OFFICE OF FAIR TRADING

A report to the Secretary of State for Culture, Olympics, Media and Sport in response to the undertakings in lieu offered by News Corporation pursuant to Schedule 2 paragraph 3 of the Enterprise Act 2002 (Protection of Legitimate Interests) Order 2003 concerning the anticipated acquisition by News Corporation of British Sky Broadcasting Group plc

A report pursuant to Section 93 of the Enterprise Act 2002

11 February 2011

NON-CONFIDENTIAL VERSION

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The Secretary of State has excluded from this published version of the OFT's report information which he considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂].

1. Executive summary and conclusions

Introduction

1.1. On 25 January 2011, the Secretary of State for Culture, Olympics Media and Sport (the Secretary of State) announced that he was minded to refer the proposed acquisition by News Corporation (News) of shares in British Sky Broadcasting Group plc (Sky) (together, the parties) that it does not already own to the Competition Commission (CC) for a detailed investigation.

1.2. The Secretary of State indicated that he is willing to consider undertakings in lieu (UIL) offered by News which have the potential to prevent or otherwise mitigate the media plurality concerns identified in the report sent to the Secretary of State by Ofcom on 31 December 2010.

1.3. The OFT has been asked to consult with the parties with a view to discovering whether in its view those UIL are practically and financially viable; and to consider if there are any practical issues which could undermine the operation of the UIL and whether they would be effective over the medium and long term.

1.4. The OFT has had two weeks in which to report to the Secretary of State. In the limited time available, the OFT has held meetings with News, Sky and Ofcom (in its position as sectoral regulator), and has received responses from News to a number of requests for information. The OFT has not been requested to consult with third parties and notes that this would not have been feasible in the timeframe. However, the OFT notes that third parties will have the opportunity to be consulted as provided for by statute[1] if the Secretary of State is minded to accept the UIL.

1.5. Depending on the decision of the Secretary of State, the OFT considers that further negotiation with News (with assistance from Ofcom) may be necessary on the precise terms of the UIL offered by News; however some progress has been made with News in these two weeks in terms of improving the practical and financial

[1] Schedule 10 of the Enterprise Act 2002.

viability of those UIL from the text originally proposed to the Secretary of State by News.

The clear-cut standard for UIL

1.6. UIL are typically regarded as appropriate where the remedies proposed are **clear-cut** and are **capable of ready implementation.**[2] The applicable principles are set out in the OFT's guidance.[3]

1.7. The OFT has carried out its analysis of the proposed UIL in this case by reference to the clear-cut standard. The OFT is mindful, however, that:

- the Secretary of State may consider it appropriate to adopt a different standard because he is acting under public interest considerations and the OFT's guidance is designed to deal with competition-related matters; moreover, the clear-cut standard is a policy position adopted by the OFT and other competition agencies;
- even taking into account the clear-cut standard, the OFT's preference for structural divestment solutions[4] in relation to UIL does not preclude the consideration of remedies other than divestment in appropriate cases. Moreover, the UIL offered by News bear some resemblance to a 'carve-out' remedy, which the OFT would generally regard as structural in nature, provided the relevant business or assets are capable of being separated from the parent; and
- whilst behavioural undertakings (such as price caps) are not generally accepted at the first phase of a merger investigation in lieu of a reference to the CC in competition cases, this does not preclude behavioural undertakings being provided in <u>support</u> of a structural solution provided that the overall remedy meets the clear-cut standard.

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[2] OFT Mergers - Exceptions to the duty to refer and undertakings in lieu of reference guidance (OFT1122) (the Exceptions and UIL guidance), paragraph 5.7.
[3] Exceptions and UIL guidance, paragraph 5.39.
[4] [✂], a sale of the business may be disproportionate if the proposed UIL meets the concerns raised in Ofcom's report and satisfies the clear-cut standard.

1.8. Any UIL must be assessed on a case by case basis. The basic principles for assessment are that:

- there must not be material doubts about the overall effectiveness of the remedy in solving the problem identified; and

- in practical terms, the remedy should not be of such magnitude and/or complexity that its implementation would require unworkable resources at first phase.[5]

1.9. In undertaking its assessment of the practical and financial viability of the UIL, the OFT focuses in this report on whether the UIL offered is capable of ready implementation and also, as instructed by the Secretary of State, whether the UIL would be effective over the medium and long term from the standpoint of practical and financial viability only. Ofcom will separately advise on the effectiveness of the UIL to meet media plurality concerns.

Overall assessment of the proposed UIL

1.10. The proposed UIL involve the establishment of Newco as a distinct owner of Sky News. 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. News proposes that the term of the carriage agreement between News and Newco shall be 10 years. There is no provision for renewal of the carriage agreement at the end of the term.

1.11. In terms of the clear-cut standard, News argued that the spin-off of Sky News into Newco is a structural remedy that will lead to the creation of a stable, well-resourced, viable entity over the long term. It considers that its/Sky's ongoing incentive to carry the Sky News channel and thus to purchase it from Newco is an important feature that had informed the design of the UIL and should enable the Secretary of State to have confidence in the success of the UIL. Indeed, News noted that Sky had chosen to start a 24 hour news channel and had invested in that service since Sky News was launched in 1989. In essence, unlike in a normal divestiture

[5] Exceptions and UIL guidance, paragraph 5.8.

remedy, where the merging parties may have an interest in the (competitor) divested business failing, News submits that News/Sky would have an interest in the success of Newco going forward.

1.12. The OFT accepts that the UIL involve certain structural elements supported by behavioural commitments, and considers that, in practice, the proposed spin-off of Sky News is capable of ready implementation, albeit with further detailed issues to be resolved, including those set out below.

1.13. The OFT has identified certain risks which may undermine the practical and financial viability of the UIL. These include the following:

- the successful operation of Newco relies to some extent on the incentives of News/Sky to continue to carry and fund a 24 hour news channel. There is a strong likelihood that the commercial incentives lie with the continued operation of Newco, but it remains plausible that such incentives may change over time;

- uncertainty about the prospects for renewal of the carriage agreement on equivalent terms may begin to affect Newco some years before its term date, [✗]; and

- Newco's prospects post-termination of the carriage agreement are not clear.

1.14. The OFT advises that set against these risks are:

- the commercial incentive for News/Sky to continue paying for the Sky News channel (reinforced by the contractual rights afforded to Newco under the carriage agreement and brand licensing agreement);

- the protection and transparency afforded by being [publicly traded] [✗];

- the fact that the brand licensing agreement lasts for up to 14 years, which may place pressure on News/Sky to renew the carriage agreement upon termination for a further four years; and

- the ability of Newco to diversify its product offering or to continue with a distinctive news channel that ensures that Sky is willing to re-commit to the carriage agreement at the end of 10 years (or earlier).

1.15. In assessing these risks, the OFT has been asked to advise the Secretary of State on whether there are practical issues which could undermine the effective operation of the UIL, and whether the UIL would be viable over the medium and long term. The OFT's assessment, based on the information provided to it by News, indicates that the key agreements (the carriage agreement and the brand licensing agreement) would appear to underpin the short-to-medium term (no longer than 10 years) viability of Newco and the UIL. The OFT, however, considers that the finite duration of the carriage agreement, in particular, entails a material risk to the long term viability of Newco and hence the UIL.

1.16. The OFT notes that each of News, Sky and Ofcom consider that a carriage agreement of this length and duration, in the context of the industry dynamics of the media sector, is "long-term". The OFT accepts that the carriage agreement may be longer than the industry norm. However, the OFT considers 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 stand-alone 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. This risk may also, as discussed above, affect Newco's prospects before that point. The relevance of these risks ultimately depends on the time horizon which the Secretary of State considers relevant to ensure the effectiveness of the UIL.

1.17. The OFT has not been able to identify with News any improvements to the UIL that overcome the essential structural limitation of the UIL, namely, the finite duration of the carriage agreement.

1.18. The OFT advises the Secretary of State that:

- if News enter into certain additional undertakings (details of which are set out in paragraph 1.20 below), the UIL are likely to be effective in the short and medium term (that is, no more than 10 years); and

- even if, however, News enters into such additional undertakings, the 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).

1.19. In seeking to assess this advice, the Secretary of State may want to consider whether the UIL, supplemented by the additional undertakings mentioned above, which the OFT considers likely to be effective in the short-to-medium term, are of sufficient duration to meet the media plurality concerns identified by Ofcom or are effective in relation to them.

