News in Depth: Sexual-harassment cases plague U.N.

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S&P threatens U.K. credit rating

Agency says mounting debt imperils triple-A status; stocks, bonds, currency take pounding

By Stephen Fidler And Neil Shah

LONDON—The U.K. government got a harsh wake-up call as credit-rating firm Standard & Poor's warned the country could lose its coveted triple-A credit rating, underscoring the monumental challenges the U.K. and other major developed nations face as they take on heavy debts to help dig their banks and economies out of crisis.

The warning from S&P—its first since the rating firm gave the U.K. its top triple-A rating in 1978—is another blow for Prime Minister Gordon Brown ahead of elections to take place by June 2010, and will put the country's debt problems front and center for whichever party wins.

Analysts said it could also forebode similar warnings for other nations—including even the U.S.—that are seeing their debt loads grow to levels not seen since the aftermath of World War II.

U.K. stocks plunged and the pound slid against the dollar after S&P announced early Thursday that it had changed its outlook for the U.K.'s credit rating to negative—meaning that a downgrade, while not imminent, could come in the next couple of years. S&P said that it will revisit the U.K.'s rating after the elections.

"This is a gun to the head of the next administration to get the public finances back in order," said Russell Silberston, head of global interest rates at Investec Asset Management in London.

A downgrade would exacerbate the UK's financial difficulties, including a gaping budget deficit, by making it more expensive for the government to borrow money, and would be a big comedown for a country that hasn't defaulted on its debt since 1693 and whose currency was at one time the preferred global medium of trade.

S&P said the U.K.'s public debt is likely to rise to nearly dou-

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GM and the UAW reached an agreement to reduce retiree health-care obligations and hourly labor costs, clearing a major hurdle in the car maker's expected plan to rush through bankruptcy court in as little as 30 days. **Page 4**

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■ **The unity government** in Zimbabwe agreed on key appointments in an attempt to resolve a political impasse.

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Cheney, Obama contest Guantanamo and security

Associated Press (2)

OPPOSING PLATFORMS: The former U.S. vice president, left, and the president presented vastly differing views on Thursday. **Page 8.**

Versace CEO expected to resign

By Stacy Meichtry

ROME—**Gianni Versace** SpA Chief Executive Giancarlo Di Risio is expected to resign, a person familiar with the matter said, after months of clashes with designer Donatella Versace over how to cut costs at the Italian fashion house amid the luxury-goods industry's worst downturn in years.

Mr. Di Risio plans to tender his resignation in coming days, this person said. It was unclear how the Versace family, which owns 100% of the fashion house, would react. A spokeswoman for the company declined to comment and said Ms. Versace wasn't available for comment.

The Versace family issued a statement Thursday afternoon denying "that the professional relationship between Versace and its CEO has been terminated." Versace is focusing on "measures it should adopt to confront the effects of the economic downturn on the luxury sector," the statement said.

Imaginechina/Agence France-Presse

Versace CEO Giancarlo Di Risio shown in Shanghai in 2006

Ms. Versace, 53 years old, owns a 20% stake in the company, which was founded by her brother Gianni Versace, who was killed in 1997. Santo Versace, her other brother, owns 30%, and Ms. Versace's 22-year-old daughter owns 50%.

Mr. Di Risio's likely departure, which would come as Versace's sales and profit are suffering, highlights the pressure faced by Europe's many family-owned fashion houses. These small companies are suffering more than their larger, financially sturdier peers amid the global economic slump. Many of these family businesses in recent years have brought in

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Glaxo in fight with U.S. over taxes

By Jesse Drucker

GlaxoSmithKline PLC is embroiled in a potential $1.9 billion court battle with the Internal Revenue Service, which says the pharmaceutical giant owes back taxes, interest and penalties stemming from tax deductions Glaxo generated essentially by making payments to itself.

The dispute centers on a practice known as earnings stripping, in which a multinational company reduces its taxes by claiming interest deductions for payments to a related unit overseas. The company claims deductions on its U.S. tax return, but no money ultimately leaves the parent company's coffers, and publicly reported profit is unchanged.

"The ability of U.S. subsidiaries of foreign multinationals to strip away earnings like this is a problem" because it significantly reduces the U.S. corporate-tax base, says Reuven Avi-Yonah, a former corporate tax attorney and now director of the international-tax program at the University of Michigan Law School.

The battle comes as the Obama administration is targeting corporate tax cutting, this month unveiling a list of tactics it wants to curtail. One of the proposals addresses earnings stripping, but only for a narrow segment of companies.

The tax-savings technique used by Glaxo is popular among foreign companies that have large U.S. operations and often is legal. But the strategy has come under greater scrutiny as U.S. tax authorities crack down on

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Inside

Beautiful exile

A sleepy French town marks Picasso's retreat to a castle **Weekend Journal**, page W8

Markets

4 p.m. ET

	CLOSE	PCT CHG
DJIA	8292.13	-1.54
Nasdaq	1695.25	-1.89
DJ Stoxx 600	207.57	-1.97
FTSE 100	4345.47	-2.75
DAX	4900.67	-2.74
CAC 40	3217.41	-2.60
Euro	$1.3761	-0.14
Nymex crude	$61.05	-1.60

LEADING THE NEWS

Obama defends national-security decisions

President urges trust in U.S. approach; Cheney backs Bush

By John D. McKinnon
And Cam Simpson

WASHINGTON—President Barack Obama sought to reassure lawmakers and the public about his national-security decisions, including plans to shut down the Guantanamo Bay detention center in Cuba and transfer some suspected terrorists to U.S. soil.

Shortly afterward, former Vice President Dick Cheney launched a broad defense of the Bush administration's terrorism policies, accusing critics of engaging in "feigned outrage based on a false narrative."

In the president's speech at the National Archives—home to the U.S. Constitution, the Bill of Rights and other documents related to the country's founding—he urged Americans to trust their government and the country's courts and other institutions to deal with suspected terrorists appropriately, while keeping ordinary Americans safe.

"We are not going to release anyone if it would endanger our national security, nor will we release detainees within the United States who endanger the American people," Mr. Obama said.

The president's speech, which sought to appeal to American democratic ideals while addressing policy details, came in the wake of growing criticism from Republicans and Democrats of his national-security decisions. Wednesday, the Senate rejected, by a 90-6 vote, the administration's request for $80 million in funding to shut the Guantanamo facility, following a similar move by the House.

Mr. Cheney, in a speech that started just minutes after Mr. Obama's Thursday, warned against moving the "worst terrorists" from Guantanamo, and suggested that Mr. Obama was seeking to score political points at the previous administration's expense. "In the fight against terrorism there is no middle ground, and half-measures keep you half-exposed," Mr. Cheney said.

Mr. Obama, meanwhile, decried a "return of the politicization of these issues that have characterized the last several years." He warned that "we will be ill-served by some of the fear-mongering that emerges whenever we discuss this issue."

His speech suggested, however, that his administration could take a harder line on some security issues in the wake of the furor, specifically in setting up a system to hold detainees whom officials regard as genuinely dangerous but who likely couldn't be convicted either in civilian or military courts.

Thursday's speech appeared aimed primarily at responding to rising concerns over the planned shutdown of Guantanamo and what to do with its 240 detainees. Mr. Obama announced in January that he planned to shut down the facility within a year. But the administration has provided few details on how it would handle detainees, except to say that some would be sent overseas and others would be brought to the U.S. to be tried in civilian or military courts.

Before Mr. Obama's speech, Senate Republican Leader Mitch McConnell of Kentucky noted that top Federal Bureau of Investigation officials have warned that Guantanamo detainees transferred into U.S. prisons could "still be able to conduct terrorist activities, much like gang leaders who've been able to run their gangs from prison." Earlier this week, Senate Majority Leader Harry Reid suggested that lawmakers didn't want any of the detainees placed in U.S. prisons.

Mr. Cheney, in his speech, also weighed in on the debate about closing Guantanamo, saying Mr. Obama has found "that it's easy to receive applause in Europe for closing Guantanamo. But it's tricky to come up with an alternative."

Mr. Obama argued that the country's maximum-security prisons were capable of holding convicted terrorists. "Where demanded by justice and national security, we will seek to transfer some detainees to the same type of facilities in which we hold all manner of dangerous and violent criminals within our borders," he said. "Nobody has ever escaped from one of our federal 'supermax' prisons, which hold hundreds of convicted terrorists."

Perhaps the most-controversial proposal was one that would establish a system to detain indefinitely suspects who couldn't likely be convicted in civilian or military courts but whom authorities deemed too dangerous to be released. Such a move could expose Mr. Obama to some of the same criticisms made against the Bush administration and its establishment of Guantanamo, and open up potential questions over legality.

Mr. Obama, a Harvard University-trained lawyer and former law professor, said he would seek to ground the program in sound legal principles. "We do need to update our institutions to deal with this threat," he said. "But we must do so with an abiding confidence in the rule of law and due process; in checks and balances and accountability."

