

The University of Michigan
Regents Communication
Action Request

Subject: Master Affiliation and Related Joint Venture Agreements, each with Sparrow Health System

Action

Requested: Approval to Enter into a Master Affiliation Agreement and Related Joint Venture Agreements with Sparrow Health System

Background:

The University of Michigan, through its academic medical center and clinical enterprise, Michigan Medicine and the University of Michigan Health System, respectively, serves patients from across the state through a network of relationships with health systems, hospitals, and physicians. A strategic priority in expanding this statewide network is a greater presence in communities across the state.

Michigan Medicine and Sparrow Health System seek to develop successful collaborations dedicated to advancing the provision of high-quality, accessible, and affordable health care for the populations that they serve based, in part, on the complementary attributes and resources of Michigan Medicine as an academic health system and Sparrow Health System as a health care system with unique capabilities operating community hospitals and health insurance businesses.

Michigan Medicine and Sparrow Health System desire to develop and implement new collaborations throughout mid-Michigan through organized systems of care focused on particular clinical initiatives to improve the health of the communities that they serve and to enhance the efficiencies and value of each system's investment in health care. In addition, Michigan Medicine and Sparrow Health System desire to operate systems of care committed to providing the right care, at the right time, in the right place through shared clinical objectives, rationalization of health care assets to reduce costs, bringing care closer to patients' homes when clinically appropriate and serving as responsible stewards of community resources.

Sparrow Health System owns and operates two Lansing, Michigan hospital campuses, and several community hospitals: Sparrow Clinton Memorial Hospital in St. Johns, Sparrow Ionia Hospital in Ionia, and Carson City Hospital. Sparrow Health System also owns and operates Physicians Health Plan, a regional health maintenance organization (PHP), PHP Insurance Company, a statewide preferred provider organization, and a third-party administrator business.

In 2017, Michigan Medicine and Sparrow Health System engaged in discussions regarding (a) the formation of a master affiliation; (b) a joint venture with respect to pediatric services performed at Sparrow Hospital and other locations within Sparrow Health System; (c) a joint venture of PHP and related health insurance businesses; and (d) the creation of a joint oncology council to explore opportunities to collaborate in cancer care. Michigan Medicine and Sparrow Health System entered into a Master Affiliation Term Sheet on February 20, 2018. Since then, Michigan Medicine entered into negotiations with Sparrow Health System and continues to undertake extensive due diligence. These activities culminated in the proposed master affiliation and related joint ventures and collaborations.

Under the proposed Master Affiliation Agreement, Sparrow Health System and Michigan Medicine express a desire to develop multiple collaborations overseen by an oversight committee with equal representation, provide each other with rights of first consideration to participate in certain health care programs, and affirm Michigan Medicine as Sparrow Health System's preferred provider of tertiary and quaternary care within Michigan.

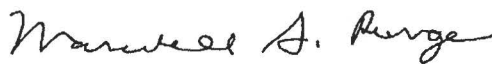
Under the proposed Pediatrics Joint Venture Agreements, Michigan Medicine will acquire a 50% contractual interest in Sparrow Health System's pediatric service line in exchange for cash consideration. The master affiliation oversight committee along with a joint pediatric clinical council will oversee the joint venture with each system retaining reserved powers with respect to key decisions related to the joint venture (e.g., approval of the joint venture's annual operating and capital budgets; the creation of any joint debt obligation; offer of any new interest in the joint venture to another party; approval of the sale or transfer of all or substantially all of the joint venture's assets; and approval of the imposition of any additional capital contributions). Co-Medical Directors (one from Michigan Medicine and one from Sparrow Health System), a Nursing Director, and an Administrative Director will manage the joint venture. The joint venture will be co-branded using Michigan Medicine and Sparrow Health System brands and logos in a manner that maintains and respects their respective individual brands, subject to mutually agreed upon conditions of use.

Under the proposed PHP term sheet and Joint Venture Agreements to be developed, subject to receipt of regulatory approvals, Michigan Medicine will acquire a 25% membership interest in a new holding company of PHP and its related health insurance businesses in exchange for cash and non-cash consideration consisting of a revised provider contract. Michigan Medicine will appoint one-third of the members of the holding company board, the PHP Board, and other subsidiary boards. Certain major actions of the holding company and its subsidiaries (e.g., changes to PHP's strategic plan, capital calls outside calls required by maintenance of mutually-agreed upon reserves or regulation, acquisitions and divestitures, and the admission of new partners) must be approved unanimously by Michigan Medicine's appointees on the boards. Each system will have a no-cause exit right for fair market value of its interest subject to participation in dispute

resolution. The parties will maintain cash at an agreed-upon level pursuant to capital calls as necessary. These and other details are described in the PHP term sheet and will be described in the Joint Venture Agreements to be developed.

Accordingly, we request that the Board of Regents approve the framework of these agreements as described. We request that the Board of Regents authorize the Executive Vice President for Medical Affairs and Dean of the Medical School, and the Executive Vice President and Chief Financial Officer to negotiate any final changes to the Master Affiliation Agreement and Pediatrics Joint Venture Agreements; to negotiate, execute and deliver PHP Joint Venture Agreements consistent with the PHP term sheet; to execute and deliver, individually or jointly, any other agreements and instruments contemplated in the Master Affiliation Agreement and Joint Venture Agreements; to take any other actions necessary or desirable to consummate the transactions described in this action request and in the Master Affiliation Agreement and Joint Venture Agreements; and to obtain or make, as applicable, all governmental and third-party approvals, consents, notices and authorizations that may be necessary, including a Form A (Statement Regarding the Acquisition of Control of or Merger with a Domestic Insurer) from the Michigan Department of Insurance and Financial Services.

Respectfully submitted,



Marschall S. Runge
Executive Vice President for Medical Affairs
and Dean of the Medical School



Kevin P. Hegarty
Executive Vice President
and Chief Financial Officer

March 2019