

[Redacted]  

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**From:** Ellison, Jordan [Redacted]  
**Sent:** 17 May 2011 23:07  
**To:** Guy Black  
**Cc:** LOUVEAUX, Bertrand  
**Subject:** FW: FW: B SkyB consultation  
**Attachments:** Response To Consultation.pdf

Dear Guy

I hope all is well.

Please see below an email from DCMS on publication of the alliance's response to the SoS's consultation.

I don't think there is anything confidential in the response which it would be sensible to redact. However, perhaps you could let me know whether the alliance members would be happy for the document to be published or would prefer it was not published?

Happy to discuss.

Best regards

Jordan

**Jordan Ellison**  
Slaughter and May  
[Redacted]

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**From:** [Redacted]  
**Sent:** 17 May 2011 15:46  
**To:** Blanchard, Tim  
**Cc:** [Redacted]  
**Subject:** B SkyB consultation

Thank you for your response to the consultation on the undertakings in lieu in respect of the proposed acquisition by News Corporation of up to 60.9% of B SkyB Group PLC.

Whilst we are analysing the responses received we are writing to you to see if you would be happy either:

- 1) for us to publish your response to the consultation you provided. We understand you provided it marked as strictly confidential.
- 2) if we published a redacted version of your response to the consultation, and if so, could you provide us with one that you are happy with.
- 3) if you would prefer that we did not refer to your response in our summary of responses.

I would be grateful if you could let us know what your preference would be within five working days. No final decisions have been taken on whether or when we will publish the responses.

Thank you

Sam

[Redacted]

Department for Culture, Media and Sport

2-4 Cockspur Street

London

SW1Y 5DH

[Redacted]

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**RESPONSE TO NOTICE OF CONSULTATION ON THE PROPOSED  
ACQUISITION BY NEWS CORPORATION OF UP TO 60.9% OF BRITISH SKY  
BROADCASTING GROUP PLC**

**1. Introduction**

- 1.1 This paper contains submissions made on behalf of BT, Guardian Media Group, Associated Newspapers Limited, Trinity Mirror Plc, Northcliffe Media and Telegraph Media Group (together, the "**Concerned Parties**") in response to the Department for Culture, Media and Sport's Notice of Consultation on the proposed acquisition by News Corporation of up to 60.9% of British Sky Broadcasting Group PLC ("**BSkyB**").

**2. Executive Summary**

- 2.1 The Secretary of State's proposed remedy (and the process through which it has been formulated) represent an unprecedented departure from normal standards as applied under the UK's merger control regime. Furthermore, the Secretary of State has departed from the advice of the Office of Fair Trading (the "**OFT**") in accepting a proposal which offers no effective or lasting solution to the plurality concerns raised by the merger.
- 2.2 OFCOM found that News Corporation's proposed acquisition of BSkyB (the "**Takeover**") would give rise to serious plurality concerns and threaten to operate against the public interest. It therefore recommended that the Takeover be examined by the Competition Commission ("**CC**"). Detailed consideration by the CC could only legitimately be dispensed with if any undertaking in lieu ("**UIL**") of reference addressed the concerns in a clear-cut manner that removes all material doubts.
- 2.3 The UIL proposed by News Corporation entirely fails to address the plurality concerns. To be effective, the remedy would need to ensure that Sky News remains independent of News Corporation. In reality, the UIL will make Sky News almost entirely dependent on News Corporation. For example, Sky News will be:
- (i) Dependent upon a contract with News Corporation for 85% of its revenues (and 25% of its costs).
  - (ii) Dependent upon News Corporation to distribute its TV news output on the BSkyB network.
  - (iii) Dependent upon News Corporation for its future existence – since Sky News will be unviable were the carriage agreement not to be renewed.
- 2.4 In these circumstances it is fanciful to expect that Sky News will enjoy any meaningful independence allowing it to offer a separate contribution to news plurality. Instead, the editors and directors of Sky News will be acutely aware that the viability of the company (and therefore their own job security) depends entirely on maintaining the approval of News Corporation.

