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**Report on the Proposed Sale of the Detroit  
Medical Center Hospital Businesses to  
Vanguard Health Systems, Inc.  
November 13, 2010**

STATE OF MICHIGAN  
DEPARTMENT OF ATTORNEY GENERAL



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The attached Report summarizes the Attorney General's review of the proposed sale of Detroit Medical Center's hospital system to Vanguard Health Systems. The reliance of indigent patients on DMC's hospitals for quality health-care services cannot be overstated. DMC is also the largest employer in Detroit and provides training resources for future physicians, nurses, and other health-care professionals. It is essential that DMC continue to operate.

DMC has successfully weathered periods of financial distress, in particular rebounding from a crisis in 2003-2004 that threatened to close hospitals. Because DMC is a charitable organization, it cannot raise funds through private equity offerings and must instead raise needed capital through debt financing. Due to DMC's poor credit rating, the Michigan Hospital Finance Authority has not issued tax-exempt hospital revenue bonds for DMC since 1998, and DMC's limited access to private bond financing was extinguished by the credit crisis of 2008. As a result, DMC lacks capital to make the necessary improvements to its facilities in order to remain financially viable in the long term.

Vanguard's offer includes a commitment to invest \$850 million in Detroit to improve the DMC facilities. Vanguard also promises to maintain charity care, to continue operating DMC's hospitals, and to provide essential core health-care services. But DMC hospitals will no longer be owned and operated by a Michigan charitable nonprofit hospital system.

As the Michigan official charged with overseeing charitable gifts and trusts, the Attorney General must ensure that charitable assets are preserved and protected for their designated charitable uses. To this end, I assigned a core team of eight professionals on my staff, including seven attorneys and an accountant, to conduct a thorough and independent evaluation of this complex transaction and to consider every comment received from the public.

After extensive review, I approve the proposed sale, provided that the parties agree to make additional commitments necessary to safeguard the public interest. These commitments include protections for \$140 million in charitable gifts held by DMC; assurances of resources necessary to police Vanguard's performance; and, acknowledgement of the Attorney General's authority to institute legal action to enforce Vanguard's promises. With these additional commitments, I conclude DMC will receive fair market value for its assets; Vanguard will have the means to carry out its promises; adequate means exist to hold Vanguard to its word; and, restricted charitable gifts held by DMC will be preserved for intended charitable purposes.

I would like to thank DMC and Vanguard for their cooperation; Focus Management Group and AlixPartners, LLP, whose expert assistance was invaluable; and finally, the concerned citizens of Michigan, who placed their trust in my office to protect the public interest.

Mike Cox  
Attorney General

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## I. INTRODUCTION

The proposed sale in the Purchase and Sale Agreement<sup>1</sup> between the Detroit Medical Center (DMC)<sup>2</sup> to Vanguard Health Systems, Inc. (Vanguard)<sup>3</sup> is a complex transaction that involves the transfer of eight hospitals and other health-care facilities. DMC is vital to the health and economy of Southeastern Michigan and forms the majority of Detroit's health-care "safety net,"<sup>4</sup> providing health-care services to nearly one million people annually and serving a disproportionate share of the indigent, uninsured, and underinsured, thus exerting a dramatic effect on the State's Medicaid budget.

### A. Transaction Overview

The most significant provisions of the Purchase and Sale Agreement are the following:

1. DMC will transfer substantially all health-care assets to Vanguard;
2. Vanguard will transfer to DMC approximately \$391 million in cash at Closing, primarily to be used to retire DMC's long-term debt;<sup>5</sup>
3. Vanguard will assume DMC's unfunded pension and malpractice liabilities of about \$232 million;<sup>6</sup>

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<sup>1</sup> The Purchase and Sale Agreement, as amended, June 10, 2010, (Purchase and Sale Agreement) is on the Attorney General's website: [http://michigan.gov/ag/0,1607,7-164-17337\\_55911-237649--,00.html](http://michigan.gov/ag/0,1607,7-164-17337_55911-237649--,00.html). All capitalized terms used but not otherwise defined in this Report are defined in the Purchase and Sale Agreement. Terms defined in this Report are listed in Appendix A, and referenced entities and institutions are repeated in Appendix B.

<sup>2</sup> Detroit Medical Center, a Michigan nonprofit hospital system, and its affiliates and subsidiaries (DMC).

<sup>3</sup> Vanguard Health Systems, Inc., a Delaware corporation with its national headquarters in Tennessee, and its subsidiaries (Vanguard).

<sup>4</sup> For our purposes, "safety net" is defined as the web of organizations and programs that have assumed a legal obligation or are otherwise committed to providing direct health-care services to the uninsured, underinsured, and other underserved groups. More than one-half of DMC's patients are uninsured or on Medicaid.

<sup>5</sup> Estimate as of November 8, 2010, in Vanguard's Securities and Exchange Commission 8-K filing. This figure has changed since the original signing of the Purchase and Sale Agreement because various amounts on DMC's balance sheet have changed with the passage of time and DMC's day-to-day operations.

<sup>6</sup> The breakdown of the \$232 million liability equals approximately \$190 million in pension liability and \$42 million in net malpractice liability per DMC financial statements as of August

4. Vanguard will invest a minimum of \$850 million in special and routine capital projects in DMC facilities over the next five to seven years;
5. Vanguard will commit for at least 10 years to keep all DMC hospitals open, continue enumerated essential core services, and maintain DMC's charity care policy;
6. Legacy DMC<sup>7</sup> will retain approximately \$140 million in restricted charitable funds;
7. Legacy DMC will have legal authority to monitor and enforce Vanguard's commitments to continue charity care, retain essential core health-care services, and invest in capital projects.

Significant pre-Closing conditions in the Purchase and Sale Agreement include:

1. State, County, and City approval of a property tax exemption as a Renaissance subzone for DMC's central campus;
2. Attorney General approval;
3. Michigan Department of Community Health approval of all licenses necessary for Vanguard's hospital operations and the provision of health-care services;
4. Center for Medicaid and Medicare Services (CMS) assurances of continuing medical education allotments;
5. CMS assurances that Medicare and Medicaid provider agreements and related provider numbers are complete, and that necessary certifications will be granted for participation in government payment programs;<sup>8</sup>

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31, 2010. DMC's actuary, Aon Hewitt, estimates that the unfunded pension liability will increase to \$293 million as of December 31, 2010. If this amount is added to the \$42 million net malpractice liability, the total estimated pension and malpractice liabilities to be assumed by Vanguard as of December 31, 2010, equal approximately \$335 million.

<sup>7</sup> While the precise name of this entity has not yet been finalized and is not used in the Purchase and Sale Agreement, for the purposes of this Report, "Legacy DMC" refers to the continuation of DMC as a charitable entity after Closing.

<sup>8</sup> There is uncertainty at the time of this Report regarding the CMS provider agreements. The Purchase and Sale Agreement contemplates that Vanguard will acquire new CMS provider numbers, and Legacy DMC will retain DMC's existing numbers and related assets and liabilities. If, however, the Purchase and Sale Agreement must be revised to reflect Vanguard's assumption of DMC's existing provider numbers, then the Parties must obtain the Attorney General's written consent.

B. The Review Process

After the public announcement of the proposed sale of DMC to Vanguard in March 2010, the Department of Attorney General (Attorney General) assembled a team to conduct a thorough and objective examination of the terms of the transaction.<sup>9</sup> Michigan does not have a statute specifically governing nonprofit to for-profit hospital conversions; however, the Attorney General does have broad authority to act on behalf of the People of Michigan to protect and preserve charitable property. Therefore, the parties to the Purchase and Sale Agreement specifically conditioned the Closing on the Attorney General's approval.<sup>10</sup>

In order to conduct an expeditious yet thorough review, the Attorney General required DMC to pay independent experts selected by the Attorney General to conduct a financial and operational analysis of the Purchase and Sale Agreement. After extensive interviews, the Attorney General selected two firms: AlixPartners, LLP (AlixPartners) and Focus Management Group (Focus). AlixPartners is a global company based in Southfield, Michigan, with an international reputation for expertise in forensic accounting, corporate and operational performance, corporate restructuring, and corporate valuation, and includes more than 25 years of experience in health care valuation and advising various state attorneys general on hospital conversions. Focus is a national consulting firm that has earned its reputation for cash flow management and corporate restructuring across multiple industries, with a special expertise in

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<sup>9</sup> The Attorney General's team included: Chief Deputy Attorney General Carol Isaacs; Assistant Attorneys General: Robert Ianni, Chief, Consumer and Environmental Protection Bureau; Katharyn Barron, Chief, Consumer Protection Division; Tracy Sonneborn, Charitable Trust Section; Susan Balkema, Licensing and Regulation Division; Joseph Potchen, Health, Education and Family Services Division; Thomas Marks, M.D., Health Care Fraud Division; and, Joseph Kylman, Charitable Trust Section Auditor. Additional attorneys contributed time and expertise on a variety of issues.

<sup>10</sup> Significant sources of the Attorney General's authority in the area of charitable assets and trusts are summarized in Appendix C.

hospital management, operations, and financing. AlixPartners and Focus were retained by, and therefore accountable solely to, the Attorney General and, by extension, the People of Michigan. The Attorney General supervised the activities of these experts, who interacted with Vanguard and DMC as directed and permitted by the Attorney General.<sup>11</sup>

In developing principles to guide the review, the Attorney General studied model health-care conversion laws, conversion statutes of other states, review protocols in states without conversion statutes, statutory and common law principles applicable to charitable trusts, and other relevant legal authorities. The primary goal was to identify and apply established legal standards to protect the Public's interest in the charitable mission and assets of DMC. On the basis of this research, the Attorney General adopted a core set of considerations to evaluate the proposed transaction.

The Attorney General's review and the majority of this Report focus on:

- A. The terms of the Purchase and Sale Agreement, specifically the following important aspects:
  - 1. Financial valuations;
  - 2. Maintenance of essential core hospital services; and,
  - 3. Charity care.
- B. The following questions concerning the process followed by DMC's Board of Trustees (DMC Board) that led to the Purchase and Sale Agreement:
  - 1. Was the decision of the DMC Board to explore alternatives to conventional financing the product of diligent examination rooted in the needs of the community and the charitable purposes of DMC?
  - 2. Did the DMC Board identify criteria to be used in considering strategic options that were designed to protect the community's interest and to serve DMC's charitable mission?
  - 3. Did the DMC Board consider all viable strategic options other than the sale to a for-profit entity?

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<sup>11</sup> AlixPartners and Focus had significant access to DMC and Vanguard information and personnel. Principal documents reviewed in preparing this Report are listed in Appendix D and individuals interviewed are referenced in Appendix E.



4. Did the DMC Board assess short- and long-term risks the proposed sale to Vanguard would pose to the community?
  5. Did the DMC Board solicit, receive, and consider multiple offers?
  6. Did the DMC Board obtain an independent valuation of DMC's net worth?
  7. Did the DMC Board conduct a reasonably open review and deliberation process under the circumstances?
  8. Is there any basis for concern that private interests or potential or actual conflicts of interest on the part of trustees or senior management affected the decision of the DMC Board?
  9. Were in-house meetings for employees and physicians, as well as community forums, conducted to seek input and discussion regarding the impact of the conversion on stakeholders?
- C. An independent valuation of DMC's assets in order to determine whether the proposed purchase is for fair market value.
- D. An independent review of Vanguard's financial resources in order to determine whether Vanguard has the long-term financial ability to carry out its capital expenditure and other commitments.

## **II. CONCLUSIONS AND FINDINGS: THE ATTORNEY GENERAL'S CONDITIONAL APPROVAL**

The Attorney General finds that Vanguard's proposed purchase of DMC protects the charitable assets of DMC and serves the public interest by the following:

1. Vanguard will pay approximately \$391 million toward retiring DMC's outstanding bonds;
2. Vanguard will assume approximately \$232<sup>12</sup> million in current unfunded pension and medical malpractice liabilities owed by DMC;
3. Vanguard will be contractually obligated to spend \$850 million over the next five years to upgrade and modernize DMC's facilities—the largest single capital investment in Detroit in decades;
4. Vanguard's total commitment of approximately \$1.5 billion exceeds the highest estimate of DMC's value by independent analysts<sup>13</sup>;

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<sup>12</sup> The breakdown of the \$232 million liability equals approximately \$190 million in pension liability and \$42 million in net malpractice liability per DMC financial statements as of August 31, 2010. DMC's actuary, Aon Hewitt, estimates that the unfunded pension liability will increase to \$293 million as of December 31, 2010. If this amount is added to the \$42 million net malpractice liability, the total estimated pension and malpractice liabilities to be assumed by Vanguard as of December 31, 2010, equal approximately \$335 million.

5. Vanguard will be contractually obligated to meet or exceed DMC's charity care policy for at least the next ten years;
6. Absent discriminatory reduction in state or federal funding, Vanguard will be contractually obligated to keep open all the current DMC hospitals for at least the next 10 years;
7. Legacy DMC will be structured to protect the remaining \$140 million in charitable assets and ensure that those assets will be maintained or granted in a manner consistent with donors' intentions; and,
8. Legacy DMC will monitor and enforce Vanguard's compliance with its contractual commitments.

Based upon these findings, the Attorney General approves the sale outlined in the Purchase and Sale Agreement of June 10, 2010, subject to the condition that Vanguard and DMC enter into the following agreements in a form satisfactory to the Attorney General and substantially similar to Exhibits 1-4.

1. Amendment No. 2 to the Purchase and Sale Agreement. Exhibit 1. The Parties must modify their Purchase and Sale Agreement to include the following provisions:
  - a. The Attorney General's written consent is required:
    - before Closing, to make *any* material modification to the Purchase and Sale Agreement (including amendments required to reflect the handling of issues related to DMC's CMS provider numbers);
    - after Closing, to make modifications to Purchase and Sale Agreement sections setting forth Vanguard's promises regarding charity care, essential core services, and capital expenditures.
  - b. Vanguard must adhere to the more generous of DMC's and Vanguard's own charity care policies.
  - c. Vanguard must prominently advise patients of the following:
    - the availability of financial assistance to uninsured and underinsured patients on terms at least as generous as the applicable charity care policy;
    - the availability of assistance in applying for Medicaid coverage;
    - the availability of a patient-care ombudsman, a patient-care hotline, and other measures to facilitate resolution of billing and treatment issues.
    - patients' rights; and,
    - its debt-collection policy, which shall comport with all federal and state collection practices laws.

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<sup>13</sup> Of the \$850 million capital commitment, approximately \$350 million is designated for routine maintenance capital expenditures, while the remaining \$500 million is earmarked for special capital projects and is secured by warrants for equity in Vanguard. When comparing Vanguard's financial commitment to the valuation of DMC, one would not take the \$350 million in maintenance capital expenditures into account.

- d. Vanguard must agree to provide certain operational information to Legacy DMC annually for at least 10 years after Closing; and,
    - e. The Attorney General may enforce Vanguard's commitments to provide charity care, continue essential core services, and make specified capital investments if Legacy DMC fails to do so.
2. Enforcement Agreement. Exhibit 2. The Parties must acknowledge in an agreement with the Attorney General:
  - a. The Attorney General may enforce Vanguard's commitments to provide charity care, continue essential core services, and make specified capital investments if Legacy DMC fails to do so; and,
  - b. The Attorney General's consent is required for material modifications of Vanguard's Post-Closing Covenants contained in Article 12 of the Purchase and Sale Agreement.
3. Monitoring and Compliance Agreement. Exhibit 3. The Parties must acknowledge in an agreement with the Attorney General:
  - a. The DMC Board will be restructured after Closing in order to best serve Legacy DMC's obligation to monitor and enforce Vanguard's promises:
    - to continue providing access to necessary medical care to those who cannot afford to pay;
    - to continue operating DMC's safety-net hospitals and essential core health-care services; and,
    - to make substantial capital expenditures in Detroit to improve the DMC hospitals.
  - b. Legacy DMC's 20-member Board will include members of the DMC Board, new Trustees, and appointees by the Mayor of Detroit, the Wayne County Executive, and the Attorney General.
  - c. Vanguard must provide Legacy DMC with detailed periodic reports and other requested information regarding its hospital operations for no less than 10 years.
  - d. Legacy DMC must review and evaluate information it receives from Vanguard and must publish annual reports on its findings.
  - e. Legacy DMC must establish methods by which the public can easily, at minimal or no cost, submit complaints regarding Vanguard's practices.
  - f. Legacy DMC will comply with charity laws administered by the Attorney General.
4. Protection of Charitable Assets Agreement. Exhibit 4. DMC must acknowledge in an agreement with the Attorney General that Legacy DMC will:
  - a. refrain from transferring donor-restricted funds to other charities before obtaining commitments to cover Legacy DMC's potential future monitoring and enforcement expenses;
  - b. refrain from other transfers, except those in the ordinary course of business or as required by the Purchase and Sale Agreement, without the approval of the Attorney General; and,

- c. provide detailed information on all donor-restricted charitable funds subject to Legacy DMC's control.

The Attorney General determines that, with the addition of these conditions, the proposed transaction properly protects charitable assets and promotes DMC's charitable mission. In addition, the sale serves the public interest by safeguarding the availability of health-care services to underserved populations, improving DMC's facilities, and attracting quality health-care providers to the DMC system.

There are risks inherent in any conversion or sale of a nonprofit health-care corporation to a for-profit business. The Attorney General considered the risks presented by the proposed sale of DMC and concluded that they are clearly outweighed by the greater risk that DMC will be forced to close some or all of its safety-net hospitals, causing a loss of access to critical medical services for many people who lack the means to obtain them elsewhere. This Report explains the basis for this conclusion.

### **III. CONCLUSIONS AND FINDINGS: DETAIL AND DISCUSSION**

#### **A. DMC History and Financial Challenges**

DMC's history is described in Appendix F. Four expert reports issued in the last decade recount DMC's recent financial distress and emphasize the importance of significant, stable financing in maintaining safety-net hospitals in Detroit. The recent performance of DMC demonstrates an inability to generate cash flow sufficient to fund necessary levels of capital expenditure and investment. DMC has lacked ready access to capital for many years. Its financial deterioration is exhibited by its failure after 1998 to qualify for hospital revenue bonds issued through the Michigan State Hospital Finance Authority, and its financial crisis that culminated in a public bailout in 2003.

