

Antonio Bavasso
Allen & Overy LLP

Your ref 0012561-0000367
Our ref
Date 1 February 2011

Direct line
Fax
Email



Dear Antonio

News / BskyB

Information request

Further to our conversation earlier today, and your presentation to us yesterday on the proposed undertakings in lieu (UIL) offered by News Corporation (News) to the Secretary of State in relation to the above matter, I attach a list of questions for News in relation to the UIL.

These questions are designed to assist the OFT in preparing its advice to the Secretary of State under section 93 Enterprise Act 2002 (EA 02) and in particular responding to the request in the Secretary of State's letter of 27 January 2011 to the Chief Executive of the OFT that the OFT discover whether the UIL would be practically and financially viable. I would also note that Ofcom has been asked to provide any assistance the OFT may require in considering the UIL, as well as advising the Secretary of State on the potential impact of the UIL on the concerns they raised about media plurality in their report of 31 December 2010.

Given the short time period within which we are required to report to the Secretary of State, we would be grateful for a response to these questions as soon as reasonably possible. It would greatly assist us if you were able to provide what information you can by **midday on 3 February 2011**, following up with the remaining responses as soon as possible afterwards.



Disclosure of information

We have discussed today the question of whether News would be willing to consent to the OFT disclosing to Ofcom information provided by News to the OFT. This is an issue that I have also discussed directly with Andrea Appella at News this afternoon.

We note your position as set out in your email to me of this evening.

Having regard in particular to the fact that the Secretary of State has asked Ofcom to provide any assistance the OFT may require in considering the UIL, we will revert to you in due course in relation to any specific information that will need to be disclosed in order to facilitate the exercise of our own functions under section 93 EA 02 and/or Ofcom's functions under 106B EA 02.

As you have agreed today, we look forward to receiving from you confidential and non-confidential versions of your responses to the attached questions, the latter version of which may be freely disclosed by us to Ofcom.

We note that your email of this evening states that News *'has legitimate concerns about confidentiality of the information shared with you which [it] would only want to be circulated on a need-to-know basis and not discussed widely in intra-government communications'*. However, in relation to any specific information or category of information that is redacted from your responses, we would ask you to set out the reasons why you believe that disclosure of that information to Ofcom would be detrimental to News, having regard to the fact that Ofcom would itself be bound by restrictions on the use and further disclosure of such information.

Yours sincerely



Sheldon Mills
Director, Mergers

PROPOSED ACQUISITION BY NEWS CORP OF BSKYB

QUESTIONS RE UNDERTAKINGS IN LIEU PROPOSAL (1)

1 FEBRUARY 2011

1. Introduction

- 1.1. The OFT sets out below questions it has in relation to the undertakings in lieu offered by News Corporation (News) in relation to its proposed acquisition of the remaining shares in BSKyB Group plc (Sky) (the UIL).
- 1.2. The questions below are based on the draft text UIL offer submitted to the Secretary of State, the memorandum explaining the UIL offer of Allen & Overy of 18 January 2011 and the presentation and commentary provided by News to the OFT at the meeting on 31 January 2011.
- 1.3. These questions are designed to assist the OFT in preparing its advice to the Secretary of State under section 93 Enterprise Act 2002 and in particular responding to the request in the Secretary of State's letter of 27 January 2011 to the Chief Executive of the OFT, that the OFT discover whether the UIL would be practically and financially viable.
- 1.4. The OFT requests a response to these questions by midday on 3 February 2011.
- 1.5. References to 'slides' are to page numbers of the slide deck supplied to the OFT at the meeting on 31 January.

2. Revenue and costs for NewCo

- 2.1. Over what period are the revenue streams to Sky News likely to build up? Slide 8 states 'NewCo will be profitable from day one' but a comment in the meeting suggested that the income may not be immediately in place?

