



Tragic flaw: corruption, cronyism feed the debt crisis in Greece

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Poles mourn as president is laid to rest



Agence France-Presse/Getty Images

Pall bearers carry the coffins of Polish President Lech Kaczynski and his wife, Maria, up a hill toward Wawel Castle in Krakow. Grieving Poles packed Krakow for the burial. **Article on page 6.**

Goldman fights back against SEC

BY SUSANNE CRAIG

Goldman Sachs Group Inc. is mobilizing for a counterattack against the U.S. government's fraud accusations amid mounting concerns that the company could lose business to Wall Street rivals.

On Sunday, the New York firm again denied the Securities and Exchange Commission's allegations that it duped clients by selling them a financial instrument secretly designed by hedge-fund firm Paulson & Co., which then made a \$1 billion profit by betting on the deal's downfall.

Goldman said all three firms that participated in the deal the SEC is investigating were sophisticated players and had a hand in selecting the mortgages they subsequently bet on. Goldman added that it wasn't required to disclose who provided input into the mortgage-selection

process or what views their clients were taking on the portfolio.

"As normal business practice, Goldman does not disclose the identities of a buyer to a seller and vice versa, and the suit is unfounded in law and fact," a Goldman spokesman said Sunday.

There were few signs Sunday that the crisis is forcing executives to launch a large-scale damage-control campaign with customers and shareholders, though Goldman Friday emailed its staff and its sprawling "alumni network," which includes many hedge-fund clients, and was in contact with clients all weekend, trying to dispel any concerns.

The email denied any wrongdoing in the handling of the \$2 billion financial instrument called Abacus 2007-AC1. Goldman was paid \$15 million to arrange the deal but suffered a \$90 million loss be-

cause it took a bullish position on the securities.

Some financial-services industry experts said the accusations by the Securities and Exchange Commission could be impossible for Goldman to overcome no matter how hard it tries.

"Even if unfounded...the impact is profound," said Dee Soder, an executive coach in New York whose clients include financial executives.

Goldman has thousands of clients and counterparties in its role as adviser, asset manager, financier, investor, market maker and trader. In investment banking alone, Goldman has advised more than 1,000 clients in 67 countries during the past five years.

The mess is especially awkward for Goldman's powerful chairman and chief executive, Lloyd C. Blankfein, who pushed hard during the past

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The Quirk



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Trapped in Britain's most dismal election campaign of the last 50 years **Page 13**

Airline closures harm recovery

The extended closure of European airspace because of a cloud of volcanic ash threatens to snuff out the region's feeble economic recovery and has prompted airlines to take unusual measures in an effort to regain some control of the situation.

By **Daniel Michaels** in New York, **Steve McGrath** in London and **Doug Cameron** in Chicago

As aviation authorities prolonged the ban on flights into Monday, bringing the number of canceled flights to more than 63,000, hard-hit European airlines conducted test flights over the weekend to assess the safety of operating through ash and dust spewing out of an Icelandic volcano since Thursday. Many

aviation officials say that authorities have overreacted by closing vast swathes of airspace without detailed analysis of atmospheric conditions and the dangers posed.

"It is completely safe to operate flights during hours of daylight," said Peter Hartman, chief executive of KLM Royal Dutch Airlines.

British Prime Minister Gordon Brown interrupted his campaigning for the U.K. national election to call an emergency cabinet meeting to figure out what to do about the thousands of Britons stranded outside the country, potentially by routing them through Spain or using the Royal Navy.

"We clearly have a reasonable lift capacity within the Royal Navy for lifting people," Alan West, U.K. Parliamentary Undersecretary of State, said outside 10 Downing Street af-

ter the cabinet meeting Sunday night. "That is being looked at at the moment to see what's available."

Late Sunday, aviation and meteorological authorities held out a slight hope that more flights could operate Monday as winds appeared to shift slightly, carrying the cloud away from eastern Germany, Poland and the Czech Republic, a spokeswoman for the European Union's transport commissioner said.

Meanwhile, airlines improvised solutions to move passengers where they could. The Air France unit of **Air France-KLM SA** said it would operate nine long-haul flights Monday to airports in southern France that reopened. **Continental Airlines Inc.**, one of the largest trans-Atlantic operators, said it was changing its sched-

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PAGE TWO

Greek problems will drive integration

[Agenda]

BY IRWIN STELZER



European politicians seem to have learned from their counterparts in the Obama administration. Rahm Emanuel, Barack Obama's tough-minded chief of staff, surveyed the inherited wreckage of the American economy, and told the president, "You never want a serious crisis to go to waste." No one can accuse European Union politicians and their bureaucrats of wasting the serious crisis created for the euro zone by Greek profligacy.

Not that they have solved it quite yet. Mere talk of bailouts and International Monetary Fund intervention didn't satisfy the markets, which remained sufficiently wary to levy so hefty a charge on Greeks bearing bonds that the Greek government capitulated and publicly rattled its begging bowl. It will soon be filled by a euro-zone-IMF consortium.

For the proponents of greater European integration, Greece's crisis is their opportunity to push their agenda further than they would have dreamed possible had the Greeks not cooked their books and gone on a borrowing binge to support the lavish lifestyle of the ever-increasing number of government employees.

It was no secret that a common currency and a one-size-fits-all interest rate would sooner or later run into problems in the absence of a unified fiscal policy. Nor did anyone really believe the 3% limit on the deficit: GDP ratio contained in the Stability and Growth Pact was more than a sop to the Germans for surrendering their stable Deutschmark. But so long as the world's economies were booming, this kink in the armor of Europe's integrationists was of little consequence. Germany's export machine kept rolling, Greek consumers kept importing, borrowing at attractive



International Monetary Fund Managing Director Dominique Strauss-Kahn

rates to pay for the imports, and all seemed well.

Except that it wasn't. So the not-to-be-wasted crisis is upon the euro zone. At this stage, we can make only educated guesses as to whether the final bailout plan will satisfy markets or even

The bailout will lead some nations to have taxations without representation. They won't stand for it

whether the plan will win the necessary votes from the parliaments of countries expected to lend money to Greece at below-market interest rates. But whatever happens, the process is built on an important new principle that will define the euro zone: Each nation is indeed its brothers' fiscal keeper.

No matter that troubled Ireland, Portugal and Spain are expected to contribute to the bailout, or that Angela Merkel has yet to explain to her disapproving electorate why every German should cough up €100 each to enable Greeks to retire earlier than any German can hope to. A long step has been taken to move

the integration project forward.

No taxation without representation is another American notion that will now come into play. European citizens will now, in effect, be taxed to support the Greek government, which they didn't elect and in which they aren't represented.

Soon, they may be called upon to give similar support to Spain, or Portugal, or some other Southern European country. It should come as no surprise that such taxation will result in demands for representation in the fiscal affairs of the beneficiary countries. Not demands to determine the details of any country's tax or spending policy—that would be a bridge too far from the nation-state construct. Rather, those who are paying the piper will want to call the tune on the overall budgetary situations of their EU partners.

But—and this is something of a surprise—the European Central Bank is unlikely to become a key player, despite the fact that it has so far been the defender of the value of the euro.

ECB President Jean-Claude Trichet lost a battle to keep the IMF out of the rescue operation. Although widely praised for his management of monetary policy during the recent recession, Mr.

Trichet found his foray into fiscal policy unacceptable to his euro-zone members.

So where does Europe go from here? That will depend on the outcome of the current battle to determine just who sets the conditions on the support Greece has all-but formally requested. The IMF, which would put up about one-third of the rescue package (€15 billion, or \$20 billion), feels it should set those conditions; members of the euro zone believe it is their right, with France leading efforts to keep the IMF role to a minimum, not least because its managing director, Dominique Strauss-Kahn, is considering challenging Nicolas Sarkozy in France's 2012 presidential election.

My own guess is that the issue will be resolved with one of those messy compromises at which Europe's politicians excel. The IMF will set the conditions, modified sufficiently to meet some of the demands of the member states, so as to avoid an all-out turf battle with those countries.

Olli Rehn, EU commissioner for economic and monetary affairs will begin using his long-dormant budget-monitoring powers, supplementing IMF oversight, and allowing Mr. Sarkozy to claim Europe is following Voltaire's advice and cultivating its own garden. Not to be left behind in the scramble for new powers, Jean-Claude Juncker, head of the euro zone's finance-ministers group, says he will view each country's overall economic performance, with the economies of Spain, Finland and Portugal the first to benefit from his intervention.

We are about to learn just how much additional sovereignty each euro-zone nation is willing to surrender as Europe takes another step—a giant step—down the road to more complete economic integration.

—Irwin Stelzer is a business adviser and director of economic-policy studies at the Hudson Institute.

What's News

■ **The two major parties** in the U.K. are taking different approaches after the Liberal Democrats' strong performance in Thursday's debate tightened the election race: Labour is courting the party, the Tories attacking. 6

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Iain Martin on Politics

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Iain Martin on U.K. Conservative leader David Cameron's battle on two fronts



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NEWS

Pope meets victims

Benedict says the church will bring abusive priests to justice

BY STACY MEICHTRY

ROME—Pope Benedict XVI met privately with a group of clerical-sex-abuse victims in Malta on Sunday, pledging to bring sexually abusive priests to justice and to implement measures to protect children from abuse.

