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Prime Minister

You will also want to see

Brian's postscript (Flag) which indicates some confusion in the IBA.

PRIME MINISTER

6 November 1990

AT 6/11

SKY - BSB MERGER

While the details of the merger are still being worked out the following major features are agreed:

- the new company British Sky Broadcasting will be owned 50/50 by News International and BSB's shareholders (Reed International, Pearson, Granada, Chargeurs); (See Diagram)
- the Chairman of the new group is Ian Irvine, Deputy Chief Executive of Reed and Chairman of TV am (Bruce Gyngell speaks very highly of him);
- the new company will provide a 5 channel service drawn from BSB's existing 5 channels and Sky's 4 (probably 2 film channels, Sky News, one sports channel, and one entertainment channel);
- initial transmission will use both the Astra satellite (from which Sky leases its transponders) and BSB's own Marco Polo satellite: but the intention is to phase out the latter as BSB subscribers have their equipment replaced by Astra dishes.

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Reasons for the Merger

The major reason for the merger is financial. Sky has been losing £2.3 million a week and BSB has been losing £8 million a week. When the negotiations started BSB had spent £900 million and was about to draw on its tranche of loans which had severe performance clauses attached and which they would not have met. Both companies are facing a decline in advertising revenue and News International which has enormous debt (about £4 billion) faces declining markets in other parts of the world in which it operates. Meanwhile BSB had only sold 100,000 dishes and while their target was to sell 20,000 per week they were actually selling 8,000.

Murdoch's strong opinion is that BSB has been badly managed - a judgement which I think is not open to question.

Already BSB have spent £900 million with very inadequate cost controls in certain areas eg. the chief executive drove a Bentley and senior staff BMWs; the directors did not want to give a major party at the launch so the chief executive took senior staff and their families (including children) to Cape Canaveral for a weekend at a cost of £1m; BSB's studios and offices are in the Marco Polo building near Chelsea Bridge, whereas Sky is an industrial estate in Osterley!; many people who know Hollywood have told me that BSB paid very fancy prices to build up a film archive eg. for an equivalent amount of second tier movies specially made for television and due to be delivered in 1992-3 Sky has paid £1.9 million for them and BSB £74 million for them.

A few months ago the Chief Executive of BSB was quoted in the press as saying "I can't tell you how enjoyable it is to be spending other peoples money." This kind of statement raises questions about the role played by the Chairman of BSB, Sir Trevor Holdsworth and the shareholders.

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Consequences of the Merger

The merger is effectively a takeover of BSB by Sky:

- (a) The new company will be managed by the chief executive of Sky and the operating base of the company will be the old Sky.
- (b) At present the total employment of both companies is 2,000 (roughly 50/50): Murdoch is looking for redundancies of around 1,000, the major part of which will come from BSB.
- (c) The new company will use PAL technology which is used at present by Sky rather than the more sophisticated DMAC system used by BSB.

The main driving force for developing the MAC standard was the IBA research department. Although it was technologically interesting it was never commercially driven. It really arose out of the fact that in the early eighties it was thought one could not have a low power technology capable of delivering entertainment services by satellite. Technological developments in the eighties proved this wrong. America and Japan stuck with PAL. Meanwhile the difficulties in developing MAC technology was one of the reasons BSB failed to get off the ground and offer serious competition to Sky.

- (d) The arrangements for profit (which reflect the capital structure) are:
 - continuing losses 20:80 in favour of News International;
 - first £400 million of distributable profits to be paid 80:20 in favour of News International;

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- profits then divided 50:50 for twice the period it took to achieve the first £400 million;
- 80:20 pay-out in favour of BSB shareholders for a further £400 million;
- and then equality of pay-out.

Legal Position

This is complicated because in the short term it is proposed that both the Astra and BSB satellites will be used for transmission; but these involve different regulatory regimes.

The Astra satellite does not use UK allocated broadcasting frequencies (ie DBS) and is effectively outside UK regulatory control. Because these channels are carried on cable systems, basic consumer protection standards are enforced by the Cable Authority (under the 1984 Cable and Broadcasting Act). From 1 January 1991, the Broadcasting Act comes into force, and services using Astra will be regulated by the ITC as non-domestic satellite services - involving consumer protection requirements and ownership restrictions (eg prohibition on cross-ownership in DBS licenses exceeding 20%).

BSB is different. Its license to provide a DBS service (5 channels) was granted by the IBA under the 1981 Broadcasting Act. This license involves programming requirements and ownership rules. The latter stipulate that a DBS contractor cannot be controlled by a non-EC company and involves restrictions on newspaper ownership, if the IBA or Secretary of State deem this necessary "in the public interest". This contract is due to be transferred to the ITC in January 1991 and to be replaced on 1 January 1993 with a domestic satellite service license. It is expected that this will involve a prohibition on newspaper

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interests exceeding 20% in the domestic satellite license.

