

Practice Update

SPAC Mergers in the SEC's Crosshairs

July 23, 2021

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The past few weeks have seen a turn of events for companies involved with Special Purpose Acquisition Company (SPAC) vehicles. First, the Securities and Exchange Commission (SEC) announced civil administrative charges against a SPAC, the SPAC sponsor and the CEO of the SPAC, as well as the proposed merger target and the former CEO of the target. Second, the SEC and Department of Justice (DOJ) are investigating Lordstown Motors Corp. and the SPAC merger with DiamondPeak Holdings Corp. Third, hedge-fund billionaire William Ackman dropped his plans to use his SPAC to invest in Universal Music Group due to SEC concerns. These events come on the heels of SPACs raising billions of dollars in 2020 and 2021.

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In the Matter of Momentus, Inc. et al.

The SEC brought charges against: the SPAC, Stable Road Acquisition Company; the SPAC's sponsor, SRC-NI; its CEO, Brian Kabot; the SPAC's proposed merger target, Momentus Inc.; and Momentus' founder and former CEO, Mikhail Kokorich. (available [here](#)). All the parties but Kokorich settled the charges. The crux of the SEC's allegations are statements made to investors that Momentus had "successfully tested" its propulsion technology in space when, in fact, Momentus' only in-space test had failed to achieve its primary mission objectives or to demonstrate the commercial viability of the technology. The SEC also alleges that Momentus and Kokorich misrepresented the extent to which

national security concerns involving Kokorich undermined Momentum's ability to secure governmental licenses essential to its operations. The Order states that these misrepresentations and omissions were adopted by Stable Road and incorporated into multiple public filings, most notably, Stable Road's November 2020 registration statement filed on Form S-4 and related amendments as well as slide presentations given to potential investors in connection with the business combination. In addition, the SEC alleges that Stable Road conducted inadequate due diligence related to Momentum's technology and the undisclosed national security concerns involving Kokorich despite touting the "extensive due diligence" that it undertook.

The SEC charged Momentum and Kokorich with violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act of 1934, and Rule 10b-5 promulgated thereunder, for making knowing or reckless misrepresentations and omissions of material fact regarding its propulsion technology and Kokorich's status as a national security threat — scienter based offenses. The SEC's order also found that Stable Road violated certain negligence-based antifraud provisions of the federal securities laws, Section 14(a) of the Exchange Act of 1934 and Rule 14a-9 promulgated thereunder, as well as certain reporting and proxy solicitation provisions (namely Section 17(a)(3) of the Securities Act of 1933) by repeating misleading statements in public filings associated with its proposed merger with Momentum. The order also found that the SPAC's sponsor, and its CEO, caused Stable Road's Section 17(a)(3) violations.

The SEC ordered Momentum, the SPAC, the SPAC's sponsor, and the SPAC's CEO to cease and desist any violations of securities laws and regulations. The SEC also ordered, among other things: the SPAC to pay a \$1 million civil money penalty; the SPAC's sponsor to forfeit its rights to 250,000 founders shares; the SPAC's CEO to pay a \$40,000 civil money penalty; and Momentum to pay a \$7,000,000 penalty.

The SEC further required Momentum to, within 60 days of the consummation of its anticipated merger, create an independent committee within its Board of Directors to institute controls related to public disclosures to investors and to retain an outside consultant to review, implement, and/or propose any ethics or compliance programs.

Key Takeaways

- The SEC's enforcement action is a reminder that a SPAC business combination is similar to a traditional IPO in potential liability for misrepresentations.
- 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.
- The SEC's scrutiny of SPACs will continue. This is especially true given Chairman Gensler's personal interest as evidenced by his statement in the enforcement press release. (see below)

Lordstown Motor, Corp.

On July 16, 2021, Lordstown confirmed reports that the U.S. Attorney's Office for the Southern District of New York in Manhattan is investigating allegedly false statements and omissions made to investors by Lordstown, including the SPAC deal with DiamondPeak Holdings Corporation. This is a continuation of issues that have dogged Lordstown following the SPAC deal.

A March 12, 2021, report by a short seller led to the creation of a Special Committee of its Board of Directors to investigate the short seller's allegations. The Special Committee of independent directors concluded that while many of the allegations were false and misleading there were issues regarding the accuracy of certain statements about the Company's pre-orders. In May, shortly following the SEC's April 12, 2021 statement discussing the accounting

implications of certain terms that are common in warrants issued by SPACs, Lordstown announced a restatement. Shortly thereafter, the Company's CEO and CFO resigned.

The Company had previously confirmed that it is under investigation by the SEC. The Company revealed in securities filings that it had received two subpoenas from the SEC for the production of documents and information, including relating to the Merger between DiamondPeak and Lordstown and pre-orders of vehicles.

Ackman Drops SPAC Plan

On July 19, 2021, Ackman announced that he dropped his plans to use his SPAC to invest in Universal Music Group. Ackman noted that he was dropping his plans because of issues raised by the SEC concerning the structure of the transaction. Ackman stated, "The SEC raised a deal killer. They said that, in their view, the transaction did not meet the New York Stock Exchange SPAC rules and what that meant was what I would call a dagger in the heart of the transaction." In a July 19, 2021, letter to shareholders explaining the decision to walk away from the Universal investment, Ackman reemphasized that the decision was "driven by issues raised by the SEC with several elements of the proposed transaction – in particular, whether the structure of our [initial business combination] qualified under the NYSE rules." One of the takeaways from the failed transaction is that creative SPAC deals must meet legal muster as defined by the SEC.

Conclusion

The takeaway from the very different issues raised in the three matters is that regulators are looking at SPAC transactions with increased scrutiny. SEC Chairman Gary Gensler has taken a personal interest in the matter, as evidenced by the fact that he commented on the Momentum enforcement action. It is rare for the Chairman to appear in press releases

about enforcement actions. Chairman Gensler stated, **“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...”** [The SEC’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.” <https://www.sec.gov/news/press-release/2021-124> (emphasis added).

Finally, it remains to be seen whether the developments in these three SPAC-related transactions are anomalies that happened to occur close in time or whether they are the beginning of a trend.

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