**Leading the News:** With oil field deal in hand, BP's real work now starts in Iraq


# THE WALL STREET JOURNAL.

VOL. XXVII NO. 104 | EUROPE | THURSDAY, JULY 2, 2009

DOWJONES A News Corporation Company

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THE WALL STREET JOURNAL.


## What's News

**Ford Motor fared** better than its rivals as its June car sales fell 11%. Chrysler, GM and Toyota had declines of more than 30%, and U.S. sales appeared to miss the hoped-for annualized rate of 10 million. Page 3

■ **BA called for** a mediator to facilitate union talks as the Unite union criticized the carrier for failing to appear for negotiations. Page 4

■ **Declines in U.S.** manufacturing activity slowed in June, raising the likelihood the sector could see growth in the second half. Page 8

■ **Strong data on housing** and manufacturing helped send U.S. stocks higher. Miners contributed to advances by European shares. Page 18

■ **German Chancellor Merkel** is seeing fault lines open in her coalition over her pledge to reduce taxes. Page 9

■ **U.K. data showed** manufacturing gains, as revised figures indicated the EU is recovering at a slower pace. Page 9

■ **Roche will cut** the price of its Tamiflu antiviral drug by half for developing nations. Page 5

■ **A law took effect** in the EU that cuts mobile-telephone roaming prices by more than 60%. Page 4

■ **Albania's governing** Democratic Party claimed it won a weekend parliamentary vote, but election officials said it was too early to tell. Page 9

■ **Former Citigroup** Chairman Win Bischoff is included in a list of candidates to succeed Lloyds Banking Group's chairman. Page 17

■ **Japanese manufacturers** showed improved sentiment last month, but the outlook for capital spending remained weak. Page 23

■ **Japanese banks** Shinsei and Aozora agreed to a $5.9 billion merger and vowed to steer clear of risky international investments. Page 23

■ **The hard-line government** of Ahmadinejad is seeking to cast its reformist opponents as outlaws who are undermining Iran. Page 2

■ **Croatian Prime Minister** Ivo Sanader unexpectedly resigned, saying he had decided to withdraw from politics.

■ **SABMiller will place** a 10% stake in its South African business with black investors, in a $778.2 million deal. Page 5

### EDITORIAL&OPINION

**Mr. (EU) President**
Barroso's second term will be better if he sticks to liberalism. Page 11

Breaking news at europe.WSJ.com

# Bond-market finance takes hold

*European companies follow American counterparts' lead as banks curb lending in downturn*

By Stephen Fidler
And Neil Shah

LONDON—An unprecedented rise in European companies' use of bond markets, rather than banks, to raise money could cool off in coming months. But the shift toward bond-market finance across the continent may be here to stay.

European companies have historically relied on lending from banks, rather than tapping the bond markets as U.S. companies tend to. Yet despite the fact that European politicians have loudly blamed "Anglo-Saxon capitalism" for the global financial crisis, companies across the continent have this year raised billions of dollars, American style, from the bond markets.

As banks curb lending in an effort to strengthen their own finances, the bond markets have come to life like never before, providing companies with a crucial lifeline amid a sharp recession. So far this year, with no help from government guarantees, European nonfinancial companies outside the U.K. have raised some $318 billion from the bond markets, up 45% from the whole of 2008 and more than any entire year on record, according to data provider Dealogic Inc.

Although official data show bank lending flattening rather than tumbling through the first quarter, companies and bank regulators report that banks are starting to rebuild their balance sheets.

One drawback with bond-market financing is that the market isn't always open for business. In fact, in the short term, such a setback may be in the cards. "The market has gotten a little ahead of itself," says Stephen Dulake, a credit analyst at J.P. Morgan Chase. According to J.P. Morgan, 60% of European credit investors plan to reduce their exposure or hold steady, even as more than half expect to have more money to manage.

Nigel Sillis, director of fixed-income and currency research at Baring Asset Management, says he remains "enthusiastic" about corporate debt but has grown more wary of where the market is headed.

"We're certainly a lot keener on watching market developments," he says. Bond investors are questioning economic recovery, and worries about the financial strength of companies are beginning to revive. Also, some of the bond buyers in the recent rallies may have been speculating on market momentum rather than taking long-term views, suggesting a selloff is possible.

Nonetheless, many bankers say they expect the trend to continue in the long term. Banks are likely to shrink their balance sheets, a process that will curb lending over an extended period. Bank regulators are also determined for banks to hold more capital against their lending, thereby driving up the price of loans and increasing the attractiveness of bond finance. Until the financial crisis, some bank lending was also enabled by securitization as banks shifted their loans to investors in the form of securities, but bankers don't expect that to revive to anywhere near its pre-crisis heights.

One other reason for the shift to bonds was also responsible 30 years ago for driving U.S. companies into bond markets: Many banks now have a worse credit rating than their customers. "As a result, companies that can bypass the banks to access capital markets directly are doing so," Mervyn King, governor of the Bank of England, said last month.

Going forward, continental European companies "will have to become much more interested in the capital markets

*Please turn to page 31*

## U.K. seizes franchise that runs London-Edinburgh trains


Reuters

**NEW DRIVER:** Passengers walk past a National Express train at Waverley Station in Edinburgh, Scotland, on Wednesday. The government takeover of the unprofitable company highlights the problems facing the country's fragmented rail network. Page 4.

# U.S.-Russia summit gets a dose of reality

U.S. President Barack Obama, heading to Moscow for a summit with Russian leaders on Monday, is hoping that progress on a nuclear arms-control accord and a softened U.S. stance on missile defense and NATO expansion could reduce bilateral tensions over a host of issues.

*By Jonathan Weisman in Washington and Gregory L. White and Alan Cullison in Moscow*

But a series of recent Russian actions have lowered expectations for the summit, and decisions on the thorny subjects of Iran, Georgia and the U.S. plan to locate a missile-defense system in Eastern Europe are likely to be left for the future.

"We shouldn't have excessive hopes," said a senior Russian diplomat in Moscow. "Despite all this constructive atmosphere, the deeper you get into details, the more difficulties you find."

In the last few weeks, Russia has recognized the controversial re-election of Iranian President Mahmoud Ahmadinejad, forced peacekeepers out of Georgia, and suggested that Mr. Obama could realize his ambitious goals for nuclear-weapons reduction only if he pulls back on the U.S.'s missile-defense plans.

"The president made very clear he wanted to establish a different kind of relationship with Russia," said National Se-

*Please turn to page 31*

## Inside

### Cautious optimism

U.S. stocks surged in quarter, but many investors are wary

**Markets Review**, page 21

## Markets

4 p.m. ET

| | CLOSE | PCT CHG |
|---|---|---|
| DJIA | 8504.06 | +0.68 |
| Nasdaq | 1845.72 | +0.58 |
| DJ Stoxx 600 | 209.46 | +1.76 |
| FTSE 100 | 4340.71 | +2.15 |
| DAX | 4905.44 | +2.01 |
| CAC 40 | 3217.00 | +2.44 |
| Euro | $1.4130 | +0.73 |
| Nymex crude | $69.31 | -0.83 |

## LEADING THE NEWS

# Oil grouping faces hurdles in Iraq

*BP-led consortium will help define new partnerships*

By Gina Chon And Guy Chazan

BAGHDAD—Now that a **BP** PLC-led consortium has won the rights to rehabilitate one of the world's biggest oil fields in Iraq, the real work for the British giant and its Chinese partner is just beginning.

The project will be a test case for how Western oil companies will be received in Iraq.

The BP consortium, which includes **China National Petroleum** Co. as the minority partner, won a fee-based contract to boost production at Iraq's Rumaila oil field.

Other major oil concerns, such as **Exxon Mobil** Corp., **ConocoPhillips** and Italy's **Eni** SpA, walked away from the bidding round this week, saying the ministry's terms—in some cases payouts of as little as $2 per barrel of oil pumped—weren't acceptable.

Still, big oil companies, eager for new frontiers, will likely remain interested in Iraq, home to some of the world's largest reserves. India's **ONGC**; China's **CNOOC** and **China Petroleum & Chemical Corp.**, or Sinopec; **Korea Gas Corp.**, or Kogas; and Russia's OAO **Lukoil** and OAO **Gazprom**, all were involved in the failed bids on Tuesday.

Iraq's cabinet officially approved the BP-led offer on Wednesday. It rejected bids submitted for six other fields, saying the bidders' demands for per-barrel payouts were too high. An eighth contract—Mansuriya gas field—in the volatile Diyala region drew no bidders.

The oil ministry is considering its next step, including whether to include the remaining fields in a second bidding round later in the year.

The successful BP-CNPC bid has cemented Beijing as a big player in Iraq, following the Chinese company's $3 billion deal late last year to develop a field in southern Iraq. Despite the terms, industry analysts say the consortium can make a profit in the deal, though the returns will be far less than initially expected.

The prize for BP is a rare opening to pump crude in the Middle East, where most of the world's oil is concentrated and which is largely off-limits to major oil concerns. A BP spokesman declined to comment.

The project won't have a big impact on the value of BP's global portfolio, with the rates of return marginal and the upfront costs high, said Alex Munton, an Iraq specialist at oil consultancy Wood Mackenzie.

"But this is still a viable project economically," he said. "And where else in the world can you access an opportunity on this scale?"

BP's Rumaila deal faces other big uncertainties and challenges. Some Iraqi lawmakers are saying they have legal authority to vet the contract. The oil ministry maintains BP's contract needs approval only from Iraq's cabinet. Meanwhile, Iraq's parliament hasn't passed a petroleum law laying out the legal ground rules for foreign investment in the country's petroleum sector. This week's auction round was meant to spearhead development despite that stalled legislation.

Some executives have questioned whether contracts signed by the current government will be honored by the new government, due to take power after elections next year. And it is unclear how BP and CNPC will work with Iraq's formidable state-owned oil companies, which now control almost every facet of the oil-production process.

One of the prospective local partners—the **South Oil** Co., based in Basra in southern Iraq—already has signaled its reluctance to work with the bid winners. "There are a lot of unknowns about how things will run on the ground," said Nadia Salem, Iraq legal team leader for Dubai-based Al Tamimi & Company, which advised some of the companies participating in the bid round.

