April 28, 2015

TO: The voting members of the ‘Pataphysical Broadcasting Foundation, Inc.

The Board of Directors requests an advisory vote from the Foundation’s voting membership on the following question:

“Should the ‘Pataphysical Broadcasting Foundation enter into a Letter of Intent to assign through a purchase agreement its current FCC licenses and transmitting equipment to Classical Public Radio Network, while retaining all of its other assets (including KUSP’s call letters, trademarks, programming rights, music library, studio equipment and leases, and donor lists)?

This would allow KUSP to retire accumulated debt, avoid bankruptcy, and preserve the possibility of continuing our mission and stated corporate purposes in some other form.”

**Your Board of Directors recommends a yes vote.**

This statement provides you with background on KUSP’s present situation and the options the Board and station management believe are open to the Foundation if we proceed with this Letter of Intent, and if we do not.

## LONG-TERM BACKGROUND

In 1971 the founding Articles of Incorporation of the Foundation stated that its specific and primary purposes are “to operate a non-profit educational radio station and to perform public services.” The organizational mission statement was revised in 2005 and has only had minor editorial changes in the past ten years. It presently reads, “KUSP is an independent, community-based nonprofit interactive multimedia voice serving the greater Monterey Bay Area. We inform, engage, and entertain our community by providing a thoughtful mix of news, public affairs, arts, and music programming.”

Operation of the Foundation and KUSP has followed the principles defined in the mission statement and the Articles of Incorporation, and been governed by applicable law and the Foundation’s Bylaws. The Bylaws were restated in 1991; only technical amendments, to comply with new FCC rules and permit electronic voting, have been made in the past twenty-four years.

Since sign-on in 1972 the KUSP format has mixed multiple genres of music with news and information, in line with the mission statement. For over thirty years KUSP programming has included news from NPR and other national distributors.

The net assets of the Foundation generally increased until about 2001, which was the year after KAZU was acquired by Cal State Monterey Bay and switched to a full-time news and information format. Despite the best efforts of management and fundraising performance that is substantially above national benchmarks for public radio (when factoring in the size of the station’s audience), the station’s financial condition has steadily deteriorated since 2001. Since 2011 the station’s audited financial statements have noted that the Foundation was investigating the combination of some or all of KUSP's operations with other California public radio stations. The note goes on to say that if that strategy proved unsuccessful the Foundation would seek to assign its FCC licenses and other assets to a nonprofit entity qualified to operate a public radio station.

In seeking prospective public radio partners the Board and management had these objectives:

- Restoring financial health and sustainability for the Foundation;
- Maintaining capacity to create local programming and distribute it as widely as possible;
- Fostering diversity in public radio programming available to listeners in the region;
- Maximizing local control over the region's public media resources;
- Providing fair wages and appropriate working conditions for Foundation employees.

**RECENT DEVELOPMENTS**

Political and civic leaders strongly urged KUSP to seek some kind of combined operation with KAZU after the appointment of Eduardo Ochoa as Cal State Monterey Bay's new President in 2012. This initiative was also strongly supported by KUSP's Community Advisory Board and many donors. A number of major donors made exceptional gifts to ensure KUSP would remain financially viable while discussions proceeded. At the end of 2013 President Ochoa informed KUSP that the university was not interested in pursuing any sort of combined public radio operation.

After discussions with Cal State Monterey Bay ended, KUSP explored possible partnerships with public radio stations immediately north, south, and east of our service area. None expressed interest. Concurrently we entered into an agreement with Public Media Company, or PMC (a national nonprofit providing financial and strategic planning services to public broadcasters) to seek possible partners beyond the immediate area, given the above objectives. This was reported to the Foundation at the 2014 Annual Meeting last May.

A special meeting of the Foundation was called in September 2014 to report on progress over the summer. At that meeting a "straw poll" indicated widespread support for initiating partnership discussions with KCRW in Santa Monica, which had indicated to PMC its interest in working with KUSP. At the time KCRW was completing its first expansion of programming and production capacity outside the Los Angeles area, through a complicated multi-party transaction in Santa Barbara.