1.20. The additional undertakings referred to in paragraph 1.18 above are as follows:

- **interim protection** – interim protection for the business to be divested is a standard feature of divestment remedies in competition cases, and will normally be included in OFT UIL. News has agreed to the inclusion within the UIL in this case of commitments from News regarding the preservation and continued operation of Sky News pending its spin-off. These will provide an assurance that the Sky News business to be spun-off will not be materially different to the Sky News business today;

- **non reacquisition commitment** – a commitment not to reacquire the business to be divested without prior OFT approval is a standard feature in OFT UIL; News has proposed to provide the Secretary of State with a form of non-reacquisition commitment, subject to two carve-outs: (a) a sunset provision which means that the clause would no longer apply at the end of 10 years; and (b) a carve-out in the event that a third party bid is launched for Newco. In the particular circumstances of this case, and subject to the more general points about the finite nature of the carriage agreement, the related long-term risks and the extent to which the Secretary of State considers the duration of the carriage agreement sufficiently 'long-term', the OFT believes the 10 year limitation (that is, point (a)) to be acceptable, but would recommend against the carve-out in (b) given that this would still risk the frustration of the purposes of the UIL;

- **prior review of key agreements** – the success of Newco depends significantly on at least two key agreements – the carriage agreement and the brand licensing agreement; News has agreed that the form of both agreements should be subject to approval by the Secretary of State before he accepts the UIL; the OFT considers that there may be other key contracts which should require prior approval by the Secretary of State should he be minded to accept the UIL; the OFT would envisage that both the OFT and Ofcom (potentially supported by an independent expert funded by News) would have a role in the approval process of these agreements;

- **inclusion of an arbitration/dispute resolution mechanism** – given the importance of the key agreements between News and Newco going forward, News has agreed to the insertion of an arbitration or dispute resolution mechanism to ensure that any contractual disputes in relation to these agreements are resolved promptly, efficiently and without undue cost; more precise details of how such an arrangement would function have not been determined in the time available;

- **restrictions on termination of the key agreements** – the success of Newco depends significantly on at least two key agreements – the carriage agreement and the brand licensing agreement; these agreements are terminable only in the event of 'material breach'; in order to protect Newco against the risk of an unjustified termination by News, (and in light of concerns expressed by the OFT about the potential inequality in the positions of News and Newco and their respective resources in the context of a possible contractual dispute) News has offered a commitment in the form of a undertaking not to terminate either agreement prior to a formal and final determination having been made under that dispute resolution mechanism applicable under the relevant agreement (that is, a finding that Newco has committed a material breach of the carriage agreement or brand license agreement); the OFT advises that it believes that this proposal is acceptable in order to reduce the risk of an unjustified termination of the key agreements by News that could jeopardise Newco; and

- **other obligations** - the OFT sets out in sections 7 to 12 of this report further detail on each of the points raised above, together with further undertakings and improvements to the UIL.

1.21. The OFT notes that further review, negotiation and consultation on the UIL may be necessary as part of this process. It also notes that News has, to date, signalled its unwillingness to agree to one of the above additional undertakings. Given the limited time available, News has not provided the OFT with a revised version of the UIL. As a matter of prudence, the OFT considers that any finalised draft of the UIL for acceptance by the Secretary of State should be submitted by News to the OFT and Ofcom for further advice.

1.22. On the basis that the Secretary of State were minded to accept the UIL in an amended form, the OFT advises that it would be appropriate for the Secretary of State to test further the viability and robustness of the commitments offered during the statutory public consultation process.

1.23. The OFT has given such advice as it considers appropriate, having regard to the limited time period in which to consider the UIL and consult with News.

2. Transaction

2.1. The proposed transaction involves the acquisition of sole control by News over Sky through an offer for the remaining 60.86 percent shareholding in Sky not already owned by News.

3. Jurisdiction

3.1. The Secretary of State for Business, Innovation and Skills issued a European Intervention Notice on 4 November 2010 (the Intervention Notice) as permitted under Article 21(4) of the EC

Merger Regulation[6] to protect the UK's legitimate interest in media plurality, and pursuant to section 67(2) of the Enterprise Act 2002 (the Act) and the Enterprise Act 2002 (Protection of Legitimate Interests) Order 2003 (the Order).[7]

3.2. The Intervention Notice referred to the public interest consideration set out in section 58 of the Act to ensure the sufficiency of plurality of persons with control of media enterprises in the UK. In this regard, the Secretary of State for Business, Innovation and Skills requested that Ofcom provide its recommendation and advice on the specified public interest consideration in deciding whether to refer the case to the CC for detailed investigation.[8]

3.3. On 31 December 2010, Ofcom issued its report, as provided for under Article 4A of the Order, which concluded that in its reasonable belief, the proposed acquisition may be expected to operate against the public interest on the basis that there may not be a sufficient plurality of persons with control of media enterprises providing news and current affairs to UK-wide cross-media audiences.

3.4. In deciding whether to refer the transaction to the CC under Article 5 of the Order, the Secretary of State has the discretion to accept undertakings in lieu of making such a reference (UIL) from the parties, as permitted under paragraph 3 of Schedule 2 of the Order.

3.5. In a statement issued on 25 January 2011, the Secretary of State said he was minded to refer the merger to the CC but would first consider, with the involvement and advice of the OFT and Ofcom, the UIL offered by News and whether they would have *'the potential to prevent or otherwise mitigate the potential threats to media plurality identified in the Ofcom report.'*[9]

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[6] Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings (the Merger Regulation).
[7] The transaction falls within the sole jurisdiction of the European Commission to assess the competitive effects of the merger in the European Economic Area or a substantial part of it. On 21 December 2010, the European Commission cleared unconditionally the proposed transaction.
[8] As also required by the Intervention Notice, the OFT provided advice to the Secretary of State, pursuant to Article 4 of the Order, confirming that, in its view, the Secretary of State has jurisdiction and is able to exercise the power to make a reference to the CC.
[9] Statement from Culture Secretary Jeremy Hunt of 25 January 2011.

4. Scope of OFT advice

4.1. The Secretary of State has asked the OFT, pursuant to section 93 of the Act, to give its view on whether he should accept the UIL offered by News.

4.2. By letter to the OFT of 27 January 2011, the Secretary of State requested that, within two weeks, the OFT determine whether the UIL would, in its view, be practically and financially viable, so as to be acceptable to the Secretary of State. In particular, the OFT has been asked to consider if there are any practical issues which would undermine the operation of the UIL and whether they would be effective over the medium and long term. The Secretary of State requested that Ofcom provide any assistance required by the OFT in considering the UIL.

4.3. The Secretary of State has not asked the OFT to consult third parties. In any event, if he were minded to accept the UIL, third parties would have this opportunity as provided by the consultation provision in Schedule 10 of the Act.

4.4. In this report, the OFT does not advise on the potential impact of the UIL on the concerns raised by Ofcom regarding media plurality. This is being specifically addressed by Ofcom as a separate piece of advice requested by the Secretary of State pursuant to section 106B of the Act.

4.5. The OFT has received submissions from News and has met with each of the parties. The OFT has also received assistance from Ofcom in its role as sectoral regulator.

5. OFT approach to UIL

5.1. The OFT has carried out its analysis of the proposed UIL in this report by reference to its clear-cut standard. However, the OFT acknowledges that the Secretary of State may consider it appropriate to adopt a different standard in light of his assessment of public interest considerations in this case, whereas the OFT's guidance is designed to deal with competition-related matters.

5.2. In order to accept UIL (or in this case to recommend acceptance by the Secretary of State of proposed UIL), the OFT must typically be confident that all the potential concerns that have been identified by it (in this case, all concerns identified by Ofcom relating to sufficient media plurality) would be resolved by means of the UIL without the need for further investigation.[10] This is necessary since, once the UIL are accepted, the Secretary of State has no further recourse to refer the case to the CC after this point.

5.3. The explanatory note to section 73 of the Act states:

> *'The purpose of accepting undertakings is to allow the OFT (where it is confident about the problem that needs to be addressed and the appropriate solution) to correct the competition problem the merger presents without recourse to a potentially time-consuming and costly investigation. This provision mirrors the existing power...for the Secretary of State to accept undertakings-in-lieu, but with responsibility transferred to the OFT.'*

5.4. UIL are accordingly only appropriate where the remedies proposed to address any concerns raised by the merger are clear-cut and are capable of ready implementation.[11] For these reasons, the OFT typically does not consider that behavioural undertakings will be sufficiently clear-cut to address identified concerns.[12]

5.5. The clear-cut requirement has two dimensions: (1) there must not be material doubts about the overall effectiveness of the remedy; and (2) in practical terms, the remedy should not be of such magnitude and/or complexity that its implementation would require unworkable resources at first phase of a merger investigation.[13] The European Commission adopts a similar approach to remedies accepted at Phase I.[14]

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[10] Exceptions and UIL guidance, paragraph 5.6.
[11] Exceptions and UIL guidance, paragraph 5.7.
[12] Exceptions and UIL guidance, paragraph 5.39.
[13] Exceptions and UIL guidance, paragraph 5.8.
[14] Commission Notice on remedies acceptable under Council Regulation (EC) No 139/2004 and under Commission Regulation (EC0 No 802/2004: 'Commitments in phase I can only be accepted where the competition problem is readily identifiable and can be easily remedied. The competition problem therefore needs to be so straightforward and the remedies so clear-cut that it is not necessary to enter into an in-depth investigation and that the commitments are sufficient to clearly rule out "serious doubts" within the meaning of Article 6(1)(c) of the Merger Regulation.', paragraph 81.

5.6. In the present case, the OFT is concerned with the second part of its clear-cut requirement, since Ofcom will address the effectiveness of the UIL in its separate report to the Secretary of State.

5.7. Whilst behavioural undertakings are not generally accepted at Phase I of a merger investigation in lieu of a reference to the CC in competition cases, this does not preclude such undertakings being offered in support of a structural solution, so long as the overall remedy meets the clear-cut standard. In any event, the UIL are assessed on a case-by-case basis.

5.8. The monitoring of compliance with undertakings in lieu accepted by the Secretary of State under paragraph (3)(2) of Schedule 2 of the Order is the responsibility of the OFT pursuant to section 92 of the Act.[15]

6. Outline of News' proposed UIL

Summary of the proposed UIL

6.1. News proposes to offer to the Secretary of State a commitment involving the following core elements:

- Sky News will be spun off as an independent UK public limited company (that is, Newco), with its shares publicly traded [✂], either at the Closing Date[16] or as soon as reasonably practicable following the Closing Date and, in any event, no later than nine months from the acquisition of control of Sky by News. Shares in Newco will be distributed to existing shareholders of Sky in the same proportions as their existing shareholdings, such that News will retain the same 39.1 percent shareholding in Newco as it currently has in Sky;

- all tangible assets currently used exclusively for the purpose of carrying on the Sky News business, as well as key Sky News editorial staff, and all relevant licences, agreements and other material contracts will be transferred by Sky to Newco;

[15] See Schedule 3, paragraph 1(5)(b) of the Order.
[16] 'Closing Date' means the date on which News acquires all or a majority of the share capital of Sky or, if the Transaction is effected by a scheme of arrangement, the date on which the scheme of arrangement becomes effective.