But Baghdad officials say Iraq—suffering from a cash crunch due to faltering oil production and lower global crude prices—has an interest in making BP's entry into Iraq smooth.

### Oil auctions

Schedule for bid round process by Iraqi oil ministry:

**Feb. 18, 2008:** Prequalification deadline for bid round

**April 14:** Announcement of 35 prequalified companies

**June 30:** Formal announcement of round

**October 13:** London roadshow

**End of October:** Data packages available

**April 1, 2009:** Deadline for comments from companies on contract

**June 1:** Deadline for payment of participation fees

**June 30:** Bidding and announcement of winner

**July 15:** Deadline for submission of proposed development approach by winning bidder

**August:** Contracts signed

# Iranian hard-liners condemn opposition as 'outlaws'

By Farnaz Fassihi

BEIRUT—As elements of Iran's government called for opposition leader Mir Hossien Mousavi to be investigated, Mr. Mousavi and former President Mohammad Khatami lashed back, with Mr. Mousavi saying the government's crackdown on demonstrators was "tantamount to a coup."

In a statement posted on his Web site, Mr. Khatami accused Iran's leadership of a "velvet coup against the people and democracy" and criticized what he called "a poisonous security situation" in the wake of violent street protests.

Mr. Mousavi and Mr. Khatami appeared to be responding to efforts of President Mahmoud Ahmadinejad's government to cast its reformist opponents as outlaws who are undermining the state.

Opposition leader Mir Hossein Mousavi has been accused by some hard-liners as fanning the flames of unrest and blamed responsible for blood spilled during clashes between protestors and security forces.

On Wednesday, a student wing of Basji—plainclothes militia responsible for crushing protesters with guns, batons and chains—asked Tehran's chief prosecutor to investigate Mr. Mousavi's role in "destabilizing national security." A conviction on the charge carries a maximum 10 years in prison and would bar Mr. Mousavi from running for office again.

Mr. Mousavi struck back defiantly, announcing he plans to form a political party with a group of like-minded intellectuals. He said the party would make public all the allegations of vote fraud and pursue their complaints legally through the judiciary.

"They keep asking me to forgive and forget. I will not compromise nor negotiate over the vote and the right of the public," Mr. Mousavi said in his statement, his ninth since election unrest began, posted on his personal Web site.

The post-election unrest over the disputed presidential vote has created the worst crisis in the Islamic republic's 30-year history. As security forces crushed the continuing street protests, the regime began pursuing the line that the turmoil was conceived by reformers and funded by Westerners—namely Americans and British. Purported confessions are surfacing in state-media from detained journalists and prominent reformers acknowledging their role in orchestrating a "velvet revolution" to topple the regime.

In waves of arrests, security forces quietly rounded up hundreds of reformers, journalists, human-rights lawyers, students and activists. Iran also arrested nine local national staff of the British Embassy over the weekend, creating a diplomatic uproar across the European Union. All but one has been released.

"Despite the enemies' both hidden and obvious plots to overthrow the system with velvet revolutions, they were defeated and did not achieve their objective," Mr. Ahmadinejad said when election results were certified early this week by the Guardian Council, a constitutional supervisory board.

EU diplomats are likely to discuss on Friday a British proposal to jointly recall their ambassadors from Tehran to protest Iran's arrest of British Embassy employees, EU diplomats said. Although it would be temporary, the proposal is controversial within the EU.

Some countries are concerned that cutting diplomatic ties with Iran would only serve to further isolate the regime at a time when the international community is trying to persuade Tehran to engage in talks over its nuclear program, according to an EU diplomat familiar with the discussions.

*—Marc Champion in Brussels contributed to this article.*

## CORRECTIONS & AMPLIFICATIONS

**Chad Mirkin**, winner of the 2009 Lemelson-MIT Prize, founded Nanosphere Inc., in which he owns a small stake, and closely held NanoInk Inc., where he is also a shareholder. A June 25 Marketplace article incorrectly said that Mr. Mirkin owned the 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.




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: Daniel Hertzberg M-17936-2003


## INDEX TO PEOPLE

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

# Toyota has a lock on hybrid cars

## *Rivals left to license the Prius patents or to get around them*

By John Murphy


Associated Press

Toyota has filed for more than 2,000 patents for its hybrid technologies. A shopper checks out the 2010 Prius in May.

The Obama administration's tough new fuel-efficiency standards could pose problems for some car makers, but **Toyota Motor** Corp. is hoping to benefit.

The Japanese company is betting the rules will give an advantage to its expanding lineup of hybrid vehicles, and it also aims to boost revenue by licensing to other car makers the patents that protect its fuel-saving technologies.

Since it started developing the gas-electric Prius more than a decade ago, Toyota has kept its attorneys just as busy as its engineers, meticulously filing for patents on more than 2,000 systems and components for its best-selling hybrid. Its third-generation Prius, which hit showrooms in May, alone accounts for about half of those patents.

Toyota's goal: to make it difficult for other auto makers to develop their own hybrids without seeking licensing from Toyota, as **Ford Motor** Co. already did to make its Escape hybrid and **Nissan Motor** Co. has for its Altima hybrid.

"Our system is the best technology for hybrids to get the best carbon-dioxide emissions and best fuel economy. [Rivals] will not be able to compete," said Gouichiro Kuriyama, a manager in Toyota's product planning division.

Whether Toyota's two-pronged strategy will pay off is unclear. While the Prius has won a strong following among environmental-minded consumers, it will face stiffer competition to win mass-market appeal.

Almost all car companies are working on more fuel-efficient gasoline engines that could boost miles-per-gallon ratings enough to damp interest in hybrids. Makers also have diesel vehicles coming to the U.S. that deliver nearly the same fuel economy as the Prius.

"Toyota's patent-filing strategy has made it far too risky to copy the Prius without Toyota's blessing," said Justin Blows, a patent attorney with Griffith Hack Patent and Trade Mark Attorneys in Australia.

In a recent study of intellectual property for hybrid vehicles, Mr. Blows found that Toyota has about 2,100 patents, nearly double that of its closest rival, **Honda Motor** Co.

Toyota, which isn't known as a particularly litigious company, declined to say how many attorneys it uses to file and defend its hybrid patents.

No lawsuits involving the patents have become public. Toyota also won't say how much revenue it has received from licensing its patents, if any. Patent cross-licensing may involve no exchange of money.

Instead of trying to catch up to Toyota in hybrid vehicles, Nissan has chosen to pour its resources into developing a mass-produced electric car starting in 2010.

Ford, meantime, said it developed its own hybrid technology but agreed to cross-license patents with Toyota to prevent any legal issues. No money changed hands, Ford said. Other car makers will likely need to cross-license technology to develop the fuel efficient vehicles they need before the government deadline.

*—Matthew Dolan contributed to this article.*

# Ford fares better than rivals as U.S. sales fall

By John Kell

The annualized rate of U.S. vehicle sales likely remained at less than 10 million in June, though there are signs of improved business at the retail level and continuing gains in other markets.

**Ford Motor** Co. beat expectations with an 11% year-on-year decline, according to data released Wednesday, while **General Motors** Corp., **Toyota Motor** Corp. and **Chrysler** LLC all lagged behind.

Executives noted a "softening" in sales at the end of the month, while Ford officials noted the emergence of regional variations in U.S. sales, with central regions outperforming relative weakness on both coasts.

The declines at GM and Chrysler, 34% and 42% respectively, were caused in part by tumbling fleet sales as the companies tightened their inventories and dealers reduced their stock of vehicles.

Fleet sales fell 49% and 95%, respectively.

Still, Chrysler said its retail market share rose by one percentage point from a year earlier to 9%, while GM said its retail sales increased month to month for the fourth consecutive month.

Ford's market share rose three percentage points from a year earlier, while Toyota's ongoing woes meant it was outsold by Ford in the U.S. for the third straight month and put the company behind Ford on a year-to-date basis.

The ongoing struggles in the U.S. contrast with key markets showing improvement, helped in part by scrappage programs at a more advanced stage than in the U.S. France logged a 7.1% increase in auto sales, while Italy was up 12% and the rate of decline in Japan abated. China has also remained a source of relative strength for most manufacturers.

Ford's U.S. light-vehicle sales totaled 154,873, with Ford, Lincoln and Mercury car sales down 11% and sport-utility vehicles falling 20%, less than previous months. Trucks and vans declined just 6.9%, helping Ford top GM in that segment.

June had 25 selling days, one more than a year ago.

GM's total was 176,571, with trucks slumping 40% and cars down 24%. At the end of June, GM's inventories were down 26% to about 582,000 vehicles and down about 33% compared with January.

Toyota's sales slid 32% to 131,654 as car sales slumped 36%. The Corolla saw a 53% plunge, while Camry sales dropped by 37%.

**Honda Motor** Co. reported a 30% drop to 100,420, with cars slumping 41% and trucks off 4.9%.

"We are seeing signs of strength in our light-truck segments with solid gains for Honda's Odyssey and Pilot models this month," said sales executive John Mendel.

Chrysler's 42% decline to 68,297 was led by a 48% drop for cars. Chrysler, which didn't produce any vehicles for fleet sales in June, reported it finished the month with 195,272 units in inventory, down 56% from a year ago and representing a 71-day supply.

**Nissan Motor** Co. posted a 23% decline in sales to 58,298.

*—Doug Cameron contributed to this article.*

# European car sales get a lift from incentive efforts

By A.H. Mooradian And Alice Dore

Car makers in Europe felt something of a reprieve in June, as incentives from governments and dealers stemmed or reversed sales declines.

New-car registrations in France rose to 235,407 in June from 219,754 a year earlier, according to data published Wednesday by the French Automobile Manufacturers Association. The association said the government's temporary cash incentives for car owners to scrap their old vehicles and buy new ones motivated car buying. But discounting by car makers and dealers also played a prominent role. Incentives accounted for 20% of French June new-car registrations, according to the association.

The rapid decline in Spanish car registrations during recent months also eased in June thanks to government aid, Spanish car manufacturers' association Anfac said Wednesday. Car registrations fell 16% from a year earlier in June after falling 39% in May and 46% in April, according to Anfac. The government subsidies boosted individuals' car registrations 15% in June from a month earlier, Anfac said. It was the first month in more than two and a half years where registrations by individuals increased compared with the previous month.

