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THE WEEKEND JOURNAL

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Gillard hoping to pocket election victory



Getty Images

Australian Prime Minister Julia Gillard, who faces an election only two months after taking power, shoots pool on Thursday with patrons at a tavern in Raymond Terrace, New South Wales, during a campaign visit ahead of Saturday's federal poll. **The Big Read**, pages 14-15

## Intel to buy McAfee in bet on security

By DON CLARK

Intel Corp. agreed Thursday to buy security-software specialist McAfee Inc. for \$7.68 billion, a surprise transaction that underscores the company's determination to expand beyond its stronghold in chips that power most of the world's computers.

The deal, the largest in Intel's 42-year history, was described by the companies as evidence that security is becoming one of the fundamental pillars of computing.

With Internet connections rapidly being added to consumer electronics, appliances, industrial equipment and other hardware, the approaches that have served to protect today's personal computers and servers aren't adequate, Intel and McAfee officials said.

The deal values McAfee at \$48 a share, a premium of 60% over the company's closing price Wednesday. McAfee shares jumped 58% after the

deal was announced, and rose 57%, or \$17.11, to \$47.04, in 4 p.m. composite trading on the New York Stock Exchange. Intel's shares fell 3.5%, or 68 cents, to \$18.91 on the Nasdaq Stock Market.

Armed with expertise from McAfee, Intel suggested security could be built more broadly into computer chips and other hardware, creating products that are more resistant to attack.

"We believe security will be most effective when enabled in hardware," said Paul Otellini, Intel's chief executive, in a conference call. He said the companies believe that everywhere Intel sells a chip, it now has the opportunity to sell security software along with it.

The pact is another sign of consolidation that is winnowing the ranks of mid-size technology companies. Tech giants dominant in particular areas of the industry are using acquisitions to grab footholds in faster-growing mar-

kets. **Hewlett-Packard** Co.'s recent purchase of Palm Inc. was aimed at moving the world's largest PC maker into the smartphone sector.

Meanwhile, **Oracle** Corp. purchased Sun Microsystems last year to expand from selling software into providing a complete hardware and software package for corporate information-technology departments.

McAfee, founded in 1987 and best known for its popular antivirus software, has marshalled more resources to go after the quickly developing mobile market. It recently announced the purchase of mobile-device security company tenCube, a move that follows its purchase of Trust Digital, another mobile-security-software firm.

McAfee has long battled rival **Symantec** Corp. in the computer-security market. The company, based along with Intel in Santa Clara, Calif., was widely thought to be

Please turn to page 4

## Sarkozy faces a tough meeting on France's growth and deficit

French President Nicolas Sarkozy is facing a significant meeting with his top ministers on Friday to discuss the country's growth and deficit.

Many observers, including members of Mr. Sarkozy's UMP party, consider the French government's growth forecast to be overly optimistic. As a result, the statement that Mr. Sarkozy and his advisers make after the meeting will be closely parsed for their views on growth.

The French government forecasts growth in gross domestic product to accelerate to 2.5% in 2011 after a 1.4% expansion in 2010.

French politicians aren't the only ones with a less rosy view of France's economy. The

International Monetary Fund's forecast for France's 2011 GDP growth is 1.6%, and the IMF doesn't expect the French economy to resume growing more swiftly than 2% until 2013.

The pressure has been ratcheted up in recent days after ratings agency Moody's said that certain countries with triple-A ratings, including France, are much closer than they had been to a downgrade—though the rating is safe for now. The report pointed out two weaknesses in French public finances: a high initial level of tax pressure and spending rigidities.

For Friday's meeting, Mr. Sarkozy has summoned Finance Minister Christine

Lagarde, Prime Minister François Fillon and Budget Minister François Baroin to his summer residence.

The combination of better-than-expected second-quarter growth and the burden of the optimistic forecast for 2011 is pulling the government in opposite directions, making the meeting a high-pressure event for Mr. Sarkozy.

If the government dials back its forecast, it might be forced into further spending cuts, as ministers have said targets to trim the deficit are immutable and the government will take all necessary measures to meet them.

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A comprehensive rundown of news from around the world. **Pages 30-31**

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Brian Wilson on Scotland's disgrace over the Lockerbie bomber. **Page 13**

## Potash Corp. seeks BHP alternative

By ANUPREETA DAS AND GINA CHON

Potash Corp., the Canadian target of a hostile \$39 billion bid from BHP Billiton, is exploring potential alliances with an array of global actors, from petrochemical and agribusiness multinationals to Chinese sovereign banks, that could cobble together competing offers, people familiar with the matter said.

Sovereign wealth funds, Chinese banks and other national financial institutions could provide the funding for a global consortium that makes a counteroffer to keep the world's largest fertilizer maker out of the hands of BHP Billiton, the Anglo-Aus-

tralian mining giant, the people said.

On Wednesday, BHP took its \$130-a-share offer directly to Potash shareholders after the company rebuffed its initial Aug. 12 offer and disclosed it publicly.

Potash said the BHP bid "grossly undervalued" the company; the Anglo-Australian company has said the offer is full and fair.

The people familiar with the matter said that the company may decide to run a full auction to secure the best value for its shareholders.

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## PAGE TWO

# Message for Basel—there is another way to avoid those big bank bailouts

## [ Agenda ]

By THEO VERMAELEN

The Basel committee on Banking Supervision is set to finalize new capital requirements for banks by the end of the year. They are also looking closer at so-called cocobonds, or contingent convertibles as an alternative to issuing equity to meet these requirements.

A contingent convertible is a bond that converts into equity after some triggering event such as the decline in the debt equity ratio below a threshold level. For example, the first cocobond was issued in November 2009 by Lloyds bank. The bond converts into equity as soon as the bank's Core Tier 1 leverage ratio falls below 5%.

The issuance of contingent capital has been proposed as a method to avoid a new financial crisis and avoid government bailouts of banks "too big to fail." Interest in such securities has been made stronger after the observation that in the recent crisis governments bailed out subordinated debt holders.

There are, however, a number of concerns with cocobonds.

First, how should the trigger be set? In the case of Lloyds the trigger is based on regulatory capital ratios, which are computed only once every quarter.

Such a mechanism will not work where a bank capital structure deteriorates rapidly. For example, Citibank had a Tier 1 capital ratio that was measured at 11.8% in December 2008, at the height of the financial crisis. This means debt holders are not likely to get their money back, which makes the bonds very expensive, and reduces their attractiveness as an alternative to simply issuing equity.

An alternative is to set the trigger based on market values of



The first cocobond was issued in November 2009 by Lloyds bank.

equity, not book values. For example the bond with \$1,000 nominal value is convertible into 200 shares whenever the bank's stock price falls below \$5. So the conversion price is in this example equal to the trigger price: \$5.

In theory, this should make the bonds risk-free as the investor can sell the 200 shares at \$5 and get his money back.

However, market-based triggers create other problems. Specifically, they create incentives

## The design protects equity holders against dilution caused by manipulation and/or market panic.

for bondholders to short the stock to trigger conversion and dilute the equity holders. What makes manipulation easy here is that the short seller does not have to cover his short position by buying in the open market: the issuers will deliver the shares to the bondholder after conversion.

Even without manipulation through short sales, market panic that drives the stock price below "fair" value and triggers conversion can create the same

diluting effect. Moreover, in a financial crisis, stock prices tend to experience strong downward jumps that make the numerical example above purely theoretical: when the stock hits \$5 on a specific moment and conversion is triggered, by the time the investor has received his 200 shares, stock prices may well be significantly less than \$5. In other words, the bondholder is again exposed to risk, which will make the bonds expensive and therefore unattractive to issuers.

In a recent paper George Pennacchi, Christian Wolff and I have proposed a new type of cocobond that we have baptized as "COERC," a Call Option Enhanced Reverse Convertible. We believe that our design deals with the three concerns about cocobonds.

First, the trigger is based on market values, not "old" capital ratios. Second, the design protects equity holders against dilution caused by manipulation and/or market panic. Third, the COERC is far less risky than the typical cocobond structure proposed by others. As a result, banks will be able to issue them without paying large risk premiums.

How does a COERC work? Going back to our numerical example: the bond converts again

into equity whenever the stock price falls below \$5. However, now the conversion price is much lower than the trigger price, say \$1 per share. That means that the bond holder will now receive 1,000 shares instead of 200 shares.

Of course, this will create massive dilution to shareholders if this happens. However, under our structure the shareholders will have a right to buy back the shares from the bondholders at \$1, thereby undoing the dilution. Shareholders will do this by making a rights issue at \$1 per share as soon as the conversion is triggered.

So what, effectively, will happen is that equity holders will be coerced into refinancing the bank and repaying the debt. So the equity issue is not imposed by the government or the regulator, but by the concern about massive dilution.

Note that under our structure the shareholders don't have to worry about manipulation or short selling as they can always undo any dilution created through these activities. Second, because the equity holders have a large incentive to repay the debt holders, COERCs are much less risky than other bonds or non-convertible bonds. Our simulations show that credit spreads are generally small so that the instrument should be interesting to issuers as well as risk-averse fixed-income investors.

