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U.S. Department of Justice

Civil Division

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VIA ELECTRONIC MAIL

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**Re: Joe Federico, et al., v. Lincoln Military Housing, LLC, et al.,
Case No. 2:12-cv-00080-RGD-FBS (E.D. Va.)**

Dear Ms. Bertram:

Thank you for taking the time to talk with us regarding the government's concerns and the potential dispute arising from the characterization by Lincoln Military Housing, LLC ("LMH"), Mid-Atlantic Military Family Communities, LLC ("Mid-Atlantic"), and LPC Property Management, Inc. ("LPC") (hereinafter referred to collectively as "privatization entities") of their relationship with the Department of Navy ("DoN") in the Notice of Removal (Rec. Doc. 1) and Motion and Memorandum of Points and Authorities in Support of Defendants' Motion to Dismiss Plaintiffs' Complaint (Rec. Doc. 7). For the reasons we discussed, the United States respectfully requests that the privatization entities reconsider their position and withdraw their argument that Mid-Atlantic is a Federal agency under 28 U.S.C. §§ 451, 1442(a)(1), and for purposes of the Federal Tort Claims Act ("FTCA"), 28 U.S.C. §§ 1346(b)(1), 2671-80. Further, the United States also requests the privatization entities withdraw their claim that they acted under direction of a Federal Officer, 28 U.S.C. § 1442(a)(1), and that their claims are barred by derivative immunity and the FTCA's discretionary function exception. 28 U.S.C. § 2680(a).

Removal under 28 U.S.C. § 1442 – Mid-Atlantic is not a Federal Agency

The privatization entities contend that for purposes of federal officer removal that Mid-Atlantic is an "agency" of the United States. *See* 28 U.S.C. § 1442(a)(1); Notice of Removal ¶16. Privatization entities suggest that DoN's status as a non-management member and its financial contribution to Mid-Atlantic constitutes a "proprietary interest" and, therefore, Mid-Atlantic is a Government agency under Title 28. *See* 28 U.S.C. § 451. As an initial matter, the privatization entities' argument to the Court omits the last clause of § 451. The quoted language and accompanying punctuation in the privatization entities' argument suggests that the

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Government's possession of **any** proprietary interest in a corporation makes the corporation a Government agency for purposes of Title 28.

The full language of § 451 and review of the Reviser's Note shows that this is not the case. That relevant portion of § 451, in its entirety, including the omitted language, provides:

The term "agency" includes . . . any corporation in which the United States has a proprietary interest, *unless the context shows that such term was intended to be used in a more limited sense.*

28 U.S.C. § 451 (omitted language emphasized). In addition, the Reviser's Note accompanying §451 incorporates the Reviser's Note for 18 U.S.C. § 6. *See* Reviser's Notes, 28 U.S.C. § 451 ("[t]he definitions of agency and department conform with such definitions in section 6 of revised Title 18, U.S.C. (Title 18, Crimes and Criminal Procedure) 80th Congress H.R. 3190). The Reviser's Note for 18 U.S.C. § 6 instructs that the term "agency" is intended to exclude corporations in which the interest of the Government is simply custodial or incidental. Reviser's Notes 18 U.S.C. § 6 ("[t]he phrase 'corporation in which the United States has a 'proprietary interest' is intended to include those governmental corporations in which stock is not actually issued, as well as those in which stock is owned by the United States. It excludes those corporations in which the interest of the Government is custodial or incidental. 80th Congress House Report No. 304"); *see also United States v. National City Lines*, 337, U.S. 78, 81 (1949) (reviser's notes are authoritative in interpreting the Code).