Italian car sales bounced higher in June, rising 12.4% compared with June 2008, as government payments to people who trade in old cars for newer, less-polluting ones kicked in, data showed Wednesday. Overall, Italian new car registrations in June increased 12.4% to 209,315 vehicles. That compares with an 8.6% annual decline posted in May.

Along with the car-sales incentives, "the improvement of the economy, or at least expectations of improvement, could have played a factor" in June's rebound, according to Italian auto analysts Centro Studio Promotor.

# GM sales show the significance of China's market

By Patricia Jiayi Ho

BEIJING—**General Motors** Corp. on Wednesday said its first-half sales in China rose 38% from a year earlier to a record 814,442 units, underlining the importance of the Chinese auto market to the U.S. car maker as it works to emerge from bankruptcy protection.

Sales of small autos helped GM's January-June period, and GM China Group President Kevin Wale said new models will boost second-half sales.

The market has benefited from Chinese-government stimulus policies and growing demand in rural areas, Mr. Wale said. In January, China halved the purchase tax on small cars to 5% and also introduced a subsidy program for rural residents who scrap old vehicles and buy new ones.

GM's China sales in June climbed 61.6% from a year earlier to 143,294 units, the company said, but the increase was a slowdown from May's sales jump of 75% to 156,000 units.

The company's sales rose 25% in March and 50% in April and have been outstripping China's overall auto sales.

First-half sales by GM's commercial-vehicle joint venture, SAIC-GM-Wuling Automobile Co., rose 49.9% from a year earlier to 524,598 units, GM said.

The joint venture sold 295,789 Wuling Sunshine minivans, more than all the models sold by GM's passenger-vehicle joint venture, Shanghai General Motors Corp. First-half sales by Shanghai GM totaled 288,843 units, an increase of 20.8% from a year earlier, the company said. Sales of the venture's best-selling Buick brand jumped 34% from a year earlier to 195,989 units.

GM owns 34% of SAIC-GM-Wuling Auto. The company is 50%-owned by **SAIC Motor** Corp. and 16% by **Wuling Automobile** Co. Shanghai GM is a 50-50 a joint venture with SAIC.

Sales for China's auto industry overall rose 5% in March, 25% in April and 34% in May, according to the China Association of Automobile Manufacturers. Data for June aren't available yet.

China's auto sales in the January-May period increased 14% from a year earlier to 4.96 million units

GM has said it aims to double its annual sales in China to two million units in five years. It sold 1,094,561 units in 2008, an increase of 6%.

**Personal Technology**

## Lost chords no more

*TuneUp Media clears up mysteries on your digital music player* > Page 27

# National Express rail franchise seized

*U.K. takes over London-to-Edinburgh route after operator says it is unable to shoulder further financial losses*

By Steve McGrath

LONDON—The U.K. government said it seized the unprofitable franchise running passenger trains between London and Edinburgh because rail and bus operator **National Express Group** PLC wouldn't support it financially, once again highlighting the problems facing Britain's fragmented rail network.

The seizure came the same day that the company's chief executive said he would step down to take a job in the Middle East. The company said the departure was unrelated to the government seizure.

The U.K. Department for Transport, which will take over operation of the East Coast line between London and Edinburgh, said it may also have grounds to take control of National Express's franchises to operate trains in eastern England—including the express-train service from London to Stansted airport.

National Express said that all its businesses are being hit by the recession, but indicated it aims to hold on to its two other rail franchises, which are profitable—the East Anglia franchise, which includes the route to Stansted, and the smaller c2c commuter-route franchise.

The government seizure of the East Coast franchise makes National Express more vulnerable to a takeover, analysts said.

The company—which also runs bus services in the U.K., school buses in the U.S. and Canada, and bus and coach operations in Spain—said Monday that it had turned down a preliminary takeover approach from bigger rival **FirstGroup** PLC, which runs four U.K. rail franchises. FirstGroup also has a substantial U.S. business operating school buses and Greyhound buses, having acquired transport provider Laidlaw International in 2007.

National Express said it rejected the FirstGroup approach because it was focused on "a number of initiatives" to strengthen the company.

FirstGroup said Monday that it continued to believe that there is "significant industrial and commercial logic" to a tie-up. FirstGroup declined to comment on Wednesday.

Shore Capital analyst Greg Johnson said the government seizure made a new approach from FirstGroup likely, adding that he thinks the handing over of the East Coast franchise will be considered a default and would likely affect National Express's ability to hold on to its other rail franchises.

The U.K.'s railway network has attracted many critics since it was privatized between 1994 and 1997, under the last Conservative government. The process was complicated, with one company running the tracks, others controlling the trains, still others the communications network and several operators running the services. The industry has struggled since privatization to meet the huge amount of investment necessary to bring tracks and trains up to modern standards, even with sharp increases in ticket prices over recent years.

Train operators are awarded fixed-term franchises to run services. They enjoyed healthy profits during the recent boom years, but as the recession has hit, those profits have fallen as passenger numbers have declined. The East Coast franchise, a high-speed rail link between London and the east of Scotland, has been particularly hard hit, with a significant number of travelers trading down from premium fares.

Former operator GNER was forced to hand the East Coast franchise back to the government in 2007 after the London bombings resulted in decreased travel on the line and power prices rose. Operators of other rail lines have in the past been stripped of their franchises for failing to meet performance targets.

National Express was criticized when it won the East Coast tender just before the credit crunch struck. Critics said it had put forward a business case that was based on overly optimistic projections for growth in passenger numbers and revenue.

Passengers walk past a National Express East Coast line train in Edinburgh, Scotland. The recession has deepened losses on the London to Edinburgh route.

"The government is not prepared to renegotiate rail franchises because I'm simply not prepared to bail out companies that are unable to meet their commitments," said U.K. Transport Secretary Andrew Adonis.

Lord Adonis said the government would create a publicly owned company to take over the East Coast franchise and would tender for a new private operator from the end of 2010. It wasn't immediately clear when the public company would take control of the franchise, but National Express said it would honor its commitments until that time.

Virgin Rail Group, which is owned by Richard Branson's **Virgin Group** Ltd. and travel operator **Stagecoach Group** PLC, said it would be interested in taking over the franchise. Virgin Rail already runs the West Coast franchise, the high-speed rail link between London and the west of Scotland that has been dogged by technical problems in recent months after the tracks were upgraded by Network Rail to allow faster train speeds.

Lord Adonis also warned National Express that it would struggle to win any more rail franchises.

"A company which had defaulted in the way National Express now intends would not have prequalifed for any previous franchises" from the Department of Transport, Lord Adonis said. "It is simply unacceptable to reap the benefits of contracts when times are good, only to walk away from them when times become more challenging."

National Express Chief Operating Officer Ray O'Toole said the company had sought legal advice and had been told it shouldn't lose its other rail franchises as a result of giving up the East Coast franchise. The company also rejected the government's claims that it had defaulted on the terms of its contract.

The company said it would book a £20 million ($32.9 million) loss on the franchise in the first half of the year, but its financial liability related to the franchise is limited to £72 million because it had set up a special purpose vehicle, NXEC, to run the franchise.

NXEC, a separate legal entity, will likely later this year use up the all the financial support that National Express contracted to provide it, National Express said. Therefore, control over the franchise would automatically pass back to the government.

The loss to the government and taxpayers is potentially much bigger. NXEC had promised to pay the government about £1.4 billion over the life of the franchise, which runs until 2015.

*—Kaveri Niththyananthan contributed to this article.*

# BA is criticized by union for failing to appear for talks

By Kaveri Niththyananthan

LONDON—Britain's Unite union criticized **British Airways** PLC for failing to appear for negotiations, saying the union could strike if the carrier tries to impose permanent wage freezes and changes to work practices.

BA on Wednesday called for a mediator to facilitate union talks, saying it wasn't able to reach an agreement on concessions by the airline's Tuesday deadline.

Steve Turner, Unite's national secretary for aviation, said the airline failed to appear for a meeting the union called for Wednesday. He said he didn't approve of using state-funded ACAS as a mediator.

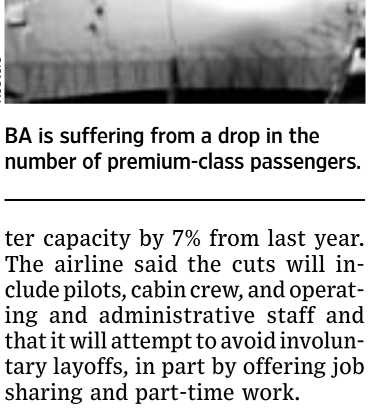
British Airways' earnings are in deep decline because of the rapid rise in oil prices last year and a steep drop this year in the number of premium-class passengers. In response, the airline has asked unions to accept permanent freezes in pay and changes to work practices.

Mr. Turner said the union had offered proposals for temporary changes that would save millions of pounds, but that BA is less willing to come to a mutually acceptable agreement.

The Unite union, which represents 27,000 of BA's 40,000 employees, has balked at permanent concessions. About 7,000 BA employees have volunteered to take unpaid leave, some unpaid work and to switch to part-time.

A BA spokesman said the airline is willing to resume mediated talks with the Unite and GMB unions.

Separately, **Virgin Atlantic Airways** Ltd. said it plans to cut as many as 600 jobs as it reduces winter capacity by 7% from last year. The airline said the cuts will include pilots, cabin crew, and operating and administrative staff and that it will attempt to avoid involuntary layoffs, in part by offering job sharing and part-time work.




BA is suffering from a drop in the number of premium-class passengers.

# Limits on texting charges crimp EU mobile operators

By Elizabeth Bewley And Peppi Kiviniemi

BRUSSELS—A European Union law cutting mobile-telephone roaming prices or text messages and Internet use by more than 60% took effect Wednesday.

The law, approved by the European Parliament in April, slices the cost of sending text messages abroad from 28 European cents to 11 cents. The law also caps the wholesale price of downloading media on mobile devices at €1 ($1.40) per downloaded megabyte from the current average price of €1.68 a megabyte.

Companies will likely follow the new rules to keep their prices competitive, but it is too soon to tell if mobile companies have complied with the new regulations, a spokeswoman for the commission's telecommunications department said.

