



PROPOSED ACQUISITION BY NEWS CORP OF BSKYB
UNDERTAKINGS IN LIEU PROPOSAL
RESPONSE TO OFT QUESTIONS OF 7 FEBRUARY 2011

Defined terms in this response shall have the same meaning as in News' response to the OFT's questions of 1 February (the First OFT Response). This response contains highly sensitive commercial information and therefore News requests the confidential treatment of the entire content of this response.

Questions for News

- 2.1. *Non-solicitation – News states that neither Sky nor News will be a direct competitor of the spun-off Sky News business and therefore a non-solicitation clause is unnecessary. However, what would prevent News launching a neighbouring channel, such a current affairs channel, from which it might acquire staff from Newco? Would News be willing to give a short non-solicitation clause in respect of the employees transferred to Newco?*

Unlike those cases in which a non-solicitation clause is typically required by the OFT in the context of UILs, the Transaction does not involve an acquisition of a direct competitor where the viability of a business to be divested could be threatened if the party who is required to dispose of that business for competition reasons were to poach key staff.

As explained in response to questions 8.2 and 5.6 of the First OFT Response, neither News nor Sky plans to develop a competing supplier of TV news and there is no reason to believe that Sky will seek to acquire staff from NewCo.

News also does not believe that a non-solicitation obligation would make sense in a context where News/Sky continues to rely on NewCo producing quality news output.

It is in any event News' current practice when dealing with companies in which it has an interest never to solicit staff directly but rather, were it to be interested in seeking to employ a staff member currently employed by that company, to approach the company's CEO and to discuss the issue. This would not, of course, fall within the definition of "solicitation" of staff.

For this reason, and without prejudice to its views as to the lack of need for such protection, News would be prepared to give a standard non-solicitation commitment for a short period of time if the OFT took the view that such a commitment was needed.

- 2.2. *Enforcement – at present, the Secretary of State is reliant in terms of the success of the UIL on (a) News' incentives in relation to the continuation of Newco and (b) on Newco's contractual rights under the carriage agreement and brand license agreement vis-à-vis News. Would News be willing to offer commitments to the Secretary of State within the UIL that it would not terminate the carriage agreement and brand license agreement without the prior written consent of the*

OFT (such consent to be given only in the event that the OFT was satisfied there had been a material breach of the agreement that had not been cured)?

NewCo will be an independent company, with independent shareholders and with a board consisting of a majority of independent directors. There is no reason to believe that NewCo would not be in a position to enforce its contractual rights.

All agreements between Sky/News and NewCo will contain provisions relating to choice of law and jurisdiction as is customary in commercial agreements. Moreover, News is prepared, as set out further in response to question 13, to commit to a more specific dispute resolution mechanism (e.g. arbitration) if the OFT considers that an ad hoc mechanism is needed.

These mechanisms will be more than sufficient to enable NewCo to protect its own interests.

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.

Any disputes about material breaches would be resolved through the relevant dispute resolution mechanism.

- 2.3. *Brand licensing agreement – at present, paragraph 4.3 of the UIL requires that the form of the carriage agreement must be approved by the Secretary of State before the UIL are accepted (the 'Effective Date'). Given the importance of the brand licensing agreement, would News be willing for a similar approval mechanism to be adopted in relation to the brand licensing agreement?***

News is willing to provide that the Secretary of State should also approve the form of the Brand Licensing Agreement before the Effective Date.

Should the Secretary of State be minded to accept the proposed UIL and issue a consultation notice, News' suggestion would be that detailed heads of terms for both the Carriage Agreement and the Brand Licensing Agreement are provided to and agreed with the Secretary of State while a public consultation on the UIL is ongoing.

- 2.4. *Corporate governance – Articles – although News is clearly not in a position to change the Articles of NewCo itself, would News be willing to give an undertaking that it would vote against a change to the Article of Association designed to remove the superior governance provisions and board design detailed in paragraph 3.1(ii) – (iv) of the UIL?***

A change in the Articles of Association of NewCo would require the approval of 75% of the votes cast at a general meeting.

Therefore News would only have the power to prevent a change in the Articles of Associations of NewCo insofar as it remains a shareholder with voting rights of more than 25% of the votes.

On that basis News is prepared to agree to vote against any change in NewCo's Articles of Association which would remove the governance provisions provided for in sections 3.1 (ii) to (iv) of the draft UIL for so long as no single shareholder group has more than 50% and News has the right to vote more than 25% of the shares in NewCo.

- 2.5. *Corporate governance – Board – please comment on whether NewCo might struggle to attract suitable talent for its board given the significantly contracted focus of its activities compared to Sky.***

News believes that a position on the board of NewCo, an independent media company active in news provision, will be an attractive one for a director to hold.

Recently Channel 4 appointed four new non-executive directors, who are leading figures in retail, law, property and consumer product sectors. There is a high interest among qualified executives to gain closer knowledge and understanding of digital media businesses. Moreover, NewCo's reputation for quality is likely to draw interested candidates.

