Legacy DMC

April 15, 2015

Mr. William R. Bloomfield
Michigan Department of Attorney General
Corporate Oversight Division
Charitable Trust Attorney

Dear Mr. Bloomfield:

The purpose of this letter is to provide Legacy DMC's fourth annual report covering VHS of Michigan's compliance with respect to certain Post-Closing Covenants contained in the Purchase and Sales Agreement (PSA) among the Department of Attorney General, Legacy DMC, VHS of Michigan, Inc. and Vanguard Health Systems, Inc. Legacy DMC is required to report annually on the status of these commitments by Article 3 (Item E) of the Monitoring and Compliance Agreement among the same four parties.

Article 12 of the PSA, Post-Closing Covenants of Buyer, established 20 Post-Closing Covenants, which are provided for reference in Attachment 1 (Tab 2). A list of these Covenants along with the related reporting and monitoring responsibilities is provided in Attachment 2 (Tab 3). As shown by underline, VHS of Michigan (VHS) is required to report to Legacy DMC (Legacy) annually on 15 of the 20 Covenants.

The annual VHS Report provides information regarding the status at the end of 2014 for each of the 15 covenants for which status reporting was required. Note that Legacy is required to monitor seven of the Covenants – all of which are included in the VHS Report.

During 2013, Tenet Healthcare Corp. (Tenet), a Dallas-based company, purchased Vanguard Health Systems, Inc. including its subsidiary VHS of Michigan. Tenet has acknowledged its obligation to fulfill the commitments established in the PSA as conditions of the sale of the Detroit Medical Center.

SUMMARY OF COMPLIANCE MONITORING

Legacy has established quarterly reviews relating to four critical Covenants: the two capital spending commitments, the indigent care commitment, and the commitment to maintain the six hospitals and their key lines of service. Information relating to these four commitments is reviewed by Legacy's Board of Trustees as soon as practicable, usually two months after each quarter-end. Related matters, such as the hotline, escrow transactions, and the Karmanos-DMC dispute are also reviewed at these meetings. Information on the other commitments (research, education, health and wellness initiatives, etc.) is provided by VHS in its annual report and reviewed then.

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VHS submitted its 2014 Report on February 27, as required. The VHS Report (Tab 9) provides excellent updates on all commitments and includes six Exhibits. Once again, no escrow deposit relating to the Specified Capital Expenditures was required. VHS has raised the potential for a $100 million reduction to the escrow requirement at the end of 2015, based on a PSA provision relating to federal and state subsidies.

Legacy believes that all minimum commitments have been met at the end of 2014. Specific observations on the monitored Covenants are provided below and on the following pages. Attachment 3 (Tab 4 - *Fourth Year Status Summary*) provides a summary of the compliance situation. It identifies the following issues: the continuing risk of a shortfall to the Routine Capital Expenditures Commitment at the end of 2015, the ongoing Karmanos litigation, the escrow reduction issue, and the delay of completion of the Children's Hospital Tower to 2017.

INDIGENT AND LOW INCOME CARE

The VHS Report states that Tenet has continued the "more benevolent" charity care policy established in 2011 at the time of the Vanguard purchase. DMC's executives have regularly confirmed this at meetings with Legacy's Board.

Legacy reviews financial statement expense data relating to charity care and bad debt each quarter. The VHS Report included 2014 expense data that is consistent with these quarterly reviews. These expenses have decreased dramatically as a result of the combined effects of the Affordable Care Act and the state of Michigan's expansion of Medicaid eligibility.

The VHS Report includes information on its successful efforts to identify and enroll patients in these programs in the discussion of Health and Wellness Initiatives on page 11 and Exhibit E. Tenet has classified the charity care and bad debt expense information in the VHS Report (Exhibit A) as confidential.

The VHS Report mentions that the reduction in the cost of uncompensated care must be balanced against "... future reductions ... in support for programs directly beneficial to the DMC". To the extent that these reductions adversely affect the financial results of a DMC hospital, the PSA provides for a modified escrow threshold in 2015. (Exhibit B-3 of the VHS Report provides additional information.)

Legacy operates a telephone hotline and email and postal addresses to obtain patient complaints relating to indigent care; it also reviews DMC's ombudsman records to identify issues associated with the charity care policy. There were no actionable complaints in 2014.

Legacy believes that the DMC hospitals continue to provide patient treatment that is consistent with the charitable care policy that was implemented in January 2011 and that this key commitment has been met.

HOSPITALS AND CORE SERVICES

The VHS Report for 2014 provides information on the event that led to the "cessation of services" at the Detroit Surgery Hospital located in Madison Heights and confirms that the six hospitals referenced in the PSA and their lines of service have been maintained. Legacy agrees that this key commitment has been met. Attachment 4 (Tab 5) provides the list of hospitals and services.

CAPITAL EXPENDITURES

VHS reported capital expenditures of $84.9 million in 2014 for the Specified Capital Projects. Cumulative expenditures on the Specified Projects total $359.5 million at the end of 2014. This amount exceeds the $320 million escrow threshold, so no escrow deposit was required.