Several European mobile companies said that they were already in compliance with the new price caps. **Vodafone Group** PLC, Dutch **KPN** NV and **France Télécom** SA all said they had lowered their roaming tariffs in accordance with the new law. However the commission continues to be concerned about the lack of cross-border traffic in Europe's mobile market and will "analyze the roaming market again in 2010," said Martin Selmayr, a spokesman for the telecommunications department.

European mobile operators are struggling with declining revenues as increased regulation in already mature markets is limiting the money they make per call. The commission has also asked operators to end what it deems excessive charges for passing on competitors' calls on their own networks.

# Roche to ease drug access

## *Maker of Tamiflu will lower the price for poorer nations*

By Julia Mengewein


Bloomberg News

Roche will allow specified developing countries to spread payments over years for Tamiflu anitviral capsules. About 70 countries can participate in the program.

ZURICH—Drug maker **Roche Holding** AG on Wednesday said it will cut the price of its Tamiflu antiviral drug for developing economies by half and allow them to spread payments over several years.

Under the program, Roche will produce and store Tamiflu pandemic stockpiles for specified developing countries, charging between €5 and €6 ($7 to $8.40) for a pack of 10 Tamiflu capsules at the highest dose of 75 milligram, said company spokeswoman Martina Rupp. The usual price for the drug, which is used to treat the A/H1N1 swine-flu virus, is about €12 a pack. Lower doses are provided at a lower price.

The actual price will depend on the storage and delivery services provided by Roche, Ms. Rupp said, adding that the company will finance the program alone. "This will significantly cut into our profits in those countries," she said.

Some 70 countries, which are members of the Global Alliance for Vaccines and Immunization, can take part in the program. India, where a generic version of Tamiflu is available, is excluded from the program, Ms. Rupp said.

Roche won't lower the price of Tamiflu any further under the program, Ms. Rupp said. But the company is in talks with the World Health Organization, the United Nations, and other agencies to see if they are willing to step in for countries that can't afford the drug at the cheaper prices, she added.

In 2008, Roche's pharmaceutical division generated total sales of 35.96 billion Swiss francs ($33.09 billion). The Latin American and Asia-Pacific regions had shares of 6% and 5%, respectively.

The countries can exercise their option to purchase the product at any time, and Roche said it is confident it has the capacity to provide what's needed.

"In the May-to-September period, we increased our capacity to produce 110 million packs of Tamiflu per year, and next year, this will go up to 400 million," Ms. Rupp said.

Over the last five years, governments around the world have stockpiled Tamiflu or Relenza, a similar drug made by U.K.-based GlaxoSmithKline PLC, to prepare for a potential pandemic outbreak. However, only 0.02% of all low-income economies have a stockpile of Tamiflu, Roche said.

Last month, WHO declared the first flu pandemic in 41 years, even as it stressed there are no signs the H1N1 virus has turned more lethal as it has spread across the globe.

# SABMiller to offer stake in unit to black investors

By Robb M. Stewart And Kathy Sandler

JOHANNESBURG—**SABMiller** PLC said it plans to place a 10% interest in its South African business with black investors in a six billion rand ($778.2 million) deal that would comply with a government-led push to reverse the economic disparity caused by apartheid.

The London-based brewer said the transaction will target about 60,000 new shareholders among its employees, beer and soft-drink retailers and local communities.

By offering shares to people in its distribution network, SABMiller may help defend its dominant share of the South African market and encourage legalization of informal bars.

South Africa's government mandates that all companies operating in the country sell equity stakes to black people, as well as change procurement and hiring practices to bring black people into the still largely white-controlled economy. Early black-empowerment projects were criticized for benefiting only a handful of investors, while other deals have fared poorly in recent months as the value of stock used to finance programs has fallen and required additional funding.

Unlike some of those earlier black-empowerment deals, which are struggling as the recession has eroded companies' value, SABMiller's deal won't rely on external bank funding. The company said it expects to pay the new shareholders a dividend in the first year of the deal's 10-year term.

"The deal will be affordable and easily accessible," Chief Financial Officer Malcom Wyman said in a conference call with reporters.

SABMiller said the transaction will cost it about $220 million over the 10-year term of the deal, based on a complicated formula under which the new shareholders will ultimately swap shares in unit South African Breweries Ltd. for shares in the parent company.

The deal should be viewed positively, said Trevor Stirling, an analyst at Sanford Bernstein in London, adding that the transaction will allow the company to comply with South African legislation at a cost to shareholders of less than 1% of market capitalization.

SABMiller, the world's second-largest brewer after **Anheuser-Busch InBev** NV, was founded in 1895 with the launch of Castle Lager, which remains popular in South Africa.

SABMiller executive Norman Adami said the transaction will leave the company's South African unit with a shareholding of about 16% among black investors in the country, including shares already held by pension funds and institutions.

About 40% of the new shares would be issued to employees, 40% to retailers, including taverns and the informal bars known as shebeens. The remainder will go to beneficiaries of a new trust to be set up on behalf of historically disadvantaged communities.

Retailers would be able to participate with a "relatively small" cash payment that would be based on a sliding scale, the company said.

It said shareholders would be asked to approve the transaction, and it expects to distribute shares during the first half of the year.

# No need to halt Lantus, FDA says

By Jared A. Favole

WASHINGTON—Patients should continue taking **Sanofi-Aventis** SA's diabetes drug, Lantus, despite recent studies showing the drug may be linked to cancer risks, the U.S. Food and Drug Administration said Wednesday.

The FDA said it is reviewing the safety of Lantus, an artificial form of insulin that had sales of $3.45 billion in 2008, and is in talks with Sanofi about whether any more studies need to be done to determine the drug's safety.

Studies published Friday in Diabetologia, the journal of the European Association for the Study of Diabetes, showed a possible link between Lantus and cancer. The FDA criticized the studies in an early communication warning posted Wednesday on its Web site.

The agency said the duration of follow-up for patients in the studies was shorter than what is generally considered necessary to evaluate cancer risk from drug exposure.

"Further, inconsistencies in findings within and across individual studies raise concerns as to whether an association between the use of insulin glargine and cancer truly exists," the FDA said, using the scientific name for Lantus.

This is the FDA's first comment on the recent concerns about Lantus, which have helped drive Sanofi's share price down more than 10% over the past week.

A spokesman for Paris-based Sanofi said the company is committed to working with the FDA, other authorities and scientific experts to clarify the situation surrounding its diabetes drug Lantus. "Sanofi-Aventis has just seen the early communication from the FDA about the safety of Lantus," the spokesman said, adding that the company is continuing to stand behind the safety of the drug.

# Novartis vaccine gets scrutinized

By Julia Mengewein

ZURICH—In a setback for **Novartis** AG, the U.S. Food and Drug Administration asked the Swiss drug maker for more information about its meningitis-vaccine candidate, Menveo, with respect to patients between ages 11 and 55.

"The FDA has requested additional information mainly on the manufacturing of the drug, but it didn't ask about data on the safety or efficacy of Menveo," Novartis spokesman Eric Althoff said.

Novartis now expects the drug to be approved late in 2009 or early in 2010, he said. Novartis had expected to get approval for the drug this year.

"While the financial impact is small, the setback is nevertheless a disappointment," said Vontobel analyst Andrew Weiss

Menveo has shown, in extensive clinical trials, that it can protect against the four most common subgroups of meningitis. It is seen as an important driver of Novartis's future sales, with analysts estimating a peak annual sales potential of about $650 million.

New trials won't be necessary and Novartis expects to "fully respond" to the FDA's questions by the end of 2009, the company said. Earlier this year, Novartis said approval for Menveo as a treatment for younger children will also be delayed in the U.S., because the FDA asked to test the drug on 1,500 more children.

# Warnings sought by U.S. on drugs to halt smoking

U.S. regulators want strong warnings added to two smoking-cessation drugs, **Pfizer** Inc.'s Chantix and **GlaxoSmithKline**'s Zyban, amid concerns the drugs can cause aggressive behavior and suicidal thoughts.

Pfizer's Chantix has been dogged by concerns that the medicine is linked to suicidal behavior, mood swings, and most recently to a skin allergy. Chantix brought in $489 million in U.S. sales in 2008, down 30% from $701 million in 2007.

The FDA said it wants "black box" warnings, the agency's strongest, added to the labels of Zyban and Chantix to alert people about the mental-health risks associated with the products.

Pfizer said it is working with the FDA to update the label, which will also include warnings about allergic and serious skin reactions.

Glaxo couldn't immediately be reached for comment.

# Valentino's lenders seek changes to avoid default

By Sabrina Cohen

ROME—Valentino Fashion Group's lenders are seeking to renegotiate the Italian luxury group's debt by the end of the summer amid falling sales across the luxury goods industry, according to people familiar with the matter.

**UniCredit** SpA, **Mediobanca** SpA and **Citigroup** Inc. are pressing Valentino Fashion Group and its owner, the U.K.-based private-equity fund **Permira**, to agree to new lending terms that will allow the Italian fashion company to avoid defaulting on debt payments in 2009.

Permira's takeover of Valentino Fashion Group in 2007 left the fashion firm saddled with debt. At the time, Permira bet that Valentino, which had benefited from years of strong growth in the luxury industry, could quickly pay down the debt load.

A global downturn in spending on luxury goods, however, has severely weakened Valentino Fashion Group's sales, leaving the Italian company in a financial bind. Today, Valentino Fashion Group owes about €2.5 billion ($3.51 billion) in debt that is currently spread across seven loans payable to banks, the people familiar with the matter said.

Spokesmen for Valentino Fashion Group and Citigroup declined to comment on the matter.

For years, the Italian firm counted on German fashion house Hugo Boss, which is controlled by Valentino Fashion Group, to generate a steady cash flow, offsetting lackluster sales at the group's namesake Valentino brand. Hugo Boss, which makes up about 75% of Valentino Fashion Group's sales, posted a 27% decline in net profit in 2008.

Valentino Fashion Group joins a growing number fashion companies struggling to make their debt payments on time. IT Holding SpA, owner of the Gianfranco Ferre label, is currently under bankruptcy protection. The owners of Prada SpA, designer Miuccia Prada and her husband and Prada CEO Patrizio Bertelli, are also in talks with banks to renegotiate debt at the fashion house's holding company.

In March, Permira's largest investor, **SVG Capital** PLC wrote down its investment in Valentino by £92.2 million ($151.7 million) to £78.6 million. Permira wrote down its investment in the fashion house by about 50% at the end of 2008, according to a person familiar with the matter.

