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October 21, 2010

Attorney General Mike Cox
Office of the Attorney General
Charitable Trust Division
G Mennen Williams State Office Building
Lansing, MI 48909

Dear General Cox,

We write to the Office of the Attorney General to present two options available to Detroit Medical Center ("DMC") that could enable DMC to remain a viable enterprise without converting from a charitable trust to a for-profit entity.

Your Office asked us to evaluate a potential acquisition by, affiliation with or merger with Ascension Healthcare ("Ascension"), Trinity Health Systems ("Trinity"), and Catholic Health Initiatives ("CHI"), three large nonprofit systems with operating strongholds in the Midwest. Based on our analysis, each of these three systems has the ability to assume DMC's long-term debt and make the necessary capital and IT improvements. Accordingly, any of these systems might be positioned to acquire DMC on terms more favorable than the proposed Vanguard transaction. Moreover, as we discuss below, DMC's substantial market share and recent investments in technology would likely make it an attractive target for acquisition by any of these systems, not only by Vanguard.

In addition, DMC may be well positioned to access the bond market at this time. Although DMC tried unsuccessfully to issue debt in the fall of 2008, that attempt unfortunately coincided with the collapse of the financial markets. Stability has now returned to the credit markets and three Michigan nonprofit hospital systems successfully issued debt in 2009. Accordingly, DMC should consider raising debt in order to remain independent.

In evaluating the proposed Vanguard-DMC transaction, the Attorney General should be mindful of his role as the principal guardian of the public interest with respect to nonprofit institutions in Michigan. A crucial aspect of that role is to ensure that nonprofit institutions that engage in major transactions affecting charitable assets are complying with their fiduciary duties, so that charitable assets continue to be used consistently with their charitable purposes for the benefit of the people of Michigan. As we demonstrate below, pursuant to its fiduciary duty of care, the DMC Board of Directors should have fully explored the possibility of attracting other potential buyers, or returning to the capital markets itself, before agreeing to the Vanguard deal on the terms offered.

The proposed Vanguard-DMC transaction would be the first in Michigan history to allow a for-profit entity to take control of a charitable hospital. At a minimum, the proposed Vanguard-DMC transaction should not be approved unless the Attorney General is satisfied that the DMC Board of Directors has complied with its fiduciary duties by considering other reasonable alternatives to the sale that would safeguard DMC as a charitable institution operating for the benefit of the Michigan public.

THREE EXISTING NONPROFIT SYSTEMS MAY BE ABLE TO ACQUIRE DMC

In the Midwest region there are several examples of strong nonprofit systems with the necessary capital, capacity, and infrastructure investments to acquire and operate DMC. For example, nonprofit systems Ascension, Trinity and CHI All currently have strong balance sheets, low leverage and high liquidity. As such, all three would be well positioned to acquire DMC.

As illustrated in the Table 1 below, the three nonprofit systems in this analysis are materially larger than either DMC or Vanguard when measured by revenue. Ascension, CHI and Trinity are nearly eight, five and four times the size of DMC respectively, compared to Vanguard, whose revenue is only twice that of DMC. Absorbing DMC's debt would also be relatively easier for these large nonprofit systems – DMC's long-term debt represents 12 percent of each of Ascension and CHI's long-term debt and 19 percent of Trinity's long-term debt. In contrast, DMC's debt represents nearly one-third of Vanguard's long-term debt.

Several important financial indicators illustrate the level of a company's debt burden, its liquidity position and ability to service its current debt load. These ratios all indicate that the nonprofit systems mentioned above are less levered and have higher capacity to meet their debt obligations compared to Vanguard. Being part of a financially strong system would better ensure DMC's long-term sustainability.

TABLE 1: COMPARISON OF KEY INDICATORS FOR DMC, VANGUARD AND THREE NONPROFIT SYSTEMS

	Fiscal year end	Revenue ($M)	Long-term debt ($M)	Cash flow from operations ($M)	LT Debt / Assets	Interest coverage	Days cash on hand
DMC	12/31/09	$1,952	$490	$84	38.9%	3.9x	15.2
Ascension	6/30/10	$14,773	$4,235	$709	23.5%	11.2x	218.0
CHI	6/30/10	$8,969	$4,201	$1,403	32.8%	7.3x	210.1
Trinity	6/30/10	$6,988	$2,550	$462	27.4%	8.7x	232.5
Vanguard	6/30/10	$3,377	$ 1,743	$315	63.9%	1.8x	32.1*

Source: Company Audited and Unaudited Financial Statements. Days cash on hand is not commonly applied to for-profits because investor owned operators tend to keep enough cash to fund working capital needs and can access the equity or debt markets for additional capital.

THESE NONPROFIT SYSTEMS HAVE LOWER DEBT BURDEN. All three nonprofit hospitals have much lower long-term debt-to-assets ratios, higher interest coverage and higher days cash on hand compared to Vanguard, which affords those systems greater financial flexibility and solvency.