Mr. Obama said the administration would work with Congress to set up such a system, and that it would include periodic reviews to show that continued detention of suspects was justified, in addition to having congressional and judicial oversight.

Describing himself as "someone whose own life was made possible by these documents" in the National Archives, the president appealed to Americans' pride in the country's civil liberties, in explaining his recent national-security decisions. Besides closing Guantanamo, Mr. Obama has banned so-called enhanced-interrogation techniques authorized by the Bush administration that some have called torture.

Emirates net falls 80%; extended weakness likely

By Stefania Bianchi

DUBAI—**Emirates Airline**, the Middle East's largest carrier, said its fiscal full-year net profit fell 80%, providing another indication that even the region's relatively strong carriers are feeling the pain from a sharp drop in travel.

The Dubai-based carrier said Thursday that its net profit fell to 982 million dirhams ($267.4 million) in the year ended March 31 from a record five billion dirhams a year earlier.

"As we move into the new financial year, the outlook is not improving," Chairman Sheikh Ahmed bin Saeed Al Maktoum said in a prepared statement. "Although fuel prices are dropping, demand for business- and first-class traffic is still weak in many markets," he added.

The sharp decline in the airline's earnings also sends a worrying signal for the health of Dubai's tourism and investment-dependent economy. Emirates is considered the jewel in the crown of the business empire of Dubai's ruler, Sheikh Mohammed bin Rashid al Maktoum.

Emirates said record fuel prices at $147 a barrel and declining yields with the strengthening of the U.S. dollar meant that net margins for the company, which also includes Dnata Travel Services, fell to 3.3% for the year from 13.2% the previous year.

Fuel accounted for 36% of Emirates Airline's operating costs, up from 33% a year earlier.

The company's total revenue grew 10% to 46.3 billion dirhams, as the airline's sales rose 9.9% to 44.2 billion dirhams.

"Under the circumstances this is a satisfactory result," Sheikh Ahmed said.

The International Air Transport Association, or IATA, said in March that Middle Eastern airlines will be the only carriers to see demand grow this year, but overcapacity will result in a $900 million combined loss for airlines in the region.

Demand growth for air travel in the region is expected to reach 1.2% this year, but this will be overshadowed by the impact of a 3.8% rise in capacity, the Geneva-based trade group said.

Despite the gloomy outlook, Sheikh Ahmed said the carrier will continue to forge ahead with its aggressive expansion plans.

"Our development plans remain unchanged," he said. "Without downplaying the global economic situation and its challenges for our business, I still believe that the coming year will be one of satisfactory growth for the Emirates Group."

Emirates currently has 161 aircraft on order, valued at $52 billion, excluding options.

—Andrew Critchlow contributed to this article.

CORRECTIONS & AMPLIFICATIONS

Premiere AG, the German pay-TV company partly owned by **News Corp.**, is changing its name to Sky Deutschland AG. A Corporate News article in the May 15-17 edition incorrectly said that News Corp. was changing Premiere's name.

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

INDEX TO BUSINESSES

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

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Mulcahy to end 8-year stint as Xerox chief

Veteran to remain chairman, taps lieutenant for CEO

By Jerry A. DiColo

Xerox Corp. Chairman and Chief Executive Anne M. Mulcahy, known for turning around the company during her eight-year tenure, will retire as head of the company, ceding the position to her handpicked successor, President Ursula M. Burns.

The 56-year-old Ms. Mulcahy, who will continue as chairman of the board after relinquishing the CEO title July 1, leaves Ms. Burns to navigate Xerox as it relies increasingly on the services side of its business to counter the steady decline of printing, which is suffering as more information is exchanged digitally.

While the 50-year-old Ms. Burns had been projected as Ms. Mulcahy's heir-apparent since becoming president in 2007, the timing of the move surprised company followers. In addition, Ms. Burns's promotion—made during Xerox's annual shareholder meeting Thursday—makes her the only African-American female chief executive among the Fortune 500's top 150 companies.

Xerox, Norwalk, Conn., makes printers both for offices and large-scale production, but garners most of its sales from its services businesses, which include maintenance contracts, printing supplies and lease revenues. The recession has exacerbated weak demand for printers, and results have been muted by a strong dollar as much of its revenue comes from overseas.

Nonetheless, Xerox is perceived to be in solid shape, and certainly much stronger than the near-bankrupt condition which Ms. Mulcahy assumed in July 2001.

"Despite a tough economy, we are generating cash, building our technology and services pipeline, and poised for a period of steady profitable growth in the future," Ms. Mulcahy said in a press release.

Xerox spokesman Carl Langsenkamp said Ms. Mulcahy had "prepared Xerox for the time when she chose to retire." Shannon Cross of Cross Research acknowledged as much by describing the promotion as "long telegraphed."

Ms. Burns won't keep the president post, and Mr. Langsenkamp said the company doesn't intend to name a replacement.

Ursula M. Burns

Ms. Mulcahy became CEO of a company struggling after a string of quarterly losses amid falling market share and a probe regarding Xerox's accounting practices. Its copier business was struggling, debt was piled high, and she was soon forced to concede that Xerox had an "unsustainable business model."

Ms. Mulcahy, who joined the company in 1976 as a sales representative, rescued Xerox from near-bankruptcy by rebuilding relations with customers; cutting costs through the outsourcing of manufacturing and back-office operations; introducing new products; selling preferred stock and most of the company's Asian operations; and resolving a government probe by paying a then-record $10 million fine.

She also is credited with expanding Xerox's business beyond traditional copiers and printers into the computer systems used by customers to manage documents, as well as into consulting services.

Ms. Burns, meanwhile, is seen as a significant contributor to Ms. Mulcahy's achievements. For example, Ms. Burns is credited with successfully negotiating with unions to eliminate or outsource thousands of jobs in 2001, a key part of Xerox's rebound.

Ms. Burns, who grew up in New York City and got a master's degree in engineering from Columbia University, is a Xerox lifer who started as a mechanical engineering summer intern in 1980.

Air France, Delta outline benefits of cooperation

By Daniel Michaels

PARIS—An expanded trans-Atlantic alliance between Franco-Dutch carrier **Air France-KLM** and **Delta Air Lines** Inc. will boost each partner's profit by $150 million starting next year, executives from the two airlines said Wednesday.

Air France-KLM CEO Pierre-Henri Gourgeon told a news conference that the new joint venture pooling revenue and costs for flights between Europe and the U.S. and cooperating closely on many other flights will significantly boost both carriers' revenues while cutting costs.

The agreement, which will run for at least 13 years, builds on a longstanding joint venture between Northwest Airlines and KLM Royal Dutch Airlines and a more recent one between Delta and Air France. Air France bought KLM in 2004, and Delta last year bought Northwest.

The merged airlines, which are both in the SkyTeam marketing alliance, had said they planned to reorganize and expand their cooperation. The profit increase includes benefits from the earlier alliances. The companies declined to specify how much the new pact would increase profits.

The pair said their venture now represents about 25% of the industry's total trans-Atlantic capacity and will sharpen their ability to compete against the other airline alliances, Star and Oneworld. Based on 2008-2009 data, the annual joint-venture revenue is estimated at $12 billion, the companies said.

The new venture will include more than 200 transatlantic flights and about 50,000 seats daily, the companies said.

The airlines are able to cooperate by sharing sensitive pricing and marketing data—behavior normally forbidden as illegal collusion—because they have been granted antitrust immunity by U.S. regulators. The European Union has been reviewing antitrust implications of airline alliances for years.

Delta Chief Executive Richard Anderson said the grouping has been "thoroughly reviewed by authorities on both sides of the Atlantic."

CORPORATE NEWS

Reversals mark new auto deals

Schaeffler, once a bidder, weighs sale to tiremaker Continental; VW, Porsche switch roles

In a sign of how the financial crisis is reordering business, German auto-parts maker **Schaeffler Group** has begun discussing a sale to **Continental** AG—just 10 months after Schaeffler launched an $18 billion hostile bid to buy the German tiremaker.

By Dana Cimilluca, Marcus Walker and Stacy Meichtry

Schaeffler's reversal of fortune—the latest twist in a takeover saga that, on paper, has virtually wiped out the founding German family's $9 billion net worth—comes just two weeks after another audacious bid in the German auto industry boomeranged. **Porsche Automobil Holding** SE, which for three years has sought to acquire **Volkswagen** AG, has begun to discuss an effective sale to VW instead.

Continental and Schaeffler said Wednesday they are discussing a number of options to cooperate. One person involved in the talks described a takeover of Schaeffler as the leading scenario, with the companies eager to reap cost savings to help alleviate financial pressures from the recession. The person said any deal is months away.

Schaeffler—long a sleepy company best known for making ball bearings—last July made a surprise bid for its larger rival. After at first resisting, Continental agreed to a deal in August after Schaeffler boosted its offer to €75 a share ($112 at the time) and pledged to keep its stake below 50% for the time being.

Things quickly began to unravel. Continental shares took a dive as auto demand plummeted, and that increased the attractiveness to shareholders of Schaeffler's tender offer.