The meeting was Benedict XVI's first encounter with sex-abuse victims since a wave of clerical abuse allegations washed across Europe this year, roiling his papacy.

He previously met with abuse victims during visits to the U.S. and Australia.

The Malta victims, who received phone calls from local church officials inviting them to meet the pope on Sunday, said the pontiff's eyes welled with tears as he met with them individually and then prayed with them as group.

"Everybody was crying," said Joseph Magro, 38, one of eight abuse victims who met the pope. "I told him my name was Joseph, and he had tears in his eyes," Mr. Magro told Associated Press Television News after the meeting.

The pope "was deeply moved by their stories and expressed his shame and sorrow over what victims and their families have suffered," the Vatican said in a statement.

Sunday's meeting came at the end of a two-day trip to Malta that had been planned to mark the 1,950th anniversary of St. Paul's shipwreck on the Mediterranean island.

Benedict XVI has been under pressure for more than a month to respond to the sex-abuse crisis. Benedict XVI has faced criticism for his handling of an abusive priest in his former Archdiocese of Munich-Freising and subsequently for his response to sex-abuse cases as the head of the Congregation for the Doctrine of the Faith, a Vatican office charged with defrocking priests.

Throughout the crisis, however, the pope hasn't engaged his critics with overt gestures or public comments.

On Thursday the pope used a private Mass inside the papal palace to call for "penance" in the face of the scandal.

Although the pope's trip to Malta was overshadowed by the sex-abuse crisis, he didn't mention it in his public appearances, speaking vaguely on Saturday of how "our sins" had left the church in Malta "wounded."

His meeting with victims on Sunday, held behind closed doors inside the Vatican's embassy in Malta, was planned with similar reserve.

Lawrence Grech, who is suing the church for alleged sex abuse by priests, praised the pope's gesture as "something big," according to the AP. Mr. Grech said Benedict XVI told the victims he was "very proud of you for having come forward to tell your story," according to the AP.

The Vatican said the pope told them it would do everything possible to protect young people and ensure justice for perpetrators.

"He prayed with them and assured them that the church is doing, and will continue to do, all in its power to investigate allegations, to bring to justice those responsible for abuse and to implement effective measures designed to safeguard young people in the future," the

Vatican statement said.

Speaking to reporters after the meeting, Vatican spokesman Rev. Federico Lombardi didn't offer any details of what kinds of measures the Vatican planned to implement to fight sexual abuse.

Father Lombardi, who attended the Sunday meeting with victims, told Italian TV the pope "experienced the encounter as something personal."

Critics of the Vatican's response

to sex-abuse have described current Vatican rules as toothless and called on Benedict XVI to deter future abuse by removing bishops who have covered up abuse in their dioceses.

"Not a single adult should feel relieved until strong steps are actually taken, not promised, that will prevent future child sex crimes and cover-ups," said Peter Isely, a member of SNAP, the Survivors Network of those Abused by Priests.



The pope arrives to celebrate a Pontifical mass on the Granaries.

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THE SEC V. GOLDMAN SACHS

Tracking the fallout on Goldman

Wall Street foresees an 'incredible battle'; some see government's case as strong, while others say stock fell too far

BY AARON LUCCHETTI
AND RANDALL SMITH

Friday, news of U.S. regulators' fraud lawsuit against **Goldman Sachs Group Inc.** dominated trading floors and financial channels.

Saturday, it moved to the sidelines of little-league baseball games, birthday parties and other weekend venues of adult conversation.

"It's the flavor of the day," said Gustavo Dolfino, senior managing director at executive recruiting firm Accretive Solutions, on his way to a dinner meeting in London. The Goldman case, he said, was the No. 1 topic at nearly every meeting he had there this weekend.

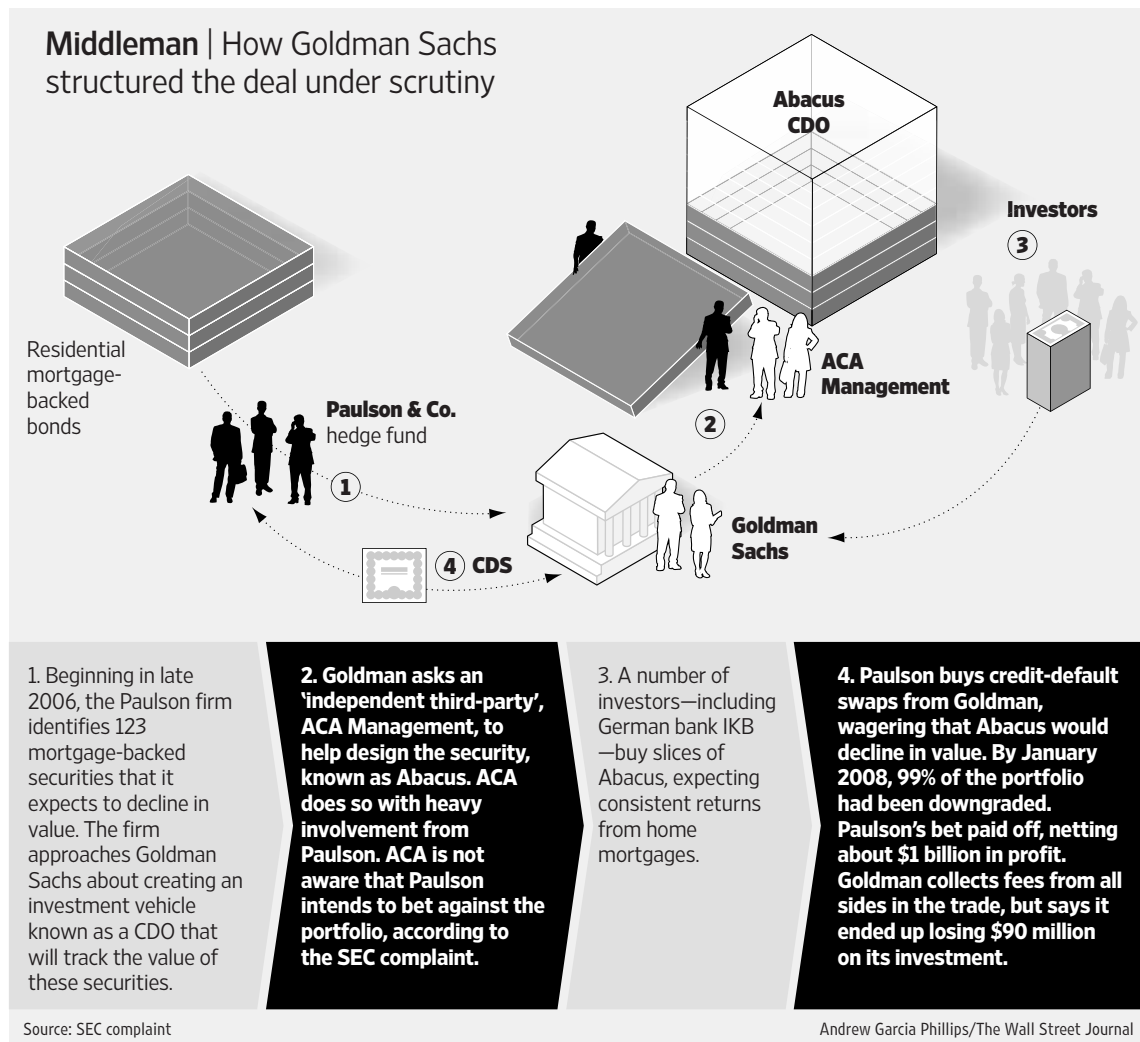
The Securities and Exchange Commission on Friday filed civil charges against Goldman, claiming it deceived clients by selling them mortgage securities designed by a hedge-fund firm run by John Paulson, without revealing his role in structuring the deals. Mr. Paulson profited from betting on the housing market's collapse. Goldman has denied the charges. Mr. Paulson and his company, **Paulson & Co.**, aren't charged.

Some welcomed the government's move or thought it had legs.

"We're starting to peel back a layer of the onion that we hadn't gotten to yet," said Christopher Whalen, managing director of Institutional Risk Analytics, a research and risk-management firm. After reviewing the case, Mr. Whalen said it appears the "SEC has been very cautious."

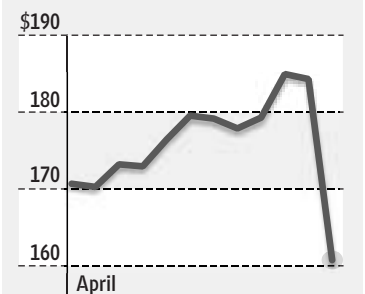
Catherine Banat, a former Goldman employee in treasury and securities services who now specializes in compliance issues, said she has felt "shock and disappointment" at the charges. "We all hold Goldman to a higher standard," she said.

On the other hand, Ms. Banat said, the case "reassures investors



Sinking feeling

Goldman Sachs shares fell 13% to \$160.70 on Friday.



In Greenwich, Conn., Gary Cunningham, chief executive of boutique investment bank Execution Noble LLC, stared at his computer screen Saturday while glancing at an English Premier League soccer match on television. He exchanged emails with colleagues about what the Goldman bombshell meant.

His view: Investors overreacted to the news. Goldman's stock fell nearly 13% Friday.

"To take \$13 billion off the market capitalization of Goldman Sachs is overdone," said Mr. Cunningham, who questions whether the case will succeed. Traders like to exit their positions before a weekend anyway, he figured.

