

JULY 19, 2021

SEC Initiates First Enforcement Proceeding of the SPAC Boom Against SPAC, Sponsor, Merger Target and CEOs

On July 13, 2021, the SEC charged a SPAC, its sponsor, its proposed merger target and both the SPAC's and target's CEOs with making false and misleading statements about the target company's technology and ability to obtain essential licenses.¹ The charges represent the SEC's first enforcement action against a SPAC since the "SPAC boom" took off late last year. In the past several months, the SEC has focused on SPACs in its investor releases,² disclosure guidance,³ accounting guidance,⁴ and staff statements but, in that time, had not brought charges against any SPACs before now.⁵ The charges allege that the SPAC's inadequate due diligence on the target led it to make misleading public disclosures, an issue the SEC's Chair said reflects the "risks inherent to SPAC transactions" and the misaligned "incentives" between SPACs and their investors. The charges illustrate the SEC's heightened interest in SPACs and confirm the importance of SPAC sponsors, directors and officers taking appropriate steps to [mitigate litigation and regulatory risk, as we have previously reported](#).

The Enforcement Proceeding

Stable Road Acquisition Corp., a SPAC, completed its initial public offering in November 2019, with an 18-month window to complete a business combination. The SPAC's CEO was also one of three managing members of the SPAC's sponsor, SRC-NI Holdings, LLC. On October 7, 2020, the SPAC announced a merger with Momentus, Inc. ("Momentus"), an early-stage space transportation company. On the same day, the SPAC raised \$175 million of capital by entering into subscription agreements with private investment in public equity ("PIPE") investors in exchange for shares in the merged company after the business combination was approved.

Before the proposed business combination closed, the SEC brought charges against several entities and individuals associated with both the SPAC and Momentus. The SEC charged Momentus and its CEO with scienter-based fraud under Section 17(a) of the Securities Act and Section 10(b) and Rule 10b-5 of the Exchange Act. The SEC alleged that Momentus claimed that its propulsion technology had been successfully tested in space, when in reality its sole in-space test suggested that the technology lacked commercial potential. The SEC also alleged that Momentus misled investors about its CEO's ability to obtain essential licenses by downplaying known national security concerns about him.

The SEC also charged the SPAC, its sponsor, and its CEO with violations under Section 17(a)(2) and (3) of the Securities Act and Sections 13(a) and 14(a) of the Exchange Act. The SEC alleged principally that the SPAC issued misleading disclosures because it "did not perform reasonable due diligence" on the target. Although the SPAC retained a space technology consulting firm to investigate the target, it did so only one month before the merger announcement, and it did not instruct the consulting firm to evaluate the target's one in-space test. The SEC also accused the SPAC of executing the merger agreement despite never

receiving an adequate response to its repeated questions about documents indicating national security concerns with Momentus's CEO. Accordingly, the SEC alleged that several statements in the SPAC's investor presentations and public filings, including financial projections and statements that the target had "successfully tested" its technology, were materially misleading. The SEC also alleged that the SPAC's CEO caused the SPAC's violations and that the CEO's actions were attributable to the SPAC's sponsor because he served as the sponsor's managing member and his actions were taken on behalf of and for the benefit of the sponsor.

The SEC announced its charges against the SPAC, its sponsor, its CEO, and Momentus in an administrative order filed on July 13, 2021 (the "Order").⁶ The SEC also filed a complaint against Momentus's CEO on the same date in the United States District Court for the District of Columbia.⁷ The parties settled on a "no admit, no deny" basis, except Momentus's CEO, against whom the litigation is currently proceeding in United States District Court for the District of Columbia. As part of the settlement, the SPAC, its CEO, and Momentus agreed to pay civil penalties. The SPAC and Momentus also agreed to offer every PIPE investor the right to terminate its subscription agreement, and the SPAC's sponsor agreed to forgo 250,000 founder shares that it would have otherwise been entitled to upon shareholder approval of the business combination. Momentus also agreed to retain an "Independent Compliance Consultant" to review its ethics and compliance programs and issue a written report to the SEC with its findings and recommendations.