The long-term debt-to-assets ratio measures the portion of a company's assets that are financed by long-term debt (bonds, bank loans, revolving lines of credit, etc.). A lower ratio indicates that a company has lower leverage and potentially more room on its balance sheet to access the capital markets. Ascension, CHI and Trinity have much lower ratios than Vanguard.

Interest coverage measures a hospital system's ability to pay the interest that is due on its debt with its earnings before interest and taxes ("EBIT"). Higher interest coverage indicates that a company has a greater capacity to meet its interest payments. Again, the nonprofit systems surpass Vanguard in this indicator; in fact, even DMCs' interest coverage is also almost double that of Vanguard.

Days cash on hand estimates the number of days a hospital could operate with the amount of cash and liquid assets it currently holds. In many ways it is gives a snapshot of the system's rainy-day fund. Each of the nonprofits could operate for more than 210 days. These systems' days cash on hand rates are 25 percent higher than the median days cash on hand for nonprofit systems according to Standard and Poor's.[1] A hospital system with strong cash flow and a large amount of cash on hand would be in a better position restore long-term solvency and fund capital improvements at DMC.

DMC WOULD MAKE A COMPELLING ACQUISITION CANDIDATE FOR ANY OF THESE THREE NONPROFITS. DMC has several strengths and favorable characteristics. Vanguard itself has touted its interest in DMC based on DMC's substantial market share. Vanguard's Chief Development Officer Trip Pilgrim noted that "In Detroit, the DMC already is a dominant player with a 13.4 percent market share."[2] While a majority of hospital transactions this year have involved standalones or smaller systems than DMC, Ascension, CHI, or Trinity would likely welcome the opportunity to gain such a strong foothold in a new market by acquiring a market leader.

DMC is also financially sound. Again, according to Trip Pilgrim, "It's remained profitable despite harsh economic conditions and the deal will give Vanguard a robust network of hospitals and doctors' offices."[3] Standard and Poor's analysts agree, citing among several strengths a "record of positive operating profitability and the numerous creative customer service initiatives developed by the current management team that have helped to bolster volumes in certain key service lines despite a very competitive market and a challenging economic period."[4]

Additionally, DMC has made significant investments in its pension and infrastructure (which in part contributed to its low liquidity). These investments increase DMC's marketability to potential buyers.

LIKE DMC, OTHER NONPROFIT SYSTEMS HAVE ALSO INVESTED IN INFRASTRUCTURE

A recent news article reported that "about 2[redacted] of Michigan hospitals have electronic medical record systems in all their units, compared with only 1[redacted] nationwide."[5] The author characterized DMC, as well as another major Michigan hospital system Trinity Health, as being "much further along" in information technology development, noting that these systems are also expected to qualify for IT based federal incentives starting in 2012.[6] The Bond Buyer also reported that DMC made a "costly decision a few years ago to invest in a sophisticated medical records system that won DMC national recognition for its information technology."[7] This level of investment by DMC should increase DMC's marketability to potential suitors, and, moreover, should be considered in the Attorney General's determination whether Vanguard's proposal undervalues DMC.

In particular, Ascension, Trinity and CHI are all investing heavily in information technology in order to streamline patient care and take advantage of the benefits provided by the recent health care bill. Ascension is parent to an IT services company, Ascension Health Information Services ("AHIS"), one of

[1] Standard and Poor's. Global Credit Portal Ratings Direct. "U.S. Not-For-Profit Health Care System Fiscal 2009 Ratios Show Moderate Improvement" July 26, 2010. p.4. The median days cash on hand metric was 168.5 days as of December 2009,

[2] Rogers, Christina. The Detroit News. "Vanguard's cautionary Chicago story" June 21, 2010. Retrieved from: http://detnews.com/article/20100621/BIZ/6210321

[3] Rogers, Christina. The Detroit News. "Vanguard's cautionary Chicago story" June 21, 2010. Retrieved from: http://detnews.com/article/20100621/BIZ/6210321

[4] Desai, Suzie. Standard and Poor's RatingsDirect. "Michigan State Hospital Finance Authority Detroit Medical Center" March 31, 2010.

[5] Anstett, Patricia. "One-Stop Safety for Patients and Doctors," Detroit Free Press. August 16, 2010.

[6] Anstett, Patricia. "One-Stop Safety for Patients and Doctors," Detroit Free Press. August 16, 2010.