As a result, Schaeffler ended up with 90% of Continental, much now held by third parties, and took on debt to buy the shares that ballooned to €12 billion ($16.5 billion). Meanwhile, anemic cash flow hurt its ability to handle the debt.

The result has been a debacle for Schaeffler and its principal owner, Maria-Elisabeth Schaeffler. She married company co-founder Georg Schaeffler when she was in her early 20s. When he died in 1996, she took over the company and shook it up with more aggressive dealmaking.

The Continental deal, the climax of that run, now could mean the family's financial undoing. The Schaeffler family's wealth was estimated at nearly $9 billion in 2007. Bankers now estimate the source of that wealth—Schaeffler equity—has negative value.


Sipa/Newscom

Maria-Elisabeth Schaeffler caused a flap by wearing a fur at a ski resort as her company sought state aid.

Compounding her problems, the 67-year-old Ms. Schaeffler was photographed recently in a fur coat at a ski resort, stoking populist ire as the company sought state aid.

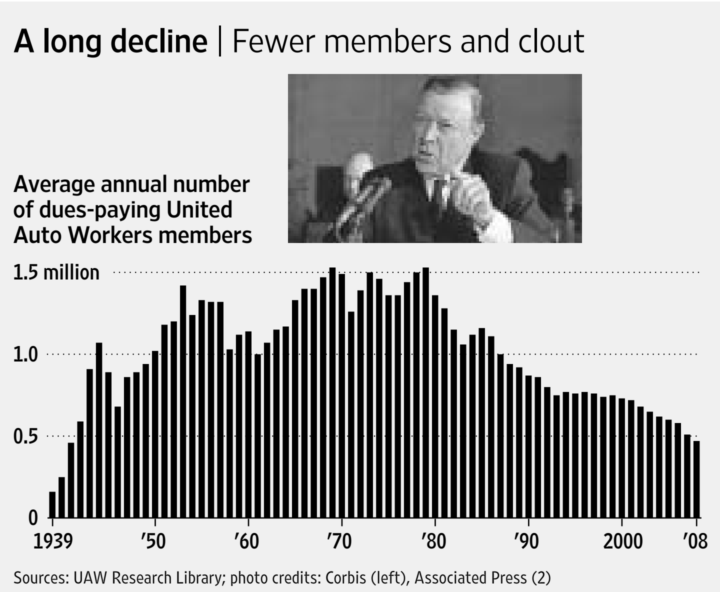
Turning the deal upside down may be a way for her to salvage some value. A person familiar with the matter said the family could end up with a not-insignificant stake and some management role in a merged company.

Should the companies succeed in combining, their challenges wouldn't end. Schaeffler and Continental have combined debt of €23 billion.

In the case of Porsche, the company spent about €23 billion in the last three years to build up a stake of nearly 51% in Volkswagen, a company with annual sales 16 times Porsche's.

Porsche's goal was to raise its stake to 75%, which would have allowed the company to get its hands on VW's large cash reserves to help it pay off the cost of the takeover. However, the same factors that torpedoed Schaeffler's bid—slumping car sales and the global credit crisis—mean Porsche no longer can afford to complete its plan.

Instead, Porsche is now hoping to combine with VW on terms that would allow it to retain a semblance of independence.



Sources: UAW Research Library; photo credits: Corbis (left), Associated Press (2)

UAW members picket a Ford plant in St. Louis in 1937 (left), former UAW President Walter Reuther testifies before a Senate subcommittee in 1966 (center) and current UAW President Ron Gettelfinger talks to the media about Chrysler's bankruptcy on May 4.

GM, UAW union agree on cost-cutting steps

By John D. Stoll And Sharon Terlep

General Motors Corp. and the United Auto Workers reached an accord to reduce retiree health-care obligations and hourly labor costs, clearing a major hurdle in the car maker's expected plan to rush through bankruptcy court in as little as 30 days.

GM, facing a June 1 deadline to restructure out of court, sought a UAW deal to cut by at least half the $20 billion it owes for retiree health care, and shave at least $1 billion from the company's $8 billion in annual hourly labor costs.

Details of the agreement weren't immediately available as the union wants to first present the pact to 60,000 GM workers starting May 26. About one-third of those employees will lose their jobs under GM's restructuring plans.

The new UAW agreement is expected to include a provision for future job buyouts, as well as to forbid strikes for a certain number of years.

In exchange for receiving a $10 billion break on cash needed to fund retiree health care, GM offered the UAW 39% of the company's equity and representation on its board of directors.

Under the deal, wages are expected to remain unchanged. Rather than attack pay, GM focused on eliminating costly work rules, job classifications and employment-security provisions.

A UAW spokesman didn't immediately return phone calls, and a GM spokeswoman declined to comment.

The deal is the latest concession by the UAW after several years of cutbacks. Unlike past negotiations, which often dragged on for months and went past deadlines, the parties—under intense pressure from the U.S. Treasury, which is overseeing GM's restructuring—moved relatively quickly to revise a contract approved in 2007.

"Everybody can see the grim picture in full, reality is staring in everyone's faces and the entity that is making sure that everyone does not miss this story line is the U.S. Treasury," said Donald Schroeder, a bankruptcy attorney with Mintz Levin in Boston. "It's been very transparent as a result of the government oversight."

UAW officials from across the U.S. will gather Tuesday in Detroit to review the agreement.

Although a deal was expected, tensions between the UAW and GM heightened in recent days over the company's plan to import more vehicles to the U.S. in coming years, including its first cars from China in 2011. UAW President Ron Gettelfinger has been an outspoken critic of efforts by U.S. auto companies to import more cars.

Mr. Gettelfinger has managed to secure several promises from GM, **Chrysler** LLC and **Ford Motor** Co. to assign specific models to assembly plants stretching into the next decade. The UAW has already inked new labor deals with Chrysler and Ford.

The UAW deal was considered to be GM's top priority in the days leading up to a bankruptcy filing that is expected because the company has been unable to reach a debt-for-equity exchange with bondholders that the Treasury has mandated.

By lining up a new labor agreement ahead of a filing, the auto maker can walk into bankruptcy court armed with the backing of one of the most critical claimants on the company.


Associated Press

C. Robert Kidder will lead Chrysler's board after bankruptcy.

U.S. Treasury appoints Kidder to head Chrysler

By Alex. P. Kellogg And Sharon Terlep

DETROIT—**Chrysler** LLC said C. Robert Kidder, lead director at Morgan Stanley, will replace Robert Nardelli as chairman after the company completes its reorganization in bankruptcy court and seals its alliance with **Fiat** SpA.

Mr. Kidder, 64 years old, was selected by the U.S. Treasury Department, which had the right to select four of the nine members of Chrysler's new board, a Treasury spokeswoman confirmed. He will help select other members of the board that will oversee the restructured company, which will be called Chrysler Group LLC.

Separately, dealers and analysts said Chrysler's auto sales are faring surprisingly well in May following its April 30 bankruptcy filing. Chrysler sales are down but the decline is not out of line with the industry's overall drop in sales through the first part of May, according to J.D. Power & Associates data released Thursday. **General Motors** Corp. fared worse as it heads for an increasingly likely bankruptcy filing by June 1.

Bargain hunting is likely driving the sales traffic, as consumers hope to score big discounts from dealerships going out of business as part of the auto maker's plan to eliminate about one-quarter of its sales outlets.

On Thursday, Steven J. Landry, Chrysler's executive vice president for North American marketing, warned that if the company's sale of most of its operations to Fiat isn't approved by the bankruptcy court, all 3,181 of its remaining dealers face elimination. Chrysler has already notified 789 dealers that it plans to drop them from its retail network next month.

The selection of Mr. Kidder, a Michigan native and a former chairman of Borden Chemical Inc. and Duracell International Inc., paves the way for the departure of Mr. Nardelli, who has been Chrysler's chairman and CEO since August 2007, when Cerberus Capital Management LP acquired the company. Chrysler had previously said he will be replaced as chief executive when it exits bankruptcy protection. Chrysler's new CEO will be Fiat boss Sergio Marchionne.

Mr. Kidder wasn't available for interviews this week, according to a company spokeswoman.

—Joann S. Lublin and Kerry E. Grace contributed to this article.

CORPORATE NEWS

Chinese face Iraq oil struggle

Farmers complain of damage caused by CNPC's drilling

BY GINA CHON

BAGHDAD—During a ribbon cutting in March, China National Petroleum Co. began work to develop the Ahdeb oil field in southeastern Iraq, marking the first significant foreign investment in the country's vast but creaky oil industry.

Company officials expected logistical and security challenges in the war-torn country. But two months later, their investment is running into an unexpected obstacle: angry farmers.

CNPC's hassles could offer important lessons for other big international oil companies jockeying for a role in Iraq's oil industry. Next month, Iraq is set to award a series of drilling contracts to major international companies. **Royal Dutch Shell Group** PLC, **BP** PLC and **Exxon Mobil** Corp. are all vying for deals.

