

THE UNIVERSITY OF TENNESSEE
BOARD OF TRUSTEES

MINUTES OF THE HEALTH AFFAIRS COMMITTEE

October 2, 2012
Nashville, Tennessee

The Health Affairs Committee of The University of Tennessee Board of Trustees met at 12:15 p.m. on Tuesday, October 2, 2012, at 226 Capitol Boulevard in Nashville, Tennessee.

I. CALL TO ORDER

Charles Anderson, Chair, called the meeting to order.

II. ROLL CALL

Catherine S. Mizell, Secretary, called the roll, and the following members of the Health Affairs Committee were present:

Charles C. Anderson, Jr.
Joseph A. DiPietro
David E. Millhorn
James L. Murphy, III (participating by telephone)
Don C. Stansberry, Jr.

The Secretary announced the presence of a quorum of the Committee. Trustees Cates and Wharton and members of the administrative staff were also present. Trustee Gregg participated in the meeting by telephone

III. APPROVAL OF MINUTES OF PRIOR MEETING

Chair Anderson asked for any corrections to the minutes of the June 20, 2012 meeting of the Committee. Trustee Stansberry moved approval of the minutes as presented in the meeting materials. Trustee Murphy seconded the motion, the Secretary conducted a roll call vote, and the motion carried unanimously.

IV. 2013 DATES FOR HEALTH AFFAIRS COMMITTEE MEETINGS

Chair Anderson noted that the dates for the Health Affairs Committee meetings coincide with the Executive and Compensation Committee. The proposed dates are January 28, May 13, and September 10, 2013. Trustee Stansberry moved that the agreed-upon dates for Health Affairs Committee meetings in 2013 be approved. Chair Anderson seconded the motion, the Secretary conducted a roll call vote, and the motion carried unanimously.

V. UPDATE ON PHASE II OF UT METHODIST PHYSICIANS

Dr. Schwab introduced Tony Ferrara, UTHSC Vice Chancellor for Finance and Operations, to present an update on Phase II of UT Methodist Physicians (UTMP) (Exhibit 1). Mr. Ferrara explained that the UTMP practice plan was created in February 2012 with the approval of the Board of Trustees. The board of directors for UTMP consists of three UTHSC directors, three Methodist directors, with no more than 1/3 representation by physicians. The chair of the UTMP board is the UTHSC Executive Dean. UTMP is a faculty group practice, in which physicians are full time, part time, or volunteer members of the UTHSC faculty. Mr. Ferrara then described the various steps in converting UTMP from Phase I to Phase II.

UTMP Phase II will elevate the relationship between UTHSC and Methodist University Hospital to function as an academic medical center. It will be beneficial financially to both the University and the hospital based on changes in reimbursement, patient increase, and changes in the healthcare/education industry. The goal of phase II is to take the alignment already established and strengthen it. Mr. Ferrara stated that strengthening the relationships, developing service lines with UT faculty, leading the service lines, and collaborating with community physicians would elevate the success of the faculty practice plan and UTHSC.

Dr. Schwab interjected, outlining the success of the UT Le Bonheur practice plan and linking it with the national ranking of the Methodist Le Bonheur Hospital as the 24th best children's hospital in the United States. To duplicate this success, UTHSC needs to create a similar relationship with an adult hospital. Methodist University Hospital is the largest hospital of the Methodist hospitals in Memphis and is located adjacent to the UTHSC campus. This, combined with a large faculty physician presence, make it an ideal candidate for this mission.

