K&L GATES

DEI Enforcement: False Claims Act and Other Risks on the Horizon

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Agenda

1. Trump Administration Diversity, Equity, and Inclusion (DEI) Initiatives
2. False Claims Act (FCA)
   a) Overview
   b) Significant Caselaw Developments
3. Enforcement Implications of DEI Executive Actions
4. Other FCA Issues and Mandatory Disclosure Rule

Trump Administration DEI Initiatives - Overview

Executive Order 14173: *Ending Illegal Discrimination and Restoring Merit-Based Opportunity*

Four Key Elements:

1. Revokes Exec. Order No. 11,246, 30 Fed. Reg. 12319 (Sept. 28, 1965), which imposed affirmative action obligations on government contractors to prevent discrimination against any employee or applicant because of certain protected characteristics.
2. Directs agencies to immediately cease DEI practices.
3. Requires federal contractors to "certify," under the FCA, that they do not operate programs promoting unlawful DEI.
4. Discourages DEI in the private sector through civil compliance investigations.

Executive Order 14173

Ending Illegal Discrimination and Restoring Merit-Based Opportunity

Requires all federal contracts and grants to contain the following terms:

The contractor/ grantee "does not operate any programs promoting DEI that violate any applicable Federal anti-discrimination laws."

That compliance with all applicable federal anti-discrimination laws is "material" to government payment decisions for purposes of the FCA, 31 U.S.C. § 3729(b)(4).

Sample Federal Contract Provisions

- In accordance with EO 14173, Contractor agrees that its compliance with all applicable Federal anti-discrimination laws is **material** to the [Government's] payment decisions for purposes of 31 U.S.C. § 3729(b)(4). **Contractor certifies it does not operate any programs in violation of any applicable Federal anti-discrimination laws**.
- This Award is funded in whole or in part with U.S. Government funds. To implement Executive Orders entitled *Ending Radical and Wasteful Government DEI Programs and Preferencing* and *Initial Rescissions of Harmful Executive Orders and Action,* your organization **must immediately terminate, to the maximum extent, all programs, contracted personnel, activities, or contracts promoting "diversity, equity, and inclusion" (DEI) at every level and activity, regardless of your location or the citizenship of employees or contractors, that are supported with funds from this Award**. Any vestige, remnant, or re-named piece of any DEI programs funded by the U.S. Government through funds provided under this Award are immediately, completely, and permanently terminated, globally regardless of language or affiliated translation. No additional costs must be incurred that would be used to support any DEI programs, personnel, or activities. **Please email confirmation to ___ by [*insert short and unreasonable deadline here*] that any and all DEI programs, personnel, or activities funded with U.S. Government funds have been terminated or closed**.

Legal Challenges

Nat'l Assoc. of Diversity Officers in Higher Educ. v. Trump, 1:25-cv-00333-ABA (D. Md. Feb. 3, 2025).

On 21 February 2025, the US District Court for the District of Maryland issued a nationwide preliminary injunction enjoining the following directives in the DEI executive orders:

1. The canceling or freezing of any awards, contracts, or obligations for government contractors engaging in illegal DEI.
2. The requiring of contractors to make certifications with respect to illegal DEI.
3. The bringing of any FCA enforcement action by the Department of Justice (DOJ) against federal contractors premised on any such certifications (although DOJ is allowed to continue investigating and there is no bar on qui tam actions).

The Trump administration has appealed the preliminary injunction to the Fourth Circuit.

What to Expect Next?