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- 2.5 The Secretary of State's answer to these concerns appears to rely on governance provisions. As the Secretary of State is aware, however, such behavioural obligations are ineffective in the absence of genuine structural independence. James Murdoch, Chairman of BSkyB, expressed the position succinctly as follows:

*"[W]e must have genuine independence in the news media. Genuine independence is a rare thing. No amount of governance in the form of committees, regulators, trusts or advisory boards is truly sufficient as a guarantor of independence...On the contrary, independence is characterised by the absence of supervision and dependency."*<sup>1</sup>

- 2.6 Over the "short and medium" term, the remedy contained in the UIL is therefore deeply flawed. But over the longer term, it is simply non-existent. The likelihood is that Sky News will cease to exist after 10 years unless News Corporation decides to extend the carriage agreement. The OFT expressed the problem clearly when it stated that:

*"[T]he UIL are unlikely to be effective over the long term; the finite duration of the carriage agreement is a practical and financial issue which poses a significant risk to the operation of the UIL beyond 10 years (and possibly earlier)."*<sup>2</sup>

- 2.7 Nonetheless, the Secretary of State is proposing to accept News Corporation's proposal despite its failure to include a lasting remedy. He appears to do so simply on the basis that the current plurality problems might disappear over the next few years. There is, however, no apparent evidence to support such an assessment (indeed, the Secretary of State himself does not explain how it might occur). In effect, he is asking the general public (rather than News Corporation or BSky B) to take the risk that it does not occur. Again, this approach is entirely out-with the normal standards as applied under the UK's merger control regime and, indeed, contrary to the Department of Culture, Media and Sport's role as being "responsible for representing the public interest in media industry mergers".<sup>3</sup>

- 2.8 In sum, the proposal completely fails to address the serious plurality issues raised by the Takeover. Any such decision to accept the UIL would fail to meet basic public law requirements of reasonableness and would show a cavalier disregard for the public interest in maintaining news plurality in the UK.

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<sup>1</sup> James Murdoch – MacTaggart Lecture (2009).

<sup>2</sup> Paragraph 1.18, OFT report dated 11 January 2011.

<sup>3</sup> See [http://www.culture.gov.uk/what\\_we\\_do/media\\_mergers/7766.aspx](http://www.culture.gov.uk/what_we_do/media_mergers/7766.aspx)

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**3. The Plurality Concerns**

- 3.1 The Takeover gives rise to plurality concerns which have been recognised by both OFCOM and the Secretary of State. The core of these concerns is that News Corporation (as the largest supplier of national newspapers in UK) and Sky News (as one of only three suppliers of TV news and one of only two suppliers of national radio news) are two of the most important voices in the UK news media, such that combining them would result in an insufficient plurality of news suppliers post-Takeover.
- 3.2 It follows that the plurality concerns can only be addressed by ensuring that News Corporation and Sky News remain as separate contributors to news plurality in the UK. Any UIL which allows News Corporation to influence Sky News will not achieve the key requirements of ensuring that they remain as separate and independent contributors to news plurality.

**4. Key Requirements for a Genuine Remedy**

- 4.1 Any genuine remedy must ensure that Sky News is a viable, independent operator post-Takeover. Sky News can only be an independent source of news plurality if it has (i) editorial, (ii) financial, (iii) commercial and (iv) operational independence from News Corporation. Some of the implications are as follows:
- (i) Editorial independence – this would require Sky News to have freedom from direct or indirect editorial influence.
  - (ii) Financial independence – this would require Sky News to have access to sufficient sources of income to fund its own news-gathering and distribution without reliance on News Corporation.
  - (iii) Commercial independence – this would require Sky News to have its own market presence and a sustainable third party customer base.
  - (iv) Operational independence – this would require Sky News to be free from any ability for News Corporation to impede the operation of Sky News or the distribution of its content.
- 4.2 Any UIL must ensure Sky News' independence on each of these parameters if it is to provide a genuine remedy to OFCOM's plurality concerns. It is unrealistic to expect editorial independence in the absence of the other forms of independence.
- 4.3 Importantly, to fulfil the OFT's standard for a "clear-cut" remedy, there "*must not material doubts about the overall effectiveness of the remedy in solving the problem*".<sup>4</sup>

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<sup>4</sup> Paragraph 5.8, OFT Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance (December 2010).

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**5. Proposed UIL will Remove Sky News' Independence**

- 5.1 News Corporation's proposal fails to ensure the independence of Sky News on any of the above parameters.
- 5.2 Currently News Corporation does not exercise control over Sky News or its output. BSkyB previously reported to the CC, in the context of *BSkyB/ITV* that "*neither News Corporation nor any of its subsidiaries has the ability to influence BSkyB's...news content.*"<sup>5</sup> Similarly, News International reported that it "*did not intervene or influence the presentation of news content, choice of stories or editorial stance taken by Sky News...*"<sup>6</sup> In addition, the CC has reported that "*we received no evidence from third parties to suggest that senior executives at BSkyB or its parent companies exerted influence on the Sky News agenda*".<sup>7</sup>
- 5.3 This is in stark contrast to the position post-Takeover, where under the Secretary of State's proposal, the relationship between Sky News and News Corporation will be characterised by almost total dependence. For example, Sky News will be:
- (i) Dependent upon a contract with News Corporation for 85% of its revenues and 25% of its costs.
  - (ii) Dependent upon News Corporation to distribute its TV news output on the BSkyB network.
  - (iii) Dependent upon News Corporation for its ongoing existence, since Sky News will be unviable if the carriage agreement is not renewed.
- 5.4 Furthermore, while the UIL offers a weakened and dependent Sky News in the short term, it offers absolutely no remedy to the plurality concerns in the longer term (in the lead up to and following the expiry of the 10-year carriage agreement). In effect, the Secretary of State's only proposal for the plurality concerns in the long term is to hope that they will disappear over time.
- 5.5 We now consider each of these fundamental defects in more detail.

