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Gunning for victory



Spain's Alberto Contador sprays photographers with a water gun during the final stage of the 2010 Tour de France. Mr. Contador won the race by 39 seconds over Andy Schleck, with Russian Denis Menchov in third place. It was Mr. Contador's third Tour title. **Related article on page 28.**

BP's Dudley will succeed CEO Hayward

The board of BP PLC is negotiating the departure of its embattled chief executive, Tony Hayward, according to people familiar with the matter, a bid by the oil giant to move beyond the Gulf of Mexico disaster that has undercut his three-year bid to remake the company.

By Bruce Orwall,
Monica Langley
And James Herron

The BP board is scheduled to meet Monday to discuss and approve Mr. Hayward's departure, these people said, describing the decision as "mutual."

If that happens as expected, the board is set to name Managing Director Bob Dudley as the new chief executive on Tuesday, when it releases second quarter results. The move would install at the top of the British oil titan a veteran insider who not only is an American, but hails from

the region devastated by the oil spill.

The plan before the board would elevate Mr. Dudley to CEO on Oct. 1, according to a person familiar with the plan, allowing for an orderly transition at a company that was thrust into crisis by the April 20 explosion and fire that sank the Deepwater Horizon oil rig in the Gulf of Mexico, killing 11 people and setting off the worst offshore oil spill in U.S. history.

Mr. Hayward would stay on the board for the rest of the year. BP's chairman, former Telefon AB LM Ericsson chief Carl-Henric Svanberg, would remain in place. As expected, Mr. Hayward will discuss BP's second-quarter results on Tuesday, when the company will unveil a big loss and describe the massive liability from the environmental disaster.

A BP spokesman said: "Tony Hayward is the chief executive and has the confi-

dence of the board and senior management."

Although the Obama administration made it clear that it was unhappy with Mr. Hayward's handling of the crisis, the decision to replace the CEO is a "decision for BP's board," said a White House official.

Mr. Hayward's exit has been widely anticipated, given the heavy criticism of BP's response to the crisis. Most observers, however, expected that he wouldn't depart until the completion of a relief well that is expected to permanently shut down the flow of oil from the well because the company didn't want to saddle a new chief with the stigma of the Gulf disaster.

With a new cap appearing to hold the oil for now while the relief well is drilled, however, the talks between Mr. Hayward and BP intensified in the past week to 10 days, these people indicated. One

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The Quirk



San Diego makes a move to close loophole allowing boozey floating parties. Page 29

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Tanzania's and Uganda's presidents call to stop taxing the fight against malaria. Page 13

Piaggio revs up strategy with China, India push

PONTEDARA, Italy—Piaggio & Co. SpA plans to export its Vespa scooter to China and double production in India as part of the company's push to expand in the world's fastest-growing scooter markets, according to Piaggio Chairman Roberto Colaninno.

In an interview, Mr. Colaninno outlined Piaggio's expansion plans in Asia, a region that is likely to be a focus of the company's three-year strategy presentation in September. Growing demand for two-wheel transportation in the region's increasingly traffic-choked cities will help Piaggio offset sluggish sales in Europe, Mr. Colaninno said. Piaggio will invest €100

million (\$130 million) to boost production at its Baramati plant over the next three years. About €30 million of that investment will be used to produce a specially designed version of the Vespa 125 LX by 2012, marking the scooter's return to India for the first time in 15 years.

The remaining €60 million will be used to beef up production of small trucks and three-wheel APE scooters.

Piaggio has recently begun shipping its MP3 model, a pricey three-wheel scooter that tilts on an axis like a two-wheel bike, from Italy to showrooms across the China. The Vespa, Mr. Colaninno said, won't be far behind, but

so far no delivery dates have been set.

If the MP3 gains a following in China, Piaggio will seek to produce it locally within the next three years, helping to lower production costs and the scooter's price tag, Mr. Colaninno said.

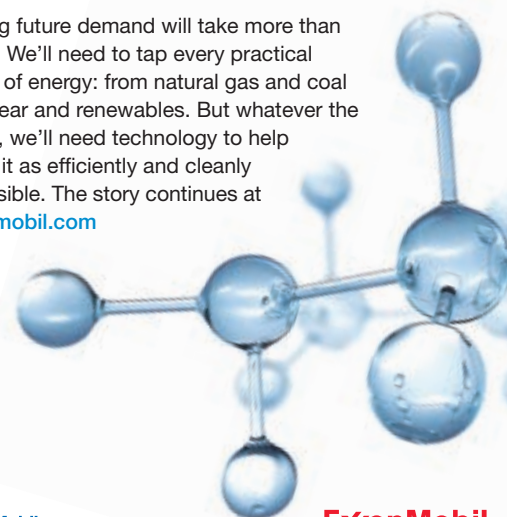
The barriers to entering China, India and other emerging Asian economies, however, are high. Piaggio must compete against better-known Japanese brands like Honda Motor Co. and Yamaha Motor Co., as well as domestic manufacturers, such as India's Bajaj Auto Ltd.

Full interview with Piaggio's Mr. Colaninno 10

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PAGE TWO

Stress tests have good and bad news, depending on which way you look

[Agenda]

BY IRWIN STELZER



Now we know why so many eurocrats announced that very few banks had failed the stress tests — before the tests were completed. The tests were sufficiently unstressful to allow such foresight. In the event, only seven of the 91 sample banks in 27 countries flunked, five small ones in Spain and one each in Greece and Germany.

The stress tests proved three good things. We are not facing apocalypse now — later, perhaps, but not now; the eurocracy is capable of getting a complicated program done in quick time when disaster threatens; and all save the German banks, which came reluctantly to the party, revealed their exposure to sovereign debt so that the market can decide just how stressed they really are.

And two bad things.

■ The quality of a stress test determines the number of banks that will pass: pretend that there is no threat of sovereign default, place outdated values on assets, pretend that troubled loans of Spain's banks constitute about 5% of the total when the real figure is closer to 14% (estimates UBS analyst Carvajal Cebrian), and you can make a balance sheet seem to have an abundance of capital. The tests include an assessment of the impact on bank viability of the "haircuts" that might be imposed on holders of sovereign debt, but not of default, which the eurocracy insists can't happen. And the haircuts are applied only to the debt held on trading books. That impact, says the European Central Bank in an appendix, "is mitigated by the fact that banks' holdings of government securities are primarily in the banking



Zapatero, left, will be fine so long as Merkel pays to keep the euro healthy

book." Translation: we have not asked the banks to mark-to-market 80% of their holdings of government securities, even though the market value of those securities is far less than the value recorded on the books.

■ The fact that only seven banks failed to pass is less relevant than the fact that the five Italian banks tested only squeaked by, as did Postbank, one of

urgent reform." These regional banks are an important source of funding for Germany's small businesses. If they fail, the locomotive of the European economy may have a lot less fuel.

Song writers Rodgers and Hart were right that "the self-deception that believes the lie" results in "no more pain, no more strain," at least for a while. But not permanently. It seems that the eurocracy has deceived itself into believing that all is well — it is, after all, easier to deceive others if you first deceive yourself. So the Committee of European Banking Supervisors, or CEBS, professes to find the results of the tests "rather reassuring" even though almost half of the banks that passed the test continue to "incorporate [in the required capital] a significant amount of government support." Indeed, the CEBS assumes that "government paid in capital cannot be simply withdrawn." Except for those life-saving tubes we have inserted in your arms, José Luis Rodríguez Zapatero and friends, you are in fine shape, capable of handling

any stress the world economy might dish out.

