THE WALL STREET JOURNAL.

VOL. XXVII NO. 124 | EUROPE | THURSDAY, JULY 30, 2009

DOW JONES
A News Corporation Company

europe.WSJ.com

THE WALL STREET JOURNAL.

What's News

Sanofi is close to announcing a deal to buy Merck's half of a joint venture that makes drugs for animals. News of the potential deal came as Sanofi reported a 4.9% rise in second-quarter profit. Page 6

■ **Microsoft and Yahoo** formed a 10-year Internet-search pact, uniting against rival Google. Page 5

■ **BHP moved forward** in its effort to change the way iron ore is priced, settling for a 33% drop in prices with some customers. Page 5

■ **Steelmaker ArcelorMittal** reported a quarterly loss but said a recovery is strengthening outside of the U.S. and Western Europe. Page 5

■ **U.S. stocks fell** on worry that economic conditions will restrain commodity demand and hurt profits of oil firms. Europe shares rose. Page 20

■ **Crude prices slid** 5.8% to $63.35 a barrel on Nymex after a surprising rise in U.S. oil inventories. Page 22

■ **German consumer prices** fell in annual terms for the first time in years in July, amid collapsing energy prices and the recession. Page 2

■ **The pace of decline** in U.S. economic activity has "begun to stabilize," a Fed report said. A key gauge of business investment spending rose. Page 4

■ **Support slipped** for Obama's health plan, especially among the insured, and his approval rating fell to 53% in a new poll. Page 4

■ **Daimler reported** a $1.45 billion loss in the second quarter, hurt by weak demand for luxury vehicles. Page 7

■ **The FDIC is poised** to start splitting failed banks into good and bad pieces, an effort to lure buyers. Page 19

■ **Santander posted** a 4% drop in second-quarter profit, as resilient results in Europe largely offset declines in Latin America. Pages 19, 20

■ **Police blamed ETA** for a car bomb that destroyed a police barracks in northern Spain, injuring 60 people.

■ **The EU filed** a trade complaint against the Philippines over taxes the nation charges on distilled-spirits imports.

■ **A Sudan journalist** facing 40 lashes for wearing pants in public said she is resigning from a U.N. job so she can challenge the dress-code law.

EDITORIAL&OPINION

Israel vs. Iran
Time is running out for an attack on the nuclear installations. Page 14

Breaking news at europe.WSJ.com

Europe's banks still lending shy

ECB says borrowers could face tougher credit standards this quarter; dilemma for governments

*By **Margot Patrick** and **Laurence Norman** in London, and **Nina Koeppen** in Frankfurt*

European banks continued to lend only reluctantly at the midyear point, flying in the face of central-bank policies and state aid designed to spur lending and reverse the economic downturn.

Banks in the 16-country euro zone further tightened their credit standards in the second quarter, the European Central Bank said in a report released Wednesday, and companies and households could face still-tougher requirements this quarter.

In the U.K., which is outside the euro zone, the Bank of England said Wednesday that consumer lending hit a low in June, underlining the challenge the government faces in ensuring banks meet their lending promises.

For more than a year, central banks and governments have provided banks with liquidity and, in some cases, recapitalization to get credit flowing again to revive economic activity. But fragile balance sheets and worries of rising consumer defaults have caused many banks to hold back.

Analysts say that forcing banks to offer more and cheaper loans could backfire, potentially delaying their recovery and depressing share prices if the proportion of bad loans keeps rising.

Deflation returns
■ German consumer prices fell for the first time since 1987 .2

That puts the U.K. government in a particular dilemma because of its hefty stakes in two of the country's biggest banks: **Lloyds Banking Group** PLC and **Royal Bank of Scotland Group** PLC. It needs lending to increase to help the U.K. recover in time for an election due by mid-2010, but it also has taxpayer money at risk if bad loans pile up.

"The government needs to balance out its needs. It wants to make sure the banks

Please turn to page 31

BMW will park its Formula One racing team

By Marcus Walker

Reuters

Flames shooting from the car of BMW Sauber Formula One driver Robert Kubica in Bahrain in April. BMW is pulling out of the sport.

BMW AG said it will leave Formula One motor racing at the end of the 2009 season, another sign of auto makers' growing difficulty in justifying the sport's high costs at a time when global auto sales are slumping.

Reversal of fortune
■ Daimler swung to a loss in the second quarter 7

Although a marginal sport in the U.S., Formula One has established itself as the pinnacle of international motor racing and attracts huge television audiences in Europe, the Middle East and Asia. That has made it a big business, with sponsorship and television deals totaling billions of dollars.

But the loss of a team with BMW's cachet could raise doubts about other major car makers' commitment to the

Please turn to page 31

Judge sets status call in UBS vs. U.S. case

A WSJ News Roundup

A Miami judge said he would reassess the progress of talks between **UBS** AG and the U.S. Internal Revenue Service ahead of a major court hearing tied to possible tax evasion by U.S. citizens on Monday.

Judge Alan Gold offered to postpone the court hearing by a week, a UBS spokesman said. Neither side took up the offer.

The next status call between the two parties and Judge Gold on Friday coincides with the meeting in Washington between the Swiss and U.S. foreign ministers, highlighting how the case has snowballed into a diplomatic matter of high importance for Switzerland.

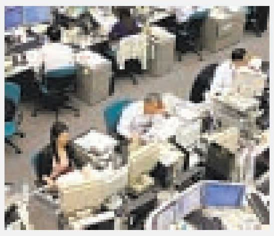
If a settlement isn't formalized before Friday, there are two possible outcomes. One is that the two sides agree they are near a settlement, in which case another postponement is likely. The other outcome is that negotiations break off without a settlement, which means the court will begin hearing the case Monday.

UBS and the Swiss government have claimed in court filings and public statements that UBS can't provide access to 52,000 accounts held by U.S. citizens at UBS because that act would violate Swiss law. The Swiss government has even gone as far as to say it would seize UBS data to protect its country's privacy laws.

A spokesman for Switzer-

Please turn to page 31

Inside



Culture clash

Brokerage Nomura stumbles in its new global push
News in Depth, pages 16-17

Markets

4 p.m. ET

	CLOSE	PCT CHG
DJIA	9070.72	-0.29
Nasdaq	1967.76	-0.39
DJ Stoxx 600	220.37	+0.84
FTSE 100	4547.53	+0.41
DAX	5270.32	+1.85
CAC 40	3365.62	+1.04
Euro	$1.4063	-0.81
Nymex crude	$63.35	-5.77

LEADING THE NEWS

Political shift in Moldova

Opposition trounces ruling Communists, exit-poll data show

BY MARC CHAMPION


Reuters

An elderly Moldovan woman leaves a booth Wednesday after filling in her ballot at a polling station in Dorotchaia village. Exit polls gave victory to the opposition.

Opposition parties in the ex-Soviet nation of Moldova won enough votes to defeat the ruling Communists in elections Wednesday, according to exit polls, in a major potential upset that could have lasting effects in a country torn between East and West.

The four opposition parties won 53.9% of the vote, according to an exit poll of Moldova's Institute for Public Politics, against 41.7% for the Communist Party. If the mainly pro-European opposition can unite to form a government, that should give it some 56 seats in the Moldovan parliament, against 45 for the Communists.

"This would be a major change" from elections in April, in which the Communists won 60 seats, said Vlad Lupan, a political analyst in the capital, Chisinau, and a former Moldovan diplomat. April's elections were followed by allegations of ballot fraud, rioting and a government crackdown on the opposition.

Mr. Lupan cautioned, however, that there were again widespread reports of ballot fraud, indicating that the final results might not be as favorable to the opposition as the exit polls. The election is being monitored by some 3,000 observers. The exit poll had a margin of error of plus or minus two percentage points.

In addition, one of the opposition parties, the Democrat party, was formed by a senior Communist party member who defected after the April elections. Marian Lupu was the Communists' top reformer, and it is unclear which side his party might join to form a coalition.

Wednesday's repeat of the April election was forced not by the protests, but by the fact that the Communists failed to muster the 61 votes needed to elect a president. No matter which side Mr. Lupu joins, it appears unlikely they will be able to reach the 61-vote threshold.

If the exit-poll results are confirmed, Mr. Lupu, who says he wants partnership with both the European Union and Russia, looks set to have considerable influence in the choice of the next government. If neither side can elect a new president, the new government would rule while outgoing Communist President Vladimir Voronin remains in power until January, the earliest when a further election might be held.

Still, Mr. Lupan said the exit-poll data itself reflect a significant change in Moldovan society. In the months since April, he said, the Communists have lost the argument over who was to blame for the rioting and ensuing police crackdown in April, when two people were killed.

More Turkish rate cuts projected

Turkey's central bank, which has cut interest rates more aggressively than any other central bank, signaled that further monetary easing is likely.

In the latest set of Monetary Policy Committee minutes, published late Tuesday, the central bank said it will be "necessary to maintain an easing bias for a long period" and envisaged that "further measured rate cuts will be necessary in the near term unless a robust recovery" emerges.

Weak demand will likely persist for the next two years and should push prices lower, according to the bank's inflation report, which calculated a 70% chance inflation will slow to 5.3% next year and 4.9% in 2011.

German prices register first decline since 1987

BY GEOFFREY T. SMITH

Prices Plunge

German consumer prices fell in annual terms for the first time in over 22 years in July due to declining energy prices and the global recession

Source: German Federal Statistics

FRANKFURT—German consumer prices fell in annual terms for the first time in more than 22 years in July, amid collapsing energy prices and the global recession, the Federal Statistics Office reported.

Prices fell 0.1% from their level in June, and 0.6% from July 2008, Destatis said. The data may usher in what European Central Bank officials and analysts expect to be a brief period of deflation in Germany, and across the euro zone in general.

German prices last fell in year-to-year terms in 1987. Then, as now, a sharp fall in the price of energy was largely responsible. Crude oil prices peaked at over $147 a barrel in the summer of 2008, and have more than halved since then. Vehicle-fuel prices at the pump have fallen by between 19.6% and 20.7% in the last 12 months, Destatis said.

The data also reflect the unwinding of a spike in global food prices in late 2007 and 2008. Prices for various food groups were between 1.2% and 3.3% lower than in July 2008, Destatis said.

In contrast with 1987, however, the German economy is now experiencing a prolonged and painful slump. The influential DIW research institute, one of half a dozen regularly advising the government, said Wednesday that Europe's largest economy would shrink by 6.4% this year, and grow by an anemic 0.5% next year. The DIW had previously expected a contraction of 4.9% for 2009 and hadn't ventured a forecast for next year.

Germany faces "a long march through an economic valley without an end in sight," DIW president Klaus Zimmermann said and warned of a sharp rise in corporate insolvencies and unemployment in the next year. DIW estimated that the number of unemployed will average over 4.5 million next year, or more than 10% of the work force.

The headline annual inflation rate is likely to turn positive again after "two or three months" and be clearly above zero by the end of 2009, as annual comparisons start taking into account the bursting energy-price bubble in the second half of 2008, Alexander Koch, an economist with Unicredit subsidiary Hypovereinsbank in Munich, said.