Executive Order 14173

Other litigation

Next steps in *Nat'l Assoc. of Diversity Officers in Higher Educ. v. Trump*

Amended executive order

Guidance from the federal government on what constitutes "illegal DEI"

FCA – Overview

FCA: Overview

- Prohibits any person from *knowingly*:
  - Submitting or causing to be submitted a false or fraudulent claim for payment to the government.
  - Using a material false statement in connection with a false or fraudulent claim for payment to the government.
  - Retaining monies owed to the government.
  - Conspiring to commit a violation of the FCA.
- Key elements:
  - False claim (request for payment to government)
  - Knowledge
    - Actual knowledge
    - Deliberate ignorance
    - Reckless disregard
  - Materiality

FCA: Scope

- Broad reach: can be implicated whenever government funds are at issue, regardless of industry
  - Contracts/procurement
  - Loan guarantees (e.g., FHA)
  - Reimbursements
  - Grants and federal aid (e.g., COVID-19 relief)
- Statute of limitations: six years from violation or three years when material facts reasonably known, but in no event longer than 10 years.
- Nevertheless, it has limits.
  - "The False Claims Act is not an all-purpose antifraud statute or a vehicle for punishing garden-variety breaches of contract or regulatory violations."
  - "[T]he FCA is not an appropriate vehicle for policing technical compliance with administrative regulations."

FCA: *Qui Tam* Provision

- *Qui tam* provision allows a private citizen (i.e., "relator") to bring an FCA suit.
  - Must be original source of information/public disclosure bar.
    - Must have knowledge "independent of and materially adds to" public disclosures.
  - A *qui tam* case remains under seal for at least 60 days while DOJ reviews it; DOJ often requests extensions.
  - DOJ may formally "intervene" and take over the litigation. Otherwise, relator can proceed with the suit at own expense.
    - DOJ declines in the vast majority of cases.
    - DOJ nevertheless closely monitors FCA cases and may file a Statement of Interest at different stages.
  - Relators are protected from retaliation.
  - Financial incentives are meaningful: *15% to 30% of ultimate proceeds*.

FCA: Consequences

- FCA provides for a penalty between US$14,308 and US$28,619 *per claim* (annually adjusted for inflation).
  - The number of claims can rise quickly.
  - FCA penalties are subject to the Eighth Amendment Excessive Fine Clause, but such challenges have had mixed success.
- Government may seek *treble* damages.
  - Caselaw is split on whether and when damages take into account the value the government received.
- Government often focuses on individual accountability.
- Other risks include:
  - Potential suspension and debarment of contractor (even if the action is settled).
  - Reputational and customer issues.

FCA: Statistics

- Government recoveries are high:
  - Over US$78 billion collected between 1987 and 2024.
  - Annual recoveries have exceeded US$2 billion since 2009.
- Recap of recent years:
  - Total recovery: US$2.9 billion in FY24 and US$2.8 billion in FY23.
  - FY23 had the highest recovery for defense procurement fraud in 15 years (over US$550 million).
  - *Qui tam* recovery is the bulk (US$2.4 billion in FY24).
- Continued uptick in cases initiated by the government:
  - FY23 saw the highest number of cases (500) and FY24 remained high (423).
  - Similar increase in number of civil investigative demands (1,504 in FY23).

FCA: Theories of Liability

- Three common types of false claim:
  - *"Traditional"/factually false claim* – an entity overbills the government or bills for good/services not provided.
  - *Express certification* – an entity obtains a payment/benefit from the government and, in the process, expressly certifies compliance with a law or regulation, which is false.
  - *Implied certification* – an entity obtains a payment/benefit from the government and, in doing so, is deemed to impliedly certify compliance with a law or regulation, which is false.
    - Endorsed by the Supreme Court in 2016.
- *Fraud in the inducement* – theory that a defendant's fraud to secure a contract or participate in a program renders all subsequent claims submitted thereunder as fraudulent.

Criminal FCA

18 U.S.C. § 287:

> Whoever makes or presents to any person or officer in the civil, military, or naval service of the United States, or to any department or agency thereof, any claim upon or against the United States, or any department or agency thereof, knowing such claim to be false, fictitious, or fraudulent, shall be imprisoned not more than five years and shall be subject to a fine in the amount provided in this title.

Defendant must have known the claim was false, fictious, or fraudulent.