And by the way, no need to worry about a double dip recession. The so-called "adverse case" defines a "double dip" as no growth in 2010 and a 0.4% decline in GDP next year in the 27-nation European Union. Not very "adverse" by historical standards, given the fact that GDP in the EU declined by 4.2% in 2009.

There's more, but you get the idea. Markets "don't think the scenarios were stressful enough," Brian Dolan, chief strategist at Forex.com told Bloomberg News. How they will react in the long run will depend on two things.

The first is Europe's ability to sustain the recent uptick in its economic growth. The CEBS "benchmark", or most likely case, assumes euro area growth of 0.7% this year, and 1.5% in 2011. Not likely to produce many jobs, or tax revenues to help bring down fiscal deficits.

The second is Germany's continued willingness to be paymaster of last resort. Europe's banks passed the tests because those who devised them assume that Germany will continue to bankroll the various institutions set up to pump capital into the banks, and to provide an implicit guarantee against default by Club Med countries. German Chancellor Angela Merkel's plummeting popularity, in part a result of her reluctant agreement to have German taxpayers foot the bill for the excesses of its euro-zone partners, suggests limits to Germans' eagerness to work harder so that banks holding Spanish, Greek and other sovereign debt will face a mere trim around the edges rather than a crew cut.

The tests might be over, but stress is not. Don't discard the Valium just yet.

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

And, by the way, no need to worry about a double dip recession.

Germany's largest, and that Germany's eight *landesbanken* received a passing grade only because they "have yet to record a substantial part of total estimated write-downs," according to the International Monetary Fund. That relieves the pressure on a sector that German finance minister Wolfgang Schäuble says needs "an

What's News

■ **One lesson from earnings** season so far is that now is not the time for CEOs to tell skittish investors that an expansion push is right around the corner. Investors last week punished Delta and other companies that talked about plans to expand. 17

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"The decision to exclude sovereign debt renders the stress test results as spin and not reality."

Bill Bunting on the results of Europe's stress tests on its banking system



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It will help

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NEWS

One crisis eclipses Hayward's career

By PAUL SONNE

LONDON—In three short months, BP PLC Chief Executive Tony Hayward learned what it meant to become the face of disaster.

Until this spring, Mr. Hayward was a brainy geologist leading a seemingly successful turnaround of BP's sluggish operations and positioning it to compete more effectively with rivals such as **Royal Dutch Shell**.

But that fell by the wayside on April 20, when the Deepwater Horizon oil rig, drilling a well for BP, exploded and sank, sending hundreds of millions of gallons of oil spewing into the Gulf of Mexico. Eleven workers died in the catastrophe.

He was making headway on cutting costs and improving safety at BP, but he failed to connect with the people of the Gulf Of Mexico region when the oil spill struck.

Now, as BP board meets Monday to decide Mr. Hayward's fate, his story has become a cautionary tale to CEOs everywhere of how a single mishandled crisis can eclipse an entire career.

Mr. Hayward became CEO of BP a little over three years ago. He promised to reverse the mistakes of his predecessor John Browne, who left amid personal scandal and left a legacy of lackluster performance and poor safety practices — the latter thanks to the 2005 explosion at

the company's Texas City refinery that left 15 people dead.

Although he 53-year-old Mr. Hayward brought in a system to enforce safety standards across the company just months after becoming CEO, his vision did not always trickle down. The company saw continued leaks in its pipeline in Alaska, and problems persisted with pressure-relief valves at its refinery in Toledo, Ohio.

BP has said that Mr. Hayward's cost-cutting drive—\$4 billion in reduced costs in 2009 alone—allowed the company to put more resources into operations, including safety, but critics have asked whether it nurtured a culture of cutting corners. Mr. Hayward rejected that criticism during an acrimonious Congressional hearing last June.

An "ouster is way overdue. He's lost his legitimacy to lead," says Jeffrey Sonnenfeld, a professor at the **Yale School of Management**.

By most accounts, it was Mr. Hayward's inability to generate much empathy from the U.S. public that led to calls for his ouster. He helped fuel that perception with a number of gaffes, such as his initial description of the spill as "relatively tiny," and his decision to attend a yacht race in June, even as the oil slick continued to spread across the Gulf of Mexico.

Robbie **Vorhaus**, a crisis expert at Vorhaus Communications Inc. in Sag Harbor, N.Y., says that in such crises CEOs face the task of becoming human. "All of a sudden you have an event where you are now standing in the spotlight among shrimp fisherman and local politicians and people who maybe make 20 or 30,000 dollars a year," Mr. Vorhaus said. "A true leader needs



BP CEO Tony Hayward discusses recovery operations aboard a drill ship in the Gulf of Mexico on May 28.

to be able to come from the heart and make these people feel that there is a connection." Mr. Vorhaus says that's where Mr. Hayward failed.

Mr. Hayward had experienced little that would have prepared him to adopt the populist touch. He joined BP in 1982, not long after he received a PhD in geology from **Edinburgh University** in Scotland. He worked as a rig geologist in the North Sea, then flew around the

world testing rocks for oil—from Papua New Guinea to Northern Yemen.

Mr. Hayward moved from specializing in science to understanding business in 1990 when he became the assistant to John Browne, then head of exploration and production who five years later became CEO.

Mr. Hayward eventually replaced Mr. Browne, who left amid a scandal connected to his personal life.

But three years on, Mr. Hayward finds himself in the midst of a different kind of scandal.

"Maybe he would have had a chance if he had been just really spectacular on his feet as the crisis manager, but he was so abysmal at that, there was no way out," says Sydney Finkelstein, a professor at the **Tuck School of Business at Dartmouth College**.

—Erin White and Guy Chazan contributed to this article.

Dudley set to take over as BP chief executive

Continued from first page
person familiar with the matter said that for some time there had been "a discussion building within the board" to make a management change, but that notion "crystallized in the last week."

Mr. Hayward has spent the last week or so weighing whether he should resign "with honor for the sake of BP," said one person familiar with his thinking. Still, in recent weeks, he sometimes sought to signal he was still in control of the company, via meetings with foreign governments and big shareholders.

Another person familiar with the process said the change wasn't meant to be seen as an indictment of Mr. Hayward, nor was it linked to any investigations of the Deepwater Horizon debacle. Rather, the move was recognition of the fact that Mr. Hayward was no longer seen as able to address one of the company's most crucial tasks: repairing BP's reputation and restoring its credibility in the critical U.S. market, where it is the biggest oil and gas producer.

According to BP's annual report, the company's standard employment contracts may be terminated at any time with the payment of one year's salary, although the company's remuneration committee may consider mitigating factors, "to reduce compensation to a departing director, when appropriate to do so."

Mr. Hayward earned £1.045 million (\$1.6 million) in 2009, a tally

that rose to £4 million with bonuses. Mr. Hayward could negotiate a richer package, however, and he regardless will be eligible for future stock bonuses under the long-term incentive program because several of those plans that began in the last few years have yet to vest.

On Sunday, some analysts described Mr. Hayward's departure as a tough but likely necessary loss, given the surging financial performance of the company before the spill. "If Tony stands down it is a political give-up for BP in order to kickstart a new era for the company," said ING analyst Jason Kenney.

"Hayward has transformed BP and improved the operational performance of the company," said Panmure Gordon analyst Peter Hitchens. "But I feel the board needs a scapegoat and that might be the CEO."