But Iraqis near the country's oil fields may not be ready for them. Local Iraqi officials and residents have little experience living and working alongside big, private investors from outside the country. And a petroleum law intended to spell out legal rights and responsibilities of foreign investors in Iraq has yet to be approved by Iraq's parliament. (See related article on page 27.)

Just a few weeks after CNPC started work in the field in Wasit Province, local farmers came to the site to complain that the company's oil drilling had damaged property. They asked for compensation, and they also asked for security jobs for relatives.

Local Iraqi officials allege farmers have looted the oil site. Late last month and early this month, oil officials noticed that some exposed electrical cables, running near farmland and powering their operation, had been severed. Farmers later came forward to take responsibility but said the damage was accidental.

Investing in Iraq was never expected to be easy. For decades, Saddam Hussein, the country's former dictator, neglected the oil fields. Iraqi oil officials say they need billions of dollars in investment to bring them back to international standards.

At the same time, security remains a big challenge. While violence across Iraq is down considerably from the worst days of the country's sectarian strife, attacks have started to rise again, just as U.S. forces prepare to accelerate their drawdown.

Wasit Provincial Council Chairman Mahmoud Abdul al-Retha plays down the dispute. He said farmers now are satisfied, after being told they would be compensated for any damage done to their land.

However, one farmer in Wasit, who asked not to be identified by name, said he and others had agreed to take compensation but are still waiting to get it. The farmer said there should have been more cooperation with them before the project started to avoid these problems. Ownership of the land is disputed between the government and the farmers, who say they have farmed it for years.

Oil Ministry spokesman Assem Jihad said problems with the farmers have been exaggerated. He said if they prove that their land has been damaged, they will be compensated.

A Chinese company official declined to talk about the problems the company has been facing in Wasit in detail. But he said Chinese officials knew that working in Iraq would have its challenges. He said that despite the obstacles, the project is progressing relatively smoothly.

"We selected this country and want to work here, so we have to deal with any situation that arises in a practical manner," he said.

Iraqi officials, meanwhile, say they have been embarrassed by the problems. Lawmaker Bassem al-Sharif, who is from Wasit, plans to go to the field soon to investigate allegations by local officials that farmers looted property of the oil company. "We need to take care of our oil industry and make sure investors are encouraged to come here," he said.

U.S. Army photo by Sgt. 1st Class Joe Thompson

Chinese and Iraqi dignitaries gathered at the ribbon-cutting ceremony for the Ahdeb oil-field project in March.

CORPORATE NEWS

Unilever goes Hollywood to sell shampoo

Zeta-Jones stars in 7-minute film aired on Asian TV

BY JONATHAN CHENG

HONG KONG—Taking a page from luxury brands, **Unilever**'s Asian arm is using a splashy Hollywood-style mini-

ADVERTISING

film starring Catherine Zeta-Jones to sell an everyday product: shampoo.

The seven-minute film, called "Alchemist," which is airing in China and Japan, features a motorcycle chase at a high-security laboratory where a youth-enhancing elixir is being produced—an elixir that turns out to be Unilever's Lux shampoo. Later, at a red-carpet ball, Ms. Zeta-Jones's shimmering hair takes center stage in a rendezvous with her motorcyclist accomplice.

Unlike similar efforts in recent years to promote BMW cars and Chanel No. 5 perfume through minifilms, "Alchemist" is being produced primarily for broadcast on TV, not just the Internet and movie theaters. It is also aimed at pushing a mass-market product—in this case, a reformulated Lux shampoo with what Unilever calls "fiberactive technology" meant to heighten hair's shimmer.

"Alchemist," which began airing in March, was produced by the advertising agency JWT, a unit of London-based **WPP**, from an original screenplay by Jeffrey Caine, who also wrote the screenplay for the James Bond flick "GoldenEye" and for the thriller "The Constant Gardener."

Unilever, which didn't disclose the cost, has been buying five-minute blocks of time on channels like China Central Television and Fox this summer to air the minifilm, mostly during programs about movies and celebrities. More than 6.5 million people saw the minifilm via the Web in its first six weeks. An edited version will also be played in movie theaters. The ad plays in English, with Chinese or Japanese subtitles.

JWT

Catherine Zeta-Jones stars in 'Alchemist,' Unilever's Hollywood-style minifilm to market its Lux shampoo. The seven-minute film is aired in Japan and China.

It comes as Lux faces entrenched market leaders in both countries. According to market-research firm Euromonitor International, Lux had a 10.2% market share in Japan last year, putting it a close second to **Shiseido**'s shampoo. In mainland China, its 5.1% market share puts it behind **Procter & Gamble**'s Rejoice, Head & Shoulders and Pantene Pro-V, which together account for nearly 40% of shampoo sales there.

In the past, Unilever has turned to actresses including Keira Knightley, Natalie Portman and Jennifer Connelly to promote Lux in Japanese TV commercials.

But the new seven-minute film is part of an effort by the consumer-products giant to go beyond traditional 30-second slots in an age where ad clutter and technology—like digital video recorders and YouTube— are challenging the effectiveness of traditional ads.

Unilever says Japanese women are exposed to about 1,000 ads in an average week. Advertisers are finding audiences are becoming increasingly sophisticated as global marketing matures, and the spread of DVRs and the use of the Internet and DVDs to watch television shows makes it tougher to capture viewers.

"The means of interacting with consumers has dramatically changed," says Enzo Devoto, Unilever's vice president of hair products in North Asia and Greater China. "A film seemed the perfect solution—by getting into the world of movies, rather than just having movie stars in our ads, which our competitors do too, we can draw consumers closer to the brand."

Unilever is already heavily involved with what's known as "branded entertainment," which traces its lineage to the soap operas of the 1940s and '50s. As advertisers turned to buying traditional TV spots, and then paying TV networks to insert their products in the storyline of a show, advertisers have been on a quest to create branded content without alienating potential customers.

In 2007, Unilever created a series called "The Gamekillers" for MTV to hawk its Axe antiperspirant. The series tried to walk a fine line as its creators tried to avoid making it seem like an extended deodorant commercial while retaining its marketing power.

The new Lux campaign has other precedents, with other brands experimenting with the delivery and length of commercials ranging from five seconds to seven minutes.

Starting in 2001, for instance, BMW hired a number of well-known filmmakers to shoot short films starring British actor Clive Owen and BMW vehicles. The series of films, known collectively as "The Hire," never ran on TV.

In 2004, Australian director Baz Luhrmann created a three-minute film starring Nicole Kidman to promote Chanel No. 5. A shorter version of the film, which cost about $42 million to make, was broadcast on TV.

The risk is that longer-form commercials could test the patience of viewers already fed up with the traditional 30-second spots.

Mr. Devoto says "Alchemist" is less of an interruption to the programming as it is a form of entertainment in and of itself. "When you're watching a movie and on comes an advertisement trying to hard-sell a product, it's pretty much interrupting your entertainment," he says. "Our project is completely different. People want to see it again, and they identify themselves with the main character."

In focus groups, Mr. Devoto says the minifilm got strong reactions when placed alongside traditional commercials. "There was a real 'wow' effect," he says.

The major challenge, was following through on a pricey campaign even as the global economy soured, according to JWT account manager Helen Heatley, who adds that planning began in late 2007. The recession, however, made it a little easier for Unilever to assemble the star-studded team, Mr. Devoto says.

Alcatel's new service gets into mobile ads

BY SARA SILVER AND EMILY STEEL

Alcatel-Lucent is entering the much-hyped market for mobile advertising with a service that will let cellphone carriers offer their customers tailored alerts about a sale at a favorite store or a bank's closest ATM.

The new service, which the big French telecom-equipment maker plans to announce Thursday, will be managed by **1020 Placecast**, a San Francisco-based developer of cellphone and online ads tied to a user's location. The closely held firm's clients include **Hyatt**, **FedEx** and **Avis Rent A Car System**.

Alcatel-Lucent's technology identifies cellphone users within a specified distance of an advertiser's nearest outlet and notifies them of the address and phone number. The ad can also include a link to a coupon or other promotion.

The service might be programmed to reach drivers within five miles of a Walnut Creek, Calif., bank or pedestrians within a five-minute walk of a Manhattan shoe store.

The service's debut comes as phone-gear makers are turning to developing services to make up for declining profits from selling equipment. **Telefon AB L.M. Ericsson** recently said it would offer cellphone carriers a turn-by-turn navigation service for their customers. Last fall, **Nokia** started selling mobile display ads targeted to consumers in 10 metro areas in the U.S. Navteq, a digital-map data company owned by Nokia, has started selling targeted mobile ads based on a consumer's location.

Wireless carriers, meanwhile, are seeking a cut of the revenues from these services.

"This is a vehicle that lets [carriers] extend their network assets" and "grab a share of the revenues that would normally be outside of their reach," says Gani Nayack, president of Alcatel's Rich Communications business. Alcatel will host the new service, testing revenue-sharing models.

Alcatel's service differs from most mobile-ad setups because its ads will be beamed only to cellular customers who sign up for them. They can specify when and how frequently they want to receive ads, and from which vendors. A customer could elect to get retail announcements at lunchtime and movie promotions on evenings and weekends.