By March 2015 the KCRW discussions yielded a programming agreement that describes the limited collaboration KCRW is prepared to offer KUSP. The scope of this programming agreement is much smaller than the deeper collaboration (referred to in the industry as a Public Service Operating Agreement) that the KUSP negotiating team presented as a possibility to the Foundation at the September 2014 special meeting. If it is implemented, the March 2015 programming agreement would facilitate a format shift away from news and information (except in drive times) and towards eclectic music, with a limited amount of music and informational programming continuing to be produced at KUSP. In those ways, this plan is similar to what was presented to the Foundation in September.

However, the limitations KCRW placed on its involvement with KUSP would require much more administration, fund-raising, and online content work to be done by KUSP personnel exclusively and indefinitely, as opposed to becoming a shared effort by KCRW and KUSP. The economic relationship between the stations and program distributors like NPR would also be different. The net effect would be significantly higher costs to run KUSP than management expected last fall.

Management now feels that a KCRW partnership (under the constraints defined by KCRW), while it would not necessarily eliminate all the Santa Cruz-produced programming elements envisioned initially, would reduce those elements to a larger extent than was presented to the Foundation at the special meeting. It may reduce them to such an extent that we would (at least initially) not be able to meet most of the objectives for a station partnership that had guided the Board and management throughout the process over the years. Nor is management certain that this method of operation would be financially sustainable in the short or long term, even with these constraints on the programming budget.

## CLASSICAL PUBLIC RADIO NETWORK PROPOSAL

Aware of the negotiating team's concerns about the viability of moving forward with KCRW, PMC reached out to another large public radio enterprise and established its interest in a transaction involving KUSP – but the nature of that possible transaction would be completely different than any plan KUSP had previously discussed with other stations.

Classical Public Radio Network (CPRN) is a limited liability company controlled by the University of Southern California (USC). In its own right and through CPRN, USC operates public radio stations in Northern and Southern California. The Northern California headquarters is in San Francisco and the station brand there is KDFC; the Southern California headquarters is in downtown Los Angeles and the station brand there is KUSC. There are some programming differences between San Francisco and Los Angeles, but many supporting functions are combined, enabling great operational efficiency.

By many yardsticks, USC/CPRN is the most successful public radio organization in the U.S. programming classical music. Their stations now reach over one million California residents every week, far more than any rival in the nation. They are strong and well regarded partners by established as well as up-and-coming classical music presenting organizations. All the stations program classical music exclusively.

CPRN proposes to acquire these assets (and only these assets) from KUSP:

- Our FCC broadcast licenses,
- The transmitting equipment connected to these licenses,
- The leases for these transmitter and translator sites.

The value assigned to these assets (which is still subject to negotiation), to be paid in cash at closing, would be more than enough to pay off all of KUSP's liabilities. Those liabilities include overdue programming payments to our national programming suppliers, an operating loan from the Santa Cruz Community Credit Union, and personal loans made by the Board President and the General Manager in order to keep the station running during recent difficult financial periods.

If this asset purchase was consummated promptly and the above liabilities were paid off in full, the Foundation would have essentially no liabilities (other than contingent liabilities related to personnel, such as vacation owed to employees that would need to be paid out if they were to leave the company) and would retain the following assets:

- Our current nonprofit tax exempt status,
- Cash estimated to be between $100,000 and $300,000,
- Our trademarks (including KUSP and kusp.org) and goodwill,
- All our programming and programming rights,
- Our donor lists and donor history,
- Our music library,
- Our studio equipment and studio lease.

We might not have to (or might not choose to) pay off all our liabilities immediately in such a scenario, which would increase our cash on hand but require debt payments in the future.