The court in *Scott v. Federal Reserve Bank of Kansas City*, 406 F.3d 532 (8th Cir. 2005), outlined factors that are examined to determine whether an entity is a government agency: "(1) the extent to which the entity performs a governmental function; (2) the scope of the government's involvement; (3) whether the entity's operations are government financed; (4) whether persons other than the government have a proprietary interest in the entity; (5) whether the entity is referred to as an agency in statutes; and (6) whether the entity is treated as a branch of the government for purposes of other statutes." *Id.* at 536 (holding that the Federal Reserve Bank of Kansas City is not a government agency, in part, because it had no obligation to consult with the United States Attorney or government agency prior to taking legal action). For entities such as Mid-Atlantic where no stock has been issued, the court must review the history of the functions, financing, and management of the corporate entity.

The Military Housing Privatization Initiative ("MHPI"), Defense Authorization Act, P.L. 104-106, 110 Stat. 186, is a public/private program. MHPI was enacted, in part, "to stimulate private sector financing of military housing construction and revitalization projects," S. Rep. No. 104-112, §§ 2811 pp. 329 (1995), and "substantially upgrade military housing on an accelerated basis" through the utilization of new "authorities" that permit the military to offer cost-saving and money-earning benefits to private entities as a *quid pro quo* for their provision of base housing and related services to military personnel. *See* 141 Cong. Rec. S18853 (1995) (MHPI provides "new

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authorities for the provision of new housing, repaired housing, [and] restored housing for our military personnel”); *see also* Vest, “Military Housing Privatization Initiative: A Guidance Document for Wading through the Legal Morass,” 53. A.F.L.Rev. 8-9 (2002) (citing, Military Housing Privatization Initiative: Hearings Before the Subcomm. On Military Installations and Facilities of the House Comm. On National Security, 102nd Cong. (1996) (statement of Robert E. Bayer, Deputy Assistant Secretary of Defense, Installations stated that MHPI would “. . . Result in faster construction of more housing built to market standards. . . . Commercial construction and operation is not only faster and less costly than military construction, but private sector funds will also significantly stretch and leverage the Department’s limited housing resources, achieving more improved housing from the same funding level)); Else, “Military Housing Privatization Initiative: Background and Issues,” Cong. Res. Serv. at CRS-1 to CRS-2 (2001). The military’s investment associated with privatization may take various forms, however, that investment is limited to 33 1/3 percent of the capital cost (45 percent of the capital cost if land or facilities are conveyed). 10 U.S.C. § 2875.

Review of Mid-Atlantic’s function, financing, and management, in context of the MHPI, shows that the Government does not possess an interest sufficient to qualify Mid-Atlantic as a Government agency under §451. Mid-Atlantic is a limited liability corporation. Lincoln Family Communities, LLC (“LFC”) is the managing member and DoN is the non-managing member.¹ Mid-Atlantic owns the housing units, and LFC, as the managing member is solely responsible for the management, operation, maintenance, and leasing. *See* Operating Agreement (“OA”). In light of DoN’s overall role in the privatization entities, the entities are not ones in which the Government’s proprietary interest meets the § 451 standard.

Moreover, as it pertains to this case, the provisioning of residential housing within the United States to military personnel and their dependents is not an essential governmental function. This is demonstrated by the fact that it is the Department of Defense and DoN’s policy “to rely on the private sector as the primary source for housing accompanied and unaccompanied personnel normally eligible to draw a housing allowance.” *See* DoD Instruction 4165.63 § 3(b) (July 21, 2008); DoD Manual 4165.63-M § 4(b) (Oct. 28, 2010). Furthermore, the services have been directed to acquire family housing only for families that can’t find suitable housing in the private sector.² As one court explained in the context of a claim against the United States and privatization entities responsible for family housing at Fort Hood, Texas:

Providing commercial residences is not the regular business of the Army: the Army is engaged in an altogether more bellicose vocation. Even if providing such residences was once part of the regular business of the Army, it is no longer so, at least at Fort Hood—that was Congress’s very purpose in allowing privatization of on-base housing.

¹ The Government recognizes that LFC has assigned all of its rights, title, and interests in the project, but for ease of reference will continue to refer to LFC as managing member.

