MINUTES OF THE SPECIAL MEETING

BOARD OF TRUSTEES

THE UNIVERSITY OF TENNESSEE

Knoxville, Tennessee
June 17, 1999

The special meeting of the Board of Trustees of The University of Tennessee was held at 7:30 a.m., Thursday, June 17, 1999 in Dining Rooms C & D, Thompson-Boling Arena, Knoxville campus. Vice Chairman William B. Sansom presided.

Mr. Sansom gave the invocation.

The Secretary called the roll and the following members were present:

Mrs. Johnnie D. Amonette
Mrs. Barbara Castleman
Mr. B. C. "Scooter" Clippard
Mr. Charles E. Coffey
Mr. Roger W. Dickson
Mr. J. Steven Ennis
Mr. Amon Carter Evans
Ms. Emily D. Graham
Mr. James A. Haslam, II
Mr. Jerry L. Jackson
Dr. Joseph E. Johnson
Mr. Thomas E. Kerney
Mr. Frank J. Kinser
Mr. R. Clayton McWhorter
Mr. Arnold Perl
Dr. Richard Rhoda
Mr. William B. Sansom
Dr. Leonard Share
Mrs. Lucy Y. Shaw
Commissioner Dan Wheeler
Ms. Susan Williams

The Secretary announced a quorum was present.

Mr. Sansom said the purpose of the meeting was to consider the proposal to transfer The University of Tennessee Memorial Research Center and Hospital to University Health System, Inc. He said the status of the proposed transfer and the transfer agreements would be discussed and approval would be sought for the transfer. Mr. Sansom called on Dr. Joseph E. Johnson for an update on the transfer process and to present the proposal.

Dr. Johnson said about three years ago the future of health care and health care delivery was discussed during a Board of Trustees meeting. The discussion included noting the possibility that the Hospital could lose money in the future, the relationship between the Hospital and the University, and the possibility of moving the Hospital outside the structure of the University and off the University's balance sheet. The Board authorized the administration at that time to seek any necessary legislation. In 1997, the General Assembly authorized the University administration to look at various ways of moving the Hospital with one prohibition--the Hospital cannot be sold to an existing hospital corporation. The legislation mandated that the Attorney General, the State Building Commission, and the Board of Trustees approve any restructuring of the Hospital. Since the winter Board meeting in Tullahoma, work has been done at a rapid pace to bring the possible lease to closure. Dr. Johnson said Board members have before them three documents. One is a lease agreement (Exhibit 1) in which the University leases the land and the facilities of the Hospital to University Health System, Inc., (UHS). The property will remain in the ownership of The University of Tennessee but will be leased for fifty years to UHS with the opportunity to extend the lease for an additional fifty years. The lease agreement provides UHS must maintain the property and if it is expanded, the expansion would be at the expense of UHS. The facility would continue to be known as "The University of Tennessee Medical Center."

The second agreement (Exhibit 2) involves the employees of Hospital. Dr. Johnson said there was a question of how to protect retirement and other fringe benefits of current employees. The University received legislative authorization in 1998 to lease those employees to UHS and for UHS to reimburse The University of Tennessee for all the benefits and compensation of those employees. After the date of the lease, anyone hired by UHS would be an employee of UHS rather than The University of Tennessee. University of Tennessee employees would have the option after the lease is executed to remain with the University or shift over to UHS.

The third agreement (Exhibit 3) to be considered is an affiliation agreement between UHS and the University that assures the continuation of the Graduate School of Medicine and the UT Research Center with an initial commitment of $20 million a year from UHS to fund that operation, which includes interns, residents, medicine, pharmacy and dentistry. The Graduate School of Medicine would report to the Dean of Medicine and the Chancellor of UT Memphis.

