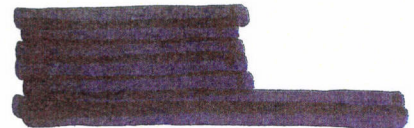


Antonio Bavasso
Allen & Overy LLP
By email

cc. Steve Unger, Ofcom

Your ref 0012561-0000367
Our ref
Date 9 February 2011

Direct line
Fax
Email



Dear Antonio

Proposed acquisition of BSkyB by News Corp

I refer to the proposed undertakings in lieu (UIL) offered by News Corporation (News) to the Secretary of State in relation to the above matter, as well as your responses to our questions of 1 February and 7 February.

The OFT has considered carefully your responses to both sets of questions in terms of determining what advice it should provide to the Secretary of State under section 93 Enterprise Act 2002 (EA 02) in particular as to whether the UIL would be practically and financially viable and effective over the medium and long term.

Given the limited time remaining in which the OFT is required to report back to the Secretary of State, the OFT does not propose to engage in a detailed consideration of revised wording for the UIL. However, the OFT believes it is appropriate at this point for it to identify to News a number of key areas where the OFT has concerns that the UIL may not be practically and financially viable over the medium and long term.



1. Absence of a non-reacquisition obligation

Firstly, the OFT is concerned at the lack of a non-reacquisition clause in the UIL. In your response to the OFT questions of 7 February (paragraph 2.16), you gave the following reasons why you believed that such an obligation was not justified:

- (i) the proposed UIL seeks to preserve the status quo including all the regulatory protections provided for by the EA 02;
- (ii) an outright ban on future acquisitions of shares would go beyond what is necessary to protect the sufficiency of plurality, creating a discriminatory and unjustifiable regulatory asymmetry against News;
- (iii) this case must be distinguished from the ordinary example of a merger where there is a competition issue for two reasons: (i) News already has a 39.14 per cent shareholding in Sky; and (ii) there would be no competition issue raised by the Transaction so that protections ordinarily needed to preserve the commercial freedom of a fully independent competing business need not apply; and
- (iv) any further acquisition of NewCo shares by News would lead to a "relevant merger situation" with consequent statutory regulatory approvals under the EA 02.

In relation to each of these points in turn:

- (i) in a very literal sense, UIL normally involve a change to the status quo, in so far as they normally contain a non-reacquisition obligation which was not present previously; in relation to the EA 02 situation, see (iv) below;
- (ii) the OFT's concern about reacquisition is based on the practical viability of the UIL over the medium and long term, not on the protection of plurality;
- (iii) neither of the factors that News uses to distinguish this case from the ordinary example of a merger where there is a competition issue are meaningful; the fact that News already has a shareholding in Sky is irrelevant: the non-reacquisition obligation would take account of that fact; the fact that there are no competition issues does not mean that the UIL do not need to be practically viable over the medium and long term in order to operate to protect plurality; and

(iv) the existence of jurisdiction under the EA 02 (in particular given the share of supply test) would frequently be the case in relation to competition UIL; this does not obviate the need for a non-reacquisition clause.

The OFT would also note that News' response ignores the practical justification for such a restriction. A key reason why such restrictions are inserted as 'standard' obligations in UILs is to prevent the improper use of public resources on a repeated public investigation. The OFT sees no reason why this reason is not applicable here. In other words, the obligation would be intended to prevent a further public investigation into the acquisition by News of the business that it has divested (in this case, spun-off). It is clear to the OFT that the absence of a non-reacquisition obligation is a practical issue that could undermine the operation of the UIL in the event of an attempt by News to re-acquire Sky News after the UIL have been accepted. The OFT notes in this respect that the Secretary of State has asked the OFT whether the UIL would be effective over the 'medium and long term'.

As News will be aware, such clauses are normally drafted as being 'subject to OFT prior written consent'. To the extent that News wished in the future to increase its shareholding in Newco, it would therefore be free to seek OFT approval to do so on the basis that there had been a change in circumstances meriting a waiver of the obligation.

Please confirm whether News' final position remains that it would not be willing to provide any form of non-reacquisition obligation in the UIL.

2. Non termination of the carriage and brand licensing agreement

Secondly, the OFT has concerns at the absence of any ongoing commitment to the Secretary of State in relation to the continued performance of News' obligations under the carriage agreement and brand licensing agreement foreshadowed respectively in paragraphs 4.3 and 4.5 of the UIL.

