

Legacy DMC

June 30, 2018

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 seventh 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 2017 for each of the 15 covenants for which status reporting is 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 several critical Covenants: the remaining capital spending commitment, the indigent care commitment, and the commitment to maintain the six hospitals and their key lines of service. Information relating to these commitments is reviewed by Legacy's Board of Trustees as soon as practicable, usually two months after each quarter-end. 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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In 2017, Board discussions focused on its serious concern about the DMC's continuing negotiations with the Wayne State University Medical School; Legacy DMC considers this relationship – or an equal or better relationship with a new academic partner - critical to maintaining the DMC's reputation as an elite teaching and research hospital system and to ensure its compliance with the PSA's Research and Education commitments. Trustees have met with top executives from both organizations to express this concern and offer assistance.

Board discussions also focused on the potential negative impact on the quality of patient care of the decline in capital spending and announced layoffs and other expense cuts. The dispute relating to Tenet's failure to make a required escrow deposit was resolved.

VHS submitted its 2017 Report on February 28, as required. The VHS Report (Tab 8) provides updates on all commitments and includes seven Exhibits. Subsequent to the filing date, an issue relating to care for indigent and low income patients was raised and there were substantive developments with respect to contracts with Wayne State University's Medical School. DMC provided information on these matters which is referenced in this report.

Attachment 3 (Tab 4 - *Tenet Covenants as of 2017*) provides a summary of Legacy DMC's view of the compliance situation as well as risks that could adversely affect forward years.

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. From that date, Legacy DMC also established various methods to monitor DMC's compliance to ensure that indigent and low income patients would receive necessary medical care; these methods included posting notifications in the hospitals, reviewing DMC's internal ombudsman reports, and quarterly reviews of uncompensated care expense.

(Uncompensated care expense combines charity care and bad debt expense and is used by CMS in Medicare and Medicaid policies and procedures. Legacy DMC believes that uncompensated care expense provides a more complete view of costs incurred in treating low income and indigent patients.)

The notifications are posted in 65 locations including all emergency departments and next to the notice boards in the financial service desks in each DMC hospital. The notices provide patients and others with a telephone hotline and email address for reporting complaints. During 2017, Legacy DMC received no actionable complaints relating to charity care; other comments, complaints and request were appropriately re-directed. (These included questions on financial support and billing errors.)

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Although Legacy DMC received no charity care complaints and did not identify any in its review of ombudsman records, a union seeking to represent nurses at Huron Valley Sinai Grace Hospital believes that care for the indigent at the DMC has declined based on its analysis of the substantial decline in DMC's charity care expense (one of the two components of uncompensated care) between 2013 and 2016.

Legacy DMC had identified the substantial decline in uncompensated care expense and included an appropriate explanation of the decline in its annual reports starting in 2014 and in following years. The DMC also noted the decline in its annual reports; its reports added that the benefits of this reduction need to be balanced against reductions in other federal and state medical care payments that have been beneficial to the DMC. Legacy DMC believes that the overall effect of reimbursement changes has been significantly favorable to the DMC hospitals.

Many factors have affected uncompensated care expense but the most obvious ones are the launch of the Affordable Care Act (ACA) and the State of Michigan's expansion of eligibility for Medicaid (the Healthy Michigan program) which allowed many previously uninsured individuals to obtain insurance to cover their medical needs. Both took effect in April 2014 and were clearly effective in reducing the need for uncompensated care in southeast Michigan. DMC, which operates two "safety net" hospitals, benefitted, as did other area providers. The decline is evidence of the success of these two government programs.

Another important factor was DMC's intense and continuing effort to assist individuals to enroll for insurance coverage. Its "Path to Health" program has enrolled over 65,000 individuals since the expanded federal and state programs became available. The cost of medical care for many, if not most, of these individuals would have been previously classified as charity care expense. In addition to continuing its monitoring of uncompensated care expense, Legacy DMC has taken the following actions to ensure it will be aware of indigent care issues:

- Legacy DMC completed an inventory of the 65 notification locations; it confirmed that signage continues to be displayed prominently. The DMC reacted quickly to correct a few discrepancies that resulted from the extensive construction project at Harper Hospital. Also, notices will be placed in five additional locations.
- Legacy DMC will establish an additional source of feedback on potential issues through regular contact with a number of Federal Qualified Hospital Centers (FQHC) that provide service in DMC's market area.
- Legacy DMC reviewed additional information on Medicaid patient days, expense and payments as well as similar information for the uninsured provided by the DMC. These data present a positive picture of continuing and increasing care for qualified patients – not a decline.

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Based on the review of the additional information and the other actions described above, Legacy DMC believes that care for indigent and low income patients has not declined at the DMC hospitals. The cost of treating patients previously reported as charity care or bad debts are now billed to Medicaid or to an insurer. We believe that the DMC is providing the care to the indigent and low income patients this Covenant was established to protect.