Amid privacy concerns, marketers are under increasing pressure to limit their digital ads to customers who "opt in" and to make their ads more relevant to those customers. "If [consumers] opt out, the odds that you hear from them ever again are low," says Phuc Truong, managing director at Mobext, a mobile-marketing network of French ad company **Havas**. "You have one shot to do things right."

In recent years, dozens of companies have raised capital on the premise that advertisers are eager to reach cellphone consumers, whether through text messages or mobile Web sites. If such advertising is targeted to a specific location, rather than citywide, consumers there are three to 10 times as likely to click through the ads, according to Michael Boland, program director of research firm Kelsey Group.

"I call it marketing as a service, not marketing as an intrusion," says Alistair Goodman, chief executive of 1020 Placecast, which uses such factors as neighborhood demographics and the weather to target its ads.

Alcatel and 1020 Placecast hope the service can overcome some of the barriers that have kept mobile advertising a minuscule, though fast-growing, slice of the online-ad market. U.S. mobile-ad spending this year is expected to grow 17% from a year earlier to $760 million, according to research firm eMarketer. That compares with a projected $24.5 billion for the U.S. online-ad market.

The spread of high-speed wireless networks and devices with global-positioning chips that pinpoint a user's location hold the promise of creating enough of an audience to justify location-based ad spending. And the popularity of applications running on **Apple**'s iPhone, **Research in Motion**'s BlackBerry devices and other smart phones shows that consumers are accessing mobile information in droves.

For now, however, the technology for location-based ads is running ahead of demand. Ad executives say they need to see more research on how targeting ads based on location translates into sales.

"The question is always the same: Can we drive more sales?" says Alexandre Mars, head of mobile advertising at ad holding company **Publicis Groupe** and chief executive of its Phonevalley mobile-marketing agency.

Alcatel-Lucent says it is in talks with carriers to start trials this summer, but it declined to identify them. Placecast is also seeking initial advertisers through ad agencies such as AKQA, which runs mobile campaigns for **Target**, **Gap** and **Diageo**'s Smirnoff vodka.

Schering filing details payouts in a Merck deal

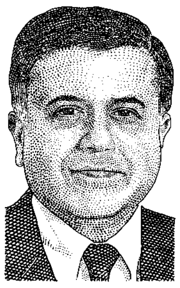
BY JONATHAN D. ROCKOFF

Schering-Plough Corp. executives could receive $107.9 million in severance and pension payments if they leave after the drug maker is taken over by **Merck** & Co.

Chief Executive Fred Hassan and nine other Schering-Plough executives would receive a total of $55.7 million in payments if they leave the company after a Merck takeover, according to a Schering-Plough securities filing. The 10 executives also would receive $52.2 million in pension benefits, according to the filing made late Wednesday.

In addition, the executives could receive tens of millions of dollars from stock options, stock units and performance shares. And they would receive continuing medical benefits valued at $2.1 million.

The disclosures come amid criticism of high executive compensation, and with the Obama administration talking about changing compensation practices in the financial-services industry. Schering-Plough spokesmen emphasized that the terms of the payouts weren't changed in anticipation of a deal, and have been in effect since the executives joined the Kenilworth, N.J., company, many as far back as 2003.



Fred Hassan

Mr. Hassan alone would receive an exit payout of $17.7 million, pension benefits of $13.2 million and medical benefits valued at $130,750, the filing said. Mr. Hassan, 63 years old, has been expected to depart sometime after the completion of the takeover.

Mr. Hassan's departure agreement has been previously disclosed by the company, and the filing said it hasn't been amended since he joined Schering-Plough in 2003, except to make required tax changes. Schering-Plough spokesmen also said none of the nine other agreements, except one to retain a Schering executive involved in combining the two companies, had been amended because of the Merck deal.

Merck, of Whitehouse Station, N.J., says the $41.1 billion deal, announced in March, is on track to be completed in the fourth quarter.

According to the filing, Schering-Plough initially rebuffed Merck's approach about an acquisition, and Mr. Hassan reached out to another company about a possible transaction. The filing didn't identify the other company but it was **Johnson & Johnson**, according to people familiar with the matter. J&J eventually eventually decided against making a bid.

Spokespeople for J&J, Merck and Schering declined to comment on Schering-Plough seeking another bidder.

The securities filing also said that Schering made a filing with the Federal Trade Commission seeking antitrust clearance for the deal on May 20, two days after withdrawing its initial request. The FTC review is focusing on the animal-health businesses of the two companies, a Merck executive has said.

CORPORATE NEWS

Novartis expands in generic drugs, acquiring Ebewe

By Anita Greil

ZURICH—**Novartis** AG said it agreed to buy the specialty-generics business of closely held **Ebewe Pharma** of Austria in a €925 million ($1.26 billion) deal, in a move to strengthen its offering of cancer drugs by adding generics.

Novartis, which sells generic drugs through its Sandoz subsidiary, already has a growing portfolio of cancer drugs that are protected by patents. With the acquisition, Novartis will be able to sell several standard chemotherapies. Ebewe's smaller neurological-products business is excluded from the deal.

Ebewe Pharma, which specializes in injectable medicines, was a subsidiary of Germany's BASF SE until 2001, when a group of investors bought it in a management buyout. Ebewe had total sales of €188 million in 2008.

The same customers —hospitals— buy the branded drugs and the generics.

The deal highlights a recent trend in the pharmaceutical industry as makers of branded drugs diversify into health-care areas outside the traditional pharmaceutical business.

Novartis will finance the acquisition from existing cash and doesn't expect a change to its credit rating. The transaction is subject to regulatory approval and will probably close this year, Novartis said.

The deal underlines the drug maker's strategy of offering its customers medicines ranging from inexpensive generics, when available, to branded products. "It is the same customers—hospitals—that are buying the branded drugs and the generics," Novartis Chief Executive Daniel Vasella said in a telephone interview.

The global market for generic cancer drugs was valued at about $3.5 billion in 2008. It will probably grow significantly in coming years, given that drugs with combined sales of $9 billion annually will lose patent protection by 2015, Novartis said.

Analysts welcomed the acquisition as a complementary fit to Novartis's existing businesses and said the price, though high, was fair. Still, some warned that drug companies' appetite for generic drugs will dent their profitability.

"Although the diversification into generic drugs reduces the risk inherent in the overall health-care business away from pharmaceuticals, boosts growing sales in emerging markets and potentially capitalizes on the patent cliff in 2011-12, it tends to affect adversely an innovative drug maker's profitability and cash flow generation," said Britta Holt, an analyst for the pharmaceutical sector at rating agency Fitch Ratings Inc.

The Novartis deal follows GlaxoSmithKline PLC's recent acquisition of a 16% stake in South African generic drug maker Aspen Pharmacare Holdings Ltd. and Sanofi-Aventis SA's takeover of Czech generics company Zentiva.

GLOBAL BUSINESS BRIEFS

Cable & Wireless PLC

Net profit inches up 2.7% as revenue increases 16%

Cable & Wireless PLC said net profit for the fiscal year ended March 31 edged up 2.7%, weighed down by restructuring costs and expenses related to the integration of Thus PLC. Shares in the company fell 9.6% Thursday in London trading, as signs of recessionary stress, particularly evident in its disappointing outlook, spooked a market used to outperformance. The indicators were subtle, but widespread, including lackluster full-year results, a weaker-than-expected outlook for its Worldwide division and difficulties at recently acquired Thus. Cable & Wireless reported a net profit of £226 million ($356 million) for the year, compared with £220 milllion a year earlier. Revenue rose 16% to £3.65 billion from £3.15 billion.

British Midland Airways Ltd.

British Midland Airways Ltd., or BMI, Wednesday said its controlling shareholder is taking legal action to force **Deutsche Lufthansa** AG to complete its acquisition of shares in BMI. The shareholder, **BBW Partnership** Ltd., said it issued proceedings in the U.K.'s High Court to declare that it has fulfilled all necessary regulatory requirements to complete the sale of BMI to Lufthansa. The German airline already owns 30%-minus-one-share in BMI, but agreed to increase its stake by buying 50%-plus-one-share from BMI founder Michael Bishop. Mr. Bishop exercised a put option in October that obliges Lufthansa to buy his stake for €400 million ($550.7 million). Lufthansa said it hasn't received any lawsuit.

Ryanair Holdings PLC

Ryanair Holdings PLC on Thursday tabled resolutions to cut the compensation of **Aer Lingus** PLC's nonexecutive chairman and nonexecutive directors to 2006 levels. Budget airline Ryanair, which owns 29.8% of Aer Lingus, proposed the resolutions for consideration at the Irish flag carrier's annual general meeting June 5. Ryanair has made two failed attempts to take over Aer Lingus. It hasn't categorically ruled out a third. Ryanair proposed that the remuneration of the nonexecutive chairman should be cut to €35,000 ($48,189) from the €175,000 that was paid in 2007. It also seeks shareholder support to cut the remuneration of nonexecutive directors to €17,500 from €45,000. Aer Lingus board members voluntarily decided in February to reduce their fees for 2009 by 20%, resulting in annual directors' fees of €36,000 and an annual chairman's fee of €140,000. Aer Lingus recommended that shareholders vote against the Ryanair resolutions, saying the fees are reasonable.