- Sky will enter into a 10 year 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. Sky will also license the 'Sky News' brand to Newco subject to payment of a royalty, for an initial period of seven years, with automatic renewal for a further seven years, and with the possibility of an extension for three more years;

- if required by Newco, Sky will enter into arms' length agreements for facilities and support services (such as advertising sales representation, lease of premises, broadcast and technical services and other assets owned by Sky); and

- the corporate governance structure of Newco will be established to replicate substantially the effects of the existing corporate structure of Sky such that: (1) News/Sky will be subject to a voting limitation of 37.19 percent of the total votes of Newco; (2) a majority of the board of Newco will comprise non-executive Directors determined by the board to be independent; (3) material transactions between Newco and News/Sky will require approval of Newco's Audit Committee, which will consist exclusively of independent non-executive directors; and (4) Newco will adhere to the obligations imposed by the Listing Rules as regards compliance with the principles set out in Section 1 of the UK Corporate Governance Code.

[News]' view on the clear-cut nature of the UIL

6.2. [News] submitted that the proposed UIL provide a clear-cut, structural solution which will maintain the existing degree of independence of Sky News. In [its] view, Newco will be established as a separate publicly-traded legal entity with corporate governance arrangements reflecting those of Sky, which can be implemented unilaterally by News based on the UIL.

6.3. [News] differentiated the proposed UIL from those in a normal divestment remedy on the basis that News would be a customer of Newco going forward, rather than a competitor. [News] emphasised that Sky had chosen to start a 24 hour news channel and had invested in that service since Sky News was launched in 1989. Sky News has therefore been a key part of Sky's commercial proposition to customers, and there is no reason to believe that News/Sky would wish to change this in the future.

6.4. News argued that its/Sky's ongoing incentive to carry the Sky News channel and thus to purchase it from Newco is an important feature that had informed the design of the UIL and should enable the Secretary of State to have confidence in the success of the UIL. In essence, unlike in a normal divestiture remedy, where the merging parties may have an interest in the (competitor) divested business failing, News submit that News/Sky would have an interest in the success of Sky News going forward.

6.5. [News] likened the UIL to that of 'an upfront remedy which does not require that a competition authority subsequently approve a suitable purchaser' and noted that 'it is therefore more clear-cut than a number of other structural remedies that are commonly accepted by regulatory authorities.'[17] [News] argued that given their structural nature, the UIL do not require ongoing monitoring as Newco will continue to operate as a distinct, profit-maximising enterprise under the direction and supervision of its board.

[News]' arguments on practical and financial viability

6.6. [News] argued that Newco will be practically and financially viable post-spin off. [It] argued that the UIL have been structured so as to ensure the continuation of Sky News as a distinct enterprise with an independent news voice, thereby addressing the relevant public interest consideration. In [its] view, it is not necessary (as would be the case if competition concerns were at issue) to require that all the links between Sky and Newco be severed; rather, that the current degree of editorial independence is preserved and that Newco is financially viable.

6.7. To address these issues, [News] submitted that by substantially replicating the corporate governance structure currently applied under Sky, Newco will be free to pursue its core news business. In [its] view, the 10-year carriage agreement means that Newco will have a reliable revenue stream for a much longer period than is typical in the media sector. This will allow Newco to independently plan for future investment and expansion based on a quantifiable

[17] News Response to the OFT's questions of 1 February 2011.

and stable cash flow over the medium to long term. Similarly, [News] argued that the grant of a licence to use the 'Sky News' brand will allow Newco to generate significant revenue streams from third parties.

7. **Legal spin-off of Sky News[18]**

7.1. The outline of the arrangements as regards the spin-off of Sky News to Newco has been set out in section 6.1 above.

7.2. In general, the OFT sees no reason why the proposed corporate arrangements in relation to the creation of Newco should not be practical. Partial divestments of businesses are common, and News provided a number of examples of spin-offs of businesses in similar sectors by way of illustration of the regularity of such arrangements.[19]

7.3. The OFT is unable to advise, given the limited time available, on the prospects of success for [an admission to trading] [✂]. When asked whether [an admission to trading] would be likely to be successful, News provided an opinion [✂][20] confirming that [✂]. The OFT has no reason to doubt the contents of this opinion but notes [✂].

7.4. The aspects of the spin-off which required the OFT's particular consideration relate to timing, the absence of any interim protection (which relates to timing), the shareholder base of Newco and the absence of a non-reacquisition commitment by News. The corporate governance of Newco is also a key consideration, which is addressed in the following section.

Timing of spin-off

7.5. News committed to effecting the spin-off of Sky News within nine months from the acquisition of control of Sky by News. [✂].

7.6. [✂].

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[18] Paragraphs 2.1, 2.2 of the UIL.
[19] News response to OFT questions of 1 February. The examples provided by News included: Time Warner's spin-off of AOL and Time Warner Cable, Liberty Media's spin-off of DirectTV, Cablevision Systems Corp's proposals to spin off Rainbow Media. News noted Cable and Wireless also split into two separate companies last year.
[20] Annex 4 of the News response to OFT questions of 1 February.

7.7. [✂].

7.8. The OFT queried why News believed that a nine month period was reasonable in order for Newco to be divested (as envisaged by paragraph 2.1 of the proposed UIL). In particular, the OFT queried whether a shorter time period would be possible.

7.9. News said it considered that there were a number of reasons why the nine month period was reasonable:[21]

- [✂];
- [✂]; and
- [✂].

7.10. News noted that the obligation on it was to effect the spin off 'as soon as reasonably practicable' but believed the nine month backstop was appropriate.

7.11. [✂]. When agreeing and accepting UIL in competition cases, the OFT will determine the appropriate divestment period within which the remedy must be implemented according to the specific circumstances of the case. The OFT would generally seek to ensure that a remedy is implemented within a time period that is significantly shorter than nine months from completion (typically closer to three months). This is generally to ensure that the business(es) being divested do not deteriorate in the meantime. The extent to which interim protection is required during the nine month period is considered in the sub-section below (see paragraphs 7.13ff below).

7.12. Overall, the OFT considers that, in the particular circumstances of this case, the proposed nine month period in paragraph 2.1 of the UIL is not unreasonable.

Absence of interim protection

7.13. The proposed UIL do not include any provision regulating the way in which News, including Sky, would deal with, and exert control over, Sky News following News' acquiring control over Sky and

[21] News response to OFT questions of 1 February.

pending completion of the spin-off arrangements as required by paragraph 2.1 of the UIL.

7.14. Such interim protection is a standard feature of divestment remedies in competition cases, and will normally be included in the UIL in competition cases before the OFT. Its purpose is to protect the position of the assets or business to be divested. In practical form, these obligations normally require the acquiring business to maintain the business to be divested as a going concern with sufficient resources; not make substantive changes to it; preserve its facilities and goodwill; continue the nature, description, range and standard of services supplied by it; maintain its name or brand; not dispose of its assets, other than in the ordinary course of business, not integrate it with the acquirer's competing business; take steps to ensure that key staff are encouraged to remain with the business; and ensure that confidential information relating to the business to be divested is not shared with the acquirer's business.

7.15. News argued that interim protection was not required given that '*ownership/control of Sky News for an interim period of less than a year, pending spin-off of that business, would not eliminate or weaken Sky News as a distinct broadcast voice contributing to media plurality in the UK.*'[22] News further noted that it would have no incentive to inflict damage on the Sky News business given that: (a) it would not be competing with it after the spin-off; and (b) it would be purchasing from it going forward.

7.16. However, in order to assuage the OFT's potential concerns in this respect, News agreed[23] to provide interim protection in relation to the preservation and continued operation of Sky News pending its spin-off in the form of an assurance that the Sky News business to be spun-off will not be materially different to the Sky News business today. Such an assurance would be in similar terms to those typically provided in UIL in competition cases (as described above). The OFT would expect that such protection would include an obligation on News to seek to ensure that at least the Key Sky

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[22] News response to OFT questions of 1 February.
[23] News response to OFT questions of 9 February.

News Editorial Staff remained with the Sky News business in the interim period.

7.17. On the basis that News ensures compliance with the interim protection as set out above, the OFT considers that its concerns would be alleviated in this regard.

The shareholder base of Newco (Sky News)

7.18. The UIL provide for the shares in Newco to be spun-off to the current shareholders of Sky in the same proportions as their current shareholding in Sky. Thus News would hold 39.1 per cent of Sky News.

7.19. The OFT considered what would happen to the shareholding in Sky News on its proposed flotation [✂], given that Sky News would be a considerably smaller entity than Sky, [✂] and the business model of Newco would be considerably narrower than that of Sky. Specifically, the OFT considered whether there was any reason why any changes to the shareholder base of Newco (compared to that of Sky at present) could undermine the viability of Sky News going forward.

7.20. News acknowledged that the shareholder base in Sky News was likely to change after admission of Newco's shares to trading. It considered, for example, that UK index tracking funds are very likely to sell their positions as [✂]. This change, and the fact that a reasonably significant proportion of Newco shares would change hands once such shares are publicly traded, would not, News argued, affect Newco's ongoing viability.

7.21. The OFT sees no reason to doubt News' submission in this respect. To the extent that there could be any concern about the change in Sky News' shareholder base, this could, the OFT believes, only likely come about through the fact that Sky News would be a considerably smaller body than Sky is at present. Specifically, the OFT considered whether this could result in Sky News having difficulty raising finance for future capital investment.

