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August 22, 2007

Hon. Joel I. Klein
Chancellor
New York City Public Schools
Department of Education
52 Chambers Street, Room 314
New York, NY 10007

[REDACTED]
Re: Christopher Cerf
SCI Case No. 2007-0672

Dear Chancellor Klein:

An investigation conducted by this office has found that Christopher Cerf, Deputy Chancellor for Organizational Strategy, Human Capital, and External Affairs of the Department of Education ("DOE"), solicited charitable contributions from executives of Edison Schools, LLC ("Edison"), a DOE vendor, and Liberty Partners, L.P. ("Liberty"), a private investment firm which is the majority owner of Edison. As a result, Cerf secured a pledge for a \$60,000 donation from one of the executives, the chairman and chief executive officer of Liberty. The requested contribution would have benefited a charitable foundation of which Cerf is a member of the board of directors. According to Cerf, although the chairman agreed to the \$60,000 donation, he did not pay it; Cerf withdrew his request after he was asked about it during the course of this investigation,

[REDACTED]

We have further determined that Cerf, who held stock in Edison, relinquished the stock in February 2007, [REDACTED]. This investigation also determined that the TEAM Academy in Newark, N.J., for which Cerf serves on the board of directors, does not do business with the DOE, although it is sponsored by the same national organization which sponsors three DOE charter schools. Finally, we determined that Cerf's [REDACTED] which he submitted at the beginning of

his DOE employment contained some inaccuracies and omissions until he was questioned about them by investigators and allowed to amend [REDACTED]

This investigation was initiated by the office of the Special Commissioner of Investigation ("SCI") after media reports appeared in February 2007 stating that Cerf had divested himself of Edison stock on the day before a DOE parents' group planned to ask him about his ties to the company.¹ SCI investigators interviewed Cerf and [REDACTED] witnesses affiliated with the DOE, Edison, and [REDACTED], and examined numerous documents obtained from those entities. In the course of the investigation, this office discovered the charitable solicitations described above, and some media accounts which conflicted with the responses on Cerf's [REDACTED]. We also examined whether there were any business ties between the DOE and the TEAM Academy, where Cerf is a member of the board of directors.² Each of these matters is described below.

Cerf's Edison stock

Cerf, an attorney, was appointed to his Deputy Chancellor position in December 2006. From May 1997 until April 2005, he was employed by Edison in various executive positions, including general counsel and, ultimately, president and chief operating officer. Edison is the parent company of Newton Learning which (along with other firms) provides Supplemental Educational Services ("SES") to DOE students under the Federal *No Child Left Behind Act*.³ In 2003, Edison, which had been a corporation whose shares were publicly traded, was essentially acquired by Liberty, a private equity investment firm. Edison was converted from a publicly-traded company to one whose stock was privately held. After the conversion, Liberty held approximately 96 percent of the equity in Edison, and most of the remainder was owned by Chris Whittle, Edison's founder and chief executive officer.⁴

Cerf was among the Edison executives who was granted Edison stock and stock options when it was a publicly-traded company. He and other Edison shareholders forfeited the publicly-traded stock and options under the terms of Liberty's purchase of the company. In return, Liberty gave Cerf and other Edison executives shares in the newly formed privately-held Edison. Liberty granted Cerf 20,000 shares of Class B common stock in Edison. Under the terms of Liberty's purchase of Edison, Cerf forfeited 14,000 shares of the Edison stock when he resigned from the company in 2005.⁵ Cerf

¹ See E. Gootman, *Schools Official Deflects Query About Stocks*, *New York Times*, Feb. 9, 2007; *An Instructive Moment*, *New York Times* (ed.), Feb. 10, 2007.

³ The SES program offers academic help to students outside of the regular school day and is funded by the Title I allocation that the DOE receives from the federal government. Edison and all SES providers certified by the New York State Education Department may service DOE students. Although the DOE does not select SES providers, it pays them and monitors their performance.

⁴ See N. Schwartz, *The Nine Lives of Chris Whittle*, *Fortune*, Oct. 27, 2003.

⁵ Cerf continued as a member of Edison's board of directors until 2006.

retained the remaining 6,000 shares of stock after leaving Edison. The stock was not tradable on any public exchange, and thus it was difficult to ascribe a monetary value to it at any particular time.

