

STATE OF MICHIGAN
DEPARTMENT OF ATTORNEY GENERAL



MIKE COX
ATTORNEY GENERAL

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December 29, 2010

On November 13, 2010, I issued a report conditionally approving the June 10, 2010, Purchase and Sale Agreement between Vanguard Health Systems and Detroit Medical Center. My approval required the parties to execute four agreements designed to protect the restricted charitable assets that will be retained after closing by DMC (which will continue as a charitable organization known as "Legacy DMC") and to enhance Legacy DMC's monitoring of Vanguard's observance of its many commitments to the community in the delivery of health care services. The parties executed the agreements and in doing so satisfied the conditions of my approval.

The agreements require the Attorney General to approve any subsequent amendments to the Purchase and Sale Agreement and to the Articles of Incorporation and Bylaws of Legacy DMC. After my report was issued, I received and reviewed the following documents, which are attached to this letter:

1. Proposed Amendment No. 3 to the Purchase and Sale Agreement;
2. Proposed Amendment No. 4 to the Purchase and Sale Agreement;
3. Proposed Restated Articles of Incorporation for Legacy DMC; and
4. Proposed amendments to the Bylaws of Legacy DMC.

I requested AlixPartners, LLP, to review Amendments 3 and 4 to the Purchase and Sale Agreement and form an opinion whether the proposed changes would affect AlixPartner's prior conclusion provided on November 11, 2010, that, from an economic perspective, the transaction was fair to DMC and that Vanguard, accordingly, would pay at least fair market value in assuming DMC's health care assets and liabilities. Because Amendment No. 3 proposes changes with economic consequences, AlixPartners issued a supplementary Memorandum regarding Amendment No. 3, which is attached to this letter. AlixPartners concluded that Amendment No. 3 does not disturb its prior opinion. AlixPartners also informally confirmed that Amendment No. 4 does not raise financial issues of concern.

Upon review, I approve all four proposals and have no objection to the transaction proceeding to closing.

A handwritten signature in blue ink, appearing to read "Mike Cox".

Mike Cox
Attorney General

December 20, 2010

**Memorandum to the Michigan Attorney General's Office Regarding a
Draft Amendment No. 3 to the Purchase and Sale Agreement**

OVERVIEW

Subsequent to the execution of the Purchase and Sale Agreement (“Original Agreement”) in June 2010, DMC and Vanguard Health Systems (“VHS”) prepared amendments to the Original Agreement in light of certain issues that arose as the transaction progressed. Most recently, the parties prepared a draft Amendment No. 3 to the Original Agreement. The Michigan Attorney General’s Office asked AlixPartners to review and comment on any significant changes to the Original Agreement as set forth in Amendment No. 3 that would affect the overall economic terms of the transaction.¹

The changes to the Purchase and Sale Agreement contained in Amendment No. 3 generally relate to the following issues:

- VHS’s assumption of DMC’s historical Medicare provider numbers;
- A Settlement Agreement between DMC and the U.S. Government;
- Specification as to the number of Warrant Shares to be issued at Closing;
- Addition of two VHS entities, “CRNAs of Michigan” and “Vanguard Physicians of Michigan” as parties to the agreement.

We reviewed the changes to the Purchase and Sale Agreement as they relate to these issues and had follow-up discussions with Steve D’Arcy, Chairman of the DMC Board (“Mr. D’Arcy”), and Phil Roe, CFO of VHS (“Mr. Roe”). Our comments are presented below.

¹ AlixPartners reviewed a draft of Amendment No. 3 from the perspective of a financial advisor and makes no representation as to the legal interpretation of Amendment No. 3.

VHS'S ASSUMPTION OF DMC MEDICARE PROVIDER NUMBERS

We understand that when the parties entered into the Original Agreement in June 2010, it was assumed, based on VHS' historical experience, that VHS would be issued new Medicare provider numbers for the DMC hospitals from the Center for Medicare and Medicaid Services ("CMS"). However, we understand that in or around late August or early September 2010, CMS informed the parties that it had re-interpreted its regulations and that if new provider numbers were issued to VHS at Closing, that VHS would not inherit the historical attributes of DMC and faced the possibility of not being compensated for care for a period of time that could range from 60 to 90 days. Based on our conversations with Mr. D'Arcy and Mr. Roe, this was not acceptable to either DMC or VHS and ultimately the parties agreed that VHS would assume DMC's historical provider numbers and any associated liability.

This was a change to the risk profile of the transaction given the possibility that VHS would be liable for additional contingent liabilities. In order to determine any potential contingent liabilities that may be associated with the historical provider numbers, DMC and VHS conducted an extensive due diligence process. After completing this due diligence, the parties prepared changes to the Original Agreement which are contained in Amendment No. 3.