The case signals a turn toward an even more difficult environment for Wall Street, particularly on the lightly regulated area of derivatives trading, some said. The regulators "all have something to prove," said Institutional Risk Analytics' Mr. Whalen. "In the past they leaned in the industry's direction. Now they are leaning the other way."

"People are thinking about how much of the vigorish will be taken out of the over-the-counter" part of Wall Street trading, he said.

Firm is fighting back against fraud charges

Continued from first page
decade to accelerate the company's transformation from a corporate-merger adviser to a trading house that is increasingly focused on using its own capital to generate business.

Although news of the allegations wiped \$12 billion off of Goldman's stock-market value, the 55-year-old Mr. Blankfein's job doesn't appear to be jeopardy. Goldman's board has embraced the firm's overhaul under Mr. Blankfein and his predecessors. He wasn't named in the complaint and it remains unclear whether he knew about the trade. The SEC hasn't alleged that he did know.

In addition, no direct link has surfaced connecting the chief executive to the collateralized debt obligation created for the hedge-fund firm led by John Paulson. Mr. Blankfein wasn't part of a Goldman management committee that was sent a company memo in 2007 describing the deal, according to people familiar with the matter.

Still, Mr. Blankfein and other top Goldman executives can expect to be grilled by analysts and lawmak-

ers this week and next. Goldman is scheduled to report first-quarter earnings Tuesday, followed by an analysts' conference call led by Chief Financial David Viniar.

Mr. Blankfein is set to testify in general terms about the financial crisis April 27 to the Senate Permanent Subcommittee on Investigations, people familiar with the matter said. The Democratic-led panel has been hostile territory for financial executives.

Brad Hintz, an analyst at Bernstein Research, estimated Friday that the SEC's lawsuit could cost Goldman as much as \$706.5 million in civil fines and investor payments.

If Goldman loses the federal civil-fraud case, "it's going to be harder for a CEO to choose Goldman over, say, Morgan [Stanley] or somebody else because then their shareholders and their board are going to be saying: 'Why are you choosing this investment bank?'" said Robbie Vorhaus, a crisis and reputation adviser in New York.

—Joann S. Lublin and Erin White contributed to this article.

in good faith."

Others were sympathetic to the investment bank's position, namely that it didn't need to disclose Paulson & Co.'s role in shaping the securities and it didn't mislead others in the process as to the hedge-fund firm's bearish position.

"I kind of rushed to judgment," upon first seeing the charges, said

David Trone of Macquarie Securities, who follows banks and broker-dealers. The "claim obviously makes the target look pretty guilty."

But after Goldman gave a detailed statement Friday afternoon, Mr. Trone said, "it was pretty convincing as well. It seems like there are two sides of every story....It's going to be an incredible battle."

Lawyers see challenges for SEC case

BY KARA SCANNELL
AND FAWN JOHNSON

The U.S. Securities and Exchange Commission unearthed significant evidence against **Goldman Sachs Group Inc.** in its fraud case filed Friday, but the agency still faces challenges in persuading a jury should the case go to trial, lawyers not involved in the case said.

The SEC's suit against Goldman is the agency's biggest assault on a Wall Street firm in a matter stemming from the credit crisis. A successful outcome for the SEC could go a long way in repairing its reputation, which was damaged by its failure to discover Bernard Madoff's Ponzi scheme and other shortcomings that emerged during the crisis.

The SEC's case against Goldman and a vice president at the firm, Fabrice Tourre, hangs on a single critical contention. The SEC says Goldman sold investors a product linked to the performance of certain mortgages without telling them that Paulson & Co., a hedge fund betting on the mortgages' demise, helped design the product. Paulson wasn't charged.

Several lawyers not involved in the case said the evidence, as laid out in the SEC's complaint, is deep

enough to support the civil-fraud charges. "From the complaint, it looks pretty strong," said Jill Fisch, a law professor at the University of Pennsylvania. "It's a test case in terms of the SEC going forward both for whether they're successful and, if they settle, will it be a meaningful penalty."

The SEC has the tricky job of showing that Goldman was reckless in deceiving investors about the hedge fund's role, said Peter Huang, a securities-law professor at Temple University.

"If you were buying something, you should care about the fact that the person who was picking the things you were buying was actually betting against them," he said.

Goldman denied the allegations and said it was "disappointed" the SEC filed a lawsuit "related to a single transaction in the face of an extensive record which establishes that the accusations are unfounded in law and fact." A lawyer for Mr. Tourre didn't respond to an email seeking comment.

One line of defense, hinted at in Goldman's initial statements, is that the sophisticated investors buying the products should have known these transactions inherently involve investors betting on the suc-

cess and failure of the underlying mortgages. Lawyers who reviewed the SEC complaint agreed that the products themselves weren't illegal.

"They're going to have to show...that [Goldman] knew that Paulson was not only short-selling it but he had a big role in collecting the weakest possible mortgages to bet against it," said Bradley Simon, a white-collar criminal defense lawyer and partner at Simon & Partners LLP. The complaint alleges that Goldman intentionally hid Paulson's role and deceived investors into thinking that an independent mortgage-analysis firm, ACA Management LLC, was responsible for designing the product.

The specifics of what ACA knew about Paulson's involvement in creating the product and what Goldman then told investors will be important to establishing the SEC's case, several attorneys said.

A jury trial will become a public-relations war, said Mark Britton, a former SEC staff attorney and founder of the lawyer rating Web site Avvo.com. "To the extent Goldman gets to a jury, they're going to attempt to assemble jurors that are very conservative and are not going to like the government meddling in capital markets," Mr. Britton said.

THE SEC V. GOLDMAN SACHS

U.K., Germany plan to seek information on Goldman

BY MARCUS WALKER
AND DAVID ENRICH

The U.K. and Germany said their financial regulators would seek information from the U.S. Securities and Exchange Commission about the case in which **Goldman Sachs Group Inc.** is accused of defrauding investors, in order to establish whether British and German banks were victims of wrongdoing.

The two countries count as Goldman's most important markets in Europe, and government investigations there would be another challenge for Goldman as it tries to fend off the charges in the U.S.

On Sunday, U.K. Prime Minister Gordon Brown said he would instruct the Financial Services Authority to conduct an immediate special investigation into how Goldman's alleged actions affected British banks, including the **Royal Bank of Scotland Group PLC.**

Mr. Brown's statement came after a spokesman for German Chancellor Angela Merkel said Germany's financial regulator Bafin would ask the SEC for information as a possible prelude to legal action in Germany.

"First we must ask for the documents, then evaluate [them] and then decide about legal steps," said the chancellor's spokesman over the weekend.

The threats of possible legal action against Goldman in Europe are a sign of the continuing anger at banks among European voters and officials, many of whom believe that Goldman and other banks, having benefited from bailouts by their respective governments, have reverted to the kind of risky trading that led to the financial crisis.

The U.S. government alleges Goldman sold mortgage investments without telling buyers they were crafted with input from a client who was betting against them.

RBS, which since the financial crisis has been majority owned by the U.K. government, was a large investor in the Goldman-constructed complex securities at the heart of the SEC case.

Germany's interest in the case stems from the fact that **IKB Deutsche Industriebank AG** bought a significant amount of the collateralized debt obligations in question, contributing to the lender's heavy losses on U.S. mortgage-related securities. Those losses led to a €3.5 billion (\$4.73 billion) bailout of IKB in mid-2007, with most of the money coming from IKB's major shareholder, German state bank KfW. IKB's near-failure marked the start of an escalating banking crisis in Germany in 2007, which found that numerous state and private-sector banks in Europe's biggest economy had invested and lost heavily in U.S. mortgage-related securities. The losses undermined German officials' claims that the subprime-mortgage crisis was a U.S. problem and forced Germany to announce a €500 billion bailout of its banking sector in October 2008.

The FSA is an independent government agency, and it isn't clear how Mr. Brown's statement will impact the U.K. regulator. A person familiar with the matter said Sunday that the FSA was monitoring the U.S. probe into Goldman.

The tale of Paulson's wager

Goldman was a willing partner as hedge fund sought to bet against mortgages

BY SCOTT PATTERSON
AND GREGORY ZUCKERMAN

A bold request by hedge-fund manager John Paulson is at the heart of one of the most significant legal cases stemming from the financial crisis.

Paulson & Co. asked banks including **Goldman Sachs Group Inc.** to structure mortgage deals that would include some of the poorest quality mortgages. The hedge fund's plan: bet against the deals and then hope for a bursting of the housing bubble—exactly what happened. Paulson and its investors scored billions of dollars in profit.

Some on Wall Street say they were reluctant to work with Paulson. One senior banker at Bear Stearns Cos. turned down the business. He questioned the propriety of selling deals to investors that a bearish client was involved in putting together, according to people familiar with the matter.

Goldman and **Deutsche Bank AG** were among those that played ball.

According to the Securities and Exchange Commission complaint on Friday against Goldman, the New York bank in one deal failed to make clear to investors Paulson's role in identifying risky mortgage assets included in the portfolio.

Goldman on Friday called the charges unfounded and said it would vigorously contest them. A spokesman for Deutsche Bank declined to comment.

Paulson isn't named as a defendant. "Goldman made the representations. Paulson did not," said Robert Khuzami, the SEC's enforcement chief.

The hedge-fund firm said in a statement that it had made no misrepresentations and wasn't involved in marketing the deals in question.

