

**BY COURIER**

**STRICTLY CONFIDENTIAL**

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Dear Victoria,

**News Corporation - British Sky Broadcasting Group Plc**

On Friday 14 January 2011, we filed - on behalf of News Corporation (News) - News' submission (the **Submission**) to the Secretary of State for Culture, Olympics, Media and Sport (the **Secretary of State**) in response to Ofcom's report dated 31 December 2010 (the **Report**) on News' proposed acquisition of those shares in British Sky Broadcasting Group plc (**Sky**) that it does not already own (the **Transaction**).

News submitted that, having reviewed the Submission and applying the legal test objectively on the basis of the relevant evidence, the Secretary of State can reasonably and should: (i) decide that the Transaction will not result in insufficient plurality for any audience in the UK; and/or (ii) decide that the Transaction will not operate against the public interest; and/or (iii) exercise his discretion not to refer.

As mentioned in the Submission, and without prejudice to the views expressed therein, should the Secretary of State otherwise be minded to refer the Transaction to the Competition Commission (CC), News is prepared to submit undertakings in lieu (UIL) in order to remedy, mitigate or prevent such of the potential effects adverse to the public interest which Ofcom identifies in its Report as potentially resulting from the Transaction which the Secretary of State still believes to be of concern.

A decision on UIL rests with the Secretary of State under paragraph 3 of Schedule 2 of the Enterprise Act (Protection of Legitimate Interests) Order 2003 (the **Order**):

*"The Secretary of State may, instead of making such a reference and for the purpose of remedying, mitigating or preventing any of the effects adverse to the public interest which have or may have resulted, or which may be expected to result, from the creation of the European relevant merger situation concerned accept from such of the parties concerned as [he] considers appropriate undertakings to take such action as [he] considers appropriate."*

News is submitting the attached UIL proposal at this stage to ensure that the Secretary of State has ample time to consider the UIL.

The attached UIL proposal involves a commitment from News that Sky News will be spun off as an independent UK public limited company (Newco), with its shares publicly traded. Shares in Newco would be distributed to the existing shareholders of Sky, as far as possible, in the same proportions as their existing shareholding (so that News will retain only the same shareholding in Sky News as it currently has in Sky, 39.1%).

The corporate governance structure of Newco will also replicate the effect of the existing governance structure of Sky, which has been in place for a number of years. In particular, after closing:

- (a) the voting agreement dated 21 September 2005 between the Sky and News which prevents News from exercising more than 37.19% of the votes in Sky will be replicated in respect of Newco;
- (b) a majority of the board of Newco shall comprise non-executive Directors determined by the board to be independent;
- (c) material transactions between Newco and News/Sky will require the approval of Newco's Audit Committee, which will consist exclusively of independent non-executive Directors. In addition Newco's constitutional documents will provide that such transactions may, depending on materiality, require an independent fairness opinion or Newco independent shareholder approval (by virtue of Newco applying controls that have equivalent effect to those imposed by Chapter 11 of the Listing Rules).

There will also be a number of commercial agreements between News/Sky and Newco, including a long-term carriage agreement which will provide Newco with a significant and committed long term revenue stream. None of the commercial agreements between News/Sky and Newco will give News/Sky any right to influence the editorial content of Sky News.

A business plan for Sky News and a letter from News' financial advisers regarding the suitability of Sky News for admission to trading will be made available to the Secretary of State in due course.

Ofcom states in paragraph 5.46 of the Report that: "*As a result, today [Sky News] makes a strong and positive contribution to plurality. [...] The proposed transaction would result in Sky ceasing to be a distinct media enterprise from News Corp.*" The attached UIL proposal, under which Sky News would be spun off as an independent legal entity, will fully safeguard the status quo as regards the editorial independence of Sky News and will ensure that Sky News remains as a distinct media enterprise and independent broadcast voice. This fully addresses all of the concerns identified by Ofcom in its Report and relied upon by Ofcom in recommending to the Secretary of State that he refer the Transaction to the CC.

The UIL will therefore remedy, mitigate or prevent any purported effects resulting from the Transaction which have been identified by Ofcom as potentially adverse to the public interest.

With such a robust structural remedy being offered by News, it is clear that a reference to the CC would serve no useful purpose. News submits that even if the Secretary of State would otherwise be minded to refer the Transaction to the CC, the only reasonable course in light of this offer of remedies is for the Secretary of State to accept UIL at this stage.

