The financially pressed Baltimore City Public School System (BCPSS) has had to make painful decisions in the last two years – laying off staff, trimming programs and increasing class sizes. At the same time, the State has redirected more than $10 million in public funding earmarked for City schools to fund retained revenue and overhead at Edison Schools, Inc. – the contractual manager of three Baltimore City public schools.

For five years, the Maryland State Department of Education (MSDE) has undertaken an unprecedented State privatization experiment in Baltimore City by allowing a for-profit company to run three failing public elementary schools. Under a contract that currently runs through 2007, Edison Schools, Inc., of New York is operating Gilmor, Montebello and Furman L. Templeton elementary schools.

The Abell Foundation has funded a study by William Ratchford, a former director of the Maryland State Department of Fiscal Services, to examine the ramifications of the contract, and to provide input into what should be a public debate about it. In the end, the community must address the question: Is the State’s contract with Edison Schools, Inc. a good deal for the Baltimore City public schools?

With this contractual arrangement, the State provides an annual payment to Edison and deducts the amount from State education funds allocated to BCPSS. In FY’05, Edison received $20.1 million to operate the three schools.

Though the facts of the arrangement have received scant publicity, the manner in which public education funds are spent is very much community business; the contract raises issues about the management of public education, particularly in light of current charter school funding negotiations.

Some of the investigation’s key findings:
- In FY ’05, Edison posted retained revenue of $3.2 million (equivalent...continued on page 2

The fiscal information in this report was developed by William S. Ratchford II, an Annapolis-based consultant and expert in Maryland school financing. Mr. Ratchford served for 23 years as the director of the Maryland General Assembly’s Department of Fiscal Services, which analyzed State budgets and spending.
to $1,425 per pupil) from its operation of three Baltimore City elementary schools. That represents nearly 16 percent of the total per-pupil funding given to the company.¹

• Edison also allocated an additional $2.4 million to pay for corporate administration beyond the cost of operating the schools, representing nearly 12 percent of Edison’s gross revenues. The amount of $1,059 per pupil budgeted by Edison for central administration is significantly higher than the $647 budgeted by BCPSS.

• The amount allotted by Edison for retained revenue, administration, and taxes grew from $4.8 million in FY’04 to $5.6 million in FY’05.

• Although the State, not the local public school system, pays the cost of retirement for Maryland’s public school teachers, the contract with Edison requires the BCPSS to pay the retirement costs of teachers employed by Edison in the three schools, inappropriately shifting what is the State’s cost to the district.

• MSDE is also supplementing the amount spent by Edison on special education students at the three schools, through a contract with the Kennedy Krieger Institute. As a result of this additional State expenditure, students in special education at the three Edison schools are receiving an average of $19,481 in services, compared to $11,585 budgeted per special education student in BCPSS.

Prior to the contract in 1999, the three public schools now managed by Edison were among the worst performing City elementary schools. The performance of each school has improved under Edison’s management. At the same time, at least four of the ten BCPSS schools on the same 1999 list of lowest performers have improved their performance even more significantly during this period. And BCPSS took the initiative to close two other poorly performing schools in this group.

In light of Maryland’s 2003 charter school legislation prohibiting a for-profit entity from chartering a school, it is interesting that the State maintains its contract with a for-profit operator to run the three City schools.

As a result, in the 2004-2005 school year, the State’s contract with Edison essentially removed nearly $2,500 per pupil for students enrolled in these three schools — a total of $5,554,191 — from the educational revenue stream in Baltimore to fund Edison’s retained revenue and overhead.

Given the careful scrutiny of every program in BCPSS, it is prudent policy to scrutinize with the same care the five-year-old contractual agreement with the Edison Schools, Inc.

