

SEC Charges SPAC, Sponsor, Merger Target and Ceos for Misleading Disclosures

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On July 13, 2021, the US Securities and Exchange Commission (SEC) announced charges against a special purpose acquisition company (SPAC), the SPAC's sponsor, the SPAC's proposed merger target and two executives for allegedly misleading claims about the SPAC target's technology and about national security and foreign ownership concerns associated with the target's former CEO. This is the first enforcement action against a SPAC following recent public statements from SEC Commissioners and the staff; these statements suggested that the SEC would scrutinize this alternative route to the public markets.

IN DEPTH

According to the SEC's settled order, Momentus Inc.—a privately held company that aspires to provide space infrastructure—and its founder and former CEO Mikhail Kokorich made fraudulent statements and omissions as it sought to go public through a business combination with Stable Road Acquisition Company, a SPAC. Specifically, Momentus and Kokorich repeatedly stated that the merger target had “successfully tested” its propulsion technology in space. However, Momentus's only in-space test had failed to achieve its primary objectives or demonstrate the technology's commercial viability. Moreover, Momentus and Kokorich allegedly concealed concerns that the US government expressed about national security and foreign ownership risks posed by Kokorich, a Russian citizen. Stable Road allegedly engaged in negligent misconduct by repeating and disseminating Momentus's misrepresentations in SEC filings without a reasonable basis in fact.

Without admitting or denying the SEC's findings, Momentus, Stable Road, Stable Road's CEO Brian Kabot and Stable Road's sponsor, SRC-NI, settled with the SEC for total penalties of approximately \$8 million. Momentus and Stable Road also agreed to multiple undertakings, including governance changes, a two-year compliance consultant, rescission rights and the return of founders' shares. The SEC filed a separate litigated action against Kokorich.

This enforcement action is interesting for several reasons. First, SPAC sponsors, underwriters, lawyers and auditors should be mindful of the SEC's use of alleged diligence gaps to form the basis of a fraud claim. Stable Road completed its SPAC offering in November 2019 and had until May 2021

to find a merger partner, obtain shareholder approval and complete the business combination. According to the SEC's order, in late June 2020, Stable Road began merger discussions with Momentus. While Stable Road engaged a space technology consulting firm to assist with due diligence, the SEC alleges that the consulting firm was never asked to evaluate the test launch of Momentus's technology. Without independently confirming Momentus's claims, Stable Road repeated Momentus's statements about the successful test of its technology in its initial and amended registration statements. According to SEC Chair Gary Gensler, "[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." Furthermore, the SEC found that Stable Road knew that the US government had ordered Kokorich to divest from another space technology company in 2018, but the SPAC executed its merger agreement and filed multiple registration statements without obtaining a complete understanding of the basis of the government's order or its impact on Momentus's business.

Second, the SEC ordered expansive undertakings. Momentus and Stable Road agreed to provide private investment in public equity (PIPE) investors with the right to terminate their subscription agreements prior to the shareholder vote to approve the merger; the sponsor agreed to forfeit 250,000 founders' shares it would otherwise receive upon consummation of the business combination; and Momentus agreed to form an independent board committee and retain an internal compliance consultant as part of an effort to enhance the company's disclosure controls. Although the SEC previously signaled its intent to use more tailored undertakings, the extent of these requirements is unusual.

Finally, this action shows the resources that the SEC's Division of Enforcement (the Division) is dedicating to investigating potential fraud in connection with SPACs. According to the Division's [2020 Annual Report](#), it takes an average of 24 months between case opening and the filing of an enforcement action. Here, the Division moved quickly, and the SEC filed its action approximately eight months after Stable Road filed its initial registration statement containing the alleged misrepresentations. Additionally, the SEC brought its action in advance of the shareholder vote on the merger, which is currently scheduled for August 2021. The staff will not hesitate to move quickly if it believes that investors do not have complete and accurate information when voting on a proposed merger. Furthermore, this case will provide a template for future investigations and actions, allowing the SEC to move more quickly in the future.

Key Takeaways

- **SEC priority:** This action highlights the SEC's focus on SPAC transactions. The SEC is likely to continue to pursue alleged wrongdoing in connection with SPAC-related business combinations aggressively. The speed of the case, nature of the sanctions and statement by the Chair all underscore aggressive enforcement. Expect more cases to come.
- **Importance of thorough diligence:** SPAC sponsors should perform thorough due diligence in evaluating targets and carefully evaluate disclosures in registration and proxy statements, including potential risks associated with a target company's ongoing operations or future prospects. According to the SEC, reliance on the target's own representations is insufficient. The SEC also signaled that subject matter experts must be afforded sufficient scope.
- **Warning to gatekeepers:** Relatedly, the SEC's focus on adequate due diligence should serve as a warning to lawyers, underwriters, auditors and other gatekeepers involved in SPAC-related business combinations. By placing pressure on the diligence process, the SEC

is looking to enlist gatekeepers to enhance disclosures and encourage more careful SPAC investments.

- **Unique undertakings:** The SEC continues to be aggressive when it comes to remedies. Requiring the sponsor to forego its founders' shares and the target company to make corporate governance changes are significant undertakings. These undertakings will likely become the model for future settlements in SPAC-related actions.

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