DMC's history shows—and common sense dictates—that without adequate access to capital, it will be difficult for DMC to meet the challenge of serving a disproportionately larger indigent, uninsured, and underinsured patient base, while facing lower revenues from a shrinking population base, aging facilities, and a loss of insured patients in the urban core to suburban hospitals with modern facilities.

B. Recent Financial Performance

The table below summarizes the consolidated historic results of DMC from 2006 through 2009.<sup>14</sup> The table also compares DMC's debt-to-capitalization ratio, which is a standard

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<sup>14</sup> Consolidated Financial Statements, The Detroit Medical Center and Subsidiaries, 2006-2009. In the table, short-term debt is the sum of DMC's revolving line of credit notes and its current portion of long-term debt as shown in DMC's audited financial statements. Long-term debt is its long-term debt, less the current portion of long term debt.

measure of DMC's indebtedness, to an industry benchmark from Moody's Investor Service.<sup>15</sup>

Historic Results 2006 - 2009 And Comparison of Debt-to-Capitalization Percentage To Nonprofit Hospitals and Single-State Hospital Systems				
<i>(000,000's omitted)</i>	12/31/06	12/31/07	12/31/08	12/31/09
Gross Patient Services Revenues	\$ 3,626	\$ 3,782	\$ 3,872	\$ 4,198
Net Patient Services Revenues	\$ 1,689	\$ 1,788	\$ 1,870	\$ 1,952
Net Revenues %	46.58%	47.28%	48.30%	46.50%
Total Revenue	\$ 1,844	\$ 1,924	\$ 1,993	\$ 2,090
EBIDA <sup>(a)</sup>	\$ 139	\$ 155	\$ 157	\$ 125
EBIDA as % of Total Revenues	7.54%	8.06%	7.88%	5.98%
DMC Short-Term Debt <sup>(b)</sup>	\$ 23	\$ 44	\$ 28	\$ 42
DMC Long-Term Debt	553	534	510	490
Total Debt	\$ 576	\$ 578	\$ 538	\$ 532
DMC Unrestricted Net Assets	\$ (108)	\$ (2)	\$ (326)	\$ (178)
DMC Net Worth	\$ 58	\$ 166	\$ (202)	\$ (35)
Median Debt-to-Capitalization %	39.1%	38.5%	42.1%	42.6%
DMC Debt-to-Capitalization %	123.1%	100.3%	253.8%	150.3%
Net Pension (Liability) / Asset	(\$66)	\$58	(\$248)	(\$184)

(a) EBIDA is defined as Earnings Before Interest, Depreciation and Amortization.

(b) Short-Term Debt includes DMC's revolving line of credit and current portion of long-term debt.

Although gross and net patient services revenues increased slightly, and net revenue remained relatively stable, DMC's total debt remains high, its net worth is negative,<sup>16</sup> and its pension liability ballooned in 2008. DMC's debt-to-capitalization percentage compared to other nonprofit hospitals and single-state hospital systems is well above the median.<sup>17</sup> As of December 31, 2009, DMC's net working capital was approximately negative \$45 million.<sup>18</sup>

<sup>15</sup> Moody's Investors Service is a credit rating agency which performs international financial research and analysis on commercial and government entities. The company also ranks the credit-worthiness of borrowers using a standardized ratings scale.

<sup>16</sup> "Net worth" is total assets minus total liabilities.

<sup>17</sup> Moody's Investors Service, Median Report: Not-for-Profit Healthcare Medians for Fiscal Year 2009 Show Improvement Across All Major Ratios and All Rating Categories, August 25, 2010. Moody's defines Debt-to-Capitalization % as (long-term debt + short-term debt) / (long-term debt + short-term debt + unrestricted fund balance).

<sup>18</sup> Working capital is a measure of an organization's short-term financial health. Generally, a positive net working capital number means an organization has the ability to pay its short-term

1. Cash On Hand<sup>19</sup>

DMC has been able to reverse its history of financial losses but has not been able to generate substantial cash reserves. As shown in the following chart, DMC has generally maintained cash reserves sufficient to sustain operations for 30 days or less.<sup>20</sup>

Year	Days Cash on Hand
2006	28.1 days
2007	23.7 days
2008	23.2 days
2009	31.7 days

This compares unfavorably with other hospitals, both locally and nationally. The following chart compares DMC cash on hand to two similar local facilities<sup>21</sup>:

Facility	Days Cash on Hand	As Of
Oakwood Healthcare	125 days	12/31/2009
Beaumont	112 days	6/30/2010
DMC	32 days	12/31/2009

Moody's 2009 Not-For-Profit Hospital Median Report reflects the following median information for hospitals with a Moody's bond rating similar to DMC's<sup>22</sup>:

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(i.e., one year or less) liabilities. A negative number means it is currently unable to meet its short-term liabilities with its current assets (cash, accounts receivable, and inventory).

<sup>19</sup> While Cash on Hand can be calculated using unrestricted and/or restricted investments, Moody's defines Cash on Hand (Days) as  $(\text{unrestricted cash and investments} \times 365) / (\text{total operating expenses} - \text{depreciation and amortization expenses})$ . The calculations for DMC conservatively include board-designated funds as unrestricted cash, which leads to an increase in the days cash on hand.

<sup>20</sup> Consolidated Financial Statements, The Detroit Medical Center and Subsidiaries, 2006 - 2009.

<sup>21</sup> Municipal Securities Rulemaking Board, Electronic Municipal Market Access, <http://www.emma.msrb.org/>. Oakwood Healthcare appears in this reference as "Oakwood Obligated group" and includes Oakwood Healthcare Inc., Oakwood United Hospitals, Inc., and Oakwood Health Promotions, Inc. Beaumont appears as "William Beaumont Hospital."

<sup>22</sup> DMC's bond rating is Ba3. Moody's bond ratings, from highest to poorest, are Aaa, Aa, A, Baa, Ba, B, Caa, Ca, C. Moody's also assigns a number from 1 to 3 to most ratings, which indicates where the bond ranks within the letter rating category. A "1" would mean that it is at the higher end of the rating. DMC's Ba3 rating means that it is at the lower end of the Ba rating. [http://v3.moodys.com/viewresearchdoc.aspx?docid=RU\\_16645371&cy=usa](http://v3.moodys.com/viewresearchdoc.aspx?docid=RU_16645371&cy=usa) (registration required).

Hospital Bond Rating	Days Cash on Hand
Baa3	92.1 days
Ba	66.5 days

On September 27, 2010, Moody's Investors Service maintained its Ba3 rating on DMC's long-term debt but revised its outlook from "stable" to "negative." This rating means that DMC's debt is "judged to have speculative elements" and is "subject to substantial credit risk."

## 2. Average Age of Facilities

With relatively little available cash, DMC has been unable to fund major capital investments, such as new projects and major renovations, improvements, or expansions of existing facilities. According to Moody's, the median annual spending on additions to property, plant, and equipment by all nonprofit hospitals and single-state hospital systems from 2005 to 2009 has ranged between approximately 7-9% of net patient revenue. If DMC spent this percentage of its approximate \$1.8 billion in patient revenue on capital expenditures, it would have invested approximately \$138 million to \$166 million on property, plant, and equipment each year.<sup>23</sup> However, DMC's recent capital expenditures total only \$50 to \$70 million per year.<sup>24</sup> This amount is barely sufficient to keep equipment and facilities operational and leaves nothing for strategic improvement to better compete with suburban hospitals.<sup>25</sup>

Thus, Focus observed that DMC has an aging, and in many respects, obsolete physical plant. The following chart shows DMC's average age of plant for years 2006 through 2009<sup>26</sup>:

<sup>23</sup> Moody's Investors Service, Median Report: Not-for-Profit Healthcare Medians for Fiscal Year 2009 Show Improvement Across All Major Ratios and All Rating Categories, August 25, 2010.

<sup>24</sup> Consolidated Financial Statements, The Detroit Medical Center and Subsidiaries, 2005-2009.

<sup>25</sup> Per DMC management, \$50 million is below the minimum level of capital expenditures needed for routine maintenance.

<sup>26</sup> Consolidated Financial Statements, The Detroit Medical Center and Subsidiaries, 2006-2009 with supplemental information provided by DMC. Average age of plant is calculated by dividing total accumulated depreciation by the current year's depreciation expense.



Year	Age of Plant
2006	19.2 years
2007	18.5 years
2008	20.0 years
2009	20.0 years

The average age of plant is quite high when compared to similarly rated hospitals<sup>27</sup>:

Hospital Bond Rating	Average Age of Plant
Baa3	10.6
Ba	13.9

### 3. Pension Liability

In addition to DMC's aging facilities, its pension liability funding requirements also pose significant challenges. At the same time that DMC's cash situation was improving due to increasing revenues and decreasing expenses, its defined-benefit pension plan, which was frozen in 2003, lost significant value when the stock market declined in late 2008. This pension plan liability now requires increased payments from DMC over the next five to seven years, and further reduces monies available for capital improvements.

According to DMC's expert in the matter, Aon Hewitt, given current asset values and interest rates, the required 2011 plan year pension funding is approximately \$35.8 million, and the annual plan year funding requirement from 2012 to 2016 is between \$27.2 and \$48.6 million if no funding relief is available or elected.

### Conclusion

The Attorney General's independent expert, Focus, concluded that if DMC continues to lack access to capital, its aging facilities will likely drive physicians and patients to other hospitals. This is particularly true of insured patients, who bring higher reimbursements that are critically needed to offset the low reimbursement rates for Medicaid services.

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<sup>27</sup> Moody's Investors Service, Median Report: Not-for-Profit Healthcare Medians for Fiscal Year 2009 Show Improvement Across All Major Ratios and All Rating Categories, August 25, 2010.

Taking into consideration the high debt-to-capital ratio, low cash balances on hand, high age of facility, and continuing pension liabilities, Focus agrees with the conclusion of the DMC Board that DMC would be unable to sustain its operations for many more years without additional capital to cover both immediate cash requirements and to fund capital improvements.<sup>28</sup>

C. Attorney General's Review Process and Conclusions

1. Financial Terms of the Purchase and Sale

AlixPartners assisted the Attorney General's office in analyzing the financial terms of the transaction, which is summarized below. AlixPartners' entire report is attached as Exhibit 5. In brief, Vanguard is actually giving more to DMC than the \$391 million Vanguard transfers at Closing primarily to retire DMC's outstanding debt. Adding approximately \$232 million in pension and malpractice liabilities,<sup>29</sup> and Vanguard's promise of \$850 million in long-term capital investments in DMC facilities, Vanguard's total financial commitment approaches \$1.5 billion.

More specifically, Vanguard (through its subsidiary, VHS of Michigan) will acquire substantially all of DMC's health-care assets. Vanguard will not, however, acquire restricted charitable funds. As shown in the chart below, Vanguard will also assume certain liabilities from DMC that total approximately \$710.2 million.<sup>30</sup>

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<sup>28</sup> DMC Board Minutes, (March 8, 2010).

<sup>29</sup> The breakdown of the \$232 million liability equals approximately \$190 million in pension liability and \$42 million in net malpractice liability per DMC financial statements as of August 31, 2010. DMC's actuary, Aon Hewitt, estimates that the unfunded pension liability will increase to \$293 million as of December 31, 2010. If this amount is added to the \$42 million net malpractice liability, the total estimated pension and malpractice liabilities to be assumed by Vanguard as of December 31, 2010 equal approximately \$335 million.

<sup>30</sup> Total is as of April 30, 2010. The balance sheet items could vary at the time of closing based on DMC's operations. The pension and malpractice liabilities previously discussed are included

<b>Total Assumed Liabilities as of April 30, 2010 (\$ in Millions)</b>	
Current Liabilities	\$ 262.6
Long-Term Liabilities	\$ 447.6
<b>Total Assumed Liabilities</b>	<b>\$ 710.2</b>

In addition to assuming certain liabilities at closing, Vanguard will pay DMC an amount equal to:

- DMC's total debt (approximately \$516.8 million as of April 30, 2010);
- working capital for Legacy DMC (\$4.5 million); and,
- estimated transactional expenses (\$2.5 million).

The subtotal of \$523.8 million (the Total Obligation) is reduced by an amount equal to certain of the Excluded Assets,<sup>31</sup> which total approximately \$117.5 million as of April 30, 2010. The Total Obligation is increased by Net Cost Reports Receivable from Medicare, which total approximately \$10.8 million as of April 30, 2010. The total proceeds due at closing, which DMC will use to retire the retained bond liabilities and long-term debt and satisfy any cost report liabilities to Medicare, are summarized below. The complete example calculation, which is attached to the Purchase and Sale Agreement as Schedule 2.5, is attached to this Report as Exhibit 6.<sup>32</sup>

<b>Example Calculation of the Purchase Price as of April 30, 2010 (\$ in Millions)</b>	
Total Obligation	\$ 523.8
Less: Total Funds	\$ (117.5)
Plus: Net Cost Reports Receivable	\$ 10.8
<b>Total Proceeds Due at Closing</b>	<b>\$ 417.2</b>

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in the \$710.2 million shown in the table below. However, the pension and malpractice liabilities are outside of the liabilities incurred during normal business operations (e.g., accounts payable), and therefore, Vanguard's assumption of these liabilities is considered additional consideration in the transaction.

<sup>31</sup> Funds Held in Trust Under Bond Agreements, Board Designated Funds for Capital Improvements, and Board Designated Funds for Endowments and Other Purposes.

<sup>32</sup> Amounts per the Purchase and Sale Agreement dated June 10, 2010. The current estimate of the total proceeds due at closing is \$391 million.

In the Purchase and Sale Agreement, Vanguard agrees to make routine capital expenditures of \$350 million during the five-year period, subject to certain extensions as provided in the Purchase and Sale Agreement, immediately following the Closing Date. In addition—and more important to DMC’s long-term financial health—during the same five-year period, Vanguard will expend \$500 million for Specified Capital Projects. Vanguard will commit to spend an annual minimum of \$80 million during each of the first four years following the Closing Date, with the balance spent during the fifth year. The Specified Capital Projects, which were developed in conjunction with DMC personnel, are summarized as follows:

<b>Specified Capital Projects (\$ in millions)</b>		
<b>Entity</b>	<b>Project Description</b>	<b>Project Cost</b>
Children's Hospital	Pediatric Specialty Center	\$ 33.1
Children's Hospital	CHM Tower Project	\$ 174.4
Corporate Offices	Relocation of Parking Deck	\$ 34.2
Detroit Receiving Hospital	Patient Care Unit Renovations	\$ 20.7
Detroit Receiving Hospital	1 Additional OR	\$ 8.4
Harper University Hospital	Surgical Services Renovation	\$ 22.9
Harper University Hospital	Unified Lobby	\$ 10.7
Harper University Hospital	Ground Floor Master Plan	\$ 13.9
Harper University Hospital	Cardiovascular Institute	\$ 77.6
Harper University Hospital	Harper Unit Renovations	\$ 6.7
Harper University Hospital	ED Expansion	\$ 3.4
Huron Valley Sinai Hospital	Private Room Renovation	\$ 7.0
Huron Valley Sinai Hospital	Additional ICU Beds	\$ 3.7
Rehabilitation Institute	6th Floor Renovation	\$ 5.6
Sinai Grace Hospital	ED/ICU/Façade/ Radiology upgrades	\$ 77.7
<b>Total</b>		<b>\$ 500.0</b>

The Purchase and Sale Agreement provides security for Vanguard's performance. At Closing, Vanguard must deliver to an escrow agent a Warrant Certificate having an aggregate value of \$500 million for warrants issuable to Legacy DMC to purchase shares of common stock of Vanguard. This Warrant Certificate is the security for the capital expenditures. In simple terms, the Warrant Certificate secures Vanguard's capital commitments by giving Legacy DMC an *ownership* interest in Vanguard if Vanguard defaults on its promises.

If Vanguard consummates an initial public offering (IPO) of common stock while the Warrant Certificate is outstanding, Vanguard may deliver an unsecured promissory note payable to DMC in an amount equal to the remaining capital expenditure commitment in exchange for the Warrant Certificate.

AlixPartners indicated that under the IPO scenario, Vanguard would have greater access to liquidity via the equity markets and the promissory note would offer equivalent or better security than the Warrant Certificate.

## 2. Maintenance of Hospital Core Services

A key provision in the Purchase and Sale Agreement requires that for at least ten years after the Closing Date, Vanguard will maintain each of the hospitals as a general acute care hospital, or as a rehabilitation hospital in the case of the Rehabilitation Hospital of Michigan.<sup>33</sup> Additionally, each hospital must provide certain core services. These core services are shown in the following table:

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<sup>33</sup> An exception to the requirement to maintain Hospitals allows for closure if reductions in state or federal funding and reimbursements discriminate against for-profits and cause the Hospital to suffer material declines in EBITDA. Purchase and Sale Agreement Section 12.3(a).

Service	Detroit Receiving	Harper/Hutzel CVI / DSH	Sinai-Grace	Huron Valley-Sinai	Rehabilitation Institute	Children's Hospital of Michigan
Emergency Dept / Services	X	X	X	X		X
Trauma Designated ED	X		X			X
General Medical Services	X	X	X	X		X
Inpatient and Outpatient Surgery	X	X	X	X		X
Radiology and Diagnostic Services	X	X	X	X		X
Obstetrics		X	X	X		
Neonatal Intensive Care Unit		X				X
Comprehensive Cardiology Services*		X	X	X		X
Intensive Care Services	X	X	X	X		X
Inpatient Rehab Services					X	
Outpatient Rehab Services					X	

\* Service availability subject to Certificate of Need approval

### 3. Charity Care

The Purchase and Sale Agreement requires Vanguard to provide medical care to indigent, uninsured, or underinsured patients (hereinafter referred to as "charity care") for 10 years after Closing.<sup>34</sup> Vanguard's commitment recognizes that the historic and ongoing provision of care for indigent and low-income patients is an intrinsic part of the culture of DMC and all its component hospitals.

According to the original Purchase and Sale Agreement, Vanguard may implement either DMC's current charity care policy or a policy used at another Vanguard hospital if that policy is as favorable or more favorable to patients than DMC's current policy.<sup>35</sup> Vanguard also contractually promises to negotiate "in good faith" for continued charity care under the DMC policy beyond the initial 10 years if requested by Legacy DMC during the six months prior to the

<sup>34</sup> Purchase and Sale Agreement, Section 12.2.