Background

Under Maryland law, MSDE monitors academic performance and attendance rates at public schools and has the authority to take over management of schools that are deemed to be failing. After roughly a decade of considering alternatives for more State involvement, MSDE moved in 2000 to take over three failing elementary schools in Baltimore City — the first such intervention in State history.²

The State accepted proposals from three outside entities interested in managing the schools: the for-profit operators Mosaica Education Inc. and Edison Schools Inc. and a not-for-profit partnership of the Kennedy Krieger Institute and the Erickson Foundation. The State Board of Education decided to contract with Edison Schools Inc., based in New York City.

About Edison Schools

Edison Schools, Inc., was founded in 1992 by Chris Whittle, a former chairman and publisher of Esquire magazine who also launched Channel One, which provides television news content and advertising to schools across the country. Whittle took Edison public in 1999 but the company did not turn a profit until 2003. By that time, the company’s stock price had dropped from $37 to less than $2.

In 2003, Whittle teamed as a minority partner with Liberty Partners, which made a $174 million investment in Edison on behalf of the Florida Retirement System. (The Retirement System provides benefits to retired public-sector employees in Florida, roughly half of them teachers.)

Now under private ownership, Edison operates 157 schools in 20 states, the District of Columbia and the United Kingdom. More than 250,000 students now attend public schools managed by Edison, according to the company. As a privately held company, Edison does not make its figures public.

The company has had mixed results. In Philadelphia, Edison recently received contracts to add two more schools to the number it manages, for a total of 22, including some of the worst-performing schools in Philadelphia.

continued from page 1

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continued on page 3
In Chester Upland School District, PA, however, Edison’s contract to run the entire troubled school system ended a year early in June 2005. The company produced only modest improvements in student achievement and reported losses of $30 million in four years.

**Edison’s Contract with Maryland**

Edison signed a contract with the Maryland State Board of Education in March 2000 to run Gilmor, Montebello and Furman L. Templeton elementary schools beginning July 1, 2000.

At the time, the schools were some of the poorest performers in the City. Then and now, the three schools have a significant number of pupils who qualify for compensatory education and require special education services. At Furman Templeton, about 90 percent of pupils qualify for free and reduced price meals and slightly more than 12 percent are in special education programs. At Gilmor, about 85 percent qualify for free and reduced price meals and 10 percent participate in special education programs. And at Montebello, about 78 percent of students are eligible for free and reduced price meals and 9 percent are in special education programs. The proportion of students considered “at risk” in the three schools as evidenced by the percentage eligible for free and reduced price meals is roughly the same as the City’s elementary average (84.5 percent vs. 83.4 percent in 2005), but the proportion of special education students is substantially less than the Citywide average for elementary students (8.7 percent vs. 14.3 percent in 2005).

The initial contract with Edison was for five years with an option for a two-year extension. In October 2004, MSDE and Edison agreed to extend the contract through June 30, 2007. When the contract began, the three schools provided education from pre-K through Grade 5. A contract addendum executed in June 2001 authorized the three schools to offer education through Grade 6 beginning in the 2001-2002 school year. At that time, the State also required Edison to provide a half-day pre-kindergarten class and full-day kindergarten classes.

State education officials negotiated the Edison contract in early 2000 under regulations relating to school reconstitution that had been adopted by the State Board of Education in January 1998. The regulations authorized the State board to reconstitute a failing school and turn its operations over to a third-party contractor. Under the regulations, the costs of operating the school were to be paid by the local school system – in this case BCPSS. The regulations authorized paying private contractors the higher of two calculated figures: the average per-pupil cost of instruction including special education, plus the cost of operation and maintenance of the facility and food service or the total actual current cost of operating the school. In the Edison contract the per-pupil amount was based on the total operating cost.

The contract provided for the company to be reimbursed $7,462 per pupil for the school year beginning in September 2000. Under the Edison contract, BCPSS continued to be responsible for food and health services, as well as for capital improvements, certain equipment, textbooks and library materials.

Chart 1 below details the calculation of the initial per-pupil amount for the Edison contract which was based on actual expenditure data for the BCPSS for the 1998-1999 school year.