Mr. Hayward is in this predicament in large part because of the torrent of criticism he has faced over the last three months, over both the company's handling of the Gulf crisis and its poor safety record. He took over BP in 2007, after his predecessor, John Browne, resigned over a scandal involving allegations about his private life. Mr. Hayward vowed to make BP a more formidable competitor in the global oil world by streamlining a company that had grown unwieldy thanks to a series of acquisitions, notably its 1998 takeover of Amoco Corp.

But at the same time, he pledged to clean up the company's poor



Robert Dudley

BP managing director and board member

- Grew up in Mississippi
 - Worked for Amoco before it was acquired by BP in 1998
 - Oversees BP's operations in the Americas and Asia
 - Was head of Russian joint venture TNK-BP from 2003 to 2008
 - Nearly became head of BP in 2007, losing out to Tony Hayward
- Sources: BP, WSJ research

safety record, which was badly tarnished by incidents like a 2005 blast at a Texas City, Texas, refinery that killed 15 people and injured more than 170 people.

Since the third quarter of 2009, BP has impressed analysts with a succession of strong quarterly results, most recently a net profit of \$6.08 billion for the first quarter of 2010. But everything changed at

7:24 a.m. on April 21, when Mr. Hayward received a call in London detailing the explosion from the night before.

In the disaster that later unfolded, Mr. Hayward became a lightning rod for criticism after his poor performance before a congressional panel and an infamous gaffe in which he complained "I want my life back" against a backdrop of economic suffering and hardship in the Gulf region. The chief executive abruptly returned to London and handed over the reins of dealing with the Gulf to Mr. Dudley.

The spill also opened the door for an unflattering re-evaluation of the safety improvements Mr. Hayward often bragged about over the last year. The picture that emerged was of a company whose cost-cutting agenda drowned out its safety message, and BP was found to be in continuing conflict with both U.S. health and safety regulators and state officials in places like Alaska.

Mr. Dudley, 54, arrived in London last week to help the company prepare for second-quarter results, specifically on quantifying the estimate of massive liability BP will disclose with Tuesday's second-quarter results. By the weekend, however, he became the choice to become the next CEO, although Mr. Dudley wasn't seeking that job, said one person familiar with the situation.

Mr. Dudley's stock rose in recent weeks as he navigated the tricky and occasionally contentious relation-

ships between BP and the federal government and affected states on numerous fronts from pushing through damage claims to working with Adm. Thad Allen, the government's point person on the spill, on sub-sea maneuvers to cap the well and shoreline defenses to clean up the oil.

Another point in Mr. Dudley's favor—he was once a top executive at Amoco, the name some advisers have recommended that BP resume for its U.S. operations.

The cost of the oil spill to BP has been enormous—and is continuing. An internal tally shows work at the sub-sea level to contain the oil and the Gulf Coast shoreline to clean up the oil is costing about \$100 million a day. That doesn't include the expected flurry of claims, for which the Obama administration pressured BP to set up a \$20 billion escrow fund. The company last week agreed to sell \$7 billion in assets.

It was costly in other ways as well. BP shares plunged by more than half in the wake of the spill, Capitol Hill pressed the company BP to pay tens of billions of dollars in upfront compensation and even President Barack Obama suggested that Tony Hayward would not be working for him. It was only by agreeing to suspend dividend payments for the remainder of 2010 and paying \$20 billion over three-and-a-half years into a compensation fund that BP was able to calm the situation.

EUROPE NEWS

Germany investigates fatal stampede

BY PATRICK MCGROARTY

Local authorities and organizers of Europe's biggest electronic-music event faced harsh criticism for their handling of a massive crowd after at least 19 people died and 342 were injured in a stampede at the "Love Parade" techno festival in Germany on Saturday.

The death toll continued to climb Sunday as organizers, German officials and police defended their decision to use a narrow roadway tunnel as the lone entrance for hundreds of thousands of revelers trying to reach the festival grounds in the western German city of Duisburg.

The tragedy has stunned Germany, a safety-conscious country usually adept at organizing large street parties and other public events without mishap.

As hospitals treated many of the injured, German public prosecutors opened an investigation into what caused the crowd of young partygoers to panic and stampede in the vicinity of the tunnel.

"This absolutely didn't need to happen," said Matthias Roeingh, a DJ known to most Germans as Dr. Motte, who founded the Love Parade festival in Berlin in 1989.

"I put a lot of blame on the organizers," said Mr. Roeingh, who wasn't involved in this year's event and didn't attend. "This entry street, which brought people together at the tunnel, and the security at the entrance created a pileup. People couldn't move forward or back. Those were the conditions that let this panic break out," he said.

"I think now we need a very thorough investigation of how it came to this," German Chancellor Angela Merkel said Sunday. "We have to do everything we can so that something like this isn't repeated."

Duisburg city officials approved the use of the site, planned the crowd flow and were responsible for managing it. Duisburg's mayor, Adolf Sauerland, appealed at a news conference on Sunday for the public "to



A man puts a candle Sunday at the tunnel where partygoers were crushed in a stampede near the Love Parade festival in Duisburg, Germany. At least 19 died.

give the investigating officials the time they need to do their work, and not to assign blame hastily."

As many as 1.4 million people descended on Duisburg for the party Saturday, according to German media reports, and the stampede started around 5 p.m. local time, shortly after police closed the tunnel because the festival grounds were too full. Police told those in the tunnel over loudspeakers to turn around and walk out from the direction they came, according to German media reports.

Duisburg police chief Detlef von

Schmeling declined to confirm the size of the crowd or that police sealed off the tunnel and told people to turn around just before the stampede. He said none of the victims—who include citizens of Australia, Bosnia-Herzegovina, China, Italy, the Netherlands and Spain as well as Germans—died in the tunnel itself, but that they fell from metal steps or were crushed against a billboard on the hillside outside as they tried to climb away from the swelling crowd.

Footage on broadcaster N-TV showed people clambering over

metal barricades and up a steep hillside outside the tunnel.

German police union leader Rainer Wendt said in an interview on the Bild newspaper's website that he warned Love Parade organizers more than a year ago that Duisburg was "too narrow, too small to handle this mass of people."

Ms. Merkel said she was "horried and saddened by the suffering and the pain."

Pope Benedict XVI, a native German, expressed his sorrow during his weekly blessing, and said he was praying for the victims.

The Love Parade was a Berlin institution during the 1990s, drawing techno fans and party-seekers from around the world to follow semi-trailers converted into rolling dance clubs.

This year was the first time the festival was held in Duisburg.

Rainer Schaller, one of the organizers, said Sunday it would be the last Love Parade. "It will always be overshadowed by yesterday's events," said Mr. Schaller, part of a small group of people who handle funding for the Love Parade. "It's over for the Love Parade."

Putin sings praises of—and with—10 spies

BY RICHARD BOUDREAUX

MOSCOW—Russian Prime Minister Vladimir Putin said he sang patriotic Soviet songs with the 10 undercover agents who were deported from the U.S. in a recent spy swap, and he declared that their capture by the Federal Bureau of Investigation was "the result of treason."

In Russia's first official comment since the agents landed in Moscow on July 9 and vanished from public view, Mr. Putin said he knew who was responsible for the betrayal.

"Traitors always end badly," he said. "They finish up as drunks, addicts, on the street."