7.22. The OFT notes the implication of the inability to raise finance could impair the ability of Newco to respond to technological advances in the way that news is collected (input) or disseminated (output) can involve significant investment. By way of example, Sky informed the OFT that the conversion of Sky News so as to be able to provide output in HD cost in total around £[✂].

7.23. News did not foresee any need for Newco to borrow to finance its activities, but noted that it should be able to do so against the revenue stream provided by the 10 year carriage agreement.

7.24. News also emphasised that, in its view, '*the key question to be addressed by the UIL is the maintenance of Sky News as a distinct and viable broadcast news voice contributing to media plurality, NOT its ability to develop and expand beyond its core news provision business.*'[24]

7.25. Sky informed the OFT that, following conversion to HD, Sky News was well positioned in terms of technological status in terms of its competitors [✂]. However, to the extent that it did wish to fund new development, it could do this either by way of borrowing and by seeking to renegotiate an enhanced carriage fee (for example, a higher carriage fee for 3D channels).

7.26. Having regard to the above, the OFT does not believe that the changed shareholder base of Newco, as compared to Sky at present, provides any reason to believe the viability of Newco would be materially undermined for the foreseeable future.[25]

7.27. The OFT also considered whether there was any risk to the ongoing viability of Newco if Newco were at any future point to cease to be [publicly traded] [✂]. In response to this, News noted[26] that [removal from the market] would not have an impact on [Newco's] commercial operations and that there were alternative methods of trading shares in Newco (for example, over the counter or via a listing in a different market). The OFT has no reason to doubt this explanation [✂]-.

[24] News response to OFT questions of 1 February 2011.
[25] The OFT notes that Newco would clearly no longer have access to the significant resources of Sky to draw on for future development or innovation. However, the OFT believes that this factor falls outside the remit of advice sought from the OFT by the Secretary of State under section 93 EA 02.
[26] News response to OFT questions of 7 February 2011.

Absence of a non-reacquisition commitment

7.28. The OFT would normally expect any UIL to contain a non-reacquisition commitment. This typically provides that the merging parties commit, except with the prior written consent of the OFT, not to re-acquire any interest in the divested business, any company controlling the divested business or any of the assets of the divested business.

7.29. The UIL proposed by News did not contain any form of non-reacquisition commitment. News submitted that such an obligation was not justified in this case for a number of reasons, including that this was not a competition case and given that any further acquisition of Newco shares by News would lead to a "relevant merger situation" with consequent statutory regulatory approvals under the Act.[27]

7.30. News emphasised[28] its view that the general practical considerations underlying a non-reacquisition restriction did not specifically relate to the practical viability of the UIL proposed by News in the present case. As such, it considered that the Secretary of State would want to decide whether this is a relevant consideration.

7.31. News also noted that any hypothetical reacquisition of Newco shares by News would not automatically trigger a substantive review on issues of media plurality – given that this would depend on the issuing of an intervention notice.

7.32. Nevertheless, in order to meet the OFT's concerns about the absence of a non-reacquisition commitment, News proposed, except with the prior written consent of the Secretary of State, to commit not to acquire shares in Newco that will result in News holding more than 39.14 per cent of the shares in Newco, subject to two carve-outs:

- the inclusion of a sunset provision which means that the clause would no longer apply at the end of 10 years; and

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[27] News' response to OFT questions of 1 February.
[28] News' response to OFT questions of 9 February.

- a carve-out to this restriction in the event that an independent third party has made an offer or proposed a merger (including by way of scheme of arrangement) or has otherwise indicated an intention to acquire 50 per cent or more of Newco's voting shares (in which case, News would promptly inform both the OFT and the Secretary of State, on confidential basis, of any acquisition by it of shares in Newco).

7.33. The OFT's UIL normally require an indefinite prohibition on reacquisition of the divested assets/business. However, News correctly identified that the CC's remedy guidelines stipulate that the standard practice of both the Competition Commission[29] and the European Commission[30] is that any undertaking for a non-reacquisition should be limited to 10 years. The OFT considers that, in the specific circumstances of this case (and subject to the Secretary of State accepting the duration of the carriage agreement to be sufficiently 'long-term' to deal with concerns about media plurality), a 10 year limitation on the non-reacquisition obligation may be justified. The OFT also observes that the ban on reacquisition would end at the same time as the carriage agreement.

7.34. However, in relation to a carve-out in the event of an attempted third party bid for control of Sky News, the OFT considers that this is unlikely to be acceptable given that this might still result, in practical terms, in the frustration of the UIL. The OFT also notes in this context that even if a non-reacquisition clause was entered into by News in the UIL, the effect of this non-reacquisition clause could be frustrated, in part, by the operation of the change of Control provisions in the brand licensing agreement. These provide (as detailed in paragraph 10.17 below) that the brand licensing agreement (and the carriage agreement) will terminate if any third party acquires in excess of 40 per cent of Newco. Should the Secretary of State wish to consider the UIL further, it would be important to consider the various agreements in detail and the risks that certain of these provisions may pose to the overall viability of Newco and the UIL.

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[29] Competition Commission - Merger Remedies Guidelines (CC2), paragraph 3.8.
[30] European Commission's Model Divestiture Commitments, paragraph 3.

7.35. On the basis of the above, the OFT considers that the non-reacquisition commitment from News for a period of 10 years would be acceptable, but that this should not include a carve-out of an attempted third party bid.

8. Corporate governance of Sky News[31]

8.1. The UIL provide for the corporate governance of Newco to be designed with a view to substantially replicate the existing corporate governance structure applying to Sky. These provisions are set out in paragraph 3.1 of the proposed UIL, and concern: voting restrictions on News; board composition; approval of material transactions; and adherence to the principles of good governance.

8.2. News emphasised to the OFT that the proposed arrangements in relation to corporate governance would provide 'symmetry' between the current arrangements, that is, between the relationship News currently has with Sky, and the proposed continuing relationship between News and Newco.

8.3. The OFT notes, however, that several aspects of the proposed relationship between News/Sky and Newco are not symmetrical with those between News and Sky today. Notably, the extensive contractual arrangements that will exist between News/Sky and Newco are not as central to the relationship between News and Sky.

8.4. The OFT considered whether there were aspects of the board arrangements that could impact on the financial and practical viability of Newco over the medium to long term. It considered that the corporate governance of Newco essentially went to the question of the independence of Sky News from News, which was essentially a media plurality question for Ofcom. However, the OFT sets out below its position in relation to Newco's adherence to the corporate governance provisions in the UIL and the definition of 'material transactions' requiring approval from Newco's audit committee.

[31] Paragraph 3.1 of the UIL.

Adherence to the corporate governance provisions in the UIL

8.5. News proposed in the UIL a number of measures by which the corporate governance structure of Newco would be established to substantially replicate the effects of the existing corporate governance structure of Sky (paragraph 3.1 of the UIL).

8.6. The OFT queried what assurance there would be that this provision would remain in place in the Newco Articles of Association going forward, in particular given that Newco would not itself be a signatory to the proposed UIL and that News would not have a controlling interest in Newco. This issue goes to the practical viability of the UIL as drafted.

8.7. In response to this, News noted that these restrictions would be embedded in Newco's Articles of Association and agreed that it would be prepared to give an undertaking that it would 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 UIL.[32]

Definition of 'material transactions'

8.8. The UIL provide that '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)' (paragraph 3.1(iii) of the UIL).

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[32] Response to OFT questions of 7 February 2011. This assurance was on the condition that it should endure for so long as no single shareholder group has more than 50 per cent and News has the right to vote more than 25 per cent of the shares in Newco. The OFT has not explored the first part of this caveat with News but notes that, in any event, this situation would have resulted in a change of control in Newco, which is a ground for termination of the brand license agreement.

8.9. No definition is provided in the UIL for what constitutes a 'material transaction'. News stated that 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: (i) 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 (ii) which involves amounts of £25 million or more; and
- 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.

8.10. News suggested that the UIL provide that such thresholds be used to define 'material transactions' for the purposes of the UIL.

8.11. The OFT is concerned, however, that the transaction thresholds that were appropriate in the context of Sky are not necessarily appropriate in the context of Sky News, given that it is a considerably smaller and more focused company. The OFT is also concerned that the above definition might exclude the brand licensing agreement. The OFT would therefore recommend that a revised definition of 'material transaction' be explored with News, that at least include the carriage agreement and brand licensing agreement (to the extent that they needed to be revised or renegotiated).

9. Transfer of Sky News[33]

9.1. The proposed UIL involve the transfer into Newco of Sky News, which is currently part of Sky.

9.2. As noted above, News cited a number of examples of when businesses have been separated or hived-off from their existing corporate structures (see paragraph 7.2 above).

9.3. At present, Sky News forms part of the wider business of Sky and is not a distinct legal entity. Sky described Sky News as being a

[33] Paragraphs 4.1, 4.2 of the UIL.

'directorate' of Sky, in that it was not a financially distinct business, but did have a distinct management structure that reported to the Head of Sky News.

9.4. The OFT considered in relation to the transfer of Sky News into Newco a number of practical issues with respect to the assets to be transferred as well as the staff. The OFT also considered the extent to which contracts where Sky is currently a party and which relate to Sky News, would be able to be transferred to Newco in order that it has the benefit of those contracts going forward.

9.5. The issues considered in this section are set out in concise form in paragraphs 4.1 and 4.2 of the proposed UIL. In terms of practical importance, they relate to the key question of what a separated Sky News business will comprise and how it will operate.