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<sup>5</sup> Paragraph 5.29, CC report into *BSkyB/ITV*.

<sup>6</sup> Paragraph 35, Appendix I to CC report into *BSkyB/ITV*.

<sup>7</sup> Paragraph 5.57, CC report into *BSkyB/ITV*.

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## 6. Dependence

(A) Revenue Dependence

- 6.1 The viability of Sky News will depend on a single carriage agreement with News Corporation. OFCOM stated that about 85% of Sky News' revenues will come from News Corporation. OFCOM itself notes that this will make Sky News "*commercially dependent on its relationship with the merged News Corporation/Sky entity*".<sup>8</sup> Furthermore, rather than Sky News becoming increasingly independent, it is expected that its dependence on News Corporation revenues will actually increase over time.<sup>9</sup> It is clear that Sky News cannot be considered financially or commercially independent of News Corporation where the latter is by far its largest customer and its main source of revenue.
- 6.2 Indeed it is as well-established as a matter of UK merger control policy that a divestment remedy is unlikely to be effective where the divestment business has an ongoing supply relationship with the merged entity. The OFT's guidance states that it is rare for it to accept even interim purchase/supply arrangements between the merging parties and the divestment business given the requirement for a clear-cut remedy in lieu of a CC reference.<sup>10</sup> It is therefore highly irregular for the Secretary of State to propose accepting a UIL where the ongoing commercial viability of the divestment business is based almost entirely on a contract with the merged entity and where this state of affairs will persist for the foreseeable life of the divestment business.
- 6.3 Underlying the OFT's standard policy is the valid assumption that in a close commercial relationship (especially one which creates dependence) there will be a multitude of means through which the merged entity could influence the divestment business and therefore nullify the purported rationale for divestment. Given the range of means that a major customer could use to influence a dependent supplier the OFT generally considers that it is simply not possible to ensure the independence of the divestment business in these circumstances.
- 6.4 Consistent with this, it is entirely fanciful to consider that Sky News would be able to disregard the views of News Corporation given the range of means by which News Corporation could, as its major customer, cause difficulties for Sky News. For example: the carriage agreement will inevitably contain a range of obligations which Sky News must perform to be entitled to payment. While editorial stance is not to be one of the

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<sup>8</sup> Paragraph 6, OFCOM letter dated 11 February 2011.

<sup>9</sup> Paragraph 10.3, OFT report dated 11 February 2011. This is based on News Corporation's own forecasts.

<sup>10</sup> Paragraph 5.23, OFT Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance (December 2010).

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relevant conditions, News Corporation could easily pursue complaints on other grounds in an attempt to discourage editorial policy of which it disapproved.<sup>11</sup>

- 6.5 These issues are further compounded by the absence of any real clarity over defined terms used in the UIL. For example, BSkyB is entitled to terminate the carriage agreement upon a "material breach" by Sky News of its obligations under the agreement – the UIL does not elaborate, however, on the interpretation of this phrase.
- 6.6 The dependence of Sky News on News Corporation was confirmed by the OFT who stated that "*the successful operation of Newco relies to some extent on the incentives of News/Sky*".<sup>12</sup>
- 6.7 News Corporation appears to consider that this departure from normal UK merger control standards is justified on the basis that Sky News and News Corporation will not be competitors and, therefore, that News Corporation will have an interest in the ongoing success of Sky News.<sup>13</sup> It is important to note that were the OFT's normal standards to be applied, the merged entity's incentive in respect of the divestment business would be irrelevant – as remedies are supposed to create independent divestment businesses (viable regardless of the incentives of the merged entity). The fact that News Corporation had to resort to its own incentives to argue that Sky News will be viable is in fact confirmation that Sky News will not be independent.
- 6.8 Furthermore, even if it were factually correct that News Corporation has a commercial interest in the ongoing success of Sky News,<sup>14</sup> the argument entirely fails to address the plurality issues. Specifically, it is false to assume that an interest influencing the editorial content of Sky News would involve any commercial sacrifice on the part of News Corporation. First, given the unequal bargaining position of the two companies, even a threat by News Corporation to use its financial and commercial leverage could change Sky News policy without necessarily endangering the success or ongoing operation of Sky News. Secondly, it may simply be the case that the benefits of influencing editorial policy (e.g. increased exposure for News Corporation newspapers) outweigh any costs involved in disciplining Sky News. It is therefore wrong to assume that an interest in the success of Sky News acts as a safeguard against editorial influence.