Around 2005, Mr. Paulson and a lieutenant, Paolo Pellegrini, had been looking for bubbles in the economy they could sell short, hoping to profit from a decline, according to the firm and investors. They zeroed in on housing.

By the middle of 2006, Mr. Paul-



John Paulson, shown here in New York last year, personally reaped a nearly \$4 billion profit in 2007 by betting against the U.S. housing market.

son and his hedge fund had already purchased protection on billions of dollars of mortgages that would pay off if the mortgages ran into trouble, according to the firm and investors. He wanted more, they said.

Goldman and Deutsche Bank agreed to create big asset pools, known as collateralized debt obligations, or CDOs, that Paulson & Co. could bet against by buying credit-default swaps, an insurance-like form of protection, according to

people familiar with the matter.

The hedge fund provided the banks with lists of securities to form the basis of the CDOs, focusing on those it viewed as the riskiest, the people said.

Sometimes securities were removed from the pool if other parties involved in the deal deemed them too risky, while others were inserted, according to people close to the matter.

One such deal, Abacus 2007-AC1,

was structured with Goldman and is the subject of Friday's complaint, which alleges that Goldman didn't disclose Paulson's role in assembling the CDO.

Mr. Pellegrini, who now runs his own hedge fund, had been the point man for Paulson in its conversations on the deal with Goldman employee Fabrice Tourre, according to people familiar with the matter. Mr. Tourre, a defendant in the SEC's complaint, was described in it as the person "principally responsible" for the deal at Goldman.

Mr. Tourre's lawyer didn't respond to requests for comment.

The hedge fund was first questioned by securities regulators about the deals in early 2008, according to a person familiar with the matter.

Late that year, as the financial system teetered on the edge of collapse, regulators met with members of Mr. Paulson's staff and the firm's attorneys in the SEC's downtown New York office to obtain details of the deal with Goldman, according to a person familiar with the matter.

Investigators had a list of CDOs sold by Wall Street firms that had led to billions of dollars of losses for investors, and they were intent on learning more.

On Friday, the SEC charged Goldman with civil fraud, alleging that the bank didn't disclose to investors on the other side of the deal the role Paulson & Co. had played in selecting the collateral for Abacus.

Paulson & Co. earned \$15 billion betting against the housing market in 2007, with Mr. Paulson, 54 years old, personally reaping a nearly \$4 billion profit. Today the company has \$32 billion in assets, making it one of the largest hedge-fund firms.

Before 2007, the firm was known primarily for merger arbitrage, betting on the stocks of companies involved in mergers. While the firm still plays mergers, its most recent big investment has been in gold, both the physical commodity and stocks and exchange-traded funds tied to it.

—Michael Corkery
contributed to this article.

SEC cites emails in making case

BY KATE KELLY

Fabrice Tourre, the **Goldman Sachs Group Inc.** employee at the center of a regulatory case alleging securities fraud, is a mid-level trader whose star rose when complex securities backed by risky mortgage loans were hot.

A 31-year-old Frenchman who described himself in an email as "fabulous Fab," Mr. Tourre received a paycheck of more than \$2 million as a vice president in the firm's New York office in 2007, people familiar with the matter say. That compensation was due partly to his success with the deal at the center of the controversy, according to one of those people.

In a case that has rocked Wall Street, The Securities and Exchange Commission accused Goldman and Mr. Tourre in a civil lawsuit of misleading a client about how subprime-mortgage assets were packaged to help a favored hedge-fund client profit on the housing collapse.

Neither Mr. Tourre nor his attorney, Pamela Chepiga at Allen & Overy LLP, responded to requests for comment. Goldman says it has done nothing wrong and is fighting the charges, filed in a New York federal court.

Mr. Tourre was "principally responsible for the structuring and marketing" of the product at the center of the SEC complaint. Mr. Tourre—who worked in New York at the time but has since moved to London as an executive director at Goldman—helped arrange the deal, believing the housing market was about to collapse, the SEC says.

In an email to an associate cited by the SEC, Mr. Tourre wrote: "More and more leverage in the system, The whole building is about to collapse anytime now...Only potential survivor, the fabulous Fab...standing in the middle of all these complex, highly leveraged, exotic trades he created without necessarily understanding all of the implications of those monstrosities!!!"

Behind the screen | Excerpts of Tourre emails

Feb. 2, 2007:

Mr. Tourre to a colleague, apparently regarding Mr. Paulson's intention to short the bonds without ACA's knowledge: "I am at this aca paulson meeting, this is surreal."

Feb. 11, 2007:

To Mr. Tourre from a more senior trader in Goldman's structured product unit: "the cdo biz is dead we don't have a lot of time left." (sic)

March 2, 2007:

Mr. Tourre to a colleague working with one of the Abacus investors: "This is a portfolio selected by ACA..."

A later Tourre email to a colleague (no date given): "the portfolio was selected by ACA/Paulson."

Source: SEC complaint

No one is suggesting that Mr. Tourre was a rogue trader. Indeed, Goldman's "Mortgage Capital Committee" signed off on the deal, according to the complaint. That committee included "senior-level management," the SEC says.

Goldman says it made the proper disclosures on the transaction, and in fact lost \$90 million on the deal. In a statement, Goldman said that the charges were "completely unfounded in law and fact" and that it would "vigorously contest them."

EUROPE NEWS

Liberal Democrats crash U.K. party

Strong debate performance elevates challengers in polls, earning praise from Labour, enmity from Conservatives

BY ALISTAIR MACDONALD
AND LAURENCE NORMAN

The two major U.K. parties are taking different approaches after the Liberal Democrats' strong performance in Thursday's debate tightened the race ahead of a May 6 election: Labour is courting the party, the Tories attacking.

Late Sunday, a poll by YouGov showed the Liberal Democrats, buoyed by the success of leader Nick Clegg in the U.K.'s first-ever televised leaders' debate, had leapfrogged both the long front-running Conservative Party and Prime Minister Gordon Brown's Labour Party.

The unexpected twist will add to unease in financial markets, given that the surging popularity of the Liberal Democrats will increase the chance of a hung parliament, in which no party wins a majority. That scenario has for weeks put pressure

on the pound, given that many investors feel a minority government would make it harder to force through the tough spending cuts needed to tackle Britain's massive deficit.

Opposition Conservative Party leader David Cameron played on that fear while campaigning over the weekend, saying a hung parliament would "be a bunch of politicians haggling, not deciding."

In the YouGov poll, 33% said they would vote for the Liberal Democrats, 32% said they would vote for the Conservatives and 26% said they would vote for Labour. Other polls have noted a surge for the Liberal Democrats, who before the debate hovered at around 20%.

Over the weekend, Mr. Brown admitted the election campaign was "wide open" and Mr. Cameron said his team is "facing the fight of our lives."

Britain's big two parties are reacting in different ways.

"At the moment, the Labour Party is trying to love bomb us and the Tories are attacking us," Ed Davey, the Liberal Democrats' senior foreign-affairs official, said in an interview.

William Hague, a senior Tory official, said in an interview with the Sunday Times newspaper that a vote for Mr. Clegg would be a vote for a "European superstate," an attempt to scare voters in this largely Euro-skeptic country. On Friday, another leading Tory described some of the Liberal Democrats' policies as eccentric.

A Conservative spokesman said the party has been critical of the Liberal Democrats for some time.

Interviewed by the British Broadcasting Corp. on Sunday, Mr. Brown



Nick Clegg, leader of Britain's Liberal Democrats, speaks to young people in a London park on Sunday.

vowed to put "major pressure" on the Liberal Democrats over their policies. But Mr. Brown also appeared to court the party, claiming he had always favored a "progressive consensus" with the liberals.

Other senior Labour officials have appeared to be even more conciliatory, with cabinet minister Peter Hain telling the Sunday Times there was "common ground" between the two parties on issues where they traditionally have disagreed. Many analysts believe a resurgence of the Liberal Democrats would affect the Conservatives more and that Labour may want to both lay the groundwork for a postelection deal and persuade Liberal Democrat supporters in constituencies where the fight

is between Conservative and Labour to back Labour.

A Labour spokesman denied the party was out to court the Liberal Democrats, but said that "the focus of our fire remains the Tories."

Mr. Davey said his party isn't aiming to do deals in a hung parliament, but to win a majority itself. "The truth is what has happened has changed an awful lot and we are in it to win," he said.

The Liberal Democrats have seen a sevenfold increase in individual donations since the debate. Mr. Davey said canvassers are being greeted more warmly at doors, more campaign posters are being put up in windows and journalists are being more deferential.

Still, Mr. Clegg may find it harder to replicate his success in the next two debates on foreign policy and the economy, not least because the party's more pro-European stance isn't shared by much of the country.

Some analysts caution reading too much into the poll jump.

Mr. Brown believes the focus on the economy will play to his strength of having been at the helm as the British economy recovered. On Sunday, he also brought bankers back into the election battle, by saying the U.K.'s regulator should investigate **Goldman Sachs Group Inc.** over how its alleged misleading of clients affected U.K. institutions such as **Royal Bank of Scotland Group PLC.**

Changing minds

Thursday's televised debate shifted some U.K. viewers' opinions on who would be the best prime minister.