Assets to be transferred

9.6. The proposed UIL state that the Sky News business to be transferred to Newco shall comprise '*all or substantially all tangible assets currently used exclusively for the purposes of carrying on Sky News' business*' (paragraph 4.1 of the UIL).

9.7. News clarified[34] that this definition was intended to capture – such that they would be transferred into Newco – all tangible assets located in the existing Sky News building and other facilities used by Sky News for newsgathering, with the exception of the land and buildings at Osterley currently used by Sky News and shared technical facilities such as data networks, transponder capacity, transmission and uplink and play out facilities.[35]

9.8. The UIL also provide that: '*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).

9.9. News clarified[36] that (in addition to shared technical facilities to be covered by an ongoing broadcast and technical services agreement (see paragraph 11.4 below) this was a reference to other facilities

[34] News response to OFT questions of 1 February 2011.
[35] Access to these is discussed in paragraph 11.4.
[36] News response to OFT questions of 1 February 2011.

and services to which Newco might require access while continuing to use the Osterley site.

9.10. News stated that it would offer to Newco a site support services agreement under which it would provide, among other things: canteen/food services, computer/IT services, finance systems, phone services, heating, lighting, security and cleaning, if required by Newco.

9.11. News stated that, to the extent needed by Newco, News/Sky will also continue to make available additional services which are in any event available on the open market, including broadcast operations (technical staff, for example camera operators) and creative services (design specialists). Sky stated it [could] provide access to the relevant facilities under a service contract to the extent required by Newco.

9.12. Sky identified the two main areas where Sky News was currently dependent, in operational terms, on services that were shared with other parts of the Sky business. These were technical services and creative services. Otherwise, Sky stated that it regarded Sky News as operationally relatively self-sufficient from the remainder of Sky.

9.13. Based on the information available to it, the OFT sees no reason why the core tangible assets required for Sky News could not be separated off into Newco. However, the OFT recommends that, given that Sky News is not currently a physically distinct business within Sky, the proposed UIL should set out precisely what assets are to be included in Newco, what assets will not be transferred, and what assets will be made available by Sky to Sky News as part of the ongoing arrangements.

9.14. News stated[37] that it[38] would be prepared to set out in greater detail the assets to be transferred / not transferred to Newco in the form of a schedule.[39] The OFT believes this would be appropriate.

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[37] News response to OFT questions of 7 February 2011.
[38] News noted 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 suggested 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).

Sky News staff, including non-solicitation

9.15. The UIL provide that all '*Key Sky News Editorial Staff and all or substantially all staff currently engaged principally in the Sky News business, including news gathering staff, production, online and multimedia staff and Sky News international staff*' will be transferred to Newco (paragraph 4.1(ii) of the UIL). Key Sky News Editorial Staff are defined as the head of Sky News, the executive editor of Sky News and the head of newsgathering of Sky News.

9.16. News noted in this respect that 'TUPE will operate to transfer staff employed in the Sky News business to Newco'.[40]

9.17. As in relation to assets (see paragraphs 9.13 to 9.14 above), the OFT proposed and News agreed[41] to ask Sky to prepare separately a list of key personnel to be transferred to Newco.

9.18. Based on the information available to it, the OFT sees no reason why the UIL as drafted should not provide for the staff required to operate the Sky News business to transfer into Newco.

9.19. The UIL as drafted do not include a non-solicitation clause in respect of any of the Sky News staff transferred to Newco. News justified the absence of any such restriction on the basis that it was unnecessary given that neither Sky nor News will be a direct competitor of the spun-off Sky News business and given that Sky will continue to have a vested interest in the continued provision of quality output from Sky News.[42]

9.20. The OFT was unsure, however, what would prevent News launching a neighbouring channel, such as a current affairs channel, from which it might acquire staff from Newco.

9.21. Although News stated that it had no such plans, in response to this concern, News stated[43] that it would be prepared to give a standard non-solicitation commitment for a short period of time if

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[39] See the Schedule to the European Commission Model Texts for Divestiture Commitments, available at: http://ec.europa.eu/competition/mergers/legislation/legislation.html.
[40] News response to OFT questions of 1 February 2011.
[41] News response to OFT questions of 7 February 2011.
[42] News response to OFT questions of 1 February 2011.
[43] News response to OFT questions of 7 February 2011.

the OFT took the view that such a commitment was needed. The OFT believes that, particularly given the importance of staff to the success of a news channel, the inclusion of a non-solicitation obligation would be sensible.[44]

Transfer of contracts – third party consents

9.22. The UIL provide for the transfer to Newco of four specific classes of contracts to which Sky is a party but which would be required by Newco if Sky News were to continue operating in the way it does at present. These four categories of agreement are: (i) carriage agreements with third parties; (ii) DTT capacity agreement with Arqiva; (iii) Channel 5 and IRN wholesale contracts; and (iv) contracts for the supply of content to Sky News/fixed newsgathering.

9.23. Where a third party consent is a critical feature of a particular remedy, then the OFT may be willing to accept undertakings in lieu only once it is clear that such consent will be forthcoming.[45] The OFT notes that, in the time available, it has only been possible to consider whether any of the above agreements proposed to be transferred to Newco were of critical importance to the ongoing viability of Newco where third party consent was required.[46]

9.24. In relation to the carriage agreements with third parties, News provided a list of these contracts, including whether consent would be required in relation to the transfer of each of them.[47] Around a third of these would require consent to be assigned. News argued that it was only the contract [✂].

9.25. [✂]

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[44] In addition, the OFT considers that interim protection is needed in relation to key staff – see paragraph 7.14.

[45] For example, see Completed acquisition by Aggregate Industries UK Limited of Atlantic Aggregates Limited and of Stone Haul Limited, OFT decision 2 March 2009, paragraph 132.

[46] If further investigation showed that these (or any other) agreements were of critical importance to the ongoing viability of Newco, and that third party consents were required, it may be appropriate to consult with those third parties prior to acceptance of the UIL or to obtain confirmation that such consents would be forthcoming.

[47] News response to OFT questions of 1 February 2011. News acknowledged that the list was non-exhaustive at this stage.

9.26. [✂]. In the limited time available, and based on the evidence supplied by the merging parties, the OFT does not, at this stage, believe that any of the existing carriage agreements can individually be said to be of critical importance for the viability of Newco going forward.

9.27. In relation to Sky's current contract with [✂][48] relating to.[49]

9.28. [✂]. The OFT examined the projected revenues and costs of Sky News on two alternative bases, under each of which Sky News would be profitable, namely:[50]

- [✂]; or
- [✂].

9.29. Based on the information supplied by News, the projected cost and revenue implications under either scenario are not significant enough to undermine Newco's profitability.

9.30. [✂]

9.31. [✂]

9.32. [✂]. Given the nature of these contracts (where services are supplied to Sky), the OFT has no reason to believe that Newco would be unable to source supply from these providers on an independent basis.

10. Carriage agreement and brand agreement with Sky[51]

Significance of the carriage agreement to Newco

10.1. Under the carriage agreement Newco will provide 'Sky News' channels and services to Sky on a wholesale basis for distribution by Sky to viewers or subscribers in return for the payment of a carriage fee. News submits that the carriage agreement will provide Newco with 'a significant and long-term revenue stream'. The 10-

[48] [✂].
[49] News response to OFT questions of 1 February 2011.
[50] See paragraphs 3.20 of the Annex.
[51] Paragraphs 4.3, 4.4, 4.5, 4.6 of the UIL.

year term contrasts with carriage agreement durations of three to five years typical in the pay TV industry.

10.2. News submitted that the terms of the proposed Sky carriage agreement reflect the importance of Sky News as part of Sky's offering to its subscribers, and that this importance has provided the basis for Sky's previous investment in, and funding of the net costs of, Sky News.

10.3. The Newco business plan indicates that the Sky carriage agreement would initially account for [✂] per cent of Newco total revenues (in 2010/2011),[52] rising to [✂] per cent of forecast total revenue in 2015/2016, and [✂] per cent of total revenue in 2019/2020.

10.4. [✂]. The Annexe contains a detailed analysis of the revenue projections for Newco including, in particular, the significance of [✂] to the profitability of Newco.

10.5. It is clear that a Sky carriage agreement in place on sufficiently long and financially attractive terms is fundamental to Newco's ability to cover its costs from the outset, and hence to its viability.

Significance of the brand licensing agreement to Newco

10.6. The proposed UIL require that Sky enter into a brand licensing agreement with Newco, which would permit Newco to use the Sky News brand in connection with its news output. This would be subject to payment of a royalty, and associated terms and conditions. In enabling Newco to provide output which is branded as 'Sky News' – an underlying requirement of the proposed carriage agreement – the brand licensing agreement is also key to Newco's ability to generate its main revenue stream, and hence its ongoing viability.

10.7. The brand licensing agreement will also place certain restrictions on Newco's activities, and will be terminable in certain circumstances.

Other agreements of key significance to Newco's viability

10.8. The carriage agreement and the brand licensing agreement are of critical importance to Newco's prospective viability. The UIL

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[52] Sky carriage fees of £[✂]; total revenues of £[✂].

provide for Newco and Sky also to enter into various operational agreements (paragraph 5 of the UIL).

10.9. It is possible that some of the operational agreements are similarly important to Newco's viability and possible also that they could not readily be obtained from third parties other than News/Sky for an identifiable market price. Given the time available, the OFT has not been able to reach a view on whether any such operational agreements fall into this category. However, to the extent that this is the case, the OFT considers that these should be subject to additional oversight as discussed below in relation to the carriage and brand licensing agreements, namely prior approval and restriction on termination.