CORRECTIONS & AMPLIFICATIONS

A Marketplace article Wednesday said **Heineken** NV's DraughtKeg generally is designed to have its contents consumed all at once, unless drinkers buy an optional BeerTender countertop chilling system, but failed to note that the product stays fresh for 30 days in a refrigerator or cooler after it is tapped.

Hitachi Ltd. plans to buy all the shares it doesn't own in five subsidiaries, including Hitachi Maxell Ltd. A Corporate News article in some editions Wednesday incorrectly called the subsidiary Hitachi Maxwell Ltd.

The Congressional Hispanic Caucus has 23 members in the House of Representatives. A chart accompanying a News In Depth article Tuesday about Blue Dog Democrats in the House misidentified the caucus as the New Democrat Coalition. The New Democrat Coalition, which has 71 members, was correctly identified in an earlier entry in the chart.

INDEX TO BUSINESSES

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

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

Editeur responsable: Patience Wheatcroft M-17936-2003

INDEX TO PEOPLE

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

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

Airlines struggle to meet plane payments

BA seeks to delay its installments on Boeing 787 orders

By Daniel Michaels

British Airways PLC is pressing **Boeing** Co. to renegotiate installment payments on 787 Dreamliners the carrier has ordered—a money-saving effort that highlights a new headache for airlines and plane makers amid the credit crunch and plunging air traffic.

BA Chief Executive Willie Walsh said in an interview in London he is seeking to delay cash payments that all airlines make to Boeing and its European rival Airbus as new planes are being built.

These so-called predelivery payments can total tens of millions of dollars per jetliner and have become very difficult for airlines to bankroll in the financial crisis, industry officials say. That, in turn, squeezes plane makers, who rely on the payments to fund jetliner production.

The move is the latest in a series of setbacks for Boeing. Its 787 Dreamliner was originally supposed to enter service in May 2008 but is now running more than two years late amid a series of supply and production glitches. On Wednesday, contractor Crane Co. said new software for the plane's braking system has yet to be completed amid a disagreement over who should pay for the work. Also Wednesday, Standard & Poor's Ratings Services cut Boeing credit ratings a notch, noting its concern about the possibility of further production cuts due to airline order deferrals and cancellations.

Airbus is also struggling to deliver A380s. The program is running more than two years behind schedule and is billions of dollars over budget.

For up to two years before a plane's delivery, airlines make installment payments that can cover more than 30% of a plane's catalog price. Airbus, a unit of **European Aeronautic Defence & Space** Co., and Boeing use this money to buy components and pay factory workers.

A Boeing spokesman declined to discuss ongoing negotiations with BA, which ordered 24 Dreamliners in 2007. The Dreamliners have a catalog price of about $150 million each, which would imply prepayments of about $50 million per airliner. However, the jets for BA are expected to be delivered over a number of years, and only some of these might be affected by negotiations over prepayments.

Traditionally, short-term bank loans to airlines covering the amount would be paid off at an airplane's delivery. But many banks that had long offered special loans to cover predelivery payments recently stopped doing so because the terms became unappealing, which has forced airlines to shoulder the expense from cash flow. The shift comes as airline revenue is nose-diving and carriers' cash reserves are shrinking.

"Having to fund PDPs out of working capital is putting pressure on airlines' cash flow—it's not easy," Marlin Dailey, Boeing Vice President of sales, said in an interview.

The new financing pressures come as many airlines are also asking Boeing and Airbus to delay airplane deliveries. BA earlier this month agreed with Airbus to reschedule delivery of 12 A380 superjumbos the airline ordered in 2007 and adjust predelivery payments. The A380 has a list price of about $300 million.

The companies gave no financial details of the deal, but bankers familiar with predelivery funding say those talks normally focus on reducing or delaying payments. Bankers say the BA-Airbus negotiations likely affect six of the 12 planes on order, the prepayments for which would be about $600 million.

"I'm pleased we reached agreement with Airbus on PDPs and rescheduling," Mr. Walsh said. "We continue discussions with Boeing."

Bankers say problems with financing pre-delivery payments most directly hit small airlines and carriers that have ordered the Dreamliner and the Airbus superjumbo. Both are new models that are behind schedule. Resulting uncertainty has made many bankers balk at funding the payments.

"You don't finance PDPs when you don't know when the plane will be delivered," said Bertrand Grabowski, a managing director at German DVB Bank SE in London. Mr. Grabowski said the bank has cut back on its predelivery financing.

Arranging predelivery financing for the latest models is also difficult because their resale values haven't yet been established. "Because the 787 is so new and doesn't have a market price, it will be hard to do," said Christian McCormick, chief executive of transport financing at French bank **Natixis** SA, a major aircraft financier. He said predelivery financing has been difficult for the A380 superjumbo, 16 of which are in service.

Lenders are more willing to finance on delivery because finished jetliners can be repossessed in a bankruptcy and are mobile assets with resale values well established.

Banks that once specialized in predelivery payment financing garnered relatively high margins for the business, industry officials say. But many quit the market two years ago amid disputes with Airbus and Boeing over terms of the financing, said Mr. McCormick at Natixis. Most other funders stopped last year when the credit crisis hit.

Predelivery loans have become tricky because they fund unfinished assets. Bankers and plane makers have argued over how to treat the loans if a borrowing airline defaults.

"It's funding for something that hasn't been built yet, so it's tough in this environment" of extreme risk aversion, said Chris Partridge, director of asset financing at **Deutsche Bank** AG in London. Mr. Partridge said his group in the past funded PDPs, "but we're doing virtually nothing now."

"It had been easy for airlines to arrange financing, but banks that were in that market withdrew," said John Leahy, chief operating officer at Airbus. Mr. Leahy, Airbus's head of airplane sales, said the shortage of predelivery financing options "is becoming a big issue."

—Ann Keeton contributed to this article.

Installment plan

Airlines are facing troubles getting cash to finance jetliner production. These pre-delivery payments can reach $50 million for a big plane. An overview:

- Airlines pays roughly 1% of plane's catalog price at contract signing.
- Over 18 – 24 months before plane is delivered, customer pays up to 30% of price. Payments financed from cash or short-term bank loans.
- Balance of plane price paid at delivery and loans are paid off. Purchase financing kicks in.

Note: figures are approximate
Source: WSJ research

Reuters

Airlines start paying for planes as they get built. Here, Boeing 787 Dreamliners undergo final assembly at the company's plant in Everett, Washington.

Change can really add up when airlines impose big fees

By Scott McCartney

THE MIDDLE SEAT

Illness, family emergencies, rescheduled meetings, postponed conferences—they add up to a big business for airlines. Change fees and cancellation penalties add up to $2 billion a year, according to new U.S. Department of Transportation filings.

At some airlines, the fees are heavier than baggage fees even though they get far less attention. At **AMR** Corp.'s American Airlines, travelers paid $116 million in change and cancellation penalties in the first quarter this year, compared with only $108 million in baggage fees.

"It's a backdoor way of charging higher airfares to frequent fliers, particularly business travelers, who have to change plans," said Paul Hudson, executive director of the Aviation Consumer Action Project, a consumer advocacy group in Washington.

In February, the Transportation Department clarified rules on how airlines report ticket-change penalties to the government. The first-quarter numbers for 2009 offer the first accurate snapshot of how much consumers pay to make changes to non-refundable tickets. It turns out to be more than many realized.

Change and cancellation fees amount to an added 3.2% of U.S. airline passenger revenue, totaling $527.6 million for the first quarter. Much of it comes from business travelers who pay the lion's share of ticket change fees and penalties.

Revenue from change fees is going up—even though fewer people are traveling—because several airlines have hiked penalties. Amid high fuel prices last year, several big airlines pushed up the change fee on domestic tickets to $150 from $100. Even **JetBlue Airways** Corp. imposed a $100 change fee, up from $40, for reservations made online. Fees collected in the first quarter this year jumped 29% at JetBlue to $32.2 million from $25 million a year earlier.

That stealthy shot of revenue is huge for airlines, helping them match discount airline prices, for example, while ending up with more revenue from customers to help cover higher costs.

Airlines say they charge change fees and cancellation penalties to limit no-shows for flights and reduce the need to overbook, and to give travelers incentives to purchase full-fare, unrestricted tickets. By paying higher prices, travelers can buy flexibility and avoid change fees; lower prices come as a trade-off for more restrictions.

"Every traveler should weigh the likelihood they will have to change their itinerary prior to travel when assessing each fare type and price," a spokesman for American said.

Unforgiving ticket penalties are unique to the airline industry; other industries typically either allow changes or cancellations, or else allow buyers to swap or resell tickets they can't use. Theaters and sports teams sell nonrefundable tickets, but buyers can give them to friends or sell them; airline tickets are nontransferable. Hotels, restaurants and other service providers may charge fees for no-shows, but they typically give customers ample time to cancel, imposing penalties only within 24 hours, or perhaps after 4 p.m. on the day of arrival.

At airlines, fares with any kind of discount are classified as nonrefundable. Customers can change and use tickets within a year of purchase, but doing so usually results in a penalty of as much as $250 on international itineraries, plus the difference in fares if the new one is higher. With some low-cost fares, the penalty can approach if not equal the value of the original ticket, leaving it worthless if a change were to be made.

Airlines say they don't make their tickets transferable because they don't want companies buying up inventories of cheap tickets and either doling them out for employee business trips or creating a secondary ticket market.

But the penalties are also a huge irritant for travelers who get frustrated trying to make schedule changes.

"I think it's scandalous how the airlines are allowed to dictate the terms that they do," says Richard Factor, a business traveler who believes airlines shouldn't be allowed to make tickets both nonrefundable and nontransferable.

Steve Landes, who runs a Florida organization of travelers who commute by air between home and business, says change fees have risen so high that many frequent travelers are switching to **Southwest Airlines** Co., which allows ticket changes without charging a penalty. "That $150 charge is a killer, and people avoid it. Airlines may think they are making money on it, but they must be losing money. They are sending their customers away," Mr. Landes says. "You buy tickets six months in advance and how do you know you're not going to get sick, and your job isn't going to be transferred?"

Mr. Hudson, the consumer advocate, says airline penalties are most analogous to hotels' late-cancellation rules, which often require one-night's payment. Like an airline seat that flies empty, a hotel room that sits vacant for a night is lost revenue that can't be recovered, so last-minute changes can be costly. "But most hotels give you the opportunity to cancel within a certain amount of time without penalty," he said.

Airline rules are tougher on consumers "partly because of a lack of competition and partly a lack of regulation," Mr. Hudson says. "Some of these things I think should be regulated."

Midwest Airlines, a Milwaukee-based carrier catering to business travelers with low fares, records the heftiest passenger change fees as a percentage of passenger revenue. Midwest's reported change and cancellation fees equaled 7% of passenger revenue. JetBlue was second at 4.6%. US Airways Group Inc. was also above average at 4.3%.