To calculate the payment, the State determined the total amount spent by

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**CHART 1:**

**Calculation of Initial Edison Per Pupil Allocation**

**2000**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total BCPSS expenditures for FY’99</td>
<td>$762,963,758</td>
</tr>
<tr>
<td>Less: Community services</td>
<td>6,838</td>
</tr>
<tr>
<td>Food services</td>
<td>510,456</td>
</tr>
<tr>
<td>Capital outlay</td>
<td>4,500,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>9,249,813</td>
</tr>
<tr>
<td>Non-public placements</td>
<td>52,447,752</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td><strong>$66,714,859</strong></td>
</tr>
<tr>
<td>Adjusted expenditures</td>
<td><strong>$696,248,899</strong></td>
</tr>
<tr>
<td>Average daily membership</td>
<td>100,913 students</td>
</tr>
<tr>
<td>Per-pupil amount</td>
<td>$6,899</td>
</tr>
<tr>
<td>Per-pupil teacher retirement payments, fiscal 1999</td>
<td>563</td>
</tr>
<tr>
<td><strong>Total per-pupil amount</strong></td>
<td><strong>$7,462</strong></td>
</tr>
</tbody>
</table>

---

continued from page 2

continued on page 4
BCPSS, for all schools, subtracted costs that BCPSS would continue to bear for the Edison schools or for students in the Edison schools attendance area, and divided that adjusted expenditures figure by the number of students in the system.

In making that calculation, State officials used the average daily membership in the BCPSS for the 1998-1999 school year, as opposed to the total enrollment established on September 30th of each school year. In Baltimore City schools the average daily membership is smaller than the total enrollment, generally by 1 to 2 percent. Using this smaller number as the denominator in determining the per-pupil payment to Edison increased that payment by approximately $100 per pupil in the first year of the contract. Consistency here would call for using the total enrollment figure to calculate the initial per-pupil payment, since the State uses the annual per-pupil enrollment figures – not the average daily membership – to determine the total annual payment to Edison for each school.

Problems with Retirement Costs

In calculating how much to pay Edison, the State included an amount to cover retirement costs. Teachers employed by Edison are not eligible to participate in the State teachers’ retirement system, and Edison is responsible for funding retirement benefits for its staff. However, the report argues, the State incorrectly required BCPSS to pay Edison’s retirement costs.

Under Maryland law, the State is responsible for paying retirement costs for the teachers in local public school systems. Any retirement costs in the per-pupil amount paid to Edison should have been paid by MSDE and not deducted from State education funds due to BCPSS.

In addition, according to the report, the State incorrectly calculated the retirement allowance for the first-year payment to Edison.

In calculating the initial per-pupil amount, the State pegged the retirement cost as $563 per student. Using the average daily membership of 100,913 students, this would indicate that the total retirement costs for BCPSS would have been $56.8 million in fiscal year 1999. However, official records of the 1999 General Assembly indicate that the retirement allocation for BCPSS employees and librarians was significantly lower -- $51.4 million. In other words, the amount used to calculate the retirement factor in the per-pupil amount for the Edison contract was too large. This increased the payment to Edison by approximately $60 per pupil. However, there was an offsetting error the other way: The initial per pupil amount of $7,462 was calculated on two-year-old data. If the amount had been calculated on one-year-old data using the approved budget, the initial per-pupil amount received by Edison would have been greater by probably $400 to $500 per pupil.

Subsequent Payments to Edison

The Edison contract established an initial per-pupil payment that increases each year, using a formula tied to the rate of increase in general State education aid. The per-pupil amounts paid to Edison are shown in Chart 2.

Chart 2 below and Chart 3 on page 5, summarize the annual allocations/payments to Edison for the first five years of the contract.