² *See* <http://www.acq.osd.mil/housing/overview.htm>.

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Wilson v. United States, Case No. A-11-CA-221-SS at 8 (W.D. Tex., Oct. 31, 2011) (dismissing claims against the United States for lack of subject matter jurisdiction) (attached). DoN is a non-managing member of Mid-Atlantic, and its primary role in connection with privatized housing is advocating on behalf of service members and military families.

Furthermore, that Mid-Atlantic is not a Federal agency for purposes of § 451 is reflected in Mid-Atlantic's structure making LFC the managing member responsible for day-to day management, operation, maintenance, and leasing activities. As the managing member, LFC possesses management and control of Mid-Atlantic and authority to make all virtually all business decisions. OA ¶4.02(b). LFC is also the Tax Matters Partner and possesses authority to manage and control all matters relating to income, gain, loss, deduction or credit for tax purposes. OA ¶3.11(a). LFC possesses the authority to modify Mid-Atlantic's development budgets without the approval of DoN. OA ¶3.12(a). Further, LFC possesses the exclusive right to enter contracts and other instruments on behalf of Mid-Atlantic. OA ¶4.02(i).

In contrast to the authority vested in LFC, DoN may not take part in the day-to day management activities or transact business on behalf of Mid-Atlantic. OA ¶4.03(a). Moreover, DoN is under no obligation to provide any additional funds to Mid-Atlantic, nor does it have any obligation to indemnify Mid-Atlantic or any other privatization entity. OA ¶¶3.01(d); 4.05(c). However, Mid-Atlantic is required to indemnify hold DoN harmless for any claims arising out of DoN's participation as a non-managing member. OA §4.05(d). Finally, LFC is only required to obtain DoN's written consent to: (1) encumber, mortgage, sell, refinance or incur additional borrowed debt; (2) admit additional members; (3) alter the application or distribution of the gross operating revenue; (4) assign or transfer an ownership interest; (5) sell all or substantially all of the assets; (6) replace the Property Manager or the Asset Manager; and (7) institute bankruptcy proceedings. OA ¶4.02(e).

Mid-Atlantic's assertion that it is a Government "agency" under § 451 is inconsistent with the MPHI and DoN's status as a non-managing member. Accordingly, the United States requests that Mid-Atlantic withdraw its argument that it constitutes a Government "agency" under § 451.

Removal under 28 U.S.C. § 1442(a)(1) --Mid-Atlantic/LPC were not acting under a Federal Officer

The Navy lacks the authority to direct or control Mid-Atlantic and LPC. Pursuant to the Operating Agreement, Mid-Atlantic is under the direction of LFC, its managing member. As previously noted, provisioning of residential housing within the United States to military personnel and their dependents, is not an essential governmental function. *See* DoD Instruction 4165.63 § 3(b); DoD Manual 4165.63-M § 4(b). Consistent with this fact, the MPHI authorizes the military to privatize military family housing, and consistent with that authority, Mid-Atlantic is the owner of the housing units and is responsible for the leasing, renovation, rehabilitation, ownership, management, operation, and maintenance. OA ¶2.03. LFC is a non-government entity and, as the managing member of Mid-Atlantic, possesses sole and exclusive authority to make all day-to-day

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decision regarding operation, management, maintenance and leasing of housing units. OA &4.02(b). As the non-managing member, DoN is explicitly prohibited from participating in such day-to-day activities, is prohibited from transacting any business for Mid-Atlantic, and lacks authority to bind Mid-Atlantic. OA ¶4.03(a).

Similarly, LPC's assertion that it acted under a Federal Officer is inaccurate. LFC as Mid-Atlantic's managing member is responsible for the leasing, managing, operating and maintaining residential units owned by Mid-Atlantic or selecting a contractor to perform these tasks. OA ¶2.03. The Operating Agreement prohibits DoN from instructing or directing contractors selected by LFC on behalf of Mid-Atlantic. Specifically, the only authority DoN possesses, as to a contractor such as LPC, is to require that Mid-Atlantic replace the contractor: (1) in the event of a default and failure to timely remedy the default, or (2) the contractor fails to meet specified performance criteria. LPC did not act under a Federal Officer because DoN lacked the authority to provide any instruction or direction to LPC.