By subpoena, SCI obtained documents from Edison and Liberty pertaining to the stock in the privately-held company. According to Edison's operating agreement and information provided to SCI by Edison's counsel, before Cerf could redeem his Edison shares, Liberty would have to sell the company at a profit. The attorney also asserted that Cerf's Class B shares were worthless. He explained that in the event that Edison was sold, the company's creditors and several categories of Class A shareholders would receive preferential payment before Cerf's Class B shares could be redeemed.⁶

SCI investigators interviewed [REDACTED], under oath. [REDACTED] stated that [REDACTED] had several conversations with Cerf in December 2006, concerning his stock in Edison. [REDACTED] said that [REDACTED] understood from Cerf that his stock had no current value, but could have value in the future. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

⁶ On December 22, 2006, [REDACTED] advised Cerf by e-mail that his 6,000 Class B shares represented 0.58% of the equity in the company.

[REDACTED]

[REDACTED]

On February 7th, [REDACTED] Cerf sent an e-mail to [REDACTED] inquiring about whether Cerf could ask Edison for documents "that create or describe the equity interest I currently retain in the company."

[REDACTED] Cerf sent the following e-mail to [REDACTED] of Liberty, [REDACTED], and [REDACTED] of Edison:

Effective immediately I irrevocably relinquish any and all equity interest in the company. The only such interest is the "option like" shares described in greater detail in the documents we exchanged at the time of my departure. I would be most grateful if you were to make, entirely at your discretion, a charitable contribution to the Darrow Foundation in recognition of this voluntary relinquishment of this interest.

Best regards,
Chris⁸

Two hours later, Cerf advised ^{Klein?} [REDACTED] and [REDACTED] by e-mail that he "elected to take the path of least resistance by relinquishing, in writing, any and all exiting interest in Edison (which are in fact limited to the one item we have been discussing)." The message made no mention of Cerf's request for contributions to Darrow.⁹

Cerf's message relinquishing the Edison shares was sent on the day before a scheduled meeting of the DOE Chancellor's Parent Advisory Council ("CPAC"), [REDACTED] at which Cerf was scheduled to speak. The advance agenda for the CPAC meeting indicated that Cerf would be asked about his interest in Edison. On the

⁸ Cerf sent a certified letter on the same date to [REDACTED] and [REDACTED] at Liberty (copying [REDACTED] confirming his e-mail and repeating his request for a contribution "to the Darrow Foundation, which runs wilderness canoing [sic] expeditions for children and teenagers (many deserving of scholarships) in Northern Canada. If of interest, I would be happy to forward the particulars."

⁹ [REDACTED]

evening before the meeting, Cerf received an e-mail message titled, "Word on the street," from [REDACTED], a reporter for the New York Times. Among other things, [REDACTED] wrote: "The minute we split, I heard word on the street in Bklyn is that [Chancellor Klein] made you give away your Edison interest to charity in response to [REDACTED] agenda." Approximately 30 minutes later, Cerf e-mailed a response to [REDACTED]

[Chancellor Klein] didn't make me do anything. Nor did he ask me to do anything. Ridiculous. Where is this coming from? What is the 'street' you are referring to? Is this out there in a way that you anticipate that it will be the subject of a grilling tomorrow? A press inquiry.

At 9:55 p.m. the same evening, Cerf e-mailed [REDACTED] to inquire when his [REDACTED] was due. [REDACTED] replied the following morning, writing that he assumed that Cerf was referring to the [REDACTED]; he referred Cerf to DOE Human Resources.

At 7:37 a.m. the following morning, prior to the scheduled CPAC meeting, Cerf sent an e-mail to [REDACTED] of Edison, stating, "Per this email, I irrevocably release you and any interests with which you are associated from any and all obligations arising under the document executed on or about the date of my departure." As with his earlier messages to the Liberty and Edison executives, Cerf asked [REDACTED] to consider a contribution to the Darrow Foundation.¹⁰

According to a newspaper account of the February 8th CPAC meeting, [REDACTED] asked Cerf to describe his financial interest in Edison, to which he "replied, 'I'd be delighted to do that,' adding: 'I have no financial interest of any kind. Zero.'" Asked by [REDACTED] when he divested himself of Edison stock, "... Cerf said he would be 'delighted' to give [REDACTED] a copy of his financial disclosure forms ... 'That will answer all your questions, and that's what I'm prepared to say.'"¹¹ After the meeting, Cerf acknowledged to a reporter that he had relinquished the Edison shares on the previous day.¹²

Cerf appeared at SCI in May and July accompanied by two attorneys and was interviewed under oath. In his May testimony, he acknowledged the series of events described in the e-mails and the media account described above. Cerf defended his description of his Class B Edison shares as a "contingent equity interest ... which operate like stock options." Cerf and his counsel acknowledged that while unlike stock options,

¹⁰ [REDACTED] replied by e-mail the following day: "Chris Got it, but don't entirely know what this means! Let's talk!"