Avoiding the next financial crisis can happen in two ways: putting restrictions on leverage and risk taking by banks that will be at the expense of economic growth. Or, thinking about innovative ways in financing banks without lowering their value and growth opportunities. We believe our COERC idea is consistent with the second approach.

—Theo Vermaelen  
is professor of finance, INSEAD

## What's News

■ **Greece's deepening recession** is driving joblessness higher, feeding discontent with the government's austerity program and dragging on the broader economy. The coming end of the tourist season is adding to worries. 4

■ **The U.K. started** the third quarter with strong retail sales, weaker-than-expected government borrowing, firm industrial orders and a pick-up in mortgage lending. 6, 32

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'I don't see it being a privacy issue. If you don't want to be seen 'here and now,' then don't do it.'

Reader **Gusner Garcia** on 'Facebook Unveils Location Service'



### Continuing coverage



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### Question of the day

**Vote and discuss:** Will you use Facebook's new feature that allows you to share your physical location online?

Vote online today at [wsj.com/polls](http://wsj.com/polls)

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Yes

25%

No

75%

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NEWS

# Visitors go on display at the museum

By ISAAC ARNSDORF

Matt Sikora doesn't look at the Rembrandts and Rodins at the Detroit Institute of Arts. His eyes are trained on the people looking at them.

Mr. Sikora watches where visitors stop, whether they talk or read, how much time they spend. He records his observations in a handheld computer, often viewing his subjects through display cases or tiptoeing behind them to stay out of their sight. "Teenage daughter was with, but did not interact, sat on bench, then left," read notes of one visit.

Mr. Sikora is the Detroit Institute of Arts's director of evaluation. He and five other observers are studying how visitors use the exhibits so the museum can tell if its information is accessible and which galleries are popular.

More museums are paying to send stealth observers through their galleries. Based on what they see, the museums may rearrange art or rewrite the exhibit notes. Their efforts reflect the broader change in the mission of museums: It's no longer enough to hang artfully curated works. Museum exhibits are expected to be interactive and engaging. As well, many foundations and donors are requiring proof that their funding is well-spent, and the studies provide data to show a rise in traffic or exhibit engagement.

The Metropolitan Museum of Art in New York is studying how visitors use its maps and signs to see if they could be clearer. And the Art Gallery of Ontario has been studying how people find different maps since it reopened in 2008. Its problem: north typically goes at the top of a map, but the entrance typically belongs on the bottom, and its entrance is on the north side of the museum. "Whichever way you do it, a significant portion of your visitors find the map upside down," says Judy Koke, deputy director of education and public programming.

It's tedious work. In Detroit, Mr. Sikora's recent morning of work led to the discovery that the average time visitors spent in a gallery was 2 minutes and 56 seconds. Out of six visitors, four stopped at Georges Seurat's pointillist seascape, "View of Le Crotoy from Upstream," making it the gallery's most popular art work. Three read the work's label.

The idea of trying to reach quantifiable judgments on how works should be hung is anathema to some. "Collections are hung at the discretion of the curators. They have a vision of how collections will be best presented to visitors," says Carrie Heinonen, vice president for marketing and public affairs at the Art Institute of Chicago. With lim-



Fabrizio Costantini for the Wall Street Journal

◀ 'The Meeting of David and Abigail' by Peter Paul Rubens. It is one of the gallery's big draws.

Matt Sikora, the museum's director of evaluation, with his hand-held computer. ▶

▲ After noticing visitors walked by the gallery summary panel, the museum moved it next to this Rubens.

◀ Museum visitor Edward Jones from Youngstown, Ohio.

The Rubens room at the Detroit Institute of Arts, photo above and diagram below.

ited research funds, Ms. Heinonen says asking visitors questions about their experiences is more useful than observing them.

The earliest visitor studies began in the 1920s, when researchers first observed that people tend to pay less attention later in their visits and favor turning right upon entering a gallery. The field has taken off in the past decade as the U.S. National Science Foundation started requiring that museums that receive its grants evaluate their exhibits as a way to hold them accountable.

Even with today's tighter budgets, many museums dedicate 10% of their operating budgets to evaluation, which includes observing visitors as well as passing out questionnaires among other steps, says Kirsten Ellenbogen, president of the Visitor Studies Association, a professional organization of museum researchers. She works at the Science Museum of Minnesota, which spends \$900,000 on evaluation annually, supporting a staff of 12.

In Detroit, the Institute of Arts, with its collections from European Renaissance painting to contemporary sculpture, is especially sensitive to its visitors' experiences because it relies largely on local and repeat visitors, not tourists. When the museum redesigned its galleries and reinstalled the art, a multi-year project completed in 2007, it used covert observation, as well as visitor interviews, panels and other studies. Now, it is evaluating 14 of its more than 100 galleries to see how well its new layout is working and if it needs to make any adjust-

ments. Because observing visitors is so slow-going, Mr. Sikora expects to finish his research in 2012.

A big problem that the Detroit museum hopes it has solved: getting visitors to read the written descriptions and analysis next to the art. In its pre-renovation studies, it found that the most-read text, between a Matisse and a Picasso, was read by just 26% of visitors. Four panels

were read by just 2% of visitors. So the museum cut the write-up's lengths and curators broke up text with bullet points and graphics.

Mr. Sikora can spend long stretches alone in the gallery, waiting for someone to enter. As soon as the first person crosses the threshold, he starts the clock, and no matter how many other people also wander in, he watches only one at a

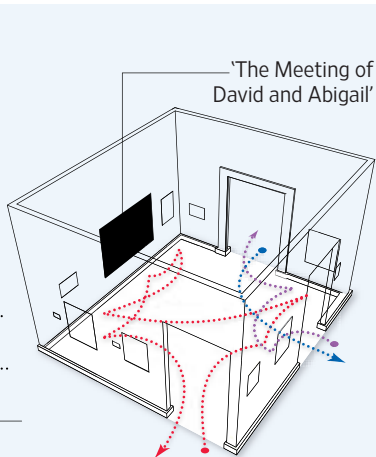
time. If someone cuts through on the way to the restrooms, it doesn't count. He records a visitor as stopping in front of a painting if both feet are planted and the person is facing the same direction for at least two seconds. He also notes details such as whether a visitor reads the label next to the work out loud.

The hardest visitors to observe, Mr. Sikora says, are the ones who drift, surveying the art from a distance, making it difficult for him to record where they stop or whether they read the painting's label. In two hours one morning, he recorded 14 observations, but discarded eight because the visitors stayed in the gallery for less than one minute, too short to count. Only one visitor qualified as what museum researchers call "a diligent visitor"—stopping at more than half the objects.

Museum researchers doubt most visitors know they might be the subjects of such studies, and Mr. Sikora carries a letter explaining the purpose of the study in case anyone asks. No one has.

When told that the museum's staff might be observing her, Ceil Toepel, a 63-year-old retiree who lives in Sterling Heights, Mich., said she has sometimes felt watched in the museum but doesn't mind.

Bob Rubin, an investment banker from Huntington Woods, Mich., who was visiting the museum to celebrate his 69th birthday with his wife, Judy, said he was pleased that the museum observes visitors. "In business they do that," he said.



## Visitor tracking

The Detroit Institute of Arts studied visitors in its Rubens gallery. Here's what some did:

AGE	GENDER	GROUP SIZE	TIME SPENT (minutes)
50s	F	3	5:31
40s	M	1	1:05
30s	M	1	0:09

Source: Detroit Institute of Arts

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## NEWS

# Greek woes spur discontent

By NICK SKREKAS

ATHENS—Greece's deepening recession is driving joblessness steadily higher, feeding discontent with the government's austerity program and dragging on the broader economy.

Greece's gross domestic product contracted by 3.5% in the second quarter from a year earlier, hitting retailers hard and sending unemployment rates to above 12% of the work force, according to data released last week.

Forecasts vary on just how bad unemployment could get. The International Monetary Fund predicts the jobless rate will reach 14.8% by 2012. But some labor experts fear that before long, one in five Greek workers could be without jobs.

A big worry is that the coming end of the tourist season, a major strut for the Greek economy, looms as the next threat to Greece's struggle back to solvency and economic growth.

"We expect real unemployment to top one million workers by the year's end, which is a rate of 20%. We warned the government early on that their policy mix was flawed and would lead to this," said Stathis Anestis, spokesman of the private-sector umbrella union GSEE.

Unemployment, rising prices and an increasing tax burden could spell social unrest in the months ahead, Mr. Anestis said. "I fully expect a social explosion and riots in autumn after summer vacations are over."

The jobs shortage underscores Greece's difficult recovery from near-insolvency in May, with financial markets still fearing a relapse that could put new strains on the euro and government debt markets. In terms of divergence within the 16-country bloc, the gap between Greece and Germany, with its strong recovery, has never been wider.

The Greek government already has dealt with flare-ups of public anger this year, when it agreed to rigid fiscal cutbacks to qualify for a €110 billion (about \$140 billion) bailout from the European Union and the IMF.

While there are no clear indications of more violence to come, public anxiety is palpable and consumers are holding back.

Store closings nationwide have risen 14.8% between mid-2009 and mid-2010, according to a survey by the National Confederation of Greek Commerce, ESEE. The situation is exceptionally dire in the center of Athens, where the overall economic woes as well as recurrent street protests have forced between 20% and 25% of the area's shops to close, according to ESEE.