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2.2. Please clarify how the cost and revenue projections that are detailed in the presentation (slides 9 to 14) have been estimated in more detail. Specifically, supported by evidence:

2.2.1. where comparative figures are available, please provide detailed actual cost and revenue figures for the historic performance of Sky News over the last five years;

2.2.2. please provide details for the calculation of the carriage deal revenue;

2.2.3. please provide details of any charges to Sky News that will be renegotiated over the 10-year period;

2.2.4. please provide a detailed breakdown of last year's syndication and advertising revenue by component and compare this with previous years;

2.2.5. where some revenue or charges would be newly created by the creation of NewCo, please advise the detailed basis for the calculation;

2.2.6. please provide a more detailed breakdown of costs by category, comparing actual and projected costs;

2.2.7. if some of the actual or projected costs relate to intra-company charges, please explain the nature of the charges and the methodology for determining their size. How will these charges be determined in the future?;

2.2.8. where services are provided by Sky, have Sky agreed the bases for the projected costs? Who would be the appropriate contact in Sky to confirm these costs from their perspective?;

2.2.9. what proportion of the revenue and costs of NewCo will be determined by News Corp through its ownership of Sky?

3. Risks for NewCo

3.1. Slide 14 identifies events that could lead to a reduction in profitability through reduced income or increased costs. Please quantify and explain the events identified. Please also clarify the period over which the 5 per cent inflation assumption is made.

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- 3.2. Please detail any other contracts or agreement renewals that come up for renewal over the period and account for 5 per cent or more of costs or revenue, with a description of the contract, the associated cost or revenue and an indication of the likelihood, in your view, of different financial outcomes.
- 3.3. From a financial perspective, what circumstances could risk a shortfall in income or an increase in costs of £1m or more over the projected period and how big is the risk? We note that five items are identified in your slide 14.

4. Financial structure of NewCo – balance sheet perspective

- 4.1. Please clarify the expected balance sheet structure for NewCo when it is floated on AIM.
- 4.2. In the meeting, an initial cash injection of £[REDACTED] was mentioned, but this did not seem to affect shareholders funds. Would the cash be provided as a loan or as an initial capital injection?
- 4.3. How would NewCo's balance sheet structure e.g. asset resources provide support for any loans NewCo chose to raise?

5. Long term viability of NewCo – the carriage agreement

- 5.1. Please provide evidence, by reference to equivalent examples, of why a 10 year carriage agreement will be of sufficient duration for NewCo to be said to be viable in the long term.
- 5.2. Please provide relevant evidence on the comparability of the overall value of the envisaged carriage fee agreement, relative to industry norms.
- 5.3. Please explain the assumptions for the pspm fees (see slide 11). How does this break down in expected real terms between basic, HD [REDACTED] [REDACTED] over the years projected? How does this compare with other third party channel deals you have entered?
- 5.4. Please provide details of the lengths of the carriage agreements that Sky currently has with other providers (see slide 18), including the three longest duration carriage agreements.
- 5.5. Please explain how NewCo's business model, viability and commercial position would be impacted by an expiry of the 10 year carriage

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agreement. In particular, whether the finite nature of the carriage agreement would:

- 5.5.1. affect NewCo's ability to attract and retain talent;
- 5.5.2. impact on NewCo's borrowing ability; and
- 5.5.3. otherwise impact on NewCo's ability to develop and expand its business.

In responding to the questions in this paragraph 5.5, please explain why NewCo's position under the UIL would be as strong as its current position within Sky.

- 5.6. What would be the impact for NewCo of Sky developing an alternative supplier of news programming during the carriage agreement?
- 5.7. Please specify precisely what would constitute a 'material breach' of the carriage agreement (paragraph 4.4(iii) of the UIL and slide 18).
- 5.8. How will any requirements for further supply of Sky News, e.g. to new media channels, be agreed? Are any additional requirements to be included in the contractual arrangements?

6. Brand licensing agreement

- 6.1. Please provide the brand licensing agreement with Sky Deutschland (see slide 19).
- 6.2. Please explain why the brand licensing agreement is structured in a 7 year + 7 year + 3 year format given the carriage agreement is for 10 years (see paragraph 4.5 of the UIL).
- 6.3. Please specify what would constitute a 'material breach' of the brand licensing agreement (paragraph 4.6(iii) of the UIL and page 19 of the presentation).
- 6.4. What specific terms in the brand licensing agreement would allow costs to increase and will any potential increase be capped?

7. Existing contracts relating to Sky News

- 7.1. Please provide a full list of third party consents that are required in relation to the transfer of Sky News to NewCo (see slide 17). Please

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also confirm the third party consents required for each of the contracts listed in paragraph 4.2 of the UIL.