In your response to the OFT questions of 7 February (paragraph 2.16), you gave a number of reasons why you believed that such an obligation was unnecessary:

- (i) there is no reason to believe that NewCo would not be in a position to enforce its contractual rights;

- (ii) News is prepared to commit to a more specific dispute resolution mechanism if the OFT considers that an ad hoc mechanism is needed;
- (iii) these mechanisms will be more than sufficient to enable NewCo to protect its own interests; and
- (iv) News does not believe that it would be appropriate for the OFT to have an ongoing monitoring role in this context where there is every reason to believe that News' compliance with its contractual commitments will be effectively self-policing.

The OFT understands these arguments. The OFT considers that a dispute resolution mechanism would be important in the UIL in order to facilitate resolution of contractual disagreements. However, these arguments do not detract from the essential proposition that the ongoing practical and financial viability of Newco is dependent on the carriage and brand licensing agreements with News. The OFT therefore considers that it would be appropriate to ensure the performance of those agreements for the period contemplated in the UIL. Specifically:

- (i) in comparison to News, Newco would be a small business with limited resource to engage in an extended dispute with News; given the importance of the carriage and brand licensing agreement to the UIL, the OFT believes it is questionable whether it would be sufficient for the success of the UIL to rest solely on Newco's ability to enforce its contractual rights; and
- (ii) although the OFT understands the point about News' ongoing incentives as regards Sky News, it is clearly impossible to guarantee that such incentives would not change in the future; here again, it may be appropriate to 'insure' against a change in News' incentives going forward.

The OFT therefore believes that it may advise the Secretary of State that it is appropriate – in this particular case – to require News to undertake to him that it would not terminate the carriage agreement or the brand licensing agreement without prior OFT consent (to be given only in the event of a material breach that could not be cured).

The OFT notes that, in the context of a first phase remedy in lieu of a detailed investigation, it would need to be confident about the success of the UIL. The OFT would note also that, given News' submissions on its incentives as regards Sky News, we do not

understand why News would be unwilling to provide such an undertaking. For the same reason, the OFT would also envisage that any monitoring obligation on the OFT would be minimal.

Please confirm whether News' final position remains that it would not be willing to provide any form of non-termination undertaking in relation to the carriage agreement and brand licensing agreement in the UIL.

3. Absence of interim protection regarding Sky News

The OFT notes that the UIL do not contain any interim protection in relation to the Sky News business pending spin-off in the event that the offer is not recommended.

News argued in its response to the OFT questions of 1 February that no such protection was required because there was no risk of a loss of plurality in the short term and there was no risk of News inflicting long-term damage on the Sky News business given that they would not be competing post spin-off (paragraph 11.2).

The OFT's concern in this regard is not in relation to an interim impact on media plurality. The OFT's concern focuses on the fact that, notwithstanding News' contention that it would not be competing with Sky News post spin-off, this contention is wholly reliant on the assertion that News' incentives are to preserve Sky News and that it does not have any incentive to frustrate the intended outcome of the UIL.

The OFT considers that it may be appropriate for News to provide undertakings as to the preservation and continued operation of Sky News pending its spin-off in order to provide an assurance that the Sky News business to be spun-off will not be materially different to the Sky News business today. Such an assurance would be in similar terms to those typically provided in UIL.

The OFT would note also that, given News' submissions on its incentives as regards Sky News, the OFT does not understand why News would be unwilling to provide such an undertaking.

Please confirm whether News' final position remains that it would not be willing in the UIL to commit to any form of interim protection in relation to the Sky News business pending spin-off.

4. Finite duration of the carriage agreement and brand licensing agreement

The OFT notes the finite duration of the carriage agreement and brand licensing agreement, on which Newco is dependent for its ongoing financial viability. The OFT has been asked to advise the Secretary of State on whether there are practical issues which could undermine the effective operation of the UIL, and whether the UIL would be effective in the medium and long term. Given the dependence of Newco on the carriage agreement for the majority of its revenue, the OFT has concerns that the UIL offered do not propose any mechanism for ensuring the viability of Newco beyond ten years.

News provided an explanation in response to the OFT's questions of 1 February as to why it believed that the UIL were clear-cut, notwithstanding the finite duration of the carriage agreement and brand licensing agreement (paragraph 14.1.1). However, News' response does not engage substantively with the question of how Newco would expect to derive its principal revenue stream once the carriage agreement (at ten years duration) has ended.

Please provide any further representations on the medium and long term viability of the UIL given the finite duration of the carriage agreement and brand licensing agreement or alternatively any further proposals to ensure the viability of Newco over the medium and long term.

I would be grateful for a response on these points by midday tomorrow. Equally, I would be happy to discuss with you, and News, by telephone today.

Yours sincerely

A black rectangular redaction box covering the signature of Sheldon Mills.

Sheldon Mills
Director, Mergers