Mr. Putin, a former KGB colonel, spoke to reporters Saturday during a visit to Ukraine. His remarks were posted Sunday on the Russian government's website.

Pressed by the reporters to say how he would deal with the alleged traitors, the Russian leader replied: "This cannot be decided at a press conference. The secret services live by their own laws, and those laws are well known to all secret service co-workers."

Intelligence analysts have been intrigued by the question of how the

FBI busted a network to which Russia had apparently devoted abundant time and resources. The 10 "illegals" arrested June 27 and charged with conspiring to act as secret Russian agents were exchanged for four Russians convicted or suspected of passing secrets to the West.

According to the FBI complaint, the 10 agents had blended into American life and held ordinary jobs while working for Russian intelligence, mainly to compile data on people who could be later recruited as spies. Seven had used false identities; some had been monitored for as long as a decade.

"The Russians have to wonder how American security got onto them," said Harvey Klehr, an Emory University professor and co-author of "Spies: The Rise and Fall of the KGB in America." "Did they intercept covert radio transmissions? Was there some error in the false documents the Russians used? Did 'legal' Russian agents from the embassy who met covertly with these 'illegals' make some kind of tradecraft error? Or does the CIA have a mole inside Russian intelligence?"

Others have speculated that the late Sergei Tretyakov, the former



Vladimir Putin speaks on Saturday.

Russian officer who ran espionage activities in New York under the guise of a press attaché at the U.N. mission, may have blown the whistle on the spy ring after his defection in 2000. Questions have arisen about the loyalty of Christopher Metsos, the 11th alleged Russian spy arrested in the case, after he jumped bail in Cyprus and vanished.

Some analysts say Mr. Putin may

have been referring to Mr. Tretyakov, who died of a heart attack last month, when he said Saturday that a traitor recently "ended his existence abroad, and it was not clear what the point of it all was." Mr. Putin didn't elaborate.

Mr. Putin's spokesman, Dmitry Peskov, declined to comment on what the prime minister had learned about the ring's detection. "This is a matter for the Russian intelligence agencies, not the prime minister's office," he said.

Mr. Peskov also declined to comment on a report by RIA-Novosti, a government news agency, that the 10 deported agents would be given lie-detector tests. He said he didn't believe any agent was under confinement or suspected of betrayal.

American lawyers for three of the agents say their clients have no restrictions on their movement but prefer, for now, to stay out of public view. Anna Chapman, the 28-year-old Russian who became a tabloid star after her arrest, has had little contact with Russian officials since landing in Moscow in the spy swap, her lawyer told the Associated Press on Thursday. American lawyers for the other seven haven't commented

on their situation.

Russians following the swap have debated whether the deported agents should be treated as heroes or failures. Mr. Peskov said "that question was not on the agenda" of Mr. Putin's two-hour meeting in Moscow with the agents during the first week after their arrival.

In his remarks to reporters, Mr. Putin voiced sympathy for the deported spies. He said their superiors would conduct a comprehensive assessment of their work, but added: "I am sure they will work in decent places. I am sure they will have an interesting and bright life."

During his meeting with the agents, Mr. Putin said, "We talked about life. We sang 'From Where the Motherland Begins,' a popular 1960s song made famous in a Soviet film about a Soviet spy working in Nazi Germany. "And other songs with a similar content."

He said the 10 agents "had a tough life" in America.

"Just imagine...You have to master a foreign language as your own, think and speak it and fulfill tasks in the interest of the motherland for many years without counting on diplomatic immunity."

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EUROPE NEWS

Preaching austerity from Poland

By GORDON FAIRCLOUGH
AND MALGORZATA HALABA

WARSAW—Poland's central-bank governor said that as Europe's economies begin to recover from the punishing global downturn, their governments need to start cutting spending and reducing debt loads.

Countries that stray from a strict path of tighter fiscal controls—as Hungary appears to be doing—could risk harming neighbors, said Marek Belka, a former senior International Monetary Fund official now at the helm of the National Bank of Poland.

“What happens in neighboring countries is a problem for us,” Mr. Belka said in an interview. Confidence in the entire region can be shaken if investors don't adequately differentiate among countries, he said. And losses in one country can prompt sales in another, pushing currencies and assets down.

The Polish zloty has been dragged down against the euro in tandem with fluctuations in the Hungarian forint. The latest such episode occurred last Monday, when the forint fell 3% against the euro after the IMF and EU walked out of talks with Budapest, saying it wasn't doing enough to cut spending.

Mr. Belka said most of the austerity programs proposed by European governments are fairly moderate, with cutbacks phased in over years. “We are not talking about something that will derail the recovery,” said Mr. Belka, who previously served as Poland's prime minister and finance minister. Countries that implement austerity measures “may have somewhat more moderate growth, but the benefit is to avoid complete collapse” in financial markets, Mr. Belka said. “I think there is little choice, especially in Europe.”

Poland is the largest of the former Communist eastern-bloc countries to have joined the European



Poland's central-bank governor, Marek Belka, advises Europe's economies to trim spending and reduce debt loads.

Union. It is also the only EU nation whose economy expanded in 2009.

In the wake of the economic crisis, the zloty devalued, making Polish exports relatively less expensive for buyers abroad, and in turn helping buoy Poland's manufacturing sector. Domestic demand remained healthy.

Mr. Belka said he believes that Polish central-bank growth estimates for this year of 3%, and 3.5% for 2011, are conservative. He said the bank's early fears of a jobless recovery seem to be unfounded.

Poland's resilience in the face of the downturn should make it easier to narrow the budget deficit, Mr. Belka said, and has been nudging the Polish government, led by Prime

Minister Donald Tusk, to move faster to do that. Initial estimates were that Poland's overall budget deficit would be about 6.9% of gross-domestic-product this year.

He said that as expansion in Poland gains steam, the country should shrink that gap significantly.

With other European countries having trouble raising money or paying more to borrow, Poland needs to strengthen its finances, Mr. Belka said.

According to the latest targets issued by the country's Finance Ministry, Poland's public-finances deficit is expected to be 5.9% of GDP in 2011, and to fall to 2.9% in 2012.

In 2009, total outstanding public debt was equivalent to 50.7% of annual

GDP. The fiscal-deficit figures include the impact of transforming Poland's pension system, because some contributions into the system now go into private funds, leaving the state-run system with a funding shortfall.

“We have to do something. But we are not in a position where we have to do it in a desperate way,” Mr. Belka said. Still, he said the government should act now to address structural budget issues.

“I think that we live in a moment when we can have the right to a little bit of pride—that we are more resilient and more resistant to crisis,” Mr. Belka said. “But we shouldn't mix pride with hubris. That, we cannot afford. No one can.”

Labor laws restraining EU firms, report says

By WILLIAM LYONS

European businesses are struggling to compete with U.S. rivals, which are far more agile at maximizing profit from their investment in people, according to new research that warns firms in the EU are being hampered by strict labor laws.

The findings, from a report on employee efficiency by PricewaterhouseCoopers LLP, shows that Western European companies are failing to compete with their global rivals and lack the key skills to operate in the new global business environment.

The report analyzed data drawn from more than 10,000 companies in 40 countries to measure the pretax profit produced for every pound, euro or dollar paid out in remuneration known as the “human capital return on investment,” or HC ROI.

It shows that during the uninterrupted growth years of 2002 to 2006, HC ROI rose by a relatively modest 4.6% in the U.K. and 8.3% in Western Europe. In the U.S., the measure leapt 19.8%.