The Edison contract calls for the per-pupil payment to increase by the same percentage as the State’s main

<table>
<thead>
<tr>
<th>School Year</th>
<th>Per Pupil Amount</th>
<th>Per Pupil Increase</th>
<th>Percent Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000-2001</td>
<td>$7,462</td>
<td>N.A.</td>
<td>N.A.</td>
</tr>
<tr>
<td>2001-2002</td>
<td>7,684</td>
<td>222</td>
<td>2.98%</td>
</tr>
<tr>
<td>2002-2003</td>
<td>7,995</td>
<td>311</td>
<td>4.04%</td>
</tr>
<tr>
<td>2003-2004</td>
<td>8,880</td>
<td>885</td>
<td>11.07%</td>
</tr>
<tr>
<td>2004-2005</td>
<td>9,370</td>
<td>490</td>
<td>5.52%</td>
</tr>
<tr>
<td>2005-2006</td>
<td>10,242</td>
<td>872</td>
<td>9.31%</td>
</tr>
</tbody>
</table>

continued on page 5
education funding formula does. While this sounds logical, this approach has led to an overstatement of the amount due Edison in later years of the contract. At the time the Edison contract was signed, the “basic current expense program” was the primary State education aid program; increases in that basic current expense program would trigger the same increase in per-pupil aid to Edison.

In 2002, the General Assembly replaced the basic current expense program with the “foundation program,” as part of what is known as the Thornton education aid program, beginning with the 2003-2004 school year. The Thornton program included a significant increase in the foundation program in FY’04 to offset the elimination of a number of State education aid programs and to prevent any of the smaller school districts from incurring a reduction in State aid. In FY’05 the increase in the foundation program was smaller as the phase-in of additional State aid for the three supplemental education programs began.

At the time the Edison contract was signed the annual increase in the per-pupil amount in the basic current expense program in the prior five years had been approximately 3.5 percent. Under the Thornton program the average annual increase in the per-pupil amount since FY’02 has been approximately 7.5 percent. Some of this increase reflected an effort to provide funding necessary for providing an “adequate” education as required by the Maryland Constitution. However, some of the increase in the foundation funding was due to the simultaneous elimination of other “categorical” education programs. In other words, the legislature did intend to increase basic State educational aid to local school systems, which rightfully led to an increased payment to Edison. However, the new State method of calculating basic education aid also lumped in other categories of funding that had not previously been used to calculate the Edison payment. Therefore, using the percentage increase in the foundation funding as an index for payments to Edison, the report makes clear, has resulted in an overstatement of the increase in the per-pupil amount, perhaps by as much as $300 to $400 per pupil.

The Edison contract includes another provision, which in this case reduces payments to the company. In 2001, an amendment was added to the contract requiring Edison to offer half-day pre-kindergarten classes and full-day kindergarten classes. The amendment agreed to weight payments to Edison for pre-K and kindergarten students. Pre-K students (who attend school for only a half day) are weighted at 50 percent and kindergarten students are weighted at 0.69, though Edison is required to provide full day kindergarten classes.

Using this weighting formula reduces the payments made to Edison. Based on enrollment as of September 30, 2004, a total of 2,287 students attended the Edison schools – including 103 in pre-kindergarten, 293 in kindergarten and 1,891 in grades 1-6. Utilizing the weighting in the contract, the amount due Edison in FY’05 is calculated on 2,145 students. Based on a per-pupil amount of $9,370, Edison will receive $20,098,650. If kindergarten students were not weighted at 0.69, the enrollment would total 2,236 and the payment would be $20,951,320, a difference of $852,670, or $381 per pupil.

In 2004-2005, Edison retained a significant amount of its budget for central administration and retained revenue – a total of $2,484 per pupil.
**Edison’s Profit and High Administration Costs**

In 2004-2005, Edison retained a significant amount of its budget for central administration and retained revenue – a total of $2,484 per pupil.

This figure increased from the amount of $2,144 retained by the company, as reported in its 2004 audit report. Among the company’s costs covered by this retained amount are central administrative spending, amortization, income taxes and, presumably, return to investors.

Breaking down the $2,484 figure, Edison budgeted $1,059 per pupil on central/regional administration in addition to the costs of school-based administration. This central office charge accounted for the other $1,425. BCPSS has no line item for retained revenue – or profit – that Edison, as a for-profit company, declares. The comparison in the next chart shows that BCPSS spent significantly less than Edison on central administration -- $647 per pupil compared to $1,059 for Edison.

