

# Regulatory and Enforcement Alert

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## SEC Focuses Enforcement Efforts on SPAC Transaction

July 14, 2021

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In one of the first major enforcement actions charging a special purpose acquisition company (“SPAC”), the SEC yesterday charged SPAC Stable Road Acquisition Company, its sponsor SRC-NI, its CEO Brian Kabot, the SPAC’s proposed merger target Momentus Inc., and Momentus’s founder and former CEO Mikhail Kokorich with misleading claims about Momentus’s technology and the national security and foreign ownership risks associated with Kokorich. While the facts of the case reflect a straightforward alleged offering fraud, the SEC’s public remarks about the matter, as well as the creative remedies, reflect the agency’s intense ongoing focus on the SPAC market and apparent intention to send a strong message to market participants.

Momentus, an early-stage space transportation company, aspires to provide satellite-positioning services with in-space propulsion systems powered by water plasma thrusters. Stable Road completed its initial public offering (“IPO”) for \$172.5 million in November 2019, with proceeds held in trust for the benefit of shareholders until completion of a business combination. In late August or early September 2020, Stable Road began due diligence on Momentus’s technology, and on October 7, a merger between Stable Road and Momentus was announced. Before publicly announcing their merger agreement, Momentus and Stable Road disclosed information to potential private investment in public equity (“PIPE”) investors. On November 2, 2020, Stable Road filed a Form S-4 registration statement, which it amended on December 14, 2020 and March 8, 2021.

The SEC charged two categories of misleading statements. First, the investor presentations and SEC filings misrepresented that Momentus had successfully tested its water based propulsion technology in space, when in fact the only in-space test failed to achieve its primary mission objectives. Although Kokorich and Momentus never shared with Stable Road and Kabot material internal analyses about the mission’s failure, the SEC found that Stable Road, the SPAC, “acted unreasonably in adopting and repeating Momentus’s claim that it had successfully tested its technology in space when it had not conducted any specific due diligence to evaluate and verify the accuracy of that material assertion.” Second, the November 2020 Form S-4 did not disclose that the Committee on Foreign Investment in the United States (“CFIUS”) had expressed specific concerns about Kokorich and ordered him to divest his interest in Momentus in June 2018, and the December 2020 amendment did not disclose that the Commerce Department had denied his application for an export license in November 2020. The SEC found that Stable Road conducted inadequate due diligence by failing to obtain a full and complete understanding of the basis for CFIUS’s order or its impact on Momentus’ business.

The Commission charged Momentus with scienter-based fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities, and with causing Stable Road's violations. It charged Stable Road with negligence-based fraud and violations of reporting and proxy solicitation provisions, and SRC-NI and Kabot with causing Stable Road's violations. Momentus, Stable Road, SRC-NI, and Kabot settled with the SEC. The terms of the cease and desist include more than \$8 million in penalties, tailored investor protection undertakings, and SRC-NI's forfeiture of founder's shares it stands to receive if the merger is approved. The SEC is litigating its case against Kokorich in the U.S. District Court for the District of Columbia.

The SEC's order and accompanying press release provide an illuminating roadmap of the Commission's enforcement approach to the SPAC market. First, although only the proposed target was charged with violating scienter-based antifraud provisions of the federal securities law, the SPAC was also charged on negligence theories for failing to undertake more probing diligence of the target's business. SEC Chairman Gary Gensler explained that "[t]he fact that Momentus lied to Stable Road does not absolve Stable Road of its failure to undertake adequate due diligence to protect shareholders." Although in this case the ultimate de-SPAC transaction had yet to be presented to shareholders, we expect the SEC to bring similar scrutiny to the level of diligence conducted by underwriters or other gatekeepers (*e.g.* audit firms) in SPAC-related transactions. Relatedly, the Commission's express focus on a seemingly abbreviated due diligence process—"conducted on a compressed timeline"—underscores the need to create thorough and robust documentation reflecting analysis and consideration of all material aspects (and risks) of the target company's business. Third, the relief ordered by the Commission demonstrated significant flexibility in tailoring remedies to the SPAC market, requiring (1) the settling parties to provide PIPE investors with the right to terminate their subscription agreements prior to the shareholder vote to approve the merger, (2) the SPAC's sponsor to forfeit 250,000 founders' shares it would otherwise have received upon consummation of the business combination, and (3) the target company to undertake enhancements to its disclosure controls, including the creation of an independent board committee and retention of an internal compliance consultant for a period of two years.

This case—with prominent remarks in the SEC's press release attributed to Chairman Gensler—shows the SEC's intense focus on the SPAC market—which began with a series of staff guidance and public remarks—now extends to the enforcement arena. This could be a harbinger of cases against other participants in SPAC transactions and diligence processes related to those transactions, including underwriters and auditors.

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