Prior approval of key agreements

10.10. Whilst the term of the Sky carriage agreement is specified in the proposed UIL, the structure and level of the carriage fees (and hence the value of Sky's contribution to Newco revenue) are not specified. The proposed UIL require that the form of carriage agreement would be subject to approval by the Secretary of State prior to acceptance of the UIL (paragraph 4.3 of the UIL).

10.11. The OFT considers that given the importance of the brand licensing agreement it would be appropriate for it to be subject to a similar approval mechanism. News has indicated[53] it is willing to include this provision.

10.12. In considering approval of these key agreements, the Secretary of State may consider it appropriate to request advice from the OFT and Ofcom on whether the specific proposed terms of the carriage agreement and the brand licensing agreement are acceptable in terms of securing the practical and financial viability of the undertakings. The OFT and/or Ofcom may need to call on expert external advice in relation to assessing the terms of these key agreements.

10.13. To the extent that there are further agreements (other than the carriage agreement and brand licensing agreement) that can be described as of key significance to Newco (see paragraph 10.8

[53] News response to OFT questions of 7 February.

above), then the OFT would recommend that such agreements also be the subject of upfront review and approval by the Secretary of State (and/or the OFT) prior to approval of the UIL.

Termination of key agreements

10.14. The carriage agreement would be terminable by Sky in the event of material breach, or in the event that Newco ceases to produce output which is branded 'Sky News'.

10.15. News explained that 'material breach' would typically be linked to commitments relating to the nature and quality of the channel to be provided to Sky.

10.16. Any change of Control of Newco which led to termination of its Brand Licensing Agreement (which permits Newco to use the 'Sky News' brand) could consequently also result in termination of the carriage agreement.

10.17. The brand licensing agreement would be terminable by Sky in the event of a material breach, or in the event of a change of Control[54] of Newco. Hence if a third party acquired a greater than 40 per cent holding of Newco's shares, Newco would be at risk of termination of both the brand licensing agreement and the carriage agreement.

10.18. Given the importance of the key agreements to the viability of the UIL, any developments resulting in early termination would have major significance. The OFT discusses below whether this consideration should require specific further obligations on News.

Restrictions on termination of the key agreements

10.19. The OFT noted the importance of the key agreements to the viability of the UIL. Although, for the reasons explained elsewhere, the OFT has no reason at present to doubt that News' incentives

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[54] Control is defined in the draft UILs in terms of holding 40 per cent of shares or voting rights. This provision means that Newco would be unlikely to be taken over by a third party, given the implications for the brand licensing agreement, and therefore the carriage agreement. The OFT does not consider that this limitation undermines the financial viability of Newco, but notes that in any event the terms of the brand licensing agreement and the carriage agreement are subject to upfront review by the Secretary of State.

are currently to ensure the successful operation of Sky News as a provider of TV news content to it, the OFT is concerned about the degree of reliance that the UIL place on the continued operation of the carriage agreement and brand licensing agreement. The OFT therefore considered carefully whether the contractual obligations owed by News to Newco in relation to performance of the key agreements should be reinforced in some way.

10.20. Specifically, the OFT considered whether it would be appropriate to seek from News a direct commitment in the UIL to the Secretary of State that News would not terminate the key agreements without first obtaining prior approval from the OFT (such approval to be given only in the event of a material breach by Newco). News argued that an ongoing obligation from it to the Secretary of State in relation to the agreements was unnecessary and considered that this would raise practical issues around how the OFT would determine whether a material breach by News had in fact occurred. News also emphasised its willingness to commit to a more specific dispute resolution mechanism if the OFT considered that an ad hoc mechanism is needed (see paragraph 10.35 below).

10.21. News proposed to undertake in the UIL that it should not be permitted to terminate the key agreements prior to a formal and final determination having been made under that dispute resolution mechanism applicable under the relevant agreement. In order to address any concerns about Newco bearing the costs of arbitration/dispute resolution,[55] News stated it would be prepared to commit in the relevant agreements that it would bear its and Newco's costs of any dispute resolution originating from News' proposed termination (irrespective of the outcome).[56]

10.22. News observed that its proposal had the benefit of avoiding the position where the OFT would itself have to make a determination on a contractual dispute between two independent parties before it is adjudicated under the applicable dispute resolution mechanism.

[55] The OFT noted that, in comparison to News, Newco would be a small business with limited resource to engage in an extended dispute with News.
[56] News response to OFT questions of 9 February.

10.23. The OFT considers that the safeguard suggested by News as described in paragraph 10.21 above provides an acceptable means in order to reduce the risk of an unjustified termination of the key agreements by News that could jeopardise Newco, subject to the details of the safeguard being further developed.

Duration of key agreements

10.24. The proposed term of the carriage agreement is 10 years. News argues that Newco will therefore have a reliable revenue stream for a much longer period than is typical in this sector. Ofcom confirmed this.

10.25. The proposed UIL require that under the brand licensing agreement Newco would receive a licence of the Sky News brand for an initial seven year term, with an automatic renewal for a further seven years, and which may then be extended at the option of Newco for a further three years. [✂].

10.26. The finite duration of the carriage agreement contributes to some uncertainty about Newco's long-term viability as a stand-alone entity. As noted above, in the Newco business plan the carriage agreement accounts for an increasing proportion of Newco forecast total revenues as the term progresses. Newco's prospects at (and in the period leading up to) conclusion of the term may depend on:

- Sky's incentives to negotiate a further carriage agreement;
- the terms Sky may prepared to negotiate at that time; and
- the alternative revenue streams which Newco has been able to develop or may have access to at that point.

10.27. The question therefore arises of how Newco would expect to derive its principal revenue stream once the carriage agreement (at ten years duration) has ended.

10.28. On one view, uncertainty about the prospects for renewal of the carriage agreement on equivalent terms may begin to affect Newco some years before its term date, [✂].

10.29. News argued that if Newco continues to produce a high quality and distinctive news service over the next 10 years, it is likely that Sky will wish to ensure that it can continue to offer Sky News as part of its offering, and renew its funding commitment to Newco in a way that ensures Newco's continued independent economic viability over the foreseeable future. As such, it argued that a renewal by Sky of the Carriage Agreement is by far the most likely counter-factual against which the OFT should consider the viability of NewCo.[57] However, notwithstanding this argument, the OFT believes it is not possible to conclude with any degree of certainty that the carriage agreement will be renewed after the expiry of the ten year period such that Newco's principal revenue stream will continue.

10.30. The OFT has been asked to advise the Secretary of State on whether there are practical issues which could undermine the effective operation of the UIL, and whether the UIL would be effective in the medium and long term.

10.31. The OFT accepts that the substantial length of the key agreements would appear to underpin the short-to-medium term viability of Newco. The OFT notes however, that the finite duration of the carriage agreement may entail a significant risk in relation to long-term viability. The relevance of this risk ultimately depends on the time horizon which the Secretary of State considers as relevant for ensuring the effectiveness of the UIL.

Dispute resolution mechanism

10.32. The proposed UIL do not contain any provision indicating what would happen in the event of a dispute between Sky and Newco in relation to any of the agreements between them, including the carriage agreement and the brand agreement. Successful resolution of such a dispute would be important given the reliance that these proposed UIL would have on the various contractual agreements between the parties.

10.33. The OFT considered that the proposed UIL should be modified by the requirement that the key contracts between Sky and Newco (that is, at least the carriage agreement and brand

[57] News response to OFT questions of 9 February.

licensing agreement – and potentially other agreements: see paragraph 10.9 above) should include within them a dispute resolution mechanism which would be binding on both parties. Such a mechanism would aim to ensure that disputes were settled quickly and efficiently by an independent arbitrator.[58]

10.34. Such an arbitration mechanism in relation to the contracts would impose a positive burden in relation to the party charged with this function. Given the technical nature of the disputes that could arise, the OFT considers that it would not be well placed to fulfil this function, but that consideration be given to the appointment of an expert independent arbitrator, to be funded by News as required.

10.35. News has indicated[59] that it would be willing to include a more specific dispute resolution mechanism (such as arbitration) in the agreements entered into between News and Newco.

11. Operational agreements with Sky[60]

11.1. As set out above in paragraph 10.9, to the extent that any of the operational agreements are of critical importance to Newco's viability and could not readily be obtained from third parties other than News/Sky for an identifiable market price, the OFT considers that they should be subject to similar protections given to the carriage agreement and brand license agreement.

11.2. However, with regard to operational agreements falling short of this status (that is, on the basis that the services to which they relate could potentially be sourced from third parties), the practical viability of Newco, at least initially, requires it to have ongoing access to currently shared technical facilities, and initial agreements in place to enable it to function effectively from the outset. This section considers how these agreements, that are not the subject of the upfront protection discussed in section 10, are treated under the UIL.

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[58] The OFT has not had time to consider with News the terms by which such arbitration or dispute resolution would proceed, but would envisage that these would have regard to the terms of the contract and the terms of the UIL themselves.
[59] News response to OFT questions of 7 February.
[60] Paragraph 5.1 of the UIL.

11.3. It is helpful to note at this point that the OFT's guidance recognises that, '*[i]n certain cases, contractual provisions such as purchase or supply arrangements between the seller and the purchaser may be necessary to support a structural divestment on an interim basis, although it will be relatively rare that this is the case given the requirement at the OFT stage for a divestment to act as a clear-cut remedy.*'[61]

11.4. The proposed UIL require that Sky will, if required by Newco, enter into various agreements under which Sky will provide facilities and support services to Newco, on arms' length terms. Specific agreements listed in the UIL are:

- an advertising sales agreement under which Sky will sell advertising and sponsorship on behalf of Newco for a term of up to three years (or such shorter time as required by Newco);
- a lease of existing Sky News land and buildings to Newco for a period of up to 15 years;
- a site support services agreement, covering services such as IT support services for a term comparable with the term of the lease; and
- a broadcast and technical services agreement, covering satellite capacity, playout and uplink, DTT transmission, online transmission and mobile distribution, for a term of up to 10 years.