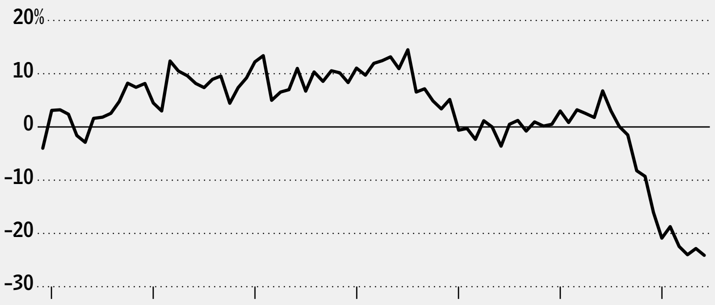
American, **UAL** Corp.'s United Airlines, Alaska Airlines and Virgin America Airlines all fell between 3% and 3.3%—about the industry average. At AirTran Airways, fees dropped 18% for the first quarter compared with a year earlier, a result of the decline in business travel this year, the airline said. "Business travelers are the most likely to cancel reservations and incur the fee," a spokesman said.

Delta Air Lines Inc. took the DOT category of "cancellation fees" quite literally and reported only cancellation fees, not change fees. (DOT guidelines lump the two together.) Penalties imposed on tickets that get changed add up to a lot more than tickets that are simply canceled and never reused, because airlines typically give customers one year from date of purchase to reuse the value of a canceled ticket. When Delta bought Northwest, it changed how Northwest reports cancellation/change fees as well.

A Delta spokeswoman said the airline couldn't change its reporting in time to report the first quarter with change fees, so it reported cancellation fees of $3.6 million. But when asked, the airline estimated total change and cancellation fees for the first quarter of $100 million for Delta and $58 million for Northwest—putting both slightly above average, when fees are compared with passenger revenue.

Leveling off

U.S. durable-goods orders excluding transportation, change from a year earlier



Note: figures are seasonally adjusted
Source: U.S. Commerce Department via Thomson Reuters

More signs add to hopes U.S. recession is easing

By Kelly Evans

The pace of decline in economic activity has "moderated" or "begun to stabilize," the Federal Reserve's latest survey of regional economic conditions found, and a Commerce Department report showed the steep drop in U.S. business-investment spending appears to be bottoming out.

Both reports reinforced expectations that the recession, which began in December 2007, may be nearing an end.

The Fed's "Beige Book," a roundup of conditions across its 12 districts, suggested that economic activity remains weak in many regions, but the slowing pace of decline is a marked improvement from previous reports.

Chicago and St. Louis, for example, reported the pace of decline in their regions "appeared to be moderating" from the last report, while New York, Cleveland, Kansas City and San Francisco reported "signs of stabilization." Minneapolis, however, said its regional economy contracted since the last report, released June 10. The report is done through interviews and surveys with local businesses.

While the report noted that households "continued to be price-conscious," signs of scattered improvement were seen in manufacturing, housing and even the labor market. Several regions reported hiring activity in health care, technology and manufacturing.

Most districts described manufacturing as "depressed but with selected signs of modest improvement." An uptick in production in some regions was attributed to the need to replenish customer inventories. Military products and pharmaceuticals saw strong demand or rising sales in some areas.

But improvement wasn't seen across the board. Travel and tourism declined in most districts. Freight and shipping volumes were reported well below year-ago levels in many areas. Commercial real estate was described as "weak" or "slow" in all 12 districts.

Meanwhile, the Commerce Department said new orders for durable goods—big-ticket items such as computers and machinery—declined in June by a seasonally adjusted 2.5% from May's level, to $158.6 billion. The drop was largely because of a decline in aircraft orders, which had surged the prior month. Excluding aircraft and other transportation, orders rose 1.1%, the second straight gain and a sign business demand is firming.

A key gauge of business investment spending, orders for capital goods excluding aircraft and defense, rose 1.4%, the second monthly gain.

"The implication is that equipment investment should begin to level off in the third quarter after plunging over the previous year," said J.P. Morgan economist Abiel Reinhart.

French cabinet moves closer to privatization of La Poste

By Gabriele Parussini

PARIS—The French cabinet took the first step toward a possible privatization of the country's postal service as it approved a bill that will turn La Poste into a joint-stock company on Jan. 1.

The bill now goes to Parliament for approval. The UMP conservative party of President Nicolas Sarkozy and its allies have a firm majority there, so the bill's passage is assured.

"We need to give La Poste the means of pursuing its modernization and its development," Finance Minister Christine Lagarde said.

Mail services will be opened to competition in the European Union in 2011.

The government would own almost all the shares in the group, either directly and indirectly. It would inject €2.7 billion ($3.83 billion) into La Poste in partnership with state investment bank Caisse des Depots and Consignations, which also would be a shareholder.

The government hasn't announced plans to privatize La Poste, but it turned national phone operator France Télécom as well as energy companies Gaz de France and Électricité de France SA into joint-stock companies before they were privatized via the stock market.

Postal companies in the Netherlands and Germany have been privatized, and their shares are traded on local stock markets. The U.K. has put off the partial privatization of Royal Mail, citing the state of the economy. The partial selloff, opposed by many lawmakers from the ruling Labour party, had been due to go before Parliament before the summer break.

Obama slipping in poll

Approval rating hits 53% as health plan loses public support

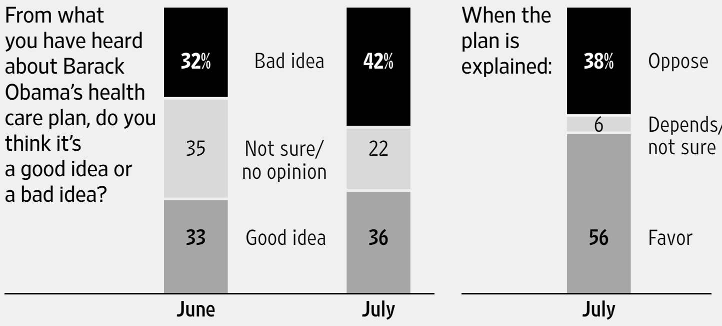
By Laura Meckler

Associated Press

U.S. President Barack Obama holds a town-hall meeting about health care at the Broughton High School in Raleigh, North Carolina on Wednesday

Communication problem

Support for President Obama's health-care plan is low, but support rises when the plan is explained to poll respondents.



Source: WSJ/NBC News telephone poll of 1,011 adults conducted July 24–27; margin of error: +/–3.1 percentage points

WASHINGTON—Support for U.S. President Barack Obama's health-care effort slipped substantially over the past five weeks—particularly among those who already have insurance—as Congress has struggled to finalize legislation and attention has focused on its high price, a new Wall Street Journal/NBC News poll finds.

In a bid to regain momentum, Mr. Obama is shifting the way he is selling his top domestic priority, focusing less on how the revamp would reduce costs and more on how it would protect those who already have insurance—the people who need to be won over. One of the president's top advisers acknowledged Wednesday that the White House's prior focus had been unsuccessful.

In mid-June, the public was evenly divided when asked whether it thought Mr. Obama's health plan was a good idea or bad idea. The new poll, conducted July 24-27, found 42% calling it a bad idea versus 36% who said it was a good idea. Among those with insurance, the portion calling the plan a bad idea rose to 47% from 37%.

The concern is fueled by rising anxiety over the federal budget deficit, which is reflected in the new poll as well. Meanwhile, worries over the economy and a drop in support from Republicans appear to be bringing Mr. Obama's overall ratings down. They are now in line with historical standards, but no longer at the highflying levels of his early weeks.

His job approval now stands at 53%, down from a high of 61% in April. The latest reading is only three points higher than President George W. Bush's rating in June 2001, after his narrow and contentious election victory in late 2000.

The poll had a margin of error of 3.1 percentage points for the overall sample, higher for subgroups.

On health care, there was another worrisome sign for the president: Only two in 10 people predicted the quality of their own care would improve under the Obama plan, and just 15% of those with private insurance thought it would. Twice as many overall, and three times as many with private coverage, predicted their own care would get worse.

"You can't pass a substantial health reform unless privately insured people see there's a benefit for them," said Bill McInturff, a Republican pollster who conducts the poll with Democrat Peter D. Hart.

Support for former President Bill Clinton's health plan hovered in similar territory in 1994, as it was on its way to defeat.

Once Congress leaves town for its August break, especially if it departs on a negative note, it will be hard for the White House to demonstrate progress toward a successful conclusion. For Mr. Obama, it is critical to change the story line that has dominated the past several weeks, which has focused on the hurdles to passing legislation. He got some good news from the House on Tuesday, as Democratic leaders worked out a deal with conservative Democrats to move their bill through the last of three committees.

The poll also had some encouraging news for Mr. Obama and his health-care allies. When given a fairly detailed description of the plan they are pushing, Americans registered strong approval, with 56% saying they favor the plan versus 38% who oppose it.

Many of these details, such as requiring insurance companies to cover people with pre-existing conditions, haven't been the focus of the congressional debate, which has centered on more controversial issues.

Mr. Obama himself has focused sharply on cost control for businesses and regular Americans who have seen premiums rise much faster than wages. White House officials believed this would give those with insurance a stake in the debate.

Concern over the health plan is fueled by rising anxiety over the budget deficit.

But it hasn't worked, partly because the debate in Washington has been dominated by the $1 trillion, 10-year price tag for covering the uninsured, making it hard to simultaneously convince people that the bill will lead to reduced costs.

"There's dissonance, and I understand the confusion," said David Axelrod, senior adviser to Mr. Obama.

"People are properly skeptical about any proposals out of Washington that speak to cost, because they've been singed by past experience," he said. "You're talking about reducing costs over time, and that's a hard thing for people to envision."

Mr. Axelrod added that "consumer protections are a lot more tangible," and that's what Mr. Obama focused on Wednesday at a town-hall meeting in Raleigh, N.C.

He outlined a series of policies, many of which the insurance industry has agreed to accept. The president said he wants rules that will require insurers to cover people with pre-existing conditions, cap out-of-pocket expenses, ban cost-sharing for preventive care, bar insurers from dropping people who become seriously ill, ban higher charges based on gender, ban annual or lifetime coverage caps, require insurers to renew policies as long as premiums are paid, and allow young adults to stay on their parents' plans through age 26.

"If you've got health insurance, then the reform we're proposing will also help you, because it will provide you more stability and more security," Mr. Obama said.

On the question of how to pay for the measure, the poll finds only one idea with majority support: a surtax on the rich, the approach taken in the bill moving through the House, but not in the Senate version.

Public support for requiring businesses that don't offer insurance to pay a fine dropped moderately from last month, with about half of those polled now in favor. Only about four in 10 liked the idea of taxing insurance companies that offer particularly generous health plans, an idea that has gained currency in the Senate Finance Committee.

—Jonathan Weisman in Raleigh, N.C., contributed to this article.

