DMC
DETROIT MEDICAL CENTER

VHS OF MICHIGAN, INC

2013 ANNUAL REPORT TO LEGACY DMC

February 28, 2014

VHS of Michigan, Inc. is pleased to present to the Legacy DMC its annual report. This report has been prepared and is being delivered for the calendar year period ending December 31, 2013 in accordance with Section 12.17 of the Purchase and Sale Agreement by and among the Detroit Medical Center, Harper-Hutzel Hospital, Detroit Receiving Hospital and University Health Center, Children's Hospital of Michigan, Rehabilitation Institute of Michigan, Inc., Sinai Hospital of Greater Detroit, Huron Valley Hospital, Inc., Detroit Medical Center Cooperative Services, DMC Orthopedic Billing Associates, LLC, Metro TPA Service, Inc., Michigan Mobile PET CT, LLC, DMC Primary Care Services II and Healthsource, as Seller, and VHS of Michigan, Inc., VHS Harper-Hutzel Hospital, Inc., VHS Detroit Receiving Hospital, Inc., VHS Children's Hospital of Michigan, Inc., VHS Rehabilitation Institute of Michigan, Inc., VHS Sinai-Grace Hospital, Inc., VHS Detroit Businesses, Inc., VHS Detroit Ventures, Inc., VHS University Laboratories, Inc., VHS Physicians of Michigan and CRNAS of Michigan, as Buyer, and Vanguard Health Systems, Inc. dated as of December 31, 2010 (the "Agreement").

Indigent and Low Income Care (Section 12.2)

In compliance with Section 12.2 of the Agreement, during 2013 VHS of Michigan ("VHS" or "DMC") has maintained compliance with the Vanguard Health System's charity care policy in place on June 10, 2010, as was required under Schedule 12.2-a to the Agreement. This charity care policy has remained in effect through the acquisition of Vanguard Health System by Tenet Healthcare Corporation ("Tenet") in 2013.

Exhibit A provides information related to charity care and uncompensated care or bad debt for 2013 and trends from 2011 to 2013.

One of the most significant efforts made by the DMC in 2013, and continuing in 2014, is in its initiation of the *Path to Health* campaign designed to improve access to care for indigent and low income persons. Additional detail of that campaign is provided in the Health and Welfare section of this report. The DMC's *Path to Health* campaign seeks to maximize enrollment of eligible uninsured individuals in Michigan's exchange and/or Michigan's Medicaid expansion (Healthy Michigan) programs under the Affordable Care Act ("ACA").

The ACA will have an uncertain effect upon charity care and uncompensated care reported on the financial statements of the DMC in 2014 and beyond. Some believe that a significant amount of previously uninsured and uncompensated care will now be covered either by exchange insurers or by Medicaid. Others have speculated that the ACA will also expand the number of uninsured and uncompensated patients who seek care and who will either refuse to participate in an exchange or who will have extremely high deductible plans that will be difficult to collect.

Other factors, described below, will also influence how unpaid costs of care will be treated in financial statements.

- Insurance agreements customarily require that deductibles and co-pays of insured patients be collected and uncollected amounts, after reasonable collection efforts, are treated as uncompensated care or bad debt even though these patients may be otherwise within the ranges established under the charity care policy. That is consistent with the manner in which insured patients have been treated under their insurance agreements and under our charity care policies in the past.

- The State of Michigan, as part of the "Healthy Michigan" Medicaid Expansion statute, enacted a statutory provision that prohibits providers from collecting more than 115% of Medicare rates from uninsured individuals with annual incomes up to 250% of federal poverty guidelines. This limitation may provide a greater discount than DMC's charity care policy for certain out-patient services provided for individuals between 200-250% of federal poverty guidelines.

These factors, and others we have yet to contemplate, could likely result in future year over year comparisons of charity care and uncompensated care statistics being more difficult to interpret.

Recent news articles have raised discussion over comparisons of charity care and bad debt levels from before and after the Vanguard acquisition of DMC. A significant issue in that discussion was the use of Medicare cost reports rather than financial reports to measure uncompensated care. A far more detailed explanation and discussion is likely needed than can be provided in this report, however, the Crain's article did accurately identify certain important accounting and other factors that influenced the difficulty in a side by side comparison of the 2010-2012 numbers. Briefly, a few of important factors noted in the article include:

1. Removal from uncompensated care numbers of any amount which is considered a "controllable bad debt", such as amounts related to insurance denials for failure to obtain a prior authorization. DMC's policy was to treat those charges as uncompensated care or bad debt. Vanguard's policy was to treat those charges as a contractual adjustment.

2. Commencing in 2011, the uncompensated care numbers for DMC's employed physicians were excluded from DMC's uncompensated care numbers.

3. Commencing in 2011, the charity care and uncompensated care numbers for Children's Hospital of Michigan and the Rehabilitation Hospital of Michigan were excluded from the report.

