supporters of Mr. Rafsanjani and Mir Hossein Mousavi—Mr. Ahmadinejad's closest challenger in the vote—risk a tougher crackdown if they continue to challenge Supreme Leader Khamenei, who has final say in all matters of state.

Agence France-Presse/Getty Images

Ayatollah Ali Khamenei, right, issues a warning to opponents as Iran President Mahmoud Ahmadinejad, second right, listens.

Mr. Mousavi, meanwhile, visited family members of some of those arrested in the crackdown. He used unusually strong language, and directed his criticism directly at the regime: "End this game as soon as possible and return to the nation its [arrested] sons," the AP quoted him saying.

U.S., India plan deals on defense, power

Clinton ends visit with Singh's pledge of two nuclear sites

BY MATTHEW ROSENBERG

Bloomberg News

U.S. Secretary of State Hillary Clinton, left, speaks with Manmohan Singh, India's prime minister, in New Delhi on Monday.

NEW DELHI—The U.S. and India announced deals Monday that could bring American defense contractors and power companies billions of dollars in business as Hillary Clinton wrapped up her first visit as secretary of state to the South Asian nation.

A long-running dispute over how to combat climate change threatened a day earlier to the sour the trip. Both the U.S.—the world's most powerful democracy—and India—the most populous—have touted the visit as an effort to strengthen ties between two countries after decades of estrangement during the Cold War, when New Delhi often leaned toward the Soviet Union.

Monday's announcements ensured Mrs. Clinton's three-day visit brought tangible gains for both sides, setting the stage for further expanding military cooperation and two-way trade, currently valued at about $45 billion and growing.

"I don't think you can understate the significance of our relationship as two democracies," Mrs. Clinton said at a joint news conference with her Indian counterpart, External Affairs Minister S.M. Krishna. "We understand the difficulties of decision-making in democracies, and we respect the vibrancy of each other's democracy. That is a much stronger base for a relationship than any other in the world."

Mrs. Clinton said she had been told by Prime Minister Manmohan Singh, whom she met earlier in the day, that India had set aside two sites where U.S. firms will have exclusive rights to build nuclear-power plants.

The sites will "facilitate billions of dollars in U.S. reactor exports and create jobs in both countries as well as generate much-needed energy" in India, which faces chronic power shortages, Mrs. Clinton said.

She didn't say where the sites would be. But the widely expected announcement is a major step toward implementing a landmark pact sealed last year between Washington and New Delhi that ended a 34-year ban on trading nuclear fuel and technology with India, which had developed atomic weapons outside the Nuclear Non-Proliferation Treaty.

Already, India has set aside sites exclusively for French and Russian companies. The U.S. sites announced Monday guarantee American access to a market for power plants valued at tens of billions of dollars.

However, a number of hurdles remain. The U.S. hasn't granted American companies licenses needed to share sensitive technical data and specifications with Indian firms. And India must pass legislation and sign an international convention that limits nuclear-power companies from liability in the case of an atomic accident.

Mrs. Clinton and Mr. Krishna also announced an "end-use monitoring" agreement that provides for the export of U.S. weapons and defense technology to India by allowing American authorities to make sure it is used as intended and not sold to other countries.

The agreement opens the way for Boeing Co. and Lockheed Martin Corp. to bid on an Indian contract to supply 126 fighter jets, a sale valued at more than $10 billion. It could also bring in billions of dollars more for those companies or other American defense contractors as India modernizes its aging, largely Soviet-made military arsenal.

India and the U.S. also finalized an agreement that would allow American parts to be launched on civilian or noncommercial Indian spacecraft.

Mumbai suspect says he is guilty

BY GEETA ANAND

Reuters

Mohammed Ajmal Kasab said Monday he is guilty of charges related to the terrorist attacks in Mumbai. Above, Mr. Kasab is shown in police custody in February.

MUMBAI—The Pakistani man captured during the terrorist attacks here in November that left more than 170 dead told the court trying him for taking part in the assault that he was guilty—an admission that surprised even his own lawyer.

"Sir, I plead guilty to my crime," said Mohammed Ajmal Kasab on Monday, a confession that drew gasps from the audience, the Associated Press reported.

Mr. Kasab, 21 years old and the sole survivor of 10 suspected gunmen in the attacks, had pleaded not guilty in the trial, which began three months ago.

Judge M.L. Tahiliyani immediately summoned prosecution and defense lawyers to confer privately about the significance of Mr. Kasab's statement. Both sides later said they hadn't expected the admission of guilt.

It wasn't clear whether the admission will be accepted by the court. "Everybody in the court was shocked the moment he said he accepts his crime," the public prosecutor, Ujjwal Nikam, told reporters.