CORPORATE NEWS

Microsoft, Yahoo unite against Google

Microsoft's Bing will become Yahoo's search engine and Yahoo will handle sales of search ads for both companies

By Jessica E. Vascellaro
And Nick Wingfield

Yahoo Inc. and **Microsoft** Corp. struck a deal for a 10-year Internet-search partnership, ending a protracted dance and uniting the rivals against **Google** Inc.

Under the deal, Yahoo will make Microsoft's Bing search engine the search provider on its Web sites. Yahoo will handle sales of search ads for both companies, using Microsoft's search-advertising technology.

There is no large upfront payment, as the two companies had earlier discussed. The agreement is a revenue-sharing pact with Microsoft paying Yahoo 88% of the search revenue generated from its sites during the first five years of the agreement, the companies said.

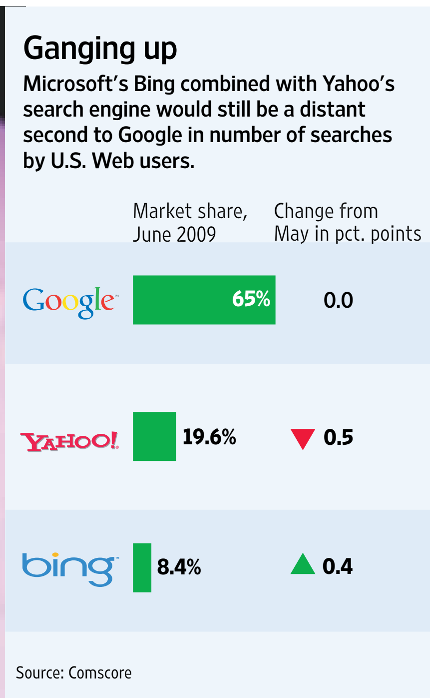
Microsoft, which last year made a failed $47.5 billion takeover bid for Yahoo, finally wins what it wanted most from the Internet pioneer—huge volumes of queries that run through Yahoo's search engine. At the same time, Yahoo will reap additional search-advertising business to expand its share of the market.

"We face a formidable competitor in search," Yahoo Chief Executive Carol Bartz said on a conference call Wednesday. "What this deal is really about is scale."

The deal narrows the gap with Google but the new partners remain a distant second. Microsoft and Yahoo combined accounted for less than half of Google's 65% share of searches in the U.S. market in June, according to research firm Comscore. Microsoft handled 8.4% of searches last month and Yahoo accounted for just under 20%.

The transaction is subject to a regulatory review, but the companies said they expect it could be sealed by early 2010.

Asa Mathat /All Things Digital



Microsoft Chief Executive Steve Ballmer said on the conference call that he expects "opposition" to the deal from an antitrust perspective from what he dubbed "the competitor," a clear reference to Google. But he said: "We think we have a good case for how this [deal] improves competition."

Last year, the U.S. Department of Justice derailed a proposed search-ad partnership between Google and Yahoo after concluding that it would give Google too much control over the market. And under the Obama administration, the Justice Department is promising to review deals more rigorously.

A key U.S. antitrust lawmaker said the deal warrants "careful scrutiny." Sen. Herb Kohl (D-Wis.) said the search pact combines "industry giants and direct competitors in Internet advertising and search markets."

A spokeswoman for the European Commission, the EU's executive arm, said the regulator hadn't been "informed about the details of the transaction." She declined to comment further, beyond saying that the commission "keeps this sector, as others, under review."

Internet users won't notice a dramatic difference on either Yahoo or Microsoft's sites, since the technology involved in the exchange operates behind the scenes. Ms. Bartz said the Yahoo branding will remain on the top of Yahoo search pages but the results will say "powered by Bing" at the bottom.

In afternoon trading Wednesday, shares of Yahoo slid $2.05, or 12%, to $15.17 on the Nasdaq Stock Market, as investors expressed disappointment over the fact that the company won't be getting an immediate windfall from the deal. Microsoft shares advanced 21 cents to $23.68.

Ms. Bartz downplayed the lack of a big upfront payment from Microsoft. "As far as we're concerned, the boatload of cash is preserving our revenue line," Ms. Bartz said. "Having an upfront payment didn't really help us from an operating standpoint."

Yahoo anticipates that the deal will save the company $200 million in capital expenditures and generate $500 million in operating income annually.

Mr. Ballmer said, under the deal, Microsoft will be investing "several hundred million" dollars in the short term, including some additional capital expenditures.

The companies argued the deal will lead to better search results, in part by giving Microsoft more data to refine its search technology.

The deal could make it simpler for advertisers to choose an alternative to Google as a vehicle for search ads, said industry observers.

"They should be worried," Danny Sullivan, editor of SearchEngineLand.com, said of Google. "It's going to give Microsoft in one fell swoop a much bigger share of the search market."

A Google spokesman declined to comment.

Bryan Wiener, CEO of digital advertising agency 360i, said the deal would make Bing more attractive to advertisers who have been excluding it from their campaigns because its search traffic is relatively low. He added it would free up Yahoo to invest in new search ad-sales staff and technology, areas where, he said, it has trailed Google.

Still, Mr. Wiener said it remains unclear whether Yahoo and Microsoft will be able to greatly boost their combined market share.

The deal comes as Microsoft has begun garnering positive buzz for Bing, which it launched in early June. But even with Bing, Mr. Ballmer made it clear in a recent interview that he still favored a deal with Yahoo to help accelerate Microsoft's search business and the creation of a more serious competitor to Google.

—Joann S. Lublin, Fawn Johnson and Jessica Hodgson contributed to this article.

Arcelor posts loss, but is upbeat

By Robert Guy Matthews

ArcelorMittal, the world's largest steelmaker, swung to a $792 million loss after charges in the second quarter and said a recovery is strengthening outside of the U.S. and Western Europe, prompting a moderate increase in prices and output.

The company said it expects another two quarters of weak demand in those two markets. Nonetheless, company executives said in an interview they expect an overall improvement during the third quarter.

"We believe the worst is over," Lakshmi Mittal, chief executive of ArcelorMittal, said in an interview. "Clearly in the third quarter, we will have improved results." Already, the company is restarting mills and blast furnaces in anticipation of a stronger second half.

The steelmaker, which a year earlier reported a profit of $5.84 billion, said that there were sustained signs of recovery in India, Russia, Eastern Europe and Brazil amid new construction and China's economic-stimulus initiatives. Output is increasing faster in those economies than in the U.S. or Western Europe, Mr. Mittal said.

"India mills are operating at full capacity," he said. "Our products from Ukraine are operating at higher capacity. We are shipping to Turkey and China from our Kazakhstan operations."

Construction of roads, buildings and other infrastructure is behind the uptick in demand in those regions, he added. China, he predicted, will need 10% more steel in 2010.

Steel demand is generally thought to be a leading indicator for the world's economies because of its use in automobiles, commercial and residential construction, road building and consumer goods such as washing machines.

Last year, when the world's credit crisis hit and demand for commodities fell dramatically, steelmakers were caught with too much steel and too few buyers. They are still struggling to get back into profitability, as most every major steelmaker has recorded large losses all year.

Despite encouraging signs in developing regions, Mr. Mittal cautioned that recovery would be slow, though, hopefully, steady. "We are expecting our volumes to increase but average steel prices should be stable or slightly down."

The drag on profit is coming mainly from the U.S. and Western Europe. While the company said that automotive demand is picking up, construction and other markets aren't expected to turn around for months. "It could take up to three quarters," Mr. Mittal said. "But we are thinking a recovery could happen in the next two quarters."

In North America, just three out of the company's nine blast furnaces are operating or planning to come back online as of now. In Europe, 15 of the company's 25 blast furnaces are expected to be online during the third quarter. Blast furnaces are used to make steel.

ArcelorMittal said that the pressure to close steel facilities permanently has eased somewhat. But because recovery is so slow and unpredictable, there is a lingering possibility that more closures could occur.

Steel prices around the globe are starting to rise again, even in North America and Western Europe. The increase in China, Brazil and other developing countries, reflects an increase in actual demand, while in the U.S. and Western Europe, it reflects a destocking of inventories.

Included in the second-quarter loss was $1.2 billion in inventory write-downs and costs related to temporary unemployment as ArcelorMittal kept its global operations running at 50% of capacity because of a slump in steel demand from customers in the automotive and construction sectors.

Second-quarter revenue fell 60% year-to-year to $15.2 billion.

BHP shifts iron-ore pricing as industry overhauls terms

By Robert Guy Matthews

BHP Billiton Ltd., the world's largest miner, said it settled iron-ore price negotiations with more than half of its steel industry customers, with a portion of buyers agreeing to annual contract rates that are 33% below last year's prices and the remaining agreeing to negotiate prices quarterly.

The deal to set prices quarterly based on the spot market and indexed futures markets represents a breakthrough for BHP and the industry. Spot market prices more immediately reflect high and lower demand and would allow BHP to more quickly capitalize on upswings in demand. It would also allow steelmakers to save when demand is low.

The agreements weaken the decades-old system of settling iron ore prices on an annual basis, which BHP has increasingly criticized as outdated.

The "current settlements are indicative of continued progress towards transparent market pricing," BHP said in a statement Wednesday.

While some of BHP's steel customers will still purchase their iron ore annually, more steelmakers are opting out of the system and hoping that they will be able to buy iron ore at below contract prices.

As a result, steel prices worldwide may become more volatile as the raw material, iron ore, fluctuates along the lines of supply and demand. BHP is hoping that it will boost its profits in more frequent negotiations.

The miner said the recent negotiations reflect only about half of its volume and that negotiations are continuing for the remaining 47% of its iron ore volumes with steel customers, including those in China.

Chinese steelmakers are BHP's largest and most important customers. The two sides have been wrestling for months over the price of iron ore, a necessary ingredient in the production of steel.

Chinese steelmakers have been seeking a 50% discount, to reflect the weakened world economy and their growing dominance in the purchase of iron ore—far steeper than the 33% BHP announced Wednesday. The 33% figure is in line with contracts between **Rio Tinto** Ltd. and Japanese, Korean and Taiwanese steelmakers.

CORPORATE NEWS

Sanofi nears Merial deal

Sanofi CEO Christopher Viehbacher said he didn't see sales of the H1N1 flu virus vaccine as affecting the long-term valuation of the company.

Associated Press

Drug maker seeking to buy out partner in animal-drug firm

BY JEANNE WHALEN
AND JEFFREY MCCRACKEN

Sanofi-Aventis SA is close to announcing a deal to buy Merck & Co.'s half of a joint venture that makes drugs for animals, according to people familiar with the matter.

Analysts and bankers value Merck's 50% stake in the Merial joint venture at $3 billion to $5 billion. The companies could announce a deal as soon as this week, though talks could still break down or be delayed, these people said. News of the potential deal came as Sanofi reported a 4.9% rise in second-quarter profit.

Currently, Sanofi and Merck each own half of Merial, which had sales last year of more than $2.6 billion from products including Frontline flea and tick treatments.

Merck is close to selling the stake in part to avoid any concerns from antitrust regulators that its pending $41 billion acquisition of Schering-Plough Corp. would make it too dominant in the animal medication business.

