

"Activision Deal Shows SEC's Human Capital Disclosure Focus," *Law360*

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The U.S. Securities and Exchange Commission announced on Feb. 3 a groundbreaking settlement with Activision Blizzard Inc. over the company's alleged control failures in dealing with human capital-related disclosures. This settlement is the latest evidence of the commission's continuing focus on human capital issues. In addition to enforcing provisions under existing law, Chairman Gary Gensler and other commissioners have highlighted the need to consider new disclosure requirements related to human capital. [1]

The February settlement, pursuant to which the video game maker agreed to pay \$35 million to resolve the charges, comes amid the controversy that Activision purportedly allowed pervasive sexual harassment, discrimination, unequal pay and retaliation to occur, exhibiting a failure to adequately respond.[2]

The SEC charged Activision not for its failure to establish a respectful culture in the workplace, but for its alleged failure to have controls and processes in place to ensure that it adequately captured the risks created by that workplace culture and described such risks in its filings.

At the same time, the SEC also settled charges related to Activision including nondisclosure provisions in its standard separation agreements that could chill potential whistleblowers from contacting the commission.

This core message — that companies need to have processes in place to ensure that they fully evaluate their risks and that they adequately disclose such risks — is not new.

But what is new is the application of that concept to address a company's failure to adequately track and assess the impact of workplace harassment and discrimination issues. This evolution in disclosure expectations by the SEC is consistent with the increasing importance of workplace culture issues to stakeholders, including shareholders.

This article discusses how the order illustrates the SEC's approach to environmental, social and governance from a disclosure perspective and the relevance of whistleblower protection rules to employee agreements covering potential workplace misconduct, providing recommendations to companies regarding potential compliance enhancements to consider in light of the focus on human capital risk.

Disclosure Policies and Procedures Charge

The SEC cannot directly regulate a company's workplace culture. Since late 2020, however, the commission has specifically required public companies to disclose human capital resources, as well as any material human capital measures or objectives.[3]

The agency can, therefore, require that public companies have sufficient policies and procedures in place to accurately make public disclosures with respect to human capital matters.[4]

The SEC's February order settled charges related to how Activision lacked "controls and procedures among its separate business units designed to collect or analyze employee complaints of workplace misconduct" across its business units between 2018 and 2021.[5] That is, the order did not allege that Activision's disclosures were misleading or that the company took steps to conceal the existence of workplace issues.

The SEC's order instead focused solely on the process that Activision went through in compiling the relevant filings.

The order, which Activision entered without admitting or denying the relevant conduct, states that Activision's management and disclosure committee lacked sufficient information to understand the universe of employee complaints about workplace misconduct and, accordingly, did not assess for material issues warranting public disclosure or whether its disclosures on workforce risk factors were fulsome and accurate.[6]

The SEC pointed to Activision's own risk factor disclosures about the importance of its workforce and its ability to attract, retain and motivate its personnel to support its case that such disclosures were important to Activision, faulting the company for highlighting these generalized risks without ensuring a means by which those making disclosure determinations could assess the potential impact of the workplace conduct complaints.[7]

Jason Burt, director of the SEC's Denver Regional Office, noted that Activision's failure to "implement necessary controls to collect and review employee complaints about workplace misconduct ... left [Activision] without the means to determine whether larger issues existed that needed to be disclosed to investors." [8]

Whistleblowing Charge

The commission's second set of charges reflects a similar application of a preexisting SEC priority to the present case — ensuring that potential whistleblowers are not inhibited or discouraged by separation or other employee agreements.

The agency's order settled charges related to allegations that Activision violated SEC whistleblower protection Rule 21F-17, which in relevant part provides that "no person may take any action to impede an individual from communicating directly with [SEC] staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement ... with respect to such communications." [9]

The commission found that between 2016 and 2021, Activision's generic separation agreement templates, used in the ordinary course for significant numbers of employees, required former employees to notify Activision within one day of learning of a disclosure obligation or request for information by an administrative agency, including the SEC. [10]

Burt said that "taking action to impede former employees from communicating directly with the Commission staff about a possible securities law violation is not only bad corporate governance, it is illegal." [11]

The SEC brought this charge even though it acknowledged that it was "not aware of any specific instances" where former Activision employees were prevented from communicating with the commission or where Activision took steps to enforce the relevant clause.

In addition, the SEC investigated and settled these charges against Activision despite the provision explicitly stating that "nothing in this separation agreement shall prohibit ... disclosures that are truthful representations in connection with a report or complaint to an administrative agency." [12]

In early 2022, Activision revised its separation agreements template, removing this notification requirement in its entirety. [13]

Compliance Recommendations

Although not every public company faces the same degree of toxic workplace culture allegations as those leveled against Activision, public companies should assess whether their current programs meet the SEC's articulated expectations regarding tracking, analyzing and potentially disclosing complaints regarding workplace culture.