Several of the changes set forth in Amendment No. 3. delete or modify language in the original Purchase and Sale Agreement to show that VHS is assuming DMC's provider agreements with government payment programs. The most significant change, however, is contained in Section 13.5, titled "Special Payments".

The "Special Payments" section discusses what happens in the event that VHS incurs a legal obligation in connection with the assumption of DMC's historical contracts and has to make a payment. In the event that the cumulative "Special Payments" exceeds \$25 million, VHS has the right to withhold any funds in excess of the \$25 million from the capital expenditure commitment of \$850 million. The first \$10 million of a Special Payment is to be withheld from routine capital expenditures, with the remaining funds withheld from specified project capital expenditures.² Based on our conversation with Mr. D'Arcy, we understand that DMC's historical fines have been small and Mr. D'Arcy and Mr. Roe do not believe that there is substantial risk in the future that VHS will be required to make significant Special Payments.

² Amendment No. 3 to Purchase and Sale Agreement.

As discussed in more detail below, DMC has also entered into a Settlement Agreement with the U.S. Government. We understand from Mr. D'Arcy that VHS is not responsible for any potential future liabilities that were discovered during the due diligence process and/or which are covered as part of the Settlement Agreement.

SETTLEMENT AGREEMENT

We understand that DMC entered into a settlement agreement with the U.S. Government which is designed to clear DMC of future liabilities arising from historical government payment program contracts that have been reported to the government. Based on our conversation with Mr. D'Arcy, we understand that the amount of the settlement is \$30 million, which will be paid at Closing and funded through DMC's cash balance.

Amendment No. 3 modifies the language in the original Purchase and Sale Agreement to show that DMC has reached the settlement agreement with the government. Two notable changes are contained in the Representations and Warranties section and the No Material Adverse Change section. The Representations and Warranties section is modified to state that the financial impact of the Settlement Agreement shall not be taken into consideration in determining whether DMC has breached its representations and warranties to VHS. The No Material Adverse Change section is modified to state that any payments associated with the Settlement Agreement do not factor into the calculation of EBITDA for purposes of determining whether or not a Material Adverse Change has occurred.³

SPECIFICATION AS TO THE NUMBER OF WARRANT SHARES

Section 12.4(h) to the Original Agreement discusses the warrants for VHS stock which will be issued at Closing and as collateral for the CapEx Commitment. We understand that the language in Section 12.4(h) to the Original Agreement has been modified in order to clarify the number of Warrant Shares to be issued at Closing. The Original Agreement, which was signed on June 10, 2010, stated that warrant shares having an aggregate value of \$500 million as of that time would be issued at Closing. The value per share of VHS stock, and therefore the number of warrant shares issued, was to be determined by an Independent Appraiser as of a date not earlier than June 30, 2010, which was subsequent to the signing of the Original Agreement. Murray Devine provided its valuation opinion in August 2010

³ Amendment No. 3 to Purchase and Sale Agreement.

and thus the number of shares that equate to the \$500 million in value are now determinable. Given this, the language in Amendment No. 3 specifies the number of warrant shares to be issued, as opposed to stating only the aggregate value. Amendment No. 3 states that a warrant certificate for 400,000 shares would be issuable to DMC at Closing.⁴ The implied value of 400,000 shares of VHS stock is slightly in excess of \$500 million, based on the valuation prepared by the Independent Appraiser (Murray Devine).

ADDITIONAL VHS PARTIES TO THE AGREEMENT

Amendment No. 3 adds two VHS entities (CRNAs of Michigan and Vanguard Physicians of Michigan) as parties to the Agreement. We understand based on our conversation with Mr. Roe that this was done for billing purposes.

VHS ACQUISITION ACTIVITY

VHS recently announced that it has purchased Holy Cross Hospital in Chicago. Based on our conversation with Mr. Roe, we understand that the purchase price was immaterial to VHS. We also understand that while VHS is always an active acquisition market participant, it is unlikely that VHS will consummate any further acquisitions in the next six months.

CONCLUSION

AlixPartners completed its analysis on or about November 11, 2010, which was prior to the preparation of Amendment No. 3. We reviewed the changes to the Original Agreement contained in a draft of Amendment No. 3 that would potentially affect the overall economic terms of the transaction. We find that our analysis and conclusions would not change in light of the modifications to the Original Agreement as contained in the draft Amendment No. 3 which we reviewed.

⁴ The exact number of shares could vary depending on overall remaining negotiations between VHS and DMC.