4. Any improvement in collections from 2010 to 2012.

Commitments to Maintain the Hospitals and Provide Core Services (Section 12.3)

DMC continues to maintain each of its Hospitals as a general acute hospital licensed in the State of Michigan, with Rehabilitation of Michigan licensed as a rehabilitation hospital under the laws of the State of Michigan. We continued to provide the Core Services as listed on Schedule 12.3 of the Agreement throughout 2013.

Capital Expenditures (Section 12.4)

Under Section 12.4 of the Agreement, Vanguard, a wholly-owned subsidiary of Tenet, is obligated to make certain "Routine" and "Specified" Capital Project Expenditures within prescribed periods. Exhibit B-1 provides information related to Routine Capital Expenditures for the calendar year ending December 31, 2013 and for the 3 year period from January 1, 2011 through December 31, 2013. Exhibit B-2 provides information related to Specified Capital Project Expenditures for the calendar year ending December 31, 2013 and for the 3 year period from January 1, 2011 through December 31, 2013.

Routine Capital Expenditures

Routine Capital Expenditures (also called "Non-Specified" Project Capital in certain reports), which are governed by Section 12.4(a) of the Agreement, have averaged slightly above the $50 million minimum required by the Agreement over the 3 year period from January 1, 2011 through December 31, 2013. This has necessitated a budget for Routine Capital Expenditures for Calendar Year 2014 (which is also DMC's FY 2014) of $79.5 million, which is considerably greater than past year run rates. It also necessitates a commitment and diligence to both maintain focus on routine project implementation as well as routine replacement projects in the event any routine project expenditure is deferred or cancelled.

Assuming the full expenditure of the FY/CY 2014 Routine Capital budget, there would remain $120.5 million of the Routine Capital Expenditure commitment to be expended in FY/CY 2015. DMC has shared preliminary detail for CY/FY 2015 Routine Capital Expenditures plans with Legacy DMC and estimates of the multi-year IT, strategic and infrastructure project costs that would be expected in 2015. The DMC will continue to engage Legacy management in review of Routine Capital expenditures during 2014 to monitor the progress of expenditures and assess any recommendation that will assure the access of Routine Capital for purposes that benefit the community, patients and future success of the DMC.

In CY 2013, Routine or Non-Specified Project Capital Expenditure totaled $49.28 million. These capital expenditures have been grouped into 3 categories on Exhibit B-1 for purposes of comparison; Routine/Infrastructure/Equipment; IT; and Strategic Initiatives. See Exhibit B-1.

The Routine/Infrastructure/Equipment category includes hospital oriented capital often related to patient safety and quality, including a major investment in surgical equipment and lights, syringe and other pumps across the system, monitors, ventilators, WOWs and other nursing equipment. Larger infrastructure and equipment items also were addressed in 2013. Harper and Sinai Grace both replaced elevators, Detroit Receiving undertook a roof replacement, and Harper acquired a Biplane/CT.

IT projects in 2013 included continued upgrades to Windows 7 for PCs, a clinical technology refresh, and new radiology PACS workstations. Capital expenditures for Strategic Initiatives in 2013 included the acquisition of a Mako Robot for Huron Valley Sinai; construction of a hybrid operating room for Vascular/Cardiothoracic surgery at Harper; and acquisition of the property for the Children's Hospital Troy Specialty Center.

Specified Capital Project Expenditures

Actual expenditures for Specified Capital Projects in the 2013 CY totaled $142.4 million, for a cumulative total of $274.6 million since 2011, subject to any reconciliation required for out-of –scope expenditures in this amount. Without discounting for those amounts, the cumulative Specified Capital Project Expenditures through 2013 are $34.6 million in excess of the $80 million per year commitment under the Agreement.

In 2013, a number of the Specified Capital Project were completed or substantially completed. These included:

- Detroit Receiving Hospital's Additional Operating Room with 9 pre-op and post-op spaces;

- Harper Hospital's Emergency Room Expansion; and

- Harper Hospital's Surgical Services Renovation.

Additionally, the following projects have been or will be completed in 2014:

- The Sinai Grace Hospital Emergency Room project, a centerpiece of the Sinai Grace improvements, was completed and opened in early February of 2014;

- The South Parking Structure, which will service the new CVI Outpatient Specialty Services Building, with an excepted completion date of March 2014; and

- The new Heart Hospital, CVI, with a scheduled opening date of August 2014.

With the exception of the Children's Hospital of Michigan Tower Project, which includes the backfill of the Carl's Medical Office Building, all other Specified Capital Projects are scheduled to be completed by the end of 2015. See Exhibit B-3.