1. Ensure your harassment and discrimination complaint procedures are effective at receiving, reporting, tracking and investigating allegations of workplace misconduct.

Many organizations currently address harassment and discrimination complaints pursuant to different procedures than those used for allegations of ethical or financial impropriety, potentially utilizing line-level management or the human resources function to address such workplace conduct concerns in the first instance.

Reassess your employee complaint policies and procedures to ensure that such complaints are being recorded and documented consistently and thoroughly investigated.

2. Track and report to the necessary finance personnel or board committees on harassment and discrimination cases.

Public companies should review their mechanisms for board-level review of human capital issues including workplace culture complaints to ensure appropriate visibility into these issues.

Review and assess disclosure controls and procedures to ensure there are mechanisms in place to elevate human capital-related issues in connection with the company's public disclosures.

3. Review your separation agreements to ensure language is compliant with current expectations on the protection of whistleblowers.

The Activision resolution demonstrates that whistleblower complaints remain an important focus of the SEC. The commission's statutory and regulatory provisions enable whistleblowers to raise complaints with confidentiality and retaliation protections.[14]

Publicly traded companies should take this settlement agreement as a reminder to review their confidentiality and separation agreements to ensure that they do not contain provisions that could be viewed as contrary to the SEC's whistleblower protection rules. Given the SEC's broad view of the whistleblower protection rule, all companies have to review exempting templates to ensure that they do not — even unintentionally — run afoul of Rule 21F-17.

Conclusion

Interestingly, despite the obvious connections to the SEC's articulated ESG priorities — in particular in this case, the human capital "S" issues — the press release announcing the action does not note whether, or how, this fits in the commission's ESG focus.

But regardless of whether the SEC applies the sometimes controversial ESG label,[15] there is no doubt that human capital disclosure controls are a type of misconduct on which the majority of the

commission is focused.

Critics of the resolution may derive support from Commissioner Hester Peirce's strong and public dissent noting that in "using disclosure controls and procedures as its tool, [the SEC] seeks to nudge companies to manage themselves according to the metrics the SEC finds interesting at the moment" — but companies that fail to consider the potential risks attendant to human capital disclosures or invest in policies and procedures to enable them to make such disclosures accurately do so at their peril.[16]

Footnotes

[1] See, e.g., Gary Gensler (@GaryGensler), Twitter (Aug. 18, 2021), <https://twitter.com/GaryGensler/status/1428022885889761292> ("Investors want to better understand one of the most critical assets of a company: its people. I've asked staff to propose recommendations for the Commission's consideration on human capital disclosure."); Gary Gensler, Chairman, Sec. Exch'g Comm'n, Prepared Remarks at London City Week (June 23, 2021), <https://www.sec.gov/news/speech/gensler-speech-london-city-week-062321> (describing request to SEC staff and remarking how it "builds on past agency work and could include a number of metrics, such as workforce turnover, skills and development training, compensation, benefits, workforce demographics including diversity, and health and safety. Disclosure helps companies raise money. It helps the efficient allocation of capital across the market. And it helps investors place their money in the companies that fit their investing needs."); see also Jaime Lizárraga, Comm'r, Sec. Exch'g Comm'n, Raising the Bar on Diversity, Equity and Inclusion (Oct. 13, 2022), <https://www.sec.gov/news/speech/lizarraga-remarks-raising-bar-diversity-equity-and-inclusion-101322> (noting that SEC's agenda included proposing rules on enhancing board diversity and human capital management disclosures, which "if proposed, represent an opportunity for investors to benefit from more meaningful, standardized and transparent diversity-related disclosures that would help them make more informed investment decisions."); Robert J. Jackson, Allison Herren Lee, Comm'rs, Sec. Exch'g Comm'n, Joint Statement of Commissioners Robert J. Jackson, Jr. and Allison Herren Lee on Proposed Changes to Regulation S-K (Aug. 27, 2019), <https://www.sec.gov/news/public-statement/statement-jackson-lee-082719> (expressing support for proposed human capital disclosure changes to Regulation S-K).

[2] Prior to acknowledging the SEC's investigation in September 2021, Activision faced months of negative publicity and litigation surrounding allegations that it allowed pervasive sexual harassment, discrimination, unequal pay, and retaliation to occur and exhibited a failure to adequately respond. See Kirsten Grind & Sarah E. Needleman, SEC is Investigating Activision Blizzard Over Workplace Practices, Disclosures, Wall St. J., Sept. 20, 2021, <https://www.wsj.com/articles/sec-is-investigating-activision-blizzard-over-workplace-practices-disclosures-11632165080>; Maeve Allsup, Activision Blizzard Sued Over 'Frat Boy' Culture, Harassment, Bloomberg Law, July 21,