Analysts said a further write-down is likely. Permira's €2.67 billion buyout of Valentino in 2007, was the biggest-ever luxury goods buyout by a private-equity company and occurred just before the credit crisis erupted in the summer of that year.

*—Sofia Celeste and Marietta Cauchi contributed to this article.*

## CORPORATE NEWS

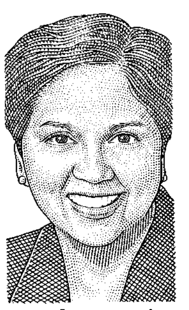
# Pepsi CEO tours China to sample market

### *Nooyi considers new business model and more investment*

BY GORDON FAIRCLOUGH AND VALERIE BAUERLEIN

SHANGHAI—**PepsiCo** Inc. Chairman and CEO Indra Nooyi ducked into a doorway on a small side street here, dodging hanging laundry and skirting parked bicycles. Cramming into a small apartment that houses four generations of a Chinese family, she and a handful of fellow executives peppered them with questions about China's rapid economic development, their shopping habits and how they feel about Western brands.

The visit, one sweltering morning last week, was part of a 10-day "immersion" tour of China for Ms. Nooyi, who is seeking to strengthen the Purchase, N.Y., company's business in emerging markets.



*Indra Nooyi*

"I wanted to look at how people live, how they eat, what the growth possibilities are," she said in an interview in Beijing.

What she has seen has persuaded her that PepsiCo's approach to the Chinese market "is good, but not good enough. The opportunities are so much bigger." The company's "model for China has to be vastly different."

China is a critical market for PepsiCo, its second-largest beverage market after the U.S. and one of its fastest-growing snack food markets. As the recession has damped sales in the U.S., it is relying increasingly for growth on big emerging markets such as China and India. Pepsi said last November that it would invest $1 billion in China over four years to build new factories, expand research and development of products tailored to local palates and bolster the company's sales and distribution network. Ms. Nooyi said she now thinks an even greater investment may be needed.

Ms. Nooyi made the trip here because she believes her senior management team needs more in-depth knowledge of a market that could one day be the company's biggest. PepsiCo knows other big emerging markets well: a native of India, Ms. Nooyi is an expert on consumers there. Mike White, chief of PepsiCo's international operations, is a Russia expert. To prepare for the visit—lengthier than most visits CEOs make to their markets—Ms. Nooyi spent several hours a week over the past six months studying Chinese history, geography and culture, sometimes in consultation with former ambassador Henry Kissinger, a PepsiCo consultant.

Pepsi is also out to make inroads against rival **Coca-Cola** Co., which was rebuffed by Chinese regulators in March from acquiring a large Chinese juice company, China Huiyuan Juice Group Ltd, for $2.4 billion. The two companies have bitterly fought over the past few years to dominate cola sales. Coke, which used its sponsorship of the Beijing Olympics to promote its namesake brand to Chinese consumers, has an edge over Pepsi, with a 47.3% share of the cola market in China, against Pepsi's 44.5%, according to market research firm Euromonitor International. But Pepsi disputes those percentages, saying data collected by other researchers show its cola dominates. Overall, Coke has a 15.3% share of the Chinese beverage market, while Pepsi has 6.2%, according to Euromonitor.

Figuring out how to effectively reach China's diverging generations is a central challenge, Ms. Nooyi found. Many older Chinese grew up without packaged goods, while teens and young adults crave Western brands and fast food.

"How we talk to them is a code we have to crack," she acknowledged.

Last Tuesday, Ms. Nooyi visited the home of a 32-year-old man, his wife, child, parents-in-law and his wife's grandmother. The man, who works for a British trading company, said he and his wife shop for groceries at Carrefour and department stores, where they buy packaged goods. He eats in fast-food restaurants every day. But his mother-in-law shops for meat, eggs and vegetables at a traditional wet market. His retired father-in-law, who is 60 years old, said: "Young people like to eat out. I prefer to eat in the house."

But Ms. Nooyi saw opportunities for Pepsi too: the whole family likes to munch on potato chips while watching television.

Ms. Nooyi challenged her China team to come up with ideas for products that cater to China's large older population. She also called for more in-depth research into women who, in China, are likely juggling work and motherhood and making the key day-to-day consumption decisions for households. She says she is calling on her executives to think "differently and disruptively," encouraging them to look beyond the company's traditional businesses in China.



# Marks & Spencer posts 1.4% drop in store sales

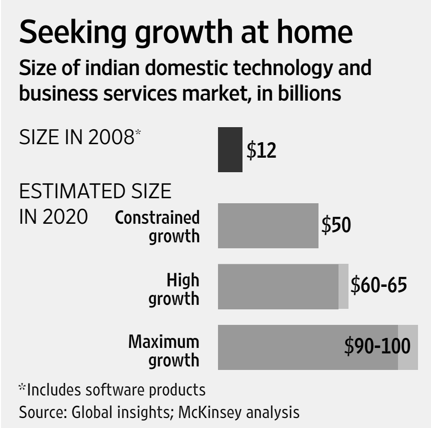
**Marks & Spencer Group** PLC reported a smaller-than-expected decline in U.K. sales for its fiscal first quarter, thanks to warmer weather, price reductions and a focus on less-expensive product offerings.

Still, the U.K.'s biggest department-store operator by sales and stores remains cautious. In a statement Wednesday, Chief Executive and Chairman Stuart Rose said the company is "cautious about the outlook for the remainder of this and next year and will continue to run the business accordingly."

M&S, a bellwether for the country's consumer sentiment, said sales from U.K. stores open at least a year fell 1.4% in the quarter ended June 27 from a year earlier. That was an improvement compared with the 4.2% drop in the fourth quarter of fiscal 2009, and better than market expectations for a 2.5% decline.

The retailer's U.K. food business posted a 0.5% decline in same-store sales, beating market expectations for a 2.1% fall. The food division, however, still isn't performing as well as the supermarket sector as a whole.

## CORPORATE NEWS




Operators in Coimbatore take customer calls. The ▶ call center company can handle 15 Indian languages, a challenge in a country of many tongues.

# In India, a domestic call

### *In shift, outsourcers' phone centers tap their home market*

By Niraj Sheth

HUBLI, India—With the U.S. in recession, India's call centers have opened a new outsourcing frontier: India.

The shift is a sign of how India's flagship export industry is shifting from providing services to the developed world to catering to its own, quickly growing market. The Indian economy grew 6.7% for the fiscal year ended March 31.

While outsourcing revenue from within India is still a tiny fraction of the global market—$12 billion in 2008 out of $500 billion spent world-wide—it is expected to hit $95 billion by 2020, or nearly 15% of the expected global market, according to a recent McKinsey & Co. report. The overall global market for business process outsourcing will reach $640 billion in the same time, the report says.

Indian outsourcers capture contracts from U.S. clients largely by touting India's low wages and big cost savings. But at home, providing those lower costs means setting up offices in rural areas, where wages and property costs are lower than in its bigger cities.

"We cannot deliver and make money in the same way we make money for an international market," says Ananda Mukerji, chief executive of **Firstsource Solutions** Ltd., a Mumbai-based outsourcer.

In April 2007, his company opened a call center in Hubli, a city of 800,000 people 370 kilometers northwest of Bangalore, India's outsourcing capital. Hubli is best known for its cotton and peanut farms.

But it is also a place where wages and rents are half of those in major cities such as Mumbai. A call center worker who gets roughly $500 a month in Mumbai would earn $250 to $300 a month in Hubli.

Firstsource now has 450 workers in Hubli, where it is the largest private employer. It is one of the company's 15 outsourcing centers for the domestic market. During the past two years Firstsource has seen the India share of its annual revenue, which stood at $370 million in the year ended March 31, jump to 13% from 1%.

Small towns such as Hubli have fewer computer programmers needed for high-tech outsourcing, so the call centers tend to handle customer queries and complaints, processing bills paid over the phone or reminding delinquent customers they need to pay.

Outsourcing as a common business practice has only recently taken hold in India. "We have always believed in focusing on our core expertise," says a spokesman for **Tata Teleservices** Ltd., one of the country's largest telecommunications companies. "Outsourcing of functions like telecalling and billing helps us focus on our core business."

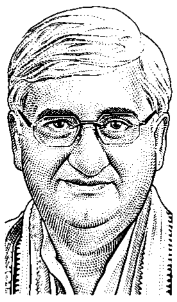
Sandeep Aggarwal, vice president for sales at Mumbai-based call-center operator **Intelenet Global Services**, says even Indian companies in conservative industries such as banking are turning to outsourcing. Since 2007, Intelenet has hired 23% more people at call centers for Indian clients, bringing the headcount to 18,500.

# India to boost corporate oversight

By Jackie Range

NEW DELHI—The Indian government before the end of the year aims to introduce a law designed to improve company disclosure, tighten accounting standards and clarify the role of independent directors, the nation's new corporate affairs minister said.

In an interview, Salman Khurshid said the measures should help guard against corporate frauds like that perpetrated at Hyderabad-based Satyam Computer Services Ltd. "If it had been passed before Satyam, much of the anguish of Satyam could have been avoided," Mr. Khurshid said.



*Salman Khurshid*

Corporate governance in India has been under a cloud ever since Satyam's chairman in January admitted to a huge fraud, including faking a bank balance of more than $1 billion. After his revelations, the government stepped in, replacing the board with high-profile Indian businessmen who arranged the sale of the company to Tech Mahindra Ltd., owned by Mumbai-based conglomerate **Mahindra Group** with British telecommunications company **BT Group** PLC owning a 31% stake. Satyam has since been renamed Mahindra Satyam.

Since the fraud, there have been many calls for improved standards of corporate governance here. In a survey this year, consultants **Bain** & Co. of Boston found that some Indian companies were below international best practices. "The loose standards in governance that led to Satyam's downfall could also trip up other leading Indian companies," Bain said.

Key measures in the government's proposed legislation, which was put forward in October 2008 but hadn't progressed very far, include improving companies' disclosure of information, more rigorous accounting standards ahead of Indian accounting rules converging with international rules in 2011, and tighter requirements and more clarity on what's needed from independent directors.

