



**VHS OF MICHIGAN, INC**

**2016 ANNUAL REPORT  
TO LEGACY DMC**

**February 28, 2017**

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VHS of Michigan, Inc. hereby presents to the Legacy DMC its 2016 Annual Report. The 2016 Annual Report intends to provide Legacy DMC with a description of the performance through December 31, 2016 by VHS of Michigan, Inc. (“VHS” or “DMC”) in maintaining compliance with the various covenants assumed by DMC.

This report has been prepared and is being delivered for the calendar year period ending December 31, 2016 in accordance with Section 12.17 of the Purchase and Sale Agreement by and among the Detroit Medical Center, Harper-Hutzel Hospital, Detroit Receiving Hospital and University Health Center, Children’s Hospital of Michigan, Rehabilitation Institute of Michigan, Inc., Sinai Hospital of Greater Detroit, Huron Valley Hospital, Inc., Detroit Medical Center Cooperative Services, DMC Orthopedic Billing Associates, LLC, Metro TPA Service, Inc., Michigan Mobile PET CT, LLC, DMC Primary Care Services II and Healthsource, as Seller, and VHS of Michigan, Inc., VHS Harper-Hutzel Hospital, Inc., VHS Detroit Receiving Hospital, Inc., VHS Children’s Hospital of Michigan, Inc., VHS Rehabilitation Institute of Michigan, Inc., VHS Sinai-Grace Hospital, Inc., VHS Huron Valley-Sinai Hospital, Inc., VHS Detroit Businesses, Inc., VHS Detroit Ventures, Inc., VHS University Laboratories, Inc., VHS Physicians of Michigan and CRNAS of Michigan, as Buyer, and Vanguard Health Systems, Inc. dated as of December 31, 2010 (the “Agreement”).

As in prior years, this Annual Report has been organized by section of the Agreement relating to a specific covenant assumed by DMC. Various documents and information supporting DMC’s performance or providing detail related to a particular matter are included as Exhibits to this Annual Report.

### **Management Overview of 2016**

Although 2016 saw many accomplishments and improvements in patient care effectiveness, it was a challenging year for DMC both operationally and financially.

While achieving greater than 100% of Tenet balanced scorecard measures in quality (based on specific outcomes measures for our patients) and people (achieved employee % turnover targets), slight declines in volume over the last six months of the year from target put pressure on the operations of DMC. While the overall SE Michigan market IP discharge volume was flat year over year, DMC saw a small decrease in discharges from prior year. This decrease accelerated in the 4th quarter as we dealt with fallout from problems with our processes in Central Sterile Processing that were highlighted in local media. It is important to note that although DMC's instrument processing issues did not impact patient outcomes, they did impact public and physician perception of DMC. We are working aggressively to address these issues and are implementing best practice processes in Central Sterile Processing as we move forward.

For 2017, we will continue to move forward with best practices as identified and a culture of excellence and accountability aiming to be a top 15 U.S. academic medical system as measured by Truven. The metrics needed to meet this qualification are consistent with those CMS now uses in their STAR ratings (1-5). These star ratings are extremely important as they carry financial penalties from CMS for poorer performing hospitals. The measures we will focus on

consist of improving the health of the communities we serve by reducing hospital acquired conditions and readmission rates. We will continue to work with post-acute providers as well to ensure the ongoing health of our patients.

There are many exciting programs for our physicians and our community including growing strength in our orthopedic and cardiovascular service lines. In addition, DMC's ongoing partnerships with McLaren/Karmanos for oncology services and Wayne State University School of Medicine for teaching, research and clinical will enhance the services provided to DMC's patients. As the Children's Hospital of Michigan hospital satellite opened in Troy in 2016 serving the broader communities of SE Michigan, the brand new Children's Hospital replacement tower will be opening this year offering an even higher level of quality service to SE Michigan with all new private rooms for neonatal and pediatric ICU's.