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<sup>11</sup> Other examples of how News Corporation could discipline Sky News might include degrading the quality of services provided under Clause 5 of the UIL or degrading the scope or quality of distribution (see further below).

<sup>12</sup> Paragraph 1.13, OFT report dated 11 February 2011.

<sup>13</sup> Paragraph 6.4, id.

<sup>14</sup> It is not even clear that this factual assumption is well-founded. For example, there is no restriction on News Corporation setting up its own broadcast news business. Therefore, it may well be the case that News Corporation will have a commercial incentive to hinder the success of Sky News. The OFT noted that News Corporation may not always have an incentive to promote the success of Sky News (see paragraph 1.13, OFT report dated 11 February 2011).



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- 6.9 Accordingly, it is clear that there is no basis to suspend the normal standards as applied under the UK's merger control regime. These standards would clearly indicate that a remedy that leaves the divestment business fundamentally reliant on the merged entity is not an effective remedy.

(B) Distribution Dependence

- 6.10 Sky News will lack operational independence. Crucially, Sky News will rely heavily on the BSkyB network for almost all of its TV distribution activities (and therefore access to audience) – this proposal represents a significant departure from arrangements typically applied in divestment scenarios under UK merger control policy.<sup>15</sup> The UIL gives no detail on what (if any) obligations will be imposed upon News Corporation to distribute Sky News on its network (see further below). Moreover, whatever distribution obligations might be imposed upon News Corporation, it would not be possible to devise obligations which deal with every possible parameter upon which the scope or quality of distribution could be degraded.<sup>16</sup>
- 6.11 Sky News' dependence on News Corporation for distribution is critically important to news plurality for two reasons. First, the ability to degrade or reduce distribution of Sky News gives News Corporation the ability to reduce directly Sky News' capacity to reach the audience and therefore contribute to news plurality. Secondly, the threat of degrading or reducing the distribution of Sky News gives News Corporation leverage which could be used to influence Sky News' editorial policy.
- 6.12 Therefore, it is clear that far from establishing Sky News as an independent news voice, the UIL makes Sky News operationally dependent upon News Corporation.

(C) Dependence on Contract Renewal

- 6.13 Even if one sets aside Sky News' inherent dependence on News Corporation as outlined above, Sky News' lack of independence is further exacerbated by the fact that its continued viability will depend upon winning a renewal of the News Corporation carriage agreement.
- 6.14 It is obvious that non-renewal of the carriage agreement would have severe (and likely terminal) consequences for Sky News, since around 85% of Sky News' revenue will derive from News Corporation. The heavy reliance on the carriage agreement was described in stark terms by the OFT:

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<sup>15</sup> The UIL states that BSkyB will continue to provide IT support services, broadcast operations and creative services to Sky News. In addition, the UIL also envisages that Sky News will rely on News Corporation for, *inter alia*, marketing and technical support.

<sup>16</sup> For example, OFCOM notes the likelihood of changing consumption habits over the next ten years. It is not clear, however, that News Corporation will be under any obligation to distribute Sky News through new channels such that it remains relevant.

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*"The financial viability of Newco – and therefore the continued operation of Sky News – relies on the existence of a proposed carriage agreement between News and Newco, without which Newco would be significantly loss-making."<sup>17</sup>*

- 6.15 It is clearly unrealistic to expect that Sky News will provide an independent news voice when its directors and employees know that failure to win the approval of News Corporation (and thus renewal of the carriage agreement) would result in such severe financial consequences. The absolute imperative to win contract renewal will profoundly influence decision-making at all levels within Sky News. For example:
- (i) Directors of Sky News (including the independent directors) will have a legal obligation (as well as a commercial incentive) to act in the best interests of the company. Maintaining the approval of News Corporation must therefore be the directors' first priority, since renewal of the carriage agreement will be essential to the continued viability of the company. The scope for these directors to be influenced by News Corporation is clear. However, the proposed UIL makes these same directors responsible for ensuring the editorial independence of Sky News.
  - (ii) The senior editorial staff of Sky News will be accountable to the directors with the incentives outlined above. Thus staff will be aware that choosing to adopt an editorial policy disapproved by News Corporation would run counter to the clear incentives of those responsible for hiring, firing and promotions within Sky News. Moreover, even if editorial staff could be expected to ignore the wishes of their bosses, they will also have a direct personal interest in contract renewal - since non-renewal will place the financial viability of Sky News (and therefore their jobs) in grave danger.
- 6.16 In light of the above incentives, it is clearly unrealistic to expect that Sky News will be able to offer an independent news voice. For example:
- (i) Were another News of the World phone-hacking scandal to arise before or during the re-negotiations of the carriage agreement, is it realistic to expect that Sky News would rigorously investigate and report on any such illegal activities within News Corporation?
  - (ii) Were there to be a general election campaign before or during the re-negotiation of the carriage agreement and all of the News Corporation newspapers supported one party, is it realistic to expect that Sky News would rigorously investigate and report on a major scandal affecting that party?