Consideration for the proposed lease calls for UHS to defease the $100 million plus indebtedness of The University of Tennessee on the buildings and equipment at the Hospital, a front end payment of $25 million to the University, and payments of approximately $2.5 million a year for 20 years, or $50,000,000. Dr. Johnson said he has been closely involved with the Hospital for many years and has mixed emotions about moving the Hospital away from the University. He said in the best interest of the Hospital, The University of Tennessee and the Medical Education program, the lease is the right move. Dr. Johnson said the state constitution places some restrictions on the University, and the Hospital as a part of the University, in such things as borrowing money for operating purposes or working capital, capital facility needs are addressed very slowly, and partnering with other health care agencies is difficult. He said there are significant advantages to the lease agreement. Dr. Johnson said presentations have been made to elected officials in Nashville and the leadership in the House and Senate and they understand what is being done. A full scale presentation has been made to the Building Commission. The concept has been approved. The Attorney General must sign off on the transfer and formal approval must be given by the State Building Commission.

Mr. Sansom asked what role will the Building Commission play if transfer of the Hospital is approved?

Dr. Johnson said one of the state procedures that would no longer be necessary for the Hospital would be those procedures having to do with buildings. The Attorney General and the State Building Commission have agreed they could remove themselves from reviewing additions or renovations to the Hospital if it were leased but not remove their review of requests to build new facilities or tear down existing facilities. The University retains the right to have input into the building of new facilities or the tearing down of existing facilities. The Building Commission has defined its role by saying the State architect would look at proposals to tear down or build new facilities and would have the right to disapprove, which means the process would be handled through an administrator without having to go through the State Building Commission and a hearing.

Mr. Tom Kerney asked for the current capital status of the Hospital and for an explanation of what happens at the end of the lease period.

Dr. Johnson said simply stated at the end of the fifty year period, new lease negotiations could take place or the property could revert to UT.

Mr. Kerney said there is a period of thirty years in the lease agreement when the University is not receiving anything from the lease.

Dr. Johnson said that statement is accurate except that the University's debt in the Hospital will be paid off, but there will be no annual payments at the end of the first twenty year period.

Mr. Kerney said if UT has a thirty year period during which no compensation is being received, additional discussion should take place.

Dr. Johnson said one of the driving factors behind the transfer of the Hospital is to get the hospital off the University's balance sheet. One of the things the University receives for fifty years is relief from the worry of what would happen to the University should the Hospital lose money.

Mr. Kerney said he would like for the University to have the ability to reexamine the agreement at the end of the twenty year period for additional lease payments.

Mr. Sansom said the Hospital's net equity is about $190 million. That value is being transferred to the new entity for $25 million upfront and the removal of risk involved in the hospital business.

Mr. Kinser said the University is saving interest on $150 million if UHS is responsible for paying the debt.

Mr. Evans said most importantly UHS will be taking the liability and the University will still own the land and the building.

Mr. Sansom said pro forma for the bonding agencies show the Hospital will break even the first year or maybe lose a little money. The first year is a short one with considerable one time expenditures for the transfer process. The first full year, the Hospital will make about $2 million, according to the pro forma, the following year about $12 million, and the next year about $15 million. All the figures are after the University has been paid. Mr. Sansom said UHS is creating an additional $25 million debt. Depreciation now is about $15 million a year. The new depreciation will be $5 million a year. Cash flow will remain the same, which shows the University is transferring the Hospital for less than its value. Mr. Sansom said if the University were getting book value for the Hospital, the depreciation would be the same. He said he does not believe there is a risk of the Hospital going under.

Mr. Jackson asked what type of financial backing UHS has.

Mr. Sansom said it has none.

Mr. Jackson asked what would happen if UHS should have a disaster, lose a great deal of money, and not come up with $50 million to pay the lease? Would the University have to go back and take over and absolve the agreement. He said graduate medical education is of utmost importance to the Board.

Mr. Sansom said the $20 million education money for the Graduate School of Medicine comes from the federal government. It does not come from the Hospital. UHS itself has no liability for the Graduate School of Medicine.