Many companies of similar size operate successfully with committed and appropriately experienced boards.

2.6. Corporate governance – Board – the proposed ULL require that the majority of the board shall comprise 'non executive directors determined by that board to be independent'. What is meant by 'independent' in this context? How would such a requirement be enshrined in Newco going forward?

Please refer to question 12 of News' response to Ofcom's information request of 3 February 2011 (the Ofcom Response).

Provision B.1.1 of the UK Corporate Governance Code (the Code) requires the board to determine whether each director is independent by reference to the following principles set out below:

"The board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement. The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director:

- *has been an employee of the company or group within the last five years;*
- *has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;*
- *has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme;*
- *has close family ties with any of the company's advisers, directors or senior employees;*
- *holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;*
- *represents a significant shareholder; or*
- *has served on the board for more than nine years from the date of their first election."*

The Articles of Association of NewCo will require that (i) for so long as no single shareholder group holds more than 50% of NewCo's shares, the majority of the board of NewCo shall comprise non-executive directors determined by that board to be independent; and (ii) NewCo shall adhere to the obligations imposed by the Listing Rules as regards compliance with the principles set out in the Code.

2.7. Corporate governance - Board – how would the initial board members of Newco be determined?

Subject to the requirement of there being a majority of independent directors (as per draft UIL 3.1(ii)), NewCo's board will comprise a mix of executive and non-executive directors (being News affiliated directors and independent directors).

It is News' current intention to conduct a search of suitable candidates which would include the independent directors currently on the board of Sky.

2.8. Corporate governance – chairman of the board – please confirm whether there would be any requirement for the chairman of the board to be independent.¹

There will not be a requirement for NewCo's chairman to be independent. This is the current position in Sky, which the proposed UIL are seeking to replicate.

2.9. Corporate governance – material transactions – the UIL do not contain a definition of ‘material transactions’? Should this term be defined (so as to include at least the carriage agreement and the brand licensing agreement).

In the case of Sky, the audit committee (which consists solely of independent directors) is required to approve any transaction between Sky or its subsidiaries and News or any of its subsidiaries:

- which involve or could reasonably involve the payment or receipt by Sky or its subsidiaries of amounts of £10 million or more but not exceeding £25 million; or
- which involves amounts of £25 million or more.

Any transactions between Sky or its subsidiaries and News or any of its subsidiaries involving amounts of £25 million or more, if approved by the audit committee, must also be approved by the board of Sky.

News is prepared to commit specifically that transactions between NewCo and News/Sky meeting equivalent thresholds would be "material transactions" requiring Audit Committee/Board approval within the terms of paragraph 3.1(iii) of the draft UIL.

In addition, as set out in paragraph 3.1(iii) of the draft UIL, the intention of News is to apply controls on transactions between NewCo and News/Sky which have equivalent effect to those imposed by Chapter 11 of the Listing Rules. The Listing Rules define in some detail the types of transactions which would be caught and which would require prior approvals. Indeed, the principles are widely cast to catch all transactions and arrangements (other than a transaction of a revenue nature in the ordinary course of business).

It is not envisaged that the Carriage Agreement or the Brand Licensing Agreement would require amendments. However, if any changes to either the Carriage Agreement or the Brand Licensing Agreement were needed and those changes were material, they would fall within the scope of the rules.

2.10. Enumeration of assets – would News be prepared to split out in greater detail (in the form of a Schedule used, eg, in the Form RM) the assets and people to be transferred / not transferred?

¹ We note your reply to Ofcom's question 11 that "the decision as to who should be the chairman of the board of NewCo will ultimately rest with the board of NewCo and that decision will be taken by the board as a whole which will include a majority of independent directors".

The OFT considers this would be beneficial given that Sky News is not a distinct enterprise (in the way that most divestment businesses are in a UIL context).

News would be prepared to set out in greater detail the assets to be transferred / not transferred to NewCo in the form of a schedule but notes that such a schedule would have to be prepared in consultation with Sky. Given that such a document would likely take a number of days to draw up, News suggests that the best way forward would be for Sky to provide it to the OFT during the public consultation on the UIL (should the Secretary of State be minded to accept the UIL).

Likewise, News could ask Sky to prepare separately a list of key personnel to be transferred to NewCo. For confidentiality purposes, News expects that Sky will want to identify these personnel by job title / payroll number rather than name.

- 2.11. *Operational agreements – would News be willing to state in the UIL that it will provide the operational agreements detailed in paragraph 5 of the UIL, with termination rights for Newco, and pricing at cost price [REDACTED] included in the contracts, so that the uncertainty in the UIL as presently drafted is removed?*

As set out in detail at slide 15 of Annex 1 to the First OFT Response, News notes that the operational agreements listed at paragraphs 5.1(ii), 5.1(iii) and 5.1(iv) of the proposed UIL will involve charges to NewCo which will be set for the first year, [REDACTED]

[REDACTED]

- 2.12. *Licensing agreement:* [REDACTED]
- [REDACTED]

News can confirm that there will not be an increase in the brand loyalty fee if the licensing agreement is extended beyond the initial 7 years.