Under the Operating Agreement, DoN does not possess authority to direct or control Mid-Atlantic or LPC's lease, renovation, rehabilitation, ownership, operation or management of the housing units. Accordingly, the United States requests that the privatization entities withdraw their arguments seeking removal under 28 U.S.C. § 1442(a)(1).

Derivative Sovereign Immunity and the FTCA's Discretionary Function Exception

Defendants move for dismissal for lack of subject matter jurisdiction, arguing that the doctrine of derivative sovereign immunity applies because, if DoN had performed the acts alleged in the Complaint, it would be immune from suit under the discretionary function exception of the FTCA. Defendants' Memo, at 4-5.³ As an initial matter, DoN has not contracted with the privatization entities to provide residential housing for military personal and their dependents. LFC and DoN formed a Limited Liability Corporation, Mid-Atlantic. Mid-Atlantic is the owner of

³ Mid-Atlantic asserts that it is also immune because it qualifies as a "federal agency" under the FTCA and there has been no waiver of sovereign immunity. Under the FTCA, "Federal agency" includes "corporations primarily acting as instrumentalities or agencies of the United States, but it does not include any contractor with the United States." 28 U.S.C. § 2671. The following factors are considered in making this determination "(1) the federal government's ownership interest in the entity; (2) federal government control over the entity's activities; (3) the entity's structure; (4) government involvement in the entity's finances; and (5) the entity's function or mission." *Menrala v. Crown Mortg. Co.*, 955 F.2d 1132, 1136 (7th Cir. 1992). Although there are "no sharp criteria for determining whether an entity is a federal agency within the meaning of the [FTCA], . . . the critical factor is the existence of federal government control over the 'detailed physical performance' and 'day to day operation' of that entity." *Lewis v. United States*, 680 F.2d 1239, 1240 (9th Cir.1982). In the instant case, and, for reasons previously discussed, Mid-Atlantic's argument is inconsistent with Congress's intent and purpose in enacting the MPFI and privatizing military family housing. Moreover, consistent with the Operating Agreement as previously discussed, DoN is the non-managing member of Mid-Atlantic and does not control the detailed performance or day-to-day operation of the management, operation, maintenance or leasing of the housing unit. Mid-Atlantic is not a federal agency and should withdraw its assertion that it is a sovereign entity and that there has been no waiver of sovereign immunity.

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the housing units. LFC, as the managing member of Mid-Atlantic, contracted with LPC. Mid-Atlantic or contractors that LFC/Mid-Atlantic hired to perform management, leasing, operation and maintenance of the unit, contracted and leased that unit to Plaintiffs. In the instant case, privatization entities are neither governmental agencies, nor are they government contractors; rather, they are private, for profit, non-governmental entities engaged in the business of owning, leasing, managing and maintaining residential housing units. Thus, the privatization entities' attempt to cloak themselves with the doctrine of derivative sovereign immunity and assert the FTCA's discretionary function exception should be withdrawn.

Furthermore, the doctrine of derivative sovereign immunity would not apply, even in the unlikely event a court were to conclude that DoN's status as non-managing member of Mid-Atlantic, DoN's transfer of ownership of the housing unit to Mid-Atlantic, or DoN's lease of real property to Mid-Atlantic, make the privatization entities government contractors (or subcontractors). Defendants' reliance upon *Mangold v. Analytical Services, Inc.*, 77 F.3d 1442 (4th Cir. 1996), is misplaced. *Mangold* extends sovereign immunity to private parties in very narrow circumstances; where imposing liability on private entities would directly impair significant governmental interest. *Id.* at 1448; *In re KBR, Inc.*, 736 F.Supp.2d 954, 967-68 (D. MD 2010). Mid-Atlantic's providing of military family housing does not implicate such significant governmental interests. As previously noted, the MHPI authorized the military to transfer ownership of military housing to private entities and for those entities to operate, manage, maintain, and lease that housing to military personnel and their dependents. This transfer of ownership and responsibility for the units is consistent with the military's policy to use the private sector to house military personnel and their families. There are no significant government interests that justify extending the doctrine of sovereign immunity and treating the privatization entities any different than any commercial entity that provides residential housing to military personnel and their dependents. That this was the intention of the parties is evidenced by requirement that the privatization entities maintain insurance against these types of claims.