Asked about the Merial stake on a conference call with analysts Wednesday, Sanofi chief executive Christopher Viehbacher said: "We like the animal health business. If there was an opportunity to extend our participation in that market we would welcome it. But you really would have to ask Merck about the timing of decisions."

A Merck spokeswoman declined to comment about an impending sale. Merck has said that it has been exploring its options and evaluating the potential of selling its stake in Merial or in Schering-Plough's Intervet animal health business.

Merck has received a high level of interest from several big pharmaceutical companies for Intervet, which had sales of $3 billion last year, according to one person familiar with the matter.

Drug companies see animal medications as attractive because they are subject to far less competition from cheap generics than human pharmaceuticals.

The news came as Sanofi raised its full-year earnings guidance, saying it now expects 10% growth in its 2009 earnings per share, instead of a previous forecast of at least 7% growth.

Net profit for the second quarter rose 4.9% to €1.06 billion ($1.5 billion) from a year ago, boosted by the dollar's strength against the euro and strong sales of the diabetes treatment Lantus and the anti-clotting drugs Lovenox and Plavix. Sales grew 11% to €7.44 billion.

Mr. Viehbacher tried to reassure investors about Sanofi's long-term future. Some of Sanofi's biggest drugs will lose patent protection and face competition from generics in the coming years, which will hit revenues hard. But cost cuts and other sources of sales growth will mean that the company by 2013 will be able to maintain sales and profits at 2008 levels, Mr. Viehbacher said.

The company is counting on emerging markets, vaccines, nonprescription medicines, Lantus and some new products to fuel this sales growth.

Recent studies suggesting a possible link between Lantus and cancer caused investor concern that Lantus sales could suffer. Mr. Viehbacher said Wednesday that he believes the medical community has concluded that the studies were inconclusive and flawed. He said Sanofi hasn't seen any negative effect on Lantus sales yet. Because the studies were published in late June, any negative effect wouldn't be noticeable in the second-quarter results.

Mr. Viehbacher played down the potential for profits from the sale of H1N1 swine flu vaccine, saying the company is viewing the pandemic as a "public health issue and not as a business opportunity."

In an interview, Mr. Viehbacher said the company probably won't book any H1N1 vaccine sales until the fourth quarter. He declined to forecast how much profit Sanofi would earn from H1N1 vaccine sales, saying it's still unclear how many doses the French drug maker will be able to produce.

"There'll certainly be some extra sales and profits associated with it. But...it's kind of a one-off effect, and I don't really see it as affecting the long term valuation of the company," he said.

Mr. Viehbacher's comments are a contrast with recent remarks from **GlaxoSmithKline** PLC Chief Executive Andrew Witty, who said last week that his company's swine-flu vaccine and other pandemic products would make a "significant contribution" to Glaxo's profits.

Mr. Viehbacher said Sanofi has signed contracts to supply H1N1 vaccine to the U.S., France and Mexico, but isn't rushing to sign additional orders. The company wants to retain some flexibility so it can ship doses to countries that need them the most, he said.

Sanofi will charge between €5 and €7 a dose in developed countries, €3 to €4 in "middle-income" countries and less in poorer countries, he said. The company has also pledged to donate 100 million doses to the WHO for use in the poorest nations.

—Mimosa Spencer and Jonathan Rockoff contributed to this article.

CORPORATE NEWS

Daimler posts a $1.45 billion loss

Luxury-vehicle sales run into headwinds; dim full-year outlook

By Christoph Rauwald

FRANKFURT—**Daimler** AG swung to a €1.02 billion ($1.45 billion) loss in the second quarter due to weak demand for luxury vehicles and confirmed that full-year revenue and sales are expected to come in significantly lower than in 2008.

Earnings at the Mercedes-Benz cars, vans and financial services units improved compared to the gloomy first quarter, but "a comparison with the very good second quarter of last year shows that there is still a lot of work to be done," Daimler Chief Executive Dieter Zetsche said in a statement. In the second quarter of last year, the German auto maker posted a €1.35 billion profit.

The Stuttgart-based auto maker said its closely watched earnings before interest and taxes, or Ebit, swung to a €1 billion loss as restructuring charges on top of deteriorating vehicle sales added fuel to the fire. But Ebit still came in ahead of analysts' expectations of a €1.53 billion loss. The net loss was also less severe than the €1.34 billion analysts had forecast.

An employee works on the production line in the Mercedes-Benz site in Sindelfingen, Germany.

Associated Press

Reacting to the steep market downturn for trucks and luxury cars, Daimler targets cost savings of €4 billion as part of a wide-ranging move to streamline its organization.

Daimler's second-quarter revenue fell 25% from the same period last year to €19.6 billion. Daimler's sales were down 31% on the year in the second quarter at 391,500 cars and commercial vehicles. Charges related to the sale of its remaining 19.9% stake in Chrysler LLC to Cerberus Capital Management LP also shaved €387 million from earnings.

A €204 million charge was booked in the second quarter for the restructuring of Daimler's Japanese truck unit plus €13 million in expenses for slashing capacity at the North American truck operations.

Daimler's core Mercedes-Benz division, which comprises the Mercedes-Benz, Smart and Maybach nameplates, posted a €340 million operating loss compared to a €1.21 billion profit in the year-earlier period, but solid sales of the new generation Mercedes-Benz E-Class and the GLK compact sports-utility vehicle cushioned the fall.

Mercedes-Benz is expected to post a positive operating result in the second half of the year, due mainly to the E-Class and the new-generation of the flagship S-Class model. But the division's full-year car sales are expected to come in below last year's level.

Daimler said inventories at Mercedes-Benz were cut by about 44,000 vehicles in the second quarter, in line with the company's target. Inventories at all other units were also reduced, it said. Daimler said the group's industrial net liquidity rose to €4.6 billion at the end of the second quarter from €3.7 billion at the end of the first three months of the year.

Honda, Nissan upbeat despite dreary results

By Yoshio Takahashi

TOKYO—**Honda Motor** Co. and **Nissan Motor** Co. both posted dismal earnings to start their fiscal years, but the big Japanese auto makers beat market expectations and offered signs that the crippling losses of the past year may be behind them.

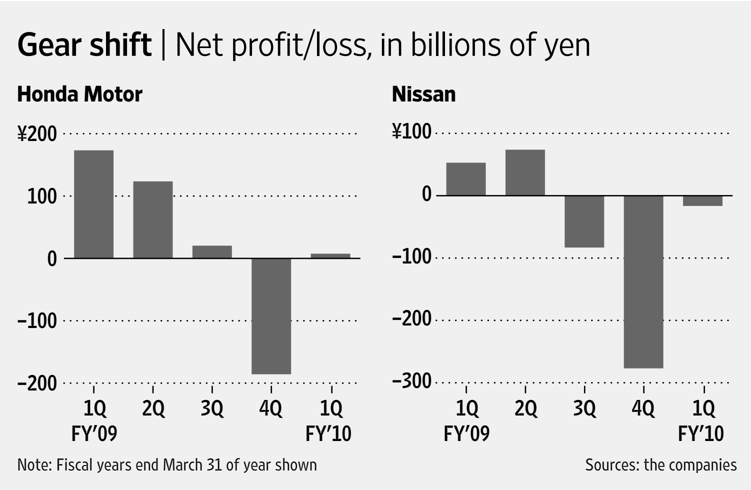
Honda, Japan's second-largest auto maker by vehicle sales after Toyota Motor Corp., said its net profit for the first quarter ended June 30 tumbled 96% to 7.56 billion yen, or about $80 million, from the same period a year ago. But it lifted its full-year earnings target, helped by stringent cost cuts and stronger-than-expected vehicle sales at home and in China.

Nissan, the country's third-biggest car maker, reported a first-quarter net loss of 16.53 billion yen, compared with a net profit of 52.80 billion yen a year earlier. At the same time, its China joint venture unveiled plans to spend five billion yuan, or about $730 million, to establish a new auto plant there.

China, which looks set to surpass the U.S. to become the world's biggest auto market as early as this year, is an increasing source of profit growth for auto makers in the developed world.

The results from the two Japanese auto makers were hurt by depressed demand in major markets, especially the U.S. Both were also hurt by the strength of the yen, which ate into the income they earned overseas and which is expected to continue to pressure results this fiscal year.

Still, both companies performed better than analysts expected. Government incentives, cost cutting and tighter inventory control along with some sales recovery in the emerging markets are beginning to improve the outlook for Japan's auto makers.



In Tokyo, Honda's shares rose 1.1% to 2,770 yen, while Nissan's shares rose less than 1% to 631 yen.

The industry's eyes will now focus on Toyota, the world's biggest car maker by sales volume, which is expected to report a net loss when it releases quarterly earnings Tuesday.

The two companies' performance echoes **Ford Motor** Co.'s results announced last week. The U.S. car maker said it returned to profitability in the second quarter, though this came mainly from gains it recorded as part of efforts to restructure its debt.

Honda, the maker of the Insight hybrid and Civic compact cars, raised its net profit outlook to 55 billion yen in the 12 months through March from its previous forecast of 40 billion yen. It cited cuts in administrative and sales costs, as well as reduced research and development spending.

"The upward revision reflects [Honda's] confidence of its own efforts" to cut costs among other steps to get back on its feet amid persistent uncertain prospects for a recovery in demand, said Mitsushige Akino, a general manager at Ichiyoshi Investment Management.

Honda's first-quarter revenue totaled two trillion yen, 30% lower than a year earlier.

Nissan left its forecast unchanged, expecting a net loss of 170 billion yen for the fiscal year ending in March. Its first-quarter sales sagged 36% to 1.515 trillion yen, from 2.347 trillion yen.

Nissan's China joint venture plans to build a new plant to expand its production capacity for passenger cars by 240,000 vehicles a year, said **Dongfeng Motor Group** Co., Nissan's partner there. The plant, to be built at an existing production base in the southern Chinese city of Guangzhou, is scheduled to start production in 2012, Dongfeng said. With the expansion, Nissan's manufacturing capacity in China is expected to rise to about 700,000 vehicles a year, it said.

Honda reports earnings under U.S. accounting standards, and Nissan's earnings are based on Japanese standards.

—Patricia Jiayi Ho and Norihiko Shirouzu in Beijing contributed to this article.

Porsche faces $7 billion Volkswagen hit

By Steve Goldstein

Porsche Automobil Holding SE on Wednesday said it will take a hit of as much as €5 billion ($7 billion) before taxes as it sells options on **Volkswagen** AG shares.

Porsche said it is in advanced talks with "one or several investors," including Qatar Holding, about selling its options in Volkswagen.

Porsche's strategy of buying up options in Volkswagen has netted it a nearly 51% stake in VW, along with options for roughly 20% more of the auto maker based in Wolfsburg, Germany.

But the options also have led the company into debt of at least €9 billion.

Porsche said the preparation for the sale of VW options will result in a "substantial book capital loss" as it will be forced to take a devaluation.

In addition, Porsche will record another loss relating to purchase-price allocation, in which all assets and liabilities will be compared against the price paid for them. Taken together, Porsche will take a hit of as much as €5 billion.