Mr. Charles Coffey asked why UT would agree to offer the UT name and UT facilities to a lessor for zero lease payment for thirty years. He suggested the contract be made a twenty year contract and be re-examined at the end of twenty years. He said if there is to be a fifty year contract there should be fifty years of income. Mr. Coffey said in 2019 or 2020 the Trustees sitting around the Board table are going to wonder what was wrong with Trustees in 1999 who leased the hospital facility for thirty years without any income.

Mr. Sansom said the same question was discussed the previous day with Mickey Bilbrey and Bill Rice. He said the lack of lease payments for the last thirty years of the lease is a major issue that has been raised by other Trustees. Mr. Sansom said the frustrating thing from his perspective is that Trustees are somewhat boxed in. The transfer agreement has been designed and the Board has been somewhat preempted about where it is. He expressed his regret with the situation facing the Board but said the issue needs to be addressed.

Mr. Sansom said his understanding is that the UT Board faces a problem because the bond agency sees a contract as it is written, as it has been prepared, which is unfortunate for the Board because it was written and the Board did not get to pass on it. There is a document setting up the financial condition of UHS so what the Board is trying to do is doctor the last thirty years of that document.

Mr. Jackson asked if the Trustees are at a point where it is take it or leave it with the agreement. Things cannot be changed without having to wait months to come back.

Mr. Sansom said he did not want the Board to think it is a rubber stamp Board. He said the Board can reject the agreement, stop it, or just not do it. If possible, Trustees need to figure out a way to solve the existing problem to keep from causing a delay in the transfer.

Dr. Johnson said the original intent was to get the Hospital off the University's books onto someone else's, get the debt paid so the University owes nothing. He said what he suggests is for the Board to find some way for the respective lawyers to put some language into the deal that would not necessarily commit anybody to do anything other than commit people twenty years from now to have a required conversation and negotiation about any future payments, dollar amount unspecified.

Mr. Kerney said the Board is wrong if it overlooks thirty years. Mr. Kerney asked Mr. Bilbrey if there is anything that prohibits a statement from being added that would do what Dr. Johnson has suggested.

Mr. Bilbrey said there is not so long as it is done in way that does not affect the current bond ratings. It must be done very carefully.

Mr. Sansom asked Mr. Bilbrey to read a suggested Resolution that would be adopted by the UHS Board of Directors, on which six UT representatives sit.

Mr. Bilbrey proposed the following:

> At the end of the nineteenth year of the lease term, representatives from UHS would propose an annual amount to be made as a continued contribution to the University for the remainder of the lease term. The amount will be proposed based upon the financial position of UHS at such time. If the agreement is satisfactory to the University, a written agreement may be negotiated and executed. The obligation of UHS under this agreement shall be prior reviewed by the applicable bond rating agencies. Review of the bond rating agencies shall be limited to whether the proposed agreement would adversely impact the financial standings of UHS resulting in the current bond ratings to be withdrawn,

suspended or lowered. If UHS has outstanding insured bond obligations at such time, the advance written approval by the applicable bond insurers shall also be required but cannot be unreasonably withheld. Whatever the agreement, it must comply with the enabling legislation that was passed two years prior.

Dr. Johnson suggested an addition to the formal agreement between UHS and UT be done and that it be brought back to the full Board. Public hearings have already been held. The addition would have to be published, but if it is done so that the two parties are obligating themselves to come together nineteen or twenty years hence and discuss the future relationship, it should not create a problem for anyone. Dr. Johnson suggested it be made a part of the formal document, not a resolution of the UT Board or the UHS Board. Dr. Johnson asked Deputy General Counsel Catherine Mizell if his suggestion was workable.

Ms. Mizell said it was but that if the agreement is changed at this time, the entire agreement will have to be published.