## Looming threat | Greece's unemployment rate is marching steadily higher



Protesters in Athens hold a banner calling for lower prices on bread on Wednesday.

<b>20%</b>	<b>32.5%</b>	<b>20%</b>	<b>-3.5%</b>	<b>€110 billion</b>
Greece's forecast unemployment rate by year-end	Jobless rate among Greece's 15- to 24-year-olds	Percentage of Greeks employed by the tourism industry	Contraction in Greece's second-quarter GDP from a year earlier	Total for Greece's bailout from the EU and IMF

Source: GSEE union, Ellstat, Association of Greek Tourist Enterprises

"Greek retail has been going through a strong crash test for a year, and the collapse of economic activity threatens businesses survival and is imposing additional serious pressure on employment," said ESEE Chairman Vassilis Korkidis.

The jobs crisis is especially acute in northern Greece, where the Macedonia and Thrace regions see jobless rates of near 16%. After the tourist season draws to a close, the Ionian and Aegean islands are expected to match those levels.

Job losses are hitting all age groups, but people fresh out of school and young people in services-related or part-time jobs are the most vulnerable. One in three 15- to 24-year-olds who have left school and are in the labor force looking for work can't find jobs, according to Greece's Ellstat statistics agency. Thanasis Alexopoulos has been relying on his parents for support since leaving university with a degree two years ago. The 24-year-old from Athens has spent stints waiting tables, but mostly has been sending out résumés.

"I am seriously thinking of leaving Greece, because we need a revolution in this country to have hopes for a better future," he said.

Public-sector workers also are taking the brunt of job losses, as national and local governments pare back to meet stiff austerity targets.

George Kiolias, 39, was queued up outside an unemployment office after losing his job—at the unemployment office. Mr. Kiolias used to work at the Athens central headquarters of the Employment and Labor Agency until he was laid off seven months ago.

"I was hoping to get married and rent a place of my own, but those dreams are gone and I am increasingly frustrated," Mr. Kiolias said.

He blames the government for agreeing to the IMF conditions. "I have never been a fan of protest rallies," he said. "This time I will join in if things don't improve."

According to a Public Issue poll published Aug. 1 in the national Kathimerini newspaper, 92% of Greeks said both the jobs situation and the country's inflation rate had worsened during the 10 months of Socialist rule. Only 2% thought either had improved.

Against a backdrop of rising joblessness, Prime Minister George Papandreou has been meeting with top government officials to discuss how to ramp up tax collections. Tax intakes are €700 million below the seven-month targets, people within the government said.

In line with the prime minister's drive, Greece's financial-crimes office is targeting issuing up to €5 billion in fines by year's end to clamp down on rampant tax evasion. The

target is an attempt to soothe widespread discontent that the rich have not been made to pay under the austerity program, as well as meet the EU-IMF bailout program's strict deficit-slashing revenue targets.

"The government is forced to cut the budget deficit by 5.5 percentage points to 8.1% by year's end, and this is naturally creating a serious economic contraction," said Nick Magginas, senior economist at the National Bank of Greece.

The government is seeking ways to provide hope for a future recovery. These include lifting restrictions imposed on such professionals as lawyers, engineers, pharmacists and notaries public that limit competition and increase costs to the consumer. Also under consideration is breaking up and liberalizing the energy and transportation sector, including the monolithic railway.

Such prospects hold little hope for older unemployed people like Vassilis Bouras. The construction worker was four years away from retirement when he was laid off in October 2009 from his job in the central Greek region of Thessaly. He hasn't found work since.

He now lives off his savings and is stretched to pay his alimony every month. "They also raised retirement ages but without work I can't gather sufficient pension contributions to ever get a pension," he said.

# Athens met aid criteria with cuts, EU says

By CAROLYN HENSON

BRUSSELS—Greece's strong action to reduce its excessive budget deficit should pave the way for the payment of a second tranche of €9 billion (\$11.57 billion) in euro-zone financial aid to the stricken country in September, the European Commission said Thursday.

The country's deficit has narrowed by 46% over the first half of 2010, the commission said—a reduction that is "faster than planned."

Spending by the state has also dropped 17% compared with the first half of 2009, and the government has undertaken public-sector wage cuts and pension reforms, the commission added.

"Greece has managed impressive budgetary consolidation during the first half of 2010 and has achieved swift progress with major structural reforms," said Economic and Monetary Affairs Commissioner Olli Rehn.

But challenges and risks remain, he said. "The main immediate challenge is to safeguard adequate liquidity and financial stability of the banking sector. At the same time, the structural reform agenda needs to be pressed ahead to unleash the huge potential for raising growth," said Mr. Rehn.

In May, countries using the euro currency along with the European Central Bank and the International Monetary Fund agreed to a €110 billion loan package for Greece to help it pay its debts. A first payment of €20 billion was paid soon afterward. Euro-zone finance ministers will discuss the second payment for Greece at their next meeting in September.

Bank of Greece Governor George Provopoulos said Thursday that there is "every reason to be optimistic on the progress that Greece is making."

"Public finances are under control, structural reforms have ambitiously started and the country has begun on an upward virtuous cycle," he said in a televised statement before a meeting with Prime Minister George Papandreou.

"The growth prospects for the local economy are positive and important progress has been made to provide security, stability and social justice for Greek citizens," Mr. Provopoulos said.

—Nick Skrekas  
contributed to this article.

# Intel wagers on security with deal to acquire McAfee

Continued from first page seeking a buyer.

Shares of Symantec rose 6.2%, or 78 cents, to \$13.37 in Nasdaq trading Thursday in a sign some investors are betting the company could also become an acquisition target.

Intel, for its part, has been looking at software firms to bring it into new markets, including chips for cellphones and consumer devices.

Mr. Otellini had indicated a major focus on software, an effort spearheaded by Renee James, Intel's senior vice president of its software and services group. And in April, In-

tel Chief Financial Officer Stacy Smith said that the company would be looking at acquisitions to help it make more customized products.

Intel is targeting the smartphone space with its Atom chip, which is widely popular in netbooks, but has yet to make waves in a cellphone market dominated by less power-hungry chips built by Qualcomm Inc. and others off of a design from ARM Holdings PLC.

Last year, Intel purchased software-maker Wind River Systems Inc. for \$884 million to help move the Atom chip into embedded de-

vices such as electronic billboards and automatic teller machines. By providing software, Intel makes it easier for customers to adopt its chips.

Like Wind River, McAfee will be operated as a separate subsidiary under its own brand. Mr. Otellini said it has received commitments from McAfee management to stay on in their current jobs for "multiple years."

The deal is Intel's second this week. Monday, Intel said it would buy Texas Instruments Inc.'s cable-modem product line for an undis-

closed amount.

The acquisitions come as Intel last month reported its best-ever quarterly results in an ongoing rebound in the semiconductor market.

Intel expects the deal to slightly cut into earnings the first year after closing because of merger-related charges, and have little impact on the bottom line in the second year.

For its part, McAfee's second-quarter earnings rose 38%, allaying concerns about its business after a weak first quarter. The company said sales grew sharply in North America, one of its key markets.

"I'm very excited and fully committed to joining the Intel team," said McAfee Chief Executive Dave DeWalt.

Both boards have unanimously approved the deal. The agreement still requires McAfee shareholder approval and regulatory clearances.

Intel was advised on the deal by Goldman Sachs Group Inc. and Morrison & Foerster LLP. McAfee was advised by Morgan Stanley and Wilson Sonsini Goodrich & Rosati.

—Nathan Becker  
and Jerry A. DiColo  
contributed to this article.



EUROPE NEWS



Agence France-Presse/Getty Images

Some of the Roma deported from France on Thursday arrive at the Baneasa airport in Bucharest, the Romanian capital.

# France deports Gypsies to Romania

BY SEBASTIAN MOFFETT

PARIS—France put around 80 Gypsies on flights to Romania Thursday as the government ratcheted up a controversial law-and-order campaign.

The French government had planned to send 93 Gypsies, or Roma, back to Romania on Thursday, but at least 18 didn't turn up for their flights, officials said.

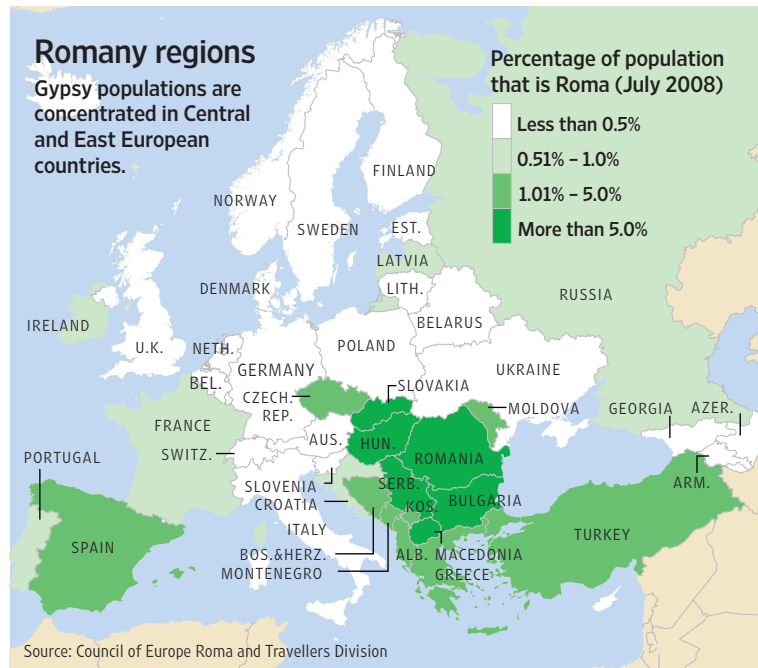
The expulsions come amid French concerns over how to deal with mobile populations in the expanded version of the European Union. Over the past decade, Central and East European countries including Hungary, Bulgaria and Romania, whose populations are generally poorer than West Europeans, have joined the EU. Most of Europe's estimated 11 million Gypsies live in the east. The EU guarantees freedom of movement to citizens of member states, but only on condition they can support themselves.