Mr. Ferrara continued his presentation on the several key components that will take place in phase II. UTHSC will see more representation on the Board of Directors at Methodist Hospital System. Chancellor Schwab has been an ex officio member of the Methodist board, but now the Executive Dean of the College of Medicine (Dr. David Stern) and a UT trustee representative (Mr. George Cates) have been added, and there is an option to add three faculty physicians as elected board members. The board currently has 18 members. In addition, in phase II, the Methodist CEO and UTHSC Chancellor will choose a UT physician leader to serve as the Executive Vice President for Medical Affairs in the Methodist System. Dr. David Stern will serve in this capacity initially for approximately two years. The changes in this phase will also create a three-part financial support system with (1) a fixed payment per year of \$3.25 million; (2) Methodist funding a health electronic records system that UT faculty/physicians will use in all Methodist associated practice, including practice through UTMG, at an estimated value of \$2 million per annum; and (3) UTHSC receiving 25% of the margin in excess of 3.5% from the Methodist System.

A Trustee asked about payer mix, margin, and volume in the two main hospitals where UT physicians would be practicing (Methodist University Hospital and Le Bonheur Children's Hospital). Chancellor Schwab replied, stating that Le Bonheur has the largest financial margin in the Methodist system and sees exclusively children. The Methodist suburban hospitals (North, South, Germantown, and Olive Branch) see less acute patients and have a better payer mix. Methodist University and Le Bonheur Children's Hospital handle a high percentage of acute patients with a less favorable payer mix. Because of the acuity, there are relatively fewer elective cases. Methodist University is the largest, busiest, and most intense hospital in the Methodist system.

In response to a Trustee's question about the hospital's financial position, Mr. Ferrara replied that Methodist has been in the 2 - 4 % margin range in the past. The Methodist system has revenues greater than \$1.7 billion.

UTHSC will receive significant payments from Methodist in FY 2013: (1) \$3.25 million for UTMP, (2) \$5 million for cancer, and (3) \$5.85 million for ULPS. In total, UTHSC will receive an estimated \$14.1 million in annual discretionary income from the Methodist system. Dr. Schwab pointed out that 90% of clinicians' compensation was funded through the practice plans.

In Phase II the branding of both organizations will merge. Methodist University Hospital will likely become the UT Methodist Medical Center, and the Le

Bonheur Children's Hospital will also be rebranded. Logo use and licensing agreements will be included in the Phase II amendment to the current affiliation agreement between UT and Methodist. This transition will also allow UTHSC to manage all clinical research in Methodist hospital, as well as receiving credit for research and national hospital rankings. As UTHSC leadership moves forward with Phase II, all negotiations will be vetted with the President and his staff and the Health Affairs Committee.

Trustee Stansberry commented on the non-existence of a termination penalty and the effect on UTHSC if Methodist decided to terminate the agreement. Dr. Schwab addressed the possibility, but reassured the committee that terminating the affiliation agreement would be seriously detrimental to Methodist as well. Schwab elaborated more on the various geographical affiliations throughout Tennessee to understand the supportive relationship between all hospitals and the importance of each agreement in the various regions, counties or cities in Tennessee.

Dr. Schwab then asked for the endorsement of the Committee to move forward with Phase II of UTMP. The consensus of the voting members was that the UTHSC administration should move forward. Phase II will be implemented by means of a 6th amendment to the current affiliation agreement between UT and Methodist, which will be presented to Health Affairs Committee and then to the full Board of Trustees for approval at the Winter Meeting.

VI. FINANCIAL UPDATE: UT LE BONHEUR PEDIATRIC SPECIALISTS AND UT MEDICAL GROUP

Mr. Ferrara started his presentation (Exhibit 2) with financial updates for ULPS. At the end of July, ULPS acquired a pediatric surgical group and has continued to move forward with physician recruitment, hoping to add several more in 2013. There has been significant improvement in payer contract reimbursements, as well as appropriate alignment of ULPS clinic and administrative costs.

Currently, the mission support payment from Le Bonheur is \$5 million with a 3% annual increase pursuant to the affiliation agreement, in addition to a program growth supplement of \$700,000. For Fiscal Year 2013, the mission support payment will be \$5.85 million. In comparing FY 2012 to FY 2013, Mr. Ferrara noted the significant increase in revenue from \$24 million to \$31.9 million, along with increased expenses from \$35 million to \$43.2 million. Over time, the new physician recruitments will close the gap between revenue and expenses.