One thorny issue is the role of independent directors. Since the Satyam fraud, a large number of independent directors at Indian companies have resigned. According to Directors Database, a division of primary capital-market-data provider Prime Database, 442 independent directors resigned between Jan. 11 and June 26 this year; in the same period last year 298 had resigned.

Mr. Khurshid, 56 years old, said the Indian government is worried about the director exodus. He said the new legislation will make it clear what independent directors' responsibilities are. The government will also protect independent directors by making a clear distinction between civil and criminal infractions, he said. In the past the edges between the two had been blurred, he added, with people either getting away without punishment or becoming embroiled in criminal cases.

Indian investors have been calling for improvements to the audit regime. Mr. Khurshid said his ministry was waiting for a report on Satyam from the governing body that regulates accountants. After that he expects some recommendations.

The Ministry of Corporate Affairs is responsible for regulating companies and promoting corporate governance. Before becoming minister of state for minority and corporate affairs following the reelection of the United Progressive Alliance government in May, Mr. Khurshid had already served as a minister and deputy minister. He also is a lawyer qualified to practice before India's Supreme Court.

## GLOBAL BUSINESS BRIEFS

### Sodexo SA

#### Sodexo sales rose, affirms profit target

Catering and services company **Sodexo** SA said Wednesday revenue for its fiscal third quarter rose 11% and confirmed its full-year targets, as acquisitions and its contracts in the healthcare and education sectors helped offset slowing business in North America and Western Europe. Revenue rose to €3.77 billion ($5.29 billion) for the three months ended May 31 from €3.4 billion a year earlier. Sodexo continues to suffer as companies reduce headcount, halt discretionary spending and shut down factories, said Chief Operating Officer Sian Herbert-Jones. Sodexo, which in April bought the India-based Radhakrishna Hospitality Services Group, expects revenue growth excluding future acqusitions of between 2% and 5% for the year, and targets operating profit of between €730 million and €760 million.

### Deutsche Lufthansa AG

The European Commission said Wednesday that it will start an in-depth anti-trust probe into **Deutsche Lufthansa** AG's planned takeover of Austrian flag carrier **Austrian Airlines** AG. The commission deepened the probe amid worries that, unchecked, the merger could lead to higher fares and reduced choice to consumers on certain routes. The commission said that in the "absence of appropriate remedies," it had "serious doubts" whether the deal could be allowed. The commission now has up to 90 days to decide whether to allow or block the deal. "Lufthansa remains confident to receive the necessary approvals with justifiable remedies," Lufthansa said.

### International Power PLC

**International Power** PLC said it agreed to sell its Czech business in a deal valued at 17.7 billion korun ($957 million) as it restructures its portfolio. Shares in International Power were up 4.6%, one of the biggest risers on the FTSE 100. The sale will likely help alleviate market concerns over the company's need to refinance more than £700 million ($1.15 billion) in debt, due next year. The U.K.-based company, which operates power plants world-wide, said it was selling the unit to Czech-Slovak investment firm **J&T Group**. As part of the deal, the buyer will also take on 4.8 billion korun in debt from International Power. "The attractive sale price, combined with the limited scope to materially expand our business in the Czech Republic, means that this transaction represents excellent value," said International Power's chief executive, Philip Cox.

### Diageo PLC

**Diageo** PLC said it is shutting down a nearly 200-year-old distillery and packaging plant, resulting in the loss of 900 jobs, to cut costs at its Scottish operations. The U.K.-based drinks company, whose brands include Guinness and Johnnie Walker, said the restructuring will trim costs by about £40 million ($65.8 million) from 2012. Diageo said the job cuts will be partly offset by the creation of about 400 new jobs through the expansion of another Scottish packing plant. The £120 million restructuring plan comes on top of a £200 million program announced in February, which the company expects will cut costs by £100 million in the financial year ending in June 2010.

### Anheuser-Busch InBev NV

**Anheuser-Busch InBev** NV said Wednesday it will sell three beverage-can manufacturing plants and a metal-lid plant to **Ball** Corp. for $577 million in cash. Ball, of Colorado, will continue supplying metal cans to the Belgium-based brewer under a long-term supply contract as part of the deal, Anheuser said. The plants—located in Wisconsin, Ohio, Georgia and Florida— represent 40% of the capacity of the brewer's can-making subsidiary. The plants being sold mainly make containers for soft drinks and thus aren't part of Anheuser's core beer business. The brewer said it has no plans to sell Metal Container's seven remaining plants. The deal is likely to close at the end of the year or the beginning of 2010, Anheuser said.

### ING Groep NV

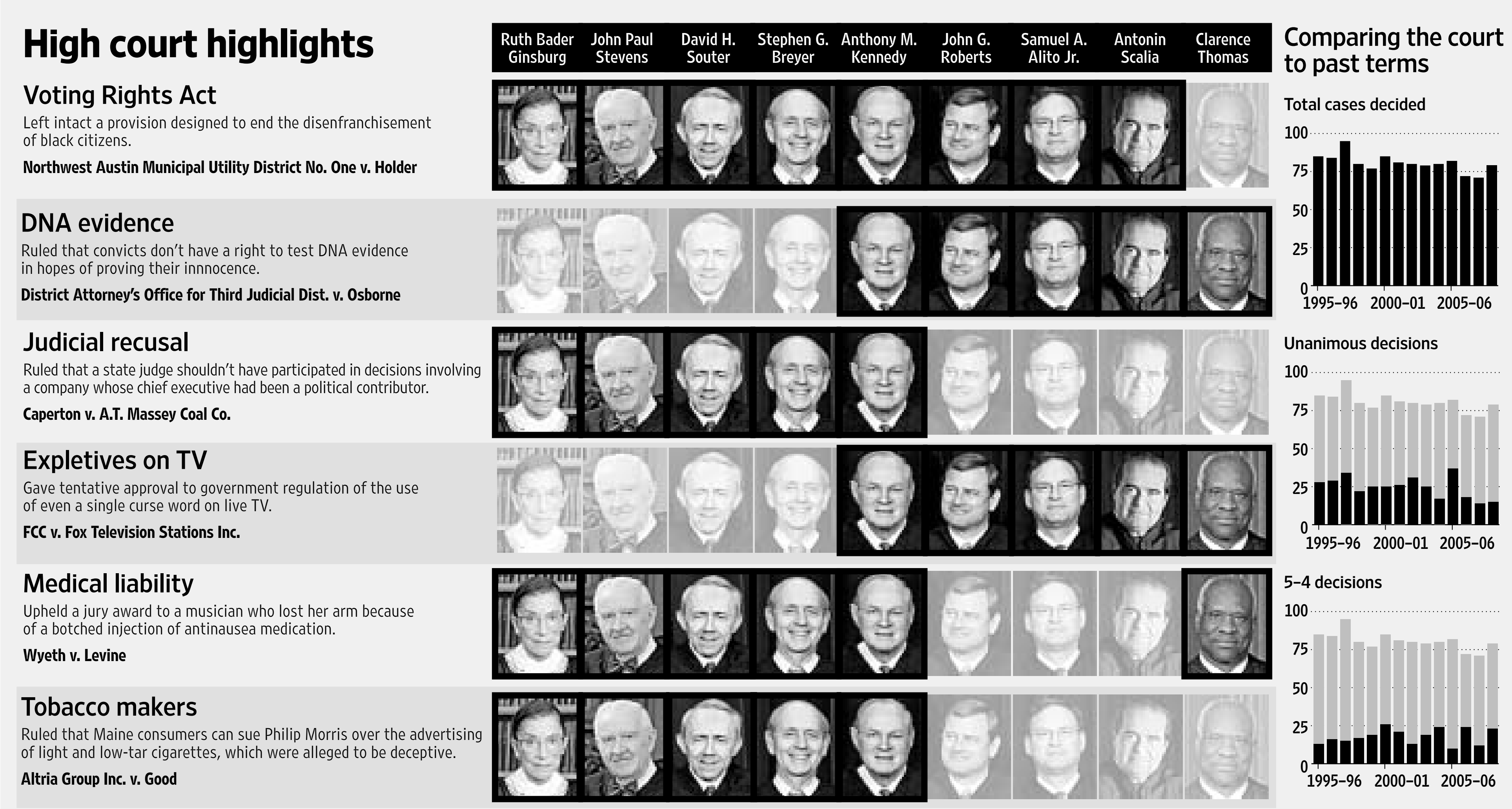
Dutch financial-services company **ING Groep** NV said Wednesday it will cut 10% of the work force at its insurance business in the Netherlands over the next three years as part of a growth and cost-savings plan that involves merging its three Dutch insurance brands. ING said 800 jobs will be cut under the plan, which should have a positive impact from 2010 and lead to annual cost savings of €100 million ($140.3 million) before tax from 2013. The existing Nationale Nederlanden, RVS and ING insurance brands will be combined into one organization under the Nationale Nederlanden brand at a cost of €165 million over the next four years. In May ING posted a first-quarter net loss of €793 million.

### Cemex SAB

Struggling to emerge from under a mountain of corporate debt, Mexico's giant building products conglomerate **Cemex** SAB has begun meeting with banks in New York and Madrid this week to renegotiate some $14.5 billion in bank debt, out of a total of $18 billion the multinational must pay through 2011. Among the 14 creditor banks that Cemex is discussing an extended payment plan are New York-based **Citigroup** Inc., **Banco Bilbao Vizcaya Argentaria** SA and **Banco Santander** SA of Spain and the U.K.'s Royal Bank of Scotland. The world's third-largest cement producer by volume, Cemex acquired smaller cement makers on six continents throughout the past two decades, but miscalculated in 2007 by adding billions to its debt just as construction activity world-wide slowed drastically. With sales of cement dropping, the company is looking at $4.1 billion in debt coming due this year, and $10.4 billion over the next two years.

*—Compiled from staff and wire service reports.*

# ECONOMY & POLITICS




Photos: Associated Press; U.S. Supreme Court

Source: ScotusBlog (historical statistics)

# Election spending on top court's agenda

## *U.S. justices to consider broader questions believed settled by a decision upholding campaign-finance limits*

By Jess Bravin

WASHINGTON—The most important case of the U.S. Supreme Court's just-ended term may be a test of restrictions on corporate and union campaign spending that the justices decided not to decide—at least not yet.