[7] Devitt, Caitlin. "Deal in Focus: Detroit Medical Center Prepares to Enter Market After 10 Year Absence," The Bond Buyer. October 1, 2008.

the largest healthcare IT companies in the country. AHIS provides software applications, including electronic medical records and support and training for hospitals throughout the Ascension system.[8]

In June this year, Catholic Health Initiatives "launched a national clinical information-technology program that is very ambitious and very comprehensive."[9] As part of this effort, CHI will hire 200 specialists in order to "implement a $1.5 billion clinical IT enhancement program" that will focus on "standardization of clinical documents, bar-coded medication administration and computerized physician order entry."[10]

Each of these systems has been making major advances in implementing the most up-to-date IT infrastructure. Any of them, therefore, would be well-positioned to incorporate DMC, which has demonstrated a high level of preparedness in terms of electronic medical records and other IT infrastructure. As a result, DMC is well-positioned to be an attractive acquisition, especially in light of healthcare reform.

STABILITY IN THE CREDIT MARKETS OFFERS DMC AN OPPORTUNITY TO ISSUE DEBT

DMC CEO Mike Duggan has said that capital and operational improvements would improve DMC's margins.[11] We encourage the Attorney General to urge DMC to access the bond markets in order to raise the needed capital to fund DMC's expansion needs.

UNFORTUNATE TIMING RESULTED IN UNSUCCESSFUL BOND ISSUANCE TWO YEARS AGO. In September 2008, as national credit markets were freezing up and the national economy was heading into crisis, DMC unsuccessfully tried to issue $340 million in bonds. The bond issue was approved by the Michigan Hospital Financing Authority, but extreme volatility in the market during that period and DMC's speculative credit rating (BB-) would have forced the hospital to pay up to 8.5% in interest payments.[12] However, Standard and Poor's seemed to view the 2008 bond issuance favorably, noting that the transaction would "provide immediate reimbursement estimated to be at least $40 million, which adds eight days' cash on hand" and "help boost liquidity over the next two years."[13] Further, in anticipation of the sale, Fitch Ratings upgraded DMC and Moody's and S&P both affirmed their ratings.[14]

At that time, DMC CFO Jay Rising stated that DMC would forego the transaction until interest rates became more stable. Since October 2008, short-term interest rates have fallen in comparison to long-term interest rates[15] and yet there is no evidence that DMC tried to access the capital markets before DMC management and the Board entered into acquisition discussions with Vanguard.

Although DMC's 2008 bond issuance may have suffered from the condition of the national credit markets at that time, we think Wall Street may now have an appetite for tax-exempt debt, as evidenced by the success that DMC's nonprofit peers experienced in raising debt this year.

A NEIGHBORING SYSTEM, HENRY FORD HEALTH SYSTEM RECENTLY ISSUED DEBT. Henry Ford Health System, a hospital system with similar operating margins as DMC, issued over $300 million in October

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8 Ascension Health Information Services website. http://www.ascensionhealth.org/index.php?option=com_content&view=article&id=285&Itemid=233

9 Sealover, Ed. "Catholic Health Initiatives Will Hire 200," Denver Business Journal. June 11, 2010.

10 Sealover, Ed. "Catholic Health Initiatives Will Hire 200," Denver Business Journal. June 11, 2010.

11 Greene, Jay. Crain's Detroit Business. "Risks to selling, risks to not selling for DMC" April 25, 2010.

12 Anstett, Patricia "Trinity, DMC Can Sell Bonds; Medical Center Must Wait on Old Debt," Detroit Free Press, October 9, 2008.

13 Sweeny, Liz. Standard and Poor's RatingsDirect. "Michigan State Hospital Finance Authority Detroit Medical Center" September 29, 2008.

14 Devitt, Caitlin. "Deal in Focus: Detroit Medical Center Prepares to Enter Market After 10 Year Absence," The Bond Buyer. October 1, 2008.

15 Bloomberg US Municipal Healthcare Yield Curve on October 8, 2010.

2009 despite facing challenges "related to what is one of the weakest economies in the nation" which include operating losses, an underfunded pension plan, and a "decline in insurance revenues as automakers continue to lay off workers and cut back on employee benefits" according to a Moody's analyst.[16] Despite these challenges, the bond issuance was successful and almost a third of the proceeds is slated toward the reimbursing the system for "for capital spent on construction of a new 300-bed hospital located in West Bloomfield as well as renovations at the system's main campus in Detroit."[17]

DMC faces similar challenges; however a comparison between both systems shows that during fiscal year 2009, DMC actually achieved higher profitability and interest coverage ratios. In addition to positive operating margins, DMC has other notable strengths according to Standard and Poor's including sizeable market share and a strong management team that has helped to turn the hospital around after several years of deteriorating performance.[18]

TABLE 3: COMPARISON OF KEY FINANCIAL INDICATORS FOR DMC AND HENRY FORD HEALTH SYSTEM

As of 12/31/2009	DMC	Henry Ford
Revenue ($M)	$2,089M	$3,968M
EBIDA margin	5.4%	3.8%
Operating margin	0.0%	-0.3%
Interest coverage	3.9x	2.8x
LT Debt	$490M	$871M
LT Debt / Assets	38.9%	28.7%
Days cash on hand	15.2	89.6

Source: Company Audited and Unaudited Financial Statements.