Moreover, in 2008, with the markets suffering after the slowdown, the index fell 2.8% in the U.K. and 1.7% in Western Europe, but held steady in the U.S.

Richard Phelps, a partner at PricewaterhouseCoopers, said U.S. companies “have proved better at flexing employment costs to market conditions,” citing their ability to adjust staff numbers and salaries. In the U.K. and Western Europe, the more regulated environment prevents such agility, he said.

The PwC research suggests that the dilemma for many governments in mature economies, specifically in Western Europe, is how they will balance entrenched social well-being policies while competing with more highly productive and lower-cost territories, such as China, India, Brazil and Russia. For Western Europe, the recession has highlighted how powerful and agile competing countries have become. Governments will need to ensure that elements such as employment law, taxes and education standards are structured to attract employers and key talent, the report says.

It suggests numerous possible avenues for increasing HC ROI. These include investigating the utilization of overtime; reviewing absenteeism; adjusting the balance of full-time, part-time staff and contract workers; assessing benefits structures, and facilities and overhead costs.

“While many companies invariably made job cuts to survive the recession, some employers introduced cost-saving initiatives with similar results but with less pain,” Mr. Phelps said. “Either way, the downturn has highlighted the need for companies to have a clear idea of the contribution their people make to the bottom line. A fact-based approach can help ensure decisive and transparent decision making.”

“However, companies need to ensure employees remain engaged during any subsequent changes as their support is equally vital to return on work-force investment,” he added.

—Jared Favole in Washington contributed to this article.

Scotland asks U.S. for Lockerbie papers

By PAUL SONNE

LONDON—Scottish First Minister Alex Salmond called on the U.S. on Sunday to declassify documents related to Scotland's release last summer of convicted Lockerbie bomber Abdel Baset al-Megrahi.

Both the Scottish and U.K. governments have released documents sent in the lead-up to last summer's decision to release Mr. Megrahi, but U.S. correspondence with the U.K. and Scottish governments remains classified. Mr. Salmond's call to release the documents comes ahead of a U.S. Senate hearing this week on

Scotland's decision to release Mr. Megrahi, the former Libyan security agent convicted in the 1988 bombing of Pan Am Flight 103, which killed 270 people, including 189 Americans, when it exploded over Lockerbie, Scotland.

“We don't normally release diplomatic correspondence,” U.S. State Department spokesman P.J. Crowley said Sunday.

“The decision to release Megrahi was made by Scottish authorities against the clear wishes of the U.S.,” Mr. Crowley said. “The burden is on Scottish authorities to explain why they made the decision that they made. ...In all correspondence and in all conversations, we opposed Megrahi's return to Libya.”

The Scottish government in August released Mr. Megrahi on the grounds that he was suffering from terminal prostate cancer and likely had no more than three months to live. More than 11 months after his release, Mr. Megrahi remains alive in Libya.

Mr. Salmond's remarks, made on Sky News, came after London's Sunday Times reported that a senior official at the U.S. Embassy in London wrote to the Scottish government to say the U.S. wanted the Lockerbie bomber to stay in jail, but that in the event Mr. Megrahi were to go free, the U.S. government preferred he be discharged under Scotland's provision for compassionate re-



Scottish First Minister Alex Salmond, shown in Edinburgh in March

lease—and not under the terms of a Prisoner Transfer Agreement between the U.K. and Libya.

While he didn't discuss the U.S. letter, Mr. Salmond confirmed Sunday that this was the American position in the lead-up to the August 2009 decision to release Mr. Megrahi. The Scottish government rejected Mr. Megrahi's Prisoner Transfer application, and instead granted him compassionate release, citing the likelihood that he would soon die.

President Barack Obama said in a meeting with Prime Minister David Cameron last week that all the facts on the Lockerbie bomber's release

must come out. Mr. Cameron has said Downing Street will see if it has any more documents to release. The Obama administration hasn't released its communications on the matter.

Though Mr. Megrahi wasn't released under the Prisoner Transfer Agreement, it has become controversial because embattled oil giant BP PLC admitted to lobbying the British government to speed its passage in late 2007.

Scotland, the U.K. and BP have all said that the oil company had no connection to Mr. Megrahi's release.

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U.S. NEWS

Humbled Haggard is back in pulpit

BY STEPHANIE SIMON

COLORADO SPRINGS, Colo.—The Rev. Ted Haggard stood at a pulpit made from stacked buckets one recent Sunday and announced his resurrection.

Mr. Haggard was forced to resign nearly four years ago as president of the politically powerful National Association of Evangelicals and to step down from the megachurch he founded, after admitting that he had bought methamphetamine from, and had a sexual encounter with, a gay prostitute.

Once one of the most prominent church leaders in the U.S., Mr. Haggard confessed in a tortured letter, calling himself “a deceiver and a liar” who had long wrestled with desires he described as “repulsive and dark.” He signed a contract promising to follow a path laid out by fellow clergy: to find a new career in a new state and to stay away from pastoral work.

Then, his wife at his side, Mr. Haggard left town.

He is back now. In a move that thrilled some of his former flock—and alarmed some of his fellow evangelical Christians—Mr. Haggard and his wife, Gayle, recently launched a new church in their backyard barn, a few miles from the enormous campus of his old congregation.

In two months of preaching with sacks of fence-post concrete at his feet, Mr. Haggard, who is 54 years old, has built a congregation of



Mr. Haggard, preaching recently in his Colorado barn, has built a congregation of nearly 200 people.

nearly 200 people. His church, St. James, has outgrown the barn and this Sunday moved to a rented community center.

Ebullient as ever, bouncing with energy, Mr. Haggard said he is back doing what he was born to do.

“Tiger Woods needs to go; Michael Vick needs to be playing football,” Mr. Haggard said as his new congregation joined him and Gayle in their backyard for a post-worship picnic. Little kids, shrieking

with joy, splashed in the pool. Men grilled burgers. Women set out chicken salad.

“Ted Haggard,” Mr. Haggard said, “needs to be leading a church.”

He acknowledged grave lapses of judgment in the episode he refers to as “my crisis.” But Mr. Haggard also said that in his sorrow and shame, he accepted too much guilt after the scandal broke.

“I over-repented,” he said. In February 2008, Mr. Haggard

asked to be released from supervision by other clergy. His former church, New Life, consented, though officials there put out a pointed statement calling Mr. Haggard’s recovery incomplete.

The four pastors who supervised Mr. Haggard wouldn’t comment on his new church. New Life pointed to an earlier statement, released in November 2008, that said, “we cannot endorse his return to vocational ministry.”

Mr. Haggard said that is ridiculous. He portrays his encounter with the prostitute as a massage that went awry and said he doesn’t have same-sex attractions. He dismisses as a “witch hunt” the findings of his former church that he engaged in a pattern of misconduct, including sordid talk and inappropriate relationships. (He said his only fault was cracking a few crude jokes.) But his assurances have raised some eyebrows.

“I’m still skeptical that the whole sorry story has come out in full,” said Tim Morgan, an editor at the evangelical magazine Christianity Today.

Others fear the pressures of leading a congregation will grind down any defenses Mr. Haggard may have built up against temptation.

“We become enamored with our own successes,” said Larry Magnuson, who counsels pastors in crisis at SonScape Retreats, outside Colorado Springs. “We fall back into the same traps.”

Friends say Mr. Haggard has matured.