In addition, consistent with 2016, in 2017 investments in strategic, routine and infrastructure will continue. In 2016 there were many capital expenditures of this type. In the first quarter, amounts in excess of \$5M were spent to bring the new Children's Hospital of Michigan Troy location online. Also approved in the first quarter and expended during the year was approximately \$6.5M for Cerner's ambulatory electronic medical record (EMR) designed to better connect DMC's employed physicians and hospital based clinics in order to better coordinate care for the patients in our community. Expenditures of approximately \$10M were made for back-up power generation and latest generation anesthesia machines campus-wide. New robotic technology for DMC's orthopedics service line was implemented as well. As we move into 2017, we have already committed to a capital project of approximately \$10M to replace our telecom and pbx systems.

Although, we do not know what the repeal of the Affordable Care Act will bring, DMC remains committed to serving our Southeast Michigan community of patients. The impact of repeal could be significant as prior to the passage of Obamacare, DMC provided and wrote off charges of \$275M annually for indigent care. This amount dropped to approximately \$120M annually with the passage of Medicaid expansion (Healthy Michigan) for Michigan residents in April, 2014. We will continue to work with federal and state legislators so that this level of coverage remains in effect for Detroit and all Michigan residents.

#### **Indigent and Low Income Care** (Section 12.2)

In compliance with Section 12.2 of the Agreement, during 2016 DMC has maintained compliance with the Vanguard Health System charity care policy in place on June 10, 2010, as was required under Schedule 12.2-a to the Agreement. This charity care policy has remained in effect through the acquisition of Vanguard Health System by Tenet Healthcare Corporation ("Tenet") in 2013.

Exhibit A provides information related to charity care and uncompensated care or bad debt for 2016 and trends from 2011 to 2016.

As reported in the 2014 Annual Report to Legacy DMC, the DMC's *Path to Health* campaign experienced greater success than projected. This program was a significant effort to enroll

uninsured residents in Southeast Michigan in Medicaid and, if unqualified for Medicaid, with Exchange plans.

The increase in the number of insured patients receiving services continued in 2015 with 2015 being the first full year of expanded Medicaid coverage. Consequentially, charity care and uncompensated care write-offs reported on the financial statements of the DMC in 2015 declined significantly.

Charity care and uncompensated care write-offs in 2016 continued at this new, lower rate, but did show a 4% increase since 2015 (Refer to Exhibit A, Page 4).

However, the financial effects of Medicaid expansion must be balanced, in 2015 and over time, with the federal reductions in Medicare DSH, the future reductions in Medicaid DSH ceilings and in targeted State reductions in support for programs directly beneficial to the DMC. Examples of the reductions are the loss of special Medicaid funding to Hutzel Women's Hospital at \$20M and continued pressure on Graduate Medical Education funding.

### **Commitments to Maintain the Hospitals and Provide Core Services** (Section 12.3)

As required by the Agreement, DMC continues to maintain each of its Hospitals as a general acute hospital licensed in the State of Michigan or, in the case of the Rehabilitation Institute of Michigan, as a rehabilitation hospital licensed under the laws of the State of Michigan. DMC continued to provide the Core Services as listed on Schedule 12.3 of the Agreement throughout 2016.

On August 11, 2014, an historic rainfall in Southeast Michigan caused flooding which resulted in significant damage to the Detroit Surgery Hospital in Madison Heights, including damage to its power plant, HVAC, central sterile processing and food service areas, and contamination to large areas of its basement. This event forced the relocation of all patients and clinical services from the Detroit Surgery Hospital to other DMC in-patient and out-patient facilities and the cessation of services at that site. The building is currently in the process of being sold to an outside party and the sale is anticipated to be completed in early 2017. DMC has relocated the medical and surgical bed licenses to Children's Hospital of Michigan and the psychiatry bed licenses and services to Sinai-Grace Hospital in 2016.