Dr. Johnson said the Board could decide it does not want to complete the transfer at all. The Board might decide it wants to keep the Hospital and manage it. He said he did not believe the Trustees want to do that. He suggested the lawyers be asked to come up with something that commits no one to pay anything, but to simply sit down twenty years hence and determine whether there should be something and what that might be. Dr. Johnson said the intent has been to get a transfer made by the first of August and therefore UHS has had to proceed in trying to work with bond counsel and bond evaluators to get in a position to issue bonds quickly and get the debt defeased so the transfer can proceed.

Mr. Dickson said, assuming the language is written to everyone's satisfaction and is approved, his thought is that the $25 million upfront not be used to do a quick fix for some current problem. The Board needs to firmly establish its preference which is to take the money and place it in a matching endowment. The Board could determine over a period of time where the money should go. Mr. Dickson said his personal belief is that a part of the endowment should be used for graduate medical education. He said the money comes from that source and a portion of it should go to that program.

Mr. Haslam said Mr. Dickson's thoughts are correct. He said the money should be placed in the endowment fund where it can make money, but more importantly the development staff should set up some sort of matching program where the money can be taken and leveraged. The $25 million could become $100 million in three to five years. Mr. Haslam said the University has a tremendous opportunity but it needs to go slow and make sure the money is invested properly.

Mr. Coffey said it is a great opportunity to put to rest something he hears too often and that is the University does not have enough money to hire and retain the best faculty. He suggested the money be set aside for the faculty and make it the money that will take the University to the next level.

Dr. Johnson said Mr. Haslam is absolutely correct in saying that if the University has $25 million and goes to a carefully chosen potential donor requesting matching money, the money can be leveraged into much more.

Mr. McWhorter said regardless of how the money is used it should be set up as an endowment and leveraged.

After additional discussion, Mr. Sansom recessed the meeting to allow the attorneys an opportunity to come up with additional language for consideration by the Board before acting upon the proposed transfer.

Following its regular Board meeting, Mr. Sansom reconvened the special meeting of the Board of Trustees in the Board Room, Andy Holt Tower at 11:00 a.m. Mr. Sansom asked for the additional proposed language to the lease agreement as requested earlier in the meeting.

Copies of the proposed language were distributed to Board members as follows:.

ADDITION TO THE END OF SECTION 2.4 OF
THE LEASE AND TRANSFER AGREEMENT

Section 2.4 Consideration

In the year 2019, Lessor and Lessee shall meet to consider an annual lease payment for the last thirty (30) years of the Term of this Lease and Transfer Agreement. The amount of any proposed annual lease payment will be based upon the financial position of lessee at such time and will be subject to prior confirmation from the bond rating agencies which at that time have an active rating on outstanding debt obligations issued by Lessee that the proposed annual lease payment would not result in the withdrawal, suspension or lowering of Lessee's then current bond rating. If Lessee has outstanding insured debt obligations at such time, then the advance written approval by the company or companies which have insured lessee's debt obligations shall also be required. In any case, any amendment to this Lease and Transfer Agreement pursuant to this Section 2.4 must comply with the terms and conditions of the Enabling Legislation and shall be subject to the prior approval of Lessor's Board of Trustees and Lessee's board of directors.

Deputy General Counsel Catherine Mizell said an effort was made to reflect the discussions from earlier in the meeting. She called to the Board's specific attention that the proposed new language only says there would be a "consideration" of an annual lease payment.

Mr. Haslam said that would be subject to the confirmation and approval of the bond rating agencies and the lenders.

Dr. Johnson said it would require the approval of both UHS and the UT Board of Trustees for anything to happen.

Mr. Jackson said as he understands the new language it really has no legal strength.

Mr. Sansom said it only says "they shall meet to consider."

Mr. Kerney said it seemed as though the new language weakened the pledge that was read earlier in the day rather than strengthening it.

Dr. Johnson said the language read earlier said UHS would independently, if it wished to do so, make a proposal. This language says there will be a meeting and there will be discussion.