Porsche stressed the write-offs are purely accounting moves, and selling the options will improve its liquidity because it no longer will need to set aside more than €1 billion as cash collateral.

Peugeot-Citroën records a loss amid sales slump

By David Pearson

PSA Peugeot-Citroën SA said shrinking vehicle sales pushed it into the red in the first half and warned that it doesn't expect the European automobile market to recover before the end of 2010.

The French car maker reported a net loss of €962 million ($1.36 billion) for the first six months of the year, compared with a year-earlier net profit of €733 million. Revenue dropped 22% to €23.5 billion, reflecting a 20% drop in sales of the company's vehicles.

Like other volume car makers, Peugeot-Citroën has been squeezed by the plunge in global automobile sales, as well as a rapid shift in customer preference to smaller, less-polluting cars. With European auto sales likely to contract by 7% in the second half, Peugeot-Citroën said it still expects a full-year operating loss of between €1 billion and €2 billion. Despite the disappointing results and gloomy outlook, the auto maker surprised analysts by announcing it had achieved positive free cash flow of €467 million in the first half thanks to a 31% drop in its inventory of unsold cars.

At the same time, net debt improved to just over €2 billion on June 30 from €2.9 billion at the end of last year, and Peugeot-Citroen said it has restructured its debt-maturity profile so there were no major debt repayments through 2014.

The improvement in Peugeot-Citroen's financial situation was "a massive positive surprise," said Max Warburton, automotive analyst at Sanford Bernstein.

The positive free cash flow in the first half will be more than offset in the second half, as there will be no further reduction of inventories, which have returned to a "normal" level equivalent to 66 days of production, Chief Executive Philippe Varin told reporters. Provision reversals and a steady level of research-and-development spending will also contribute to the second-half cash burn, said Chief Financial Officer Frédéric Saint Geours.

Mr. Varin was put in charge of the company just two months ago, succeeding Christian Streiff, who was forced out after disagreements over strategy with the controlling Peugeot family.

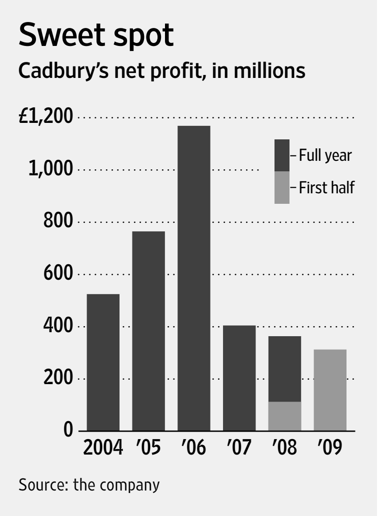
Europe's second-largest automotive group said it expected its European market share to increase to above 14% in the second half of this year from 13.6% in the first six months, boosted by new product launches.

Mr. Varin said his strategy for the group will focus on reducing its dependence on Europe for sales, increasing operational efficiencies, and getting a competitive edge in vehicle technology and services.

He didn't exclude new partnerships or alliances with other automotive manufacturers to fill gaps in Peugeot-Citroen's product lineup, and said he wanted to expand and deepen existing industrial cooperation arrangements with companies such as BMW AG, Ford Motor Co., Fiat SpA, Toyota Motor Co. and Mitsubishi Motors Co. to share development and industrial costs.

CORPORATE NEWS

Associated Press



Cuts and price increases heal Cadbury's margins

U.K. profits rise on smaller chocolates and impulse buys

By Aaron O. Patrick

LONDON—**Cadbury** PLC increased profit margins in the first half, a step toward shedding its position as one of the least-profitable major producers of confectionary.

The chocolate, candy and gum maker on Wednesday said operating margins rose to 11.5% from 9.7% a year ago. After coming under pressure from shareholders over the company's weak performance two years ago, Chief Executive Todd Stitzer promised tough action to get margins raised to about 15% by 2011.

In 2007, Cadbury had lower profit margins than five of its main competitors, including **Hershey** Co., **Wm. Wrigley Jr.** Co., and **Nestlé** SA, according to figures compiled by Sanford C. Bernstein & Co. Cadbury's margins still trail most of its rivals, according to public accounts.

To boost margins, Mr. Stitzer has cut a layer of management, closed several factories in Europe and jacked up prices. After Wednesday's results, analysts said Cadbury is making good progress but could still miss the margin target. "It is too early to be categorical about that," said Julian Hardwick, a food analyst in London at Royal Bank of Scotland.

Mr. Stitzer said Wednesday that the company is "firmly on track" to hit the target.

Cadbury's net profit rose to £313 million ($514.6 million) in the first half from £113 million a year earlier, driven by gains on the sale of an Australian soda business to Asahi Breweries of Japan. Chocolate sales were strong, rising 10% in the half—about double the long-term growth rate.

To boost sales in Britain during the recession, Cadbury assigned its best salespeople to convenience stores, figuring they could increase sales by targeting impulse buyers, Mr. Stitzer said.

Cadbury also reduced the size of some 9-ounce chocolate bars by 0.7 of an ounce, allowing it to pass on higher costs and keep the price of the bars around £1, according to Mr. Stitzer. Cadbury's U.K. chocolate sales rose 12% in the half, he said.

But in the U.S., Cadbury stumbled as its Dentyne gum lost market share. The company hasn't launched a big new gum product in the U.S. since 2007 because it has been working on a new version of its popular Trident gum, Mr. Stitzer said. The new product, Trident Layers, is made of three gum strips stuck together and will go on sale beginning in September. "It looks like a gum sandwich," Mr. Stitzer said.

Overall, the volume of Cadbury confectionery sold fell 2% in the half while sales by value rose 4%, after stripping out the effect of currency fluctuations and divestments.

—Michael Carolan contributed to this article.

Chip makers see steadier market

By Archibald Preuschat

DÜSSELDORF, Germany—**Infineon Technologies** AG and **STMicroelectronics** NV joined a growing chorus of microchip makers spotting a bottom to a months-long slump.

Germany's Infineon Wednesday posted a 13% increase in third-quarter sales compared with the second quarter and narrowed its net loss significantly to €23 million from €379 million in the second quarter a year earlier. The improvement was helped by stronger demand from mobile-handset producers like LG Electronics Inc. and cost cutting.

Swiss-based **STMicroelectronics** NV, meanwhile, late Tuesday posted its sixth consecutive quarterly net loss as sales and margins continued to decline, but Chief Executive Carlo Bozotti Wednesday said he expects the chip market as a whole to decline less than STMicro had previously forecast.

STMicro reported a loss of $318 million in the second quarter, including a restructuring charge of $86 million, compared with a $47 million loss in the same period a year before.

GLOBAL BUSINESS BRIEFS

AkzoNobel NV

Company's net drops 13%; ICI integration proceeds

Coatings and chemical company **AkzoNobel** NV Wednesday refrained from giving a full-year outlook as it reported a 13% fall in second-quarter net profit, hurt by lower volumes in all three of its business units. It nevertheless kept its target of achieving a 14% earnings margin before interest, taxes, depreciation and amortization by the end of 2011. It plans to make savings of at least €540 million ($770 million) by then through synergies from its acquisition of U.K. paint maker ICI, as well as restructuring. Chief Executive Hans Wijers said the ICI integration is ahead of schedule, with synergies reaching €340 million. Second-quarter net profit fell 13% to €155 million from €179 million a year earlier, while revenue dropped 10% to €3.67 billion.

Bayer AG

German pharmaceutical and chemical company **Bayer** AG on Wednesday said its second-quarter net profit fell 7.3%, though the company reported strong sales at its HealthCare unit. Net fell to €532 million ($754 million) from €574 million a year earlier, while revenue declined 5.9% to €8.01 billion. A 30% drop in sales at MaterialScience was offset by an 8.3% rise in sales from Bayer's HealthCare subgroup, which accounts for about half of total revenue. MaterialScience, hard-hit by collapsing demand for its plastics, foams and chemicals, seems to have reached the bottom of the cycle, but a lasting improvement isn't yet in sight, Bayer said. Existing restructuring programs will be expedited and further measures may be introduced, particularly in its polycarbonates unit, it said.

Tata Steel Ltd.

Tata Steel Ltd.'s fiscal first-quarter profit fell 47%, which the company said was due to lower product prices and a change in accounting practices. Unconsolidated profit for the standalone company fell to 7.9 billion rupees ($164 million) in the quarter ended June 30 from 14.88 billion rupees a year earlier. Revenue at Tata Steel, the world's eighth-largest steelmaker by capacity, fell 10% to 55.54 billion rupees from 61.65 billion rupees. The company said profit would have been 2.77 billion rupees higher if it had followed an earlier accounting practice allowing it to state its foreign exchange gain in the profit and loss account. Its total steel production in the quarter rose to 1.5 million metric tons from 1.2 million tons.

Randstad Holding NV

The decline of Europe's labor markets contributed to a 90% fall in Dutch staffing group **Randstad Holding** NV's second-quarter net profit, although cost cuts helped prevent it from falling into a loss. Revenue dropped 33% to €2.99 billion ($4.24 billion) compared to a pro forma figure of €4.44 billion, which was adjusted for the acquisition of Vedior, a Dutch staffing agency it bought in 2008. The company closed 340 offices in the quarter and operating expenses excluding restructuring and integration costs fell 24% to €531.1 million. Randstad said net profit fell to €11.6 million from €96.2 million a year ago. The figure includes €7.6 million in restructuring costs, €5 million in integration costs and €39.7 million in amortization on acquisition-related intangibles.

British Airways PLC

British Airways PLC Wednesday said it will no longer offer meals to economy travelers on short-haul routes. A company spokeswoman said the U.K. airline will stop offering meals on flights of under 2½ hours and after 10 a.m. to those traveling in economy class. The move is aimed at saving the struggling carrier £22 million a year. Meals will still be provided to those in premium business class and a snack and non-alcoholic drink will still be offered at no extra charge to all travelers. BA's move mirrors low-cost carriers easyJet PLC and Ryanair Holdings PLC, neither of which serves in-flight meals for free, offering food for sale instead. BA Chairman Martin Broughton said earlier this month the firm couldn't compete as a low-cost carrier and instead would offer "better value" for money.

EasyJet PLC

British budget airline **easyJet** PLC posted a 12% rise in revenue for its fiscal third quarter and said it expects a pretax profit of between £25 million ($41.1 million) and £50 million for its fiscal year. Revenue increased to £721 million for the three months ended June 30 from £641 million a year earlier, boosted by the timing of Easter, which fell in the fiscal third quarter this year and second quarter last year. Average revenue per seat rose 11% to £51.42 from £46.36. EasyJet said it will increase its feet to 187 aircraft by Sept. 30, 2010, from 181 currently. It plans to operate 196 aircraft by the end of fiscal 2011 and 207 by the end of fiscal 2012. EasyJet's results come just days after fellow budget carrier **Ryanair Holdings** PLC scaled back its full-year profit forecasts.