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<sup>17</sup> Paragraph 1.10, OFT report dated 11 February 2011.

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- 6.17 In each case, Sky News could only be expected to provide an independent news voice if its directors and editorial staff are expected to act with complete disregard for their own job security and success of the company.
- 6.18 Both the OFT and OFCOM have recognised that contract renewal is likely to have an impact on Sky News during the 10-year term. The OFT stated that "*uncertainty about the prospects for renewal of the carriage agreement on equivalent terms may begin to affect Newco some years before its term date*"<sup>18</sup> and OFCOM stated that the effectiveness of the UILs "*may start to diminish in the run up to the end of 10 year period*".<sup>19</sup> The Secretary of State appears to ignore this advice and to assume instead that the UIL will be effective for 10 years.
- 6.19 In circumstances where Sky News will be dependent upon News Corporation for its continued existence it is irrational to conclude that Sky News can be expected to act as an independent source of news plurality.

**7. Governance Provisions do not Address Dependence**

- 7.1 As outlined in Section 4 above, editorial independence is impossible if Sky News does not also enjoy financial, commercial and operational independence. For the reasons outlined in Sections 5 and 6 above, it is clear that given Sky News' lack of financial, commercial or operational independence, it is entirely unrealistic to expect that it would have sufficient editorial independence to constitute a distinct news voice. This analysis is not altered by the governance provisions contained in the UIL.
- 7.2 The two main governance elements of the UILs which are intended to safeguard independence are:
- (i) the appointment of independent directors, and
  - (ii) a commitment in the articles of association to abide by the principle of editorial independence (together with a governance and editorial board to oversee such matters).
- 7.3 Neither of these elements will be effective given Sky News' lack of financial, commercial or operational independence.
- 7.4 First, as regards the independent directors, the structural dependence of Sky News upon News Corporation means that, even if a director has no other relationship with News Corporation, he will have a clear incentive to maintain the approval of News Corporation. Any independent director will have a commercial incentive (and legal obligation) to promote the success of Sky News. Since Sky News will be dependent

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<sup>18</sup> Paragraph 1.13, id.

<sup>19</sup> Paragraph 24, OFCOM letter dated 11 February 2011.

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upon News Corporation any director will therefore have an incentive to maintain the approval of News Corporation. Accordingly, the independent directors who are supposed to police the editorial independence of Sky News will have to do so in circumstances where taking a stand against News Corporation would be contrary to their other incentives and duties.

7.5 Second, the safeguards for editorial independence as contained in the UIL are weak and of the nature that News Corporation has previously being able to circumvent (see further below). In particular:

- (i) Only one of the independent directors will be required to have editorial or senior journalistic experience; and
- (ii) The effectiveness of the UIL relies on an unspecified "*principle of editorial independence and integrity in news reporting*". As noted above, senior editorial staff of Sky News will be accountable to Sky News' directors who also have incentives to maintain the approval of News Corporation. Thus staff will be aware that choosing to adopt an editorial policy disapproved by News Corporation would likely be considered an extreme and risky step. Moreover, in practice, true editorial independence is exerted on a day-to-day basis and operationally rather than *in extremis*. The proposal to establish a committee to oversee the safeguard of such editorial independence would therefore likely fail to provide an adequate means to police whether such independence is in fact being maintained on a day-to-day basis.

7.6 Third, even aside from the lack of genuine independent oversight, experience demonstrates that behavioural obligations are entirely ineffective in ensuring editorial independence. In particular, since editorial independence is difficult to define it is very difficult to identify and prove clear breaches of the principle. Precedents suggest that News Corporation has previously taken advantage of this fact to circumvent editorial independence undertakings.

7.7 Fourth, were News Corporation to attempt to influence (directly or indirectly) the editorial independence of Sky News, for example by objecting to the reporting of and/or investigation into another News of the World phone-hacking scandal, there is no explicit right of redress provided for in the UIL in order to address such concerns. The relevant obligations in the UIL merely require the editorial committee to "*consider representations made by the head of Sky News...and report any such representations to the board of Newco*".

