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SEC Announces Novel Human Capital Internal Controls Settlement with Activision Blizzard, Inc.

On February 3, 2023, the SEC reached a novel \$35 million settlement with Activision Blizzard, Inc., one of the world's largest video game developers and publishing companies, to resolve allegations that the company failed to maintain controls and procedures to ensure the adequacy of disclosures it made related to human capital in SEC filings. Activision Blizzard agreed to settle the allegations without admitting or denying the SEC's findings, concluding an almost 17-month investigation stemming from workplace misconduct complaints at Activision Blizzard and its subsidiaries.¹

The SEC alleges that although Activision Blizzard disclosed—in Form 10-K and 10-Q filings made between 2017 and 2021—that a failure to attract, retain and motivate key personnel could materially affect the company's performance, the company lacked internal controls and procedures “designed to ensure that information related to employee complaints of workplace misconduct would be communicated to Activision Blizzard's disclosure personnel to allow for timely assessment on its disclosures.”² As a result, the SEC alleges, Activision Blizzard's management “lack[ed] sufficient information to understand the volume and substance of employee complaints of workplace misconduct” and was unable “to assess related risks to the company's business, whether material issues existed that warranted disclosure to investors, or whether the disclosures it made to investors in connection with these risks were fulsome and accurate.”³ The SEC concludes that through this failure, the company violated Exchange Act Rule 13a-15(a), which requires issuers to implement and maintain controls and procedures “designed to ensure that information required to be disclosed” in SEC filings is (1) timely “recorded, processed, summarized and reported” to the SEC and (2) “accumulated and communicated to the issuer's management . . . as appropriate to allow timely decisions regarding required disclosure.”⁴

¹ Press Release, Activision Blizzard, Activision Blizzard Provides Update on Workplace Initiatives (Sept. 21, 2021), <https://investor.activision.com/news-releases/news-release-details/activision-blizzard-provides-update-workplace-initiatives>.

² *In the Matter of Activision Blizzard*, Exchange Act Release No. 96796 (Feb. 3, 2023) (hereinafter “Release No. 96796”), at ¶ 2, <https://www.sec.gov/litigation/admin/2023/34-96796.pdf>.

³ *Id.* at ¶ 10.

⁴ *See id.* at ¶ 5 (quoting 17 C.F.R. § 240.13a-15(e)). The Order also addresses Activision Blizzard's separation agreements with employees, which from 2016 to 2021 contained a provision whereby former employees were allowed to respond to requests from administrative agencies in connection with any reports or complaints only if the former employee “notif[ied Activision Blizzard] of a disclosure obligation or request within one business day after [the former employee] learn[ed] of it and permit[ted] the Company to take all steps it deem[ed] to be appropriate to prevent or limit the required disclosure.” *Id.* at ¶ 15. The Order concludes that this provision, which was included in a significant number of signed separation agreements, violated Exchange Act Rule 2f-17(a) because it “undermine[d]” the rule's purpose to “encourage individuals to report to the Commission.” *See id.* at ¶¶ 16, 20 (quoting Securities Whistleblower Incentives and Protections Adopting Release, Release No. 34-63434 (June 13, 2011)).

The Activision Blizzard order reflects an expansive view as to what Rule 13a-15(a) requires with respect to internal controls and procedures concerning human capital. The rule requires that issuers implement controls and procedures to ensure timely communication of information “required to be disclosed” to the SEC.⁵ In the Order, the SEC does not allege that the company’s disclosures themselves were incomplete or inaccurate. Instead, the SEC contends that Activision Blizzard’s disclosure controls and procedures were inadequate because they “should capture not only the required disclosures but also information that is relevant to an assessment of the need to disclose developments and risks that pertain to the issuer’s businesses.”⁶

This conclusion not only finds a violation of the rule based on language that the rule does not in fact contain, but interestingly the Order does not allege that workplace misconduct—or reports of workplace misconduct at Activision Blizzard—was in fact relevant to retention and recruitment efforts, *i.e.*, was relevant to the underlying disclosure, let alone that such information was material such that it needed to be disclosed.

This Order raises important questions as to how broadly the SEC believes companies must implement controls and policies concerning information that may be connected to employee retention and recruitment. Workplace complaints are one of any number of sources of information potentially relevant to employee retention and recruitment. As such, they are also one of any number of topics as to which the SEC may in hindsight allege that a company’s management “lack[ed] sufficient information to understand” when making human capital disclosures, resulting in alleged Rule 13a-15(a) violations.⁷ In this sense, the Order may be an ominous sign of forthcoming SEC regulation by enforcement, where the SEC is limited—for now—by hindsight and not much else.

Going forward, human capital will continue to be a critical area of enforcement activity to monitor as the Enforcement Division continues to refine what controls, policies and disclosures are required in this space. There may also be rulemaking on the horizon that further clarifies disclosure and internal control requirements in the human capital space.

In 2020, the SEC amended Item 101 of Regulation S-K to require that public companies disclose “the number of persons employed by the registrant, and any human capital measures or objectives that the registrant focuses on in managing the business (such as, depending on the nature of the registrant’s business and workforce, measures or objectives that address the development, attraction and retention of personnel).”⁸ Since that time, there has been ongoing discussion about enhancing those disclosure requirements, particularly with respect to how public companies value their investments and expenses in human capital.

In June of 2022, a Working Group on Human Capital Accounting Disclosure, composed of academics, market participants and former SEC officials, submitted a petition for rulemaking asking the SEC to develop rules requiring human capital accounting disclosure requirements.⁹ The petition requested that the SEC “develop rules to require public companies to disclose sufficient information to allow investors to assess the extent to which firms invest in their workforce,” and recommended enhanced accounting-related disclosure to reflect that human capital-related costs are deemed expenses as opposed to investments.¹⁰ Chair

⁵ 17 C.F.R. § 240.13a-15(e).

⁶ Release No. 96796 at ¶ 5 (quoting Certification of Disclosure in Companies’ Quarterly & Annual Reports Final Rule Adopting Release, Release No. 33-8124 (Aug. 29, 2002)).

⁷ See *id.* at ¶ 10.

⁸ 17 CFR § 229.101.

⁹ Working Group on Human Capital Accounting Disclosure, Petition for Rulemaking (June 7, 2022), <https://www.sec.gov/rules/petitions/2022/petn4-787.pdf>.

¹⁰ *Id.*

Gary Gensler indicated on several occasions in 2022 that he is seriously considering acting on this petition and/or otherwise revisiting the human capital disclosure requirements.¹¹

In 2023 and beyond, human capital is likely to remain a hot button area for SEC enforcement activity and rulemaking. We will continue to monitor this critical and emerging area for significant developments.

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¹¹ See, e.g., Gary Gensler, Remarks to the Investor Advisory Committee (Sept. 21, 2022), <https://www.sec.gov/news/speech/gensler-remarks-investor-advisory-committee-092122>.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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