

\$35M SEC Settlement Underscores Processes, Procedures Ensuring Appropriate Public Disclosures

By Richard J. Cino, Susan M. Corcoran, Laura A. Mitchell, Joseph C. Toris &

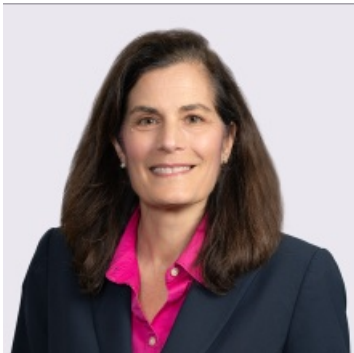
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Meet the Authors



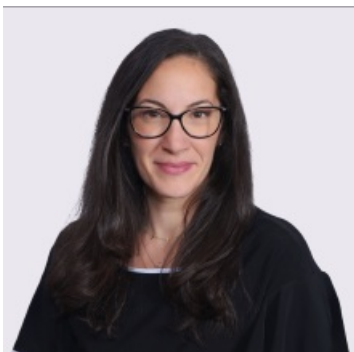
Richard J. Cino

Principal
908-795-5131
Richard.Cino@jacksonlewis.com



Susan M. Corcoran

(She/Her)
Principal
(914) 872-6871
Susan.Corcoran@jacksonlewis.com



In a \$35 million settlement that emphasizes the “S” for social in Environmental, Social and Corporate Governance (ESG) issues in public filings, publicly traded video game developer [Activision Blizzard, Inc. has agreed with the Securities and Exchange Commission \(SEC\)](#) to pay to resolve the company’s alleged failure to maintain adequate disclosure controls and procedures that would have allowed it to evaluate properly the adequacy of its human capital disclosures.

The settlement highlights the need for adequate controls and Board of Directors access to and fluency in information about company activities, including discrimination and harassment complaints. In addition, the agency’s stance previews the SEC’s use of financial reporting tools to move beyond material financial concerns and toward ESG-related concerns over the cumulative and aggregate effects of company practices.

SEC Rules 13a-15(a), (e)

SEC Rule 13a-15(a) requires that covered issuers maintain disclosure controls and procedures.

SEC Rule 13a-15(e) requires the disclosure controls and procedures be “designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the [Exchange] Act (15 U.S.C. 78a *et seq.*) is recorded, processed, summarized and reported, within the time periods specified in the Commission’s rules and forms.” This includes those “designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the [Exchange] Act is accumulated and communicated to the issuer’s management ... to allow timely decisions regarding required disclosure.”

Significantly, the controls and procedures are intended to cover a broader range of information than the issuer’s financial reporting controls, including information “relevant to an assessment of the need to disclose developments and risks that pertain to the issuer’s businesses,” according to the SEC’s *Certification of Disclosure in Companies’ Quarterly & Annual Reports Final Rule Adopting Release*, Release No. 33-8124 (Aug. 29, 2002).

Background

Activision’s troubles began in July 2021, when California’s Civil Rights Department (formerly known as the Department of Fair Employment and Housing or DFEH) filed a complaint against the company in the Superior Court of California.

DFEH accused Activision of gender pay discrimination and of allowing sexual harassment incidents to go unresolved. The complaint cited examples of Activision’s alleged “frat

Laura A. Mitchell

(She/Her)

Principal

303-225-2382

Laura.Mitchell@jacksonlewis.com



Joseph C. Toris

KM Attorney

908-795-5220

Joseph.Toris@jacksonlewis.com

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boy” workplace culture, where male employees “banter[ed] about their sexual encounters, talk[ed] openly about female bodies and joke[d] about rape[.]”

The complaint noted Activision’s workforce was only 20 percent female and the company’s leadership exclusively male and White. The complaint alleged that few women received promotions, women were paid less for the same roles as their male counterparts, and women would be subject to layoff more often than male employees.