Chart 4 below reflects that BCPSS’s significant allocation of funds totaling $44 million to reducing its long-term budget deficit in FY ’05 as part of its financial recovery effort. As shown in the next to last line of the chart, that payment essentially cost the system $509 per pupil in spending on instructional or other categories in 2005. Since that amount was not spent on instructional activities, the actual per-pupil payment to Edison (shown in the last line of the chart) exceeded the per-pupil amount being spent on students in BCPSS schools.

Though the line item for per-pupil spending on instruction is greater for BCPSS schools than for the Edison schools, particularly if the amount per pupil for retirement is included, part of the variation can be explained by higher instructional per-pupil costs in secondary schools than in elementary schools. Edison manages only elementary schools.

**Edison Receives Additional Funding and Benefits for Its Special Education Students**

Thanks to MSDE, the Edison schools enjoy the benefits of a partnership with the Kennedy Krieger Institute to provide special education instruction for its students.

The Edison contract provides for two categories of special education pupils. The first category includes pupils who spend at least 60 percent of their time receiving general education in a regular classroom and receive special education services as a supplement. Edison provides both the regular classroom and the supplemental special education services for these pupils, although the company receives some assistance from Kennedy Krieger.

The second category includes pupils who spend less than 40 percent of their time receiving general education in a regular classroom. These pupils receive special education services from the staff of Kennedy Krieger, through the Institute’s contract with MSDE.

Under the partnership, some special education students at Edison schools are taught solely by the Edison staff, some are taught by both Edison and Kennedy Krieger staff, and some are taught solely by Kennedy Krieger staff. Chart 5 details arrangements for the 213 Edison students receiving special education services.

All of these special education programs are offered at the three schools.

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**CHART 4:**
**Edison/BCPSS Per Pupil Allocations**
**FY’05 Budget**

<table>
<thead>
<tr>
<th></th>
<th>Edison Schools</th>
<th>BCPSS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal/administration</td>
<td>$ 675</td>
<td>$ 696</td>
</tr>
<tr>
<td>Instruction</td>
<td>4,377</td>
<td>4,715</td>
</tr>
<tr>
<td>Special education</td>
<td>1,855</td>
<td>2,040</td>
</tr>
<tr>
<td>Student personnel services</td>
<td>---</td>
<td>146</td>
</tr>
<tr>
<td>Teacher retirement</td>
<td>---</td>
<td>536</td>
</tr>
<tr>
<td>Transportation</td>
<td>42</td>
<td>330</td>
</tr>
<tr>
<td>Facilities – operations</td>
<td>612</td>
<td>710</td>
</tr>
<tr>
<td>Facilities – maintenance</td>
<td>79</td>
<td>133</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>$7,640</td>
<td>$9,171</td>
</tr>
<tr>
<td>Administration</td>
<td>1,059</td>
<td>647</td>
</tr>
<tr>
<td>Retained revenues (Edison)</td>
<td>1,425</td>
<td>---</td>
</tr>
<tr>
<td>Deficit reduction (BCPSS)</td>
<td>---</td>
<td>509</td>
</tr>
<tr>
<td><strong>Total Per Pupil</strong></td>
<td><strong>$10,124</strong></td>
<td><strong>$10,462</strong></td>
</tr>
</tbody>
</table>
The cost of the Kennedy Krieger contract is shared by Edison and MSDE. After projecting how many students will receive services, MDSE withholds a per-pupil amount from its payment to Edison.

In addition, MSDE contributes funds from its “non-public placement” appropriation to pay some of the costs of Kennedy Krieger’s services. Not only is it a high percentage of special education students served with non-public placement, but MSDE’s 73% subsidy of funding toward these placements is higher than its contributions to other school districts.