French Interior Minister Brice Hortefeux said the problem was illegal camps. "We are enforcing simple rules," he said. "One cannot just illegally occupy land without authorization."

The returns on Thursday were part of a "voluntary" repatriation program, in which each adult is granted €300 (about \$390) and each minor €100 for returning to his or her country of origin. Those who stay too long in France and who don't choose to return voluntarily will later receive an order from the government to leave the country anyway, though such orders are sometimes difficult to enforce.

France has been expelling foreign Gypsies for the past few years—an estimated 12,000 were deported in 2009, according to Alexandre Le Clève, a spokesman for advocacy group Rom Europe. There have been 25 rounds of expulsions already this year, according to the Interior Ministry, which didn't give the total number of people involved.

Thursday's deportations—ex-



pected to be the first of several rounds this month, expelling a total of about 700 people—have attracted attention because they come amid increasingly tough talk about crime in general. On July 28, President Nicolas Sarkozy ordered the dismantling of illegal sites used by Gypsies. He has linked Roma camps to drug trafficking, prostitution and the exploitation of children. He also has proposed stripping French citizenship from people of foreign origin convicted of trying to kill police or other public officials.

The statements followed several violent incidents in French cities, including riots in Grenoble and an attack by a group of Gypsies on a police station after police shot dead a Gypsy for failing to stop at a roadblock. However, these incidents involved French nationals, not Romanians. There are an estimated 15,000 foreign Gypsies in France, and more than 100,000 French Gypsies.

Critics of Mr. Sarkozy point out that his law-and-order drive followed a series of setbacks, from dis-

appointing regional election results for his ruling UMP party to accusations he received illegal campaign donations, which he has denied.

"The expulsions are not new," said Mr. Le Clève of Rom Europe. This time, however, "the Roma are serving as scapegoats and to distract from other issues. This [foreign Roma] community has been made responsible for all security issues."

Romania's foreign minister called for France and Romania to take a cool-headed approach to the problem. "I am worried about the risks of populism and xenophobic reactions in a context of economic crisis," Teodor Baconschi said in an interview Wednesday with the Romanian-language service of Radio France Internationale.

Mr. Hortefeux, the French interior minister, is scheduled to meet next week in Paris with Romanian officials, including Secretary of State for Roma Integration Valentin Mocanu, an official at the Romanian Embassy in Paris said.

# Growth question poses challenge for Sarkozy staff

BY WILLIAM HOROBIN

PARIS—Pressure is building on French President Nicolas Sarkozy ahead of a meeting with his top ministers on Friday to confront the thorny question of unrealistic growth forecasts and how the government can keep its commitments to cut a swelling public deficit.

There won't be any news conference or briefing after the meeting, an official at the Élysée Palace said Thursday, but a statement is expected to be issued Friday afternoon.

A key question is what Mr. Sarkozy and his advisers will say in that statement about growth. Currently, the official forecast for French gross domestic product in 2011 is a 2.5% rise after an expected 1.4% expansion in 2010. The figure for 2011 is a cornerstone for a French budget that aims to bring the public deficit down to 6% of GDP from an expected 8% this year.

But the growth outlook for 2011 is widely contested, even by members of Mr. Sarkozy's own UMP party.

"Growth at 2.5% is imaginary. Nobody believes in that," said Philippe Marini, the chief rapporteur of the French senate's finance commission.

Mr. Marini said the economy has entered a recovery phase, particularly in the services sector, but his expectation still differs from the government's.

"We can say for now that the economic situation in 2010 doesn't make it impossible for activity to reach the potential level of growth in 2011, that is to say 2%," Mr. Marini said.

And Mr. Marini isn't alone with his less optimistic projections for the French economy.

The International Monetary Fund's most recent forecast for 2011 GDP growth is 1.6% and the IMF doesn't expect the French economy to start growing at more than 2% until 2013.

The official forecast for 2011 "would put France well above the potential growth of 2% for the euro zone. This seems really too optimistic, as there are few reasons for France to outperform its European peers," said ING euro-zone and France economist Oscar Bernal. He forecasts 1.7% GDP growth in 2011.

The government's task on Friday is complicated further by a better-than-expected second-quarter growth figure.

When figures from national statistics agency Insee last week showed 0.6% GDP growth, Finance Minister Christine Lagarde greeted the news as "magnificent," much better than expected, and evidence the French economy had entered a "virtuous circle."

The finance ministry has said it would revisit its 2.5% forecast for 2011 in the preparation of the budget and once the second-quarter growth figures were known.

But Ms. Lagarde said on the day of the publication that wasn't on the day's agenda and would wait until the budget preparations.

The pressure has been ramped



France's Sarkozy earlier this month

up in recent days after a report from credit ratings agency Moody's said that although the triple-A ratings of countries including France are well-positioned, they were much closer than they had been to a downgrade. The report identified two weaknesses of French public finances: a high initial level of tax pressure and rigidities of expenditure.

France has committed to cutting its deficit from an expected 8% of GDP in 2010 to 6% in 2011 and 4.6% in 2012, before reaching the 3% stipulated by European treaties in 2013. That means reducing the deficit by €40 billion (\$51 billion) in 2011 and by €100 billion by 2013.

About half of the €100 billion is expected to come from spending cuts and the other half as the economy recovers.

But tweaking growth forecasts will make the government's job more difficult.

"If you cut the growth hypothesis...it leads to a significant cut in the tax receipt forecasts for the government," Natixis euro-zone economist Jean-Christophe Caffet said. "The targets for spending cuts are achievable, and France has shown it can do that in the past, but betting simultaneously on a strong rise in receipts seems very optimistic to me."

Mr. Caffet noted that government spending cuts will hurt consumer spending in particular because more than half of public spending feeds household income. Natixis expects only 1% GDP growth in 2011.

The government says its targets to cut the public deficit are immutable and it will take all necessary measures to meet them.

In the government's sights are tax exemptions and rebates, known as "niches fiscales."

Cutting them out could bring in savings of between €8 billion and €10 billion, ministers say. But the government will have to be careful not to target one group of beneficiaries more than another, Mr. Marini said.

"The right solution is an arithmetical, proportional one that involves a minimum of isolated cases. Everyone should be treated in the same way," Mr. Marini said.



## EUROPE NEWS

## A year on, bomber deal scrutinized

BY CASSELL BRYAN-LOW  
AND ALISTAIR MACDONALD

LONDON—Scottish opposition politicians are set to demand their justice minister “come clean with the facts” over his decision to release the convicted Lockerbie bomber one year ago Friday, marking renewed trans-Atlantic scrutiny over the circumstances surrounding the release.

On Aug. 20, 2009, Scotland’s Justice Secretary Kenny MacAskill freed Abdel Baset al-Megrahi, the only person ever convicted for the 1988 bombing of a Pan Am airliner as it flew over the Scottish town of Lockerbie, saying he had three months to live. Today, Mr. Megrahi remains alive in his home country of Libya.

Politicians in the U.S. and Scotland have recently ratcheted up pressure on the Scottish authorities to release all medical documentation underpinning last year’s release on so-called compassionate grounds.

On Friday, Scottish Labour Party leader Iain Gray is set to call on Mr. MacAskill to “apologize for his gross incompetence” over the handling of the decision and seek the publication of medical records that led to the release.

A close examination of the case by The Wall Street Journal, published earlier this month, showed no evidence that any of the four specialists who treated Mr. Megrahi signed off on the three-month prognosis that formed the basis for his release.

Instead, one young, part-time prison doctor, Peter Kay, provided guidance to Andrew Fraser, the prison health-service director. That guidance was subsequently passed to Mr. MacAskill, who made the decision to release Mr. Megrahi.

On Thursday, Mr. MacAskill defended his decision to set Mr. Megrahi free, saying he followed the rules and laws of Scotland. “I acted appropriately and I stand by the decision,” he said in a statement.

The minister has turned down a request by a U.S. Senate committee to testify at a hearing that will explore Mr. Megrahi’s release. But Mr. MacAskill said Thursday he would “try and provide” a meeting with the senators if they came to Scotland.

In an apparent attempt to defuse criticism, the Scottish Prison Service on Thursday circulated a statement



Hundreds of Libyans welcome Abdel Baset al-Megrahi, as he is accompanied by Seif al-Islam el-Gadhafi, son of Libyan leader Moammar Gadhafi upon his arrival at airport in Tripoli, Libya, last August.

from one of the doctors involved in discussions ahead of Mr. Megrahi’s release. “The background medical portion of that application is a fair reflection of the specialist advice available at the time,” oncologist Grahame Howard said in the statement.