Yours sincerely

**Antonio Bavasso**  
Partner

cc: Jeff Palker and Andrea Appella - News Corporation; John Pheasant and Suzanne Rab - Hogan Lovells International LLP; Cery Darbon and Dominic Long - Allen & Overy LLP



## NEWS/SKY

## UNDERTAKINGS IN LIEU PROPOSAL

**1. Introduction**

- 1.1 News Corporation (News) proposes to acquire the shares in British Sky Broadcasting Group plc (Sky) that News does not already own (the Transaction).
- 1.2 The Secretary of State for Business, Innovation and Skills issued a European Intervention Notice on 4 November 2010 (the **Intervention Notice**) under section 67(2) of the Enterprise Act 2002 (the **Act**) and the Enterprise Act 2002 (Protection of Legitimate Interests) Order 2003 (the **Order**). On 31 December 2010, as requested by the Secretary of State for Business, Innovation and Skills and provided for in Article 4A of the Order, Ofcom issued its report on media plurality issues (the **Report**).
- 1.3 The Secretary of State for Culture, Olympics, Media and Sport (the **Secretary of State**) is now considering whether or not to refer the Transaction to the Competition Commission (the **CC**) under Article 5 of the Order. In doing so, he is not bound by the content of the Report.
- 1.4 If the Secretary of State would otherwise intend to make a reference to the CC, he has the power to accept undertakings from News in lieu of making such a reference (undertakings in lieu or **UIL**), under paragraph 3 of Schedule 2 of the Order:

*"The Secretary of State may, instead of making such a reference and for the purpose of remedying, mitigating or preventing any of the effects adverse to the public interest which have or may have resulted, or which may be expected to result, from the creation of the European relevant merger situation concerned accept from such of the parties concerned as [he] considers appropriate undertakings to take such action as [he] considers appropriate."*

- 1.5 The decision as to whether or not to accept UIL lies with the Secretary of State and Ofcom has not provided any specific advice on this aspect of the decision to be taken by the Secretary of State. Even if the Secretary of State would otherwise be minded to refer the Transaction to the CC in this case, he must give full consideration to News' offer of undertakings which, as explained below, will remove any perceived risk identified in the Report that a public interest concern might arise as a result of the Transaction.
- 1.6 For the reasons summarised in News' submission to the Secretary of State of 14 January 2011 (the **News Submission**) News believes that (i) the Transaction will not lead to there being insufficient plurality in media voices serving any relevant audience in the UK; and (ii) the Secretary of State should decide that the Transaction does not operate against the relevant public interest consideration (**PIC**) identified in the Intervention Notice without a reference to the CC.
- 1.7 The basis for the perceived concerns as to media plurality set out in the Report is the loss of Sky News as an independent broadcast news voice. The potential loss of Sky News as an independent contributor to plurality (on the assumption, which News does not accept, that News would influence or control Sky News' editorial agenda post-Transaction) is the only concern which is, in fact, identified in the Report as specifically justifying (in Ofcom's view) a reference to the CC.<sup>1</sup>

<sup>1</sup> Ofcom has not relied upon its "dynamic" concerns (set out in section 6 of the Report) in providing advice to the Secretary of State that the Transaction might merit reference to the CC. This is the correct approach, since speculative arguments about the potential exit of other media providers or a reduction in their influence in setting the agenda cannot form the basis for a finding of adverse effects to the public interest arising from the Transaction and provide no reasonable basis for seeking a further review of the Transaction at this stage. Furthermore, the European Commission has unconditionally approved the Transaction in a first phase procedure thereby dismissing any perceived concerns that the Transaction may give rise to competition issues (including but not limited to a risk of exit of rival operators in

- 1.8 Regardless of News' view that more than sufficient cross-media plurality would remain post-Transaction in any event, the concerns identified by Ofcom could not arise if Sky News was maintained as a distinct media enterprise as per the situation pre-Transaction.
- 1.9 Without prejudice to News' views on the outcome of a properly conducted media plurality analysis, in order to forestall any potential concerns which have been identified by Ofcom and avoid a CC reference which would create a serious risk to the successful completion of the Transaction, News is prepared to offer the UIL described below for the purpose of remedying, mitigating or preventing the potential effects of the Transaction which are perceived to be adverse to the relevant PIC.
- 1.10 This UIL is a structural solution which ensures the continued existence of Sky News as a distinct media enterprise and an independent editorial voice and preserves the pre-Transaction status quo, therefore negating any possible need for further regulatory review by the CC.
- 2. UIL Proposal - structural solution which will maintain the status quo with respect to Sky News**
- 2.1 News is prepared to offer a structural commitment that Sky News will be spun off as an independent UK public limited company (**Newco**), with its shares publicly traded. Shares in Newco would be distributed to the existing shareholders of Sky in the same proportions as their existing shareholding (so that News will retain the same shareholding in Newco as it currently has in Sky, i.e. 39.1%, following completion).
- 2.2 News envisages that the structural solution will involve the following elements:
- (i) Sky will form a new public limited company incorporated under the laws of England and Wales as a subsidiary of Sky to which the business of Sky News (including its employees) will be transferred in exchange for shares in Newco. The transfer will extend to all the activities of Sky News, including the provision of wholesale news inputs to third party media enterprises.
  - (ii) Shares in Newco will be spun-off to existing shareholders of Sky (including News which will remain a shareholder) and will be publicly traded.
  - (iii) Sky will enter into a long-term carriage agreement with Newco under which Sky will pay a carriage fee to Newco for the provision of its news services to Sky for distribution to end users, thereby providing Newco with a significant and committed long-term revenue stream.
  - (iv) Sky will license to Newco the "Sky News" brand (subject to payment of a royalty and standard terms and conditions).
  - (v) Ongoing agreements for support services between Sky and Newco (including in relation to access to facilities, premises and other assets owned by Sky to the extent required by Newco) will be dealt with on an arms'-length basis. Sky will also provide advertising sales representation for Newco on agreed terms.
  - (vi) Newco will be adequately financed by virtue of Sky News being demerged [X] and via the long-term carriage agreement with Sky, together with other revenue streams, including existing revenues from activities such as the sale of advertising space, licensing and international distribution.
  - (vii) The corporate governance structure of Newco will be established to substantially replicate the effects of the existing corporate governance structure of Sky. In particular:

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the foreseeable future). Consequently, these issues are irrelevant to the decision-making process and should be ignored by the Secretary of State.

- (A) News/Sky will be subject to a voting limitation of 37.19% of the total votes of Newco on the same terms as currently apply in relation to Sky.
  - (B) A majority of the board of Newco will comprise non-executive Directors determined by the board to be independent.
  - (C) Material transactions between Newco and News/Sky will require the approval of Newco's Audit Committee, which will consist exclusively of independent non-executive Directors. In addition Newco's constitutional documents will provide that such transactions may, depending on materiality, require an independent fairness opinion or Newco independent shareholder approval (by virtue of Newco applying controls that have equivalent effect to those imposed by Chapter 11 of the Listing Rules).
  - (D) Newco will also adhere to the obligations imposed by the Listing Rules as regards compliance with the principles set out in Section 1 of the Combined Code (Principles of Good Governance).
- (viii) News will procure that the shares of Newco commence trading at or as soon as possible after the closing of the Transaction and, in any event, no later than 9 months from the acquisition of control of Sky by News.

#### ***Effect of proposed UIL***

- 2.3 In its summary of the analysis of external plurality Ofcom states that: "*As a result, today [Sky News] makes a strong and positive contribution to plurality. [...] The proposed transaction would result in Sky ceasing to be a distinct media enterprise from News Corp.*" (paragraph 5.46 of the Report).
- 2.4 The proposed UIL will ensure that Sky News remains as a distinct media enterprise and independent broadcast voice. This fully addresses all of the concerns identified by Ofcom in its Report and relied upon by Ofcom in recommending to the Secretary of State that he refer the Transaction to the CC.
- 2.5 News does not agree with Ofcom's conclusions as regards the potential impact of the Transaction on News' level of influence over Sky News, for the reasons set out in the News Submission. However, it is notable that Ofcom takes the view that, in practice, News' influence over Sky News is currently limited by the presence of independent shareholders and directors. These limitations will persist under the proposed UIL. At paragraph 1.16 of its Report Ofcom states that "*the proposed acquisition would give it a 100% ownership of shares in Sky so that Sky would become a wholly owned subsidiary of News Corp. Currently, News Corp's stake in Sky, while representing material influence over Sky, does not enable News Corp to pass general and special resolutions alone given the presence of other shareholders and independent directors.*"
- 2.6 News' proposed structural solution will maintain the editorial independence of Sky News and the Transaction will therefore have no effect on the plurality of persons with control of media enterprises serving audiences in the UK.
- 2.7 Newco will be subject to the Takeover Code such that, as is currently the case for Sky, any further acquisition of shares by News in Newco would trigger a mandatory offer for the shares and such an offer would be subject to the same regulatory approvals which apply to the Transaction.
- 2.8 Without prejudice to News' submission as to its view on the effect of the Transaction on the relevant PIC, the proposed UIL will therefore address, *ab initio*, the key change brought about by the Transaction which is perceived by Ofcom to give rise to concerns about potential effects adverse to the public interest.

**3. Conclusions**

- 3.1 For the reasons summarised in the News Submission, News believes that (i) the Transaction will not lead to there being insufficient plurality in media voices serving any relevant audience in the UK; and (ii) that the Secretary of State should decide that the Transaction does not operate against the relevant PIC identified in the Intervention Notice without a reference to the CC.
- 3.2 Without prejudice to this view, News has submitted a comprehensive UIL which will ensure that the Transaction has no adverse effect on the independence of Sky News, or on the sufficiency of plurality of news provision in the UK thereby maintaining the status quo and removing any potential public interest concern identified by Ofcom as justifying a reference of the Transaction to the CC.
- 3.3 In these circumstances it is clear that no public interest would be served by a further lengthy investigation by the CC which would prejudice the chances of successful completion of the Transaction.
- 3.4 No issue of substance has been identified by Ofcom in its Report which would not be addressed by the proposed UIL. Given that the remedy being offered by News removes any doubts as to the continued sufficiency of media plurality in the UK, the only reasonable decision at this stage would be for the Secretary of State to accept the UIL being offered by News.

**Allen & Overy LLP on behalf of News Corporation**

**18 January 2011**