7.8 For example, the Concerned Parties have previously provided OFCOM (and the Department of Media and Sport) with a range of evidence on the ineffectiveness of the editorial independence undertakings provided by News International when it purchased The Times in 1980. This includes evidence from two editors and one of the independent directors that the undertakings were ineffective. This evidence is

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consistent with the view of the House of Lords Committee on Communications which stated that "*it is questionable how effective the Independent National Directors [the system required by the undertakings] have been...*"<sup>20</sup> Indeed, similar deficiencies can also be identified with the commitments given to ensure editorial independence in the context of the acquisition of the Wall Street Journal by News Corporation in 2007.<sup>21</sup>

- 7.9 The ineffectiveness of undertakings and committees to ensure independence in circumstances of financial dependence was perhaps most eloquently expressed by James Murdoch, Chairman of BSkyB, when he stated that:

*"[W]e must have genuine independence in the news media. Genuine independence is a rare thing. No amount of governance in the form of committees, regulators, trusts or advisory boards is truly sufficient as a guarantor of independence...On the contrary, independence is characterised by the absence of supervision and dependency."*<sup>22</sup>

- 7.10 Accordingly, it is clear that the governance provisions are wholly ineffective in the context of Sky News' dependence upon News Corporation.

## 8. News Corporation's shareholding should in fact be reduced

- 8.1 As discussed in the preceding Sections of this paper, it is clear that News Corporation's continuing 39.1% shareholding in Sky News after the spin-off will therefore result in Sky News remaining heavily dependant on News Corporation. As a consequence, News Corporation will have the ability to influence significantly Sky News' editorial policy in direct contradiction of the key objective of the UIL to address any such plurality concerns.
- 8.2 Indeed, News Corporation may argue that, since the proposed ownership structure of Sky News mirrors the current distribution of control over BSkyB, the remedies envisaged by the UIL would ensure that there is no change in the degree of influence that News Corporation holds over Sky News (i.e. that when compared to pre-Takeover, the remedy merely preserves the *status quo*).
- 8.3 Any such argument is, however, deeply misguided. It is clear from the above discussion that News Corporation will in fact hold increased influence over Sky News post-Takeover. In particular, through the Carriage Agreement, News Corporation will gain further influence over Sky News as a result of Sky News' financial dependence on News Corporation for c. 85% of Sky News' revenues. Moreover, it is clear that the governance provisions envisaged by the UIL fail to allay these concerns.

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<sup>20</sup> Paragraph 217, House of Lords Select Committee on Communications: "*The Ownership of the News*" (2008).

<sup>21</sup> See submission to the OFT and OFCOM by Enders Analysis, entitled "*The use of a behavioural remedy to rectify the loss of plurality resulting from the purchase of BSkyB by News Corporation*", for further details.

<sup>22</sup> James Murdoch – *MacTaggart Lecture* (2009).

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8.4 In light of the above, therefore, instead of maintaining the *status quo* with regard to News Corporation's shareholding in Sky News (by reference to the present ownership structure of BSkyB), any remedy envisaged by the UIL should in fact reduce News Corporation's shareholding in Sky News post-Takeover in order to ensure the remedy is adequate and takes account of this increased influence that News Corporation will enjoy over Sky News through, *inter alia*, the Carriage Agreement.

**9. No Lasting Remedy**

9.1 Even if one sets aside all the concerns (as set out above) as to Sky News' dependence upon News Corporation during the 10-year term of the carriage agreement, the UIL suffers from another profound defect: it makes no provision to protect news plurality on an ongoing basis. Instead, the UIL simply leaves it to News Corporation to decide (by virtue of the carriage agreement renewal decision) whether Sky News should continue to exist after 10 years. Therefore, while over the "short and medium" term the remedy contained in the UIL is deeply flawed, over the long term it is simply non-existent. This is completely contrary to normal merger control standards which require a divestment remedy to effect a lasting change in the market structure.<sup>23</sup>

(A) OFT/OFCOM Advice

9.2 There is no doubt that the viability of Sky News will be in severe jeopardy if the carriage agreement is not renewed after 10 years. The OFT explained that:

*"in the context of ensuring the 'long-term' viability of Newco and the UIL, it is important to consider whether Newco can continue as a standalone entity on a permanent or lasting basis. It is clear that, absent the revenue stream provided by the carriage agreement, Newco is effectively loss-making. As a consequence, absent renewal on a similar basis, an alternative revenue stream, or being acquired, there is a real risk that Newco may not survive as envisaged by the UIL beyond the term of the carriage agreement."*<sup>24</sup>

9.3 The OFT states that this threat to the survival of Sky News threatens the efficacy of the UIL: "*the finite duration of the carriage agreement, in particular, entails a material risk to the long term viability of Newco and hence the UIL*".<sup>25</sup> The OFT went on to describe the finite duration of carriage agreement as an "*essential structural limitation of the UIL*"<sup>26</sup> and stated that it had been unable to identify any improvements to the UIL which would address this flaw.