HOSPITALS AND CORE SERVICES

The VHS Report for 2017 confirms that the six hospitals referenced in the PSA and their lines of service have been maintained. It provides information on the event that led to the "cessation of services" at the Detroit Surgery Hospital located in Madison Heights. 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 \$38 million in 2017 for Specified Capital Projects – mainly continuing construction of the Children's Hospital Tower. Cumulative expenditures for the Specified Projects total \$533 million at the end of 2017, which exceeds its \$500 million commitment (see Exhibit C in the VHS Report).

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 as Exhibit D and classified as confidential.)

As noted in Legacy DMC's 2015 and 2016 reports, Tenet had failed to make a required escrow deposit at the end of 2015. During 2017 this matter was settled with an agreement to purchase emergency department equipment totaling \$2.5 million split between the two safety net hospitals.

As noted in Legacy DMC's 2016 report, an annual capital expenditure of \$50 to \$70 million is required to preserve the facility and equipment improvements realized in the DMC's six hospitals since the sale. In 2016, routine capital expenditures fell well below this level. In 2017, these expenditures achieved the minimum level. Although the PSA Covenant governing capital expenditures expired in 2015, Legacy DMC will continue to monitor capital spending in view of its importance in ensuring the continuing vitality of the DMC. The DMC has been more responsive in providing requested information about its spending.

SALE OF HOSPITALS

No sale has occurred.

COMMITMENT TO EDUCATION AND RESEARCH MISSIONS

The VHS Report includes its annual report on Graduate Medical Education (Exhibit E) and its 2017 report includes additional information on this critical function as well as on its research service agreements. DMC executives also provided the Legacy DMC trustees with updates on its ongoing education and research efforts and confirmed that these activities are critical functions of the DMC hospitals.

The executives also discussed the DMC's plan to be ranked among the top 15 academic medical centers and its report notes a substantial improvement in its Watson (formerly Truven) national ranking from the 20th to the 50th percentile. Continued improvement will be required to meet the DMC's stated goal.

Notwithstanding these assurances, the DMC and Wayne State's School of Medicine have been unable to reach agreement on extending their clinical and administrative services contracts despite several extensions. At one point, it appeared that these contracts would be terminated abruptly. As noted earlier, Legacy DMC trustees have met with both parties to encourage a resolution that maintains the DMC's reputation and enhances patient care.

Recently the two parties have announced a two-part, six month agreement: first, an Advisory Board will resume negotiations on contract extensions with a deadline of September 30th; second, for any contracts which cannot be agreed by that time, they will be extended for an additional three months so both parties can make arrangements to maintain service.

Legacy DMC believes that effective research and education arrangements are necessary to avoid an adverse effect on the DMC and the patients it serves. Legacy DMC will review the results of the negotiations to assure that the DMC's commitments in the PSA to continue to support the hospitals' research and education missions are maintained and not jeopardized.

KARMANOS CANCER INSTITUTE

The VHS Report summarizes the 2015 Settlement Agreement and provides an update on how both parties continue to abide by the agreement and meet the needs of the community.

HEALTH AND WELLNESS INITIATIVES

The VHS Report includes information on the evolution of its "Path to Health" enrollment program initiated in 2015 to enroll uninsured individuals in either the insurance exchanges or Medicaid. Exhibit F provides detailed information on the program and reports that over 65,000 individuals have benefitted from this effort. It notes that the initial outreach and enrollment effort has evolved to focus on annual communications and reliance on in-hospital Certified Application Counselors.

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Patient safety and quality are not specifically identified as commitments within the PSA, but Legacy DMC monitors Leapfrog reports, which provide an independent evaluation of hospital outcomes. Continuous improvement in these publicly available quality measures will be essential for DMC's success.

OTHER COMMITMENTS

As mentioned above, the VHS Report provides the required confirmation of compliance with several additional commitments, including the Warrant (no longer applicable), Supplier Diversity (updated with 2017 data), Project Genesis (Exhibit G) and Naming Conventions (no change).

CONCLUSION

Legacy DMC believes this year's report from VHS of Michigan is complete.

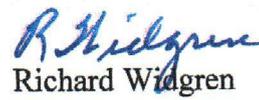
As noted above, the DMC hospitals have continued their long-standing record of care for the indigent and complied with the related Covenant. The final Specified Capital Project, the Children's Hospital Tower, is now scheduled to be completed and total capital expenditures will exceed the requirement.

In 2018, Legacy DMC will review the outcome of the negotiations with the Wayne State University School of Medicine. It will also continue to champion increased spending on facilities and equipment, improvement in patient safety and quality scores and progress on achieving DMC's goal to be ranked among the top 15 teaching hospitals. Finally, it will closely monitor potential adverse changes to federal and state subsidies for the indigent.

The aim of these efforts will be to mitigate risks to the DMC's progress to date in the forward years.



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