A significant amount of attention was focused upon the Children's Tower Project in 2013 to ensure that this project would address the identified needs of the entire community being served and would do so in a way that delivered care in the most efficient and highest quality manner. Inherent in DMC's review of this project was fact that this project was born years prior to the sale of the DMC to Vanguard. From the inception of this project through today, basic constructs underlying the original design, including demographic, reimbursement, clinical and market factors, have dramatically changed.

Those changes presented an opportunity to refocus the project in a forward looking manner. Integrating additional space added to the Pediatric Specialty Center and the strategic commitment of funding from the Routine Capital pool to the Troy Specialty Center project, allowed the Children's Tower project to be redesigned to provide greater emphasis on higher acuity and subspecialty services. The Tower Project now, when viewed in conjunction with these and other projects funded from the Routine pool, complement the other services being provided at the central campus and other ambulatory sites. A more detailed discussion with Legacy DMC, including a request for any necessary modifications to the scope of the Project Description in the Agreement, will be shared with the Legacy DMC Board at an upcoming meeting.

Renovations on the Carl's Medical Office Building have continued, however, the redesign of the main tower has delayed the start date on a significant portion of the project. The Agreement did foresee this circumstance, and provides for the extension of the completion date of this project and accompanying escrows to December 31, 2017. A December 31, 2017 completion date remains achievable, though it is understood that the escrow requirements of the Agreement will need to be met.

Warrant (Section 12.5)

At Closing, Vanguard delivered to the Escrow Agent an initial Warrant Certificate for the Warrant. In connection with Vanguard's initial public offering of its common stock in June 2011, Vanguard delivered to the Escrow Agent (in exchange for the Warrant Certificate then in the possession of the Escrow Agent) the Note in the original principal amount of $500,000,000. In accordance with Section 12.5 of the Purchase and Sale Agreement, the principal amount of the Note is automatically reduced on a continuous basis by the amount of any reduction in the Remaining CapEx Commitment under the Agreement.

No Sale of Hospitals (Section 12.7)

There has been no sale of VHS of Michigan, Inc. d/b/a Detroit Medical Center. VHS of Michigan, Inc. continues to be a wholly-owned subsidiary of Vanguard Health Systems, Inc. Vanguard Health Systems, Inc. became a wholly-owned subsidiary of Tenet Healthcare Corporation on October 1, 2013, a Permitted Transferee of the Hospitals under Section 12.7 of the Agreement.

Commitment to Education Mission (Section 12.8)

Throughout the preceding year, DMC fully supported its historic medical education mission in satisfaction of its commitment under Section 12.8 of the Agreement.

Attached as Exhibit C is the Annual Report for Academic Year 2012 -2013 which reviews in detail the status of the Graduate Medical Education Program.

DMC remains affiliated for undergraduate medical education with Wayne State University School of Medicine and Michigan State University College of Osteopathic Medicine.

The largest licensed group of health care professionals in the State of Michigan is Registered Nurses, with nearly 170,000 licensed nurses providing the majority of healthcare services to the people of the State. The Detroit Medical Center has a nursing workforce of 3,219 registered nurses providing direct patient care. The DMC with over fifty academic partners provides a wide range of clinical experiences for nursing students. The complexity of the clinical environment and access to numerous specialty areas, allows for a wide range of experiences for students. These clinical rotations are provided to students pursuing degrees from the Associate through Doctoral levels of study. DMC employed Advanced Practice Nurses serve as clinical preceptors, adjunct faculty and guest lecturers for the graduate nursing programs of nine colleges and universities. Staff nurses of the DMC are encouraged to pursue opportunities for professional and academic development. This is facilitated through financial support for tuition reimbursement. This represents organizational efforts to comply with the Institute of Medicine (IOM) recommendation to increase the proportion of nurses with baccalaureate degrees to 80% by the year 2020.

DMC also functions as a placement site for other allied health professions, including, without limitation, pharmacists, dieticians, and pastoral care.

Commitment to Research Mission (Section 12.9)

DMC’s commitment to research and develop is evidenced by the over 600 studies in which it, its hospitals, its faculty and staff participate, including retrospective, observational, or proof of concept designs that are conducted to collect basic information as precursors to the planning of formalized, interventional studies. With the addition of over 300 open interventional clinical studies occurring at DMC hospitals, over 1000 studies are being currently supported as a commitment to the research mission of DMC. The 2013 Annual Report is attached as Exhibit D.

Karmanos Cancer Center (Section 12.10)

Section 12.10 of the Agreement states VHS of Michigan (“Buyer”) , is committed to supporting Legacy DMC’s (“Seller”) historic partnership with Karmanos Cancer Center

("KCC") and that, to that end, VHS of Michigan, Inc. d/b/a Detroit Medical Center, assumed all contracts with KCC.