The VHS Report provides information on the three projects completed in 2014; one of these, the Heart Hospital, will require expenditures in 2015 and 2016 to finish out certain floors. Ten of the 15 projects are now "substantially complete". VHS plans to complete three more in 2015, one in 2016, and the Children's Hospital Tower by the end of 2017 (see Exhibits B-1 and B-2 in the VHS Report). VHS forecasts that total expenditures on these 15 projects will meet or exceed its $500 million commitment, and project expenditures to date support that position.

The VHS Report provides a brief discussion of the reasons for delayed construction of the Harper-Hutzel Ground Floor Master Plan and the Children's Tower. Both have had substantial building design changes from the original projects.

The PSA provided for an additional two years to complete the Children's Hospital Tower including specific escrow requirements for 2015 and 2016. VHS proposed an additional extension of six months (to June 2018). Legacy, which understands and supports the revised design, suggested that the extension should take the form of an amendment to the PSA and proposed an additional amendment to establish a procedure to deal with the possibility of a shortfall to the Routine Capital Expenditure Commitment. VHS subsequently concluded, as noted in its Report that the PSA provides "necessary flexibility". (Neither proposal was agreed and the PSA remains unamended.)

With respect to the commitment relating to Routine Capital Expenditures, VHS reported expenditures of $70.1 million in 2014, about $9 million less than the 2014 budget amount provided in last year's report. Expenditures from 2011 to 2014 total $220 million, $20 million more than the cumulative requirement of $200 million (four years at the annual minimum of $50 million). For the first time, accumulated expenditures for Routine Capital exceed the minimum requirement.

Legacy has expressed its concern about the risk of a shortfall to this commitment in previous reports because of the continuing low rate of spending in this category. In 2015, the VHS budget for Routine Capital Expenditures is $130 million, more than double the annual rate of the first four years.

The VHS Report includes a good description of the new process it has put in place to meet the commitment. Also, for the first time, it provides substantial detail on its planned expenditures. Its executives regularly attend Legacy Board meetings to explain results and answer questions, including detail on specific projects in individual hospitals. Legacy believes that the new process has reduced, but not eliminated, the risk that routine capital expenditures may fall short of the $350 million commitment.

Attachment 5 (Tab 6) provides a dashboard used to track routine spending in 2014. Note that December was the first month in 2014 that expenditures exceeded the level of spending required to recover from the minimum investments in the first three years.

As noted in last year's report, the PSA does not define a remedy for an expenditure shortfall at the end of 2015. VHS and Legacy have agreed to meet after actual mid-year expenditures are available to assess progress and develop a plan to deal with a shortfall if one appears likely.

An independent certified public accounting firm reviewed the capital expenditure information pursuant to the agreed upon procedures included in the PSA. Legacy was provided with a copy of the related report, which did not note any exceptions to the reported capital expenditure figures. (It was included in the VHS Report, but classified as confidential.)

SALE OF HOSPITALS

The VHS Report confirms that no sale has occurred.

COMMITMENT TO EDUCATION AND RESEARCH MISSIONS

The VHS Report provides substantially improved discussion and supporting information relating to its commitments to education (Exhibit C) and research (Exhibits D-1 and D-2). These activities are critical functions of the DMC hospitals and they continue to receive management support.

KARMANOS CANCER INSTITUTE

The VHS Report provides information on the legal dispute between the DMC and Karmanos, which remains unsettled.

HEALTH AND WELLNESS INITIATIVES

The VHS Report includes information on its new "Path to Health" initiative to maximize enrollment of uninsured individuals in the insurance exchanges and make them aware of the State's expansion of Medicaid. Exhibit E provides an excellent overview of the effort and outcome of the program. Exhibit F, the DMC's Annual Report, is provided for the first time; it provides information on patient safety and service quality initiatives.

OTHER COMMITMENTS

As mentioned above, the VHS Report provides the required confirmation of compliance with several additional commitments, including the Warrant (no change), Supplier Diversity (updated with 2014 data), Project Genesis (updated with 2014 data) and Naming Conventions (no change).

CONCLUSION

Legacy DMC believes this year's report from VHS of Michigan is complete and informative. Information on the Health and Wellness initiatives is expanded and relates directly to the reduced cost of uncompensated care. Capital expenditures for Specified Projects were sufficient to avoid a deposit to the Escrow Account, and, for the four-year period, Routine spending exceeded the minimum requirement for the first time. All other commitments were met.

In 2015, Legacy DMC will work with VHS of Michigan to monitor the final year of the Routine Expenditure Commitment, progress on the remaining Specified Capital projects (particularly the Children's Hospital Tower), and the outcome of the dispute with Karmanos. If VHS proposes a reduction to the scheduled escrow threshold relating to Specified Capital Projects, Legacy will review all relevant information (uncompensated care, changes in state and federal funding, etc.) affecting the request.

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Cc. Mr. Trevor Fetter
Mr. Joseph Mullany