The merger is being examined in government by the IBA and the OFT.

Issues Facing the IBA

The IBA were not consulted in advance about the merger. The question they face is whether they should transfer BSB's existing DBS contract to the new company. This involves three issues:

(a) Control from outside the EC

A 50% interest does not give News International de jure control, but as the other 50% is held by a number of shareholders it might mean de facto control.

(b) Newspaper Interest

Newspaper shareholders must not act contrary to the public interest (Section 23 of the 1981 Broadcasting Act). Traditionally the IBA have interpreted this to mean an equity holding of no more than 20%. But they relaxed this in the case of Pearsons' holding in BSB, when Bond withdrew. In the new company they must consider the interest of both Pearson and News International.

(c) Transferring the Contract to a New Company

This will depend on legal advice as to whether it is possible under the terms of the Act.

Aside from the legal issues there are the commercial realities. The new company only wishes to use the BSB satellite for a limited period of time. If the IBA refused permission this would

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simply mean depriving some existing BSB subscribers until they have new Astra dishes.

In addition, in the past, in the cases of LWT and TV am, the IBA has allowed these companies to continue operating despite their failure to meet programme commitments.

Competition Issues

The competition aspects facing the OFT fall under the merger provisions of the 1973 Fair Trading Act.

The OFT have indicated publicly that they are thinking about the issue but they are at a very early stage. One complication is that the Sadler enquiry, which is looking at cross-media promotions involving publishing and broadcasting, and which arose out of complaints by BSB about Sky, is not due to report until the end of the year. It will cover some of the same issues.

Meanwhile the initial view of the OFT is that the merger will not significantly reduce competition. Indeed the very opposite may be true. Sky has been the most successful competition so far for the duopoly. The fact that satellite television companies are reduced from 2 to 1 but that the new company is that much stronger, (whereas Sky and BSB separately were likely to collapse) must strengthen competition in television. Despite the fact that the company has a monopoly of satellite television transmission, satellite television is only 2% of the television market.

In addition to that Astra is an 'open' system. At present it has 16 channels. It will have 32 by February 1991 and 48 by late 1992. It is quite likely that Disney, CNN and HBO will take up other channels on Astra as well as many other foreign companies. This is real competition for the duopoly.

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Apart from competition the OFT may also concern itself with the broader public interest, because of the involvement by newspapers on the new company. It would seem odd however for the OFT to review legislation in this area given that the Bill became law only last week.

Conclusions

1. Without the merger BSB would have gone bust in a matter of days.
2. Satellite television in Britain is more viable with the new merged company than previously.
3. The new company does not reduce competition in any meaningful sense: in fact it strengthens it.
4. The government's broadcasting policy objectives are not damaged by the merger: they were and remain to create a level playing field between terrestrial and non-terrestrial technologies but not to back winners. This is precisely what is happening as a result of the new Act and the merger.
5. It is highly unlikely that either the IBA or the OFT will raise objections to the merger.
6. The one issue however which will be raised in public debate is the cross-ownership between newspaper and television. There will be a vicious public campaign made up of the Good and the Great on the Left to denigrate Murdoch and everything he stands for.

When satellite television proves to be commercially successful, cross-ownership will become an issue.

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Meanwhile, when satellite TV has less than 2% of the total market, and the problem for satellite companies is survival, this is not an issue that should or need concern us now.

Brian Griffiths

BRIAN GRIFFITHS

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PRIME MINISTER

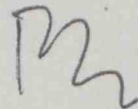
6 November 1990
8.00 pm

SKY - BSB MERGER

A curious thing happened this evening. During the late afternoon George Russell rang me from his car and we discussed the above. He said that he was keen for the merger to go ahead and saw no real problems, except that when satellite became successful there would be a problem down the road in terms of cross-ownership between newspapers and television companies. He said that he was on his way to the IBA, having been visiting companies all day.

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My suspicion is that when he arrived at the IBA he was lobbied furiously by IBA officials to take the strongest possible action.



BRIAN GRIFFITHS

(114)

ANDREW TURNBULL

6 November 1990

BSB/SKY MERGER

Chris Scoble in the Home Office informs me that the IBA did not know of the merger until it was announced on Friday evening at 9.00 pm.

Home Office officials were informed at around 4.00 pm on Friday afternoon that a merger would be announced later that day.

Brian Griffiths

BRIAN GRIFFITHS

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