In October 2013, the President and CEO of KCC notified DMC that KCC had executed a written agreement with McLaren Health Care Corporation ("McLaren") under which McLaren became the sole member of Karmanos Cancer Institute ("KCI"). KCI is the sole member of KCC. KCC did not seek DMC's consent to this arrangement. The various agreements between DMC and KCC place a number of restrictions upon DMC and KCC. For instance, the agreements imposed limitations upon use of the "Karmanos" name; requirements for DMC's consent to clinical integration with other providers; and exclusivity covenants that KCC had agreed to which relate to academic medical centers.

Prior to delivery of the notice and without seeking DMC's consent to the arrangement, McLaren and KCC filed a lawsuit alleging, as claimed in their letter, that the various terms of the agreements between KCC and DMC/VHS of Michigan that require consent to clinical integration and the use of KCC's name outside the DMC-KCC arrangements are unlawful and unenforceable. Seeking to defend its position under the agreements under which the DMC sold its cancer business in 2005, DMC filed a motion for summary judgment and counterclaimed seeking to enjoin breach of the DMC/KCC Agreement and any clinical arrangement between KCC and McLaren.

On February 13, 2014, the Circuit Court issued a ruling on DMC's motion for summary judgment. While other issues remain in question, as to the question of whether the Affiliation Agreement would allow use of KCC name by McLaren in Oakland County, the Judge has given McLaren 14 days to provide more evidence to support their claim that the Affiliation Agreement produces significant anticompetitive effects. However, the Judge found their claim that the Affiliation Agreement was "an unreasonable noncompetition agreement" failed as a matter of law.

The foregoing notwithstanding, DMC has remained committed to its complex relationship with KCC and KCI. This is evidenced by DMC's sharing of its residents with KCC for the purposes of continuing to develop oncology subspecialties. Additionally, KCC purchases a number of services from DMC, i.e., emergency services, ICU services, imaging services, nursing services, and IT services. In short, DMC has the same commitment to KCC today as it did prior to its acquisition by Vanguard.

<u>Health and Wellness Initiatives</u> (Section 12.11)

As noted above in discussing Indigent and Low Income Care, DMC has engaged in a campaign entitled *"Path to Health"* that seeks to maximize enrollment of eligible uninsured individuals in exchange and Medicaid expansion (Healthy Michigan) programs under the Affordable Care Act. This campaign, in addition to its objective of increasing the amount of coverage and care available to indigent low income individuals in Southeast Michigan, has provided a direct opportunity to educate and provide health and wellness education to the community. In December, 2013 the DMC hosted a Community Leader Breakfast attended by 75 different organizations. From this group, 50 acknowledged their partnership status and have vigorously supported enrollment activities. This campaign has included:

- Creation of web based information and tools, include an imbedded Health Insurance Cost and Savings Calculator;
- Training Certified Application Counselors available by hotline and in person at DMC sites;
- Contacting 57,000 individuals to take part in a virtual town hall event with the participation of 8000 individuals;
- Organizing 6 community enrollment events, the first of which was February 15, 2014, with a participation count of 600 individuals.

Annually each hospital, corporate human resources representatives and community affairs representatives participate in regular and special activities, identified in Exhibit E, that represent the commitment identified in Section 12.11 of the Agreement.

Supplier Diversity Program (Section 12.12)

The DMC continues to support "Seller's Supplier Diversity Program"; there were no amendments or changes made to the Supplier Diversity Program Policy since closing. Overall diversity spending for FY 2013 was $43.2 million dollars.

With respect to the Specified Capital projects DMC has met all the requirements of the Renaissance Zone Agreement.

Project Genesis (Section 12.13)

During the summer of 2013, DMC completed its 8th year sponsoring Project Genesis. 100 students were employed from Detroit area high schools and colleges placing the students in various departments throughout DMC. Each student worked 30 hours per week for 8 consecutive weeks. Students are required to attend weekly career development sessions and participate in at least one community outreach assignment. The 2013 program commenced with the distribution of applications to high school counselors. Typically more than 500 students apply for the 100 slots. Each student must complete an application, write an essay explaining their interest in healthcare, provide 3 letters of recommendation, and include a current transcript.

Detroit Based Systems (Section 12.14)

In compliance with Section 12.14 of the Agreement, the DMC continues to operate its hospitals as a Detroit-based system with its regional headquarters located in the City of Detroit, Michigan.

National Support Centers (Section 12.15)

Since the closing of the acquisition of Vanguard in 2013, senior executives of Tenet visited Detroit frequently to meet with DMS management and local, municipal and state officials of the state of Michigan. In December 2013, Tenet organized a meeting of its Board of Directors in the city of Detroit in order to introduce its Board members to the city, state and local governmental officials and the management employees of DMC, which is owned by Tenet's indirect wholly-owned subsidiary VHS of Michigan, Inc. . Those meetings gave Tenet leadership, the City and the State an opportunity to express and understand conditions for mutually beneficial growth strategies.

Naming Conventions (Section 12.16)

The DMC continues to honor all naming conventions as designated in donor agreements.