Additional Michigan hospital systems that issued debt in the last year include MidMichigan Health, which issued $85.2 million in June 2009,[19] and Trinity, which issued $343 million in October 2010, $143 million or over 40 percent of which was issued in Michigan.[20] These recent successful debt offerings by other nonprofit hospital systems suggest that DMC would receive a warmer welcome now on Wall Street than it did in 2008.

We understand your Office may be concerned with respect to a recent ratings outlook revision by Moody's from "Stable" to "Negative." However, it is important to note that Moody's did not downgrade DMC.[21] Standard and Poor's, like Moody's also cites low liquidity as significant source of concern. However, a bond issuance could address DMC's low liquidity. Indeed, Standard and Poor's acknowledged that "DMC was aiming to further strengthen its liquidity levels with a financing in 2008 that did not materialize, given the challenges of the bond and investment market in the fall of 2008."[22]

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16 Devitt, Caitlin. "Henry Ford Health Offering $322M to Expand Reach," The Bond Buyer. October 13, 2009.

17 Devitt, Caitlin. "Deal in Focus: Detroit Medical Center Prepares to Enter Market After 10 Year Absence," The Bond Buyer. October 1, 2009.

18 Desai, Suzie and Brian T. Williamson. "Michigan State Hospital Finance Authority: Detroit Medical Center; System," Standard & Poor's Global Credit Portal. March 31, 2010.

19 Desai, Suzie and Antoinette W. Maxwell. "Michigan State Hospital Finance Authority: MidMichigan Health; System," Standard & Poor's Global Credit Portal, July 25, 2010.

20 Holloran, Kevin and Martin D. Arrick. "Michigan Finance Authority: Trinity Health; CP; System," Standard & Poor's Global Credit Portal, September 27, 2010.

21 De Lombaerde, Geert. Nashville Post. "Moody's goes negative on Vanguard's Detroit buy" September 28, 2010. Retrieved from: http://business.nashvillepost.com/2010/09/28/moodys-goes-negative-on-vanguards-detroit-buy/

22 Desai, Suzie and Brian T. Williamson. "Michigan State Hospital Finance Authority: Detroit Medical Center; System," Standard & Poor's Global Credit Portal. March 31, 2010

DMC's low liquidity is due in part to significant investments DMC has made. According to DMC's CFO "Everyone else is going to have to catch up with us on pension and IT"... "It really drained our cash for the past couple years, but it put us in a great position."[23] These investments speak positively to the strength of DMC. We encourage the Attorney General to seriously consider the option of urging DMC to issuing new debt rather than converting to a for-profit entity.

DMC may be able to remain a sustainable independent charitable institution if it could fund its capital needs by issuing debt. DMC and the Detroit community could then reap the rewards from DMC's skilled management team and DMC's solid financials. Remaining independent would also allow the benefits of DMC's capital improvements to accrue to the City of Detroit and the State of Michigan, and could spur job development as well. As such, we encourage the Attorney General to consider this alternative before approving a sale of the system to Vanguard.

RETAINING AN INDEPENDENT NONPROFIT HOSPITAL SYSTEM IS A BETTER SOLUTION FOR DETROIT. Michigan has traditionally been served by nonprofit hospitals. Therefore, there are significant implications if the proposed sale of DMC to Vanguard is approved. Vanguard would be the first large for-profit chain operating in the state. Moreover, DMC is the largest Medicaid and charity care provider in the state.[24] Efforts to help DMC remain an organization with a charitable mission would preserve this important safety net for Detroit. At the very least, the Attorney General must be satisfied, before approving this transaction, that it would not impair the charitable mission of the existing DMC network or restrict access to medical care for Michigan consumers.

In summary, there are many favorable options available to DMC, especially in light of the low price-to-revenue multiple that Vanguard is offering. Accordingly, we urge the Attorney General to conduct a full review of the strategic options and believe that the DMC board must fulfill its fiduciary duty to ensure that an appropriate long-term solution is chosen for DMC, the people of Michigan, and, in particular, the community of Detroit.

Sincerely,

Sandra Sebastian
Research Coordinator
Service Employees International Union

CC: Tracy A. Sonneborn, Assistant Attorney General
Michigan Attorney General's Office, Consumer Protection and Charitable Trusts

Marge Faville, RN President SEIU Healthcare Michigan

[23] Devitt, Caitlin. "Deal in Focus: Detroit Medical Center Prepares to Enter Market After 10 Year Absence," The Bond Buyer. October 1, 2009.

[24] Sweeny, Liz. Standard and Poor's RatingsDirect. "Michigan State Hospital Finance Authority Detroit Medical Center" September 29, 2008.