Swiss Life Holding

Insurer **Swiss Life Holding** AG appointed industry veteran Thomas Buess as its chief finance officer, following the departure of Thomas Mueller. Mr. Buess, a 52-year-old economist, joins Swiss Life from German insurer Allianz SE, where he is the head of operational transformation. Before that, he held several posts at Zurich Financial Services AG, including chief financial officer of the company and chief operating officer of Zurich Financial Services Global Life. Mr. Buess will take up his new post in the third quarter. "Thomas Buess is an experienced CFO and insurance manager who will strengthen our management team," Swiss Life Chief Executive Bruno Pfister said. "With his in-depth knowledge of the international life-insurance business and his wide-ranging experience of managing transformation processes, especially with regard to productivity and efficiency improvements and the shift toward unit-linked life insurance products, he will make a significant contribution to our group's further success."

Volvo AB

Sweden's **Volvo** AB's truck deliveries plunged 63% in April. Volvo, which sells trucks under brands such as Renault, Nissan Diesel and Mack, as well as its own name, delivered 9,196 vehicles last month, down from 24,616 a year earlier. In Europe and North America, deliveries fell 69% to 4,052 and 1,128 trucks, respectively. Deliveries in Eastern Europe dropped 87% to 382 trucks, as the region's previously fast-growing economies unraveled in the wake of the global credit crisis. The Gothenburg-based company's "near-term picture doesn't look very bright," Hampus Engellau, an analyst with Handelsbanken Capital Markets in Stockholm, said Wednesday. But Mr. Engellau said he believes the North American truck market is getting close to a recovery. "If you look at replacement needs [of old trucks] and how long that market has been in a downturn, then we should be able to anticipate an improvement," he said.

Daimler AG

Daimler AG agreed to pay a fine related to the resignation of former Chief Executive Jürgen Schrempp, but made clear that it admits no wrongdoing and was acting to end a legal saga. The €200,000 ($272,740) fine was imposed by Germany's market regulator, BaFin. BaFin argued that plans for Mr. Schrempp's departure were so advanced by July 10, 2005—18 days before DaimlerChrysler's announcement—that the company should have informed the public then. The announcement of his departure had sent the company's shares higher, hurting investors who had sold in preceding days. Last year, a Frankfurt court rejected the regulator's decision and acquitted the company, now renamed Daimler, but prosecutors appealed. A higher court faulted the amount of evidence considered in the original proceedings and sent the case back for a new trial. A Daimler spokeswoman said the company was now accepting the fine to avoid lengthy new legal proceedings that would generate higher costs.

Sony Corp.

Sony Corp., expecting another year of huge losses, on Thursday said it plans to reduce its suppliers by half over the next two years and save at least 500 billion yen ($5.28 billion) in purchasing costs this fiscal year. Major Japanese electronics makers such as Sony, the maker of Bravia-branded televisions and PlayStation game devices, and rival **Panasonic** Corp. are engaged in sweeping restructurings that focus on cutting costs in an attempt to weather the economic downturn. By March 2011, Sony aims to reduce the number of global suppliers of parts and materials to 1,200 from the current 2,500 to buy in bulk at lower prices. In April, it launched a purchasing department to integrate parts procurement across all its divisions. A Sony spokesman said the savings are already built into the company's earnings forecast for a net loss of 120 billion yen, wider than the 98.9 billion yen loss in the previous year.

AstraZeneca PLC

AstraZeneca PLC said a U.S. court has granted its request for an injunction barring Canada's **Apotex** Inc. from selling a generic version of AstraZeneca's children's asthma medication Pulmicort Respules. The federal district court in New Jersey granted the injunction until a patent-infringement trial is held. A date for the trial hasn't yet been set. The U.S. Food and Drug Administration granted approval to Apotex for a generic version of the drug in March, leading AstraZeneca to start legal action. Patents covering the drug expire in 2018, with pediatric exclusivity extending to 2019. U.S. sales of Pulmicort totaled $982 million last year. Pulmicort Respules accounted for about 90% of that total.

Abertis Infraestructuras SA

Spain's antitrust regulator Thursday said it fined the telecommunications unit of **Abertis Infraestructuras** SA €22.7 million ($31.3 million) for abusing its dominant position with Spanish broadcasters. The regulator said Abertis Telecom breached competition laws on two instances linked to the operation and rollout of the country's digital terrestrial broadcasting network. Abertis abused its dominant position by applying "excessive" penalty fees for early contract cancellations and by demanding an excessively long duration on certain contracts with local broadcasters, the regulator said. The Spanish regulator also says Abertis had offered bigger-than-necessary discounts when bundling broadcasting signals for different Spanish regions, effectively setting barriers of entry for new competitors. An Abertis spokesman said the company will appeal the ruling on grounds that cancellation penalties introduced in contracts in 2006 were eliminated two years later. Abertis also says that the life of the contracts was set by broadcasters. Abertis Telecom has invested €400 million in digital broadcast networks.

Arcandor AG

German companies **Arcandor** AG and **Metro** AG on Thursday said they are considering a merger of their respective department-store units, Karstadt and Kaufhof. The companies said "a combination of Karstadt and Kaufhof can be a fundamentally sensible step for the future of department stores in Germany." Metro and Arcandor said they would form a new German department-store company only if there is "a sustainable and economically sensible concept." The chief executives of the two companies agreed on a further meeting but also agreed not to disclose the content of the talks. Arcandor, which is scrambling for state aid to refinance debt, on Monday initially rejected a proposal from Metro that the companies combine department-store operations. Metro is opposed to state aid for Arcandor because it feels such a move would distort competition.

British Land Co.

U.K. real-estate investment trust **British Land** Co. said its net loss for the fiscal year ended in March widened to £3.9 billion ($6.14 billion), from £1.6 billion a year ago and warned that the financial-market stress of the past 12 months continues to pose challenges. It posted a 64% decline in net asset value per share, the market's preferred measure of the company's performance, but said the values of some parts of its portfolio, such as superstores, have stabilized. Despite falling values, Chief Executive Chris Grigg said he is in no hurry to buy. "We are out there looking...there are some interesting things, but we haven't bought anything yet," he said. British Land sold £1.9 billion of property in the year and raised £740 million in a rights issue. The company will pay a full-year dividend of 29.8 pence, slightly ahead of the prior year and said it will pay a 6.5-pence quarterly dividend in the year to March 2010.

—Compiled from staff and wire service reports.

German presidency test looms

Vote result Saturday could cement Merkel's dominance ahead of September election

By Marcus Walker

Associated Press

Horst Köhler is expected to win a second five-year term to the German presidency in voting by delegates Saturday. Mr. Köhler wasn't widely known until he was chosen as chief of the International Monetary Fund in 2000.

BERLIN—Germany chooses its federal president on Saturday, a contest for a mainly ceremonial post that could boost Chancellor Angela Merkel ahead of September's general election in September.

The ballot pits incumbent President Horst Köhler, a conservative ally of Ms. Merkel, against Social Democrat challenger Gesine Schwan, a left-leaning intellectual, and will be settled by 1,224 delegates from Germany's national parliament and its 16 states. Although ordinary German voters can't take part, presidential elections are often a sign of which way the political wind is blowing in the European Union's most populous nation.

Mr. Köhler, a former head of the International Monetary Fund, is expected to win a second five-year term, as the recession and global financial turmoil have strengthened moderate conservatives in Germany and elsewhere in Europe, while the political left struggles to profit from the current crisis of capitalism.

A Köhler victory would allow Ms. Merkel to associate herself with a popular winner and could also expose potentially embarassing divisions among her left-leaning rivals.

Mr. Köhler, like Ms. Merkel, used to champion market-oriented overhauls of Germany's economy and welfare state, but has backed away from that agenda. In a state-of-the-nation speech in March, he assailed bankers for seeking "freedom without responsibility" and called for "the primacy of government over financial markets."

Growing verbal support among European conservatives such as Mr. Köhler for strong government and a more-equal society "is a sign of a trend in Germany and many Western countries," says Martin Lück, an economist at UBS in Frankfurt. "Supply-side, shareholder-value, free-market policies are on the defensive."

Germany's president has few formal powers, although he or she can dissolve parliament and veto laws on constitutional grounds. The president's main job is to represent the country and articulate its values and challenges.

Opinion polls show Mr. Köhler is widely popular with ordinary Germans, who particularly approve of his recent attacks on unfettered markets. His opponent, Ms. Schwan, is struggling for the support of even her own party's delegates, thanks to the popular Mr. Köhler's moderate stance and her own sometimes controversial views.

If Ms. Schwan is to do better than expected on Saturday, she needs the votes of the Left party, heirs to East Germany's former ruling Communists. But that could backfire on the Social Democrats, who risk losing moderate voters in September's national election if they're seen as too close to the radicals of the Left, says Oskar Niedermayer, a political scientist at Berlin's Free University.