Administrative FCA

- Added via 2025 National Defense Authorization Act
  - Replaced/expanded the Program Fraud Civil Remedies Act.
  - Applies when DOJ declines to pursue via the FCA.
- Streamlined process
  - Agency investigating official (often an inspector general) investigates, can subpoena, and makes findings to a reviewing official.
  - Relaxed rules of evidence and procedure.
  - Same elements and statute of limitations as the FCA.
  - No *qui tam* provisions.
- Remedies
  - US$5,000 penalties for each written false statement and false claim.
  - Double damages, up to maximum of US$1 million.
  - Agency costs from the investigation/prosecution.

FCA – Key Supreme Court Cases

Universal Health Servs., Inc. v. United States ex rel. Escobar, 519 U.S. 176 (2016)

- Unanimously upheld the implied certification theory:
  - A party that "knowingly fails to disclose [its] noncompliance with a statutory, regulatory, or contractual requirement" can be held liable where:
    - The claim not only requests payment but also makes specific representations about goods/services provided.
    - The failure to disclose the noncompliance transforms the representations into "misleading half-truths," i.e., "omitting critical qualifying information."
  - Arises even if the government does not expressly designate compliance as a condition of payment.
  - Recognition that entities receiving government payments "are often subject to thousands of complex statutory and regulatory provisions."

Universal Health Servs., Inc. v. United States ex rel. Escobar, 519 U.S. 176 (2016)

- Imposed a "demanding" materiality standard:
  - Courts must consider the "effect on the likely or actual behavior of the recipient of the alleged misrepresentation."
    - Insufficient (but may be relevant): designating a requirement as a condition of payment, or the government having the option to decline payment if it knew of noncompliance.
    - Government payment of a claim despite knowledge of the regulatory violation would be "strong evidence" against a finding of materiality. Conversely, consistent refusal to pay claims based on noncompliance supports materiality.
  - Materiality is not established by "garden-variety breaches of contract or regulatory violations" or where noncompliance is "minor or insubstantial."
  - Questions involving materiality are appropriate to resolve on motions to dismiss or for summary judgment.

Interpreting *Escobar*

- Courts split over whether *Escobar* requires the defendant to have made a *specific representation* about the good/services provided or if that was merely one way to support an implied certification.
- Differing approaches on what allegations (and evidence) are sufficient to plead (or establish) *materiality*.
  - Bare assertions of materiality or a "precondition to payment" are generally insufficient.
  - Relators increasingly point to similar matters where parties remitted funds or the government filed FCA actions.
  - Courts vary in the treatment of continued payment by the government in the face of known allegations or issues.
    - Often depends on what the government knew, who knew it, what it could do with that information, the importance of the contract, and the importance of the contract term allegedly violated.
  - Some courts evaluate and balance various factors.

U.S. ex rel. Schutte v. Supervalu (U.S. 2023)

- Unanimously rejected the argument that a plausible interpretation of an ambiguous requirement was sufficient to defeat scienter.
  - "[T]he FCA's standards focus primarily on what respondents thought and believed."
  - The "facial ambiguity" of a statute, regulation, or other relevant language "does not by itself preclude a finding of scienter under the FCA."
  - "[I]f respondents correctly interpreted the relevant phrase and believed their claims were false, then they could have known their claims were false."

U.S. ex rel. Schutte v. Supervalu (U.S. 2023)

- Further explained knowledge standards:
  - Deliberate ignorance means that a defendant has knowledge of a "substantial risk" that its statements are false but "intentionally avoids" confirming the relevant legal or regulatory requirement.
  - Reckless disregard "captures defendants who are conscious of a substantial and unjustifiable risk that their claims are false, but submit the claims anyway."
- Helpful for defendants:
  - A good faith, even if mistaken, interpretation of requirements may be a defense to scienter.
  - Even some objectively unreasonable interpretations may avoid liability if the defendant believed them to be accurate.

U.S. ex rel. Schutte v. Supervalu (U.S. 2023)

- Impacts:
  - The decision removes a potential early defense argument (i.e., that any after-the-fact objectively reasonable interpretation negates scienter).
  - Efforts to defeat FCA cases based on scienter may often need to be fought after discovery, at either summary judgment or at trial.
  - Contemporaneous documentation of a party's interpretation of a requirement and belief that it complied with the law will be important.
  - Government and relators may argue that best practices include a duty to inquire when faced with a "substantial risk" that interpretation of an ambiguous term may be incorrect.