At the time of execution of the Agreement, the Detroit Surgery Hospital was part of the Harper-Hutzel Hospital tax identification number and services it rendered were billed under that number. For that reason, the Detroit Surgery Hospital was not separately listed as a hospital in the definition of a "Hospital" under the Agreement, but was instead a separately listed component comprising part of Harper-Hutzel Hospital.

### **Capital Expenditures** (Section 12.4)

Under Section 12.4 of the Agreement, DMC is obligated to make certain "Routine" and "Specified" Capital Project Expenditures within prescribed periods. Exhibit B provides information related to Routine Capital Expenditures for the five year period from January 1, 2011 through December 31,

2015. Exhibit C provides information related to Specified Capital Project Expenditures for the six year period from January 1, 2011 through December 31, 2016 Actual/CY 2017 Forecast.

- *Routine Capital Expenditures*

Routine Capital Expenditures (also called “Non-Specified” Project Capital in certain reports), which are governed by Section 12.4(a) of the Agreement, totaled \$346.1 million over the five year period from January 1, 2011 through December 31, 2015. The requirement per the Agreement was \$350M and with some carryover into Q1 2016, the \$350M commitment has not only been met but exceeded.

- *Specified Capital Project Expenditures*

Actual expenditures for Specified Capital Projects in the 2016 CY totaled \$75.1 million, for a cumulative total of \$494.6 million since 2011. The DMC expects to meet the \$500 million threshold by the end of February, 2017. The largest project in 2016 was the continuing construction of the Children’s Hospital of Michigan Tower Project, which includes the renovations and backfill of the Carl’s Medical Office Building. Portions of the new building will open in spring 2017 and construction will be complete in 2017.

DMC management projects that total spending on Specified Capital Projects will exceed the commitment amount by \$46M by the end of 2017.

Additionally, the following projects were completed in 2016:

- Harper Hospital Unified Lobby Phase II
- Harper Hospital Ground Floor Master Plan

Exhibit C includes:

- Specified Capital Expenditures CY 2011-2016 Actual/CY 2017 Forecast
- Specified Capital Projects – Forecasted Requirements CY 2017
- Specified Capital Project Expenditure Schedule
- Projected Specified Capital Forecast By Project/By Quarter

- *Agreed-Upon Procedures Report*

Pursuant to Section 12.17(a) of the Agreement, the Deloitte & Touche Independent Accountant’s Report on applying Agreed-Upon Procedures has been prepared and is attached as Exhibit D to assist in the evaluation of DMC’s annual compliance for CY 2016 with the requirements of section 12.4 of the Agreement. The Report on Applying Agreed-Upon Procedures Report is made solely for the information and use of the specified parties and is included as part of the confidential portion of this report.

### **Warrant** (Section 12.5)

At Closing, Vanguard delivered to the Escrow Agent an initial Warrant Certificate for the Warrant. In connection with Vanguard's initial public offering of its common stock in June 2011, Vanguard delivered to the Escrow Agent (in exchange for the Warrant Certificate then in the possession of the Escrow Agent) the Note in the original principal amount of \$500,000,000. In accordance with Section 12.5 of the Purchase and Sale Agreement, the principal amount of the Note is automatically reduced on a continuous basis by the amount of any reduction in the Remaining CapEx Commitment under the Agreement. (See Exhibit E – Letters December 23, 2016)

### **No Sale of Hospitals** (Section 12.7)

There has been no sale of VHS of Michigan, Inc. d/b/a Detroit Medical Center. VHS of Michigan, Inc. continues to be a wholly-owned subsidiary of Vanguard Health Systems, Inc. Vanguard Health Systems, Inc. became a wholly-owned subsidiary of Tenet Healthcare Corporation on October 1, 2013, a Permitted Transferee of the Hospitals under Section 12.7 of the Agreement.

### **Commitment to Education Mission** (Section 12.8)

Throughout the preceding year, DMC fully supported its historic medical education mission in satisfaction of its commitment under Section 12.8 of the Agreement. DMC continued to employ and train over 1,000 residents and fellows during the 2015-16 academic year.