Dr. Howard, one of four experts involved in the discussions, emphasized that the final assessment was made by Dr. Fraser. “As an external adviser I was involved in discussions leading up to the point where Mr. Megrahi was considered for release on medical grounds,” said Dr. Howard.

The doctor didn’t say what advice he gave or whether he supported Dr. Fraser’s conclusion at the time that Mr. Megrahi’s life expectancy could reasonably be estimated at three months, the bar for compassionate release under Scottish law. Dr. Howard couldn’t be reached to comment for this article.

Mr. Megrahi was sentenced in 2001 to life with a minimum 27 years imprisonment for his involvement in blowing up a New York-

bound Pan Am airliner, killing 270 people.

Abdulmajeed Eldursi, director of Libya’s Foreign Media Corporation, said Mr. Megrahi is living with his family and is “very sick.” Tony Kelly, Mr. Megrahi’s lawyer, declined to comment on his client’s health.

Mr. Megrahi previously has called his conviction “unjust” and said he had been the victim of a miscarriage of justice.

Last year, following his release, he posted hundreds of documents online detailing arguments supporting his abandoned appeal in an effort to clear his name.

A person familiar with the matter said the Libyan government was keen to play down the anniversary and would not be celebrating in public, given the embarrassment it caused to Scotland last year when Mr. Megrahi was greeted on his return to Tripoli to crowds waving Scottish flags. The U.K. government said it has told Libya not to hold the sort of celebrations that angered the relatives of the victims of the bombing upon Mr. Megrahi’s return to

## Securing release

Megrahi’s medical saga

■ August 2008: Mr. Megrahi reports discomfort and blood tests are carried out.

■ September 2008: Mr. Megrahi is diagnosed with advanced metastatic prostate cancer.

■ October 2009: Mr. Megrahi applies to a Scottish court to be released from prison to a bail house

■ Aug. 20, 2009: Mr. Megrahi is granted application for compassionate release

WSJ research

Libya. “We made our position clear, any celebration of his release we would consider that tasteless, offensive and insensitive,” a spokesman for the Foreign and Commonwealth Office said.

—Tahani Karrar  
contributed to this article.

## U.K. plans temporary bans to hit ‘legal highs’

BY JEANNE WHALEN

The U.K. is giving its law-enforcement authorities extra powers to fight a wave of new narcotics known as “legal highs.”

The drugs are often legal when they hit the market because authorities haven’t yet seen and banned them. With names such as Meow Meow and NRG-1, the drugs have been popular in Europe. New synthetic cannabinoids that are similar to marijuana also have appeared widely in the U.S.

It can take authorities months to catch wind of a new drug and ban it. The U.K. says it is trying to shrink that interval by allowing law-enforcement agencies to issue immediate bans of up to 12 months on new substances, until full reviews can be carried out.

“The drugs market is changing and we need to adapt current laws to allow us to act more quickly,” James Brokenshire, minister for crime prevention at the Home Office, said in a statement.

“The temporary ban allows us to act straight away to stop new substances gaining a foothold in the market.”

The U.K., Sweden and Germany all recently banned one of the most popular drugs, mephedrone, or Meow Meow, which appeared in 2007.

“Legal highs” are often sold as powders that can be snorted or packed into tablets. They create highs that mimic those from a range of drugs including cocaine and ecstasy.

The new drugs have been blamed for the deaths of two young people in the U.K. and Sweden, and authorities say they may have contributed to as many as 30 deaths in the U.K. in recent years.

The temporary U.K. bans will allow police and border guards to confiscate new drugs, the Home Office statement said.

People dealing the drugs after a temporary ban is in place will face a maximum of 14 years in prison. Possession of a temporarily banned drug for personal use won’t be considered a crime.

Drugs may be temporarily banned after an “initial consideration by the Advisory Council on the Misuse of Drugs,” or ACMD, a body that advises the government on drug policy, the statement said.

The ACMD would then carry out a full review to decide whether the drug should be permanently banned.

The U.K., Sweden and Germany all recently banned one of the most popular drugs, mephedrone, or Meow Meow, which appeared in 2007. The U.K. also recently banned naphyrone, or NRG-1, which surfaced after the mephedrone ban.

A number of U.S. states and counties have banned synthetic cannabinoids called Spice and K2, which are similar to marijuana.

## U.K. economy kicks off quarter strongly

BY NICHOLAS WINNING

LONDON—The U.K. economy began the third quarter strongly, with healthy retail-sales growth, weaker-

than-expected government borrowing, firm industrial orders and a modest pickup in mortgage lending, data showed Thursday.

Although the data lifted the pound and made it even less likely that the Bank of England will need to provide additional stimulus in the near term, economists said the government’s planned spending cuts would hinder growth in the future.

The Office for National Statistics said July retail-sales volume was up 1.1% from June and 1.3% higher than July 2009—the strongest monthly gain since February.

“The message from these data is that the consumer is still alive and well,” said Brian Hilliard, an economist at Société Générale.

Although food sales were weak, sales overall were boosted by spending related to the World Cup and sales of sports equipment, games, watches and jewelry, the ONS said.

“This and other evidence suggests that [gross domestic product] growth got off to a good start in [the third quarter],” said Philip Shaw, an economist at Investec. The U.K. economy grew 1.1% in the second quarter from the first, the strongest expansion in four years.

But economists said consumer confidence remains weak and the pace of retail-sales growth should ease in August. Further down the line, sales are expected to suffer from public-sector spending cuts and tax increases that aim to shrink the budget deficit.

ONS figures released Thursday showed the public sector borrowed £3.2 billion (\$4.99 billion) in July, below expectations for net borrowing of £4.3 billion and net public-sector borrowing of £5.5 billion in July 2009—while central government receipts rose 10.5% on the year due to a strong increase in corpora-

tion tax revenue.

For the fiscal year that began in April, the government has borrowed £42.6 billion, down from £46.4 billion a year earlier.

“The improved outturn for July is largely due to the strength of corporation tax receipts ... given that we are still in the early stages of the recovery, the size of the bounce demonstrates how resilient company finances have been during the recession,” said Andrew Goodwin, senior economic adviser at Ernst & Young ITEM Club.

Other data released Thursday showed the prospects for the manufacturing sector remain positive and mortgage lending rose in July, although the housing market remains subdued.

—Laurence Norman, Paul Hannon,  
Ilona Billington  
and Ainsley Thomson  
contributed to this article.

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## U.S. NEWS

# U.S. job market bleak as claims jump

BY LUCA DI LEO  
AND SARAH N. LYNCH

The number of U.S. workers making new claims for jobless benefits rose last week to the highest level in nine months, a distressing sign for an already weak labor market.

Initial unemployment claims increased by 12,000 from a week earlier to 500,000 in the week ended Aug. 14, the Labor Department said in its weekly report Thursday.

It was the highest level since Nov. 14, when claims stood at 509,000.

The increase indicates that the labor market remains in the doldrums and adds to evidence that the economic recovery is slowing.

The four-week moving average,

which aims to smooth volatility in the data, rose by 8,000 to 482,500. It was the highest level since December 2009.

The number of continuing claims—those drawn by workers for more than one week—fell by 13,000 to 4.5 million in the week ended Aug. 7.

“While we do not expect that the U.S. will fall back into recession, the rise in the four-week average of claims is quite troubling and signals that private payrolls may not expand in August,” analysts for RDQ Economics LLC wrote in a note to clients.

“From a political perspective, a weak labor market makes for a dreadful economic backdrop for incumbents in the November midterm elections,” they added.

The level of new claims had fallen steadily from a high of 651,000 in March 2009 to a low of 439,000 in early February.

Since then, it has been creeping back up.

The U.S. job market was already weak.

The economy lost 131,000 jobs in July, and the unemployment rate stayed at a high 9.5%.

After its policy-setting meeting last week, the Federal Reserve noted that the recovery in the jobs market had slowed.

The central bank decided to keep its money in the bond market as one way to counter the slowdown in the economy.

Two other reports released Thursday also pointed to a gloomy economic outlook.

The Federal Reserve Bank of Philadelphia's regional business survey plummeted, and an index of leading indicators increased a slight 0.1% last month after falling a revised 0.3% in June, the Conference Board said.

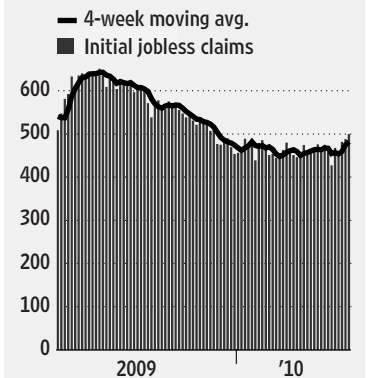
The Philadelphia Fed manufacturing index fell to -7.7 in August from 5.1 in July.

Signs of weakness in manufacturing are concerning because it has been one of the few sectors of the economy that has continued to show strength—and to add jobs.

“The reality of the current recovery is that more sectors of the economy remain weak than are expanding,” said Dan Greenhaus, an economist at Miller Tabak & Co. “Growth in the second half is going to be hard to come by.”