If his admission is found to be voluntary, it could put a quick end to the trial and strengthen India's claims that the attacks were plotted in Pakistan, as police say Mr. Kasab has told them in prior interrogations.

Relations between Pakistan and India have been severely strained since the attacks, which Pakistani officials initially denied were plotted in that country or carried out by any of their nationals. Pakistan has since admitted the attacks partly were plotted there.

Asked by the judge why he confessed now after consistently denying his role, Mr. Kasab said it was because the Pakistani government recently acknowledged he was a Pakistani citizen, dealing a blow to his defense.

India has been hesitant about restarting peace talks with Pakistan that were aborted in the aftermath of the attacks, which have been linked by officials in both countries to a Pakistani Islamic militant outfit, Lashkar-e-Taiba.

Indian Prime Minister Manmohan Singh has taken political heat in the past few days for a joint statement put out after he met Pakistan's prime minister on the sidelines of a recent meeting in Egypt. The statement said neither country should link peace talks to progress in fighting terrorism, although Mr. Singh was quick to say Pakistan had to bring the Mumbai plotters to justice before there could be any moves toward a settlement.

Pakistani government officials declined official comment on an ongoing legal case.

Mr. Kasab was charged in the special court in Mumbai with 12 crimes, including murder and waging war against India, and could face the death penalty if convicted.

He was captured during the 60-hour siege of India's financial capital that began Nov. 26. Police say he admitted during multiple interrogations he was one of 10 gunmen trained in Pakistan who traveled together by sea on the terrorist mission.

The assailants shot and killed people at Mumbai's top two five-star hotel complexes, the Chhatrapati Shivaji Terminus train station, a Jewish center, a hospital and a restaurant. Hemant Karkare, the head of the city's antiterrorism squad, and several senior police officials were among the more than 160 people killed and 300 injured before combat police were able to recapture Mumbai's landmark Taj Mahal Palace & Tower hotel.

—Zahid Hussain in Islamabad and Sonya Misquitta in Mumbai contributed to this article.

Indonesian investigators seek to identify bombers

BY TOM WRIGHT

JAKARTA—Police searching for the identities of two suicide bombers who attacked hotels in Jakarta last week are believed to be investigating a 35-year-old alleged terrorist known as Nur Sahid who attended one of Indonesia's best-known Islamic schools in the 1990s.

Police took DNA samples from the family of Mr. Sahid in a village in Central Java, a province on Indonesia's biggest island, state media reported. Police have been unable to identify the recovered bodies of the suicide bombers because of the extent of their injuries from the blasts. A senior national police spokesman declined to comment while the investigation was continuing.

The coordinated attacks ripped through Jakarta's JW Marriott and Ritz-Carlton hotels Friday morning, killing nine people, including the two bombers and injuring 53. Intelligence officials have said they believe Noordin Mohamed Top, one of Southeast Asia's most-wanted terrorism suspects, masterminded the bombings, though police haven't formally identified him by name.

Intelligence experts say Mr. Noordin was a superior to Mr. Sahid in Jemaah Islamiyah, a Southeast Asian affiliate of al Qaeda that carried out attacks against nightclubs, embassies and hotels in Indonesia from 2000 to 2005, killing almost 300 people.

Mr. Sahid graduated from the al Mukmin Islamic boarding school in a suburb of Solo in Central Java in 1995, said Sidney Jones, an adviser to the International Crisis Group, a Brussels-based peace-building advocacy body.

Many of the school's alumni went on to become members of Jemaah Islamiyah. Ms. Jones, an expert on Islamic terrorist groups in Southeast Asia, estimates that 15 members of the class of 1995 have carried out terrorist attacks, including a suicide car bombing at the JW Marriott in 2003 that killed 12 people. Mr. Sahid, she said, was in this class.

The latest attacks have rattled many Indonesians, who had grown accustomed to several years of stability after the run of terrorist attacks earlier in the decade. On Monday, Indonesia's trade minister said she thought the suicide bombings would have a limited impact on local markets, including the stock and currency markets, and that Indonesia's economic fundamentals remain strong, with growth of 4% to 4.5% expected this year.

Indonesian police say the latest bombings, which used homemade explosives and hit Western targets, show the hallmarks of Jemaah Islamiyah, whose suspected spiritual leaders have said they seek to create an Islamic caliphate in Southeast Asia.

Mr. Sahid is believed to have rented safehouses in Central Java for Mr. Noordin and his associates, Ms. Jones said.

Ms. Jones said she didn't think Abu Bakar Bassyir, a cleric who co-founded the al Mukmin school in 1972 and has been described as the spiritual leader of Jemaah Islamiyah, was involved in the latest attacks.

Mr. Bassyir was jailed for conspiracy after the 2002 Bali nightclub bombings. He was released in 2006 and Indonesia's Supreme Court later overturned his conviction.

