

PUBLICATION

Court Blocks VC Firm from Issuing Grants to Black Women-Owned Businesses

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June 24, 2024

Recently, the United States Court of Appeals for the Eleventh Circuit (the Court) held in *Am. All. for Equal Rts. v. Fearless Fund Mgmt., LLC* (Fearless Fund) that the Fearless Strivers Grant Contest (the Contest), a startup funding competition open only to companies owned by Black women, is substantially likely to violate a federal civil rights law that prohibits private parties from discriminating on the basis of race when making or enforcing contracts. The competition is the brainchild of venture capital firm Fearless Fund (Fearless), which has a stated goal of investing in women-of-color-led businesses at the pre-seed, seed, or Series A financing stage in an effort to "bridge the gap in venture capital funding" for such founders seeking to grow and scale their businesses aggressively. Although the Eleventh Circuit's decision in *Fearless Fund* is not the final resolution of the case, the ruling raises questions regarding the legality, under 42 U.S.C. § 1981, of grants and financings that aim to benefit a specific class of persons on the basis of race.

What is the Legal Framework?

Enacted in the aftermath of the Civil War, Section 1981 of the Civil Rights Act of 1866 (§ 1981 or Section 1981) grants to all individuals within the U.S. the same rights to enter into and enforce contracts as "enjoyed by white citizens." The statute has been interpreted to prohibit discrimination on the basis of race (including color and ethnicity but excluding national origin) in making and enforcing public and private contracts. Section 1981 was traditionally applied to employment relationships but has been expanded by courts to apply to non-employment contractual relationships. The U.S. Supreme Court has held that plaintiffs bringing a claim of discrimination under § 1981 must ultimately prove that it was denied a protected right, and that race was the "but-for" cause of such discrimination, rather than a mere "motivating factor." That is, a plaintiff must prove that but for the plaintiff's race, the defendant's intentional, wrongful conduct and thus, the plaintiff's alleged injury, would not have occurred.

How Did the Fearless Contest Work?

Under the Contest rules and guidelines, winners are each offered \$20,000 in cash, certain digital tools, and mentorship, collectively aimed at supporting business growth. Only Black female residents of the U.S. are eligible for participation, and each business must be at least 51 percent Black woman owned. A panel of judges selects winners based on the growth potential and viability of each business, as well as its plans for the grant if awarded.

Does the Contest Likely Violate Federal Civil Rights Law?

In reversing the lower trial court's denial of a preliminary injunction, an initial question before the Court was whether § 1981 applies to the Contest. As previously mentioned, § 1981 prohibits race-based discrimination in making and enforcing contracts. Thus, a threshold issue in the Court's decision was whether the Contest rules constituted a "contract" between each of the contestants and Fearless. As of immediately prior to the filing of the lawsuit, Fearless specifically stated and acknowledged that the rules of the Contest were "a contract." These rules included, principally; (i) the obligation of each contestant to release and indemnify Fearless for certain liabilities and resolve all disputes by arbitration rather than litigation; (ii) Fearless's right to freely disclose or use the ideas in the contestant's entry; and (iii) Fearless's right to use the contestant's name, image, and likeness for promotional and other purposes. After the lawsuit was filed, however, Fearless made

certain changes to the Contest rules, including removing the acknowledgement that the Contest rules constituted "a contract." In rejecting Fearless's argument that the Contest was not a contract and merely constituted a means of granting "discretionary gifts," the Court found that the Contest conferred upon Fearless certain legal rights in connection with the contestants' participation in the Contest, and therefore constituted a contract.

A bedrock principle of contract law is that a contract is formed when parties agree to do or refrain from doing a particular thing, so long as sufficient consideration is present. The Court found that both under the original and amended rules, there was a "bargained-for exchange" between Fearless and the contestants that was "supported by good and sufficient consideration"; that is, there was a contract, irrespective of whether it was labeled as such. Thus, the Court held, that to the extent the Contest; (i) constitutes a contract; and (ii) discriminates based on race, there is a substantial likelihood that the Contest violates § 1981.

Key Takeaway #1: Naming conventions are not dispositive in determining whether there is a contract within the meaning of § 1981. A contract may be found where there is a *quid pro quo*, regardless of whether the arrangement is specifically referred to as a "contract." True discretionary gifts confer no enforceable rights upon the gift maker and impose no enforceable obligations upon the recipient. Grant programs intended to be discretionary gifts should be carefully constructed not to include a *quid pro quo*.

Are All Race-Conscious Contracts Invalid Under of § 1981?

Generally, even if an arrangement is a "contract" within the meaning of § 1981, it could be permitted under the judge-made exception for "remedial programs." Remedial programs are valid if they; (i) address "manifest racial imbalances"; and (ii) don't "unnecessarily trammel" others' rights, or "create an absolute bar" to the advancement of others. The Court found that because the Contest was open only to Black women, it therefore served to "create an absolute bar" to the advancement of non-Black women founders who apply to the Contest. Thus, the Contest failed the remedial program exception to § 1981. In addition, the Court found that the First Amendment, which generally prohibits the government from restricting a private party's freedom of speech, was substantially likely not to protect the Contest as a form of expressive conduct, because the First Amendment does not protect acts that constitute discrimination on the basis of race.

Key Takeaway #2: A race-conscious contract may fall within the "remedial programs" exception to § 1981's prohibition on contracts that discriminate based on race if such contract is remedial in nature and addresses obvious racial imbalances and does not unnecessarily hinder the rights of others or create an absolute bar to the advancement of others. A race-conscious contractual arrangement that is not intended to redress any clear racial disparity and excludes persons based on race will likely not be deemed a permissible "remedial program" under § 1981.

Summary

In deciding whether an arrangement constitutes a "contract," courts generally look beyond the name and form of the arrangement to its substance. So long as there is an exchange of value by mutual consent and mutual obligation, there likely is a contract within the meaning of § 1981, regardless of whether the arrangement is designated a "contract." A contract or other financing arrangement targeted at Black-owned businesses may be permissible under § 1981, if it is remedial in nature, designed to address obvious racial disparities, and does not unnecessarily hamper the rights of non-Black persons or create an absolute bar to the progress of non-Black persons.

Next Steps

1. **Stay Informed on Developments in the Fearless Fund Case.** Venture capital firms and other investors that engage in race-conscious programs and financings should closely follow the

progression of *Fearless Fund*, which has been remanded back to the trial court with instructions to enter a preliminary injunction to suspend the Contest. Further appeals may ensue pending the outcome of those proceedings, and developments in the law following final resolution of this case could profoundly impact race-conscious venture capital investments and grant-making activities moving forward.

2. **Proactively Assess the Potential Impact and Consult Legal Counsel.** Investors should take inventory of their programs, policies, and contractual arrangements and assess whether they potentially fall within the scope of § 1981 and therefore face risk of legal challenge under the federal civil rights laws. Grant programs intended to be gifts should be carefully drafted and documented as such. To reduce litigation risk under § 1981 with respect to non-gift, race-conscious contracts, investors should work with trusted legal counsel to ensure that such arrangements are structured with the aim of remedying particular, clear racial imbalances that do not impermissibly inhibit the rights or advancement of others. Alternatively, investors may consider broadening eligibility criteria to include demographic characteristics other than solely race, such that "but-for" causation is difficult to establish.

Should you have any questions about this topic, please contact [Chris Sloan](#), [Robert H. Laird Jr.](#), or any member of Baker Donelson's [Business and Corporate Group](#).