“He has a humility of spirit and a recognition of how gripping sin can be in a person’s life,” said Paul DeVries, president of New York Divinity School, an evangelical seminary in Manhattan.

WSJ.com

ONLINE TODAY: See photos from the church at WSJ.com/US.

White House raises 2011 deficit forecast

BY JONATHAN WEISMAN

The White House raised its forecast for the fiscal-2011 budget deficit to \$1.4 trillion, or 9.2% of the economy, adding new fuel to the political battle over how to tame the flood of red ink.

The broad review of the Obama administration’s February budget numbers will provide fodder for November’s midterm elections, in which the deficit looms as a major issue, and for a bipartisan presidential commission on the debt expected to deliver recommendations on Dec. 1.

The 2011 deficit projection was up from the \$1.267 trillion forecast in February. The forecast for the current year of \$1.47 trillion actually fell \$85 billion from the February forecast. The following three years were adjusted upward. Over 10 years, the White House is projecting \$8.5 trillion of additional debt, slightly down from the previous forecast.

The deficit is likely to be the centerpiece of White House policy-making after the elections, which are expected to cost President Barack Obama his large Democratic majorities in Congress and possibly control of at least the House. Congress must also decide what to do with former President George W. Bush’s tax cuts, all of which are set to expire Dec. 31.

Under the new projections, federal debt held by the public would reach 774% of gross domestic product by 2020, and deficits, after falling in the middle of the decade,

would again be on the rise, to \$900 billion that year, or 3.8% of GDP.

The White House expects the unemployment rate to stay high, falling only to 8.1% in 2012, when Mr. Obama is expected to stand for reelection. Economic growth is expected to be 3.2% this year, a faster clip than the 2.7% projected in the budget. But growth is now expected to be slightly slower next year.

“The most pressing danger we face is unacceptably weak growth and persistently high unemployment,” said White House budget director Peter Orszag, who is leaving the post at the end of this month. But, he said, that is better than outright economic “collapse.”

The White House budget office’s new numbers were the first to reflect the expected impact of the new health-care law, the financial-regulation overhaul, a remake of student lending and other measures enacted since the fiscal-2011 budget was drafted. The White House said the health-care law, heralded as a powerful deficit-tamer in the long term, is expected to add \$51 billion of debt between now and fiscal 2012. Those increases more than offset modest savings through 2020.

Overall, policy changes enacted since the February budget will add \$114 billion of debt through 2020, the White House said, a relatively small fraction of the total, which is dominated by the growing cost of entitlement programs such as Social Security and Medicare.

—Jared Favole
contributed to this article.

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U.S. NEWS

Cambodia awaits genocide verdict

Decades after Khmer Rouge regime, U.N. tribunal's first trial is nearly done; more-complicated cases lie ahead

BY PATRICK BARTA

PHNOM PENH, Cambodia—A United Nations-backed tribunal will issue its first verdict here Monday after years of investigating the Khmer Rouge genocide and arguing the case for justice in Cambodia.

But while the initial verdict, in the case of former prison commander Kaing Guek Eav, known as Duch, will mark a major achievement for Cambodia, a series of more complicated and potentially divisive cases lies ahead.

Those cases involve former senior officials of the Khmer Rouge regime; legal experts say they must be prosecuted before Cambodia can bury its past and complete its re-emergence as one of Asia's most promising frontier economies, which analysts say has been held back by worries over the lack of legal accountability for wrongdoers.

The prosecution of these still-untried senior officials "is essentially the Nuremberg trial of Cambodia," says David Scheffer, a professor at Northwestern University School of Law and former U.S. ambassador-at-large for war-crimes issues. "While Duch is a very significant figure in the Pol Pot atrocities, he wasn't at the top of the leadership pyramid."

An estimated 1.7 million people—or a fifth of Cambodia's population at the time—died of starvation, illness or were killed during the reign of the Khmer Rouge, a radical Communist rebel group that ruled Cambodia from 1975 to 1979 under the leadership of the late Pol Pot.

The regime was toppled by Vietnamese forces in 1979, and after more than a decade of civil war, Cambodia is peaceful again. It has begun to attract interest from foreign investors who see Cambodia as an important new emerging market, with cheaper labor than China and fertile land for agricultural projects.

But the country is still struggling to escape its reputation as a dangerous and unpredictable place. Many investors are watching the tribunal carefully for a final confirmation that rule of law has returned.

The process has struggled from the start. Before launching the tribunal in 2006, Cambodian leaders and international donors argued for years over its powers and composition, with Cambodia seeking more control over the proceedings.

The government still has some former Khmer Rouge cadres in its ranks, including Prime Minister Hun Sen, who served in the Khmer Rouge but later defected. He isn't under suspicion of involvement in the atrocities, legal analysts say, but other officials or politicians could

Uneasy justice | Steps in prosecuting the Khmer Rouge



A Khmer Rouge soldier orders store owners to abandon their shops in Phnom Penh, on April 17, 1975.

■ **1975-1979:** An estimated 1.7 million Cambodians die during the reign of the Khmer Rouge.

■ **1997:** Cambodian leaders ask the U.N. to help set up a tribunal to prosecute the Khmer Rouge.

■ **2003:** U.N. and Cambodian officials agree on a framework for international participation in the tribunal, after intense debate over the body's powers and composition.

■ **2006:** The tribunal is formally established.

■ **2007:** Authorities arrest several Khmer Rouge leaders.

■ **March 2009:** The tribunal begins its first trial, the case of Kaing Guek Eav, or Duch, the former chief of Phnom Penh's notorious Tuol Sleng prison.

■ **September 2009:** Cambodian Prime Minister Hun Sen warns that arresting more Khmer Rouge leaders could trigger civil war.

■ **April 2010:** The tribunal, facing funding shortfalls, temporarily suspends salaries of Cambodian staff.

■ **July:** Donations enable the tribunal to meet payroll.

■ **July 26:** Verdict on the Duch case is to be announced.

■ **September:** A decision is expected on whether tribunal will proceed with trial of four Khmer Rouge leaders.



Ex-prison chief Kaing Guek Eav, known as Duch, attends his trial in Phnom Penh in November. He has denied killing or torturing anyone.

be. Attempts to reach a government spokesman were unsuccessful.

Mr. Hun Sen has argued that aggressive investigations could destabilize Cambodia and possibly trigger civil war—an outcome political analysts describe as unlikely.

"If you prosecute [more leaders] without thinking beforehand about national reconciliation and peace, and if war breaks out again and kills 20,000 or 30,000 people, who will be

responsible?" he said in September.

Advocacy groups have repeatedly complained of interference from Cambodian officials. Mr. Hun Sen has denied interfering with the tribunal process.

Such disputes have made it harder for the tribunal to raise money from foreign countries to fund its operations. In April, it suspended salary payments to Cambodian staff when money ran out,

though staff got their back pay after Japanese donors provided \$2.2 million in early July. The tribunal remains about \$50 million short of its projected \$87 million budget for 2010-11.

Despite those problems, legal experts say the Duch case went smoothly after its start in March 2009, and should greatly bolster the tribunal's credibility as an independent and viable institution.

Monday's verdict "is an important milestone and shows that this court can function," says Alex Hinton, a professor and expert on the Khmer Rouge genocide at Rutgers University.

Mr. Duch, 67 years old, has been charged with committing crimes against humanity and war crimes, as well as torture and homicide, in his role as chief jailer at the notorious Tuol Sleng prison in Phnom Penh, where some 14,000 Cambodians were detained before being killed.