<sup>35</sup> Specifically, Vanguard may choose to implement the charity care policy utilized by any affiliate of Vanguard from time to time, provided that policy is "no less favorable to indigent and low-income patients in any respect" than the historic DMC policy specified in schedule 12.2. Original Purchase and Sale Agreement, Section 12.2.

end of the ten-year commitment. As a result of further negotiations with the Attorney General, Vanguard now agrees to abide by the more benevolent of either DMC's present charity care policy or Vanguard's corporate-wide policy.<sup>36</sup>

### **Vanguard's Charity Care Policy**

Vanguard's current corporate-wide policy for provision of charity and indigent care, Reference No. 11-0801 as revised January 23, 2009, is titled "Charity Care, Financial Assistance, and Billing & Collection Policies for Uninsured Patients," and is attached to this Report as Exhibit 8.

Vanguard's policy is actually more patient-friendly than DMC's current policy since it allows patients with higher incomes to qualify for charity care. While current DMC policy provides charity care for patients with incomes up to twice the federal poverty level, Vanguard's charity care policy will provide care to patients with incomes up to five times the federal poverty level.

Vanguard's charity care policy also includes well-defined procedures and explanations concerning a wide variety of topics including application for government assistance, collection policies, and treatment for homeless patients. Importantly, Vanguard's collections policy is more patient-friendly because it includes limits on seizing indigent or underinsured patients' assets through liens or garnishment. The policy also provides liberal interest-free extended payment plans.<sup>37</sup>

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<sup>36</sup> Amendment No. 2 to Purchase and Sale Agreement, Section 12.2. See Exhibit 1.

<sup>37</sup> A summary statement of Vanguard's policy is that "[Vanguard] shall provide charity care (free care) or financial assistance to Uninsured Patients for emergency, non-elective care to those who qualify for classification as Financially Indigent or Medically Indigent in accordance with the Charity Care Financial Assistance process set forth in the policy." Vanguard defines "Financially Indigent" as income below 200% of the Federal Poverty Guidelines ("FPG"). The

Vanguard intends to maximize enrollment of all eligible patients into government assistance programs, such as Medicaid, at or near the time services are provided. If executed, this diligent enrollment will reduce the overall cost of charity care. It is incumbent on Legacy DMC to exercise its mandate to enforce Vanguard's covenant maintaining the *policy* of charity and indigent care. It is a reality that dollars spent and patient volumes will fluctuate over the course of ten years; thus, Legacy DMC must be vigilant in focusing on preserving the standard of charity care provided. The Attorney General will require Legacy DMC to adopt policies and procedures to monitor and verify Vanguard's adherence to contractual promise of charity care.

#### 4. Other Provisions in the Purchase and Sale Agreement

The following noteworthy provisions are also contained in the Purchase and Sale Agreement:

- Excluded assets: the assets purchased do not include endowments, pledges receivable and other donor restricted assets.
- Employee matters: Vanguard agrees to employ all current employees as of the Closing date. Vanguard will maintain all DMC employee benefit plans until at least June 30, 2011, and Vanguard agrees to be bound by all current collective bargaining agreements.
- As of Closing, VHS of Michigan shall establish an Advisory Board with up to 11 members—the majority named by VHS of Michigan and the balance appointed by Legacy DMC. The VHS of Michigan Advisory Board will oversee the conduct of the business of the Hospitals and the Hospital Businesses after Closing, nominate members for each of the separate Hospital Advisory Boards, and advise VHS of Michigan concerning the conduct of the business of the hospitals.
- Vanguard will permit all members of the Hospitals' medical staffs to retain their current medical staff appointments until the expiration of the current appointments.

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policy provides that charity care (a 100% discount) will be available for uninsured patients with incomes below 200% of the Federal Poverty Level (FPL). Vanguard further defines "Medically Indigent" as income below 500% of the FPG or a balance due the hospital in excess of 50% of annual income. Discounts of 40% to 80% are available for underinsured patients either (1) with income below 500% FPL or (2) with balances due for hospital services in excess of 50% of patients' annual income.



- For at least ten years after Closing, Vanguard will not sell or otherwise transfer all or substantially all of the assets constituting one or more of the Hospitals, or its equity interest in the Hospitals.
- Vanguard agrees to continue to fully support DMC's historic mission in undergraduate and graduate medical education, nursing education, and allied health services education.
- Vanguard will support DMC's historic research mission and will assume DMC's obligations to the Wayne State University partnership with the National Institutes of Health for the Perinatal Research Branch operation.
- Vanguard agrees to support DMC's partnership with the Karmanos Cancer Center and will support DMC's contracts with the Karmanos Cancer Center.
- Vanguard will enhance DMC's current health and wellness initiatives, community outreach and prevention programs, and quality improvement programs.
- Vanguard will also support the Supplier Diversity Program to provide opportunities for minority-owned, women-owned, and Detroit-based businesses.
- Vanguard will support the Project Genesis summer employment/internship program for Detroit Public High School students.
- For at least ten years, Vanguard will keep the DMC hospitals' headquarters in Detroit.
- If Vanguard seeks to establish national centers for system support services, Vanguard will solicit and afford the City of Detroit a full opportunity to present a proposal.
- Vanguard will honor all donor agreements for the naming of buildings, facilities, or programs.
- Vanguard originally agreed to provide written reports to Legacy DMC on its performance and adherence to its commitments for six years after Closing. The Attorney General asked, and Vanguard committed, to extend the reports for a full 10 years to coincide with the length of Vanguard's maintenance of Hospital and Core Services, and charity care commitments. Other aspects of the report must include information and data on Vanguard's charity care activities, educational and research activities, health and welfare activities, and supplier diversity commitments. Also, within 30 days of providing the written report, Vanguard will make a presentation to Legacy DMC regarding the annual report and Vanguard's plans for the Detroit market.

D. The Attorney General's Review: The DMC Board's Decision-Making Process

The Attorney General closely reviewed the DMC Board's decision-making process prior to its decision to enter into the Purchase and Sale Agreement with Vanguard. While Chief

Executive Officer Michael Duggan and his management team run the day-to-day operations of DMC, only the Board has the power and authority to enter into the Purchase and Sale Agreement.<sup>38</sup> The Chair of the Board is Stephen D'Arcy, a retired managing principal at PriceWaterhouseCoopers. Mr. D'Arcy leads a high-powered Board that includes some of Michigan's—and the country's—leading business luminaries: Roger Penske, Chair of the Penske Corporation; DMC Vice-Chair John Levy of Base Tactical Disaster Recovery; Cynthia Pasky, CEO of Strategic Staffing Solutions; Yousif Ghafari, former United States Ambassador to Slovenia and owner of architectural firm Ghafari Associates LLC; and, Frank Torre, CEO of Torre and Bruglio.

Trustees of charities are held to high fiduciary standards of loyalty, due care, and obedience to the charitable mission of the organization.<sup>39</sup> To carry out these obligations, trustees and directors must use due diligence when deciding to change an organization's charitable mission or to sell the organization's assets.

In 1998, the National Association of Attorneys General passed a Resolution Adopting Model Legislation on Conversion of Nonprofit Healthcare Entities to For-Profit Status. In describing the fiduciary standards to be followed, the Resolution stated:

The review by the Attorney General must be conducted to determine if the transaction involves self-dealing or other conflicts of interest violations. In all cases, the directors of the nonprofit entity should reach their decision based upon independent valuation information and should exercise due diligence to determine that the proposed transaction is for fair value.<sup>40</sup>

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<sup>38</sup> Bylaws of the Detroit Medical Center as adopted July 31, 2007.

<sup>39</sup> The Restatement (Second) of Trusts confirms that charitable fiduciaries are subject to the duty to administer the trust solely in the interest of effectuating the trust's charitable purposes (§ 170) and the duty to act with prudence (§ 174) and with due care for the purpose of accomplishing the goals of the trust (§ 179). See Restatement (Second) of Trusts § 379 (1992).

<sup>40</sup> National Association of Attorneys General, *Commentary to the Proposed Model Act for Nonprofit Healthcare Conversion Transactions* sec II, cmt. 2(B) (1998), available at

Similarly, the Model Nonprofit Conversion Act developed by Consumer's Union, suggests the Attorney General should determine whether:

The governing body of the nonprofit exercised due diligence in deciding to dispose of the nonprofit's assets, selecting the acquiring entity and negotiating the terms and conditions of the disposition[.]<sup>41</sup>

With the background of these model laws and considering the specific laws and guidelines in other states, the Attorney General considered whether DMC trustees exercised due diligence throughout the decision-making process leading up to the execution of the Purchase and Sale Agreement. Specifically, the Attorney General reviewed reports and minutes of DMC Board and committee meetings, and conducted extensive interviews to determine whether DMC's trustees exercised due diligence when they engaged in the following board activities:

- evaluated options allowing DMC to remain a “stand-alone” hospital system;
- considered whether a change in ownership was required to ensure a continuation of the charitable mission;
- examined potential partnerships with other nonprofits and explored alternatives other than a sale to a for-profit business;
- selected Vanguard as the purchaser; and,
- negotiated the terms and conditions of the sale.

In particular, the Attorney General asked the following questions, each of which is discussed separately below:

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<http://www.nasconet.org/NAAG%20Model%20Act%20for%20NP%20Healthcare%20Conversion%20ns.pdf>.

<sup>41</sup> Model Nonprofit Conversion Act sec 5 at 8 (Consumers Union of U.S. 2003), available at <http://www.consumersunion.org/pdf/ModelAct03.pdf>. In addition to reviewing these model standards in the preparation of this Report, the Attorney General also considered standards used by states that have specific statutory guidelines. *See* Cal Corp Code 5923(f) (California). *See also* Conn Gen Stat 19a-486(c) (Connecticut); Mass Gen Laws ch 180 8A(d) (Massachusetts); Neb Rev Stat 71-20,108 (Nebraska); Or Rev Stat 65.803 (Oregon); and Wash Rev Code 70.45.060 (Washington). The Attorney General also considered Pennsylvania's comprehensive protocol for evaluating transactions involving fundamental changes affecting health-care nonprofits. *See* <http://www.attorneygeneral.gov/consumers.aspx?id=229>.

1. Was the decision of the DMC Board to explore alternatives to conventional financing the product of diligent examination rooted in the needs of the community and the charitable purposes of the DMC?
2. Did the DMC Board identify criteria to be used in considering strategic options that were designed to protect the community's interest and to serve DMC's charitable mission?
3. Did the DMC Board consider all viable strategic options, other than the sale to a for-profit entity?
4. Did the DMC Board assess short- and long-term risks the proposed sale to Vanguard would pose to the community?
5. Were multiple offers solicited, received, and considered?
6. Did the DMC Board obtain an independent valuation of DMC's net worth?
7. Did the DMC Board conduct a reasonably open review and deliberation process under the circumstances?
8. Is there any basis for concern that any private interest or potential or actual conflicts of interest on the part of trustees or senior management affected the decision of the DMC Board?
9. Were in-house meetings for employees and physicians, as well as community forums, conducted to seek input and discussion regarding the impact of the conversion on stakeholders?

**1. Was the decision of the DMC Board to explore alternatives to conventional financing the product of diligent examination rooted in the needs of the community and the charitable purposes of the DMC?**<sup>42</sup>

DMC incurred approximately \$461 million in operating losses between 1998 and 2003.<sup>43</sup>

These losses essentially depleted DMC's cash reserves and forced the hospitals to operate with minimal cash on hand, leaving limited funds for maintenance of buildings and equipment and very little cash available for capital investments. In 2003, DMC considered closing two of its safety-net hospitals—Detroit Receiving and Hutzel Women's Hospital. The City of Detroit,

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<sup>42</sup> Conventional financing consists of loans made from companies that do not involve financing from the federal government. Because lenders provide these loans without government or other guarantees, the requirements for obtaining these loans can be strict. Lenders usually look at a borrower's cash flow, financial performance, and the quality of potential collateral.

<sup>43</sup> Detroit Medical Center and Subsidiaries consolidated financial statements, 1998 – 2003.

Wayne County, and the State of Michigan provided \$50 million to keep Detroit Receiving and Hutzel Hospital open.

In conjunction with the government rescue efforts, DMC hired former Wayne County Prosecuting Attorney Michael Duggan to take over as DMC's CEO in 2004.<sup>44</sup> Following the arrival of Mr. Duggan and former State Treasurer Jay Rising as Chief Financial Officer, DMC's performance improved significantly; DMC began posting break-even or slightly positive performance results for the first time in many years.

Although its financial performance improved, DMC was still unable to generate enough cash to engage in significant capital improvements that would allow DMC to compete with other systems that had more insured patients, fewer indigent patients, and newer facilities.

Accordingly, DMC pursued outside financing for capital improvements. In 2008, DMC identified probable underwriters for a substantial bond issue. However, the credit crisis of 2008 and resultant market turmoil denied DMC the opportunity to secure debt financing from private investors or bond markets.

The market crisis also significantly increased DMC's pension obligations under its discontinued defined-benefit plan. While the defined-benefit pension plan was frozen in 2003, the drop in the value of DMC's pension plan assets produced a pension funding shortfall that DMC must cover within the next five to seven years.

As of December 31, 2009, DMC's unfunded pension obligations for the plan were approximately \$184 million. More recent estimates based on current interest rates have

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<sup>44</sup> Prior to serving as Wayne County Prosecutor, Michael Duggan was the Deputy CEO of Wayne County, where he oversaw thousands of employees and a billion-dollar budget.

projected the December 31, 2010, unfunded pension obligation to be \$293 million, and DMC will have to make a projected \$35.8 million payment to its fund for the 2011 plan year.<sup>45</sup>

DMC has not qualified for financing supported by the Michigan Hospital Finance Authority for some time. While limited financing supported by the Federal Housing Administration (FHA) may have been available if DMC satisfied eligibility criteria, DMC considered this option and determined that it would not offer a sufficient long-term solution.

Board minutes reflect concerns over the capital needs of the hospital system and the necessity of finding a long-term solution to the problem. The Board determined it was unlikely that DMC could sustain its operations for many more years without access to capital. The Board retained a financial advisor and initiated a process to find a long-term solution to fulfill its capital needs. After reviewing various options and performing due diligence, the Board concluded that the proposed transaction with Vanguard would provide capital and ensure that the medical safety net provided by DMC would continue.

In its resolution approving the transaction, the Board specifically noted:

- Vanguard's Capital Expenditure commitment of \$850 million over five years will result in a substantial benefit to the communities served by DMC;
- Vanguard's obligation in the Purchase and Sale Agreement to continue the charitable missions of DMC and its Affiliates, including: (1) Vanguard's commitment to continue operation of the hospitals and their core services and DMC's charity care policies, and (2) Vanguard's stated commitment to DMC's historical educational and research missions and health and wellness initiatives, will result in a substantial benefit to the communities served by DMC facilities.

In short, DMC's search for alternatives to conventional financing was solidly grounded in the capital needs of the DMC system, which the Board reasonably concluded DMC could not finance on its own. The Attorney General concludes that DMC's decision to explore alternatives

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<sup>45</sup> Consolidated Financial Statements, The Detroit Medical Center and Subsidiaries, Years Ended December 31, 2009 and 2008; Aon Hewitt, Funding and Expense Projections, Funding Relief, Detroit Medical Center Consolidated Pension Plan, October 7, 2010.

to conventional financing was the product of diligent examination rooted in the needs and charitable purpose of the DMC.

**2. Did the DMC Board identify criteria to be used in considering strategic options that were designed to protect the community's interest and to serve DMC's charitable mission?**

Generally, the DMC Board sought alternatives to conventional financing to keep its facilities operational while also seeking a long-term solution to generate cash sufficient to cover bond and pension obligations and fund needed capital improvements.

Specifically, the DMC board sought a relationship that would:

- a. create a stronger financial position for DMC — sufficient to cover debt obligations and pension liability, maintain essential services, modernize and replace equipment, maintain and expand facilities, and develop new capital projects for future profitability and long-term viability;
- b. maintain or increase support for clinical program services, sufficient to retain existing services, and develop new programs;
- c. maintain physician support services sufficient to support and retain independent physicians and to recruit new physicians;
- d. maintain community support sufficient to maintain and improve patient satisfaction, to continue observing DMC's charity care policy, and to provide adequate health-care education and community services;
- e. maintain DMC's high-quality workforce; by retaining current employees with seniority pay scales and benefit structures.

The Attorney General concludes that DMC identified appropriate criteria designed to preserve the community's interest and to serve the charitable missions of the hospitals.

**3. Did the DMC Board consider all viable strategic options other than the sale to a for-profit entity?**

To fulfill its fiduciary obligations, the DMC Board, in the exercise of due diligence, was required to consider all reasonable alternatives to selling substantially all of its health-care assets to a for-profit business. Such options for DMC included remaining independent or becoming affiliated with another charitable nonprofit entity.

In early 2009, DMC leaders met with a representative of another prominent nonprofit health care entity to discuss partnership possibilities, but the entity was not interested.

In June 2009, DMC engaged Kaufman Hall, an independent consulting firm specializing in hospital finance, to research possible avenues for raising capital.

In late summer 2009, Kaufman Hall described the following options:

- Status Quo / Stand-Alone – If DMC were to adhere to newly-recommended operating improvements, its probable annual cash shortfall would be \$84 million by the year 2014. If suggested operating improvements were not implemented, the projected annual cash shortfall by year 2014 would grow to \$259 million.
- Partial Divestiture of Hospital Assets – Kaufman Hall examined the possibility of selling certain business units and real estate in order to generate cash to support DMC's overall capital and financial plan. This option was considered unacceptable because it would not raise enough money and would impair DMC's future earnings prospects while increasing pressure on the remaining DMC hospitals to cover costs.
- Partnerships with Other Nonprofit and For-Profit Companies – Kaufman Hall initially identified 23 potential local, regional, and national partners and matched them against a set of partnership goals and objectives developed to test a candidate's alignment with the needs of DMC and the needs of the community. Most nonprofit hospital systems could not absorb the assets and liabilities reflected on DMC's balance sheet without jeopardizing their own financial stability. Others were excluded due to a lack of a strategic fit. Descriptions and profiles of 17 candidates were shared with DMC. A final determination was made of candidates who most closely matched the outlined goals and objectives. Kaufman Hall had introductory calls with six organizations. These introductory calls did not identify DMC as the prospective partner. Five organizations expressed interest in receiving information. After entering into confidentiality agreements, Kaufman Hall shared limited information with five entities and ultimately had exploratory meetings with two of these companies in September 2009. The first meeting was with Vanguard, which expressed interest in DMC. The second meeting ended relatively quickly when the prospective affiliate learned that DMC was the principal partner. Further meetings with Vanguard led to the negotiation of the proposed sale.
- Federal Housing Administration (FHA) Financing – If DMC's application was accepted, FHA financing might enable DMC to refinance its debt and provide up to \$130 million to improve DMC's cash position and provide funding for DMC's capital needs. There was some doubt that DMC could satisfy federal bond covenant conditions required for participation in the FHA program. However, the negative effect of FHA borrowing on DMC's debt profile and operating margins, FHA program restrictions, and limitations the FHA places on future outside financing might outweigh any immediate cash benefits.