- 2.13. *Dispute resolution mechanism – would News be prepared to agree to the inclusion within the UIL of a dispute resolution mechanism in relation to the agreements between News and Newco*

in order to assist in the resolution of any commercial disagreements between News and Newco (and therefore enhance the viability of Newco by avoiding protracted and expensive legal disputes with News)? Would News be willing to agree to the inclusion of some form of monitoring mechanism in relation to the observance of the contractual commitments (see question 2.2).

As noted above, NewCo will be an independent company, with independent shareholders and with a board consisting of a majority of independent directors. There is no reason to believe that NewCo would not be in a position to enforce its contractual rights. Moreover, as noted in the Ofcom Response, the agreements entered into between Sky and NewCo will contain contractual provisions governing disputes and providing recourse in the event of disagreement as to an appropriate dispute resolution mechanism as is common practice in agreements between distinct legal entities.

However, should the OFT feel it necessary to ensure the practical and financial viability of the proposed UIL, News would be willing to include a more specific dispute resolution mechanism (e.g. arbitration) in the agreements entered into between News and NewCo. These mechanisms will be more than sufficient to enable NewCo to protect its own interests and would therefore obviate the need for any formal monitoring in relation to the observance of the contractual commitments (as discussed in more detail in response to question 2.2).

2.14. Listing – would be the effect on Newco of it being de-listed from the AIM market?

If NewCo were to be delisted from AIM, we do not believe that there would be any impact on its commercial operations. A delisting would not have any impact on the commercial arrangements such as the carriage agreement or on the corporate governance arrangements including the Board composition.

The only immediate practical implication of such a delisting would simply be that the ability to trade shares in NewCo in the absence of another listing would be reduced. It could however be affected via alternative methods, such as trading over the counter or via a listing in a different market (e.g. Euronext).

2.15. Apps – please provide further details of the proposed exclusive rights to be granted by Newco to News in relation to tablet apps. What remuneration will Newco receive from these rights? Will these rights be in the carriage agreement?

News will not acquire any exclusive rights in relation to Sky News tablet apps with respect to retail sales or with respect to territories other than the UK. NewCo will be free to sell tablet apps to end-consumers.

The only exclusive right granted by NewCo to News with respect to tablet apps will be for the wholesale distribution of such apps in the UK. Consideration for these rights is included within the main pspm fees set out at slide 5 of Annex 1 of the First OFT Response.

2.16. Re-acquisition – please confirm whether News would be willing to give a commitment in the UIL not to acquire further shares in Newco such as to take its shareholding level beyond 39.1 per cent.

As noted in question 12.1 of the First OFT Response, the proposed UIL seeks to preserve the status quo including all the regulatory protections provided for by the Enterprise Act. 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. 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% 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. As such, any further restriction on subsequent acquisitions by News of NewCo shares would be redundant and not necessary to ensure the sufficiency of plurality of media enterprises.

Moreover, any further acquisition of NewCo shares by News would lead to a "relevant merger situation" with consequent statutory regulatory approvals under the Enterprise Act.

As such, News believes that any commitment not to acquire further NewCo shares is neither necessary nor appropriate for the purposes of remedying, mitigating or preventing any of the effects of the Transaction identified by Ofcom in its report of 31 December 2010 as being adverse to the relevant public interest consideration.

2.17. *Affiliate – please explain why Sky should not be treated as an affiliate of News until the Closing Date, given News' existing shareholding in Sky.*

The definition of "Affiliate" in the proposed UIL includes subsidiaries regarded as being under common control for the purposes of section 26 of the Enterprise Act 2002. Ordinarily, Sky would, for the purposes of this definition, be deemed to be an "Affiliate" of News. However, pre-transaction, Sky is an independent listed company with a board consisting of a majority of independent directors and, in fact, only Sky's independent directors are responsible for considering the terms of the Transaction. The Transaction has not yet been recommended by the Sky board. As such, News is unable to procure that Sky will comply with the proposed UIL as if Sky had itself given them.

2.18. *Financial projections – technical services and operational agreements: How long would the restrictions on price to cost plus [REDACTED] run for?*

Please see the response to question 2.11 above.

In light of the additional concessions above which News has indicated it is prepared to make, News would also request the express inclusion in the UIL of a provision enabling News to apply to the Secretary of State for the removal or variation of any or all of the obligations contained in the UILs which is in any event provided for under of Schedule 2(3)(7) of the Enterprise Act 2002 (Protection of Legitimate Interests) Order 2003.

Allen & Overy LLP on behalf of News Corporation

8 February 2011