

SEC charges SPAC, sponsor, target and CEOs for misleading disclosures and inadequate due diligence

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The SEC continued its recent focus on SPACs by filing charges against both sides of a planned but not yet completed SPAC merger, including charges against the SPAC and its CEO for adopting and repeating the target's claims without conducting adequate due diligence.

SEC charges SPAC, sponsor, target and CEOs of both companies

On July 13, 2021, the SEC [announced](#) charges relating to the planned merger of Stable Road Acquisition Company (Stable Road), a special purpose acquisition corporation (SPAC), and Space Transportation Company Momentus Inc. (Momentus), the proposed merger target. The SEC charged the target and its former CEO with making misrepresentations, and also charged the SPAC, its CEO, and the sponsor with due diligence failures. The enforcement action is notable in a couple respects—it is the first SEC enforcement action aimed at a SPAC since Chairman Gary Gensler was sworn into his post, and the SEC enforcement action occurred *prior to* closing of the proposed business combination.

The planned merger followed a traditional private placement process in which, prior to the merger announcement, investors were sought to invest in the combined business at closing via a private placement of equity securities—commonly referred to as a PIPE transaction. A PIPE marketing process is typically conducted using an investor presentation prepared by management of the target company, with input and review by the SPAC. After this marketing process, the parties announced the deal and the SPAC filed a registration statement on Form S-4, including several amendments. The S-4 registration statement was not declared effective at the time of the enforcement action—and, at the time of this writing, the transaction has not yet closed.

The SEC alleged two sets of misrepresentations occurred in public interviews, social media commentary, marketing materials and SEC filings for the planned merger:

- First, the materials said that Momentus had successfully tested its key space transportation technology when, in fact, the test had failed and had involved a prototype that was not commercially viable. The SEC alleged that multi-billion dollar revenue projections were based on this unproven technology.
- Second, the materials did not disclose that the U.S. government had expressed national security concerns about Momentus's then-CEO. The SEC alleged that the concerns were material because the government agencies could deny necessary licenses for Momentus to be involved in space launches.

The SEC [settled](#) scienter-based fraud charges against Momentus and negligence-based charges against Stable Road, its CEO, and the deal sponsor (the CEO was a managing member of the sponsor). The settlements include over \$8 million in penalties, governance undertakings, and forfeiture of a portion of the SPAC sponsor's founders shares. PIPE investors will also be given the right to terminate their subscription agreements that would have otherwise required them to fund their investment at closing of the business combination. The SEC separately filed contested litigation against the

former CEO of Momentus, which the SEC is continuing to pursue.

Due diligence

The SEC alleged that, before executing the merger agreement, the target told the SPAC that the test mission was a success. The SEC did not allege that the SPAC ever learned otherwise, but charged the SPAC and its CEO with adopting the misstatements without adequate due diligence. The SEC said that the SPAC did not begin substantive due diligence until a little more than a month before the merger announcement and did not ask its space technology consulting firm to review the test mission. The SEC also alleged that the SPAC knew that the U.S. government had forced the target's CEO to divest from a prior space company but did not conduct adequate due diligence about it or of the CEO's status as a national security risk.

"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."

– SEC Chair Gary Gensler

Key takeaways and continued SPAC scrutiny

The SEC's enforcement action is a reminder that a SPAC business combination is similar to a traditional IPO in potential liability for misrepresentations. These can include statements made in PIPE investor presentations, registration statements, and other public statements related to the transaction. The SEC suggested that SPACs and their sponsors have a gatekeeper role in conducting adequate due diligence to ensure accurate disclosures in light of their significant financial interests in the transaction. This means SPACs, their sponsors, and their advisors will need to undertake sufficient diligence to ensure that the disclosures relating to a potential transaction are materially accurate and complete.

The SEC action also suggests there could be liability with respect to statements made in *pre-effective* registration statements filed by SPACs in anticipation of closing a SPAC transaction. We do not believe the traditional hooks for liability (e.g., Section 11 of the Securities Act of 1933) would be applicable to a registration statement that has not yet been declared effective by the SEC staff. However, the SEC's enforcement case shows that the existing public trading market for the SPAC's securities creates a risk that investors might rely on statements in the SPAC's S-4 registration statement. Accordingly, SPACs and their sponsors will want to take steps and conduct appropriate diligence to ensure the statements in the initial S-4 registration statement are materially accurate and complete.

Lastly, we expect the SPAC scrutiny to continue. The enforcement action follows a series of SEC staff statements about SPACs,¹ and SEC Chair Gary Gensler signaled his personal interest with a statement in the enforcement press release (excerpted above). We expect that the SEC's scrutiny of SPAC transactions will continue under Chairman Gensler, including a focus on holding SPACs, sponsors, and the relevant individuals responsible for engaging in sufficient due diligence into targets.

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¹ These include a statement from Paul Munter, the Acting Chief Accountant on [financial reporting and auditing considerations](#); a statement from the Division of Corporate Finance Staff on [issues relating to SPACs](#); a statement from John Coates, the then-Acting Director of the Division of Corporate Finance (and now SEC General Counsel) on [liability relating to SPACs under the securities law](#); and statements from Coates and Munter on [accounting and reporting considerations for warrants issued by SPACs](#).