In December, 2009, the DMC Board approved a resolution supporting DMC's FHA application. It also directed that DMC continue exploring other financing alternatives, including the possibility of a broader partnership that would have the potential for much greater capital investment in DMC facilities.

As described earlier, Kaufman Hall sought prospective partners for DMC. The consultants investigated several national public and private hospital investors to identify possible partners willing to consider a joint venture, merger, or acquisition of DMC. Kaufman Hall attempted to find partners who could strengthen DMC's cash and capital position, as well as to respond to non-financial priorities such as the continuation of clinical programs and the needs of the Detroit community, physicians, and employees. DMC's and Kaufman Hall's search process and due diligence efforts reasonably attempted to identify potential partners. The search determined Vanguard was the only realistic partner and the only viable partnership option.

Accordingly, the Attorney General concludes that DMC explored all viable options before deciding to pursue a transaction with Vanguard.

**4. Did the DMC Board assess short-term and long-term risks that the proposed sale to Vanguard would pose to the community?**

The DMC Board identified the following financial risks:

- Vanguard's inability to fund the sale;
- Vanguard's inability to fund its future capital expenditures; and,
- Vanguard's inability to continue operating DMC's hospitals and providing essential core services long-term.

The DMC Board additionally identified the following non-financial risks:

- interruption of hospital operations;
- discontinuation of essential core services, including services that have been historically unprofitable;
- discontinuation of DMC's charity care policy;
- discontinuation of various community commitments; and,

- reductions in staffing or compensation to DMC's workforce.

The DMC Board researched the transaction risks by taking the following steps:

- The DMC Board hired Hiring Ernst & Young to perform a due diligence review of Vanguard's financial condition in order to assess factors related to Vanguard's ability to meet its long-term capital commitments. Ernst & Young reviewed financial and tax information with a focus on whether Vanguard's future cash flows could support Vanguard's capital commitments during the five years following the close of the Purchase and Sale Agreement. Ernst & Young also developed a full profile on Vanguard. While Ernst & Young was not specifically asked to assess Vanguard's ability to fund the sale, it reviewed both balance sheet and off-balance sheet accounts, as well as Vanguard's debt obligations. This review gave the DMC Board confidence that Vanguard could continue its operations while paying off its debt service;
- As a condition of the Purchase and Sale Agreement, DMC obtained a contractual commitment from Vanguard to satisfy the \$850 million in capital improvements during the first five years after Closing. To secure Vanguard's capital commitment, Vanguard agreed to issue warrants for Vanguard stock and/or deposit cash or notes with an escrow agent;
- DMC Trustees, corporate officers, and health-care providers toured and studied a formerly nonprofit, faith-based hospital system in San Antonio, Texas that Vanguard bought in January, 2003. The inspection included interviews with a number of citizens, advocates, physicians, administrators, and other health-care professionals on their experiences with Vanguard;
- DMC also retained Ernst & Young to determine whether the DMC transaction would leave Vanguard with insufficient access to capital to fulfill the financial commitments to DMC;
- DMC demanded the right to monitor and enforce Vanguard's performance of its commitments set forth in the Purchase and Sale Agreement, including capital expenditures, charity care, core services, education and research requirements, and community service pledges;
- DMC required Vanguard to give DMC an annual report for at least the first 6 years after the closing.<sup>46</sup> The annual reports must describe Vanguard's performance under, and compliance with, covenants related to the required levels of capital expenditures; and,
- Legacy DMC will have an opportunity to nominate a member for a seat on Vanguard's corporate board of directors.

The Attorney General concludes that the DMC Board properly assessed and considered the short and long-term financial and community risks of the proposed transaction.

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<sup>46</sup> The Attorney General negotiated with Vanguard to increase the report commitments from 6 to 10 years.

## **5. Were multiple offers solicited, received, and considered?**

As described earlier, Kaufman Hall sought prospective partners for DMC. The consultants researched a number of national public and private hospital investors to identify possible partners willing to consider a joint venture, merger, or acquisition of DMC. Kaufman Hall attempted to find partners who could both strengthen DMC's cash and capital position and respond to non-financial priorities such as the continuation of clinical programs and the needs of the Detroit community, physicians, and employees.

The Attorney General concludes that DMC's and Kaufman Hall's search process and due diligence efforts reasonably attempted to solicit multiple offers. The search determined Vanguard was the only realistic partner and the only viable partnership option. Since DMC did not have the benefit of receiving and considering multiple offers, the Attorney General directed AlixPartners to conduct an independent valuation of DMC. As detailed below in Section III.E of this Report, AlixPartners determined that the asset sale purchase price provides more than fair value for DMC.

## **6. Did the DMC Board obtain an independent valuation of its net worth?**

Kaufman Hall conducted an extensive study of DMC's value to determine the "right price" before the execution of the June 10, 2010, Purchase and Sale Agreement with Vanguard. Kaufman Hall's valuation of DMC was conducted from a third-party perspective and utilized three acceptable valuation methodologies: 1) discounted cash flow analysis; 2) public market comparables; and, 3) comparable sales.

In brief, Kaufman Hall reviewed services and key drivers for each facility, developed base-line assumptions for revenue and expenses, and identified potential additional revenue and efficiencies. A business enterprise value range was determined for DMC using each of the above

valuation methodologies. It was Kaufman Hall's conclusion that the enterprise value of DMC was less than the consideration being offered by Vanguard. Issues relating to DMC's valuation, as analyzed by the Attorney General's experts, are discussed in greater detail below in the "Independent Valuation of DMC's Fair Market Value" section of this Report (See III E).

The Attorney General concludes that the DMC Board met its due diligence responsibility to obtain an independent valuation.

#### **7. Did the DMC Board conduct a reasonably open review and deliberation process under the circumstances?**

The Attorney General's office and Focus reviewed Board minutes and conducted multiple interviews with Board members. In November of 2008, CEO Duggan informed the Finance Committee of the DMC Board that the collapse in the bond market had limited DMC's access to capital; he suggested exploring possible FHA financing.

In March of 2009, the DMC Board formed a Special Committee to develop a plan for contingency financing for DMC. In June of 2009, the special committee retained Kaufman Hall to provide high-level financing planning and to look for capital partners. In November of 2009, Kaufman Hall prepared a report for the Special Committee regarding DMC's options, including a preliminary list of potential partners.

Additional minutes from DMC Board meetings reflect the following:

- At its December 14, 2009 meeting, the Board reviewed several financing options under evaluation by the Special Committee. The Board gave approval to the Special Committee to pursue the two most viable options: (1) raise \$163 million in new FHA financing; or, (2) pursue other capital partnership opportunities if they provided the potential for much greater capital investment in DMC facilities.
- On January 7, 2010, the Board received updates regarding DMC's FHA application and ongoing discussions with a potential investor.
- On January 26, 2010, the Board Chair summarized new developments in the search for an investor. The Chair explained that DMC had retained the services of Ernst & Young to assist with this preliminary process. The CEO explained the possible timeline for the first phase of consideration and cautioned that neither party had made

a decision. The Chair invited all Board members to attend the Special Committee meetings.

The first time minutes were recorded for a Special Committee meeting was on February 12, 2010, nearly a year after the formation of the Committee.

According to management, the Special Committee kept a low profile due to concerns that information leaks would undermine the Committee's work. In particular, management believed that incomplete or inaccurate information might lead to overreactions by DMC employees and health-care providers.

The Attorney General is not in a position to dispute this assessment. But while concern regarding "leaks" is understandable, it does not excuse the Special Committee's failure to keep detailed and accurate minutes of all meetings, subject to appropriate confidentiality protections. The Attorney General does not condone the absence of detailed minutes.

Nevertheless, the DMC Board members were fully informed of the Special Committee's work and conclusions, at the latest, in December 2009 when the trustees authorized the Special Committee to pursue two of the various financing options presented to the full Board. At that time, DMC had neither agreed to any definitive transaction, affiliation, or partnership nor foreclosed any options. The Attorney General finds that the trustees had adequate time to request information, raise concerns and objections, encourage further pursuit of other options, or advocate against seeking external financial support.

The Attorney General concludes that the DMC Board followed a prudent and reasonably open review and deliberation process, especially given its concerns regarding premature or incomplete disclosure.

**8. Is there any basis for concern that any private interest or potential or actual conflicts of interest on the part of trustees or senior management affected the decision of the DMC Board?**

Each year, DMC's Corporate Compliance Office requires each Board member and executive manager to complete a conflict of interest statement. The statement also applies to family members of the Board member or executive manager. Examples of required disclosures requested include:

- whether the individual or family member provided legal, consulting, or professional services to DMC or any of its related entities during the previous three years;
- any ownership interests or other affiliations to entities that do business with DMC;
- any management of or board affiliations with charitable organizations to which DMC contributed in the past three years;
- any position served with any other hospital or health-care provider in Southeastern Michigan; and,
- any other relationship or affiliation that might reasonably be within the spirit of the other questions.

The Attorney General interviewed DMC's Corporate Vice President and Chief Compliance and Governance Officer, as well as its Manager of Corporate Compliance, to learn about the organization's compliance procedures and practices. Both indicated that no one declared a conflict of interest during the period when DMC was considering strategic long-term options, including the Vanguard evaluation and final selection. The Corporate Vice President believes that all DMC Board members and senior management are fully aware of DMC's conflict of interest statement and practices. Neither the Corporate Vice President nor the Manager of Corporate Compliance is aware of any employment offers to senior management by Vanguard. Additionally, a condition imposed by the Attorney General through the Monitoring and Compliance Agreement requires Vanguard and DMC senior management to attest that no

member of DMC's Board of Trustees, Officers, nor Key Employees will receive any increase in salary, incentive payment or bonus, or other form of compensation in return for identifying, negotiating, or entering into the Purchase and Sale Agreement or any related agreement, promises, or offer. Vanguard and senior management must also agree that any incentive compensation Vanguard may award to previous members of DMC's senior management after Closing is pursuant to DMC's previously established incentive program or will only reward individuals based on post-Closing performance. These additional disclosures are due five (5) days prior to Closing.

The Attorney General's review did not identify any actual or potential conflicts of interest that may have compromised the DMC Board's decision to enter into the Purchase and Sale Agreement with Vanguard.

**9. Were in-house meetings for employees and physicians, as well as community forums, conducted to seek input and discussion regarding the impact of the conversion on stakeholders?**

On March 30, 2010, DMC's CEO Mike Duggan reported to the DMC Board that he, along with a Senior Vice President from Vanguard, held employee forums at every DMC hospital. Also, CEO Duggan and a Vanguard representative met with professional staff, health-care providers, and community groups, including:

- Black Slate, Inc.;
- Unifying Detroit Coalition;
- Eastside Community Slate;
- Community Coalition; and,
- NAACP.

DMC staff and the Attorney General received and evaluated comments from community members regarding the sale. The Attorney General hosted a community forum that included

representatives from DMC and Vanguard to make sure community members had adequate opportunity to voice concerns and comments. The Attorney General established and published an email address for persons who preferred to electronically convey comments and concerns.

In addition, members of the Attorney General's office and experts from Focus met on several occasions with members of the DMC medical and nursing staff to gauge the knowledge, interest, and opinion of the DMC provider community regarding the proposed sale.<sup>47</sup> Those interviewed individually or in small group sessions include the following: 1) John Haapaniemi, D.O., elected president of the more than 2,000-member combined medical staff; 2) M. Safwan Badr, M.D., DMC Executive Vice-President and Chief Medical Officer; 3) Steven D. Grant, M.D., DMC Executive Vice-President for Physician Partnerships; 4) Herman B. Gray, M.D., President of the Children's Hospital of Michigan; 5) Lorna Thomas, M.D., DMC Corporate Board Member; and, 6) Patricia Natale, R.N., M.S.N., DMC Senior Vice President and Chief Nursing Officer.

These interviews illustrate there is little or no opposition among the provider community to the proposed sale. Each individual expressed that updated facilities are paramount to quality medical care, improvement in provider retention, and increased market share. Moreover, those interviewed emphatically stated providers would deliver high-quality care for their patients whether DMC was owned by a nonprofit or for-profit entity.

Medical staff displayed a sense of pride in providing high-quality medical care in spite of financial distress, outdated facilities, and changing demographics. There was also a pervading sense of optimism that the impending sale to Vanguard and the infusion of capital would result in

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<sup>47</sup> Appendix E lists all individuals interviewed in the course of the Attorney General's examination.



an improved DMC with the ability to provide better care for more patients while continuing the mission of DMC as a safety net for the disadvantaged in Detroit.

When pressed for an objective basis for his optimism, Dr. John Haapaniemi, DMC's President of the Medical Staff, stated he toured the San Antonio Vanguard facilities and spoke with management and staff at Baptist Health System. Harper Hospital's Chief Nursing Officer, Ms. Patricia Natale, stated she thoroughly researched Vanguard's nursing philosophy and practice and was certain that nursing care would continue to be excellent. The Chief Executive Officer of the Children's Hospital of Michigan, Dr. Herman Gray, indicated he was working on plans to build a new Children's Hospital, including an accompanying provider office and clinic building. Dr. Gray stressed Vanguard's commitment to a world-class pediatric hospital.

A theme that emerged from the interviews is the calculated positioning of the DMC-Vanguard collaboration to implement a medical care delivery system aligned with the federal health care reform legislation. The sale of DMC to Vanguard will allow the new entity to quickly deliver accountable health care, promote vigorous participation in global reimbursement schemes, deliver efficient high-quality care to improve the health of designated populations, limit nosocomial infections<sup>48</sup> and hospital re-admission rates, and coordinate incentives among all involved in the provision of medical care. Additionally, DMC has been advancing cutting-edge electronic medical records interactivity and capacity, while Vanguard adds experience in accountable health-care organizations and a pilot acute-care project in its San Antonio facilities. DMC's recent announcement of a physician-hospital organization with DMC, its Affiliates, and

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<sup>48</sup> Nosocomial infections are infections that are a result of treatment in a hospital or a health-care service unit. Infections are considered nosocomial if they first appear 48 hours or more after hospital admission or within 30 days after discharge.

employed providers and physicians, further emphasizes that participation of all health-care providers is a key both to the success of the proposed sale and to optimal delivery of health care.

The Attorney General concludes DMC management made reasonable efforts to communicate with stakeholders, notwithstanding the fact that these efforts occurred late in the process.

### **DMC Board's Decision-Making Process Conclusion**

Relative to the previous nine questions, the Attorney General concludes, on the basis of the foregoing review of documentation and interviews with DMC Board members, management, and staff that the DMC Board exercised reasonable care in fulfilling its fiduciary obligations in the process that resulted in the current Purchase and Sale Agreement.

E. The Attorney General's Review: Independent Valuation of DMC's Fair Market Value

The Attorney General's review focused closely on whether Vanguard offered fair market value for DMC.<sup>49</sup> The DMC Board properly retained its own expert, Kaufman Hall, to prepare a valuation of DMC. However, due to the absence of a competitive bidding process and the resulting lack of market-based support for the fairness of Vanguard's offer, the Attorney General retained AlixPartners to perform a complete, independent financial valuation of DMC.

AlixPartners' report on its detailed analysis is attached as Exhibit 5.

In brief, AlixPartners considered the value of DMC using two different established methodologies.

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<sup>49</sup> "Fair market value" is the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. (Estate Tax Regs., Sec. 20.2031-1(b); Rev. Rul. 59-60, 1959-1 C.B. 237).

First, AlixPartners utilized a Discounted Cash Flow Approach using projections of DMC's future profitability prepared by both DMC management and Vanguard. DMC management projected modest growth in patient volume and pricing in the future while expecting expenses to increase at the rate of inflation. Notably, the DMC management projections did not project significant capital investment in DMC facilities. On the basis of DMC management's projections, AlixPartners placed a range on the fair market value of DMC, as of October 15, 2010, of \$72 million to \$164 million.<sup>50</sup>

Second, AlixPartners used a Market Transaction Approach to value DMC by comparing it to hospital companies recently purchased in the United States, including both for-profit and not-for-profit, urban and rural hospitals that were financially stressed or operated at lower levels of profitability. This approach resulted in a fair market value ranging from \$35 million to \$416 million.

Using a combination of these methods, AlixPartners ultimately estimated DMC's fair market value at between \$63 million and \$227 million.<sup>51</sup>

Vanguard will pay approximately \$391 million in cash at Closing to DMC primarily to retire DMC's outstanding bonds. Vanguard will also assume \$190 million in unfunded pension liability and \$42 million in malpractice liability. Further, Vanguard has committed to spend

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<sup>50</sup> In applying the Discounted Cash Flow Approach, AlixPartners also considered Vanguard's projections of DMC's future profitability in order to account for "upside" potential attributable to Vanguard's efficiencies, the positive revenue impact of Vanguard's ownership, and, significantly, Vanguard's substantial capital investment commitment. Using the Vanguard projections in the Discounted Cash Flow Approach, AlixPartners placed a range on the value of DMC of \$296 million to \$324 million. This Discounted Cash Flow Approach scenario results in a value premise that is greater than the overall fair market value as determined by AlixPartners because it considers the potential synergies that Vanguard would bring to the transaction.

<sup>51</sup> AlixPartners' valuation is the net of the pension and net malpractice liabilities being assumed by Vanguard. Accordingly, when comparing AlixPartners' value conclusion to the consideration offered by Vanguard, the analogous amount is the cash portion of the consideration of \$391 million.

\$850 million in capital expenditures. In simple terms, Vanguard will commit close to \$1.5 billion to DMC. There are, of course, returns on this investment, including anticipated revenue growth, DMC's patient base, work force, and other intangibles, such as the DMC brand or business goodwill. Even so, it is clear that Vanguard is giving more than AlixPartners' assessment of DMC's fair market value.