¹¹ E. Gootman, *supra*.

¹² *Id.* In response to an SCI subpoena, Edison produced a stock certificate indicating 6,000 shares in Cerf's name; the certificate was stamped "CANCELLED."

Class B shareholders need not take action to obtain their shares, his description was nevertheless applicable. He claimed that it was valid because in the event Edison was sold, Class A shareholders – who invested \$112 million in the company – would be the first entitled to full reimbursement of their investment, plus annual interest, before the remaining value, if any, was paid to Class B shareholders. He added that the Edison Operating Agreement categorized the Class B shares under the description, “Contingent Shares.”¹³

Cerf was asked about his February 7th e-mail to [REDACTED], and he said that it pertained to a document which [REDACTED] prepared in connection with Cerf’s departure from Edison. Cerf said that the document was drafted by [REDACTED] as a contract or an agreement concerning Cerf, and that the two had discussed it over several months. Cerf was shown two letters dated January 10, 2005 and May 1, 2005 obtained by SCI from Edison pursuant to subpoena, and he acknowledged that they were the documents he referred to in his e-mail to [REDACTED]. The letters were on the letterhead of [REDACTED] and were written over [REDACTED] name and apparent signature. Each letter contained a signature line indicating “Accepted” above Cerf’s typed name, but neither letter bore his signature. Cerf testified that he believed that he never signed the letters in any form. The letters were styled as a consulting agreement for Cerf’s services to [REDACTED] for ten years after his departure from Edison. In return, Cerf was to be paid the lesser of \$2.5 million, or five percent of any proceeds of the sale of [REDACTED] Class C and Class D stock in Edison. However, any payments to Cerf were to be made only after [REDACTED] satisfied six specified financial obligations, including outstanding loans, a mortgage, and tax obligations to the IRS and the States of New York and Tennessee.

Cerf testified that he did not regard the [REDACTED] letters as operative, and explained that they were an attempt by [REDACTED] to make amends for not including a payment to Cerf in the agreement to sell Edison to Liberty. Cerf said that he considered the letters as “meaningless,” that he never expected to realize any payment under their terms, and that he therefore ignored them. He stated that for the Class C and Class D shares to realize any value, Edison, which was sold to Liberty for \$112 million, would have to fetch more than \$700 million in a future sale, and the Class A and Class B shares would receive first preference. Moreover, according to Cerf, [REDACTED] had personal debts of more than \$35 million which would also receive preference before any payments to Cerf as set forth in the [REDACTED] letters. [REDACTED]

Asked what prompted him to dispose of his Class B Edison shares on the day before the CPAC meeting [REDACTED] Cerf said that he knew he would be asked about Edison, and he wanted to represent to the group

¹³ Cerf’s attorneys produced the referenced document to SCI.

that he had no interest in Edison. Asked why he wrote to [redacted] regarding the [redacted] letters (which he regarded as "meaningless") on the morning of the CPAC meeting, Cerf stated that he had awakened late the previous night (or early that morning) and remembered that there existed some documentation of "an indeterminate negotiation" with [redacted].¹⁴ He said that he was concerned that someone might "make something" of the letters, and to stave off this possibility, he decided to relinquish any "purported interest" described in the letters.

Solicitations of contributions for the Darrow Foundation

As he disclosed in his [redacted] and as he further described in his testimony at SCI, Cerf is a member of the board of directors of the Darrow Foundation, a not-for-profit organization which supports a wilderness camp, and provides scholarships for children and teenagers to attend the camp. Cerf explained that beginning in 2005, he took "a leadership role" in a capital campaign to "save the camp from extinction," and so requested contributions in his February 2007 e-mails to [redacted] and [redacted]. Cerf added that he had not previously solicited contributions to Darrow from anyone affiliated with Edison or Liberty. In his May interview at SCI, Cerf said that on approximately March 1, 2007, he had a conversation with [redacted] of Liberty, in which he again asked [redacted] for a contribution to Darrow.¹⁶ According to Cerf, [redacted] Cerf testified that he specifically requested a donation of \$60,000, and that [redacted] responded: "I can help you with the full amount." According to Cerf, he understood that the gift would be from [redacted] personally, and not from Liberty or Edison. As of the May interview at SCI, Cerf said that [redacted] had not made any payment toward his pledge, nor had they had any further communication on the matter.

Soon after Cerf's May interview at SCI, his counsel wrote to SCI arguing that his request for a donation from [redacted] was permissible [redacted]

[redacted]

Cerf's counsel stated that Cerf was recused from handling DOE matters concerning Edison, including its SES contract with its Newton Learning Division. Counsel's cited authority, however, limited itself to solicitations

¹⁴ Cerf said that he did not have copies of the [redacted] letters.