For FY’05, Kennedy Krieger was under contract to provide services to 82 of the 213 (38.5 percent) special education pupils with the greatest need at Edison schools, at a cost of $3,309,326. Of that amount, MSDE withheld $768,340 from contract payments to Edison and contributed $2,540,986 (76.8 percent) in MSDE funds from its non-public placements account. In comparison, only 5.4 percent of Baltimore City’s special education students receive non-public placement funding. The average cost per pupil for students served under the Kennedy Krieger contract is $40,358.

MSDE reports that there are approximately 20 such public-private partnerships in Maryland. In terms of the number of students served, the contract with Kennedy Krieger for the Edison schools is the largest public-private partnership for special education students in the State.

Data for the five years of the MSDE contract with the Kennedy Krieger Institute are shown in Chart 6.4

Edison’s 2004-2005 budget for special education totals $4,149,412; of that $1,608,426 came from Edison funds and $2,540,986 was paid by MSDE as part of its “non-public placement” contract with Kennedy Krieger. This equates to an overall spending of $19,481 per Edison special education student.

In contrast, BCPSS budgeted $176.2 million for 15,209 special education pupils – or $11,585 per pupil. The State’s rationale for spending more non-public placement funding on behalf of a disproportionate number of Edison special education students is not explained, and raises questions.

Edison’s Academic Achievement Is Solid, But Exceeded by Comparable BCPSS Schools

The report does not attempt to analyze the work of Edison in its three Baltimore schools. However, the three schools have made substantial progress since 2000. In particular, attendance and enrollment at the three schools have increased significantly. Standardized test scores at the schools have also improved in many areas.

MSDE recently released its assessment of how Maryland’s public schools are progressing under the terms mandated by the federal No Child Left Behind law. MSDE deemed two Edison schools, Montebello and Furman L. Templeton, to have made sufficient progress to exit the category of schools that must implement a school improvement plan. The last school, Gilmor Elementary, will be eligible to move out of School Improvement in a year if current performance continues.

At the same time, test scores have also improved significantly in many
other Baltimore elementary schools and in BCPSS as a whole. In all, MSDE identified nine schools in Baltimore to come off the list of schools requiring rigorous school improvement as of June 2005.

More relevant, of the seven City elementary schools that shared the lowest performing status with the Edison schools in 1999, the State has removed four schools from School Improvement status. 2005 MSA scores at William Paca, Bay Brook, and Martin Luther King Jr. elementary schools were, in fact, higher than those at the three Edison schools without outside intervention. Furthermore, BCPSS took the initiative to close an additional two of these lowest performing schools.

Conclusion

Two key questions grow out of this report’s assessment of the 2000 contract between the State Education Board and Edison Schools, Inc.: both center on the ramifications of the State’s decision to bring in a for-profit company to operate certain City schools, choosing that expenditure over competing needs within BCPSS.

First: Given the intense scrutiny to which every issue and policy in the BCPSS is subject, is it not time, after five years, for a similar public accounting of the State’s first school privatization contract?

A second question follows: Is it not time, too, for State officials to publicly debate the question: Is the Edison contract a good investment of Baltimore City’s public education dollars?

Endnotes

1 This figure represents retained revenues before deductions for income taxes, amortization and other costs.

2 This was the State’s first attempt at privatization of schools. However, the Baltimore City Public School System contracted with a private for-profit firm, Education Alternatives Inc., in 1992 to operate or consult in a dozen schools. The school system terminated the contract in 1996.

3 See the 1999 edition of “The 90 Day Report,” produced by the General Assembly’s Department of Legislative Services.

4 Each year one or two pupils in the attendance areas served by the Edison schools may receive special education at an off-site private entity under the non-public placement program administered by the Baltimore City Public School System. The MSDE contracts with Edison and Kennedy Krieger do not involve these pupils.

5 Scores were based on combined 3rd and 5th grade MSPAP scores for 1999; special education or alternative elementary schools were excluded. Lowest performing schools in 1999 exiting school improvement are William Paca, Bay Brook, Martin Luther King, Jr, and Lafayette elementary schools.