David Cameron

BEFORE DEBATE 43%

LATEST POLL 33%

Gordon Brown

31

30

Nick Clegg

14

29

Note: YouGov questioned 1,091 viewers of the TV debate among the party leaders, first between April 8 and 13, and the latest daily polling figures from April 16 and 17.

Source: YouGov

At Polish leader's funeral, signs of diplomacy

BY MARC CHAMPION

Volcanic ash kept most Western leaders away from the lavish state funeral of the late Polish President Lech Kaczynski on Sunday, but not Russian President Dmitry Medvedev.

The attendance of the Russian president at a funeral filled with Catholic and Polish military pomp underscored Moscow's efforts to improve relations since last Saturday's air disaster. Mr. Kaczynski and 95 others died on April 10, when their plane crashed in thick fog on its approach to Smolensk airport, in western Russia.

Nature kept most Western lead-

ers away in the form of volcanic ash from Iceland that closed airspace over Western and Central Europe. That turned the funeral into a kind of reunion of the ex-Soviet bloc, as only those traveling from the East could fly. But the importance of Mr. Medvedev's presence was evident.

After some two dozen purple-robed bishops processed into Krakow's St. Mary's Church to thundering strains of Mozart's Requiem, Cardinal Stanislaw Dziwisz opened with a reference to Katyn—the 1940 massacre of some 22,000 Poles by Soviet agents. Mr. Kaczynski had been on his way to commemorate the killings when his plane crashed.

"These words I address to the President of Russia," said Poland's Cardinal Dziwisz, calling for last Saturday's crash to bring reconciliation between the two nations. "This is the task of our generation." Poland's acting President Bronislaw Komorowski went further, calling for the whole truth about Katyn to be revealed, and calling Mr. Medvedev's presence a sign that it might.

Before flying back to Moscow, Mr. Medvedev responded ambivalently in remarks to cameras in front of his plane. Noting that Poland and Russia had been doing "a lot" recently to repair their difficult relations, he said Katyn was "one of such difficult issues."

"Yes we do remember about



Mourners wave Polish flags during the president's funeral in Krakow on Sunday.

crimes committed by Stalin and his cronies," he said. "What is needed is extra research and extra tests. However, our position is steady and unchanged." Russia has yet to acknowledge Katyn as a war crime, link it directly to Stalin, or release many documents concerning the killings.

Sunday's funeral service against the backdrop of the St. Mary's dramatic 13-meter (42-foot) high carved altar piece capped an extraordinary week of public grief in Poland. Already in Warsaw on Saturday, close to 100,000 people at-

tended an outdoor Mass for the crash victims. Thousands more, many again in military or historical Polish dress, stood in Krakow's main square as the service was played on giant television screens.

Close to 50 world leaders who had planned to attend Sunday's ceremony canceled, according to a Polish government press official in Krakow. Airspace over much of Western and Central Europe remained closed, due to the cloud of volcanic ash drifting from Iceland.

A propeller driven military transport aircraft carried the re-

mains of the first couple from the capital Warsaw in the morning. The plane stayed below the 6,000-meter ceiling considered safe, the press official said.

U.S. President Barack Obama canceled Saturday. Germany's Chancellor Angela Merkel, driving back to Berlin from Italy Sunday morning, also canceled. So did French President Nicolas Sarkozy, Britain's Prince Charles and others. Germany President Horst Koehler arrived by helicopter. Leaders from Central Europe, however, made the journey by land, while those from farther east were able to fly through clearer skies. Those included Ukraine's new pro-Russian president, Viktor Yanukovich, and Georgia President Mikhail Saakashvili. Mr. Kaczynski was a staunch supporter of Georgia during its 2008 war with Russia, and of Ukraine's Orange Revolution, which denied Mr. Yanukovich the presidency in 2004.

Mr. Medvedev left before the burial. Mr. Saakashvili walked to Wawel directly behind the coffins.

Saturday's tragedy could have sent relations between the Russia and Poland into a tailspin, as some analysts predicted at the time. But Moscow has gone to unusual lengths to show goodwill in response to the crash. I

—Laura Stevens in Krakow contributed to this article.

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EUROPE NEWS



Associated Press

Marc Fournier and his family wait for a flight to Geneva at Barajas Airport in Madrid on Sunday.

Grounded fliers scramble

Travelers halted by volcano seek new routes; Houston has a problem

BY PAUL SONNE
AND MARCUS WALKER

LONDON—Pop diva Whitney Houston hunkered down on a ferry crossing the Irish Sea. Folk singer Don McLean reported by Twitter that he was headed to Dover, “guitar and oar in hand,” to traverse the English Channel. And German Chancellor Angela Merkel, on an odyssey home from California, found herself on the side of a Tuscan highway waiting for a bus to be fixed.

British actor and Monty Python star John Cleese, meanwhile, spent more than \$5,000 to take a taxi from Oslo to Brussels in order to board a Eurostar train back to the U.K., according to Norwegian TV2.

The stories are many, but the plight is one: European travelers, no matter how connected or important, have been thwarted by Eyjafjallajökull, the Icelandic subglacial volcano whose marauding ash cloud has caused the biggest shutdown of European airspace since World War II. The volcano left hundreds of thousands of people traversing land and sea in search of any way home.

On Sunday, airlines operated less than 20% of the 24,000 flights that take off on a normal Sunday, according to Eurocontrol, which coordinates air-traffic control in 38 nations. Less than a quarter of scheduled flights operated in Europe on Saturday, including just 73 of the 300 trans-Atlantic operations seen normally, Eurocontrol said. By the end of Sunday, it expected more than 63,000 flights to have been canceled since the flight bans started Thursday.

With no end to the aviation chaos in sight, stranded travelers did their best to head in the general direction of their destination, inching their way across the globe via boats, trains, cars or the few flights still operating.

“It’s like John Candy on acid,” a spokesman for Virgin Group Ltd. said, referring to “Planes, Trains and Automobiles,” the 1987 film in which the late Mr. Candy and Steve Martin play stranded travelers trying to make it home for Thanksgiving.

Virgin Atlantic Airways Ltd. was forced to cancel its board meeting because most members couldn’t make it and company executives were busy rerouting flights, the spokesman said. Meanwhile, Virgin

Group’s executives were scattered helpless across the globe. Patrick McCall, the company’s commercial director, was stuck in South Africa, looking to return to the U.K. via Madrid after turning down an offer to take a £100,000 (\$153,580) plane ride to Syria, which would have got him about halfway home.

BP PLC, the British oil major, also said foreign directors attending last Thursday’s meeting of the BP board in London, such as George David, the former chairman of United Technologies Corp, were now stranded, with no means of getting home.

Eric Salama, CEO of WPP Group PLC’s Kantar Group, was vacationing with his two sons, Raffi and Sam, in the Egyptian seaside resort Sharm El-Sheikh, only to find out that his British Airways flight home to London had been cancelled Sunday. The trio grabbed a local taxi and spent hours traversing the Sinai peninsula to Israel, passing through about eight Egyptian military checkpoints that had been set up after a recent terrorist threat.

The Salamas boarded a local flight from the Israeli city of Eilat to Tel Aviv, where they were staying Sunday night, with the hopes of boarding a flight to Barcelona the next morning. Mr. Salama said he planned to rent a car in Barcelona and drive through Toulouse to Paris, with the intention of catching a Eurostar train back to London.

“With a bit of luck we’ll be back for Wednesday,” Mr. Salama said from Tel Aviv. His sons “think it’s a big adventure.”

Railway and ferry companies have hurried to increase capacity. The Eurostar, the train that shuttles passengers under the English Channel to and from the U.K., added eight routes on Saturday and planned to operate an additional 10 on Sunday. By Sunday, the Eurostar will have carried an additional 50,000 passengers, a spokeswoman said. Virgin Trains offered an extra 2,000 seats on its rail services within the U.K.

That didn’t help travelers who needed to traverse oceans and continents to get home.

Last week, Tod Brilliant, a writer from Healdsburg, Calif., traveled to Europe for a friend’s wedding along with his wife, Angela Barrett, who is 32 weeks pregnant. Now the couple is stuck in the Shakespearian village of Stratford-Upon-Avon, their flight

from London to San Francisco having been canceled twice.

“We can’t really make the big run down to Spain like other people are doing to beat the cloud, because our mobility is greatly reduced,” said Mr. Brilliant, 38 years old, who was worried that his wife was facing too much stress late in her pregnancy and getting too close to her due date to fly home. The couple started a Facebook page to connect with other doomed travelers and are contemplating a name for their baby: “Now we’re looking closely at Icelandic names,” said Mr. Brilliant. “But it won’t be named after the volcano.”

Neither world leaders nor celebrities managed to escape the travel mayhem that overtook Europe last weekend. After performing a number of shows in the U.K., Ms. Houston boarded a ferry crossing the Irish Sea Thursday night in order to make her scheduled performance in Ireland, a spokesman for the Irish concert venue said.

Mr. McLean was on tour in the U.K. without his band, which has been stranded in Nashville, Tenn., since the ash cloud emerged. Mr. McLean performed solo and then headed to the English port of Dover on Sunday night to board a ferry headed for continental Europe, hoping to make it to Amsterdam for a gig Monday night.

Ms. Merkel was the most prominent victim of the ash cloud. The chancellor, most of her top advisers and a group of German journalists were on the return flight from an official visit to California on Friday when they learned northern Europe was unreachable by plane and the nearest they could land was Lisbon. “Lisbon is also a nice place,” the chancellor joked with reporters.