SEC Order on Failure in Processes, Procedures

Notwithstanding allegations of significant and, most critically, numerous discrimination and harassment issues at the company, between 2018 and 2021, Activision stated in its SEC filings that attracting, retaining, and motivating a workforce of employees with specialized skills is particularly important to its business.

However, during this same period, Activision “lacked 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,” according to the SEC’s February 3, 2023, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order.

According to the Order, between 2018 and 2021, Activision knew its ability to attract, retain, and motivate employees (human capital concerns) constituted a particularly important risk in its business. However, the company lacked adequate controls and procedures to collect and analyze data from its separate business units, including complaints of workplace misconduct.

Indeed, while Activision required individual business unit leaders to report certain categories of potentially material information to its Disclosure Committee, the data reported did not include information relevant to Activision’s ability to attract, retain, and motivate employees. Significantly, employee complaints of workplace misconduct likely to negatively impact employee engagement or retention were not included. Because the information failed to include data concerning workplace misconduct, management and disclosure personnel could not determine if a disclosure was required.

The SEC determined in its Order:

By lacking sufficient information to understand the volume and substance of employee complaints of workplace misconduct, Activision Blizzard’s management 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.

In the company’s required Form 10-K disclosures during this period, however, Activision made risk factor disclosures pertaining to its workforce, including stating, “If we do not continue to attract, retain, and motivate skilled personnel, we will be unable to effectively conduct our business.” The company also identified its ability to attract, retain, and develop key personnel and developers as a factor that could cause its actual future results and other future circumstances to differ materially from those expressed in any forward-looking statements.

The SEC concluded the company violated Exchange Act Rule 13a-15(a) because of

Activision's failure to have adequate disclosure controls and procedures in place that would allow it to report on the nature and extent of misconduct.

SEC Findings on Separation Agreements

Separately, the SEC also found that, from 2016 through 2021, Activision entered into a significant number of separation agreements using a form agreement that required former employees to notify the company if the individual received an administrative agency request in connection with a report or complaint. The SEC found these agreements violated Dodd-Frank Act whistleblower protections (SEC Rule 21F-17(a)) by requiring the former employees to notify Activision if they received a request for information from the SEC staff.

Dissent

Strikingly, as noted in the sole dissent to the Order, SEC made no substantive finding or allegations of fraud and no violations of the securities laws. The SEC made no allegation that Activision's disclosures themselves were incomplete or inaccurate, the dissent pointed out. Activision agreed to settle the allegations without admitting or denying the SEC's findings.

Lessons

Whether publicly traded or not, companies need to have adequate processes and procedures in place so that important information regarding the company's operations can be brought to and vetted by the Board. A CEO or general counsel usually determines which matters need to be escalated to the Board. The Activision settlement demonstrates that processes should be adopted to ensure the Board has regular notice of all material aspects of the company's business, including complaints of workplace misconduct.

For example, the types of procedures and processes related to workplace misconduct and employee relations investigations should provide the Board sufficient, cumulative, and aggregated periodic information such that it can understand:

- What types of complaints are being made;
- How often they are being made;
- The business units from which these claims are arising; and
- Other relevant information.

With this, the Board would be alerted to the types of issues the company faces, what management is doing to correct the situation, and what disclosures may need to be made. This must be proactive. The effort must focus on maintaining a healthy workplace environment and (in circumstances like that affecting Activision) focused efforts must follow to rebuild and sustain a healthy workplace culture.

These processes and procedures should be reviewed regularly to ensure they are providing the Board accurate and useful information. This calls for an active relationship among the company's C-Suite, Board, and SEC compliance personnel, as well as the company's employment attorneys who assist in disclosure decisions. To the extent it ever was, this is not an HR-only issue any longer.

The company should also provide the Board training on the types of issues the company typically faces, so it can make informed decisions on the adequacy of the company's

response and the necessity of any disclosures.

Please contact a Jackson Lewis attorney with any questions.

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