## In the doldrums

Initial jobless claims for unemployment insurance, in thousands



Source: U.S. Labor Department

# Spill caused Manhattan-size plume

BY ROBERT LEE HOTZ

At the height of the Deepwater Horizon spill, oil escaping from the damaged well was trapped underwater in a drifting plume of hydrocarbons the size of Manhattan and helped turn the Gulf of Mexico into a test-tube of experimental petroleum chemistry, scientists said Thursday.

Confirmation of the plume will further fuel skepticism about U.S. government estimates that the vast majority of the 4.9 million barrels of spilled oil is already gone from the Gulf or being rapidly broken down by bacteria, marine experts said.

The new findings also add to evidence from other independent research groups this week that the offshore spill—the largest in history—is confounding expectations about the behavior of oil and water.

No one knows yet whether the oil has dissipated since a team from the Woods Hole Oceanographic Institution in Massachusetts measured it at the end of June, but several researchers suggest the submerged plume may last for a year or more. The long-term impact of such plumes remains unknown.

Some of the oil may persist deep underwater and in seafloor sediments—at levels thousands of times higher than those caused by the natural oil seeps that dot the Gulf sea floor—where it can elude conventional detection and clean-up efforts, scientists said.

Richard Camilli, chief scientist on the Woods Hole research team, said that at the time of the study the plume was moving along in a very regular manner. “These hydrocarbons may well show up somewhere else, running undetected below the surface,” he said.

Even so, the chemicals are not concentrated in these depths at levels high enough to be directly toxic to marine life, several ocean experts who study the Gulf said.

An independent research group from the University of Georgia is expected to launch a month-long cruise to the Gulf spill area Friday to pick up the study of the plume.

For 10 days in June, Dr. Camilli and his colleagues aboard a U.S. National Science Foundation research vessel called the Endeavor explored the plume—22 miles (35 kilometers) long and more than a mile wide—as it snaked along 3,000 feet (914 meters) below the surface of the Gulf. They made 57,000 measure-



Ricky Breaux wades in from the ocean near a pool of dispersed oil on a public beach in Grand Isle, La., earlier this month.

ments, mainly using sensors on a remote-controlled robot deployed from the ship.

Reporting their preliminary findings Thursday, they confirmed that oil from the well had been caught below the surface of the Gulf in pools of microscopic oil drops and petroleum-based trace chemicals, which were degrading more slowly than many had expected. The plume resembled a mist of trace chemicals largely invisible to the eye, rather than a river of oil.

“We don’t know why there is oil down there that we otherwise thought should be floating at the surface,” said Woods Hole marine chemist Christopher Reddy.

In normal circumstances, crude oil readily floats to the surface, where it can be skimmed, burned off or evaporated. Floating on the waves, it can be churned into smaller drops readily digested by bacteria that evolved in the oil-rich Gulf waters.

But oil from the ruptured well, broken down by sprays of chemical dispersants and held at depth by water pressure, had formed microscopic droplets not buoyant enough to break through the transitional

layer that separates warm surface currents from the cold bottom water, several experts said. Moreover, as the oil breaks down into its various chemical constituents, each new compound behaves differently, with different buoyancy.

In their analysis, published by the journal *Science*, the Woods Hole researchers said they found high concentrations of benzene, toluene, xylene and other so-called BTEX petroleum compounds that could be traced back to the leaking well. They calculated that the plume contained between 5% and 6% of the signature BTEX petroleum hydrocarbons released during the spill. “This is the first number that anybody has been able to put on how much of the stuff from the well is ending up in the plume,” said University of Georgia oceanographer Samantha Joye, who is studying the Gulf spill but was not involved in the project.

But the researchers saw little evidence, two months after a wellhead explosion triggered the spill, that oil-eating microbes had reduced this cloud of chemicals.

Contrary to previous predictions by other researchers, the Woods Hole group found no evidence of

“dead zones,” in which bacteria feasting on oil can use up so much oxygen that no fish or marine life can survive. They speculated that earlier oxygen readings might have been wrong because some measuring devices can give artificially low readings when coated by oil.

“It looks like the oil is degrading relatively slowly,” said Woods Hole chemist Ben Van Mooy.

# Final plug for BP well is pushed back

BY GUY CHAZAN

It may be mid-September before BP PLC puts the final plug in its blown-out well in the Gulf of Mexico, a government official said, or roughly a month later than initially expected.

Coast Guard Adm. Thad Allen, overseeing the federal response to the Gulf oil spill, said on Thursday that BP will first attempt to replace the blowout preventer, a crucial piece of equipment that sits on the seabed, to prevent any oil leaks during the plugging operation. He said the last step would be pushed back to “the week after Labor Day,” which falls on Sept. 6 this year.

The postponement, caused partly by weather delays, is frustrating for both BP and the government, which are eager to finally draw a line under the Gulf disaster. No oil has been leaking out into the sea since July 15, when BP installed a new, tight-fitting cap on the well. But federal officials have made it clear that the rogue well won’t be declared dead until a “bottom kill” has been carried out to seal it from below.

BP’s well blew out April 20, killing 11 people, destroying the Deepwater Horizon rig and triggering the worst offshore oil spill in U.S. history. The government has estimated that some 4.9 million barrels of oil were released into the Gulf during the spill. BP has been drilling a relief well since the beginning of May, which was expected to intercept the rogue well by mid-August.

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## U.S. NEWS

# Cuts in Social Security weighed by U.S. panel

By LAURA MECKLER

WASHINGTON—A White House-created commission is considering proposals to raise the retirement age and make other changes to shore up the finances of Social Security, prompting key players to prepare for a major battle over the program's future.

The commission is looking into ways to address the country's long-term fiscal problems, but even before it settles on proposals, many liberals are vowing to block cuts in retirement benefits. Some key players appear open to a deal, however, including the White House and the powerful senior group AARP.

Beginning in 2014, Social Security is projected to routinely pay out more in benefits than it collects in taxes, drawing on reserves that have been funding the rest of government. By 2037, the reserves are projected to be depleted, leaving the program able to pay about 75% of

promised benefits.

How to fix that long-term problem is under consideration by the 18-member National Commission on Fiscal Responsibility and Reform, which is examining a number of ways to cut benefits or raise taxes, according to two commission members and others briefed on the panel's deliberations.

In addition to a higher retirement age, specific cuts under consideration include reducing benefits for wealthier retirees and trimming annual increases that address inflation, perhaps only for wealthier retirees, according to two people.

On the tax side, the leading idea is to increase the share of earned income that is subject to Social Security taxes, officials said. Under current law, any income beyond \$106,000 is currently exempt.

To be endorsed by the commission, an idea must garner 14 of 18 votes. The commission is to issue its report by Dec. 1.

The proposals will face an uncertain reception in Congress, which would have to approve changes to the retirement program. "Are Republicans willing to sign on to a tax increase, and are Democrats ready to sign on to a benefit cut? I think the answer is probably yes in both cases if the other is willing to do it," said commissioner Alice Rivlin, a Democrat who once directed the White House budget office.

Republicans on the commission have mostly held their fire. Rep. Jeb Hensarling (R., Texas) said Thursday he opposes tax increases but wouldn't rule anything out at this stage in the discussions, otherwise "the thing blows up before it has a chance to work."

Many liberal Democrats oppose any proposal that includes benefit cuts. They argue the program's finances can be fixed with tax increases alone.

—John McKinnon  
contributed to this article.

## Why Charlie Cook predicts a romp by the Republicans

[ Capital Journal ]

By GERALD F. SEIB



In the panoply of political prognosticators populating Washington, few have painted a bleaker picture of Democrats' 2010 election prospects than Charlie Cook.

And he doesn't see that picture getting any brighter.

To the contrary, Mr. Cook, who is editor and publisher of a newsletter that bears his name, and who stands as perhaps the most respected crystal-ball gazer in politics, now says it more definitively than ever: Republicans are on track to win back control of the House of Representatives, claiming their most coveted prize of 2010.

"I think Republicans are going to get the House back," he said flatly in a conversation taped for WSJ.com's "Big Interview" segment, which will be posted Friday morning.

To be precise, Republicans need to win 39 Democratic seats to get control of the House, and Mr. Cook's current estimate is that they are in line for a 35- to 45-seat gain. "But frankly, I think we're being very conservative with that," he added. "The odds of it being higher than that range are a lot better than lower."

Mr. Cook just this week raised his newsletter's forecast of Republican gains to reflect this new view. The analysis is significant, not only because Mr. Cook has a strong track record—he correctly called the last wave that brought Democrats into power in the House, in 2006—but also because Mr. Cook and his small staff of analysts probably devote more hours and shoe-leather to analyzing individual House and Senate races than anyone outside the political parties.

It's also significant because Mr. Cook has consistently been more bullish on Republicans' prospects this year than many other nonpartisan analysts have been, and events have generally evolved to match his view.

The basis of his analysis is simple: This doesn't look or feel like a normal midterm election. "There are two kinds of elections," he said. "There's sort of the Tip O'Neill all-politics-is-local, and then there are wave elections. We're seeing just every sign in the world that this is going to be a wave, and a pretty good-sized wave."