In such a situation, the Foundation (acting through its Board of Directors) would have a number of options in terms of how to proceed as an organization. This would not be the first time in public radio history that such a situation arose. There are examples of stations using such an opportunity to start or acquire another FM signal; there are also examples of stations that furthered their mission and purpose by moving into public media roles that did not involve FM broadcast station ownership, such as Internet-only broadcasting or serving as a studio/production center. Given the rapid growth of audience for “public radio” content distributed online, future opportunities along those lines might be significant.

The CPRN Letter of Intent to negotiate an asset purchase expires on May 15, 2015. As CPRN is seeking growth opportunities and other acquisition opportunities are probably open to it in this market (including commercial FM stations) there is no guarantee that this offer would be open to the Foundation beyond that date. PMC believes CPRN would work with the Foundation to accommodate a longer timeline for considering the Letter of Intent, developing an asset purchase agreement and closing the transaction, if KUSP felt that was beneficial.

**THE FOUNDATION’S OPTIONS**

Today you are being asked to cast an advisory vote on whether or not to enter into this Letter of Intent. If the Foundation does enter into the Letter of Intent, we would negotiate specific terms of an Asset Purchase Agreement with CPRN (including exactly what would be sold and the amount that would be paid by CPRN to the Foundation). The Letter of Intent – what you are voting on now – would not commit the Foundation to do anything other than continue the negotiation. If the Board of Directors approved the resulting Asset Purchase Agreement, it would be submitted to the Foundation voting members at a special meeting later in 2015 for final approval.

The negotiating committee established by the Board of Directors last year sees five general paths forward for the Foundation at this point. Two options would follow from a decision to enter into a Letter of Intent to sell the assets specified above to CPRN. Three options would be open if the Letter of Intent was rejected.

*If the Foundation approved the Letter of Intent:*

1. Complete the transaction with CPRN and use the remaining KUSP assets to further the Foundation's mission in a new way – either by seeking a new FM license (which would probably have a much smaller coverage area local to Santa Cruz) or by moving into a new public/community media role that did not involve holding an FCC license. If a new FM license is involved, this might leave open the possibility of working with KCRW on the basis of the proposed programming agreement. A continued role as part of NPR would be much less likely. Whether a new FM license could be used by KUSP in the near future, either through acquiring a license or construction permit, or a collaboration of some kind with a current licensee or permitee, is uncertain.
2. Complete the transaction with CPRN and dispose of the Foundation's remaining assets in accordance with applicable law and requirements of various grants we have received in the past – then cease operation of the Foundation.

*If the Foundation did not approve the Letter of Intent:*

3. Pursue to the best of our ability operation within the terms of the KCRW programming agreement, keeping our existing network of transmitters and translators. As observed earlier, management doubts that it would be possible to reduce expenses enough to make this work financially – in part because canceling the programming that would have to be eliminated as part of reducing expenses could result in a loss of listening, at least in the short term. That in turn might decrease listener-sensitive support even more than the expense reductions. Over time, listening and listener support would probably increase, but that increase may be "too little, too late."
4. Pursue some kind of asset transfer to Cal State Monterey Bay. While the university ruled out the idea of working with us as partners at the start of 2014, there is reason to think they might consider taking over KUSP's FCC licenses and related assets if the terms were extremely favorable to the university (as was true for them when they obtained the KAZU assets from the failing community licensee that founded that station). This would not leave 'Pataphysical with the same level of resources or flexibility after the transaction as option 1 or 2, but would maintain a degree of local control over the 88.9 frequency (if you regard Cal State Monterey Bay as a local entity) that would not be present under those two options.
5. Do nothing. Absent the unexpected arrival of another buyer, or some other extraordinary way to address the debt burden carried by the Foundation, doing nothing would almost certainly lead to bankruptcy in a short period of time. In that case a receiver appointed by the bankruptcy court would take charge of reorganizing or liquidating the Foundation and satisfying the creditors to the best of his or her ability. The KUSP community (voting Foundation members, Board of Directors, staff) would have little to say about the ultimate outcome.

Your Board of Directors recommends a "yes" vote to approve the Letter of Intent.