After his release, Mr. Bassyir returned to the school and set up a new above-ground Islamic group to focus on religious education and the imposition of Shariah law in Indonesia, a secular nation.

—P.R. Venkat contributed to this article.

ECONOMY & POLITICS

German downturn eases

Finance Ministry, Bundesbank cite effects of stimulus

BY GEOFFREY T. SMITH AND ANDREA THOMAS

FRANKFURT—Germany's government and central bank said that the pace of the country's economic contraction slowed in the second quarter but that it was largely due to stimulus effects that could wane later this year.

Neither the finance ministry nor the Bundesbank gave precise figures in their respective reports Monday. The government statistics office is set to publish second-quarter gross-domestic-product data Aug. 13.

Germany's GDP shrank 2.2% in the fourth quarter of 2008 from the previous three months and then contracted a further 3.8% in the first quarter of this year.

The finance ministry concluded that "the second quarter of 2009 might have been better than previously expected," while the Bundesbank said that the trend of falling output "weakened significantly."

Government measures to support the car market in particular, and the labor market in general, have helped to support the German economy this year. A plan encouraging people to trade in older cars for cash helped the auto industry, which employs around one in seven German workers directly and indirectly.

Likewise, government subsidies to employers that put workers on short shifts rather than laying them off kept the jobless lines shorter than they would otherwise have been.

But a widening budget deficit is limiting government's ability to extend either support mechanism. The government will end the car-scrapping scheme by 2010. And economists almost unanimously expect further rises in unemployment even as earlier labor market subsidies are reduced.

"Falling tax revenues and extra spending for social-security systems have led new borrowing to shoot up to a level unimaginable one year ago," Deputy Finance Minister Jörg Asmussen said in the report.

The government's latest figures project a general budget deficit of 4% of gross domestic product this year, rising to 6.4% next year, partly because of the recession's effect on tax revenues.

U.S. leading indicators signal a recovery is near

BY GREG ROBB
MARKETWATCH.COM

WASHINGTON—The U.S. index of leading economic indicators rose 0.7% in June, the third straight monthly gain, the Conference Board said Monday, signaling a recovery is likely in the second half of the year.

Over the past six months, the index has improved at a 4.1% annual rate, up sharply from a negative 6.2% rate in the prior six months. This is the fastest pace since the first quarter of 2006.

The trend is consistent with a slow recovery this autumn, according to Ken Goldstein, an economist at the Conference Board.

"The unqualified jump in the index holds out hope that the upturn is not far away," said Joel Naroff, president of Naroff Economic Advisors.

The gain in the index was in line with estimates of Wall Street economists, according to a survey conducted by MarketWatch.

Seven of the 10 indicators increased in June. The positive contributors—beginning with the largest positive contributor—were interest-rate spread, building permits, stock prices, weekly initial claims, average weekly manufacturing hours, index of supplier deliveries, and manufacturers' new orders for consumer goods and materials.

The negative contributors were real money supply, manufacturers' new orders for nondefense capital goods, and index of consumer expectations.

Philippines says budget deficit widened in half

BY RHEA SANDIQUE-CARLOS

MANILA—The Philippine government said its budget deficit in the first half of the year widened dramatically to 153.4 billion pesos ($3.21 billion) due to weaker tax collection and higher spending to boost the economy, but was optimistic the shortfall for the full year wouldn't breach its ceiling.

The deficit from January to June was more than eight times the 18 billion peso shortfall in the year-earlier period, but lower than a 155.1 billion peso ceiling for the period, Finance Secretary Margarito Teves said.

"Given the fiscal performance in the first six months of the year, we are hopeful that we will remain on track with our deficit program of 250 billion pesos or 3.2% of gross domestic product this year," Mr. Teves said.

The government has adopted measures to boost collection efficiency and generate an additional 30 billion pesos in revenue, he said, while privatization is expected to contribute 30 billion pesos before year-end.

Revenue totaled 545.7 billion pesos, less than a targeted 581.4 billion pesos. Expenditure rose 19% to 699.1 billion pesos, falling short of an estimated 736.5 billion pesos.

Mr. Teves said tax collection was hurt by slower economic growth. Domestic economic growth slowed to 0.4% year-to-year in the first quarter, compared with growth of 3.9% in the year-earlier period.

Slower imports also meant reduced customs revenue. Spending was lower than expected because of reduced borrowing costs, he said. Mr. Teves said Congress must pass pending revenue-enhancing bills to "ensure sustainable resources for the government."

Budget Secretary Rolando Andaya said the deficit will likely narrow next year to around 2.5% to 2.8% of GDP through a combination of fiscal discipline and a recovery in the global economy.

Mr. Andaya said the targeted improvement in fiscal position next year is in line with the government's vision of a balanced budget by 2013.