Ms. Schwan, a 66-year-old political philosophy professor, made her name as a moderate Social Democrat strongly critical of Marxism. But in her bid for the presidency she has echoed some of the Left party's rhetoric, including a statement that not everything about East Germany's Communist dictatorship was unjust.

Her comments sparked fierce debate in Germany and earned her rebukes from fellow Social Democrats, who are lagging far behind Ms. Merkel's conservative Christian Democrats in opinion polls ahead of the September election.

In contrast to the intellectual Ms. Schwan, Mr. Köhler, also 66, is an unassuming farmer's son, a trained economist and career civil servant who became widely known when Germany's government unexpectedly vaulted him to the post of IMF chief in 2000. Four years later, Ms. Merkel engineered his election as president, proclaiming him as symbol of a conservative-led government to come.

Ms. Merkel has said she wants to break free of the Social Democrats in September and form a new alliance with the business friendly Free Democrats—something she failed to do at national elections in 2005.

Euro-zone data show economy is bottoming out

By Nicholas Winning

LONDON—The euro zone remains in the grip of its most severe recession since World War II, but data released Thursday provided further evidence that the downturn is bottoming out and companies are no longer as quick to cut jobs.

Markit Economics said the preliminary euro-zone composite Purchasing Managers Index, an early gauge of private-sector activity, rose for a third consecutive month to 43.9 in May from 41.1 in April, marking its highest level since September.

Although the headline figure remains well below the neutral level of 50 and indicates a 12th consecutive month of contraction, the result was stronger than the consensus estimate of 41.9 from a Dow Jones Newswires survey of economists last week.

"Those anticipating a V-shaped recovery will surely take great solace from these figures," said Martin van Vliet, an economist at ING. "While we acknowledge that second-quarter [gross domestic product] may come in better than expected, we remain skeptical whether a sustainable return to positive growth is on the horizon."

The Markit survey showed the PMI for the manufacturing sector increased to 40.5 in May from 36.8 in April, while the PMI for the services sector rose to 44.7 from 43.8. Both marked seven-month highs and beat economists' expectations.

Increasing unemployment remains one of the main threats.

New orders posted their smallest decline for eight months, Markit said.

Looking ahead, expectations of activity in the service sector rose to the highest level for 13 months in May. The rate of new orders to stocks in the manufacturing sector, a gauge of future output, also surged to a 15-month high.

"The PMI data suggest that euro-zone GDP will have fallen at a quarterly rate of around 0.5% in the first two months" of the second quarter, said Chris Williamson, chief economist at Markit.

Economists said the PMI data suggested the European Central Bank was on the right track to slash interest rates to a record low of 1% from 4.25% in October and to unveil plans to buy €60 billion ($82.6 billion) of covered bonds.

Rising unemployment remains one of the main threats to the euro zone's economic rebound, with economists debating whether there will be a sharp V-shaped recovery or an initial bounce followed by a period of stagnation or even another downturn.

Markit said that although euro-zone companies cut employment for the 11th consecutive month in May, the pace of job losses eased from April's record. Job cuts in the service sector were at a record rate, but they moderated in the manufacturing sector.

"While job losses remain widespread, it is also encouraging to see employment fall at a reduced rate for the first time in this downturn," Mr. Williamson said.

As Obama seeks a bridge, Cheney sees a gulf

By Gerald F. Seib

CAPITAL JOURNAL

The headlines will say that two big, dueling speeches about the war on terror were delivered in Washington on Thursday, one by U.S. President Barack Obama and one by former Vice President Dick Cheney.

And that's true, as far as it goes. But it would be more accurate to say that four quite different speeches were delivered.

Mr. Cheney gave one speech, a remarkably focused, blistering attack on those who criticize the Bush administration's methods for detaining and interrogating terror suspects. Scathing in terminology, scornful in tone, the Cheney speech took on those critics, and gave not an inch of ground to them. He questioned both the integrity and wisdom of those, including the current president, who would reverse policies that he said have kept America safe for more than seven years since 9/11.

Meanwhile, Mr. Obama, facing the trickier task of selling a new policy to both parties, really gave three speeches wrapped into one. His first speech was meant to address his critics on the right, who charge he has gone soft on terror and that his decision to close the military detention facility at Guantanamo Bay will bring to U.S. soil dangerous extremists who wish America great harm.

The second speech was to those on the left who say he actually has hewn too closely to Bush policies, as shown in his decision to retain military tribunals for some suspects, his refusal to release photos of the treatment of terror suspects and his disclosure, in Thursday's speech itself, that he will continue to indefinitely detain some suspects without trial.

The third speech was directed to Americans in the middle, to whom Mr. Obama offered assurances that he's searching for a sensible middle ground that will keep terror suspects out of circulation while also honoring American values.

In fact, though, the most basic difference between the Obama and Cheney presentations came on the very question of whether such a middle ground is even possible in the struggle against radical Islamists.

Mr. Obama portrayed the search for the proper strategy for handling terror suspects as a debate between those on the left who "make little allowance for the unique challenges posed by terrorism" and those on the right who argue that "anything goes" in the fight against terrorism.

"And both sides may be sincere in their views, but neither side is right," he said.

Mr. Cheney would have none of it. "The administration seems to pride itself on searching for some kind of middle ground in policies addressing terrorism," he declared. "They may take comfort in hearing disagreement from opposite ends of the spectrum....But in the fight against terrorism, there is no middle ground. And half-measures keep you half-exposed."

Unlike the former vice president, of course, Mr. Obama is coping with the practical problem of persuading Congress to buy his new strategy, meaning he had to at least try to satisfy multiple sides in the national argument. In the strange minuet of the day, the president spoke first, and his specific goal was to convince lawmakers that his decision to close Guantanamo was correct and worthy of their support.

Even some in his own party fear closing the facility means scores of suspects will end up in the U.S., with some possibly set free. The president's response: I have no choice but to fix a legal "mess" over Guantanamo, which was caused by the decision to open it in the first place.

He then walked through a careful explanation of how prisoners would be divided into five categories, with most brought to justice and a small group kept in open-ended detention. That was followed by an equally careful explanation to critics on the left of why his decision to keep secret photos of terrorist interrogations wasn't a betrayal of his promise of transparency.

Mr. Cheney, who began talking literally the minute the president was done, replied: Forget it. Trying to make everybody happy is a recipe for disaster. Guantanamo, he said, has worked. Using "enhanced interrogation techniques" against prisoners also worked. Critics of those techniques are engaged in "contrived indignation and phony moralizing" and, worse, are endangering the country to making it lose its "focus" on stopping terrorism, he said.

As he began his remarks, Mr. Cheney declared: "Today, I'm an even freer man" than while in office to speak his mind. Boy, did he prove it.

CAPITAL ▪ DAVID WESSEL

Keeping joblessness temporary can minimize its scars

Add this to the to-do list in this deep, prolonged recession: prevent the rising number of workers who have been without jobs for six months or more from dropping out of the labor force forever.

The U.S. unemployment rate is at 8.9% and rising. At last tally, 3.7 million people, more than a quarter of the officially unemployed, had been out of work for more than six months—and that counts only those who said they had looked for work in the week when the Bureau of Labor Statistics knocked. An additional 2.1 million weren't counted as unemployed but were deemed by the BLS to be "marginally attached" to the work force; they had looked for a job during the past 12 months but weren't looking now, because there was no point or because they were ill or for some other reason.

Federal Reserve officials' latest forecast, released Wednesday, shows the unemployment rate remaining at a painfully high level next year—between 9% and 9.5%—as the economy regains its strength only slowly. That means a growing band of American workers will go without a paycheck for so long that many will stop thinking of themselves as workers, a development that could hurt them and the overall economy.


Barack Obama

The longer a person is out of work, the more likely he or she will never go back to work, a problem long in evidence in Europe. Skills atrophy. Employers grow skeptical about hiring someone with long spells of unemployment, particularly when they have other applicants from which to choose.

"There is probably less stigma to being unemployed now—losing your job when every one else is," says Lawrence Katz, a Harvard University labor economist. "But when people are out of work for a long time, they become discouraged and stop thinking of themselves as in the labor force. Keeping them connected so they think like they're still workers is important," he adds.

The plight of the long-term unemployed was a worry even in good times, more so now that their ranks are growing. About 46% of all workers collecting state unemployment benefits already have hit the standard 26-week maximum without finding work, the highest level since 1972, when the data were first reported, according to the National Employment Law Project.

The federal government has responded by extending unemployment benefits to as many as 33 additional weeks, depending on the state. Making unemployment benefits too generous can discourage the jobless unemployed from looking for work aggressively or taking a less-than-perfect job—hence prolonging unemployment. But at a time when jobs are scarce, an unemployment-compensation check and the nudge to look for work can help an unemployed worker think of his or her condition as temporary.