Ms. Mizell said to some extent the new language reflects the position of the bond insurers, specifically the requirement of approval by the bond insurers.

Mr. Coffey said the new language does nothing legally. It binds no one to anything.

Mr. Kerney expressed his view that the new language does not adequately express the true spirit of the morning's meeting.

Mr. Dickson said if the Board wants to finalize the lease agreement, it is going to have to go through with the deal that has been negotiated with the addition that is being suggested.

Mr. Coffey said he did not agree. He said the Board is presently negotiating.

Mr. Jackson said negotiations only with respect to the period beyond twenty years.

Mr. Coffey asked why the lease could not simply be for twenty years instead of fifty years.

Mr. McWhorter asked what effect a twenty-year lease would have on the bonding agreement.

Mr. Kevin Outterson, counsel for UHS, said the proposed language was reviewed by the bonding advisors and bond counsel. The bond underwriters will not issue or underwrite the bonds for a twenty-year lease because the average maturity is past thirty years. He said if the language is changed to guarantee payment after twenty years or something stronger than the newly proposed language, the bonding agencies have indicated all the bond ratings will be downgraded significantly as a result of additional obligation that might be added. If the Hospital happens to do very well over the next twenty years, additional lease payments can be added and an "A" bond rating can be maintained.

Mr. Kerney said the language should say that.

Mr. Evans asked Mr. Outterson if the bonds would be more than thirty years?

Mr. Outterson said the average maturity is beyond thirty years.

Ms. Mizell said the new language does not impose a requirement that there be any additional lease payment because of the effect such payments would have on bond ratings.

Mr. Coffey said UHS has an opportunity to do extremely well and make lots of money to reinvest, but UT could still be without a lease payment twenty years from now. There could be a stalemate between UT and UHS on whether lease payments should continue after year 20. In that event, UT would not receive any additional payment.

Dr. Johnson said the best thing that can happen to the UT Board, the Knoxville community, the UT Hospital and the graduate medical education program is for the Hospital to be phenomenally successful. He said he truly believes if the relationships are as they should be in 2019, the Boards could sit down and do what is done in Memphis with a different kind of relationship with Baptist, Methodist, LeBonheur, St. Joe and St. Jude's where each year those hospitals regularly make significant gifts and contributions to the UT College of Medicine, Pharmacy and Dentistry. They do it not because they have to, but because there is a relationship of mutual respect and interest. Dr. Johnson said he believes the University has a pretty good deal with UHS, and it is his hope that if things are going well in five or six years, both Boards will be back at a table talking about additional contributions and support to the academic programs of UT from UHS. He said what the new language requires is that twenty years hence the Boards will have to sit down and once again discuss the position of UHS and UT with regard to lease payments. Dr. Johnson said if the right kind of people are on those Boards and the right kinds of things happening, people will be talking from day one rather than waiting twenty years to do it.

Mr. Brogan said an assumption must be made that UHS Board will negotiate with the University in good faith.

Mr. Sansom said the new language says the bonding agency "must approve" and the proposed resolution that was read earlier in the day said review of the bond rating agencies would be limited. He said with the new language a concession was made and questioned why the change was made.

Mr. Outterson said the bond counsel recommended removing the former clause because he did not think the bond insurers would accept it.

Mr. Clayton McWhorter moved that the addition to the lease agreement be approved as written. The motion was seconded by Mr. Jerry Jackson.

Mr. Kinser made a motion to adopt a resolution mandating that in the year 2019 Board members at that time must actively negotiate for additional lease payments beyond year 20.

Mr. Sansom said what has been said in the meeting is important and should be conveyed.

Dr. Johnson said he would second Mr. Kinser's motion that the action suggested be entered into the minutes of the Board of Trustees of this meeting.

Because there were two motions on the floor, Mr. McWhorter withdrew his previous motion, and Mr. Jackson withdrew his second.