In the SEC's press release announcing the charges, SEC Chair Gary Gensler explained that the case illustrated the risk "inherent" in SPAC transactions of misaligned incentives between the parties to a SPAC transaction and SPAC investors:

This case illustrates risks inherent to SPAC transactions, as those who stand to earn significant profits from a SPAC merger may conduct inadequate due diligence and mislead investors. . . . Stable Road, a SPAC, and its merger target, Momentus, both misled the investing public. The fact that Momentus lied to Stable Road does not absolve Stable Road of its failure to undertake adequate due diligence to protect shareholders. Today's actions will prevent the wrongdoers from benefitting at the expense of investors and help to better align the incentives of parties to a SPAC transaction with those of investors relying on truthful information to make investment decisions.⁸

Implications

As the last several months of SEC commentary, guidance and public statements have shown, the SEC is acutely focused on SPACs. This case further highlights SEC scrutiny of SPACs and related parties, and serves as a reminder that SPACs and their sponsors and directors—and even merger targets—should take affirmative steps to mitigate litigation and regulatory exposure. SPACs and their sponsors and directors should engage in robust and well-documented due diligence on merger targets, and ensure their efforts conform with appropriate M&A disclosure practices. We expect the SEC, and the private plaintiffs' bar, to continue carefully scrutinizing public statements and filings associated with SPAC transactions—including public statements and filings for the hundreds of recently launched SPACs still looking for a merger target.

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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:

Susanna M. Buerge
+1-212-373-3553
sbuerge@paulweiss.com

Geoffrey R. Chepiga
+1-212-373-3421
gchepiga@paulweiss.com

Andrew J. Ehrlich
+1-212-373-3166
aehrich@paulweiss.com

Harris Fischman
+1-212-373-3306
hfischman@paulweiss.com

Daniel J. Kramer
+1-212-373-3020
dkramer@paulweiss.com

Gregory F. Laufer
+1-212-373-3441
glaufer@paulweiss.com

Jane B. O'Brien
+1-202-223-7327
jobrien@paulweiss.com

Lorin L. Reisner
+1-212-373-3250
lreisner@paulweiss.com

Audra J. Soloway
+1-212-373-3289
asoloway@paulweiss.com

Securities Litigation and Enforcement Practice Management Associate Daniel S. Sinnreich and Associate Jack Day contributed to this client memorandum.

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- ¹ See *In the matter of Momentus, Inc.*, Order Instituting Cease-and-Desist Proceedings, Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order, Sec. Act. Rel. No. 10955, Exchange Act Rel. No. 92391, Admin. Proc. File No. 3-20393 (July 13, 2021), <https://www.sec.gov/litigation/admin/2021/33-10955.pdf>.
 - ² *What You Need to Know About SPACs*, SEC Investor Bulletin (May 25, 2021), <https://www.sec.gov/oiea/investor-alerts-and-bulletins/what-you-need-know-about-spacs-investor-bulletin>.
 - ³ *Special Purpose Acquisition Companies*, SEC Div. of Corp. Fin. Disclosure Guidance: Topic No. 11 (Dec. 22, 2020), <https://www.sec.gov/corpfin/disclosure-special-purpose-acquisition-companies>.
 - ⁴ John Coates, Acting Director, Division of Corporate Finance & Paul Munter, Acting Chief Accountant, *Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies ("SPACs")*, Public Statement (Apr. 12, 2021), <https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs>.
 - ⁵ John Coates, Acting Director, Division of Corporate Finance, *SPACs, IPOs and Liability Risk under the Securities Laws*, Public Statement (Apr. 8, 2021), <https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws>.
 - ⁶ See *In the matter of Momentus, Inc.*, Sec. Act. Rel. No. 10955, at 6.
 - ⁷ Complaint, *Sec. Exch. Comm'n v. Kokorich*, Case No. 1:21-CV-1869 (D.D.C. July 13, 2021), <https://www.sec.gov/litigation/complaints/2021/comp-pr2021-124.pdf>.
 - ⁸ Press Release, Sec. Exch. Comm'n, *SEC Charges SPAC, Sponsor, Merger Target, and CEOs for Misleading Disclosures Ahead of Proposed Business Combination*, Release No. 2021-124 (July 13, 2021), <https://www.sec.gov/news/press-release/2021-124>.