11.5. News and Sky have each noted that Sky currently has agreements of this sort with various third party channel providers ([✂]).

11.6. The initial services agreements would be put in place before the spin-off of Newco. News has indicated that the pricing of the above services (other than the advertising sales agreement[62]) would be fixed at Sky's cost of provision plus a five per cent margin, with increases each year measured by CPI.[63] News further stated that it would be willing to commit to such a cost structure within the UIL if required. News stated that Newco would be free to source

[61] See OFT Exceptions and UIL guidance, paragraph 5.23.
[62] News stated that the terms of the advertising sales agreement would be [✂].
[63] News response to OFT questions of 7 February.

services from third parties once its initial service agreements with Sky have expired if it chose to do so, or subject to early termination provisions to be agreed in the relevant contracts, and that this will also give Newco the ability to market test the terms being offered by Sky.

11.7. The UIL do not contain any provisions for monitoring or approval of the pricing or terms of initial services agreements, nor dispute resolution in relation to ongoing operational relationships between Sky and Newco. The proposed UIL also do not make such agreements between Newco and News a mandatory part of the ongoing Newco business. Rather, the option for them is provided to Newco, with the duration of the potential agreement specified in the majority of cases (for example, that the lease of the land and buildings should be for a period of up to 15 years).

11.8. To the extent that these agreements could be provided by third parties in the event that Sky News and News were for some reason unable to agree terms following spin-off of Newco, the OFT does not believe that the UIL need to provide for the continuation of these agreement beyond the initial terms set out in paragraph 5.1 of the UIL.

11.9. The OFT nevertheless considers that the current position under the UIL, under which such agreements are merely potentially available, is confusing given that News/Sky will have set up Newco and that Newco will inevitably require such services at its inception in order to be able to commence operations and function as a news channel provider.

11.10. The OFT would therefore recommend that the proposed UIL be amended such that:

- News is required to put in place, or to procure the putting into place of such agreements at the time of the spin-off of Sky News for the terms provided for in paragraph 5.1 of the proposed UIL;

- the UIL include reference to the pricing structures for these agreements (as described in paragraph 11.6 above);

- the list of initial operational agreements and associated services required by Newco to operate its core business are set out in full;

- the UIL require that Newco be provided with termination rights in relation to each of these contracts, with a reasonably short notice period; News/Sky should not enjoy such termination rights; and

- to the extent that a monitoring or arbitration function is envisaged in relation to the key agreement aspects of the UIL, that this mechanism should extend also to resolution of any disputes in relation to these agreements.

12. Review of Sky News income and cost projections

12.1. The OFT summarises in this section the financial analysis set out in the Annexe. This analysis relies on information supplied, in the main, by News and limited discussions with Sky. The OFT notes that it has had limited time to review the income and cost projections supplied by News; the forecasts supplied by News are based on its review of Sky and Sky News' financial information and industry knowledge; and the OFT understands that the information supplied has not been subject to rigorous analysis by Sky or Sky News itself [✂].

12.2. The UIL propose that Sky News be formed into an independent public limited company, Newco, following Sky's development of Sky News over the last two decades. The financial analysis review conducted by the OFT has focussed on a review of assumptions and, where possible, some consideration of risks that could mean that projections are not achieved, such as income shortfall or cost overrun, which could threaten the viability of Newco.

12.3. [✂]. The UIL envisage contractual arrangements that provide a significant payment from Sky to Newco, for the news service and, on the basis of projections provided, would be expected to keep Newco profitable, for the duration of those arrangements. The use of the Sky name would continue, in return for a payment from Newco related to its revenue.

12.4. The two way income flow, with the bulk of the net income transfer from Sky to Newco for provision of the news service, is intended to ensure that incentives are aligned:

- Newco has the financial resources to continue providing a 24-hour news service. It continues to operate under the Sky News brand which has achieved a strong reputation;

- Sky has an incentive to utilise the news service for which a substantial payment is being made. While the carriage agreement remains in force, this may provide a significant disincentive to set up a competing news service, which would undermine Newco, diminishing the return from Sky's 39 per cent share in Newco; and

- similarly, while the brand licensing agreement is in force, use of the Sky brand ensures that Sky will want Sky News to maintain a good reputation for high quality output.

12.5. [✂]. Newco would be strengthened by the size of the payment under the carriage agreement, which provides a strong and relatively stable income stream and shows the high value that News appears to place on the news service. [✂].

12.6. The period over which the OFT has considered the financial viability of Newco extends to 2019/20 (FY20), for which financial projections have been provided and which approximates the period of the carriage agreement.

12.7. The OFT's analysis in the Annexe considers Newco's projected profitability, followed by a review of revenue and costs.

Overall assessment

12.8. Forecasting accurately over a 10 year period is difficult, particularly in an area where technological change can be rapid. A small error in assumptions can lead to an increasing cumulative effect at the end of the period, or a combination of adverse events could cause an otherwise profitable company to move into losses that could ultimately threaten its financial viability. However a reasonable test of financial viability would be that the proposed structure and projections are based on reasonable assumptions and there is some flexibility to handle any unforeseen problems that arise.

12.9. Sky News is currently a directorate within Sky, but is not accounted for on a standalone basis. [✂].

12.10. [✂].

12.11. This change is driven by a subscriber-related payment for the news service totalling £[✂] in FY12. Additional charges in FY12 of circa £[✂] relate to property and facilities (£[✂]); depreciation on equipment (£[✂]); new 'listed company costs' (£[✂]) and a new charge for use of the 'Sky News' brand (almost £[✂]).

12.12. After reviewing the financial projections, some risks to the achievement of the projections and ways in which confidence in Newco's continued viability could be increased are outlined in the Annexe, which also contains a more detailed review of the financial information provided. The key importance of the carriage agreement and brand licensing agreement is emphasised.

12.13. Although well-placed in terms of HD technology, 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. Success in raising funds would depend on the return expected from the investment and the period over which the return was expected to be made.

Operating Profit[64] 2011/12 – 2019/20

[✂]

12.14. While it is possible to imagine a combination of unfavourable events that could cause the financial viability of Newco to be threatened, this is not considered to be very likely. The assumptions made in the projections for Newco appear to be reasonable and there is some flexibility to handle unforeseen

[64] Operating Profit excludes the £[✂] per year revenues earned through joint ventures.

problems. The benefit of the assured income from the carriage agreement strengthens the financial position of Newco. While this agreement operates, based on the evidence seen, the OFT has no reason to expect that Newco would not be financially viable.

Clive Maxwell
Executive Director, Office of Fair Trading
11 February 2011

Annexe

Analysis of Revenue and Cost Projections

1 **Overall profitability**

1.1 This Annex sets out the OFT's analysis of Sky News income and cost projections.

1.2 The analysis relies on information supplied, in the main, by News and limited discussions with Sky. The OFT notes that it has had limited time to review the income and cost projections supplied by News; the forecasts supplied by News are based on its review of Sky and Sky News' financial information and industry knowledge; and the OFT understands that the information supplied has not been subject to rigorous analysis by Sky or Sky News itself or the subject of external assessment.

1.3 Sky News is currently a directorate within Sky, but is not accounted on a standalone basis. [✂].

1.4 Based on the projections provided, when Newco is formed additional income streams partly offset by new recharges of costs, will increase operating profit by £[✂] to show an operating profit of £[✂] in 2011-12 (FY12):

1.5 This change is driven by a subscriber-related payment for the news service totalling £[✂] in FY12. Additional charges in FY12 of £[✂] relate to property and facilities (£[✂]); depreciation on equipment (£[✂]); new "listed company costs" (£[✂]) and a new charge for use of the 'Sky News' brand (almost £[✂]).

1.6 [✂].

Operating Profit[65] 2011/12 - 2019/20

[✂]

Analysis of Revenue

[✂]

2 Revenue

2.1 **Total revenue** projected in FY12 amounts to £[✂], comprising:

2.2 **Sky subscription payment:** £[✂] payment from Sky based on a carriage agreement between Sky and Newco. Payment is based on the number of Sky subscribers, the number of Sky HD subscribers, and an exclusivity premium as long as Sky News HD is only distributed on Sky platforms.

2.3 Subscriptions are based on December 2010 reported subscribers and HD penetration. [✂].

2.4 [✂].

2.5 **Sensitivity:** HD penetration grows from [✂] per cent in FY11 to [✂] per cent in FY15. If the increase was a [✂] at [✂] per cent in FY15, with HD subscribers increasing from [✂] to [✂] (rather than [✂]), income would be almost £[✂] lower in FY15. This compares with projected operating profit of £[✂] in that year.

2.6 [✂].

2.7 **Other subscriptions:** £[✂] payment is received for supply to other subscriptions, [✂].

2.8 **Sensitivity:** Income would be £[✂] from FY15 [✂].

[65] Operating Profit excludes the £[✂] per year revenues earned through joint ventures.

2.9 If the market for news on tablets grew less rapidly or was less remunerative, income would be up to £[✂] lower. However it is quite possible that other technological opportunities, as yet unknown, could offset this, particularly if Newco had access to technological developments made within Sky.

2.10 **Net advertising and sponsorship**: Income of £[✂] largely stems from spot advertising revenue, with smaller contributions from sponsorship and other forms of advertising. [✂].

2.11 This revenue is dependent on a contract with Sky to sell advertising and sponsorship. Commission of [✂] per cent and a sales margin of [✂] per cent are deducted from revenue.

2.12 **Sensitivity:** Dependence on Sky to sell advertising: [✂].