Aftermath of *SuperValu*

- Generally harder to get dismissal or summary judgment.
  - *U.S. ex rel. Heath v. Wis. Bell, Inc.* (7th Cir. 2023) – court reversed summary judgment in case about whether defendant complied with rule requiring charging the government with the lowest price paid to similarly situated commercial customers.
    - Evidence supported that for many years defendants did not train personnel on the rule or put in place mechanisms to determine if the company complied with it.
    - Court held that this indicates at least a genuine dispute of material fact as to whether defendants acted with reckless disregard.

Aftermath of *SuperValu*

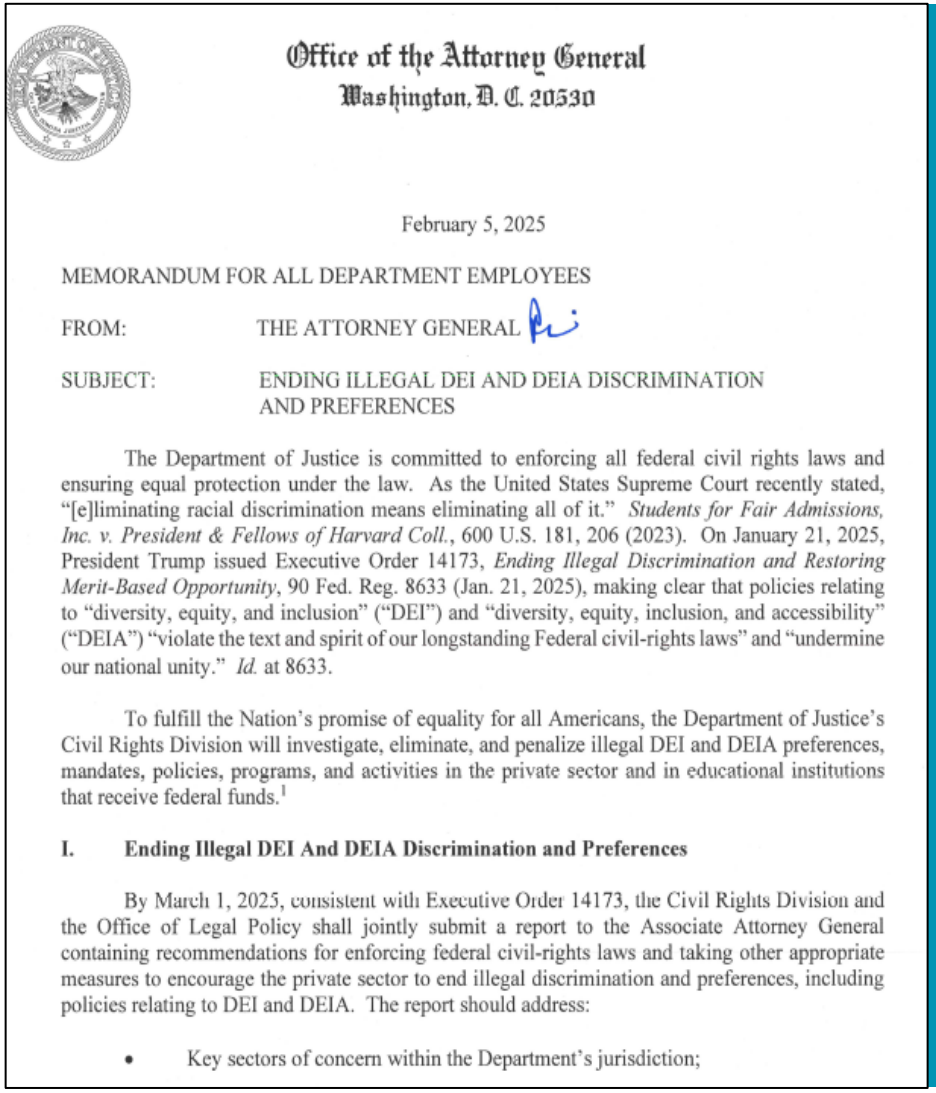
- However, defendants can succeed at trial when the requirement is ambiguous and they have an objectively reasonable interpretation:
  - *U.S. ex rel. Kraemer v. United Dairies LLP* (8th Cir. 2023) – court affirmed bench trial verdict in favor of defendant, finding that defendant's reliance on opinions of its insurance agents and continued payment of insurance claims after thorough audits undercut allegation of scienter, even if one nonmanaging partner of the business had an opinion that the claims were false.
    - Defendant's interpretation of the ambiguous policy at the time was objectively reasonable. This is in contrast with *SuperValu*, where the interpretation was developed after the fact.

