

Smith, Christine:CO (LN)

From: Sheldon Mills [REDACTED]
Sent: 23 February 2011 22:50
To: Bavasso, Antonio:CO (LN)
Cc: Jeff.Palker [REDACTED]; Appella, Andrea; Steve Unger; Nicholas Scola
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Dear Antonio,

I refer to our call earlier this evening in which we promised to respond to you on certain points in relation to the Second Revised Draft UIL (attached to your email of 22 February 2011) to which paragraph references in this email relate. We have considered the discussion and the points made on the call carefully and set out below our further requests in relation to the Second Revised Draft UIL.

Paragraph 3 of the UIL - corporate governance provisions - amendments to the Articles of Association

We note your comments in relation to the corporate governance provisions at paragraph 3.2 and 3.1 (iii) and (viii) of the UIL. In particular, your view that these provisions provide a potential purchaser who acquires a shareholding above 50% but below 75% in Newco with an opportunity to remove the restrictions in the Articles of Association.

For the reasons below, we kindly request that News agree to the following amendments to the UIL:

- (1) removal of the reference to a 15 per cent 'floor' in paragraph 3.2; and
- (2) amend the 50 per cent 'ceiling' (paragraphs 3.1(iii) and (viii) and 3.2) to refer only to a situation in which News has over 50 per cent of the voting rights.

Overall, we consider that these amendments would address our concerns over their impact on the practical effectiveness of the UIL in terms of their operation. To assist you in considering these requests, we set out our reasons in more detail below.

Amendments to the 50 per cent ceiling

We consider that inclusion of this provision could, in practice, serve to undermine the operation and practical viability of the UIL in achieving their objectives. First, although we note your view that Newco's financial viability may be enhanced with the inclusion of such a provision in the UIL, as discussed on the call, we consider that the provisions in the proposed brand licensing agreement relating to a change of control reduce the likelihood of a third party acquiring control of Newco (absent renegotiation of those terms with News/Sky). In such circumstances, we see limited benefit in terms of the financial viability of Newco from the inclusion of such a provision in the UIL. Rather, we consider that our paramount consideration should be ensuring the practical viability of the UIL in achieving their objectives – one of which is to ensure that the circumstances in which the corporate governance of Newco can be changed are, of necessity, limited in

scope.

We take a cautious approach in relation to design of the UIL and it is important to ensure that they are effective in meeting the concerns they have been designed to address. In the light of this, whilst we have considered the reasons you have given for the inclusion of this provision, we remain concerned to ensure the continued effectiveness of the provisions protecting the independence of Newco (from an editorial and governance perspective) as enshrined in the Articles of Association in the event of an acquisition by a third party of 50 per cent or more of the voting rights - the extent to which such protections would continue to be necessary would ultimately depend upon the factual circumstances surrounding such an acquisition, including the identity of the acquirer. As such, at this stage, our preference would be to an amendment which provided that the corporate restrictions apply (and the voting restriction in paragraph 3.2 applies) unless News owns more than 50 per cent of Newco's voting rights (which would be following approval from the Secretary of State pursuant to paragraph 6.1).

Removal of the 15 per cent floor

We are concerned, taking into account the need to reduce the risks to the practical viability of the UIL in achieving their objectives, to avoid a scenario in which - as a result of a temporary reduction in News' shareholding - the Articles of Association are during that time amended, with News not having to vote against such an amendment as a result of the level of its shareholding, whilst at the same time there is some ambiguity about whether (when News reacquires the shares it had temporarily disposed of) there is then a change in the level of News' control over Sky News such that a relevant merger situation or special merger situation had been created. We consider that such an amendment is necessary to reduce the risk of a creation of a potential gap in the ongoing effectiveness and operation of the UIL, we therefore request that the 'floor' level should be set at zero.

Paragraph 5 of the UIL - operational agreements - upfront approval

We would like to thank you for your time in providing us with a further explanation of the operational agreements set out in paragraph 5 of the UIL. As agreed, we have considered this issue further and agree that the advertising sales agreement in paragraph 5.1 of the UIL need not be approved by the Secretary of State on an upfront basis, given the existence of third party providers and the likely ease with which Newco could source services from such a provider. We would insist upon, however, as you agreed on the call, to the satellite capacity, playout and uplink and DTT transmission arrangements being reviewed upfront.

Paragraph 10 of the UIL - removal or variation

We note your points in relation to inclusion of a removal of variation clause.

We would not normally expect UIL to include provisions which merely repeat rights that already exist under statute. We consider that such provisions are unnecessary and may lead to confusion as between the UIL obligation and the statutory provisions. In addition, to the extent that we were to agree to the inclusion of such provisions in a UIL, they should follow the letter and spirit of the legislation. In this regard, we note that notwithstanding the wording of paragraph 3(9) of Schedule 2 to the Enterprise Act 2002 (Protection of Legitimate Interests) Order 2003, it is plain from section 92 of the Act that the expectation is that UIL will be considered for variation or release when there has been a change of circumstances. It is quite plain that if there has not been a change of circumstances, that begs the question why variation or release should be considered. In summary, we consider

that paragraph 10 of the UIL is may create the misleading impression that the Secretary of State should consider a variation or release request when there has not been any change of circumstance, which clearly does not follow the intended operation of the statute or practice, and we therefore request its removal (or that it is amended accordingly).

I would be grateful if you could send through tomorrow morning as early as possible a revised draft of the UIL, reflecting your position on the above points and having regard to the issues you agreed to take away in relation to paragraph 5.1(iv) (providing for upfront review of the satellite capacity, playout and uplink and DTT transmission arrangements) and (v) (clarifying what is meant by broadcast operations and creative services).

Kind regards

Sheldon

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