DMC is the Institutional Sponsor for more than 100 GME training programs. In 2015-2016, the Annual Institutional Review (AIR) subcommittee of the DMC GMEC met throughout the course of the year to review DMC's Institutional Performance as required by the Accreditation Council for Graduate Medical Education.

The DMC GME AIR Committee generated the following action plan for the 2016-2017 academic year:

1. Implement improved protocols for DMC GME program monitoring and oversight through implementation of the DMC GME Performance Dashboard.
2. Develop metrics to monitor Resident and Faculty Scholarly Activity for the 2016-2017 Annual Institutional Review.
3. Develop training programs for Program Directors and Coordinators aligned with identified deficits in key performance indicators.
4. Continue to identify and implement programs to support Resident Wellness.

5. Continue to identify and implement protocols to support excellence in the Clinical Learning Environment.

Attached as Exhibit F is the Annual Report for Academic Year 2015 -2016, which provides a summary of the status of Graduate Medical Education Programs at the DMC.

DMC remains affiliated for undergraduate medical education with Wayne State University School of Medicine and Michigan State University College of Osteopathic Medicine. DMC continues to be a member in the Detroit Wayne County Health Authority Consortium which partners with local area hospitals and health care systems in training its residents.

The largest licensed group of health care professionals in the State of Michigan is Registered Nurses, with nearly 170,000 licensed nurses providing the majority of healthcare services to the people of the State. The Detroit Medical Center has a nursing workforce of approximately 3,200 registered nurses providing direct patient care. The DMC, with over fifty academic partners and access to numerous specialty areas, provides a wide range of clinical experiences for nursing students. These clinical rotations are provided to students pursuing degrees from the Associate through Doctoral levels of study. DMC employed Advanced Practice Nurses serve as clinical preceptors, adjunct faculty and guest lecturers for the graduate nursing programs of nine colleges and universities. Staff nurses of the DMC are encouraged to pursue opportunities for professional and academic development. This is facilitated through financial support for tuition reimbursement. This represents organizational efforts to comply with the Institute of Medicine (IOM) recommendation to increase the proportion of nurses with baccalaureate degrees to 80% by the year 2020.

DMC also functions as a placement site for other allied health professions, including, but not limited to, pharmacists, dieticians, and pastoral care.

#### **Commitment to Research Mission** (Section 12.9)

The continued commitment of DMC to its historic research mission extends to the approximately 1,000 ongoing clinical trials and retrospective research reviews at the DMC hospitals. The DMC supports a broad spectrum of research related to Quality and Patient Safety conducted by the DMC Medical, Nursing, Pharmacy, Allied Health Professionals, and their respective Fellows, Residents and Students. A listing of the Open Research Studies and Retrospective Research Studies ongoing in the DMC is available for viewing upon request.

The DMC maintains a valued collaborative relationship with Wayne State University Researchers. The DMC and Wayne State University maintain a Master Research Services Agreement, which establishes a relationship that fosters continued coordination and integration between the University and the DMC. The affiliation agreement acknowledges a shared mission in the pursuit of academic and clinical research.

In 2016, the DMC engaged in new research services agreements valued at \$4,500,000, with an additional \$800,000 pending final approval. Of this, \$2,500,000 relates to research conducted at the DMC Heart Hospital's Cardiovascular Research Program.

A three year, \$10 million research grant was awarded to Dr. Suzanne White and the DMC for the "Gateway Project" in 2014 and continues to be a robust program. This transformational project creates four Patient Centered Medical Homes adjacent to DMC emergency department. Focusing on a subset of people who are regular visitors to Detroit emergency rooms because they do not have access to a primary care provider, this project will test whether an integrated care model will achieve improved medical outcomes and decreased utilization.

#### **Karmanos Cancer Center** Section 12.10)

Section 12.10 of the Agreement states VHS of Michigan ("Buyer") is committed to supporting DMC's ("Seller") historic partnership with Karmanos Cancer Center ("KCC") and, to that end, VHS of Michigan, Inc. d/b/a Detroit Medical Center assumed all contracts with KCC.