Dr. Schwab added that the strategy of the increase is to aggressively grow the practice as well as children's research with these recruits and receive recognition in the national rankings. As a result, Le Bonheur has seen substantially more patients in 2012 than 2011 and has continued its climb up the US News rankings with now 5 nationally ranked areas and a 24th overall national rank.

Mr. Ferrara continued his presentation with a financial update for UTMG. In Fiscal year 2012, the net income in operations was \$2 million, with a goal to reach \$3 million operational margin in FY 2013. Dr. Schwab added that the market share of UTMG has increased and as a result, negotiations with UTMG for alignment by 3rd parties have markedly increased. In regard to end of year cash flow, UTMG ended the year with \$9 million in net cash on hand in addition to substantial other long term financial reserves and real estate equity. UTMG pays approximately \$2 million per annum in a Deans Tax to UTHSC.

VII. UPDATE ON UT ERLANGER MEDICAL GROUP

Dr. Schwab asked Dr. Ken Brown to update the committee on the current status of the other hospital affiliations. Dr. Brown updated the committee on the proposed affiliation agreement with Erlanger Hospital in Chattanooga, noting that he is awaiting communication from the Erlanger board. Currently, Erlanger is experiencing some leadership changes and has hired a management consultant firm to assist in its efforts.

VIII. UPDATE ON UT MED PRACTICE PLAN

Dr. Brown continued with his update, focusing on The Med/Regional Medical Center of Memphis, advising that both UTHSC and The Med are actively engaged in developing an adult practice plan, with physicians eager to discuss. The affiliation with The Med could possibly produce a women's and infants tower which would be branded as The University of Tennessee Regional Medical Center Women's and Infants Pavilion, adjacent to Le Bonheur.

IX. UPDATE ON UTHSC ST. THOMAS CLINICAL CAMPUS IN NASHVILLE

Dr. Schwab stated that UTHSC has previously signed an exclusive agreement for graduate medical education (GME) with the St. Thomas system, a five-hospital system based in Nashville. UTHSC is in the process of creating the residency program and will be required to form a faculty practice group in the future. The

program is in its infancy, designed to mature in three to four years. Dr. Brown stated that Meharry administration is concerned regarding the impact this agreement may have on their GME program and has reached out to UTHSC.

X. OTHER BUSINESS

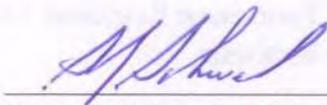
President DiPietro asked Chancellor Schwab to discuss the ranking of the UT Medical Center in Knoxville. Chancellor Schwab stated that Le Bonheur is the US News and World Report's 24th nationally ranked hospital and climbing. Methodist Hospital ranked about 50th in 2011, but did not make the top 50 in 2012. On the other hand, the UT Medical Center in Knoxville entered the top-50 rankings in 2012 in two areas of excellence, so the UT system still has two nationally ranked hospitals. Methodist is the highest ranked hospital in West Tennessee, UT Medical Center is the highest ranked in East Tennessee, and despite its troubles, Erlanger is still ranked in its region. Dr. DiPietro stated how proud he is to have nationally ranked hospitals in our system.

In response to Trustee questions, Chancellor Schwab stated that the UT Medical Center in Knoxville bears the university's name, and we have a graduate school of medicine on the campus. He also stated UT has seats on the board and the residents and fellows are exclusively UT; but while the practices are aligned with the hospital, they are not governed by the university. The university hopes to address this in the future.

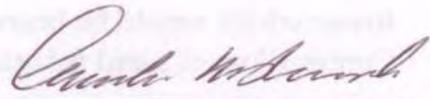
XI. ADJOURNMENT

There being no further business to come before the Health Affairs Committee, the meeting was adjourned.

Respectfully Submitted,



Steve S. Schwab, MD
Chancellor, UT Health Science Center



Charles M. Peccolo
Treasurer and Chief Financial Officer