Mr. Duch has denied killing or torturing anyone. He has, however, acknowledged an oversight role at the jail, and has repeatedly expressed remorse. He has sought leniency on the basis that he was following orders, and has cooperated with the tribunal.

Mr. Duch faces a sentence of five years to life in prison if convicted.

The next case is more important, legal experts say, and also likely more difficult. It is expected to involve four members of the Khmer Rouge's inner circle: Nuon Chea, a former acting prime minister who is considered one of the group's main ideologues; Ieng Sary, a former deputy prime minister and minister of foreign affairs; his wife Ieng Thirith, a Shakespeare scholar who was also a government minister; and Khieu Samphan, a former head of state.

All four were arrested in 2007 and are accused of crimes against humanity; all have denied the charges. The tribunal is aiming to make a decision by September on whether to take them to trial, which is widely expected, with the trial expected to begin next year.

Some advocates fear the trial won't be completed. All four of the accused are in their late 70s or mid-80s and in declining health. Any further delays could test donors' willingness to keep spending, particularly after the tribunal has yielded a verdict in its first case.

"The problem of donor fatigue and the desire of the donors to take their winnings and move on—that remains a significant problem," says James Goldston, executive director of the Open Society Justice Initiative, a global group that promotes legal reform.

There are also questions about whether additional trials will—or should—occur. Rights advocates have argued at least another 10 or so Khmer Rouge leaders must be taken to trial before the full truth is known.

Prosecutors have submitted the names of five more possible defendants. Those names haven't been released and Cambodian authorities have said they don't want to pursue the cases.

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Iran says it is ready for fuel-swap talks

BY MARC CHAMPION AND JOE PARKINSON

ISTANBUL—Iran said Sunday it was ready to start negotiations "immediately" with the major powers over a potential nuclear-fuel swap, and was sending a letter to the United Nations' nuclear watchdog in Vienna on its terms for the deal.

Iran's foreign minister, Manouchehr Mottaki, was speaking after a lunch in Istanbul with his Turkish

and Brazilian counterparts, who brokered the potential fuel-exchange deal in May, but also voted against a new round of sanctions on Iran at the U.N. Security Council in June.

"Tomorrow the letter will be conveyed to the IAEA [International Atomic Energy Agency] in Vienna ... then we can immediately start negotiations for details of exchanging the fuel," the foreign minister said.

Turkish Foreign Minister Ahmet Davutoglu said the talks between

Iran's chief nuclear negotiator and European Union foreign-policy representative Catherine Ashton could take place in Istanbul, probably in September after the Muslim religious holiday of Ramadan, "if the parties would like to do that."

The swap deal agreed on in May is a near copy of one the major powers offered to Iran last year, but which Tehran at the time turned down.

Under the agreement, Iran would

transfer 1,200 kilograms, or 1.32 tons, of low-enriched uranium for safekeeping in Turkey.

In return, Tehran would later receive fuel rods enriched to a higher level of 20%, for use in a medical-research reactor.

Mr. Davutoglu said on Sunday that Turkey had a right and obligation to mediate between the two sides, because any conflict in the region would have a big impact on Turkey.

WORLD NEWS

On voting day, Bangkok bomb leaves one dead

By PATRICK BARTA

BANGKOK—A bombing in Bangkok's central commercial district killed one person and left 10 wounded Sunday, after the close of polling in a parliamentary by-election in which a member of the ruling Democrat Party defeated an antigovernment "Red Shirt" protest leader for a seat representing a large section of the Thai capital.

The highly anticipated vote was the first such election since mass demonstrations rocked the city earlier this year, and indicated continued support for the government despite harsh criticism from protesters and some human-rights activists for its decision to mount a bloody crackdown on the demonstrators on May 19.

In the first big election since mass demonstrations rocked the city earlier this year, a member of the ruling party defeated an antigovernment 'Red Shirt' protest leader.

The bomb exploded at a bus stop in the same area where Red Shirt protesters established their fortified encampment earlier this year before being driven out by government troops. That clash, along with earlier skirmishes in April and May, left nearly 90 people dead and some 1,400 wounded in some of the worst

political violence in Thailand in decades.

The fatality was a 51-year-old Thai man, the Associated Press reported.

Police officials didn't comment on who might have planted the bomb, which left trash and debris scattered across a major thoroughfare across from a massive mall that remains closed after being torched by protesters during the May 19 crackdown. It capped an otherwise peaceful day in which voters went to the polls to fill the parliamentary seat left open after the death of a lawmaker in June.

Panich Vikitsreth, a former Bangkok deputy governor and candidate for the ruling Democrat Party, defeated Kokaew Pikulthong, a Red Shirt leader jailed after the May 19 crackdown on charges of terrorism, with some 54% of the vote, according to unofficial results from the Election Commission. Official results are expected in the coming days.

Mr. Kokaew, who represented Thailand's opposition Puea Thai party, denies the terrorism charges. It remains unclear when—or whether—he will go to trial. Although a Thai court ruled he could leave his cell to register for the vote, he wasn't allowed to actively campaign and his contact with the outside world was limited largely to meetings with lawyers and family members.

The margin of victory wasn't as large as some government backers had hoped, especially given the limitations on Mr. Kokaew's movements. Still, it confirmed that many Bangkokians approve of the way the gov-



'Red Shirt' antigovernment protesters lie on the ground during a demonstration in Bangkok on Sunday.

ernment is handling the country's continuing political crisis.

It may also indicate that some city residents who once sympathized with the Red Shirt movement have become disenchanted after some protesters burned buildings and wreaked havoc across Bangkok after being dispersed from their central-city stronghold in May.

The vote "shows at least some of the middle class disapproves of what the Red Shirts have done," said Somchai Phagaphasvivat, a political scientist at Thailand's Thammasat University. Still, Sunday's bomb "is another early warning that the situation is not yet finished," he said.

Thailand's divisions are driven in part by a feeling among some residents that the current government—which came to power in a 2008 parliamentary vote, with military backing—is illegitimate because it didn't result from a fresh national

vote. Many of the protesters would prefer to see a government headed by former Prime Minister Thaksin Shinawatra, who was deposed in a 2006 coup amid corruption allegations and now lives in self-imposed exile overseas.

Mr. Thaksin denies the allegations and remains popular because of his past support for populist programs such as low-cost health care.

The Democrat Party, led by Prime Minister Abhisit Vejjajiva, has said Thailand is too unstable to call a full national election, though it must do so by law before the end of 2011.

In the meantime, it is hoping to shore up its support by promoting a series of reconciliation programs and by heavy spending on social programs, including in the areas where Mr. Thaksin and his allies are most popular.

The Puea Thai party, which is allied with Mr. Thaksin and draws

much of its support from Red Shirt backers, plans to press hard for a national vote, which many analysts say it would win. The party and Red Shirt movement draw much of their support from rural areas that comprise the majority of Thailand's population, despite Bangkok's roughly 10 million residents.

The party is also pressing for action from Thailand's Constitutional Court, which is expected to rule in coming months on allegations that the Democrat Party received illegal donations in past years. Prosecutors recommended in mid-July that the party be dissolved and about 40 of its executives—including Mr. Abhisit—be banned from politics for five years.

Party officials have vowed to contest any ruling against the Democrat Party.

—Wilawan Watcharasakwet contributed to this article.