On Saturday, the group flew to Rome, then drove north, with Ms. Merkel and her top aides in armored Mercedes limousines, and the press corps and other officials in buses.

The road trip took an unexpected turn in Tuscany when one of the buses blew a tire. The German convoy blocked the right-hand lane of the Italian highway until the bus was fixed. After spending the night in northern Italy, the convoy crossed the Alps on Sunday and finally reached the German border.

—Cassell Bryan-Low
and Guy Chazan
contributed to this article.

Prolonged disruptions will hurt EU recovery

Continued from first page
ule to put more flights into the few open airports in Southern Europe.

Economists said that if the closure ends in coming days, its financial impact will remain limited to industries such as aviation, tourism and manufacturers that rely on just-in-time delivery by air. If the flight ban drags on, however, the pain will be far deeper, analysts predicted.

“Europe is the biggest exporter in the world and the second biggest importer. It is China’s biggest customer,” said Eric Chaney, chief economist at AXA Group. “Trade has been the biggest component in the global recovery and [an extended grounding] will have a significant impact on global trade and on the recovery that’s still fragile.”

Hard-hit airlines stepped up efforts to show regulators that flying is safe. KLM and Air France said several jetliners that they flew as high as 12,500 meters showed no ill effects from the abrasive powder. British Airways PLC said it also conducted a test flight. The airlines passed their analyses to their national aviation authorities, which make decisions on airspace closure.

“We asked the authorities to go up there and make real tests,” said a spokesman for Germany’s Deutsche Lufthansa AG, which flew 10 wide-body jetliners within Germany on Saturday beneath controlled airspace to reposition them but didn’t collect atmospheric data.

Trade groups representing European airports and airlines on Sunday called for an “immediate reassessment of flight restrictions” in a joint statement, saying nearly seven million people had been affected.

“The eruption of the Icelandic volcano is not an unprecedented event, and the procedures applied in other parts of the world for volcanic eruptions do not appear to require the kind of restrictions that are presently being imposed in Europe,” said the statement from the Association of European Airlines and Airports Council International Europe.

Aviation authorities and safety experts have said they are following United Nations guidelines and experience from past incidents.

“These flights are a useful canary in the coal mine, but we must remember that the airspace and weather are dynamic and changing hour by hour,” said Graham Lake, di-

rector general of Civil Air Navigation Services Organization, an umbrella organization for the world’s air-traffic control agencies. “Only a coordinated, Europe-wide safety assessment will enable the aviation system to get moving again, and we are working hard with the authorities and governments to secure that.”

Axel Raab, spokesman for the German national air-safety agency, DFS, said Europe lacked balloons able to measure the density or concentration of the ash in the air and equipment to do so wasn’t in place because it had never been needed. Weather stations were being upgraded and a plane was being fitted with equipment to measure how much ash is really in the air, he said.

The growing airline push-back came as the ash cloud threatened to cause broad economic impact just as Europe and the world were pulling out of recession. In a forecast Friday that doesn’t account for the grounding, the accountancy firm Ernst & Young predicted a “feeble” recovery for the 16 nations of the euro zone, with growth of just 1% this year after a negative 4% in 2009.

For anyone trying to ship to or from Europe, the closure has a “tremendous impact because nothing is moving, whether it’s a legal document, or seafood, or fresh flowers, or heavy freight,” said Norman Black, spokesman for shipping giant United Parcel Service Inc. If the ban continues into this week, UPS will consider a contingency plan, such as a temporary hub in another part of Europe, he said.

Mr. Chaney at AXA said it would take several months of airspace closure for the problem to have a profound impact on Europe’s economy, and effects could vary. It would have a deflationary effect on commodity prices, such as oil. Meanwhile, it would have an inflationary impact on prices generally because transport costs would most likely rise.

On Sunday, airlines operated less than 20% of the 24,000 flights operated on a normal Sunday, according to Eurocontrol, which coordinates air-traffic control in 38 nations. By the end of Sunday, it expects more than 63,000 flights to have been canceled since the flight bans started Thursday.

—Stephen Fidler in Brussels
and Jennifer Levitz in Atlanta
contributed to this article.



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U.S. NEWS

IMF ponders China and U.S. wallet

As finance ministers and central bankers address the global recession, here are a few questions for IMF confab

BY BOB DAVIS

When finance ministers and central bankers jetted down to Washington last April for a meeting of the International Monetary Fund they pondered how deep the global recession would turn out to be and how long it would last. The IMF predicted the downturn would continue well into 2010 and the U.S., Europe and Japan wouldn't grow at all this year.

In hindsight, the gloom was excessive. But this year, policy makers could fall into the opposite trap.

THE OUTLOOK A number of forecasters are looking for 4% global growth in 2010 and 2011—not bad by past standards—with more than 3% growth in the U.S., somewhat slower in Japan and a double-digit advance in China. Time to party?

That's not the style of central bankers and finance ministers, at least in official sessions. They mull and qualify and debate.

Here are some of the questions they'll be wrestling with at this spring's IMF confab, which takes place April 24-25:

What went right?

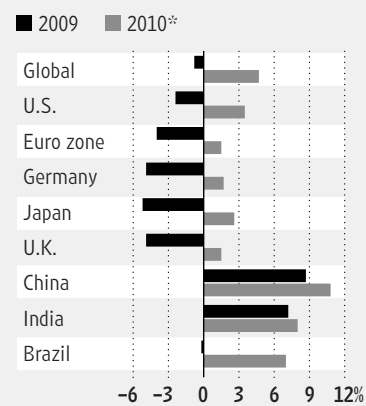
On this one, the IMF attendees will pat themselves on the back for flooding the world with money, which picked up economies battered by plunging housing prices, rising unemployment and buckling financial institutions.

The country with the largest stimulus program, China, produced

Global growth

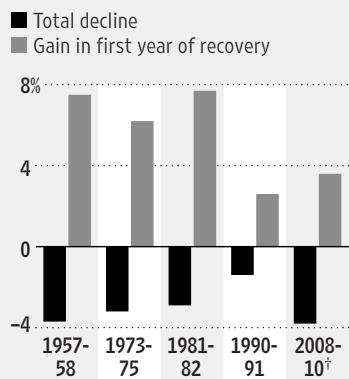
Economic growth is picking up around the world, but the strength of recovery in the U.S. is modest compared to previous episodes.

Annual change in real GDP



*Estimate †2008-10 recovery is an estimate.

U.S. GDP, contractions and recoveries



Source: J.P. Morgan

the largest increase in growth.

The surprise: countries managed to act in a concerted fashion, deepening the impact of the stimulus. The concern: All those trillions of dollars look like they are producing a turnaround that's mild by historical standards. The fear: What happens when all that money is withdrawn from the system?

Central bankers say they are conferring to make sure they don't all head for the exit at once and, so far, only a few banks have started to raise interest rates. The IMF regularly nags them that the Great Depression in the 1930s and Japan's slump in the 1990s were extended

when stimulus ended prematurely.

How much can the world count on the U.S. consumer?

U.S. consumers remain the single largest source of global demand, even if their clout isn't what it once was. J.P. Morgan estimates U.S. consumer spending will account for one-fourth of the global total in 2010, down from about 35% in 2003. Still, the global recession spread to Latin America and Asia when U.S. buyers put away their credit cards.

In recent months, U.S. consumer spending has turned upward and may continue that way for some time, says Economy.com economist Mark Zandi, who figures pent up de-

mand will boost car and home sales. But the long-term outlook is hardly solid. Part of the reason for Mr. Zandi's short-term bullishness is that he figures about five million households aren't making payments on their mortgages, giving them an additional \$60 billion to spend—for now.

What are the prospects for employment?

Pretty bleak. The IMF forecasts unemployment levels of 9%, on average, in wealthy countries through 2011, despite the recovery. Even China with its muscular growth record is a job-producing weakling. The country has added jobs at the rate of a little more than 1% a year says China expert Nick Lardy of the Peterson Institute for International Economics. Joblessness—or fear of it—undermines consumer spending and the business investment tied to the consumer market.

The German unemployment rate of around 8% didn't budge much during the recession. But that's hardly a sign of strength. It indicates how difficult it is in Germany to fire workers and how wary German employers are to hire them when the economy turns up, thus lengthening stagnation.

How mercantilist will China become?

The Chinese economy is booming, but, for once, not because of a huge trade surplus. Last month, for the first time in six years, China ran a small trade deficit and may run another one this month. That's important as an indication that China

is starting to power its growth with domestic consumption.

For the rest of the world, that's a plus, so long as China welcomes imports and investment. But that change could turn out to be short-lived, as the country's export machine revs up. A surge in Chinese exports is bound to boost protectionist reactions, which have been held in check thus far by the global crisis. A revaluation of the Chinese currency would help show that China seeks fundamental economic change.

Are banking crises really different from other crises?

Harvard economist Kenneth Rogoff and University of Maryland economist Carmen Reinhart have examined financial crises over the past 200 years and found they produce recessions that last longer than average and are followed by weaker recoveries and, often, sovereign debt crises. Not a bad description of what's happened so far. The current recovery looks to be a lot weaker than the rebound from other sharp declines, which have averaged about 6% growth in the first year, estimates J.P. Morgan

Now, the problems in Greece, where the IMF looks set to intervene to stave off possible government default, may be the first of many such problems, said Mr. Rogoff, a former IMF chief economist, as governments struggle to get spending and borrowing under control. "When you have banking crises, you have a wave of international sovereign debt crises within two or three years," he said. "We're on track."