Enforcement Implications of DEI Executive Actions

FCA-Implicated Provisions of Trump Executive Order 14173

- Contractors must certify in every contract or grant award that they do not operate any programs promoting DEI that violate any applicable federal anti-discrimination laws.
- All future contracts must include a term requiring that the contractor "agree that its compliance in all respects with all applicable Federal anti-discrimination laws is material to the government's payment decisions for purposes of [the FCA]."
- The attorney general (AG), in consultation with agency heads, must submit a report with recommendations for enforcing federal civil rights laws and taking other appropriate measures to encourage the private sector to end illegal discrimination and preferences.
  - Each agency shall identify up to nine potential civil compliance investigations of publicly traded corporations and certain large non-profits, foundations, higher education institutions, and professional associations.

AG Bondi's "Ending Illegal DEI" Memo



Office of the Attorney General
Washington, D. C. 20530

February 5, 2025

MEMORANDUM FOR ALL DEPARTMENT EMPLOYEES

FROM: THE ATTORNEY GENERAL

SUBJECT: ENDING ILLEGAL DEI AND DEIA DISCRIMINATION AND PREFERENCES

The Department of Justice is committed to enforcing all federal civil rights laws and ensuring equal protection under the law. As the United States Supreme Court recently stated, "[e]liminating racial discrimination means eliminating all of it." *Students for Fair Admissions, Inc. v. President & Fellows of Harvard Coll.*, 600 U.S. 181, 206 (2023). On January 21, 2025, President Trump issued Executive Order 14173, *Ending Illegal Discrimination and Restoring Merit-Based Opportunity*, 90 Fed. Reg. 8633 (Jan. 21, 2025), making clear that policies relating to "diversity, equity, and inclusion" ("DEI") and "diversity, equity, inclusion, and accessibility" ("DEIA") "violate the text and spirit of our longstanding Federal civil-rights laws" and "undermine our national unity." *Id.* at 8633.

To fulfill the Nation's promise of equality for all Americans, the Department of Justice's Civil Rights Division will investigate, eliminate, and penalize illegal DEI and DEIA preferences, mandates, policies, programs, and activities in the private sector and in educational institutions that receive federal funds.[1]

I. Ending Illegal DEI And DEIA Discrimination and Preferences

By March 1, 2025, consistent with Executive Order 14173, the Civil Rights Division and the Office of Legal Policy shall jointly submit a report to the Associate Attorney General containing recommendations for enforcing federal civil-rights laws and taking other appropriate measures to encourage the private sector to end illegal discrimination and preferences, including policies relating to DEI and DEIA. The report should address:

- Key sectors of concern within the Department's jurisdiction;

Directs DOJ's Civil Rights Division to investigate, eliminate, and penalize illegal DEI policies and activities in the private sector and in educational institutions that receive federal funds.

Civil Rights Division shall issue a report to the Associate AG by 1 March 2025 that addresses:

- Key sectors of concern.
- The most egregious and discriminatory DEI practitioners in each sector.
- A plan with specific steps to deter the use of DEI programs that constitute illegal discrimination or preferences, "including proposals for criminal investigations and for up to nine potential civil compliance investigations."
- Additional potential litigation activities.