Taliban kill one U.S. sailor, seize another

By MARIA ABI-HABIB

KABUL—The Taliban killed one U.S. Navy sailor and took a second captive after a firefight in eastern Afghanistan on Friday, a spokesman for the insurgent group said.

Militants ambushed the U.S. servicemen as they drove around Logar province Friday night in an armored sports-utility vehicle, engaging in an exchange of fire that killed one of the sailors, said Zabiullah Mujahid, the Taliban spokesman.

"A meeting of top Taliban leaders will be called soon to discuss the fate of the captured soldier and the dead body," Mr. Mujahid said.

U.S. and North Atlantic Treaty Organization officials declined to comment on whether the men were ambushed by the Taliban, but said an aggressive search mission is under way to locate them. Authorities didn't release the sailors' identities.

Afghan and coalition forces have dispatched helicopters and more troops to Logar, and are establishing a security perimeter around the site where the men disappeared, said Din Mohammed Darwesh, a spokesman for the provincial government

in Logar. The sailors left their compound in Kabul on Friday and were last seen driving near a market in the Charkh district of Logar. They appeared to be lost and drove into a Taliban-held area, Mr. Darwesh said.

"We will do all we can, everything we can," said U.S. Adm. Mike Mullen, chairman of the Joint Chiefs of Staff, who was in Kabul for meetings with U.S., NATO and Afghan officials, and to tour military bases in the southern and eastern regions of the country. "We have a large number of forces focused on the return of these two individuals."

Mr. Mullen called it an "unusual circumstance" for the sailors to be driving so far from their base in Kabul without security backup.

Coalition forces are offering \$20,000 to Logar residents for information to help find the missing servicemen, a NATO official said.

One other coalition service member is known to be held by the Taliban. Spc. Bowe Bergdahl disappeared from his base in the eastern province of Paktika in June 2009.

—Habib Zahori and Matthew Rosenberg contributed to this article.

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INTERVIEW



Bloomberg News

Piaggio will soon roll out its MP3 scooter in China, says CEO Roberto Colaninno, while plans are also being developed for India and Vietnam.

Vespa gears up for Asia as European sales slow

The scooter maker's chairman believes customizing for individual countries will be the driving force for growth

[Roberto Colaninno]

BY STACY MEICHTRY

PONTEREDERA, Italy—During a recent meeting with engineers and designers, Piaggio SpA Chairman Roberto Colaninno mounted the back seat of a cherry-red Vespa with his legs dangling over one side of the scooter.

"The ladies sit this way," Mr. Colaninno said, demonstrating how women in India typically ride side-saddle on the back of a scooter to accommodate their floor-length saris. For months, Piaggio designers in India and Tuscany had been retooling the design of the red scooter, which Mr. Colaninno informally calls the "Indian Vespa." As Mr. Colaninno spoke, an engineer offered to add a fin-like footrest to the scooter's left side.

Redesigning the Vespa to appeal to different markets is a big part of Piaggio's plans to push deeper into Asia, the world's largest scooter market. In India, Piaggio will invest €100 million (\$129 million) over the next three years to double production capacity. The strategy calls for Piaggio to produce Vespas locally by the end of 2012, after a 15-year absence. It also involves re-engineering a new line of tiny trucks and three-wheel "tuk-tuks" that keep India's economy humming along.

In Vietnam, the company is beefing up the factory it opened a year ago to produce a new generation of Vespas for Vietnam, Malaysia, Indonesia and the Philippines.

Piaggio is also taking tentative steps to enter China, the world's single-biggest

scooter market by deliveries. In August, Piaggio will begin selling the MP3, its three-wheel, high performance scooter, across China, Mr. Colaninno said. The Vespa will be shipped to China soon, but dates and a price haven't yet been set.

Piaggio's shift toward faster growing-Asian markets aims to offset sluggishness in Europe, where a deep recession and limping recovery have undercut Piaggio's revenue. Squeezed by the sovereign-debt crisis, governments such as Italy are now withdrawing incentives that helped Piaggio and other manufacturers survive the worst of the recession. Piaggio's European revenue declined 4.9% over the first five months of the year to €444 million, compared with the same period last year. In Asia, revenue increased 74% to €200 million.

Growing car traffic, Mr. Colaninno said, will spur sales of scooters that can easily weave between cars that have begun to choke Asia's streets and park in tight spaces.

The barriers to entering China, India and other emerging Asian economies are high. European scooter and motorcycle makers have traditionally struggled to match the cutthroat prices of Asian rivals. Piaggio must compete against better-known Japanese brands including **Honda Motor Co.** and **Yamaha Motor Co.**, as well as domestic manufacturers, such as India's **Bajaj Auto Ltd.**, that churn out low-price scooters with few frills. China accounts for more than 40% of the motorcycles and scooters sold world-wide but generates only 15% of the industry's revenue.

The Vespa, with a swan-like body molded

from steel rather than the low-cost plastic used by rivals, is "too much of a higher-end product" for markets like China, said Alessandro Falcioni, an analyst at **UniCredit**.

In the late 1990s, Mr. Colaninno stunned markets by engineering a buyout of **Telecom Italia SpA** in what was then Europe's largest ever hostile takeover. After selling out of the telecommunications operator, he invested €100 million through his Immsi SpA holding company to buy a controlling stake in Piaggio.

At the time, Piaggio was burning through cash and struggling with massive debts. The Vespa, in particular, had disappeared from most markets during the late 1980s and early 1990s, because its steel body was considered too costly to make.

Mr. Colaninno retooled Piaggio's assembly lines so that any kind of scooter could be produced in Pontedera. Today, the plant can churn out 50 different versions of the Vespa as well as high-tech scooters such as hybrids and the MP3, which has three wheels for stability but can tilt on an axis like a two-wheel scooter.

In Piaggio's design studio, at the center of the sprawling Pontedera plant, designers carve prototypes out of synthetic wood that are then scanned into computers.

One Vespa prototype, painted in bubble-gum blue, had a space-age silhouette. Mr. Colaninno worries that the unconventional design hadn't tested strongly with focus groups in some European markets. "Maybe it could work in Los Angeles," he said.

For now, Piaggio will export Vespa and MP3 scooters produced in Italy to dealerships in Shanghai, Beijing and other Chinese

cities in order to test the market. Given the competition, Piaggio is aiming to target the high-end market there. Those scooters will carry European-level price tags.

The Vespa LX 125 sells for about €3,380, or about \$4,300, in European markets, while the latest MP3 models retail for about double that price. If China responds well to the MP3, Piaggio could begin to produce it there within the next three years, significantly lowering the scooter's price, he said.

Piaggio is already at work bringing down the price of the Vespa in India, which there by the end of 2012. Mr. Colaninno said a Vespa scooter will cost about \$800 to produce in India, about half of what it costs to produce a similar model in Italy. Models are expected to be competitively priced in the Indian market.

The Indian Vespa's engine won't have a fuel-injection system and isn't designed to meet emissions standards in Europe and North America. The scooter is fitted with drum brakes instead of disc brakes, making it easier to change tires that frequently get flattened along India's patchy roadways.

Designers narrowed the Vespa's floorboard so the feet of riders, who tend to be shorter in India, according to Piaggio's market research, can easily reach the ground.

A similar design challenge, he said, has recently cropped up in Vietnam where more women have begun to wear high-heel shoes. "You need to pay attention to the ergonomic design in relation to the people you're targeting," Mr. Colaninno said. "And now with the heels...we have to modify."

—Margherita Stancati
contributed to this article.