President Barack Obama is pushing states to encourage those collecting jobless benefits to enroll in community colleges or other training programs in lieu of looking for jobs that don't exist, and he has changed the federal student-aid rules to make Pell grants more available to the unemployed. The administration is pondering ways to enlist the unemployed to do community service as well.

It's not only compassion. For lots of workers, particularly those over 40, the alternative to looking for work is applying for Social Security disability benefits—and dropping out of the labor force forever.

Of course, many of those collecting disability truly can't work. But for workers with minor disabilities who could and, in many cases, would rather work, the Social Security benefits become the only way to pay the rent. Applications for Social Security disability in April were 20% higher than a year earlier. The application process can be arduous, often taking two years. Even among those whose applications are ultimately rejected, 60% never go back to work, says David Autor, a Massachusetts Institute of Technology economist who has studied disability trends.

At times like these, Mr. Autor says, "People are going to be taking a hiatus. What we want to do is, one, support them so they don't think they should give up this whole work thing and go on disability and, two, we want to give them things to do—to potentially build skills and certainly diminish the pleasure of leisure a bit."

One approach is to tweak the disability benefit to encourage recipients, more than current rules do, to think of the benefit as a temporary, rather than an all-or-nothing, permanent condition. At a recent town-hall meeting, Mr. Obama was asked about lifting limits on the wages a person on disability can earn. The president's answer suggested he'd been briefed recently: "Social Security disability has gone up significantly during this recession. In principle...I would like to raise the income limits to encourage people to become more self-sufficient. In practice, it costs money on the front end, even though long term it may save money." But he made no promises: "What I'd like to do is examine this in the broader context of Social Security reform and Medicare/Medicaid reform," he said.

Recessions as severe as the current one can scar individual workers and an entire economy for a long time after the recovery arrives. Preventing that is impossible. Minimizing it is wise.

Write to me at capital@wsj.com or discuss at wsj.com/capital.

U.S.'s Pelosi heads to China

Sharp Beijing critic to lead delegation from Congress

BY IAN JOHNSON

BEIJING—House Speaker Nancy Pelosi is due to visit China next week, in what observers here hope will be an improbable continuation of the Obama administration's charm offensive in China.

Widely regarded as one of China's sharpest and most public critics, Ms. Pelosi will arrive Sunday and stay a week, according to China's official Xinhua news agency. A Pelosi spokesman didn't respond to a request for comment, but an official from the U.S. embassy in Beijing confirmed that Ms. Pelosi will visit China next week.

According to Western diplomats here, she will head a delegation of members of Congress and is expected to travel to Beijing and Shanghai.

Ms. Pelosi has been one of the most vocal critics of China, most famously unfurling a banner on Tiananmen Square in 1991, where pro-democracy protests in 1989 led to a government crackdown that killed hundreds of people. During the 1990s she was a regular opponent of normal trade relations with China. Last year she earned a series of condemnations from Beijing for suggesting that President George W. Bush boycott the opening ceremonies of the Olympics and for visiting Tibet's exiled spiritual leader, the Dalai Lama, at his base in India.

Next week's visit is especially sensitive because it comes just 10 days before the 20th anniversary of the 1989 uprising. The government's official verdict is that the soldiers had to clear Tiananmen Square of troublemakers in order to preserve social stability. But in recent weeks, new Chinese critics have begun to publicly challenge this interpretation, with a group of academics holding a meeting that called for the event to be re-evaluated and with the posthumous publication of the Communist Party's former general secretary's memoirs, which criticized leaders for not pursuing a peaceful strategy.


Nancy Pelosi

"It's not great timing, but it's positive that she comes to China," said Yan Xuetong, head of the Institute of International Studies at Tsinghua University. "Her image of China is still of the time of the Tiananmen events; this might help her change her view."

The visit will have a green focus, with Ms. Pelosi due to give the keynote address at an environmental energy forum. Sen. John Kerry, chairman of the Foreign Relations Committee, is also due to speak, according to organizers of the conference.

Although the Obama administration has been in office only a few months, so far it has played down human rights as a major theme in China. During a visit in February, Secretary of State Hillary Clinton had little to say publicly on the matter, instead focusing on economics.

That isn't necessarily a bad thing, according to people with long experience in dealing with China, because China rarely responds positively to public criticism. William McCahill, formerly a senior diplomat in the U.S. embassy and now a consultant with JL McGregor & Co., said the most effective critics come to China with a carefully researched list of political prisoners and behind closed doors put pressure for their release.

"Megaphone diplomacy has never yielded very much," Mr. McCahill said. "It might be satisfying for those who wield the megaphones, but for the prisoners it doesn't do much good."

ECONOMY & POLITICS

Irish panel details abuses

Harsh practices cited at institutions run by Catholic church

By Cassell Bryan-Low

A long-awaited report by an Irish commission has concluded that children commonly suffered beatings, rape and molestation in dozens of Catholic-run institutions that operated mainly between the 1930s and the 1970s, shedding a harsh light on practices the church has long sought to play down.

The Commission to Inquire into Child Abuse, set up in 2000 by the Irish government after a string of sexual-abuse cases emerged, presented its findings Wednesday in a report containing evidence from more than 1,000 witnesses who attended or were residents in schools, orphanages, children's homes and other institutions run by the Roman Catholic Church.

The report paints a picture of systematic abuse, and blames religious organizations and government for failing to act when the abuses came to light. Most of the institutions have been closed or converted to other uses.

The report stops short of identifying perpetrators, but documents the cruel and prison-like manner in which priests and nuns ran so-called industrial and reformatory schools, which housed children who were poor, orphaned or had been convicted of crimes. The report says sexual molestation was "endemic" in institutions for boys, and that while girls suffered less sexually, they were victims of frequent beatings and severe emotional abuse.

Many victims the commission spoke to said they struggle with their childhood experiences as adults, describing difficulties with parenting and forming stable relationships as well as debilitating mental-health concerns such as depression, alcohol abuse and suicidal behavior.

The Roman Catholic Archbishop of Dublin, Diarmuid Martin, in a statement praised the courage of victims who had told their stories to the commission, and said the organizations involved in the report should seriously examine "how their ideals became debased by systematic abuse."

The Sisters of Mercy, one of the religious orders named in the report, offered an apology on its Web site to the people who "were hurt and damaged while in our care."

Britain offers Gurkhas automatic right to settle

Associated Press

LONDON—The storied Nepalese warriors who have served Britain's military for nearly two centuries were given the automatic right Thursday to settle in Britain, gaining a hard-won victory after years of lawsuits and lobbying.

The Gurkhas' fierceness has carried them through wars in the Falklands, Iraq and Afghanistan. But their latest triumph owes much to an aristocratic television star who used her passion and popularity to wring concessions from politicians eager to survive the next election.

Joanna Lumley, whose articulate advocacy for Gurkhas made her the face of the campaign to secure their rights, said the decision made it "a fantastic day for my brothers and sisters." She joined Gurkhas gathered outside Parliament in screams of "Ayo Gurkhali!"—the soldiers' famous battle cry.

"Finally, congratulations, they've done the right thing," opposition lawmaker Iain Duncan Smith told Britain's House of Commons as the new government policy was announced.

British Home Secretary Jacqui Smith told lawmakers she was proud to be able to offer the Gurkhas settlement in the U.K., but her government had spent the past few months trying to deny many of them that right. Since 2004, Gurkhas who have served more than four years in the military have been allowed to come to the U.K. after they retire, but that had applied only to soldiers who retired after July 1, 1997.

All others had to apply on a case-by-case basis, something campaigners said effectively left thousands of Nepalese veterans out in the cold.

The government argued that those who retired before 1997—when the Gurkha base was in Hong Kong—had weak links to the country. The government also warned that lifting the restrictions on all Gurkhas would lead to as many as 100,000 Nepalese migrants flooding into the U.K. at a cost to the British taxpayer of £1.4 billion ($2.2 billion).

Rising indicators provide evidence recovery is near

By Justin Lahart

In a sign that economic recovery may be near, the Conference Board said its index of leading economic indicators rose 1% in April. It was the first time the index rose in 10 months, and the largest gain in nearly four years.

The index—a composite of 10 economic and financial indicators, including manufacturing workers' weekly hours, consumer expectations and stock prices—has made similarly sharp increases within two months of the end of past recessions. The Conference Board, a private research group, reported that all but three of the indicators that make up the index rose.

"One month does not a trend make—we don't have anything definitive yet," cautioned Paul Kasriel, an economist at Northern Trust. Still, he said the rise in the index signals that the worst of the downturn is over.

The index began slumping in the second half of 2007, ahead of the beginning of the recession in December that year. In March, it fell to its lowest level since 2004.

Separately, the U.S. Labor Department reported the number of workers filing new unemployment claims fell 12,000 to 631,000 in the week ended May 16. In the prior week, claims rose by 38,000 as workers furloughed by the Chrysler LLC bankruptcy filing signed up for unemployment benefits.

The four-week average, used to smooth the volatile initial jobless claims figures, fell 3,500 to 628,500. But the total number of workers filing for claims hit a new all-time high of 6.6 million.