On October 30, 2013, KCC notified DMC that KCC and its sole member, Karmanos Cancer Institute ("KCI", collectively "Karmanos") had executed a written agreement with McLaren Health Care Corporation ("McLaren"). Under that agreement, McLaren became the sole member of KCI, McLaren would use the "Karmanos" name in its marketing, and KCC would enter into clinical affiliations with McLaren hospitals. KCC did not seek DMC's consent to this arrangement which led to litigation which was subsequently resolved via a Settlement Agreement executed on October 7, 2015.

With the execution of the Settlement Agreement, the Court dismissed the litigation. Among the Settlement Agreement terms are:

1. The continuation of long-term Purchase Service, Laboratory and IT agreements between KCC and the DMC with options for renewal;
2. Clarification on the rights and limitations of the Karmanos name in Wayne, Oakland and Macomb counties and the requirement to include DMC's name in specific cancer marketing, advertising and promotional activities;
3. Selection of an external independent consultant to verify existing purchase service rates are at fair market value and updates are done consistent to agreed methodologies; and
4. Establishment of a Services Oversight Committee with executives from all parties to review the relationship and status of various agreements between the parties; and, to resolve any potential issues that may arise.

As part of the settlement, DMC and KCC/McLaren will evaluate adult cancer service partnerships at select DMC facilities in the market. The Settlement Agreement will not require such partnerships, will not be breached if there are no new partnerships and the DMC pursues adult cancer services independently. DMC and KCC/McLaren continue to work as good stewards of the community on plans to increase access, service and quality to meet the needs of Southeast Michigan and beyond that require world class oncological care.

### **Health and Wellness Initiatives** (Section 12.11)

In 2016, we continued to promote our Community Ambassador program which proved to be very successful in 2015.

Our Community Ambassadors (CAs) were largely instrumental in our success in 2016 as a result of our engagement efforts. It was important to regularly engage, inspire, and encourage them to continue to support our work. Our team of Community Ambassador Organizers kept in touch with the original 1,440 ambassadors who enrolled in the program in 2015 and were able to recruit 1,140 additional ambassadors. The efforts of these ambassadors resulted in 738 insurance enrollments for 2016. To date, we have achieved 1,436 insurance enrollments through this effort.

The engagement of our DMC Community Ambassadors did not stop with insurance enrollments. We were able to create an open dialogue with the ambassadors and begin discussions on their needs in the community and most importantly with their health. We conducted surveys to find out exactly what issues they faced and offered assistance when needed and where possible. In addition to regular follow-up calls, we created an ongoing email exchange to communicate pertinent information regarding community services including but not limited to food drives, health fairs and employment fairs. The ambassadors also helped us market DMC events and often served as volunteers.

Similar to 2015, the DMC's external healthcare outfit continued its successful partnership with churches, community and business partners. We also experienced great community response, when we briefly rekindled our partnership with FM 105.9 for our Coney Island outreach in targeted zip codes. As a result of all of these efforts combined we were able to enroll 2,008 individuals in the community in 2016.

Continuing with Conifer's presence in the Emergency Rooms and In-Hospital operations coupled with our external Path to Health team's community, ecumenical and retail efforts the DMC was able to enroll 20,873 individuals for 2016. The details of the 2016 campaign are contained in Exhibit G.

The DMC will discontinue use of the "Path to Health" brand and we will use our hospital brand to localize the enrollment program for 2017.

Going forward, we will continue to leverage our relationship with the community ambassadors to seek enrollment opportunities. We will continue to partner with local churches and organizations to facilitate enrollment events upon their request. We will support the Center for Medicaid and Medicare's "Coverage to Care" initiative to ensure those covered are using their benefits and receiving the care they need.