Jobless data prove tricky

BY CARLBIALIK

It isn't all that simple to work out how many Americans are out of work.

The ranks of unemployed individuals grew by 134,000 last month from February, to 15 million, the U.S. Department of Labor's Bureau of Labor Statistics says. But it also is plausible, the agency says, that the number of unemployed rose by 500,000. Or, it could have fallen by 200,000.

In fact, at a time when high unemployment tops many people's worries about the economic recovery, the BLS can say only that it is 90% confident that the true change in the number of unemployed in March was somewhere between a drop of 243,000 and a rise of 511,000. In other words, it isn't even clear whether the number of unemployed rose or fell. The ranges are similarly broad for seven of the past 10 months—and for more than 75% of the time in the past decade.

This isn't a failing of government or of statisticians, say economists. Instead, it is the inevitable result of trying to measure small changes in a sprawling, complex economy. There is no doubt that the unemployment rate remains near the highest it has been in decades. But the government doesn't really know how much that rate has been changing from month to month, which can be vexing for economists attempting to identify signs of a na-

scent recovery.

The difficulty, says Patrick O'Keefe, director of economic research for accounting firm J.H. Cohn in Roseland, N.J., "is in providing the public a real-time sense of what is going on." He adds: "Most of the month-to-month changes are not only nonsignificant in a statistical way, but they are very often straddling zero, so you can't even infer the direction of the change has been accurately represented."

Take, for instance, monthly housing data. Last month, the Census Bureau said that sales of new, single-family homes tumbled to a record-low annual rate of 308,000 in February, after a seasonal adjustment. But in the report's fine print, the agency added that it could only say, with 90% confidence, that the true figure was between 260,000—which would have been an even more striking record low—and 356,000, which would have represented a 13% increase from January. Just once in the past 12 months has the Census Bureau been able to say definitively whether new-home sales rose or fell.

While the fuzzy information can be frustrating for those whose job it is to analyze what the numbers mean, economists are accustomed to a lack of precision in surveys.

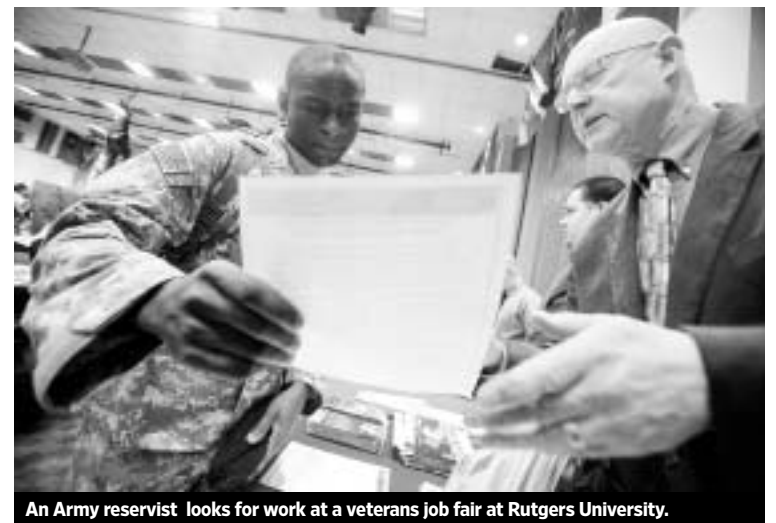
"I make it my business to take all information with a grain of salt, given the inherent inaccuracies in the estimation process," says Richard DeKaser, who sits on the statistics committee of the National Association for Business Economics, a

professional association of economists.

Economic data come packaged with uncertainty the same way political polls do. If every person in the country were asked about employment status or home purchases, data crunchers wouldn't need to calculate a cautionary statistical margin of error. But surveying everyone is neither practical nor affordable, so pollsters take a sample of the population. This sample can't be expected to perfectly mirror those who aren't included, which is why statisticians allow for a margin of error.

The uncertainty in new-home sales arises because a small fraction of sales are counted for the monthly report. To arrive at the monthly total, the Census Bureau surveys about 5% of 19,000 geographical units in the U.S. Within those units, field representatives sample just one in 50 of all new houses and small apartment buildings to see whether they have been sold.

Similar sampling techniques help explain why there is so much uncertainty in the unemployment numbers that the government can't say, most months, whether more or fewer Americans were trying and failing to find work. The jobless numbers are calculated by surveying a total of about 56,000 households in a small number of U.S. counties. At first glance, that number might seem ample—far fewer homes are contacted for the typical political poll. But the unemployment survey, conducted as a joint effort between



An Army reservist looks for work at a veterans job fair at Rutgers University.

Grey areas

Economic statistics such as unemployment figures are reported with substantial margins of error.

Reported change in number of people unemployed each month:



Note: The U.S. Labor Department is 90% certain the numbers fall within this range. Sources: Bureau of Labor Statistics; Getty Images (photo)

the BLS and the Census Bureau, doesn't use a random geographical sample.

"The cost situation is such that you can't afford to send interviewers out to every single rural area,"

says Ed Robison, manager of BLS's statistical methods group.

Learn more about this topic at WSJ.com/NumbersGuy. Email numbersguy@wsj.com.

WORLD NEWS



Staffan de Mistura, the United Nations' new special representative for Afghanistan, speaks during a news conference in Kabul on Saturday.

Hu visits area of China quake as aid pours in

BY GORDON FAIRCLOUGH

SHANGHAI—A flood of tents, blankets and other relief supplies began pouring in for the homeless and hungry survivors of last week's devastating earthquake that hit a mountainous and remote part of the Tibetan plateau in western China, as Chinese President Hu Jintao flew in to tour the region.

Mr. Hu, who cut short a trip to Latin America, on Sunday visited injured people being treated in a stadium and spoke with schoolchildren in Qinghai province's Yushu prefecture, where most people are Tibetan. "There will be new schools. There will be new homes," Mr. Hu wrote on a blackboard in a makeshift classroom.

More than 1,700 people have been confirmed dead and 256 others are listed as missing after Wednesday's temblor, authorities said Sunday. The quake struck one of the country's most troubled ethnic minority regions. Yushu was the scene of demonstrations in 2008, when antigovernment unrest rocked China's Tibetan areas.

China's top leaders have played a prominent role in the government's response to the quake. Premier Wen Jiabao also traveled to quake-hit areas on a tour that was well-publicized in China's state media. Mr. Wen called for national unity in the wake of the disaster, saying Tibetans and the country's majority Han Chinese are "all from one family."

Still, the Communist Party's Central Committee issued instructions Sunday for police in Yushu to step up patrols in an effort to "maintain social stability and unity among different ethnic groups," the official Xinhua news agency reported.

Many Tibetans chafe at government restrictions on their religious practices and civil rights and complain that they have been left behind as the Chinese economy has boomed. After the at-times-violent protests in 2008, the government blanketed Tibetan areas with troops and armed police and detained large numbers of people.

Tibetan Buddhists' exiled spiritual leader, the Dalai Lama, said Saturday that he would like to travel to Yushu to offer "comfort" to quake survivors. Beijing hasn't commented publicly on the Dalai Lama's statement, but is unlikely to allow him to visit. China has blamed the Dalai Lama, who fled China in 1959, for instigating the 2008 unrest.

Since the quake—which Chinese seismologists said was magnitude 7.1 and the U.S. Geological Survey measured as magnitude 6.9—authorities have struggled to move men and supplies to Yushu, a 12-hour drive from the provincial capital, Xining. By Sunday, officials said, 25,000 tents, 52,000 quilts and 850 tons of food and water had been delivered.

More than 100,000 people were forced from their homes by the quake, which officials estimated had destroyed 85% of the houses in the town of Jiegu, Yushu's main population center.

More than 10,000 soldiers, police and firefighters continued to dig through the wreckage of collapsed buildings on Sunday, searching for survivors. Sunday morning, rescuers pulled a 68-year-old man from the rubble in Jiegu, where he had been trapped for 100 hours.

—Kersten Zhang
contributed to this article.

Karzai names election chief

Afghan president's compromise with U.N. paves the way for parliamentary races this fall

BY HABIB ZAHORI

KABUL, Afghanistan—President Hamid Karzai named the country's new senior election officials, reaching an agreement with the United Nations that paves the way for parliamentary elections this fall.

Following Mr. Karzai's announcement Saturday, the U.N., which had withheld international funding needed for the Sept. 18 election, citing concerns about fraud, said it has now recommended releasing the money for technical and logistical assistance to prepare for the vote.

Mr. Karzai's decree put Fazel Ahmed Manawi, a former member of Afghanistan's electoral commission, in charge of the body that will

oversee races for Parliament. Mr. Manawi succeeded a chairman who resigned following accusations of having orchestrated widespread fraud in favor of Mr. Karzai in last year's presidential election.

The Afghan president also named all five members of the Electoral Complaints Commission, a watchdog that disqualified as fraudulent more than a million votes cast for Mr. Karzai last year.

Saturday's move was in defiance of a recent parliamentary vote that rejected as illegal Mr. Karzai's decree to seize control of the commission's appointments from the U.N., which previously selected three of the body's five members. The new commission, however, includes two

non-Afghan commissioners whose candidacies were proposed to Mr. Karzai by the U.N. special representative in Afghanistan, Staffan de Mistura.