F. The Attorney General's Review: Independent Valuation of Vanguard's Long-Term Financial Ability

An important aspect of the Purchase and Sale Agreement is Vanguard's long-term commitment to invest \$850 million in capital improvements over the five-year period after Closing. To ensure that Vanguard will be financially able to meet its commitments under the Purchase and Sale Agreement, the Attorney General asked AlixPartners to evaluate the financial condition of Vanguard. To summarize, based on current financial statements, discussions with Vanguard, and Vanguard projections, AlixPartners finds that Vanguard will be financially able to meet its short-term and long-term financial commitments per the Purchase and Sale Agreement. AlixPartners' full analysis of Vanguard's financial health is provided at Exhibit 5 of this Report.

G. Enforcement of Vanguard's Commitments and Protection of Charitable Assets

Through significant commitments the Attorney General obtained from Vanguard, Legacy DMC will have the information, resources, and structure necessary to closely monitor Vanguard's Post-Closing Covenants. The Purchase and Sale Agreement provides \$4.5 million to fund Legacy DMC operations.<sup>52</sup> The Attorney General, through the Protection of Charitable Assets Agreement, provides protections for donors' intentions and gives Legacy DMC the means to obtain any necessary additional funding from other foundations that may receive any portion

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<sup>52</sup> Purchase and Sale Agreement, Section 2.5(a)(i).

of the approximately \$140 million in donor-restricted charitable assets from Legacy DMC.<sup>53</sup> Amendment No. 2 to the Purchase and Sale Agreement extends Vanguard's reporting requirements on everything but the capital commitments from six years to 10, while also outlining additional information Vanguard must provide to Legacy DMC.<sup>54</sup> Additionally, the Monitoring and Compliance Agreement additionally mandates the scope and content of information Vanguard provides, and solidifies Legacy DMC's obligations.<sup>55</sup> Finally, it is significant that in addition to Legacy DMC's ability to enforce Vanguard's obligations, the Attorney General negotiated an independent right to enforce Vanguard's Purchase and Sale Agreement obligations.<sup>56</sup>

#### **IV. PUBLIC COMMENTARY AND RESPONSE**

From the time of DMC and Vanguard's initial announcement in March 2010, the Attorney General has solicited, welcomed, and received many comments from members of the public.

The Attorney General held a Community Forum on August 18, 2010. The Forum lasted over two hours, and more than 200 people attended. The Attorney General posted the Forum's transcript and an audio recording on the Attorney General's website.<sup>57</sup>

Thirty-one people spoke at the Forum: 10 people objected to the proposed sale; 18 spoke in support; and, three comments were difficult to classify or were classified as neutral.

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<sup>53</sup> The Protection of Charitable Assets Agreement is attached as Exhibit 4.

<sup>54</sup> The Amendment No. 2 to the Purchase and Sale Agreement is attached as Exhibit 1. See changes to Schedules 11.2 and 12.17, and addition of Schedule 12.17-1.

<sup>55</sup> The Monitoring and Compliance Agreement is attached as Exhibit 3.

<sup>56</sup> The Enforcement Agreement is attached as Exhibit 2.

<sup>57</sup> [http://www.michigan.gov/ag/0,1607,7-164-17337\\_55911-241908--,00.html](http://www.michigan.gov/ag/0,1607,7-164-17337_55911-241908--,00.html).

People who spoke favorably of the transaction included DMC employees, medical professionals, City of Detroit employees, business owners, city residents, members of the Wayne County Commission and the City of Detroit Planning Commission, and citizen groups. They explained that it would help move Detroit forward by generating jobs and making positive and necessary improvements to the DMC facilities.

People who spoke against the transactions included at least one health professional, representatives of citizen groups, DMC employees, and city residents with varying backgrounds, most of whom raised concerns involving charity care or possible conflicts of interest on the part of persons at DMC. Some expressed fear over the unknown and having to depend on a for-profit company for health care. One person claimed that the proposed transaction would be illegal under Michigan's Nonprofit Corporation Act. Another claimed he would file a lawsuit if the Attorney General were to approve the Purchase and Sale Agreement.

Vanguard was the subject of both positive and negative comments. Two people claimed to have researched the company with favorable results. Another referenced negative comments about the company that appeared in a book entitled: *The Buyout of America: How Private Equity Will Cause the Next Great Crisis* by Joshua Kosman.

The record of the forum remained open for public comments through November 11, 2010. The Attorney General received a total of 17 written communications—nine in opposition, two in support, and six asking questions or offering services.

Area leaders have voiced support for the need of the transaction. Governor Jennifer Granholm said the agreement has "the potential to stabilize the hospital's future in Detroit and could help strengthen the economic resurgence in the city and the surrounding area through

investment and job-creation."<sup>58</sup> City of Detroit Mayor Dave Bing commented, "This agreement will bring jobs and improved care for our residents. It sends a strong message that Detroit is open for business and that this administration is attracting investment and jobs by restoring trust in City Hall."<sup>59</sup> Wayne County Executive Robert Ficano noted, "I think it sends a message that Wayne County is a good place to do business."<sup>60</sup> Henry Ford Health System President and CEO Nancy Schlichting said she "welcomed the proposed investment in the region. Having invested more than \$1 billion over the past five years in our Metro Detroit health care facilities, Henry Ford believes that this kind of financial commitment positively contributes to the economic transformation of Michigan."<sup>61</sup> The Wayne County Commission and the Detroit City Council also overwhelmingly support the transaction. Additionally, former Attorney General Frank Kelley wrote a letter on behalf of DMC opining that the proposed transaction is legal under Michigan law.<sup>62</sup>

Although some of the issues are addressed in other sections of the report, the following are brief responses to the main public concerns:

- Impact of For-Profit Status on Hospitals – Most opponents to the proposed transaction are concerned with Vanguard's for-profit, investor-owned status. Some oppose for-profit health-care systems in principle; others are specifically concerned that Vanguard will maximize profits for investors at the expense of health-care services. A full analysis of the risks and benefits of for-profit and nonprofit health-care operations is beyond the

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<sup>58</sup> Governor Granholm Statement on Proposed Acquisition of Detroit Medical Center by Vanguard Health Systems, March 19, 2010, <[http://www.michigan.gov/gov/0,1607,7-168-23442\\_21974-233774--,00.html](http://www.michigan.gov/gov/0,1607,7-168-23442_21974-233774--,00.html)> (accessed on November 8, 2010).

<sup>59</sup> *DMC Signs Agreement with Vanguard*, 73 Mich Chron 40, A3 (June 16-22, 2010).

<sup>60</sup> Patricia Anstett, *DMC Leaders See Rosier Future with Investment*, Detroit Free Press, March 20, 2010, at A12.

<sup>61</sup> Kim Kozlowski and Louis Aguilar, *Buyout to Give DMC Funds for Upgrades*, Detroit News, March 20, 2010, at A1.

<sup>62</sup> April 21, 2010, letter from Frank J. Kelley to Charles N. Raimi, DMC Deputy General Council available at [http://www.michigan.gov/documents/ag/Kelley\\_Cawthorne\\_Legal\\_Opinion\\_4.21.2010\\_319289\\_7.pdf](http://www.michigan.gov/documents/ag/Kelley_Cawthorne_Legal_Opinion_4.21.2010_319289_7.pdf).

scope of this Report and will remain an area of ongoing debate. Notably, DMC's Board favored charitable status and initially sought nonprofit partners. But the combined burden of DMC's size, its shortage of cash, its underfunded pension obligations, its deferred capital needs, and a declining insured patient base made DMC unattractive to other nonprofit systems.

- Charity Care – Vanguard agrees to maintain the more favorable of either DMC's or Vanguard's charity care policy at DMC for the next ten years. At no time shall Vanguard's charity care policy at DMC be less benevolent than DMC's charity care policy at the time of Closing. Vanguard and DMC representatives have consistently represented to the Attorney General's office that all persons entering their emergency rooms in need of health care will receive services. In fact, federal law requires all acute care hospitals, whether nonprofit or for-profit, to accept anyone who arrives at their emergency room doors.<sup>63</sup>
- Community Input in Oversight of VHS of Michigan – In its Frequently Asked Questions document,<sup>64</sup> the Attorney General stated the following:

Q - If the sale is finalized, will the Detroit community have a way to voice its concerns about Vanguard's operations of the DMC hospitals?

A - Yes. The Attorney General has required Legacy DMC to establish methods by which the public can submit complaints regarding Vanguard's practices. At a minimum, Legacy DMC must offer a telephone hotline and a permanent email address.

The Attorney General and Legacy DMC believe that the public's input concerning access to health care at Vanguard is vital. This input will supplement Legacy DMC's monitoring of hospital data to determine whether Vanguard is honoring its core services and charity care commitments.

- Legacy DMC – The DMC Board must be restructured after Closing in order to best serve the mission of Legacy DMC. For years, the DMC Board's purpose has been to oversee the complex finances and operation of DMC's hospital system. By contrast, the mission of Legacy DMC will be to monitor and enforce Vanguard's compliance with its commitments in the Purchase and Sale Agreement. The most important of these are Vanguard's promises to continue providing access to necessary medical care to the indigent, to continue operating DMC's safety-net hospitals and essential core services, and to make substantial capital expenditures to improve the DMC hospitals.

Legacy DMC's 20-member Board will include members of the DMC Board, new Trustees, and appointees by the Mayor of Detroit, the Wayne County Executive, and the Attorney General. These appointees will help ensure that the Legacy Board diligently monitors Vanguard's performance and, if necessary, enforces Vanguard's commitments.

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<sup>63</sup> The Emergency Medical Treatment and Active Labor Act applies to hospitals that participate in Medicare. Such hospitals must treat patients who arrive at emergency rooms with emergencies, and stabilize the medical conditions. 42 U.S.C. 1395dd(a).

<sup>64</sup> [http://www.michigan.gov/ag/0,1607,7-164-17337\\_55911-242285--,00.html](http://www.michigan.gov/ag/0,1607,7-164-17337_55911-242285--,00.html).



Vanguard must provide Legacy DMC with detailed periodic reports and other requested information regarding its hospital operations. Legacy DMC must review and evaluate this information and publish annual reports on its findings.

Too, Legacy DMC must establish methods by which the public can easily submit, at minimal or no cost, complaints regarding Vanguard's practices. Such methods must include a telephone hotline and a permanent email address. Legacy DMC must review all complaints alleging a violation of Vanguard's commitments and report its findings to the public.

As a charitable organization, Legacy DMC, will be subject to ongoing supervision by the Attorney General under Michigan law. The Attorney General may enforce Legacy DMC's obligation to monitor Vanguard's performance of its commitments. Furthermore, the Attorney General may independently enforce Vanguard's promises through legal action if Legacy DMC fails to take action to address a material violation of the Purchase and Sale Agreement by Vanguard.

- Legality of the Transaction – At the Public Forum, an attorney asserted that the proposed transaction is illegal under MCL 450.2301(5). That section of Michigan's Nonprofit Corporation Act states:

This act shall not be deemed to permit assets held by a corporation for charitable purposes to be used, conveyed or distributed for noncharitable purposes.

The attorney's concerns are misplaced. The terms "conveyed" and "distributed" are consistently used in law with respect to the gifting of assets where no consideration, or inadequate consideration, is returned. The Purchase and Sale Agreement, however, proposes a sale transaction where DMC will receive at least fair value for the assets Vanguard acquires. If charitable organizations were prohibited by this section of the law from *ever* selling *any* assets, even at their fair market value, the operations of many charities would cease.

- Valuation of DMC & Vanguard – The Service Employees International Union (SEIU) wrote letters and met with the Attorney General's office to discuss their concerns regarding Vanguard's valuation, the lack of a bidding process, and the value offered by Vanguard for DMC's assets. The concerns regarding Vanguard's valuation are addressed in AlixPartners' memorandum regarding SEIU's fair market value concerns, attached as Exhibit 9. The lack of a bidding process is addressed in this Report's review of the DMC Board's decision-making process in III D above.
- Vanguard – In opposition to this transaction, at least one person at the public forum and another in a written comment cited Joshua Kosman's book, "The Buyout of America: How Private Equity Will Cause the Next Great Credit Crisis."<sup>65</sup> Mr. Kosman mentions Vanguard and Blackstone in his book, arguing that when private equity interests acquire health-care providers, the providers then invest less and patient care suffers. The

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<sup>65</sup> Kosman, *The Buyout of America: How Private Equity Will Cause the Next Great Credit Crisis* (New York: Penguin Group, 2009).

Attorney General and Focus considered Mr. Kosman's analysis and do not believe it establishes a basis to object to the Purchase and Sale Agreement. Additionally, through Legacy DMC and applicable state and federal laws, reasonable measures are in place to protect patient care standards. In response to Mr. Kosman's book, Vanguard provided a December 3, 2007, letter from Executive Vice President and General Counsel Ronald P. Soltman to Mr. Kosman. The letter, which questions the reliability of Mr. Kosman's research and provides information to refute his underlying premise, is attached as Exhibit 10.

## **V. CONCLUSION**

Without access to significant capital, DMC will continue to struggle financially as its facilities, equipment, and technology deteriorate. While DMC has made great strides in the past five years, it lacks the resources and the independent access to funding sufficient to modernize facilities and operations. Absent this or a similar transaction, DMC would be forced to divest major assets, close facilities, and/or discontinue significant services.

The DMC Board and DMC's management team pursued a deliberate thoughtful process to solve DMC's long-term operational and capital needs. More importantly, during each step in the decision-making process, they exercised due diligence and sound judgment, mindful of protecting DMC's historic mission to provide quality health care to all regardless of ability to pay. While there are no guarantees that this transaction will indefinitely keep all the DMC hospitals open, the DMC Board acted prudently and professionally to meet DMC's challenges and to maintain the historic mission of providing medical care to indigent, uninsured, or underinsured patients for as long as possible.

Based on his extensive review as outlined above, the Attorney General concludes that with the conditions and protections described in this Report, the proposed transaction properly protects DMC charitable assets while serving the best interests of the people of Detroit and the State of Michigan.

## **VI. APPENDIX**

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## APPENDIX A

### A. Definitions

All capitalized terms used but not otherwise defined in this Report are defined in the Purchase and Sale Agreement.

Certificate of Need (CON)	A state regulatory program intended to balance the cost, quality, and access of Michigan's health care system. Anyone proposing to acquire an existing health facility; beginning the operation of a new facility; increasing or relocating licensed beds; or initiating, replacing, or expanding a covered service, must first obtain a CON and follow the applicable CON law (MCL 333.20101, <i>et seq</i> , and MCL 333.22201, <i>et seq</i> ), administrative rules, regulations, and CON review standards. An eleven member Commission, appointed by the Governor with the advice and consent of the Senate, has the responsibility to develop, approve, disapprove, or revise CON Review Standards. The Review Standards are used by the CON Program Section to issue decisions on CON applications.
Key Employee	An employee other than an officer, director, or trustee, who serves at the level of Senior Vice President or above.
Legacy DMC	The continuing 501(c)(3) charitable corporation that will remain in existence after all DMC hospital assets have been transferred at Closing to Vanguard. Legacy DMC will remain subject to the ongoing supervision of the Attorney General's Charitable Trust Section and will have primary responsibility for monitoring Vanguard's compliance with post-Closing promises in the Purchase and Sale Agreement. The Purchase and Sale Agreement does not identify "Legacy DMC" by name, as the exact name of this charity has not been finalized.

## APPENDIX B

### B. Entities and Institutions Referenced in the Attorney General's Report

Cited as	Full Name / Description
Advisory Council	The Advisory Council to the Michigan State Planning Project for the Uninsured.
AlixPartners	AlixPartners, LLP, an expert retained by the Attorney General.
Aon Hewitt	Actuary hired by DMC to independently estimate pension liability.
Authority	Michigan State Hospital Authority.
Baptist Health System	Baptist Health System, a five-hospital health system in San Antonio, Texas purchased by VHS in 2003.
Berry Center	Full-service, out-patient surgery center located in Farmington Hills, Michigan. This Michigan LLC is affiliated with Sinai Hospital of Greater Detroit.
Black Slate, Inc.	A community group in the City of Detroit.
Blackstone	A leading investment and advisory firm that owns a majority interest in VHS.
Board	Board of Trustees of Detroit Medical Center.
Child Research Center of Michigan	Entity incorporated in 1951 and that merged with Children's Hospital of Michigan in 1980.
Children's Hospital of Michigan	228 bed children's hospital operated by Children's Hospital of Michigan, a DMC subsidiary.
Children's Specialty Center	DMC freestanding facility located in Clinton Township.
Community Coalition	A community group in the City of Detroit.
Consumer's Union	An independent, nonprofit organization whose mission involves consumer issues, including nonprofit hospital conversions.
CVI	DMC Cardiovascular Institute, an assumed name of Harper-Hutzel Hospital.
Detroit General	Unofficial name used to reference Detroit General Hospital.
Detroit General Hospital	Former name of Detroit Receiving Hospital and University Health Center.

Cited as	Full Name / Description
Detroit Medical Center Corporation	Prior name of Healthsource, an affiliate of DMC that contracts with Wayne County and health care organizations to provide medical services to eligible Wayne County General Assistance recipients.
Detroit Receiving	Detroit Receiving Hospital.
Detroit Receiving Hospital	Detroit Receiving Hospital, a 270 bed hospital operated by Detroit Receiving Hospital and University Health Center, a DMC subsidiary.
DMC	The Detroit Medical Center, the parent holding company of system that operates 8 hospitals and other facilities in metropolitan Detroit.
DMC Nursing Homes Inc.	Former name of DMC Education and Research, a subsidiary of Detroit Medical Center.
DMC/WSU Health System	Original name of Detroit Medical Center when incorporated in 1985.
Eastside Community Slate	A community group in the City of Detroit.
Ernst & Young	An accounting and financial services firm that was retained by DMC.
FHA	Federal Housing Administration, a federal agency that provides insurance for hospital mortgage loans.
Focus	Focus Management Group USA, Inc., an expert retained by the Attorney General.
FQHCs	Federally Qualified Health Centers, a reimbursement designation of several federal health programs.
General Electric	An equipment seller to DMC.
Grace Hospital	A hospital founded in Detroit in 1888 and that merged with Harper Hospital in 1974 to form United Hospitals of Detroit.
Grace Hospital Ambulatory Surgery Center	Surgery facility located in Southfield, Michigan, operated by Sinai Hospital of Greater Detroit.
Harper Hospital	A hospital founded in Detroit in 1863 and which merged with Grace Hospital in 1974 to form United Hospitals of Detroit.
Harper University Hospital	470 bed hospital operated by Harper-Hutzel Hospital, a DMC subsidiary.
Harper-Hutzel Hospital	Corporate entity, a subsidiary of Detroit Medical Center, that operates Harper University Hospital, Hutzel Women's Hospital, Kresge Eye Institute, and other facilities.