2.13 **Syndication:** Income of £[✂]: All syndication contracts will be transferred from Sky to Newco. The Five News contract, with income of £[✂] in FY12, comprises over [✂] per cent of this income, with the supply contract coming up for renewal in [✂]. It is assumed that the contract is renegotiated in [✂] with [✂].

2.14 **Sensitivity:** If the Five News deal is not renewed, income would be £[✂] lower from [✂], with costs around £[✂] lower.

2.15 **Income from joint ventures** of £[✂] is assumed across the period.

2.16 Overall, revenue of £[✂] will derive from Sky in [✂], (or £[✂] if including advertising revenue sold by Sky for Sky News). This would amount to around [✂] per cent of the total revenue stream, excluding advertising. Due to the expected growth in the carriage agreement payment, this is projected to increase to £[✂] or [✂] per cent of income in [✂] (£[✂] or [✂] per cent of total including advertising revenue). [✂].

2.17 This underlines the key importance of the carriage agreement and the relationship between Sky and Newco. Beyond the term of the carriage agreement an independent Newco would be very unlikely to be financially viable, unless the agreement is renewed or equivalent favourable arrangements were agreed.

Analysis of Costs

[✂]

3 **Analysis of costs**

3.1 **Total costs [✂]:**

3.2 **Programming costs [✂].**

3.3 Newsgathering costs comprise activities to find, compile and package the news stories. Costs growth recognises cost swings due to the expense of major events in the year, for example the Olympic Games in 2012.

3.4 [✂].

3.5 Online and multimedia costs represent the incremental costs associated with producing online, tablet and mobile products.

3.6 [✂].

3.7 **Sensitivity:** If the Five News contract is not renewed after [✂], costs will be £[✂] lower, but margin will also be reduced by a further £[✂] (see Syndication revenue comment).

3.8 [✂]. If annual inflation was [✂]per cent p.a. higher from [✂], programming cost would be around [✂] per cent (£[✂]) higher by [✂].

3.9 **Administrative costs of [✂].**

3.10 Corporate costs include both existing staff who support Sky News and an estimate of additional costs (£[✂]) arising from the creation of a new company including staff (for example, company secretary), cost of board meetings and audit, and need for a new incentive plan.

3.11 Property and facilities costs include rent, rates, utilities and facilities plus IT support to shared corporate systems e.g. HR. This is based on a 15 year agreement to lease land and buildings at cost plus [✂] per cent margin, [✂].

3.12 [✂].

3.13 Details of the assets involved are not currently available, but would need to be reviewed by Newco to ensure the value was appropriate.

3.14 [✂].

3.15 **Sensitivity**: The cost projections are significantly affected by the assumed rate of price inflation. If inflation averaged three per cent higher from [✂], administrative costs would be [✂] per cent (£[✂]) higher by [✂].

3.16 The contract for premises and facilities is envisaged to run for 15 years, whereas the carriage agreement runs for 10 years (the period subject to review). Unless Newco had a break clause available after 10 years, it could be committed to the premises with associated costs for a longer period.

3.17 **Technical** and broadcast **operations** of £[✂]: These costs include technical services needed to provide the news service such as satellite capacity, uplink services, DTT transmission, online transmission and mobile distribution. Sky proposes to offer a 10 year, fixed price contract for these services, or shorter if preferred, based at cost (rising at CPI) plus five per cent margin.

3.18 Broadcast operations and creative services would be provided and charged on actual usage, at cost plus five per cent margin; however for these services, News indicated that Newco would be free to move to a different third party supplier at short notice.

3.19 While the DTT capacity providing access to the Freeview channel would be charged initially at £[✂], the contract for the capacity expires in [✂], and it is assumed that Newco would negotiate directly with the supplier, [✂]. As a small company, Newco would be in a less strong position than Sky to negotiate a favourable deal.

3.20 [✂].

3.21 **Sensitivity:** The largest unknown is the availability and cost of the DTT transmission when the contract is renegotiated by Newco which would have significantly less financial negotiating power than News. [✂]. If the contract was not renewed, Sky estimate that costs of around £[✂] would be saved, but advertising revenue of £[✂] would be lost, overall a net revenue reduction of £[✂].

3.22 **Brand licensing costs** of £[✂] relate to payments made to Sky for use of the 'Sky News' brand. [✂].

3.23 The licensing agreement would give Newco assurance that it would continue to have access to the 'Sky News' name, so it is important that the brand licensing agreement give Newco assurance that the cost would not significantly increase on renewal of the contract

3.24 **Marketing costs** of £[✂] are projected based on current spending plus an additional £[✂] for advertising as an independent channel, assuming that Newco would be responsible for its own marketing.

3.25 **Sensitivity:** This level of advertising may underestimate the cost of establishing Sky News as an independent operation. In particular, opportunities to be advertised across Sky channels would be less easily available and likely to be more expensive, as market rates are charged, rather than costs not being allocated.

3.26 Property and facilities (£[✂]) and technical services (c. £[✂]) are very likely to be provided by Sky and broadcast operations and creative services might be supplied (c. £[✂]), suggesting a total of around £[✂] provided by Sky, [✂] per cent of their [✂] cost base. [✂].

4 Ability to raise funds to finance technological change

4.1 The investment made in high definition technology means that Newco is currently well placed in terms of technology. However technology can change rapidly and the possibility that substantial further investment would be required cannot be ruled out over the

10 year period considered. Newco would not be in as strong a position as Sky to provide any finance that would be required.

4.2 If these technological opportunities require additional capital investment there are three options available to Newco:

- Using retained earnings. This will depend on future earnings steam and dividend decisions that have been taken;

- Raising debt: There is a possibility of borrowing, possibly against the value of its fixed assets or its future income stream; and

- Raising additional capital: Newco could raise the required capital through a further rights issue or external share issue.

4.3 The likelihood of success in raising funds would depend on the return expected from the investment, alternatives available and the remaining term for the carriage agreement and expectations over its likely renewal. The smaller size of Newco could be a constraint in financing a major investment.

5 Risks

5.1 **Exposure to Inflation:** [✂].

5.2 [✂].

5.3 [✂].

5.4 **Carriage agreement**: The payments made under the carriage agreement are crucial to the financial viability of Newco. If the arrangement was ended, unless the financial gap was closed by other forms of revenue, Newco would lose its major income stream and move into substantial losses.

5.5 While the agreement operates, this risk is mitigated by the term of the agreement and Sky's incentive to protect its brand and its apparent ongoing need for a well respected news service.

5.6 **Brand licensing deal:** The Sky brand is an important and valuable element of the Sky News product. The existence of a seven-year licensing arrangement gives continuity of the use of the name, which would be expected to be extended for a further seven years.

5.7 The price at which the contract would be renewed is very important to Newco and any substantial increase in the licensing cost at Sky's instigation could seriously damage Newco's financial position. However, [News] has confirmed that there will not be an increase in the brand loyalty fee if the licensing agreement is extended beyond the initial seven years.

5.8 **Estimation of costs:** [✂].

5.9 **DTT transmission contract:** The current arrangement for DTT capacity was agreed between Sky and [✂] and is due to be renegotiated in [✂]. [✂].

5.10 **Advertising revenue:** [✂]. TV advertising may not increase in demand, given alternative media available, particularly online and mobile. Also, another economic recession is a possibility that could lead in a significant fall in advertising revenue.

6 News Assessment of Risks to Financial Projections

6.1 [✂].

6.2 [✂].

7 Assessment of Risks

7.1 In the case of greater difficulties, the ability of Newco to survive short term losses would depend on its financial resources, and the company set up is projected to have some strengths:

- currently Sky News is unique insofar as it is the only HD 24 hour news channel in Europe;
- the company is set up with share capital of £[✂] and an initial cash injection of £[✂], of which half is expected to finance receivables;
- [✂];

- there is no gearing, so there could be potential to borrow against future earnings;
- shareholders, [✂], might be willing to provide further capital injections if required, as long as it maintained a strong interest in the supply of Sky News; and
- [✂].

7.2 While it is possible to imagine a combination of unfavourable events that could cause the financial viability of Newco to be threatened, this is not considered to be very likely. The assumptions made in the projections for Newco appear to be reasonable and there is some flexibility to handle unforeseen problems. The benefit of the assured income from the carriage agreement strengthens the financial position of Newco and while this agreement operates, and based on the evidence seen, the OFT has no reason to anticipate that Newco is not likely to be financially viable.

7.3 There are some areas where improvement in the financial arrangements could further reduce the risks to Newco, making it stronger and more able to face uncertainties in the future, such as:

- [✂];
- [✂]; and
- [✂].

8 Additional Future Financial Risk

8.1 Looking 10 years ahead, uncertainty about the continuation of the carriage agreement that provides the main income stream for Newco could lead to share price weakness in the final years of the agreement. Unless the agreement was renewed on favourable terms, or unexpectedly large alternative revenue sources were identified by Newco, it is difficult to foresee how Newco would continue to be viable as an independent company. [✂].

ENDNOTES

1. The OFT has corrected references in square brackets in paragraphs 1.14, 7.3 and 7.27, which were originally to 'listed' and 'listing' in its confidential report.

2. The OFT has corrected references in square brackets in paragraphs 6.2, 6.3, 6.5, 6.6 and 6.7, which were originally to 'The parties', 'they' and 'their' in its confidential report.

3. The OFT has corrected 'could' in square brackets in paragraph 9.11 which was originally 'will' in its confidential report.

4. The OFT has corrected 'Newco' in square brackets in paragraph 7.27 which was originally 'News' in its confidential report.

5. The OFT has corrected 'News' in square brackets in Annex 5.7 which was originally 'Sky' in its confidential report.