While the foreign members no longer make up a majority of commissioners, any panel decision must be endorsed by at least one of these two non-Afghan commissioners, said Mr. Karzai's spokesman, Waheed Omar.

Mr. de Mistura praised the compromise after meeting with Mr. Karzai Saturday. "I want to congratulate President Karzai for his wise decision to agree to guidelines aimed at ensuring more credible and transparent elections," he said.

Western countries in recent

months demanded a much more thorough electoral overhaul, expressing concern that a repeat of last year's ballot-stuffing during the parliamentary vote would bolster the Taliban-led insurgency. Mr. Karzai has resisted the pressure, and repeatedly lashed out at the West.

Unlike the three previous non-Afghan commissioners, who hailed from Canada, the U.S. and the Netherlands, the foreign commissioners appointed Saturday come from non-Western countries that don't belong to the U.S.-led coalition.

They are Judge Johann Kriegler, the former head of South Africa's independent electoral commission, and Safwat Sidqi, a former election official from Iraq.

Sudan elections flawed but calm

BY SARAH CHILDRESS

A pair of international missions sent to observe Sudan's elections pointed to flaws in the vote, but both stressed its importance in nudging Africa's largest country toward a durable peace between its north and south.

In a preliminary report, the Carter Center, a nonprofit organization focused on conflict resolution, said Sudan's elections "will fall short of meeting international standards." Still, the organization founded by former U.S. President Jimmy Carter noted the election was "a key benchmark," clearing the way for a critical independence referendum to be held next year.

Meanwhile, the European Union, which also sent a team of observers to the country, noted that 70% of

the polling it observed was conducted "satisfactorily," and also judged the election a "crucial step" in the peace process.

The electoral commission's chairman, Abdallah Ahmed Abdallah, defended the electoral process, citing the difficulties in staging a complex election. "Sudan's elections cannot be compared to international standards due to the current situation in the country," he said.

On Sunday, Sudanese election officials continued to count ballots, three days after the extended polling period ended in the first multiparty election in 24 years. The National Electoral Commission said that results will be released on Tuesday. International observers are expected to issue their final reports shortly afterward.

The presidential incumbent,

Omar al-Bashir, who has governed Sudan since seizing power in 1989 military coup, is widely expected to win the election. But while the result hasn't been in doubt, the election still carried high stakes.

The outgrowth of a 2005 peace agreement that ended a civil war between the north and south, Sudan's multiparty elections were seen as a crucial part in a peaceful transition to democracy. Critics pointed to the potential for violence and vote-rigging, but the southern opposition parties went along with the election largely to ensure that a botched election didn't derail their independence referendum.

So far, international observers are mostly lending their support. Both the Carter and EU interim reports praised the largely calm and orderly voting process, and said that

the election, despite its flaws, helped to move the country toward democracy. The teams noted irregularities such as polling centers opening late, voters' names missing from the rolls and the lack of election material.

Both teams attributed these problems, in large part, to the difficulties of staging a nationwide election in a country unfamiliar with democracy and still healing from decades of conflict.

Neither report noted any incidents of violence. On Thursday the Associated Press reported that the ruling National Congress Party said soldiers from the south's semi-autonomous region killed at least five of its supporters. Southern officials attributed the deaths to a quarrel.

—Godfrey Maganda
contributed to this article.

INTERVIEW



Ilo Musto for The Wall Street Journal

Andrew Moss, CEO of British insurance giant Aviva, says 'There's a wall of money coming through those European life and pension markets over the next five to 10 years.'

Aviva to move slow on Asia

As rival insurer expands its business in the east, U.K. financial-services giant chooses to focus on Europe

[Andrew Moss]

BY NEIL SHAH

Andrew Moss believes Asia is the next frontier for the financial-services industry. But the company he heads, British insurance giant **Aviva PLC**, is only dipping its toe into this fast-growing market at a time when rival **Prudential PLC** is plunging head first.

The reason: It's too early for insurers to chase Asia's consumers, Mr. Moss says, and Aviva, which has a solid position in Europe, can afford to be a little late.

"There's no doubt in my mind we're moving back into a growth phase in terms of the company's development, but you can expect us to go on being disciplined," the Aviva chief executive says. "We're still managing the company with one eye on downside risk, and making sure the capital position of the company is well protected."

Industry observers got a shock this past month when Mr. Moss's counterpart at Prudential offered to buy U.S. insurer **American International Group Inc.**'s Asian life-insurance unit for more than \$35 billion, a move that, if successful, would turn Prudential into an Asian insurance powerhouse. Prudential's boldness put in sharp relief Aviva's more cautious approach of cutting costs and sticking to the business it does best: Europe.

About 90% of Aviva's profits come from serving customers in 16 European markets, including the U.K., while Aviva's presence in Asia is relatively small. If Prudential is betting its future on Asia, Aviva is hoping that Europe's larger, mature market will deliver the same or better growth without saddling the company with additional risks that could end up draining capital. The stance is also about timing. Asia's booming econo-

mies and rising middle-class incomes should lead to more demand for savings and insurance products in the future. But while Asia's populations are relatively young, Europe's baby boomers are older and wealthier and need more financial options, Mr. Moss says. He figures that because Europe's market is much larger, insurance assets there will increase by some \$1.7 trillion during the next five years or so compared with \$1.5 trillion in the Asian-Pacific region.

"The absolute opportunity is bigger in the short-term in Europe," he says. "There's a wall of money coming through those European life and pension markets over the next five to 10 years."

The 52-year-old Mr. Moss hasn't really left home throughout his career. Raised in Winchester, a town 60 miles from London, he trained as an accountant, received a law degree from Oxford University and then set up shop at several financial firms—including HSBC Holdings PLC and insurance market Lloyds of London—based in the British capital. His big career shift, Mr. Moss says, was turning to insurance after some 15 years in banking. "Banks are about money," he says. "Insurance is about people."

Like its growth strategy, Aviva's headquarters, which occupy a few floors of a modest London building owned by U.K. property investor Simon Halabi, are unflashy—at least compared with London's "Gherkin," an imposing, pickle-shaped skyscraper across the street that houses giant insurer Swiss Reinsurance Co.

Aviva hasn't budged from its site over the past four decades. Its roots go back to a financial-services firm founded in the late 1600s that insured the house of Robert Walpole, who later became Britain's first prime minister.

Far from looking to Asia, much of Aviva's recent focus has been inward. When Mr.

Moss took the reins as chief executive in July 2007, the company started to rebrand itself globally after functioning for years as Norwich Union in its home market of the U.K.—a name many Britons found old-fashioned. Last year, the company off-loaded its slower-moving Australian business and sold a major stake in its Dutch unit to the public to bolster its financial position. Those moves helped allay some investor concerns about the firm's investment exposure.

Aviva is also fine-tuning its ability to serve often heterogeneous European markets like Britain, France, Spain, the Netherlands, Poland and Italy, along with Eastern Europe and Turkey.

For example, more than 50% of British motor insurance is sold online, while the vast majority of French customers—96% or 97%, Mr. Moss says—still meet with actual brokers to get such insurance.

Mr. Moss says such moves have strengthened the company: Aviva has saved roughly £500 million (\$770 million) a year ahead of a self-imposed deadline; slashed its ranks from about 57,000 employees two years ago to 46,000; and is seeing some sales of U.K. motor insurance picking up. In the meantime, with the global economy starting to recover, consumers and small businesses may soon have more money to spend on insurance.

And while Aviva is taking a slower approach to Asia, it's not as if the firm isn't moving at all.

This month, Aviva announced plans to nudge into Asia's general-insurance market, returning to Singapore after a five-year hiatus. (A noncompete clause related to the sale of Aviva's Asian general-insurance business in 2005 expired this year.) A few days before that, Aviva announced a push into Indonesia. Such moves ultimately amount to a kind of minor seed-planting. Aviva has only 1,600 employees in the Asian-Pacific

region compared with 37,600 in the U.K. and Europe.

Mr. Moss seems more excited about longer-term opportunities in the U.K. and Europe. The European insurance industry has fared relatively well during the financial crisis—at least compared with Europe's banks and governments—which could prompt a shift whereby insurers take on some of the risks that banks and public officials used to hold. "We've gone up in people's estimation," he says.

While Aviva's top brass have suggested they aren't hunting for major acquisitions, Mr. Moss says it would make sense to be open to attractive U.K. assets, because Aviva is already one of the U.K.'s biggest insurers.

As for government, last summer Mr. Moss co-chaired an industry working group with U.K. Treasury chief Alistair Darling that delved into Britons' bad saving habits and the future role of the insurance industry. One analysis Mr. Moss cites showed that of the roughly £340 billion paid out each year for health, pension and other benefits, one-third was paid by private insurers while the rest was the British government's responsibility. That, he says, could change as the government tries to improve its finances.

Of course, any efforts to bring Britain's insurers and government closer together will have to wait until the dust settles on the U.K.'s election, which is scheduled for May 6. There also needs to be more clarity on regulatory and tax issues, Mr. Moss says.

But insurers may need to play a bigger role in society if Britain is to cope with an age of austerity in coming years.

"With the public finances in the place that they are, it is a very worthwhile debate to see whether we could move the dial a little bit so the insurance industry takes on more of that risk," Mr. Moss says.