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<sup>23</sup> See, for example, paragraph 22, Commission Notice on remedies acceptable under the Council Regulation (EC) No 139/2004 and under Commission Regulation (EC) No 802/2004.

<sup>24</sup> Paragraph 1.16, OFT report dated 11 February 2011.

<sup>25</sup> Paragraph 1.15, *id.*

<sup>26</sup> Paragraph 1.17, *id.*

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9.4 OFCOM agreed to characterise the carriage agreement as “long term”. The Secretary of State’s press release dated 3 March 2011 implies that this amounted to advice from OFCOM on the appropriate time-frame for assessment. In reality it seems to be nothing of the sort. Whilst offering the semantic categorisation of 10 years as “long-term”, OFCOM says absolutely nothing as to whether 10 years is an appropriate frame of reference nor does it endorse the Secretary of State’s view that there is no need for a remedy in the later period. On the contrary, OFCOM pointedly agreed with the OFT’s analysis of limitations created by the finite duration of the carriage agreement and stated that “*the proposed UILs are not a permanent solution*”.<sup>27</sup> The Secretary of State should not seek to disguise the fact that: (i) he is proceeding with a UIL which the OFT has advised would be ineffective within 10 years; and (ii) OFCOM has not endorsed his view that a 10 year contract is an appropriate lasting remedy.

(B) No Remedy Provided

9.5 If we consider the basis upon which OFCOM characterised 10 years as “long-term”, it is clear that this semantic classification could not be taken as answering the OFT’s concerns over the viability of the UIL. After noting its agreement with the OFT’s assessment, OFCOM stated:

*“We consider that a carriage agreement of a 10-year term in the context of industry dynamics in this sector is long term. This is because we consider there is likely to be significant evolution of the market and consumers’ use of news and current affairs over the next decade. As a result, the situation with regard to plurality may be significantly different in 10 years time.”*<sup>28</sup>

9.6 Not only does the OFCOM report omit to state that a 10-year contract is therefore an adequate remedy, its explanation contains important points of fact and principle which highlight that the “long term” epithet does nothing to answer the plurality concerns.

9.7 As a matter of fact, the prediction that consumers’ use of news and current affairs will evolve speaks only of demand for news. It does not even address the supply side much less suggest any basis for believing that there will be significant new entry into the supply of news content over the next few years.<sup>29</sup> Since plurality is driven by the number of suppliers, the evolution of demand is not directly relevant. Given the high fixed costs of entry and financial challenges facing the news sector, the prospects for

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<sup>27</sup> Paragraph 24, OFCOM letter dated 11 February 2011.

<sup>28</sup> Paragraph 24, id.

<sup>29</sup> As outlined in the Concerned Parties’ submission to OFCOM dated 19 November 2010 (which was also provided to the Department for Culture, Media and Sport), although demand for news has changed radically over the past decade, the supply-side structure of the market has remained largely unchanged. For example, while demand for news delivered over the internet has increased significantly – this news is predominantly delivered by existing suppliers – with five established titles accounting for 80% of all online news traffic.

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significant new entry are uncertain. As such, the prediction fails to address OFCOM's concerns as to plurality.

- 9.8 However, aside the factual point, OFCOM's statement raises a critical point of principle. OFCOM notes that the situation with regard to plurality may be different in ten years. Therefore, OFCOM is not saying that that market will have evolved to a degree that the UIL is no longer necessary but only that it sees some uncertainty. In other words, OFCOM is not sure whether or not it will be necessary to have an independent Sky News in 10 years. The critical point of principle is that the risks in this uncertainty should be borne by the parties giving rise the plurality concerns (i.e. the merging parties) and not the public who will would be affected by a reduction in plurality.
- 9.9 The standard approach in merger control is for a remedy to be put in place in perpetuity (or at least for a very long term, e.g. 25 years) so as to guarantee that the concerns raised by the merger are remedied on a lasting basis. If market conditions change such that the remedy is no longer required, then the merged entity has the option to apply to the OFT for the obligations to be released or modified.
- 9.10 Again, the Secretary of State has departed from normal standards as applied under the UK's merger control regime and allowed News Corporation to transfer to the general public the risk that a temporary remedy may result in insufficient plurality in the future. In effect, while recognising that the merger raises plurality concerns, the Secretary of State proposes to attempt to remedy those concerns for only a few years. His only answer for the longer term is to hope something might happen which causes the concerns to disappear.
- 9.11 It is not clear why the Secretary of State considers (contrary to standard UK merger control policy) that the general public rather than News Corporation should bear the risk of uncertainty over the future outlook. This approach is not only at odds with standard UK merger control policy, but is also irrational and shows insufficient regard for the seriousness of the issues at stake.