**Supplier Diversity Program** (Section 12.12)

The DMC continues to support “Seller’s Supplier Diversity Program”. There have been no amendments or changes made to the Supplier Diversity Program Policy over the past year. Overall diversity spending for FY 2016 was \$28.3 million. This is down from the prior year spend by approximately \$4 million as a result of the completion of certain construction projects and the reduction in capital expenditures on Information System hardware from 2015 to 2016.

With respect to the Specified Capital projects, the DMC has met the requirements of the Renaissance Zone Agreement. Due to the completion of the majority of the projects in 2016, the DMC exceeded all but two goals under the Renaissance Zone Agreement related to Community Participation.

Goal	Result
<b>30%</b> of all construction dollars awarded to minority-owned (MBE), women-owned, (WBE) and Detroit-based businesses, (DHB, DBB)	48.84%
<b>25%</b> of all hours worked on construction projects will be by <b>City of Detroit Residents</b>	20.20%
<b>50%</b> of all hours worked on construction projects will be by <b>Wayne County Residents</b>	40.35%
<b>25%</b> of all hours worked on construction projects will be by <b>Minority workers</b>	26.78%
<b>25%</b> of all hours worked by apprentices on construction projects will be by <b>Minority apprentices</b>	36.28%

**Project Genesis** (Section 12.13)

Detroit Medical Center (DMC) completed its 12th summer of sponsoring the Project Genesis Summer Youth Employment Program (PG) in partnership with Detroit Public Schools Community District (DPSCD) (Exhibit H – DMC 2016 Community and School Programs Annual Report).

DMC designed and developed this program to provide a valuable summer employment experience for students interested in a career in healthcare.

Project Genesis incorporates the core elements of successful youth-development and practices of real job expectations. Project Genesis also provides greater awareness of various healthcare careers and opportunities for career instruction.

One hundred promising students are placed in patient care and business areas throughout DMC. Students work 30 hours per week for eight consecutive weeks.

Students attend new employee orientation. Those assigned to work in patient care areas attend a three-day clinical orientation led by DMC Nurse Educators. In addition, students complete HealthStream modules, attend weekly Career Development Sessions (where students are given an opportunity to interact with various DMC healthcare professionals), and participate in community outreach assignments.

Project Genesis Alumni are employed at DMC as registered nurses, physical therapists, pharmacy technicians, and other occupations.

#### **Detroit Based Systems** (Section 12.14)

In compliance with Section 12.14 of the Agreement, the DMC continues to operate its hospitals as a Detroit-based system with its regional headquarters located in the City of Detroit, Michigan.

#### **National Support Centers** (Section 12.15)

Senior representatives of Tenet have regularly returned to Michigan and the DMC to assess opportunities to implement and develop beneficial growth strategies and investments. Since the closing of the acquisition of Vanguard Health Systems, Inc. in 2013, senior executives of Tenet have also visited Detroit frequently to meet with DMC management and local, municipal, and state officials. Tenet's Board of Directors held its first meeting in the City of Detroit in December, 2013. We are proud to report as well that Trevor Fetter was here visiting Detroit in 2016.

#### **Naming Conventions** (Section 12.16)

The DMC continues to honor all naming conventions as designated in donor agreements.

# 2016 Annual Report to Legacy DMC

## Exhibits

Exhibit A: Indigent and Low Income Care (Confidential)

Exhibit B: Routine Capital Expenditures CY 2011 – 2015

Exhibit C: Specified Capital Expenditures CY 2011-2016 Actual/CY 2017 Forecast

Specified Capital Projects – Forecasted Requirements CY 2017

Specified Capital Project Expenditure Schedule

Projected Specified Capital Forecast By Project/By Quarter

Exhibit D: Deloitte & Touche LLP Independent Accountants Report (Confidential)

Exhibit E: Letters Dated December 23, 2016

Exhibit F: Graduate Medical Education Annual Report for Academic Year 2015-2016

Exhibit G: DMC Path to Health 2016 Summary

Exhibit H: DMC 2016 Community and School Programs Annual Report