Cited as	Full Name / Description
Healthsource	An affiliate of DMC that contracts with Wayne County and health care organizations to provide medical services to eligible Wayne County General Assistance recipients.
Henry Ford Hospital	A nonprofit hospital located in the City of Detroit, part of the Henry Ford Health System.
Huron Valley Hospital, Inc.	Subsidiary of DMC, which operates Huron Valley Sinai Hospital.
Huron Valley Sinai Hospital	153 bed hospital located in Commerce, Michigan and operated by Huron Valley Hospital, Inc., a subsidiary of DMC.
Hutzel Hospital	Detroit-based hospital that merged with Harper Hospital in 1999 to form Harper-Hutzel Hospital.
Hutzel Women's Hospital	97 bed hospital operated by Harper-Hutzel Hospital, a subsidiary of DMC.
Jewish Hospital Association of Detroit	Original name of Sinai Hospital of Greater Detroit, a subsidiary of DMC, when incorporated in 1944.
Kaufman Hall	An expert financial advisory firm retained by DMC.
Kresge Eye Institute	An assumed name of Harper-Hutzel Hospital.
Legacy DMC	The continuing 501(c)(3) charitable corporation that will remain in existence after all DMC hospital assets have been transferred at Closing to Vanguard. Legacy DMC will remain subject to the ongoing supervision of the Attorney General's Charitable Trust Section and will have primary responsibility for monitoring Vanguard's compliance with post-Closing promises in the Purchase and Sale Agreement. The Purchase and Sale Agreement does not identify "Legacy DMC" by name, as the exact name of this charity has not been finalized.
MacNeal Health Providers	A preferred provider network in Chicago owned by VHS.
MDCH	Michigan Department of Community Health.
Medical Center Corporation	Proposed name of DMC after closing.
Medical Center Development Corporation	Original name of Healthsource, an affiliate of DMC that contracts with Wayne County and health care organizations to provide medical services to eligible Wayne County General Assistance recipients.
Metropolitan Detroit Polio Foundation	Merged into Rehabilitation Institute, Inc. in 1953.
MI Mobile PET CT	Michigan Mobile PET CT, LLC subsidiary of DMC.

Cited as	Full Name / Description
Moody's	A credit rating agency.
NAACP	National Association for the Advancement of Colored People.
National Association of Attorneys General	An association comprised of all state attorneys general.
Novi Regional Imaging	Imaging center located in Novi, Michigan.
Obligated Group	Detroit Medical Center and its constituent hospitals which together are responsible for bond-financing debt.
Project	Michigan State Planning Project for the Uninsured, an initiative of MDCH, which took place from 2004 to 2006.
Rehabilitation Institute of Metropolitan Detroit	Original name of Rehabilitation Institute, Inc. when incorporated in 1951.
Rose Imaging Center	Assumed name of DMC for its imaging facility located in Farmington Hills, Michigan.
Standard and Poor's	A credit rating agency.
Safety Net Assessment Team	A research team at George Washington University Medical Center and funded by the Robert Wood Johnson Foundation.
Sinai Hospital	Hospital, also known as Sinai-Grace Hospital. Assumed name of Sinai Hospital of Greater Detroit, a subsidiary of DMC.
Sinai Hospital of Greater Detroit	Subsidiary of DMC that operates Sinai-Grace Hospital.
Sinai-Grace Hospital	383 bed hospital operated by Sinai Hospital of Greater Detroit, a DMC subsidiary. Also known as Sinai Hospital.
Surgery Hospital	Unofficial name used to reference DMC Surgery Hospital.
Task Force	Detroit Medical Center Corporation Fiscal Stability Task Force Hospital Advisory Council, a task force created by executive order in 2003 to assess the fiscal operations, governance structure, and ethical/legal concerns of DMC.
TOC	Temporary Oversight Committee, a six-member committee appointed in 2003 to monitor the release of funds to DMC under the Memorandum of Understanding.
Unifying Detroit Coalition	A community group in the City of Detroit.



Cited as	Full Name / Description
Vanguard or VHS	Vanguard Health Systems, Inc., a for-profit owner and operator of 18 acute care hospitals and complementary facilities in 4 states.
VHS of Michigan	VHS of Michigan, Inc., a Delaware corporation and subsidiary of Vanguard Health Systems, Inc., which will own and operate the DMC Hospital Businesses.
Wayne State University	Located in Detroit, Wayne State University is the 3rd largest public university in Michigan and home of the largest single-campus medical school in the U.S. Wayne State University has a contractual relationship with DMC that will continue after Closing.
Women's Hospital	Hospital founded in 1868 as Women's Hospital and Foundlings' Home, which merged with Harper Hospital in 1999.
Women's Hospital and Foundlings' Home	Hospital founded in 1868 as Women's Hospital and Foundlings' Home, which merged with Harper Hospital in 1999.
Workgroup	Detroit Healthcare Stabilization Workgroup, a workgroup convened by Governor Granholm in 2002 to assess and plan solutions for issues regarding the crisis in Detroit health care.

## APPENDIX C

### C. The Attorney General's Authority

Sources of the Attorney General's authority include:

#### Supervision of Trustees for Charitable Purposes Act

The Supervision of Trustees for Charitable Purposes Act<sup>66</sup> grants the Attorney General broad investigative and enforcement authority to take necessary action to protect charitable assets for the benefit of the public.

#### Charitable Gifts Act

The Charitable Gifts Act<sup>67</sup> requires charitable gifts, devises, and trusts to be liberally construed by courts so as to carry out the intentions of charitable donors whenever possible. It confers upon the Attorney General the obligation to enforce the terms of charitable gifts through court actions.

#### Revised Judicature Act

As fiduciaries of an incorporated Michigan charitable corporation, DMC's trustees are subject to the circuit court's jurisdiction under the Revised Judicature Act.<sup>68</sup>

#### Common Law

The Attorney General also enjoys common law authority to protect charitable trust assets.<sup>69</sup> The Attorney General's authority to act on behalf of the People of the State of Michigan in any cause or matter is liberally construed; his discretion may be disturbed only if his actions are clearly inimical to the public interest.<sup>70</sup> Common law sources of the Attorney General's authority also include the *parens patriae* doctrine.<sup>71</sup>

#### Nonprofit Corporations Act

The Nonprofit Corporations Act authorizes the Attorney General to seek dissolution of a nonprofit organization that practices fraud or willfully exceed its scope of authority or otherwise conducts its affairs in an unlawful manner.<sup>72</sup> The act does not permit charitable assets of a Michigan nonprofit to be used for noncharitable purposes.<sup>73</sup>

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<sup>66</sup> MCL 14.251 *et seq.*

<sup>67</sup> MCL 554.351-3522.

<sup>68</sup> MCL 600.3605(1).

<sup>69</sup> See e.g., Restatement of Trusts 2d, § 391.

<sup>70</sup> *Michigan State Chiropractic Ass'n v Kelley*, 79 Mich App 789, 791 (1977) (citations omitted). See also *Attorney General v Michigan Public Service Commission*, 243 Mich App 487, 497 (2000); *State of Mich ex rel Kelley v C.R. Equipment Sales, Inc*, 898 F Supp 509 (WD Mich, 1995); *Humphrey v Kleinhardt*, 157 FRD 404 (WD Mich, 1994).

<sup>71</sup> *Kelley v Carr*, 442 F Supp 346, 356 (WD Mich, 1977), *aff'd in part, rev'd in part*, 691 F2d 800 (CA 6, 1980).

<sup>72</sup> MCL 450.2821.

<sup>73</sup> MCL 450.2301.

## **APPENDIX D**

### **D. Principal Documents Reviewed**

#### **Detroit Medical Center**

- 1980 DRH sublease agreement and 2006 deed
- 2007 and 2008 agreement between Wayne County and Wayne County Hospitals for the Distribution of Indigent Inpatient Care Funds
- 2009 Packages to Prospective Partners other than HCA & Vanguard
- 2009 Presentation to HCA & Vanguard
- 2010 Budget Summary by Entity
- 2010 Consolidated Budget by Department
- Accounts payable aging: 12/31/07 – 12/31/09 and 5/31/10
- Accounts receivable aging: 2007 – 2009
- Agreements with Wayne State University and other education-related agreements
- Attorney Frank Kelley’s opinion letter regarding transaction
- Audited financial statements for DMC for the fiscal years ending December 31, 2009, 2008, 2007, 2006, and 2005
- Bad Debt & Charity Care Summary
- Board of Trustee minutes
- Budgets for Current Year by Location & Department
- Charity Care Gross Charges & Costs
- Conflicts reviews
- Corporate organization chart
- Detailed Staffing Levels
- DMC Assets & Assets Excluded from Sale
- DMC Charitable Care Policy
- DMC Insurance Company, LTD, year ended 12/31/09 and 12/31/08 audited financial statements
- DMC Senior Executive Compensation Agreements
- DMC Management presentation
- Finance Committee minutes
- Fixed Asset Summary as of December 31, 2009
- Five-Year Projection by Entity and Consolidated
- General information given to all potential interested parties in acquiring DMC
- GPSR and NPSR by Payor by Hospital 2006 – YTD May 2010
- Gross Charges & Net Revenue by Payor
- Historical Statistical Information of DMC
- Historical Statistics by Hospital by Department

### **Detroit Medical Center (cont.)**

- Management presentation provided to HCA and Vanguard
- Medicare and Medicaid DSH Payments
- Potential Partner Contact Log
- Proposed organization structure under VHS
- Purchase and Sale Agreement by and among the Detroit Medical Center, et al., VHS of Michigan, Inc., et al. and VHS and related Schedules
- Pension liability date provided by Aon Hewitt
- Renaissance Zone materials including application filed with the State of Michigan that includes the resolution enacted by the City and County
- Special Chairman's Committee minutes
- Summary schedule of Plant Property and Equipment as of 12-3-09
- Third party contracts, reports, and presentations:
  - E &Y service agreement dated February 11, 2010
- E & Y report on the financial condition of VHS
  - Kaufman Hall Discussion Materials 11-6-09
  - Kaufman Hall Discussion Materials 8-25-09
  - Kaufman Hall Engagement letter dated 1-22-10
  - Kaufman Hall Engagement letter dated 6-17-09
  - Kaufman Hall For-Profit Hospital Industry Overview 2-23-10
  - Kaufman Hall Independent Valuation of DMC 6-8-10
  - Kaufman Hall Overview Presentation regarding For Profit Industry
  - King and Spalding agreement (legal services) letter dated 12/30/09, signed 6/10/2010
  - Merrill Lynch presentation to DMC Debt Sub-Committee dated 4/16/09
  - Merrill Lynch Sub-Committee Presentation 4-09
  - Presentation to Michigan Attorney General's office regarding FHA
- Unaudited internal financial statements for DMC for the fiscal years ending 2005 – 2009 and year to date periods ending May 31, 2010 and 2009

### **Vanguard Health Systems, Inc.**

- Budgets and Financial Projections
- Capital Expenditure Budgets & Projections
- Capital Project Rev EBITDA Impact
- Confidential Financial Projections & Feasibility Studies of VHS – DMC
- Confidential Offering Memorandum for Senior Notes Offering
- Corporate & Personnel Organization Structure of VHS – DMC

### **Vanguard Health Systems, Inc. (cont.)**

- Credit Analyst Reports on Vanguard
- Debt Obligations & Related Financial Convents, Maturities
- Future Capital Commitments
- Monitoring Levels & Types of Service, Charity Care & Other
- Monthly Financial Statements
- Prior Nonprofit Acquisitions
- Pro Forma Analysis for Proposed Transaction
- Project Tiger Crosswalk 6-7-10
- Proposed roles for DMC Senior Management
- Rating Agency Reports on Vanguard
- Securities and Exchange Commission Filings
- Sources and Uses of Funds Analysis
- Vanguard Charity Care Policy
- VHS Financial Model

### **Legacy DMC and Foundations**

- 2008 IRS Form 990
- Draft Articles of Incorporation and Bylaws of Detroit Community Health Foundation
- Draft Restated Articles of Incorporation and Bylaws of Medical Center Corporation (Legacy DMC)
- Plante & Moran report on restricted assets

## APPENDIX E

### **E. Individuals Interviewed**

Allen, Floyd E.	General Counsel & Corporate Secretary, DMC
Allen, Patrick M.	Vice President, Kaufman Hall
Badr, M. Safwan M.D.	Executive Vice President and Chief Medical Officer, DMC
Beatty, Stanton M. Esq.	Corporate Vice President, Chief Compliance and Governance Officer, DMC
Brooks, Teresa L.	System Executive Director, Revenue Cycle, DMC
D'Arcy, Stephen	Chair, Board of Trustees, DMC
Duggan, Michael	Chief Executive Officer, DMC
Grant, Steven D. M.D., F.A.C.P.	Executive Vice President, Physician Partnerships, DMC
Gray, Dr. Herman	Chief Executive Officer, Children's Hospital of Michigan
Haapaniemi, John D.O.	Medical Staff President, DMC
Kamholz, Kit	Partner, Kaufman Hall
Kaplan, John A.	Vice President, Controller, DMC
Levy, John G.	Board of Trustees, DMC
Mallet, Conrad	Chief Executive Officer, Sinai Grace Hospital
Malone, Dr. Thomas	Chief Executive Officer, Harper Hospital
Manardo, David C.	Corporate Vice President, Facility Engineering & Construction, DMC
Natale, Patricia	Chief Nursing Officer, Harper Hospital
Parisi, Dr. Valerie	Dean, Wayne State University Medical School
Parker, Teresa F. R.N., M.S.N., M.B.A.	Vice President & Chief Operating Officer, Sinai Grace Hospital
Paull, Judy A.P.R.N., N.E.A., B.C.	Vice President, Patient Care Services, Sinai Grace Hospital
Pelc, Michael A. C.P.A.	Vice President, Finance, DMC
Pilgrim, Trip	Chief Development Officer, Vanguard
Pitts, Keith B.	Vice Chairman, Vanguard
Raimi, Charles	Deputy General Counsel Legal Affairs, DMC
Ralston, Kathleen	Corporate Vice President, Financial Planning and Budget, DMC
Rising, Jay B.	Executive Vice President & Chief Financial Officer, DMC
Rochefort, William F.	Vice President, Finance Controller, DMC

Roe, Phillip W.	Executive Vice President and Chief Financial Officer, Vanguard
Schwartz, Alan	Board of Trustees, DMC
Taylor, Iris A. Ph.D.	President, Detroit Receiving Hospital
Thomas, Lorna M.D., P.C.	Dermatology & Dermatologic Surgery, Board of Trustees, DMC
Zammit, Charles	Corporate Compliance Manager, DMC
Zuckerman, Mary L.	Executive Vice President & Chief Operating Officer, DMC

## APPENDIX F

### **F. Detroit Medical Center – History**

In 1954, the directors of Grace Hospital, Harper Hospital, Women's Hospital, and Children's Hospital of Michigan, along with Wayne State University, formed a committee to develop a plan for an urban complex in the City of Detroit that would include the development of a public medical service center and a medical research/training center.<sup>74</sup> In 1962, the nonprofit Medical Center Development Corporation formed to aid the development and furtherance of the General Neighborhood Renewal Plan of the City of Detroit area for the Medical Center Project.<sup>75</sup> This development corporation changed its name to the Detroit Medical Center Corporation in 1970, then to its current name, Healthsource, in 1985.

Also in 1985, the DMC/WSU Health System became a nonprofit organization.<sup>76</sup> The DMC/WSU Health System's stated purpose included providing for the development, planning, and implementation of health and health-related services and activities, and furthering charitable, scientific, research, and educational activities.<sup>77</sup> At the time, the DMC/WSU Health System included: Children's Hospital of Michigan; Detroit Receiving Hospital and University Health Center; Harper-Grace Hospital; Hutzel Hospital; Rehabilitation Institute, Inc.; Wayne State University; and, their affiliated entities.<sup>78</sup> In 1986, the DMC/WSU Health System changed its

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<sup>74</sup> Darden, Joe, T., *Detroit: Race and Uneven Development* (Temple University Press, 1990), at 171.

<sup>75</sup> Articles of Incorporation, Medical Center Development Corporation, filed February 12, 1962.

<sup>76</sup> Articles of Incorporation, DMC/WSU Health System, filed December 26, 1984, effective date January 1, 1985.

<sup>77</sup> Articles of Incorporation, DMC/WSU Health System, filed December 26, 1984, effective date January 1, 1985.

<sup>78</sup> Articles of Incorporation, DMC/WSU Health System, filed December 26, 1984, effective date January 1, 1985.



corporate name to The Detroit Medical Center (DMC).<sup>79</sup> As described in more detail below, some of the hospitals in the original partnership have changed their names. The following institutions joined the DMC later: Huron Valley Hospital; Sinai Hospital; the Surgery Hospital; Grace Hospital Ambulatory Surgery Center; The Berry Center; Children's Specialty Center; Novi Regional Imaging; Rose Imaging Center; and, MI Mobile PET CT.

**A. Original Partnership Hospitals**

**Children's Hospital of Michigan**

The Children's Hospital of Michigan opened its doors in 1886.<sup>80</sup> In 1980, Children's Hospital merged with the Child Research Center of Michigan<sup>81</sup> and became part of DMC in 1985.<sup>82</sup> Its mission is to improve the health and well-being of all children and their communities by advancing the science and practice of pediatric health care through advocacy efforts.<sup>83</sup> The facility has 228 beds.<sup>84</sup> In 2009, there were 12,710 patient discharges; 93,279 visits to the emergency room; and, 13,563 surgeries.<sup>85</sup> The hospital is located on the DMC's main campus in Detroit.<sup>86</sup>

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<sup>79</sup> Certificate of Amendment to DMC Articles of Incorporation, filed April 2, 1986.