Mr. Frank Kinser moved adoption of the following Resolution:

> BE IT RESOLVED BY THE BOARD OF TRUSTEES that in the year 2019, the Board shall actively negotiate with the UHS Board of Directors under Section 2.4 of the Lease and Transfer Agreement for additional lease payments to be made by UHS to UT for the remaining term of the fifty-year lease.

The motion was seconded by Mrs. Lucy Shaw and carried unanimously.

Mr. Sansom said what the Board is seeking to do is the will of the discussions earlier in the meeting as well as the will of the discussions that have taken place since.

Mr. Brogan asked Mr. Outterson if the wording in the proposed language could be changed from "meet to consider" to "meet to negotiate," which means it would be mandatory that the two parties meet and negotiate an annual lease payment for the last thirty years of the lease.

Ms. Mizell asked if she might address the question as well as Mr. Kerney's concern that the proposed language does not reflect the spirit of the discussion at the morning meeting. As the revised language was originally drafted, it provided that the parties would "negotiate" an annual payment so there would have been a requirement that there be some annual payment. The term "negotiate" was change to "consider" because of concern about the impact on bond ratings.

Mr. Coffey said even if a payment was required, the Trustees could choose to forego the payment if saw it was going to damage the health of the Hospital,.

Mr. Kerney asked why it could not be said there would be an additional payment provided there is no damage to the Hospital because of it.

Dr. Johnson said the bond agencies will not accept that sort of statement.

Mr. Sansom asked if the revision as written with the only change the substitution of the word "negotiate" for "consider" would present a problem with the bond agency. Mr. Sansom said the negotiated figure could be zero.

Mr. Outterson said they were asked not to include the word "negotiate" in the language, but it would work as long as Board members understood the negotiated figure could be zero or one dollar.

Mr. Coffey said although it is personally a strain for him, he could support the language if "negotiate" were included.

Mr. Sansom said it is a strain for many of those involved. He said he felt as through Trustees were outrun, which bothers him, but the proposed language represents the best that can be done because of the restraints faced by Mr. Outterson and Ms. Mizell in working with the bond agencies.

Mr. McWhorter made a motion that the revised language be included in the lease agreement with the change in wording to reflect "negotiate" rather than "consider." The motion was seconded by Mr. Roger W. Dickson and unanimously carried.

Approval of Resolution Transferring The University of Tennessee Hospital to The University Health System, Inc.

Mr. James A. Haslam, II made a motion to approve the Resolution (Exhibit 4) with the revised language in the lease agreement, transferring The University of Tennessee Memorial Research Center and Hospital to the University Health System, Inc. The motion was seconded by Dr. Joseph E. Johnson and unanimously carried.

Approval of Presidential Appointments to the Board of Directors of the University System, Inc.

> That the Board of Trustees approve the appointments of James A. Haslam, II, William B. Sansom, and Harold A. Black to the Board of Directors of the University Health System, Inc. for initial terms of three, three and two years, respectively, as set forth in Exhibit 5.

The motion was made by Mr. Jerry Jackson, seconded by Mr. Frank J. Kinser, and unanimously carried.

Mr. Sansom welcomed President-Elect Wade Gilley to the meeting and invited his comments.

Comments by President-Elect Wade Gilley. Dr. Gilley said he spent three days in Knoxville meeting staff members and attending committee and Board meetings. He said The University of Tennessee is a great university with enormous potential and significant challenges facing it. The University community is unified on the issues that are ahead. UT must be a partner with the State in solving revenue questions. Dr. Gilley said he looks forward to working with the Board in that endeavor. He thanked the Board for making it possible for Nan and him to come and be a part of the University family and hopefully make a contribution to the growth and development of The University of Tennessee. He thanked Joe and Pat Johnson and the staff for all the courtesies shown him during his visit to Knoxville.

There being no further business to come before the Board, the meeting was adjourned at 12:00 noon.

Beauchamp E. Brogan
Secretary