That wave, he thinks, won't be enough to bring the Republicans control of the Senate. Republicans would have to take over 10 seats now controlled by the Democrats to pull off that feat, and even this wave doesn't appear sufficient. In numerical terms, Mr. Cook sees 18 Senate seats up for election this year that could, plausibly, change party hands one way or the other, and Republicans would have to win 16 of the 18 to take over.

That task is "a couple of orders of magnitude higher" than the



Cook has a strong track record.

challenge Republicans face taking back the House, he said.

Could Mr. Cook's analysis of the climate be wrong? The key question at this juncture is whether something might happen to make the Cook picture less bright for Republicans, and less bleak for Democrats, by Nov. 2.

One way to analyze that question is to say that there are only about 10 weeks left before the election, and the broad trend lines don't figure to change very much in that amount of time. The other way is to say that there are 10 weeks to go and, given the speed and volatility of politics these days, that's a lifetime, and plenty of time for the picture to morph.

Some things simply won't change. One is the Democrats' most basic problem, which is that they have an awful lot of House members trying to hang on to seats in difficult territory. Because of the party's gains in the last two elections, there now are 53 House Democrats trying to defend seats that were held by Republicans just four years ago. That means a lot of Democrats are exposed to danger amid adverse conditions.

In addition, Mr. Cook says, voters tend to look for "balance" in the national political leadership. That helps Republicans right now.

On the other hand, Democrats might figure out how to do a better job convincing the nation of the wisdom of their policies. The apparent return of General Motors to health after President Barack Obama's bailout might help. Mr. Obama, who, despite his problems, remains far more popular than his party's congressional leaders, stands the best chance of making that case.

And Democrats' money advantage, which Mr. Obama was working to enhance this week with a fund-raising tour, will help in the stretch run. Above all, Democrats might finally get their base more excited.

Ultimately, though, Democrats are selling a controversial agenda amid lousy economic times. It appeared briefly in the spring that the economic trend lines might be starting to point upward. It doesn't feel that way now. And that, as much as anything, explains the Cook report.

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## U.S. NEWS

# Wager 101: Students bet on grades

By STEPHANIE BANCHERO

Two New York entrepreneurs are offering college students the chance to put their money where their grades are.

Their website lets college students place wagers on their own academic performance, betting they will earn, say, an A in biology or a B in calculus. Students with low grade-point averages are considered long shots, so they have the opportunity to win more money for high grades than classmates with a better GPA.

The pair of recent college graduates who founded Ultrinsic.com say they hope to turn a profit and inspire students to work harder. "It would be great if everyone was intrinsically motivated to get good grades, but that's, like, not reality," said Jeremy Gelbart, a 23-year-old co-founder of the site.

But students can bet against themselves, too, wagering they won't achieve a high grade-point average. And education experts—along with several of the schools Ultrinsic is targeting—say the use of money as a motivator for academic achievement is dubious at best. Questions remain about whether the venture will run up against laws restricting Internet gambling.

The website attracted wagers by 600 students from two colleges last year, said Mr. Gelbart and co-founder Steven Wolf, graduates of Queens College. This month, the site expanded to let students on 36 campuses—including Harvard, Stanford and Brigham Young University—place bets. More than 1,000 new bettors have signed on.

Lisa Lapin, a Stanford University spokeswoman, said school officials were "appalled" when they learned Stanford students could place bets



Ultrinsic co-founders Steven Wolf, from left, and Jeremy Gelbart, along with Chief Operating Officer Judah Guber, in New York on Monday.

on their grades, adding, "the concept of betting on academic performance is contrary to academic development."

Lance Miller, a finance major at the University of Pennsylvania, says the criticism misses the mark. Mr. Miller, with a GPA of 3.6, won about \$80 on two \$40 bets that he would earn A's in business courses.

"We're acing classes to make money—isn't that what they call a win-win?" said Mr. Miller, 20.

Research in K-12 schools has shown that paying for grades isn't

all that successful at boosting test scores. But paying for behavioral changes, such as paying students to read more books, can increase scores.

Brian Jacob, a professor of economics and education policy at the University of Michigan in Ann Arbor, said that, while there is no conclusive evidence that paying for good grades will raise achievement, he noted that Ultrinsic could provide a "small" incentive to college students because they were putting down their own cash. Ultrinsic oper-

ates like a sports book, where gamblers can bet on the probability they will get a certain grade in one course, two courses, three courses (known as the trifecta) or overall grade-point average. The website uses an algorithm based on the student's GPA and the grading history of the courses to set the odds.

It isn't clear whether the website would be considered illegal under state and federal laws. Federal law prohibits financial institutions from transmitting payments to and from gambling businesses that are unlaw-

ful under state law, and state laws generally bar betting on unlicensed games of chance.

Mr. Gelbart says the site doesn't constitute gambling because it is a game of skill. Anthony Cabot, a Las Vegas lawyer and an expert on the issue, said that argument would likely hold up in most courts but said the business model has risks in states with more restrictive laws.

Mr. Gelbart declined to say whether his company, which is financed by private investors, is making money.

Some students who have placed wagers say they have an advantage because they know more about their classes than Ultrinsic does. The site's founders acknowledge there are kinks in their system but say their information will improve as more bets are placed.

Colin Schloss, a business major at Penn, wagered \$50 that he would earn at least a B-plus in Finance 100 and \$50 that he would do so in Accounting 101. But Mr. Schloss hedged his bet. He also placed a \$56 wager that his overall grade point average would fall below 3.9. Winning that bet would net him an additional \$50.

"I created an arbitrage opportunity," he said, referring to the practice of making profit by exploiting market inefficiencies. He knew that if he didn't earn his target grades, his GPA would drop below 3.9, meaning he would prevail on at least one of his wagers.

"It wasn't really a motivation to get good grades," Mr. Schloss said. "It was a motivation to see if I could beat the system and win some money."

Mr. Schloss won both wagers. He sent his transcript to Ultrinsic and within a few weeks received his \$156 in winnings.

# Pentagon cost-saving drive comes under fire

By NATHAN HODGE

U.S. lawmakers worried about potential job losses in their districts have rallied against the closure of a military command in Virginia, presenting Secretary of Defense Robert Gates with a big test of his effort to hold down military spending.

Mr. Gates this month said he would cut payments to outside contractors by 10% a year for the next three years, saying the Pentagon bureaucracy had "grown over-reliant on contractors and grown accustomed to operating with little consideration to cost."

**Loren Thompson, a defense-industry analyst, said a letter from lawmakers represented the first substantial challenge to Mr. Gates's cost-cutting initiative.**

Mr. Gates also outlined plans to eliminate a major military command, the Norfolk, Va., Joint Forces Command, an organization created in 1999 to encourage cooperation and training among the various services.

The proposals represent a bet by the Defense Secretary that by holding down costs he can free up funds

for troops overseas and stave off potentially deeper cuts by Congress, which is increasingly focused on federal spending and the deficit. The moves announced this month are part of a broader effort to realize \$100 billion in cost savings over the next five years.

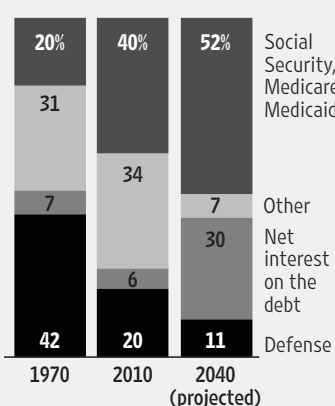
Last week, a group of congressmen from Virginia wrote to Mr. Gates challenging his recommendation to eliminate the Joint Forces Command, known as JFCOM, saying it would lead to thousands of job losses in southeastern Virginia. "Eliminating the Joint Forces Command poses significant implications for the future conduct of joint operations, entails financial and personnel costs, and will result in a substantial adverse economic impact on the local community," they wrote.

They suggested the closure should be subject to a formal review process known as base realignment and closure, which could delay or alter Mr. Gates's plan. Base closures involve public hearings and independent review before being approved. A Department of Defense spokesman said Mr. Gates's recommendation isn't subject to a base-closure process. "The Department is not closing or realigning JFCOM," the spokesman said. "The disestablishment of JFCOM does not trigger the thresholds of the federal statute."

Loren Thompson, a defense-industry analyst and consultant, said

## Military pruning

Share of federal spending, adjusted for inflation



Sources: Office of Management and Budget and other sources via Defense Business Board



the letter from lawmakers represented the first substantial challenge to Mr. Gates's cost-cutting initiative. He said Mr. Gates underestimated the political implications of eliminating a military organization where thousands of voters have jobs. Joint Forces Command has more contractors on its payroll than uniformed military and government civilian personnel.

"What Gates is doing is base closure rather than cost cutting," said Mr. Thompson. "While it's fallen under the rubric of cost cutting, it has

the political impact of a base closure."

On Monday, Sen. Jim Webb (D., Va.) called for a full hearing on Mr. Gates's recommendation to eliminate JFCOM. In a letter to the leadership of the Senate Armed Services Committee, Mr. Webb praised the push to control costs but added that Mr. Gates's "lack of prior consultation with Congress on his entire set of recommendations is deeply troubling."