<sup>80</sup> Woodford, Arthur, M., *This is Detroit, 1701-2001* (Wayne State University Press, 2001), at 233.

<sup>81</sup> Certificate of Merger of Child Research Center of Michigan into Children's Hospital of Michigan, filed January 10, 1980.

<sup>82</sup> Articles of Incorporation, DMC/WSU Health System, filed December 26, 1984, effective date January 1, 1985.

<sup>83</sup> Children's Hospital of Michigan, <http://www.childrensdmc.org/?id=280&sid=1>

<sup>84</sup> 2009 Michigan Certificate of Need Annual Survey – Hospital Inventory Report – Children's Hospital of Michigan.

<sup>85</sup> 2009 Michigan Certificate of Need Annual Survey – Hospital Inventory Report – Children's Hospital of Michigan.

<sup>86</sup> Children's Hospital of Michigan, <http://www.childrensdmc.org/Locations>

## Detroit Receiving Hospital and University Health Center

The Detroit Receiving Hospital opened in 1915 as a city owned hospital<sup>87</sup> and became Detroit General in 1965.<sup>88</sup> In 1980, by public act, Michigan's legislature transferred the Detroit Receiving Hospital and other clinical buildings owned by Wayne State University to the Detroit Medical Center Corporation. The statute specifically provides that the buildings must continue “at all times”<sup>89</sup> to be used for specific charitable purposes prescribed by the Legislature, including<sup>90</sup>:

To provide high quality ambulatory health care services by interdisciplinary health care professionals within the present and future capacities of the institution.

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To provide, together with other institutions operated by the Detroit medical center corporation, the highest quality health services to all persons needing them, regardless of the person's religious, racial, or ethnic identification, or economic status.

Detroit Receiving Hospital and University Health Center joined together as a Michigan nonprofit corporation in 1980 and became part of the DMC system in 1985.<sup>91</sup> Focusing on adult medical care for emergency, trauma, and critically ill patients, the majority of Detroit Receiving Hospital patients arrive through the emergency department.<sup>92</sup> The facility has a 273 bed

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<sup>87</sup> Detroit Receiving Hospital, at <http://www.drhuhc.org/about/mission/>.

<sup>88</sup> Detroit Receiving Hospital, at <http://www.drhuhc.org/about/mission/>.

<sup>89</sup> MCL 331.622.

<sup>90</sup> MCL 331.623; MCL 331.624.

<sup>91</sup> Articles of Incorporation, Detroit Receiving Hospital and University Health Center, filed June 12, 1980.

<sup>92</sup> Articles of Incorporation, Detroit Receiving Hospital and University Health Center, filed June 12, 1980.

capacity.<sup>93</sup> In 2009, there were 14,038 patient discharges; 102,351 visits to the emergency room; and, 6,842 surgeries.<sup>94</sup> The hospital is located at the DMC's main campus in Detroit.<sup>95</sup>

### Harper-Grace Hospital

Harper Hospital opened in 1863 to treat Civil War soldiers.<sup>96</sup> In 1868, it became a teaching hospital for Wayne State University's School of Medicine.<sup>97</sup> Grace Hospital, named after one of the founder's daughters, Grace McMillan Jarvis, opened in 1888.<sup>98</sup> In 1974, Harper Hospital and Grace Hospital merged into the United Hospitals of Detroit, a trustee corporation, and continued to do business under the names of Harper Hospital and Grace Hospital.<sup>99</sup> In 1976, the United Hospitals of Detroit changed its corporate name to Harper-Grace Hospital.<sup>100</sup> Harper-Grace Hospital is one of the founding partners of the DMC.

In 1991, Grace Hospital relocated to the former Mt. Carmel Mercy hospital facility at 6071 W. Outer Drive in Detroit.<sup>101</sup> Harper Hospital remained in its downtown location and later merged with Hutzel Hospital in 1999.<sup>102</sup> Harper Hospital, also known as Harper University

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<sup>93</sup> 2009 Michigan Certificate of Need Annual Survey – Hospital Inventory Report – Detroit Receiving Hospital.

<sup>94</sup> 2009 Michigan Certificate of Need Annual Survey – Hospital Inventory Report – Detroit Receiving Hospital.

<sup>95</sup> Detroit Receiving Hospital, at <http://www.drhuhc.org/contact>.

<sup>96</sup> Harper University Hospital, at <http://www.harperhutzetel.org/?id=133&sid=1>.

<sup>97</sup> Harper University Hospital, at <http://www.harperhutzetel.org/?id=133&sid=1>.

<sup>98</sup> Sinai-Grace Hospital, at <http://www.sinaigrace.org/?id=17&sid=1>.

<sup>99</sup> Certificates of Merger, Harper Hospital, The Grace Hospital and United Hospitals of Detroit, Filed April 29, 1974, effective date May 1, 1974; see also Articles of Incorporation, United Hospitals of Detroit, filed October 15, 1973.

<sup>100</sup> Certificate of Amendment to the Articles of Incorporation, United Hospitals of Detroit, filed November 1976.

<sup>101</sup> Sinai-Grace Hospital, at <http://www.sinaigrace.org/?id=17&sid=1>; See also Restated Articles of Incorporation, Grace Hospital, filed March 18, 1991.

<sup>102</sup> Certificate of Merger (consolidation), Harper Hospital and Hutzel Hospital, filed March 19, 1999.

Hospital, is a 470 bed hospital.<sup>103</sup> In 2009, there were 30,499 patient discharges, 34,972 visits to the emergency room, and 15,712 surgeries.<sup>104</sup>

In June 1999, Grace Hospital merged with Sinai Hospital.<sup>105</sup> Also known as Sinai-Grace Hospital, it is now a 383 bed hospital.<sup>106</sup> In 2009, this hospital had 18,602 patient discharges; 93,742 emergency room visits; and, 7,509 surgeries.<sup>107</sup>

### Hutzel Hospital

The Women's Hospital and Foundlings' Home opened in 1868 to provide care for unwed mothers and their infants, making it the second oldest hospital in Detroit.<sup>108</sup> In 1900, it became the "Women's Hospital and Infants Home" and in 1926 became known as the "Women's Hospital."<sup>109</sup> In 1965, the hospital filed new articles of incorporation that changed its name to Hutzel Hospital, after Eleanor Hutzel, a long-time employee and trustee of the hospital.<sup>110</sup> Hutzel Women's Hospital merged with Harper Hospital in 1999 and is located in DMC's main campus. The Kresge Eye Institute is also part of the Harper-Hutzel facilities. Hutzel Hospital is

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<sup>103</sup> 2009 Michigan Certificate of Need Annual Survey – Hospital Inventory Report – Harper University Hospital.

<sup>104</sup> 2009 Michigan Certificate of Need Annual Survey – Hospital Inventory Report – Harper University Hospital.

<sup>105</sup> Certificate of Merger (consolidation), Sinai Hospital of Greater Detroit and Grace Hospital, filed June 1, 1999.

<sup>106</sup> 2009 Michigan Certificate of Need Annual Survey – Hospital Inventory Report – Sinai-Grace Hospital.

<sup>107</sup> 2009 Michigan Certificate of Need Annual Survey – Hospital Inventory Report – Sinai-Grace Hospital.

<sup>108</sup> Hutzel Women's Hospital, at <http://www.hutzel.org/hutzel/aboutus/history.html>

<sup>109</sup> Articles of Association for the Reorganization of the Women's Hospital and Foundlings' Home, filed May 13, 1900, and Certificate of Amendment to the Articles of Association, Women's Hospital and Infants Home, filed October 9, 1926.

<sup>110</sup> Restated Articles of Incorporation, The Women's Hospital, filed November 22, 1965; Hutzel Women's Hospital, <http://www.hutzel.org/hutzel/aboutus/history.html>.

a 97-bed hospital. In 2009, there were 10,053 emergency room visits, and 1,662 births by Caesarean section.<sup>111</sup>

Rehabilitation Institute, Inc.

In 1951, the Rehabilitation Institute of Metropolitan Detroit opened at the Herman Keifer Hospital in Detroit. The Institute formed to "promote, correlate and provide all services for the rehabilitation of physically handicapped persons" and to "provide opportunities and facilities for research and education which will contribute to the prevention of crippling conditions and to the improvement of services for physically handicapped persons."<sup>112</sup> In 1953, the Institute merged with the Metropolitan Detroit Polio Foundation, which was located at the same site.<sup>113</sup> In 1958, it moved to its current location at the DMC's main campus in Detroit.<sup>114</sup> In 1961, the Institute officially became the Rehabilitation Institute, Inc.<sup>115</sup> In 1985, the Rehabilitation Institute became one of the original facilities in the DMC partnership.<sup>116</sup> In 2009, this 94-bed hospital had 1,178 patient discharges.<sup>117</sup>

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<sup>111</sup> 2009 Michigan Certificate of Need Annual Survey – Hospital Inventory Report – Hutzel Women's Hospital.

<sup>112</sup> Articles of Incorporation, Rehabilitation Institute of Metropolitan Detroit, filed March 12, 1951; Rehabilitation Institute of Michigan, at <http://www.rimrehab.org/?id=10&sid=1>.

<sup>113</sup> Rehabilitation Institute of Michigan, at <http://www.rimrehab.org/?id=10&sid=1>.

<sup>114</sup> Rehabilitation Institute of Michigan, at <http://www.rimrehab.org/?id=10&sid=1>.

<sup>115</sup> Certificate of Amendment to the Articles of Incorporation, Rehabilitation Institute of Metropolitan Detroit, filed February 19, 1961.

<sup>116</sup> Articles of Incorporation, DMC/WSU Health System, filed December 26, 1984, effective date January 1, 1985.

<sup>117</sup> 2009 Michigan Certificate of Need Annual Survey – Hospital Inventory Report – Rehabilitation Institute.

## B. Later Acquisitions

### Huron Valley Hospital, Inc.

Located in Commerce, Michigan, Huron Valley Hospital, Inc., opened in 1975.<sup>118</sup> The DMC acquired the facility in 1986. In 1997, it assumed the name Huron Valley Sinai Hospital.<sup>119</sup> In 2009, Huron Valley had 153 licensed beds, with 12,291 patient discharges, 33,535 emergency room visits, and 8,120 surgeries.<sup>120</sup>

### Sinai Hospital

Sinai Hospital's roots go back to a clinic opened by Harry Saltzstein, M.D., in 1922.<sup>121</sup> In 1944, the Jewish Hospital Association of Detroit<sup>122</sup> began operating the clinic and then changed the clinic's name to Sinai Hospital in 1952. The Hospital first opened its doors in January 1953 to provide Jewish health care professionals a place to practice and create a central institution for the Jewish community.<sup>123</sup>

In 1999, Sinai merged with Grace Hospital and relocated to the former Mount Carmel Hospital building.<sup>124</sup> Sinai-Grace is now a 383-bed hospital.<sup>125</sup> In 2009, the hospital had 18,602 patient discharges; 93,742 emergency room visits; and, 7,509 surgeries.<sup>126</sup>

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<sup>118</sup> Articles of Incorporation, Huron Valley Hospital, Inc., filed December 10, 1975.

<sup>119</sup> Certificate of Assumed Name, Huron Valley Hospital, Inc., filed April 4, 1997.

<sup>120</sup> 2009 Michigan Certificate of Need Annual Survey – Hospital Inventory Report – Huron Valley-Sinai Hospital.

<sup>121</sup> Sinai-Grace Hospital, at <http://www.sinaigrace.org/?id=17&sid=1>.

<sup>122</sup> Articles of Incorporation, Jewish Hospital Association of Detroit, filed June 28, 1944.

<sup>123</sup> Certificate of Amendment to the Articles of Incorporation, Jewish Hospital Association of Detroit, filed February 25, 1952; Sinai-Grace Hospital, at <http://www.sinaigrace.org/?id=17&sid=1>.

<sup>124</sup> Certificate of Merger (consolidation), Sinai Hospital of Greater Detroit and Grace Hospital, filed June 1, 1999; Sinai-Grace Hospital, at <http://www.sinaigrace.org/?id=17&sid=1>.

<sup>125</sup> 2009 Michigan Certificate of Need Annual Survey – Hospital Inventory Report – Sinai-Grace Hospital.

<sup>126</sup> 2009 Michigan Certificate of Need Annual Survey – Hospital Inventory Report – Sinai-Grace Hospital.

### DMC Surgery Hospital

The DMC opened the Surgery Hospital in 2003 in Madison Heights, Michigan.<sup>127</sup> It is one of the assumed names of Harper-Hutzel Hospital.<sup>128</sup> In 2009, this facility had 36 beds,<sup>129</sup> with 17,297 patient discharges; 8,864 visits to the emergency room; and, 2,344 surgeries.

### The DMC CardioVascular Institute (CVI)

CVI is located within Harper University Hospital and has multidisciplinary teams of physicians, nurses, and specialists working together in the areas of cardiology, cardiac surgery, vascular medicine and surgery, cardiovascular anesthesiology, cardiac behavioral medicine, and radiology. It is known as a world-class heart and vascular center that offers comprehensive cardiovascular services and treatments.<sup>130</sup>

### **C. Freestanding Facilities**

Grace Hospital Ambulatory Surgery Center – Southfield, Michigan  
2,288 surgeries were performed in 2009.<sup>131</sup>

The Berry Center – Farmington Hills, Michigan  
3,472 surgeries were performed in 2009.<sup>132</sup>

Children's Specialty Center – Clinton Township, Michigan  
159 CT scans were performed in 2009.<sup>133</sup>

Novi Regional Imaging – located in Novi, Michigan  
732 CT scans were performed in 2009.<sup>134</sup>

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<sup>127</sup> Surgery Hospital, at <http://www.dmcsurgeryhospital.org/?id=2&sid=1>.

<sup>128</sup> Certificate of Assumed Name, Harper-Hutzel Hospital, filed June 30, 2008.

<sup>129</sup> 2009 Michigan Certificate of Need Annual Survey – Hospital Inventory Report – DMC Surgery Hospital.

<sup>130</sup> <http://www.dmccvi.org/?id=125&sid=2>.

<sup>131</sup> 2009 Michigan Certificate of Need Annual Survey – Freestanding Facilities Inventory Report – Grace Hospital Ambulatory Surgery Center.

<sup>132</sup> 2009 Michigan Certificate of Need Annual Survey – Freestanding Facilities Inventory Report – Berry Surgery Center.

<sup>133</sup> 2009 Michigan Certificate of Need Annual Survey – Freestanding Facilities Inventory Report – Children's Specialty Center – Clinton Township.

Rose Imaging Center – located in Farmington Hills, Michigan  
1,082 CT scans were performed in 2009.<sup>135</sup>

MI Mobile PET CT – based in Birmingham, Michigan  
This mobile facility performed 118 PET procedures in 2009.<sup>136</sup>

**D. DMC’s Access To Capital Through the Michigan State Hospital Finance Authority**

The Michigan legislature created the Michigan State Hospital Authority (the Authority) in 1969. The Hospital Finance Authority Act provides for access to low cost funding to nonpublic, nonprofit hospitals for health care facilities and health care services through the issuance of bonds and notes, including tax-exempt bond and notes.<sup>137</sup> Executive Order 2010-2 created the Authority's successor, the Michigan Finance Authority, on March 10, 2010. As of June 30, 2009, the Authority had issued over \$15 billions in bonds for the benefit of Michigan’s nonprofit hospitals.

Since 1988, the Authority has issued bonds eight times in one or more series for the benefit of the DMC. Prior to the formation of DMC, the Authority issued bonds for hospitals which would become part of DMC on five occasions between 1976 and 1987. According to Authority records, the total amount issued to DMC and its constituent hospitals (often referred to as the “Obligated Group” in bond financings since all the members of DMC are responsible for the debt) and its predecessor hospitals is \$942,701,079.

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<sup>134</sup> 2009 Michigan Certificate of Need Annual Survey – Freestanding Facilities Inventory Report – Novi Regional Imaging.

<sup>135</sup> 2009 Michigan Certificate of Need Annual Survey – Freestanding Facilities Inventory Report – Rose Imaging Center.

<sup>136</sup> 2009 Michigan Certificate of Need Annual Survey – Central Service Coordinator Report – Michigan Mobile PET CT, LLC.

<sup>137</sup> MCL 331.31 *et seq.*



In 1988, the Authority issued Hospital Revenue and Refunding Bonds, Series 1988A and Series 1988B, in the amount of \$69,815,000. The DMC used the proceeds of the bonds to finance projects at the Harper-Grace Hospital facilities, the Huron Valley Hospital, and to refund three series of prior bonds issued for the benefit of Hutzell Hospital and prior bonds issued for the benefit of the Rehabilitation Institute.<sup>138</sup>

In 1988, the Authority also issued Hospital Revenue Bonds, Series 1988C, in the amount of \$19,155,000. The DMC used the proceeds of the bonds to construct a 53,000 square foot addition to Hutzell Hospital for the use of the Kresge Eye Institute and to build a 103,000 square foot addition to Children's Hospital.

In 1991, the Authority issued Hospital Revenue Bonds, Series 1991A, in the amount of \$51,970,000. The DMC used the proceeds of the bonds as follows: (1) to refinance debt incurred in the purchase of both land and the Mt. Carmel Hospital facility for the benefit of Grace Hospital; (2) for renovations to Grace's hospital facilities and for medical equipment; (3) for renovation, expansion, and equipping of the Huron Valley Hospital facility; and, (4) for renovations to and the equipping of the Harper Hospital facility.

In 1993, the Authority issued Revenue and Refunding Bonds, Series 1993A, in the amount of \$112,730,000. The DMC used the proceeds to refinance bank loans used for various capital projects at Grace Hospital facilities and DMC Nursing Homes Inc. The DMC also used bond proceeds to refund outstanding bonds issued in 1985 for the benefit of Harper-Grace Hospital and Huron Valley Hospital.

In 1993, the Authority also issued Revenue and Refunding Bonds, Series 1993B, in the amount of \$132,285,000. The DMC used the proceeds of the bonds to: (1) construct and equip a

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<sup>138</sup> The description of the use of bond proceeds for this bond issue and the other bond issues described in this report were taken from the official statements used to market the bonds.

22,380 square foot expansion at Children's Hospital; (2) renovate and equip Detroit Receiving Hospital; (3) renovate the Grace Hospital and expand Harper Hospital's Urgent Care Center; (4) improve various parking structures; and, (5) refund the outstanding Series 1988A and Series 1988B bonds.