The case, Citizens United v. Federal Elections Commission, was expected to focus on narrow issues under the McCain-Feingold campaign-finance law—in particular, whether a law drafted with broadcast advertisements in mind also applied to video-on-demand services.

But the justices signaled they could be ready to address broader questions believed settled by a 2003 decision upholding McCain-Feingold, which, among other things, limits political spending by corporations and unions. The bill takes its name from its primary co-sponsors, Sens. John McCain (R., Ariz.) and Russell Feingold (D., Wis.).

The court's conservative majority has chipped away at McCain-Feingold in recent years. Now, the court has asked for a fresh round of arguments on Sept. 9, in an unusual summer session, on the question of whether it is constitutional to limit corporate political spending.

"The court is reaching out to decide the foundational question about the rights of corporations in political campaigns," said Nathaniel Persily, a professor at Columbia Law School. "It's the last step in several incremental moves the Roberts Court has made to strike down the pillars of campaign-finance law."

Since the court largely upheld McCain-Feingold in 2003, Justice Sandra Day O'Connor, who voted with the majority in that opinion, has retired and been replaced by Justice Samuel Alito, who has voted to limit certain aspects of McCain-Feingold in prior cases.

The McCain-Feingold restrictions haven't dried up corporate political spending, but have channeled it into indirect activities, such as sponsoring parties at political conventions.

The court remains divided into four-justice camps of reliable liberals and solid conservatives, with Justice Anthony Kennedy usually holding the deciding vote.

Justice Kennedy's moderating influence may have led the court to take a narrow view of a case challenging an aspect of the Voting Rights Act of 1965. The plaintiffs in the case built an argument for striking down the act's Section 5, which gives the federal government oversight of state and local government election procedures in much of the South and some other areas of the country where minorities once faced barriers to voting.

By an 8-1 vote, the court upheld the broader provision authorizing such supervision, but made it easier for local governments to escape federal oversight if they could show clean records on racial bias.

On Monday, in a 5-4 decision, the court ruled that the city of New Haven, Conn., violated the rights of white firefighters by junking test results because no blacks scored high enough to guarantee promotion. But the court left intact the concept of "disparate impact" on minorities giving rise to a civil-rights complaint, rather than ruling it unconstitutional. Justice Kennedy wrote the majority opinion.

In two cases that scrambled the ideological lines, the court disappointed business by limiting federal pre-emption, or the displacement of state authority by a federal statute.

In March, the court found that pharmaceutical manufacturers aren't shielded from liability for defective products simply because their medicines are regulated by the Food and Drug Administration. Conservative Justice Clarence Thomas joined Justice Kennedy and the four liberals in the 6-3 vote.

On Monday, the court ruled 5-4 that the federal Office of the Comptroller of the Currency went too far when it blocked state authorities from suing to enforce valid state consumer protection laws against national banks. Conservative Justice Antonin Scalia wrote the majority opinion, joined by the four liberals.

The decision with the broadest implications may be the most unlikely: Ashcroft v. Iqbal, in which former immigration detainee Javaid Iqbal alleged he was abused at the behest of senior officials including former Attorney General John Ashcroft. The central issue was whether the allegations in Mr. Iqbal's suit were plausible enough for the case to proceed.

In a 5-4 ruling, Justice Kennedy, joined by the four other conservatives, wrote that the tougher requirements for getting into court applied broadly, meaning that plaintiffs have to make a "plausible" claim based on more specific allegations.

"It's going to be the most cited Supreme Court case in a decade," says Tom Goldstein, an attorney at Akin Gump Strauss Hauer & Feld LLP and founder of Scotusblog, a Web site focused on the Supreme Court. "Fifty percent of the motions filed to dismiss will cite Iqbal."

Reaction divided along predictable lines.

"It raises the pleading standard in a way that turns the clock back 60 years," says the ACLU's Mr. Shapiro.

Richard Samp of the conservative Washington Legal Foundation welcomed the change. "The court is sort of fed up with excesses in the tort system and is looking for ways to try to eliminate frivolous lawsuits," he said.

# U.S. manufacturing activity contracting at a slower pace

By Kelly Evans

Declines in U.S. manufacturing activity slowed last month, raising the likelihood that the sector—and perhaps the U.S. economy—could see some growth in the second half of this year. But separate reports showed the labor market remains weak, a key obstacle to recovery.

Rising production and a shallower drop in employment helped push the Institute for Supply Management's index of manufacturing activity to 44.8 in June from 42.8 in May. It was the sixth straight monthly increase, though activity still remains below the 50 level that signals overall growth in the sector.

The sector is a small part of overall employment and gross domestic product, but it serves as a barometer of the nation's business climate.

Separately, a June employment report from payroll company Automatic Data Processing Inc. showed that the U.S. shed 473,000 private-sector jobs last month—the smallest decline since October, but a higher number than expected and a sign that the government's official estimate, which is released Thursday, could dash hopes for notable improvement in labor-market conditions.

Meanwhile, the housing market continues to show signs of recovery. Pending home sales, an index of contracts signed that is typically released about a month before reported sales, rose slightly in May, the National Association of Realtors said. The index gained 0.1 point to a seasonally adjusted 90.7, its highest level since September. Pending sales rose in the Northeast and West, and dipped in the Midwest and South. An index level of 100 represents contract activity in 2001, the first year the data were collected.

Also Wednesday, the Commerce Department said U.S. spending on construction declined in May, falling 0.9% to $964 billion at a seasonally adjusted annual rate. The drop was led by a 3.5% decline in residential construction spending to $247.4 billion. While residential spending levels are down a third from a year ago, the declines are shallower than in the first quarter.

# U.K. and EU notch gains

## *Manufacturing data suggest slower pace for euro-zone recovery*

By Ilona Billington And Nicholas Winning

LONDON—The U.K. received a shot of promising economic data Wednesday, while revised figures for the euro zone suggest the continent's recovery may be proceeding at a slower pace.

The purchasing managers' index for the U.K. manufacturing sector rose to 47 in June from 45.4 in May, Markit Economics and the Chartered Institute of Purchasing and Supply reported. The move lifted the indicator to a 13-month high and closer to 50—the level that indicates business activity has ceased contracting. Readings above 50 indicate economic expansion.

"Add in the likelihood of increases in both the construction and service sector PMIs on Thursday and Friday, and it looks as though we could see positive [gross domestic product] in the third quarter of this year," said James Knightley, U.K. economist at ING.

Nevertheless, some analysts noted that the U.K. economy recorded its sharpest decline in more than 50 years in the first quarter and still faces a lingering credit crunch, rising unemployment and a depressed housing market.

**Turning a corner**

The U.K. Purchasing Managers' Index for the manufacturing sector


Source: Markit

In the euro zone, the revised figures for the manufacturing PMI showed recovery proceeding at a slower pace, rising to a reading of 42.6 in June from 40.7 in May, but still far from the 50 threshold.

"Pressures to cut employment also clearly remain intense across the region, as firms struggle in the face of falling demand," said Chris Williamson, chief economist at Markit.

Jean-Claude Trichet, president of the European Central Bank, said last month the ECB doesn't expect the euro zone to return to growth until the middle of 2010. The region's largest economies show different paces of recovery, with Germany and Italy recording sharp downturns in manufacturing while France inched closer to stabilization.

Data released Wednesday by Germany's statistics office showed retail sales in Europe's biggest economy edged up for the third consecutive month in May, but only slightly, with rising unemployment damping the scope for further improvement. Retail sales rose a real 0.4% in May from April, but were down 2.9% from a year ago.

German retail industry group HDE Wednesday said it is cutting its forecast for nominal retail sales this year to a 2% drop, after predicting earlier that sales would stay flat or decline 1%. Weak demand in Germany's machinery sector also foretells more dreary months. Orders for German machinery and plant equipment fell 47% in the three-month period through May from the same period a year ago, the sector's industry lobby, known by its German acronym VDMA, said Wednesday.

VDMA said the data indicate that total output in the important, export-driving industrial sector will be 20% lower in 2009 than last year.

*—Nina Koeppen and Roman Kessler in Frankfurt contributed to this article.*

# Merkel's tax cut splits coalition

By Andrea Thomas

BERLIN—Fault lines in Chancellor Angela Merkel's coalition government are opening over her pledge to cut taxes following the September general elections, but the dispute between her and her own economic advisers hasn't hurt her standing in the polls.

A fresh Forsa Institute poll published jointly Wednesday by Stern Magazine and RTL TV, showed the conservative parties that Ms. Merkel heads—the Christian Democratic Union and its Bavarian sister party, the Christian Social Union—are increasing their lead. They got 36% of the vote while her coalition partner, the center-left Social Democrats, got only 21%, down from the 34.3% they held when they first formed a government with Ms. Merkel in 2005.

The poll suggest Ms. Merkel could jettison the Social Democrats and form a 51% majority with the pro-business Free Democratic Party, which also is proposing to cut taxes.

The Social Democrats are leading a charge to debunk Ms. Merkel's tax pledge, claiming that tax cuts are unrealistic and unfundable in a recession and instead proposing a new tax on higher incomes.

On Tuesday, Peter Struck, parliamentary floor leader of the Social Democrats, accused the conservative parties and Free Democrats of deceiving voters.

"Those who are today promising tax cuts to people are deceiving them against better knowledge," he told his party's parliamentarians on Tuesday. A party spokesman confirmed his remarks Wednesday. Ms. Merkel's finance minister, Peer Steinbrück has said no government can cut taxes in the current environment.

The big DGB trade union is also coming out against the proposed tax cuts. "I think this is impossible and I believe that the people know this and they actually believe they will have to pay the bill eventually," said the union's chairman, Michael Sommer.

One of the Merkel government's top economic advisers said last week that tax hikes are inevitable after the election to close fiscal gaps.

"Since it is unlikely that there will be enough room to cut subsidies, it will probably have to come to tax increases," said Wolfgang Franz, head of the ZEW research institute and chairman of the government's economic advisory panel.

In its medium-term budget plans for the years running through to 2013, the government foresees a massive expansion in new debt to balance its books. It says the next government will have to cut spending or raise taxes by an additional €4.9 billion ($6.87 billion) in 2011, €11.1 billion in 2012 and €18.5 billion in 2013 to keep up with Germany's new debt rule that requires the government to gradually reduce borrowing.