Over the past decade and a half, defense agencies have outsourced many administrative and support

functions to private firms, which oversee logistics and maintenance work and run government computer systems and even procurement programs. Official estimates put the number of contractors working for the Department of Defense at 766,000—a work force that costs \$155 billion annually and outnumbers the Pentagon's civil service by more than 20,000.

Mr. Gates's plans have also drawn fire from the defense industry. The Professional Services Council, an association representing government contractors, described Mr. Gates's initiative as a "new round of arbitrary cuts."

The association pointed to Mr. Gates's decision to curtail "insourcing"—a drive to replace some contractors with federal employees—on the grounds that the concept wasn't yielding enough savings. The association called it evidence that contractors were often the most cost-effective way to achieve the government's work.

Winslow Wheeler, director of the Straus military-reform project at the Center for Defense Information, an institute that monitors the military, said Mr. Gates was unlikely in the longer term to shield the defense budget from deeper cuts. Current efficiency measures, he said, "will not transform the Pentagon into something that can survive significant budget reductions."



## WORLD NEWS



Michael M. Phillips for The Wall Street Journal

Lance Cpl. Derek Simpson, left, shows another Marine his helmet after it was shot by an insurgent on Sunday.

## Afghan sniper has Marines on edge

BY MICHAEL M. PHILLIPS

SANGIN, Afghanistan—Somewhere in this dusty town, concealed among the cornfields, irrigation canals and mud-walled compounds, is a man the U.S. Marines particularly want to kill.

They don't know what he looks like. But they know he is a very good shot with a long rifle, and, every day he remains alive, he is drawing Marine blood.

In the seven days since the men of Lima Company, Third Battalion, Seventh Marine Regiment arrived in town, the Sangin sniper has persecuted them with methodical, well-aimed shots, fired one at a time. His toll so far: two men killed—one American and one British—and one man wounded.

Two Marines have survived hits they say came from a second shooter, believed to be less proficient and careful than the first.

Sangin has for years been a hotbed of insurgent activity in volatile Helmand province, and, in its first days here, Lima Company has pressed through a belt of farmland between the Helmand River and a main road, Route 611. The Marines have been met with hidden explosives and ambushes.

But the sniper has caused the most damage—a deadly reminder that the Taliban insurgency has its share of well-trained fighters capable of frustrating the allied mission.

“He's hitting people—that's very

disruptive,” said 1st Sgt. John Calhoun, 41 years old, from Konawa, Okla. “But it's not interfering with what we're trying to do here.”

The sniper struck first on Aug. 13, the day after Lima Company arrived. A Marine stepped out of his armored vehicle 100 yards or so from a secure U.S.-British patrol base. He threw away some trash and exchanged a few words with another Marine. The sniper fired a single, lethal shot.

The same day, a British army engineer—20-year-old Darren Foster—was in a guard post in front of the same patrol base. British troops have built a covered, bunkered pathway so the guards aren't exposed to enemy fire as they walk down from the hilltop base. The post is protected by bulletproof glass, except for small gaps through which the guards fire their weapons. The sniper timed his single shot and killed the engineer as he walked past the opening. “He hit a moving target in a space this big,” said Capt. Jim Nolan, Lima Company's commander, holding his hands about nine inches apart.

On Aug. 14, a U.S. tank mechanic took a round in the torso as he carried sandbags across a small bridge. The protective plate in his body armor stopped the round. “We think it's the same guy,” said Gunnery Sgt. Edward Rivera, 39, of Poway, Calif.

Other Marines believe the evidence suggests a second shooter, less accurate and armed with a

smaller-caliber weapon.

Then on Sunday, the snipers hit twice. First, Lance Cpl. Derek Simpson took a round to the head.

One of the Marines' tank-like mine-clearing vehicles had slipped off of a dirt bridge, knocking the track off the sprocket wheel. The Marines hitched it to a tow-tank and pulled until the track came free, then set to work putting it back in place. Lance Cpl. Simpson, of Third Combat Engineer Battalion, was working on the project when he felt a hard blow to his head.

The sniper's bullet had apparently hit the tank and ricocheted into the front right side of Lance Cpl. Simpson's helmet. It punched into the Kevlar shell, but didn't penetrate all the way.

Lance Cpl. Simpson can't recall if he was knocked to the ground or threw himself there to avoid another shot. Another Marine dragged him to cover. He lay on his back as a friend pulled off his helmet to reveal a bloody welt on the right side of his forehead. Two Navy corpsmen, the Marine equivalent of Army medics, decided against stitches.

“I feel blessed,” he said. But he also felt guilty for leaving his comrades. “I want to be out there with everyone else,” he said. “It's not fair that I'm alive and in here, and they're still out there.”

Fifteen minutes after Lance Cpl. Simpson arrived at the patrol base, another Marine went down near the same spot. Again, just one shot.

The other Marines pulled him, too, behind an armored vehicle, where a corpsman treated his wounded leg. The men called frantically for an armored ambulance, but were relieved that the corpsman found the bullet had missed the femoral artery. The wound wasn't life-threatening.

Back at the patrol base, Sgt. Johnny Bailey watched a live video feed of the scene at the bridge and tried to find out which way the Marine had fallen. “That way I'll know the direction of the shot,” he said.

The Marines send their own snipers out hunting. The Marine scout-snipers, who go through extensive training, are reluctant to grant that title to the insurgent gunman.

“He's a decent shot—not a great shot,” one Marine sniper said as he headed out to try to kill the insurgent. He had heard the thump and crack of each of the sniper's shots. He estimates from the sound that the Sangin sniper is less than 600 yards away from his targets.

During the U.S.-led offensive earlier this year in Marjah, one insurgent sniper positioned himself two or three rooms deep in a building, concealed well enough to hide the flash of his rifle's muzzle. His shots would travel room-to-room through the building, exit through a small hole in the exterior wall and hit Marines on a rooftop outpost. It took Marine snipers days to locate and kill him.

## U.S.-Seoul drills stir China ire

BY ANDREW BROWNE  
AND EVAN RAMSTAD

BEIJING—Plans by the U.S. and South Korea to conduct military exercises in the Yellow Sea aimed at North Korea, despite China's strong objections, are ratcheting up tensions between Beijing and Washington, already at loggerheads over sensitive regional security issues.

Chinese officials warn that the exercises threaten a crisis on China's doorstep by provoking North Korea, and could inflame public opinion in China.

“There's a real danger things could get out of control—and that would be a real threat for China's national security,” a senior official said.

“The very fact that you have such a strong military presence in the Yellow Sea at this particular moment could hardly be interpreted as a friendly gesture by the Chinese public,” the official said. “This is really a political signal the United States is sending to the Chinese public, so I think a high degree of restraint is very much in order.”

In recent months, the two countries have butted heads over U.S. arms sales to Taiwan as well as China's disputed claims to sovereignty over the South China Sea.

The Pentagon said Wednesday that the U.S. and South Korea would conduct new military exercises next month to bolster defenses against attacks by North Korean submarines, this time in waters off the Western coast of the Korean peninsula close to China.

Tensions over the Yellow Sea exercises reflect growing strategic competition between the U.S. and China. Increasingly, China is challenging U.S. primacy in its own backyard. Beijing is pushing back as Washington asserts the freedom of its Navy to sail unchallenged across the vital commercial sea lanes of the region, right up to China's coast.

In a four-day drill last month, U.S. ships, led by the carrier USS George Washington, stayed east of the Korean peninsula, away from the Chinese coast.

The next exercises are still being planned, Pentagon spokesman Bryan Whitman said.

“These exercises are intended to deter North Korea from future destabilizing attacks, such as occurred with the Cheonan,” he added, referring to the South Korean warship that Seoul and Washington say was sunk by a North Korean submarine in March, killing 46 sailors.

“China has no reason to view this exercise, or this series of exercises, as a threat to its security,” Mr. Whitman said.

U.S. ships have operated before in the Yellow Sea, but the Chinese official said the new exercises were inflammatory now that military-to-military ties between the two countries have become strained.

The U.S. has stationed troops in South Korea since the Korean War of the 1950s and the two countries stage two large-scale military exercises a year, including one this week practicing communication and computer-system responses to a North Korean invasion. The two countries decided to add several naval exercises this year following the sinking of the Cheonan.

## U.S. prods China over Pakistan flood aid

BY JOE LAURIA

NEW YORK—Richard Holbrooke, the U.S. envoy to Pakistan and Afghanistan, called on China Thursday to do more to help the people in flood-ravaged Pakistan.

“I think the Chinese should step up to the plate,” Mr. Holbrooke said.

“They always say that Pakistan is their closest ally.”

The U.S. suffers from “famously low popularity” in Pakistan, though the U.S.'s image has improved over the past 18 months, the senior American diplomat told reporters in New York after an event designed to draw attention to the devastating

floods. “Although other countries' popularity is greater, including China's, the U.S. is first and the most [with aid],” he said.

The Chinese mission to the United Nations didn't immediately return a call seeking comment.

China has begun a \$7.4 million delivery of humanitarian aid to Pak-

istan—surpassing its initial commitment of \$1.5 million.

Mr. Holbrooke said U.S. Secretary of State Hillary Clinton would announce later on Thursday before the U.N. General Assembly that the U.S. had raised its commitment to \$150 million from a previously pledged \$90 million for Pakistan.