In 1997, the Authority issued Hospital Revenue and Refunding Bonds, Series 1997A, in the amount of \$174,460,000. The DMC used these bond proceeds to: (1) renovate Harper Hospital and consolidate certain services from Hutzel Hospital; (2) construct, renovate, and equip facilities at Huron Valley Hospital and DMC ambulance facilities; (3) renovate DMC's clinical information system; and, (4) refund certain of the 1991A bonds.

In 1998, the Authority issued Hospital revenue Bonds, Series 1998A, in the amount of \$108,650,000. The DMC used the bond proceeds to: (1) finance the construction, renovation, and equipment necessary for the consolidation of most of Grace Hospital's operations in Sinai Hospital; (2) equip and install a new clinical information system; (3) renovate and equip Harper Hospital; and, (4) defease outstanding bonds issued in 1995 for the benefit of Sinai Hospital.

In 2001, the Authority issued four series of notes: Series 2001A, Series 2001B, Series 2001C, and Series 2001D, respectively, in the amounts of \$4,451,000; \$4,000,000; \$3,000,000; and, \$3,000,000. The DMC used the note proceeds for direct equipment purchases. These bonds were all in the nature of direct bond purchases by the financing arm of General Electric, the equipment seller. These types of note issuances more closely resemble a purchase money security interest under the Uniform Commercial Code than a typical bond financing. They are easier to obtain because they typically do not require an investment-grade rating or credit support (letter of credit, bond insurance, guaranty) since the loans are supported by the purchased equipment.

In 2008, DMC proposed another financing, approved by the Authority, for an amount not to exceed \$355,000,000. DMC proposed certain new projects and to refund certain of its 1993 and 1995 bonds. DMC could not obtain an investment grade rating for its bonds, nor could DMC obtain credit support. This proposed financing never occurred.

The Authority was not in a position to assist DMC with respect to its financing needs because DMC's financial circumstances were deteriorating. Throughout most of its relationship with the Authority, DMC had maintained investment grade bond ratings or was able to obtain credit support. But by 2001, due to continued deteriorating financial circumstances, DMC could only obtain very limited financing for the purchase of equipment and the financing came from the equipment manufacturer's financial arm.

According to Authority records, DMC's Obligated Group consolidated balance sheet showed outstanding long-term debt of \$486,827,000 as of February 2009.

A March 25, 2010, report from Standard & Poor's indicates DMC's bonds were rated "BB-," which is a full grade below investment grade (the minimal investment grade rating is "BBB+"). On September 27, 2010, Moody's Investors Service maintained its Ba3 rating on DMC's long-term debt but revised its outlook from "stable" to "negative."<sup>139</sup> Thus, as this Report outlines, even though DMC improved its cash flow after 2004, DMC was unable to borrow the money needed to upgrade its facilities—a critical element in attracting insured patients and the substantial revenue and profits they bring.

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<sup>139</sup> [http://v3.moodys.com/viewresearchdoc.aspx?docid=RU\\_16645371&cy=usa](http://v3.moodys.com/viewresearchdoc.aspx?docid=RU_16645371&cy=usa) (registration required). Moody's Ba3 rating is defined as "judged to have speculative elements and are subject to substantial credit risk."

## **E. Financial Challenges to DMC and the Detroit Health Care Safety Net**

In the last decade, Detroit has watched as seven hospitals have closed their doors due to economic hardships.<sup>140</sup> In 1995, Detroit had twelve “safety-net”<sup>141</sup> hospitals, four of which were DMC hospitals. Today Detroit has six safety-net hospitals remaining—four of which are still DMC hospitals.

The continued viability of Detroit’s safety-net hospitals in the future of the health care of Detroit has been a major issue in the twenty-first century. Between 2003 and 2006, four major studies and resultant reports were completed with a main focus on the viability of the safety net entities and, in particular, DMC’s plight. Of these four reports, three were government-funded study groups; the other was a privately funded study completed by academic experts. All of the groups addressed different contributing factors, main concerns, and potential solutions related to the continued viability of Detroit’s health care safety net and DMC’s budget crisis. But all these reports underscore that DMC is an anomaly that has survived over the past decade despite ever-increasing challenges of population decline, economic displacement, and dwindling access to capital.

The report issued in 2003 focused on the eroding infrastructure of Detroit's health care system. The second report, released in March of 2004, considered the plight of Detroit’s health care safety net. The third report, published in August of 2004, arose specifically from the budget crisis facing DMC and the emergency funding provision of \$50 million to DMC facilities. The

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<sup>140</sup> Detroit Hope Hospital, 04/28/2009; St John Northeast Hospital, 06/20/200; St John Riverview Hospital, 06/20/2008; Greater Detroit Hospital, 11/29/2002; St John Gratiot Hospital, 07/23/2002; Mercy Hospital, 02/01/2000; and, Grace Hospital, 09/18/1999 (merged with Sinai, now part of DMC).

<sup>141</sup> The term “safety net provider” has earned a variety of meanings in the health care arena. The term as it is used in this report is an entity whose patient mix is disproportionately composed of uninsured, underinsured, and Medicaid patients and offers substantial health-care services to patients regardless of their ability to pay.

fourth report, released in 2006, was a federally-funded initiative attempting to develop realistic strategies to extend health insurance to all Michigan residents.

1. **August 7, 2003 – Strengthening the Safety Net in Detroit and Wayne County Report of the Detroit Health Care Stabilization Workgroup (Workgroup Report)**

In 2002, Governor Granholm, in collaboration with the Chief Executive Officers of the three Detroit health care systems—DMC, Henry Ford Health Systems, and St. John Health Systems—convened the Detroit Health Care Stabilization Workgroup (Workgroup) to assess and develop solutions for the crisis in Detroit health care. The Workgroup Report focused on the health-care issues that developed in response to the continuous decline in population in Wayne County (especially Detroit) and the eroding health-care infrastructure. In August 2003, the Workgroup issued its final report.

For purposes of its report, the Workgroup defined a “safety net” facility as one:

...of those organizations and programs, in both the public and private sectors, that have a legal obligation or a commitment to provide direct health care services to the uninsured, underinsured, and other under served groups.<sup>142</sup>

Wayne County’s population decline was accelerated by significant economic constraints and poor health status; in the previous sixteen years, twenty primary-care clinics and four hospitals closed, costing the city 1,220 beds and 4,468 full time jobs, and adding to the erosion of the health care infrastructure. Additionally, the Workgroup Report revealed that physicians left Detroit to practice in other cities and states, insured patients left the Detroit area for health care, Detroit could not provide its share of funding to establish Federally-Qualified Health Centers (FQHCs), and no one effectively coordinated efforts to care for Detroit’s growing population of Medicaid and uninsured patients.

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<sup>142</sup> Workgroup Report, p. 9.

The Workgroup also identified the payor-mix as one of the major factors eroding at Detroit's health care system: Detroit's extraordinarily large number of uninsured persons, the hospitals' heavy reliance on Medicaid and Medicare, and the relative absence of commercial payers were all factors that affected Detroit's stability.

The Workgroup opined that government's provision and reimbursement for public health care services should be arranged through a public entity that would: coordinate the public and private components of health care services; leverage Medicaid funds to provide insurance benefits to the uninsured; and, expand preventative and primary-care services using programs such as FQHCs. Finally, the Workgroup stated that providers should be prepared to reorganize their delivery systems in a way that would: 1) improve access; 2) enhance primary-care capacity; 3) improve efficiency; and, 4) deliver high-quality care through integrated partnerships that provide care for the uninsured.

2. **March 2004 – An Assessment of the Safety Net in Detroit, Michigan Report by the Safety Net Assessment Team, George Washington University Medical Center School of Public Health and Health Services**<sup>143</sup>

Around the same time Governor Granholm was setting up the state initiative, The Robert Wood Johnson Foundation (Johnson Foundation) established the Urgent Matters program as a national initiative. The program's purpose was to identify ways to cut down on the overcrowding in America's hospital emergency departments and to improve access to quality care for uninsured and underserved community residents. Urgent Matters examined the interdependence between emergency department use and the health-care safety net in ten communities throughout the United States, including Detroit. In March 2004, Urgent Matters released its Detroit safety net assessment.

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<sup>143</sup> [http://urgentmatters.org/media/file/aboutProject\\_reports\\_Final\\_Detroit.pdf](http://urgentmatters.org/media/file/aboutProject_reports_Final_Detroit.pdf).

Its report included the following key findings:

- The Detroit safety net is in a fragile state following a steady decline in health care resources previously available to some low-income and uninsured residents. Any further hospital closures within the Detroit Medical Center system could cause the safety net to collapse, leaving low-income and uninsured residents virtually “on their own” in terms of their access to vital health care services.
- There is a severe undersupply of primary care services for low-income and uninsured residents of Detroit and Wayne County. Most primary care for these populations is provided by a handful of community health centers and clinics that offer services at no or low cost. Access for individuals who are covered by Medicaid is hampered by a very limited supply of private physicians who are willing to accept Medicaid rates.
- Access to timely specialty care is largely dependent on an individual’s access to primary care. Community Health Centers have partnered with the three major health systems in Detroit to provide specialty care for each center’s patient population; however, access is uneven across these arrangements. Some of these patients have very good access to primary care, specialty care, inpatient services, and prescription drugs, all at deeply discounted prices. But others are less likely to receive these services in a timely or coordinated fashion, if at all.
- A significant percentage of emergency department visits at Henry Ford Hospital are for patients whose conditions are non-emergent. Nearly one-fifth (19.5%) of all emergency department encounters that did not result in an inpatient admission were for patients who presented with non-emergent conditions. More than one-fifth (22.1%) were for patients whose conditions were emergent but could have been treated in a primary care setting.
- Pressures on the Detroit safety net can only be alleviated with an infusion of additional dollars targeted toward the expansion of primary care, specialty care, behavioral health, and other health service capacity for low-income and uninsured residents. After decades of sustained neglect and retrenchment, the safety net needs more significant and stable financing to have the capacity to serve the populations in need of care.

The report emphasized DMC’s role in maintaining the safety net in Detroit. In particular, it stated that Detroit Receiving Hospital and Hutzel Hospital had a pivotal role, warning:

The potential closure of the bedrock of the Detroit safety net—Detroit Receiving and Hutzel Hospitals— has served as the tipping point, focusing state and national attention on the crisis. If these two hospitals close their doors, with no alternatives opening up for residents in the community, the remaining safety net hospitals may not be able to survive.

3. **August 14, 2004 – Preserving the Health Care Safety Net, Providing Critical Medical Services for Southeast Michigan Final Report of the Detroit Medical Center Fiscal Stability Task Force Temporary Oversight Committee**<sup>144</sup>

More specifically, the Task Force addressed the significant deficit crisis at DMC from the previous five years. On June 19, 2003, Governor Granholm created the Detroit Medical Center Fiscal Stability Task Force Hospital Advisory Council<sup>145</sup> (Task Force) to assess the fiscal operations, governance structure, and ethical/legal concerns at DMC.

In 2003, DMC faced a significant budget deficit crisis. Over the previous five years, DMC had \$360 million of expenses in excess of revenues as a result of nonpayment for services, continual decline in patient volume, and the insolvency of some managed care providers.

The Governor's implantation of the Task Force was the first attempt at an answer to the concerns of government leaders of the City of Detroit and Wayne County, and members of DMC management. However, DMC management really needed funding and began pursuing funding from the State, local governmental entities, and the federal agencies

As a result of that pursuit, DMC entered into a Memorandum of Understanding (MOU), effective August 1, 2003, with the City of Detroit, Wayne County, and the State of Michigan. Under the terms of the MOU, DMC obtained \$50 million in funding over a ten-month period as part of an emergency supplemental funding package to support the operation of Detroit Receiving Hospital and University Health Center, and Hutzel Hospital. The MOU provided for the creation of a Temporary Oversight Committee (TOC) comprised of six members (two each appointed by the Mayor of Detroit, the Wayne County Executive, and the Governor). The TOC monitored the release of funds to DMC based on criteria set forth in the MOU. Once engaged, the TOC determined that to facilitate a turnaround, a widespread approach focusing on DMC's

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<sup>144</sup> [http://www.michigan.gov/gov/0,1607,7-168-23442\\_27297-108907--,00.html](http://www.michigan.gov/gov/0,1607,7-168-23442_27297-108907--,00.html).

<sup>145</sup> Pursuant to Executive Order 2003-7.



overall operations relating to services, staffing, patient care, finances, and governance would require immediate assessment, analysis, and a responsive action plan. In its early meetings with the DMC leadership team, the TOC stressed the priority of continuing to operate and staff the safety net providers at their current levels while leaving regular services uninterrupted.

The TOC also encouraged development of both short-term and long-term fiscal strategies for preserving these facilities. Concurrently, the TOC and the Chair of the DMC Board, Charles O'Brien, focused on seven primary areas of concern: 1) cost reduction and implementation of economies of scale; 2) operational efficiencies; 3) identifying additional sources of revenue; 4) governance and board structure; 5) strengthening relations with member hospitals and staff; 6) solidifying relations with the Wayne State University Medical School; and, 7) maintaining operations at the safety net facilities. The TOC determined that the DMC was in need of outside professional assistance to identify and prioritize issues that needed to be addressed, and to recommend actions to achieve the turnaround and other requirements of the MOU. The TOC later assisted in the selection of an appropriate consulting firm.

As Mr. O'Brien and the DMC Board (Board) worked with the TOC to achieve the goals expressed in the MOU, they also searched for a new CEO to lead DMC. Eventually, they selected former Wayne County Prosecutor Michael Duggan. A new governance accountability program, including a conflict of interest policy, was put into place and the Board reduced its size, changed eligibility for service, and created conflict avoidance standards. As turnaround progress was made, DMC's relationships with its medical staff and Wayne State University's Medical School improved; services at Detroit Receiving Hospital and Hutzel Women's Hospital continued. The TOC offered guidance to DMC leadership on how such progress could be maintained on both a short-term and long-term basis.

On August 18, 2004, the Task Force issued its final report. The group found that DMC had made significant strides in its turnaround mission but noted that additional work would be needed to maintain the health care safety net in southeastern Michigan. The Task Force Report noted that during the ten-month period of its existence, the financial outlook of DMC improved. In fact, Standard and Poors' upgraded the outlook on the \$566,000,000 in outstanding debt from negative to stable in June 2004. This upgrade was based on reduced operating losses, more realistic budget projections, and the demonstrated support of governmental entities to help DMC. The Task Force was dissolved and abolished by Executive Order 2005-4.

4. **August 2006 – Michigan State Planning Project for the Uninsured Project Report**<sup>146</sup>

In light of pressing concerns over the provision of health care services to uninsured and the growing problem of access to affordable health insurance for Michigan's residents, the Michigan Department of Community Health (MDCH) launched the Michigan State Planning Project for the Uninsured (Project). This project was funded by a federal grant with the goal of developing realistic strategies to extend health insurance to all Michigan residents. MDCH coordinated this initiative from late 2004 through August 2006. While not specifically focusing on the City of Detroit or Wayne County, an integral component of the Project was to expand the current knowledge base about the uninsured population by collecting data about unmet needs, barriers to insurance coverage, and system changes needed to secure coverage for all Michigan residents.

In August 2006, the Project's Advisory Council issued its Final Report. In the Report, the Advisory Council noted the health consequences of being uninsured and the costs associated with caring for the uninsured. The Advisory Council also pointed out that these issues, along

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<sup>146</sup> [http://www.michigan.gov/mdch/0,1607,7-132-2943\\_37434-159777--,00.html](http://www.michigan.gov/mdch/0,1607,7-132-2943_37434-159777--,00.html)

with rising health care costs, are creating challenges throughout Michigan. The Advisory Council made both short-term and long-term recommendations.

For the short term, the Advisory Council supported the direction of the “Michigan First Healthcare Plan” to extend coverage to all the low-income uninsured—about half of the total uninsured in Michigan. The Advisory Council recommended addressing the adequacy of Medicaid payment rates for providers, hospitals, and managed care and strengthening the health care safety net provider system to better address the health care needs of our most vulnerable populations. In addition, the Advisory Council supported efforts to maximize enrollment of eligible individuals and dependents into group-sponsored health insurance and recommended that employers that offer health insurance to employees be provided incentives to offer dependent coverage (with or without employer contributions).

According to the Advisory Council, implementation of these short-term recommendations would secure health coverage for those up to 200% of the poverty level and for young adults and children—in other words, the majority of those currently uninsured. The Council also recommended establishing a public education initiative to inform Michigan residents and policy makers of the nature, severity, and impact of Michigan having between 800,000 and 1.1 million of its residents without health insurance.

As for long-term recommendations, the Advisory Council suggested the establishment of a successor council to pursue consensus on the key issue of the roles to be played by the affected parties — including consumers, employers, government agencies, health care providers, health insurance carriers, organized labor, and voluntary advocacy associations—in achieving meaningful health insurance coverage for all Michigan residents. The Council also warned that

the organizations comprising the safety net faced increased demands for primary and preventative care and recommended strengthening the provider system.

## VII. EXHIBITS

<b>Exhibit #</b>	<b>Contents</b>
1.	Amendment No. 2 to Purchase and Sale Agreement.
2.	Enforcement Agreement between the Attorney General, DMC, Legacy DMC, Buyer, and Vanguard.
3.	Monitoring and Compliance Agreement between the Attorney General, DMC, Legacy DMC, Buyer, and Vanguard.
4.	Protection of Charitable Assets Agreement between the Attorney General and Legacy DMC.
5.	AlixPartners, LLP Report, November 11, 2010.
6.	Example Calculation of the Purchase Price as of April 30, 2010. Purchase and Sale Agreement Schedule 2.5.
7.	Detroit Medical Center's Charity Care Policy.
8.	Vanguard Health Systems, Inc. Charity Care Financial Assistance, and Billing & Collection Policies for Uninsured Patients Reference No. 11-0801, as revised January 23, 2009.
9.	AlixPartners Memorandum Regarding Issues Raised by the SEIU.
10.	December 3, 2007, letter from Vanguard Executive Vice President and General Counsel Ronald P. Soltman to Joshua Kosman regarding " <i>The Buyout of America: How Private Equity Will Cause the Next Great Credit Crisis.</i> "