2021, <https://news.bloomberglaw.com/daily-labor-report/activision-blizzard-sued-by-california-over-frat-boy-culture>; Michelle Chapman, Hit with #MeToo Revolt, Blizzard Entertainment chief is out, Associated Press, Aug. 3, 2021, <https://apnews.com/article/activision-blizzard-walkout-brack-fed1287c94cfb30c3447ffeb7b89443f>; Complaint, Dep't of Fair Emp't & Hous. v. Activision Blizzard, Inc., No. 21STCV26571 (Cal. Sup. Ct. July 20, 2021). Later that month, Activision confirmed that it reached an agreement with the U.S. Equal Employment Opportunity Commission ("EEOC") to (i) settle EEOC claims against it, (ii) strengthen Activision's harassment and discrimination policies, and (iii) create an \$18million fund to compensate and make amends to eligible claimants, which was approved by the court in March 2022. See Press Release, Activision Blizzard, Inc., Activision Blizzard Commits to Expanded Workplace Initiatives, Reaches Agreement with the EEOC (Sept. 27, 2021), <https://investor.activision.com/node/34481/pdf>; Proposed Consent Decree, U.S. Equal Emp't Opportunity Comm'n v. Activision Blizzard, Inc., No. 2:21-cv-07682 (C.D. Cal. Sept. 27, 2021), ECF No. 11-1; Press Release, U.S. Equal Emp't Opportunity Comm'n, Court Approves EEOC's \$18 Million Settlement with Activision Blizzard (Mar. 30, 2022), <https://www.eeoc.gov/newsroom/court-approves-eeocs-18-million-settlement-activision-blizzard>; Consent Decree, U.S. Equal Emp't Opportunity Comm'n v. Activision Blizzard, Inc., No. 2:21-cv-07682 (C.D. Cal. Mar. 29, 2022), ECF No. 82.

[3] See Modernization of Regulation S-K Items 101, 103, and 105, Securities Act Release No. 33-10825, Exchange Act Release No. 34-89670, 85 Fed. Reg. 63,726, 63,728 (Oct. 8, 2020) (revising Item 101(c) to "include, as a disclosure topic, a description of the registrant's human capital resources to the extent such disclosures would be material to an understanding of the registrant's business").

[4] See 17 C.F.R. § 240.13a-15(a).

[5] In re Activision Blizzard, Inc., Exchange Act Release No. 96797, at 2, 3-4 (Feb. 3, 2023), <https://www.sec.gov/litigation/admin/2023/34-96796.pdf>.

[6] Id. at 4.

[7] Id. at 3-4.

[8] Press Release, Sec. Exch. Comm'n, Activision Blizzard to Pay \$35 Million for Failing to Maintain Disclosure Controls Related to Complaints of Workplace Misconduct and Violating Whistleblower Protection Rule (Feb. 3, 2023), <https://www.sec.gov/news/press-release/2023-22>.

[9] In re of Activision Blizzard, Exchange Act Release No. 96797, at 4 (Feb. 3, 2023), <https://www.sec.gov/litigation/admin/2023/34-96796.pdf> (quoting 17 C.F.R. § 240.21F-17(a)).

[10] Id. at 4-5.

[11] Press Release, Sec. Exch. Comm'n, Activision Blizzard to Pay \$35 Million for Failing to Maintain Disclosure Controls Related to Complaints of Workplace Misconduct and Violating Whistleblower Protection Rule (Feb. 3, 2023), <https://www.sec.gov/news/press-release/2023-22>.

[12] In re of Activision Blizzard, Exchange Act Release No. 96797, at 5 (Feb. 3, 2023), <https://www.sec.gov/litigation/admin/2023/34-96796.pdf>.

[13] Id.

[14] See Press Release, Sec. Exch. Comm'n, SEC Whistleblower Office Announces Results for FY 2022 (Nov. 15, 2022), https://www.sec.gov/files/2022_ow_ar.pdf.

[15] See, e.g., Andrew Ramonas, ESG-Wary House Republicans Seek to Rein in SEC, BlackRock, Bloomberg Law, Jan. 27, 2023, <https://news.bloomberglaw.com/securities-law/esg-wary-house-republicans-seek-to-rein-in-sec-blackrock>; Jordan Wolman, Republicans plan surge of attacks on 'woke' investing after the midterms, Politico, Nov. 1, 2022, <https://www.politico.com/news/2022/11/01/republicans-sustainable-investing-midterms-00064326>; Eleanor Terrett, Exclusive: Republicans introduce legislation to thwart ESG-related SEC disclosure demands, Fox Business, Dec. 1, 2022, <https://www.foxbusiness.com/politics/republicans-introduce-legislation-to-thwart-esg-related-sec-disclosure-demands>.

[16] Statement by SEC Comm'r Hester M. Peirce, The SEC Levels Up: Statement on In re Activision Blizzard, Feb. 3, 2023, <https://www.sec.gov/news/statement/peirce-statement-activision-blizzard-020323>.

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