IAC/InterActiveCorp

IAC/InterActiveCorp reversed a loss from a year earlier, when write-downs weighed on results, as the Internet-services group's earnings rose from the previous quarter. IAC, a collection of Internet companies, was revamped last fall but has struggled during the weak advertising environment. The company posted second-quarter earnings of $40.8 million, or 28 cents a share, compared with a year-earlier loss of $421.6 million, or $3.02 a share. The year-earlier results included a $132.6 million impairment charge. Revenue in the latest quarter declined 4% to $340 million. Earnings before amortization in the media and advertising segment, which includes the Ask.com search engine, dropped 56%.

Reckitt Benckiser PLC

Reckitt Benckiser PLC continued to shrug off the effects of the global downturn Wednesday, posting a 31% rise in second-quarter net profit and raising both its sales and profit targets for the full year. Net profit jumped to £310 million ($509.6 million) from £237 million a year earlier as sales were up 20% at £1.87 billion from £1.56 billion, said the maker of products such as Lysol, Clearasil and Senokot. Stripping currency fluctuations, sales were up 8%, thanks to price increases, the easing of input costs and cost savings. Sales were driven by Reckitt Benckiser's heroin-dependency treatment Suboxone. Stripping out the benefit of Suboxane, Reckitt's sales-growth rate was just 5%. The company is targeting net revenue growth of 5% to 6%, up from 4% previously, and net profit growth of 10% to 11%, up from a previous forecast of 8% to 10%.

ConocoPhillips

ConocoPhillips produced more crude oil in the second quarter than in the same period a year earlier, but lost money turning it into gasoline, driving overall profit down 76%. Conoco earned $1.3 billion in the second quarter, down from $5.4 billion a year earlier amid sharply lower prices for oil and natural gas. Revenue fell 50% to $35.4 billion. The Houston-based company produced 7% more oil and natural gas than in the year-earlier quarter as new projects in the U.K., Russia and elsewhere came online. Conoco's refining business, which turns crude oil into gasoline, diesel and other products, posted a loss of $52 million in the second quarter, compared with a $664 million profit a year earlier. Refiners have been hit hard as demand has fallen.

Deutsche Lufthansa AG

Deutsche Lufthansa AG said Wednesday it swung to a net loss in the first half, but reiterated its goal of generating an operating profit in 2009 despite "considerable risks" linked to declining demand for passenger air travel. The German flag carrier posted a loss of €216 million ($306 million), compared with a year-earlier profit of €381 million. Lufthansa's closely watched operating profit dropped to €8 million from €677 million a year earlier. Sales were down 15% to €10.2 billion from €12.06 billion. Lufthansa repeated its pledge to step up efforts to safeguard earnings across the company. The carrier said it hoped to achieve €1 billion in savings by the end of 2011 at its core passenger operation.

Toshiba Corp.

Toshiba Corp. said its group net loss worsened in the fiscal first quarter as restructuring costs and red ink at its chip operations continued to weigh on the company. The company left its annual net loss forecast of 50 billion yen ($528.9 million) unchanged for the year ending March 2010. The Japanese electronics conglomerate reported a 57.80 billion yen net loss in the three months ended June 30, compared with the 11.61 billion yen loss the company reported in the same period a year earlier. The company's revenue during the quarter fell to 1.340 trillion yen from 1.618 trillion yen, and it posted a 37.59 billion yen operating loss. Mired in huge losses at its chip operations, Toshiba is in the middle of a major restructuring that includes cutting temporary jobs and improving chip production efficiency.

Nippon Steel Corp.

Nippon Steel Corp., Japan's biggest steel maker by output, reported its second consecutive quarterly net loss amid weaker domestic demand for high-end steel products and the increased cost of raw materials. The world's second-largest steelmaker after **ArcelorMittal** said it incurred a net loss of 42.25 billion yen ($446.8 million) in the fiscal first quarter ended June 30, compared with a year-earlier net profit of 82.76 billion yen. Hurt by poor sales of high-end products to auto makers and other manufacturers, group sales sank 38% to 745.08 billion yen from 1.2 billion yen. Although steel demand in other Asian countries has started to improve, weak sales of high-grade products mean a recovery in Nippon Steel's earnings is likely to remain difficult for now.

—Compiled from staff and wire service reports.

ECONOMY & POLITICS

Protesters' brutal deaths spark Iran fury

Regime releases 140 detainees in apparent bid to ease opposition pressure; reports of violent interrogations abound

By Farnaz Fassihi

Reports from Tehran families in recent days of receiving the bodies of relatives arrested at opposition rallies who later died from violent treatment in prison have fueled anger at the government.

Among the dead is Mohsen Rouhalamini, the son of a prominent conservative and adviser to presidential candidate Mohsen Rezai. His family said he died of cardiac arrest and bleeding in his lungs, and that his face had been smashed.

News of his death in prison last week spurred fury across political lines, prompting even some progovernment newspapers and lawmakers to charge the regime with excessive use of force and violence in crushing its opposition. Opposition leaders warned of a backlash and urged the government of President Mahmoud Ahmadinejad to reverse its actions.

"People will not forgive these acts. How could it be possible that someone goes into a prison, then his body comes out?" opposition leader Mir Hossein Mousavi said Monday in a meeting with teachers.

Some of the families say they are speaking out despite being warned against talking to the media and holding funerals and memorial services. On receiving the bodies, they say, they were told to sign consent forms that named the cause of death as meningitis, flu or bacterial infection.

In addition, scores of protesters who have been detained and released in the past few weeks are now coming forth with details of their arrest and prison conditions.

Associated Press

At a Berlin rally, a woman places a rose by a portrait of Sohrab Arabi, who vanished in Iran in June. His body was released this month.

These accounts paint a disturbing picture of widespread abuse and torture by interrogators in detention facilities that are overflowing.

The opposition has called for a nationwide protest on Thursday to commemorate the the deaths of Neda Agha Soltan and others killed in violent protests on June 20. In Shiite Islam, it is the custom to hold a memorial service on the 40th day after a person's death.

Iran's regime appears to be responding to the pressures, seemingly wary of an even deeper divide in an already volatile political landscape. On Tuesday, it released 140 detained protesters, and Supreme Leader Ayatollah Ali Khamenei ordered the closure of a detention facility in south Tehran known as Kahrizak where protesters were being held. Before this, it had been used to jail drug dealers.

The parliament last week named a special committee to investigate the conditions of prisoners and facilities after hundreds of families wrote to lawmakers complaining about lack of transparency and reports of abuse.

On Wednesday, the Associated Press quoted Iranian state news agency IRNA as reporting "around 20" detainees involved in "planning and carrying out sabotage" will go on trial starting on Saturday. The report said this would be the "first phase" of trials, the AP said.

According to independent human-rights organizations, over 1,000 people have been arrested and nearly 100 killed after the June 12 presidential election. Among the arrested are 250 prominent reformers, journalists, lawyers and student activists.

The Iranian regime puts the number of arrested around 500 and the death toll at 20.

"The regime's first priority is survival. First they repress violently and now they realize their legitimacy is badly tarnished, so they are trying to defuse the incredible anger by people," said Payam Akhavan, a former prosecutor at The Hague and cofounder of Iran Human Rights Documentation Center in New Haven, Conn.

Last week, families who had missing relatives were taken to a cold-storage facility for fruits and vegetables in the south of Tehran that had been turned into a morgue. Pictures posted on Iranian Web sites showed bodies piled on top of one another as families tried to identify loved ones.

Among the bodies released recently to relatives in Tehran, Ramin Ghahremani, 30, died in the hospital because of internal bleeding in his chest. He was beaten and hanged upside down for long periods, according to his mother, who spoke with him while he was in the hospital.

Amir Javadifar, 27, a graduate student in industrial management, had broken bones and bruises, according to his father, Ali Javadifard, who saw his son in the hospital before he died. On Monday, Mr. Javadifard was taken to a morgue and received his son's body.

"My son was healthy and well when they arrested him, and his body was returned to me in a different condition," Mr. Javadifard said.

India's Singh walks a tightrope on statements on Pakistan

By Ketaki Gokhale

NEW DELHI—Indian Prime Minister Manmohan Singh defended statements he made weeks ago to try to improve relations with Pakistan, saying Wednesday that a new dossier from Islamabad convinced him the nation is making a sincere effort to crack down on cross-border terrorism and that peace in South Asia had to be pursued.

At the same time—in a move to smooth ruffled feathers within his own Congress party and to counter opposition taunts that he has taken a soft line—Mr. Singh repeatedly said talks between the two countries on broader issues like trade and travel can't continue unless Pakistan pursues strong action against terror.

A joint statement signed two weeks ago by Mr. Singh and his Pakistan counterpart, Prime Minister Yousuf Raza Gilani, said India and Pakistan agreed to decouple discussions about terrorism from broader talks between the two countries on issues such as trade and travel.

Mr. Singh has thrust India's relations with Pakistan to the top of the political agenda in a way few expected when he began another five-year term in office a few weeks ago. How he fares in this political skirmish could help to set the tone for how India deals with Pakistan through his administration.

His supporters say he is determined to leave good relations with Pakistan as part of his political legacy. But Mr. Singh has been facing flak from opponents who say his statement was too concessionary and a departure from popular consensus.

Yashwant Sinha, a parliamentarian from the opposition Bharatiya Janata Party, said that the Indian public, still riled by last year's Mumbai attacks, wants Pakistan to bring the terrorists responsible to justice. The agreement "obliterates the distinction between being a perpetrator and victim," said Mr. Sinha during a vitriolic confrontation in parliament. At another point, Mr. Sinha accused Mr. Singh of "walking all the way to the Pakistani camp."

Manmohan Singh

Mr. Singh countered that "unbracketing" the discussion of terror from general talks between the neighbors wasn't a signal that India's aggressive stance on terrorism had changed, or that the formal peace talks between the two countries would resume regardless of Pakistan's action against terror. What the agreement meant to convey was that Pakistan was making satisfactory progress in investigating the November attacks in Mumbai, he said.

A 34-page dossier detailing a high-level Pakistani investigation into the planning and execution of the Mumbai attacks was handed to Mr. Singh just days before his meeting with Mr. Gilani in Sharm el-Sheikh, Egypt, at a summit of non-aligned countries. It provided details of the communication networks the militant group Lashkar-e-Taiba used to plan the attacks, photographs of the alleged plotters in custody in Pakistan, and an account of the progress of the investigation. A charge sheet has been filed against 18 suspects, and a trial in Pakistan is in the offing, Mr. Singh said.

"This is the first time that Pakistan has ever formally briefed us on the results of an investigation into a terrorist attack in India," he said Wednesday. "It is also the first time that they have admitted that their nationals and a terrorist organization based in Pakistan carried out a ghastly terrorist act in India."

He said his goal is to ensure long-term peace and stability in the region, and that the best approach is to "begin to trust each other, but not blindly, but trust and verify" that the necessary steps are being taken by Pakistan to root out terrorism.