¹⁶ Cerf said that he received no responses to his February e-mail requests, and except for [redacted] he had no further communications with Edison or Liberty employees on the matter.

¹⁷

¹⁸

[REDACTED]

[REDACTED]

After Cerf's May testimony at SCI, [REDACTED]
[REDACTED] On the morning of his second scheduled appearance at SCI in July,
however, Cerf e-mailed [REDACTED]

Dear [REDACTED]
Some time ago you were kind enough to offer a generous contribution to Darrow
Camp, a not for profit wilderness foundation on which I am on the board.
Although we haven't spoken about your offer in many months, I have now
concluded that it would be the better course not to proceed with the contribution.
Again, I want to thank you immensely for your generous spirit. I hope all is well.
Best regards,
Chris.

In his July testimony at SCI, Cerf stated that aside from the referenced e-mail, he
had no further communication with [REDACTED] since he made his pledge to Darrow, and that
he did not ask anyone to contact [REDACTED] about the pledge. Cerf said that Darrow was in
difficult financial circumstances, and [REDACTED]
[REDACTED]

[REDACTED]

Why?

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

TEAM Academy

SCI investigators interviewed Cerf concerning his membership on the board of directors of the TEAM Academy in Newark ("TEAM").²³ TEAM is an "Institutional Partner" of the Knowledge is Power Program ("KIPP"), a national not-for-profit organization which sponsors and provides training and support to charter schools. Three New York City charter schools overseen by the DOE are also institutional partners of the KIPP national organization.²⁴ All KIPP charter schools pay a fee to the KIPP national organization. The fee does not exceed three percent of each school's annual per-pupil revenue. While TEAM and the City KIPP schools have this payment obligation in common, TEAM does not have any financial relationship with the DOE or its KIPP charter schools.

Cerf's

[REDACTED]
Prior to his May testimony before SCI, DOJ and SCI investigators discovered some discrepancies concerning Cerf's responses (or lack of responses) on his [REDACTED] which he filed with the [REDACTED] in February 2007.²⁵ Cerf was questioned about these matters at SCI – most of which were minor – and he was permitted to amend [REDACTED] as applicable. In the course of the interview, Cerf was advised of media accounts from May and June 2002, which stated that the United States Securities and Exchange Commission ("SEC") had conducted an inquiry of Edison, and that a number of civil class action lawsuits were filed against Edison and its officers, and that Cerf was named as a defendant in some of the suits. Cerf had not disclosed this information in his responses to [REDACTED].²⁶ He acknowledged these matters, described the SEC inquiry as "informal," and explained that it concerned a revenue recognition matter in which Edison followed the advice of its accounting firm. Cerf said that he recalled that Edison slightly adjusted its stated revenue to the satisfaction of the SEC. Accordingly, Cerf changed his response from "no" to "yes" to [REDACTED] which asked if Edison had [REDACTED]

²³ Cerf disclosed this on his [REDACTED]

²⁴ SCI obtained documents from the DOE pertaining to the DOE KIPP schools and the national organization.

²⁵ The [REDACTED] contains Cerf's notarized signature above a declaration that the information contained therein was full and complete to the best of his knowledge and information, and that false statements or intentional omissions may result in disciplinary penalties, including termination of employment and possible criminal prosecution.

²⁶ Cerf's resume was attached to his [REDACTED]. Under the entry describing his Edison employment, it stated, "Managed successful effort to resolve SEC inquiry with no penalties or finding of wrongdoing."

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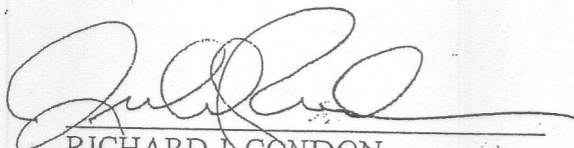
With respect to the class action suits, Cerf testified that he had not been called as a witness, nor did he recall producing any documents pertaining to the suits. He said that he did not have a personal attorney representing him in these matters, and that he relied on Edison's counsel and the company's insurer. Cerf then changed his response from "no" to "yes" to question [REDACTED] which asked: [REDACTED]

Conclusion

We refer these findings to you for whatever action you deem appropriate. [REDACTED]

Should you have any inquiries regarding the above, please contact me or [REDACTED] the attorney assigned to the case. [REDACTED] can be reached at [REDACTED]. Thank you for your attention to this matter.

Sincerely,



RICHARD J. CONDON
Special Commissioner
of Investigation for the
New York City School District

[REDACTED]