- 7.2. Please confirm what is meant by 'the benefit and burden of all or substantially all contracts to which Sky News is party associated with fixed newsgathering' in paragraph 4.2(iv) of the UIL.
- 7.3. Please provide the length and remaining duration of each of the contracts listed in paragraph 4.2 of the undertakings.
- 7.4. Please explain how the expiry of the existing capacity agreement with Arqiva in respect of the broadcast of Sky News on Freeview will impact upon the business of NewCo (para 4.2 (ii) UIL).

8. Operational agreements

- 8.1. Please provide details of the staff currently engaged principally in the Sky News business who will not transfer to NewCo (paragraph 4.1(ii) of the UIL).
- 8.2. Please comment on the absence of a non-solicitation obligation in relation to the staff transferred to Sky News.
- 8.3. Please explain which assets (including personnel, licences, contracts etc.) of the Sky News business will not be transferred to NewCo (paragraph 4.1(i) of the UIL).
- 8.4. Please comment on what is meant by 'Arrangements will also be made for NewCo to have the use of assets which are not used exclusively in the Sky News business on normal market terms if so requested by NewCo' (paragraph 4.1(i) of the UIL). Specifically:
 - 8.4.1. what assets are envisaged and how extensive are they?
 - 8.4.2. how are 'normal market terms' to be agreed?
 - 8.4.3. what is the position in the event that terms could not be agreed?
- 8.5. Please explain what would happen in the event that Sky and NewCo were unable to agree operational agreements as detailed on page 20 of the presentation and paragraph 5.1 of the UIL.

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8.6. Please explain how, in practical terms, NewCo will be independently viable given its physical proximity to Sky (in terms of the lease of the Sky News land and buildings).

9. Shareholding structure in NewCo

9.1. Please explain what you believe would be likely to happen to the shareholder profile of NewCo once it was admitted to trading.

9.1.1. Would the existing shareholders of Sky wish to retain shares in NewCo?

9.1.2. What could the impact be on NewCo of a large number of its shares changing hands soon after admission to trading?

9.2. Please provide the investment bank opinion confirming NewCo would be appropriate for admission to trading on AIM (referred to in slide 25).

9.3. Please explain what legal form the voting restriction in paragraph 3.1(i) of the UIL would take, other than the restriction in the UIL.

10. Governance of NewCo

10.1. Please explain what protection there would be against NewCo amending the protections detailed in page 21 of the presentation intended to be built into its Articles of Association (so as to provide superior corporate governance protections to those required by an AIM listing). (Note: NewCo would not be a signatory to the UIL).

10.2. Please comment on how the board of NewCo would be determined and appointed. Please confirm whether NC or Sky would have any representatives on the board.

11. Implementation of the UIL

11.1. Please explain why a 9 month period would be required in the event that the transaction is not recommended to effect the spin-off of Sky News into a publicly traded company (paragraph 2.1 of the UIL and slide 23). Please explain whether, and if so, why, this is the shortest time that is feasible.

11.2. Please explain why, in the event that the transaction is not recommended, no interim protection would be required for the period pending 'spin-off' of Sky News.

12. News' future acquisition of shares in NewCo

12.1. Please explain why the fact that further acquisition of shares by News would be subject to the takeover code and could lead to a 'relevant merger situation' (slide 24) means that a non-reacquisition clause is not required to be included in the UIL. In providing your answer, please explain why the standard provision in OFT undertakings in lieu does not, in your view, apply in this situation.

13. Monitoring

13.1. Please explain your view that the structure of NewCo, and the obligations imposed on it, would reduce the monitoring burden on the OFT in terms of compliance with the UIL.

13.2. Please explain whether you believe there would be value in having a monitor appointed (potentially with an arbitrator function in relation to the obligation on News to agree further agreements).

14. Clear-cut standard for UIL

14.1. Please explain why you believe the UIL satisfy the 'clear cut' standard that the OFT applies in relation to UIL, in particular with regard to:

14.1.1. the dependence of NewCo on Sky for its principal revenue stream, having regard to the finite duration of the carriage agreement and the brand licensing agreement;

14.1.2. the fact that the brand licensing agreement is terminable in the event of a change of control of NewCo; and

14.1.3. the nature and extent of the ongoing links between Sky and NewCo.

15. Other queries on the UIL

15.1. Please explain why post-closing, Sky should be treated as an 'Affiliate' of News for the purposes of paragraph 6.3 of the UIL.

OFT

1 February 2011