At the same time, Mr. Singh emphasized that India's general position on terrorism was unchanged. "It's not enough to say that Pakistan is a victim of terrorism," he pointed out. "They must show the same political will and take the same sustained action on terrorism on their eastern border as they are taking on their western border."

Some observers speculated that Mr. Singh would cave to pressure from his party and retract his conciliatory statements with Mr. Gilani before parliament. But according to Sanjay Kumar, a fellow at the Centre for the Study of Developing Societies, a New Delhi think tank, Mr. Singh has stuck with his original line of opening up dialogue with Pakistan.

"He didn't backtrack from anything in the joint statement," Mr. Kumar said. "In fact, the prime minister kept on repeating the verbal assurances of his Pakistani counterpart. He took the line that to emerge as a superpower in the region, India has to engage in negotiation—even if it would seem he had conceded some ground to Pakistan."

he joint statement also made reference to new information from Pakistan on the insurgency in the western province of Baluchistan, a sore point between the two neighbors. Pakistani officials have repeatedly accused India of helping Baluch separatists through its consulates in southern Afghanistan, a charge India denies. The raising of Baluchistan as an issue between the two countries could create further political static. Mr. Singh on Wednesday defended the inclusion of Baluchistan in the agreement, saying India has "nothing to hide."

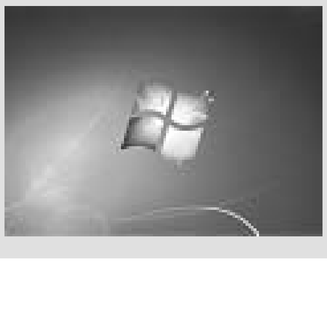
"Baluchistan is going to be in focus for a few years to come," Mr. Kumar said, and the passing reference to the situation in the joint agreement will only add fuel to the fire. "If you issue a statement on Baluchistan without saying anything on Kashmir, that will be a big problem in the coming days," he said.

—Vibhuti Agarwal contributed to this article.

Personal Technology

Looking askance

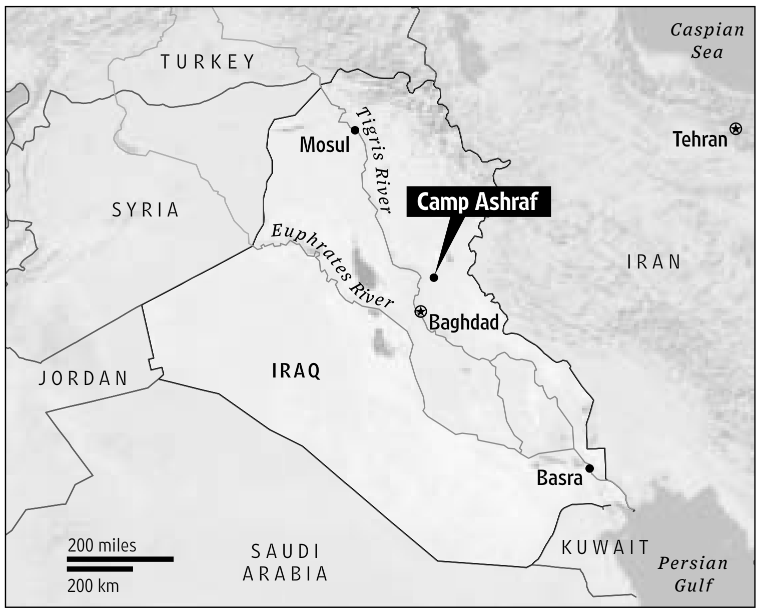
Walter S. Mossberg further explains the Windows 7 upgrade > **Page 29**



Iraq will close Iranian opposition outpost

U.S. criticizes attack on MEK's camp; praise from Tehran

By Charles Levinson
And Peter Spiegel



BAGHDAD—The Iraqi government said it plans to close a camp that is home to more than 3,000 members of an Iranian opposition group, a day after launching a violent assault on the camp that has been criticized by Washington and praised by Tehran.

Since members of the group, known as the Mujahedin el-Khalq, or the MEK, have enjoyed U.S. military protection since 2004, the raid has raised questions about whether the Iraqi government is inching closer to Iran as the U.S. withdraws its forces.

Iran's Speaker of Parliament Ali Larijani on Wednesday praised the assault on the group, which was responsible for a number of attacks against Iranian officials in the 1980s, and which fought alongside Saddam Hussein in the Iran-Iraq war.

"Although this measure was taken late by Iraq, it is admirable that they have decided to clear Iraq from terrorists," Mr. Larijani said, according to Iran's state-run Fars news agency.

U.S. officials, however, said they were unhappy about the way the raid was handled, though they stressed that it was a matter for Iraqi sovereign decision-making since the U.S. handed the area over to Iraqi control in February.

"It's a sovereign matter for the government of Iraq and it's up to them to resolve this," said one U.S. official. "But we would have preferred it be handled differently. The outcome wasn't good and we're not happy about that."

Opposition lawmakers in Iraq who oppose Iran's influence there have questioned the timing of the operation, which coincided with an unannounced visit to Iraq by U.S. Defense Secretary Robert Gates. One independent Sunni lawmaker, Dhafer al-Aani, said that attacking an Iranian opposition group just weeks after the Iranian government brutally crushed street protests throughout Iran sent the wrong signal to the international community.

A spokesman for the MEK in Rome, Shahin Gobadi, accused the Iraqi government of taking orders directly from Iran's Supreme Leader Ayatollah Ali Khamenei.

"This is happening now because Khamenei is trying to find a way to cover up for its defeat in the streets of Tehran," said Mr. Gobadi.

According to U.S. officials, the unrest started when a newly appointed Iraqi police district commander decided to put a police station within the camp, known as Camp Ashraf, in order to assert local control.

The U.S. official said that at first, unarmed Iraqi riot police trained in crowd control were deployed, but they were quickly overrun by demonstrators within the camp. The official said police then called in the Iraqi army as backup, and the infantry unit that responded acted more forcefully when it entered the camp, leading to the clash.

"They [the infantry] were not trained in crowd control," the U.S. official said. "They employed some heavy-handed tactics." He confirmed there had been fatalities in the ensuing conflict, but reports from a U.S. military assessment team had yet to determine the total number of dead.

MEK members inside the camp said eight members of the group were shot dead by Iraqi forces using live ammunition, and more than 400 people were wounded. A spokesman for the Iraqi police in Diyala province, where the camp is located, said 45 police were also injured in the clashes.

However, Iraqi government spokesman Ali al-Dabbagh denied that anyone had died in the assault, and said Iraqi forces used only nonlethal force against the camp's residents. He said the raid was simply a matter of extending the rule of law throughout the country, and that police only entered the camp by force after the MEK rebuffed police requests to enter peacefully.

U.S. officials said Iraq had informed Washington several days in advance that the government intended to put a police station inside the camp, but that the Iraqis didn't seek American help or approval.

It now appears that the Iraqi government intends to go a step further in cracking down on the MEK. According to a statement released Tuesday by the office of Iraqi Prime Minister Nouri al-Maliki, the camp will be shuttered, and residents will be relocated to a camp elsewhere in Iraq or allowed to travel to a third country of their choosing.

The majority of the MEK members inside the camp hold only Iranian passports. The MEK's leaders have said they are willing to return to Iran provided there are international guarantees that they will be safe and won't be prosecuted—conditions Iran is unlikely to agree to.

The U.S. has a mixed history with the MEK. In the 1990s the State Department included the group on its list of terrorist organizations because of its links to attacks against U.S. and Iranian officials in the 1970s and 1980s. But in 2004 the U.S. military granted members of the MEK in Iraq protected persons status under the fourth Geneva Convention, guaranteeing that MEK members would be protected from religious and political persecution and that they wouldn't be forcibly transferred to a country where they might face such persecution. Iraq has assured the U.S. it will live up to these assurances.

Pentagon chief urges Kurds to end conflict with Baghdad

By Yochi J. Dreazen
And Charles Levinson

ERBIL, Iraq—U.S. Defense Secretary Robert Gates pressed Kurdish leaders to step back from a potential armed conflict with the Iraqi central government over land and oil.

Mr. Gates told leaders of Iraq's semi-autonomous Kurdish region that they were running out of time to reach a political accommodation with Baghdad and offered American help mediating their disagreements with the government of Prime Minister Nouri al-Maliki.

"We urged them to take advantage of our remaining time in Iraq to settle some of these disputed issues," said Geoff Morrell, Mr. Gates's spokesman. "He reminded his hosts that we have all sacrificed too much in blood and treasure to see the gains of the last few years lost due to political differences."

The U.S. is concerned that the Kurdish-Arab dispute could soon turn violent, reigniting the country's sectarian bloodshed and imperiling the Obama administration's hopes of accelerating the U.S. military withdrawal from Iraq.

Iraq's overall security situation has remained largely stable since U.S. combat forces withdrew from the country's cities last month, and Mr. Gates said that there "was some chance of a modest acceleration" of the U.S. drawdown in Iraq.

There are roughly 130,000 American troops in Iraq, and U.S. commanders have already announced plans to withdraw two brigades, or roughly 10,000 troops, by the end of the year. Mr. Gates, speaking to reporters aboard his plane en route back to the U.S., said a third brigade might now also be able to leave Iraq this year.

The growing Kurdish-Arab tensions are threatening to slow the U.S. withdrawal plans. Gen. Ray Odierno, the top American military commander in Iraq, told reporters Tuesday that he sees Kurdish-Arab friction as the biggest problem facing Iraq, replacing the Shiite-Sunni divide that had initially triggered Iraq's civil war.

"That's probably our No. 1 driver of instability," he said. "We're watching very carefully to see that this doesn't escalate."

Kurdish and Iraqi troops came close to an armed confrontation last month outside Makhmur, a predominantly Kurdish town in northern Iraq. The crisis was averted when U.S. military intermediaries were able to persuade both sides to stand down and move their forces away from the city.

The incident was the highest-profile manifestation of the heated dispute between the two sides over the boundaries of the Kurdish autonomous region, the future of oil-rich Kirkuk, and the division of Iraq's oil revenue.

During his meetings here with Kurdish President Massoud Barzani and other top officials, Mr. Gates said the U.S. was prepared to help mediate, but he didn't offer any specific compromise proposals.

Instead, Mr. Morrell said, the defense chief endorsed the work of a United Nations team that issued a report in April outlining possible solutions. One recommendation calls for making the disputed city of Kirkuk a governorate with formal ties to both Baghdad and Kurdistan as a way of lowering the tensions surrounding the city's fate.

The U.N. report has drawn a muted response from Kurdish and Iraqi leaders. Kurdish officials have avoided rejecting it outright, because it appears to have the backing of the U.S., though many Kurds say they're not happy with the U.N. recommendations or the American pressure to embrace them.

Some Arab political leaders have complained privately that the report is biased toward the Kurds. Some of Mr. Maliki's political allies blame the Kurds for fueling the country's sectarian tensions by forcibly seizing control of broad swaths of northern Iraq in the security vacuum that followed the U.S. invasion in 2003.