**10. Insufficient Consultation**

- 10.1 As noted above, several aspects of the review process have been highly irregular. Rather than follow OFCOM's advice and send the Takeover for review by the CC the Secretary of State added an additional stage of the review process. During this stage the Secretary of State opted to afford News Corporation privileged access and negotiated a deal in private without input from third parties.
- 10.2 It appears that this defect is to be repeated: the current public consultation is taking place without information on many of the key elements of the proposed arrangements. For example, the key terms of carriage agreement are essential to the assessment of the UIL, including details of the financial commitments agreed between the parties. The OFT states: "*It is clear that a Sky carriage agreement in place on sufficiently long and*



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*financially viable terms is fundamental to Newco's ability to cover its costs from the outset, and hence to its viability.*<sup>30</sup> Yet, despite the key importance of the terms of this contract, it seems that third parties will be given no opportunity to comment. The genuine viability of Sky News as an independent business remains unproven to the general public.

10.3 Some of the key unknown elements of the contract are as follows:

- (i) Distribution – as outlined above, it is not clear what (if any) obligations will be placed upon News Corporation to distribute (as opposed to simply purchase) Sky News. Since Sky News' ability to contribute to news plurality depends on its widespread distribution, this omission is clearly unacceptable.
- (ii) Ability to Invest – OFCOM has noted that the consumption of news is likely to evolve over the next few years. As a result, it is possible that Sky News will need to make significant investment in order to continue to make viable contribution to news plurality. Without more information the Concerned Parties cannot comment in an informed manner on how the UIL will affect Sky News' ability to invest. For example, while the OFT report suggests that the payments will allow Sky News to cover its costs, it is not clear whether payments match the historic subsidies previously granted to Sky News by BSkyB. If not, the proposals will result in Sky News being less able to invest than pre-Takeover. This is particularly important given the concerns raised by the OFT that Sky News may face difficulties in raising finance for investment: *"the smaller size of Newco, compared with being a part of Sky, could create challenges if significant funds are required to finance investment in new technology."*<sup>31</sup>
- (iii) Public Listing – In its report to the Secretary of State, the OFT indicates that, given the limited time available to provide its views, it is unable to advise on the prospects of success of the shares of Newco being admitted for public trading. Although, the OFT's report (in its redacted form) goes on to suggest that a legal opinion submitted by News Corporation addresses any potential concerns over the feasibility of a public listing, no visibility has been provided as part of the public consultation process as to the grounds on which News Corporation's opinion is based. Consequently, it is impossible for the Concerned Parties to examine the legitimacy of any such grounds.

Moreover, to the extent that Newco's shares could not in fact be listed for public trading, this would likely result in the financial independence of Sky News being diminished even further. In particular, the financial strength of Sky News would be harmed since, without such public listing, it would be significantly more difficult for Sky News' to raise, if necessary, additional (equity) capital. As a

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<sup>30</sup> Paragraph 10.6, OFT report dated 11 February 2011.

<sup>31</sup> Paragraph 12.13, id.

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consequence, this would likely result in Sky News becoming even more dependent on News Corporation through its key revenue generating contracts (without the Carriage Agreement, Sky News *"would be significantly loss making"*) and would likely also have similar negative effects on news plurality for the same reasons discussed further above.

- 10.4 In addition, other apparent deficiencies in the content and scope of the UIL can be identified. For example:
- (i) The limited restrictions on ownership of the remaining share of Sky News not already owned by News Corporation fail to address concerns over parties that are somehow allied with News Corporation acquiring these shares. For example, the UIL does not appear to prevent the acquisition of shares in Sky News by Rupert Murdoch (or other members of his family) acting in a personal capacity.
  - (ii) The obligations imposed on News Corporation will largely be enforced through the Articles of Association of Sky News. It would remain possible, therefore, for a number of these protections to be circumvented through a simple amendment of the these Articles
- 10.5 The Secretary of State's failure to provide information on key terms of the arrangements undermines the public consultation. This is the latest in a succession of procedural and substantive irregularities.
- 10.6 The Concerned Parties strongly urge the Secretary of State to reconsider his provisional decision and instead ask the CC to provide the thorough review required properly to address the Takeover's threat to news plurality.

**Slaughter and May**  
**11 March 2011**

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