Potential FCA Liability

- By requiring certification that a contractor does not operate any programs promoting DEI that violate federal anti-discrimination laws, Executive Order 14173 is creating an express certification environment.
- Contractors are required to agree, in advance, that this certification is material to the government's payment decision.
  - However, *Escobar* made clear that designating a requirement as a condition of payment is a relevant, but not dispositive, factor.
- Result: assertions by the government or *qui tam* relators that every individual claim for payment under a government contract violates the FCA and is subject to damages and penalties for any company with a program that arguably constitutes "illegal DEI."

Open Questions

- What is “illegal DEI”?
  - Undefined in Executive Order 14173 / Bondi memo, though some indications.
  - Administration views will dictate enforcement priorities and decisions on whether to bring a case.
  - Politically and financially motivated *qui tam* relators will also decide which cases to bring.
  - However, courts will be the ultimate arbiter.
    - After *Loper Bright*, the government is not entitled to deference.
- Will courts find that compliance with these DEI certifications is material in every contract?
- How will courts calculate monetary “damages”?
  - Will the value of goods/services provided be deducted?
- What activity is sufficient to establish scienter?

Scienter Considerations

- FCA requires scienter, i.e., actual knowledge, deliberate ignorance, or reckless disregard.
  - There is no requirement to show specific intent to defraud.
- *SuperValu* offers potentially useful guidance:
  - Being aware of a "substantial risk" that a statement is false but "intentionally avoid[ing]" confirming it could constitute deliberate ignorance.
  - Reckless disregard includes submission of a claim while "conscious of a substantial and unjustifiable risk" that it is false.
  - A good faith interpretation of requirements is a defense to scienter, even if it is ultimately determined to be mistaken.
- Best practice: contemporaneously document any conclusions that programs comply with federal anti-discrimination laws.

Other FCA-Related Issues and Mandatory Disclosure Rule

Mandatory Disclosure Rule (MDR)

- Contractors must "timely" disclose "credible evidence" of certain violations of federal criminal law and the FCA.
  - Required by FAR 52.203-13, 9.406-2, 9.407-2.
- Standard: "credible evidence"
  - Term not defined in the regulations.
  - Many focus on a "possible" violation standard (e.g., 33% to 50%) and disclose if the assessment falls in/above this range.
  - Others employ a reverse form of analysis, i.e., disclose if one determines that the Government could bring a credible, if not necessarily successful, FCA case.
- Standard: "timely"
  - Term not defined in the regulations or by inspector general offices, but it recognizes the need to first examine allegations raised.

Mandatory Disclosure Rule – Process

- Disclosure is made to the [cognizant Office of the Inspector General] and contracting officer.
- DOJ
  - Upon receiving a disclosure, DOJ distributes a copy to its Civil and Criminal Divisions. Some are referred to assistant US attorneys.
  - In most instances, DOJ has allowed the agencies to investigate and resolve the disclosures themselves.
- Office of Debarment and Suspension (SDO)
  - The SDO for the lead agency relative to the subject of a disclosure is given a copy when the inspector general receives it (at least for the Department of Defense). SDO must sign off before a disclosure can be closed.
  - Disclosures rarely result in suspensions or debarments by the contractor, but individuals *have* been suspended/debarred.

Conclusion

Considerations Moving Forward

Key Points to Consider:

- Prepare for potential internal referrals/hotline calls raising issues about DEI initiatives.
  - Mandatory disclosure rule (including determination of “credible evidence”).
  - Procedures to receive, investigate, and address issues raised.
  - As appropriate, assert and protect privilege.
- Be prepared for government inquiries.
  - Train staff on what to do in the event of a government subpoena, civil investigative demand, or agent visit.
- Document conclusions regarding the legality of DEI (or similar) programs and initiatives.
- Consult counsel.

Past programs:

What to Do When the Government Comes Knocking

Handling Allegations of Noncompliance: Internal Investigations and Self-Reporting

View on the
K&L Gates HUB
http://klgates.com/hub

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