At issue in the instant litigation is whether Plaintiffs were injured because the privatization entities failed to properly manage, operate and maintain a residential housing unit. The issue in this action is a simple dispute between a tenant and the Owner/Landlord/Maintenance Contractor regarding whether the tenant's legal rights under the law of the Commonwealth of Virginia were violated resulting in injury. Under the indemnity provisions of the Operating Agreement, Mid-Atlantic has specifically agreed to assume liability, defend and hold harmless DoN. OA § 4.05(d). Allowing this action to proceed, potentially resulting in the privatization entities being held liable for money damages (for which they are required to have insurance coverage) does not interfere with DoN essential duties and function.

Production of Operating Agreement to Plaintiffs and Court

It appears from our discussion that the privatization entities and the government agree that the Operating Agreement contains essential information that the Court should consider prior to resolving Plaintiffs' Motion to Remand and privatization entities' Motion to Dismiss. We understand that it was the privatization entities intent to file the Operation Agreement as an Exhibit

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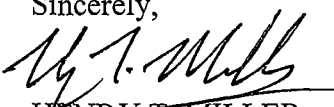
in support of their Notice of Removal and Motion to Dismiss, but that this was not done because the Operating Agreement contains Confidential Business Information ("CBI"). Privatization entities are in the process of working with the Navy to redact CBI from the Operating Agreement and intend to produce the redacted document to the Court as soon as possible. What is the proposed timeline for completion of those efforts? Alternatively, have you considered filing the Operating Agreement under seal with the Court or entering into a Protective Order with Plaintiffs' Counsel? In any event, given our discussion and to prevent the Court from deciding the pending motions without this information, privatization entities should give serious consideration to notifying the Court of the importance of that document, efforts being made to produce that document, and potentially request that Court stay ruling on the Motion to Remand and Motion to Dismiss until after the Court has had an opportunity review and to consider the document.

Proposed Course of Action

The government is hopeful that our potential dispute can be resolved without notifying or involving the Court. However, we are faced with an aggressive schedule and to ensure that the government's interests are protected, it is our intention to notify the Court of our potential interest on or shortly before the date that Plaintiffs file their Reply Memorandum in response to the privatization entities' Response in Opposition to the Motion to Remand. Currently, Plaintiffs must file the Reply Memorandum on or before April 2. If privatization entities can obtain the agreement of the Court and Plaintiffs to extend Plaintiffs' deadline for the filing of the Reply Memorandum, and ensure that Court agrees to address Plaintiffs' Motion to Remand before turning to the Motion to Dismiss, this would extend our deadline and provide additional time for you to review and consider the Government's position.

Conclusion

I believe that our discussion was helpful and am hopeful that the government can persuade the privatization entities to modify their present position and arguments without requiring the Court to address the government's concerns. For all the reasons explained herein, as well as the additional reasons we discussed during our call, the United States requests that the privatization entities withdraw their arguments that (1) Mid-Atlantic is a Federal agency under the FTCA and a Federal agency for purposes of removal; (2) Mid-Atlantic and LPC operated under instruction of a Federal Officer; and (3) that claims against the privatization entities are barred by doctrine of derivative sovereign immunity and the FTCA's discretionary function exception.

Sincerely,

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cc: Fishback, D.
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