Ms. Merkel hasn't divulged which taxes would be cut, how they would be financed or exactly when they would implemented. Wednesday's poll showed only 5% believe she can pull off tax cuts in a recession.

# Albanian election result in dispute

Associated Press

TIRANA, Albania—The governing Democratic Party claimed on Wednesday that it won weekend parliamentary elections, but the opposition Socialists disputed that, and election officials said it was too early to tell.

Near-complete results showed Prime Minister Sali Berisha's Democrats were ahead by just over one percentage point, but it was unclear whether Mr. Berisha had secured enough seats in parliament to govern alone.

Democratic Party spokeswoman Majlinda Bregu said Mr. Berisha won 71 of the house's 140 seats and could govern without forming a coalition.

However, election commission spokesman Leonard Olli declined to confirm the Democrats' claim they had secured 71 seats. "We have not brought out the final results," he said.

Unofficial calculations show the Democrats to have won 70 of Parliament's 140 seats—one short of the 71 they need to govern without forming a coalition.

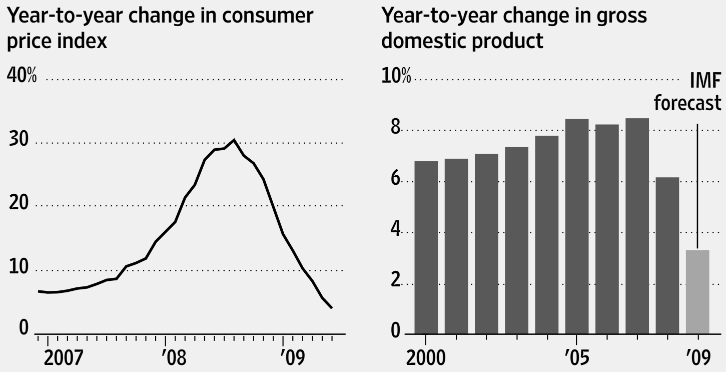
Ensuring a fair and peaceful ballot Sunday was seen as a crucial test for Albania's ambitions to join the European Union, and international monitors said that despite some violations, the voting was calm.

The two main parties ran on similar platforms, pledging to lift Albania out of poverty and secure EU membership.

Albania became a member of the North Atlantic Treaty Organization member on April 1 and is seeking to join the 27-nation EU. But election monitors from the Organization for Security and Cooperation in Europe said that while there were improvements and fewer irregularities, violations persisted.

An OSCE statement Monday said that observers "noted procedural violations," including widespread "family voting," in which one person casts ballots for all the members of a family.

**Vietnam key indicators**




Source: Thomson Reuters Datastream (CPI), General Statistics Office of Vietnam (GDP)

# Vietnam's lending push raises fears of a bubble

By James Hookway And Patrick Barta

HANOI—Vietnam boasts one of the developing world's most resilient economies this year, but economists fear the success masks serious problems, as loose state-directed lending risks pushing Vietnam into a new speculative bubble.

Those concerns were highlighted Tuesday, when Fitch Ratings downgraded Vietnam's local currency rating, citing "a steady deterioration in the country's fiscal position" and a banking system that's "vulnerable to potential systemic stress" as the government floods the economy with credit.

Similar worries affect the U.S. and China, which are under pressure to prepare to pull in the reins of government stimulus. But the fears are especially pronounced in Vietnam, one of the most-closely watched emerging economies and an increasingly important magnet for foreign direct investment. Much of its economy is dominated by state enterprises that have a history of making ill-advised investments outside their core businesses, which have contributed to past speculative behavior and bouts of overheating.

Since the onset of the global economic crisis, state banks have poured at least $19 billion in loans into the economy, equivalent to about one-fifth of the country's annual gross domestic product, according to the government. The money is a key plank of a stimulus program in which the state provides interest-rate subsidies to banks so they can make more loans to help state enterprises and exporters.

The measures appear to be paying off in the short term, with the International Monetary Fund forecasting growth of 3.3% this year, while neighbors such as Thailand and Malaysia face steep contractions.

On Wednesday, the government said GDP expanded 3.9% in the first half of the year compared with a year earlier, with growth accelerating to 4.5% in the second quarter from 3.1% during the first quarter. Vietnam's economy expanded 6.2% in 2008 and 8.5% in 2007.

Stock market prices are sharply higher, with Vietnam's benchmark index up 86% since the beginning of March. Residential property prices are climbing in many parts of Hanoi, the capital, and Ho Chi Minh City, the center of commerce and home to the stock exchange, economists say.

Providing lots of credit is "a good strategy. Our stimulus measures force banks to lend productively," says Le Xuan Nghia, vice chairman of the National Financial Supervisory Commission, one of the country's main financial regulators.

But with so much money being funneled into the economy, many people on the street fear a return of inflation, which accelerated to 28% in mid-2008 before easing to 5.6% in May.

Many Vietnamese are responding by investing whatever cash they can scrape together as fears about inflation revive. Nguyen Thi Huyen, a broker for the Van Khe New Urban City project, a development in the Hanoi suburbs, says she is putting together 10 or more deals a month, up from just two or three this time last year. Some units have changed hands five times or more and prices have risen six-fold since the project was launched at the peak of Vietnam's boom in 2007, she says. Buyers are "worrying about inflation and want to invest their money somewhere safe," Ms. Huyen says.

Some economists in Vietnam fear the country's politicians are so enmeshed in their growth-oriented five-year economic plans that they won't be willing to turn off the stimulus tap until inflation has already reared its head again. In April, the government extended by two years a lending-stimulus program that pays four percentage points of interest on any loans by Vietnamese banks to the business sector, encouraging banks to lend more aggressively.

"They are trying to turn back the clock to 2006 and 2007, when the name of the game was exporting as much as possible to profligate Americans. But Americans might not resume spending again in the same way," says an economist with close knowledge of government thinking.

While the "government's been successful at stabilizing the economy" in recent months, officials "need to consider the longer-term risks, such as excess liquidity in the banking system and its potential to spark inflation," says Tran Le Khanh, chief investment officer at Prudential PLC's Vietnam fund business.

The World Bank cautioned in a report last month that Vietnam might want to focus on helping people who have lost their jobs in the downturn. "It might be good to pause and reflect whether sustaining economic activity should remain the single priority," the World Bank said.

Other analysts worry the lending spree could escalate bad debt problems. Vietnam says nonperforming loans stand at 2.6%, up from 2.2% at the end of last year. But Vietnam doesn't calculate bad-debt rates according to international standards. Fitch Ratings recently estimated the correct figure may have been as high as 13% of total loans at the end of 2008. In its ratings downgrade Tuesday, it said the country's loan-subsidy program "is almost certain to make matters worse."

## ECONOMY & POLITICS

Reuters

Supporters of Honduras's interim president, Roberto Micheletti, rallied Tuesday in Tegucigalpa. They aim to keep the ousted president from returning to power.

# OAS weighs suspension of Honduras due to coup

### *U.S. is supporting diplomatic solution for ousted president*

BY NICHOLAS CASEY
AND JAY SOLOMON

TEGUCIGALPA, Honduras—Tension between Honduras and the international community rose on Wednesday as the Organization of American States threatened to suspend the country if it didn't reinstate President Manuel Zelaya, who was ousted in a coup Sunday.

Honduras's provisional government, however, remained defiant.

U.S. officials are hopeful for a diplomatic solution. Washington has played a key role so far in isolating the interim Honduran government. Two senior U.S. officials met late on Tuesday with Mr. Zelaya, a leftist and frequent critic of U.S. policies, and assured him that Washington was committed to seeing him back in power, according to an American official briefed on the diplomacy.

As a gesture of his willingness to negotiate, Mr. Zelaya put off plans to return to Honduras on Thursday—a trip that was shaping up as a showdown—until the weekend, to let diplomacy work.

He also pledged he wouldn't seek re-election when his term ends in January. Honduras's military launched the coup amid concerns that Mr. Zelaya was seeking to amend the Honduran constitution to extend his rule indefinitely.

The provisional government of this tiny Central American nation said there was "no chance" of Mr. Zelaya being able to serve out the remaining months of his term. Even members of Mr. Zelaya's Liberal Party said they were willing to burn bridges with the OAS.

"We're willing to take any consequences from the OAS," said Martha Lorena Alvarado, a congresswoman who is attempting to become the new government's vice minister of foreign affairs.

In a statement Wednesday, the OAS reiterated that it condemns "vehemently the coup d'état staged against the constitutionally established Government of Honduras," denounced Mr. Zelaya's expulsion and called the current government "an unconstitutional alteration of the democratic order."

The OAS, an organization that includes the 35 independent states in the Western hemisphere, said that if Mr. Zelaya wasn't returned to power within three days, it would "invoke Article 21 of the Inter-American Democratic Charter to suspend Honduras' membership."

The organization said it would press for sanctions against Honduras through the World Bank, International Monetary Fund and Inter-American Development Bank.

In a key next step, OAS Secretary General José Miguel Insulza is seeking to meet in a third country with a delegation of Honduras's coup leaders to demand Mr. Zelaya's reinstatement, according to a U.S. official.

The U.S. official said the Obama administration would welcome a scenario whereby Mr. Zelaya returned to power but didn't take part in a future election. This would restore Honduras's political process, said the official, while damping political polarization.

**The provisional government has accused Mr. Zelaya of drug ties.**

"That scenario would fit the bill," the U.S. official said. It remains to be seen if Honduras's provisional government would accept that. Almost everyone in Honduras's political establishment insists that Mr. Zelaya's ouster wasn't a coup and was done legally after the president violated the Constitution in trying to seek re-election. They say his ouster protects democracy rather than undermines it.

Honduran lawyer Octavio Sanchez, a former culture minister and presidential adviser, said that article 239 of Honduras's Constitution calls for a president to be stripped of power immediately for any attempted reform of certain Constitutional articles, including one barring re-election.

"I am extremely proud of my compatriots," Mr. Sanchez wrote in an email to The Wall Street Journal. "Finally, we have decided to stand up and become a country of laws."

Adding to the hurdles for a diplomatic solution, the provisional government has since accused Mr. Zelaya of drug ties, claiming he allowed tons of cocaine to be flown into Honduras on its way to the U.S. The U.S. Drug Enforcement Administration has said it has no comment on the allegations.

*—Paul Kiernan and David Luhnow contributed to this article.*