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Gladius Escapes Fines for Unregistered ICO after Self-Reporting to the SEC

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On February 20, 2019, the SEC announced that it settled charges against Gladius Network LLC ("Gladius") for failing to register non-exempt offers and sales of securities in violation of Sections 5(a) and 5(c) of the Securities Act. While the SEC has previously settled charges relating to unregistered ICOs, this is one of few occasions since its 2017 DAO Report that the SEC refrained from imposing civil monetary penalties for an ICO that it determined violated the registration requirements of the federal securities laws.

The Gladius Network and Sale of GLA Tokens

Gladius was founded in July 2017 to establish a blockchain-based "Gladius Network" that would enable internet content providers to fight DDoS attacks by using GLA Tokens to purchase spare bandwidth and storage space from organized pools of individuals and businesses.

Gladius sold its GLA tokens in private and public pre-sales between October and December 2017, raising around $12.7 million worth of Ether. Approximately six months after GLA Tokens were distributed to purchasers, Gladius self-reported its GLA Token sales to the SEC, expressing an interest in taking prompt remedial steps and complying with federal securities laws going forward.

The SEC's Settlement Order

The terms of Gladius' settlement generally parallel the undertakings imposed by the SEC against CarrierEQ, Inc. ("Airfox") and Paragon Coin, Inc. ("Paragon") in November 2018, each of whom, like Gladius, entered into settlements for ICOs in violation of Section 5 without admitting or denying the SEC's findings. All three issuers were required to offer rescission to token purchasers pursuant to Section 12(a) of the Securities Act and register their tokens with the SEC as a class of securities under Section 12(g) of the Exchange Act.

However, Gladius' settlement differs from Airfox and Paragon along two main axes.

First, the SEC's latest order requires Gladius to notify the SEC staff if it plans to file a Form 15 to terminate the registration of GLA Tokens on the grounds that they no longer constitute a "security" under the Exchange Act. This provision perhaps acknowledges (without necessarily endorsing) the notion that a digital asset initially sold in a securities transaction can later be offered and sold in a manner that does not implicate the federal securities laws. Its inclusion raises some important questions, including:

- Whether the SEC will later view the GLA Tokens themselves, as opposed to the initial offering, to be subject to the securities laws;
- What factors the SEC will apply to determine whether the GLA Tokens remain "securities" under the Exchange Act. Presumably, the SEC will apply the *Howey* Test, and will likely focus on whether purchasers of the tokens have a reasonable expectation of profit from the efforts of others. But it remains unclear what showing Gladius will need to make in order to establish that the GLA Tokens have sufficient independent utility, or that the Gladius Network is "sufficiently decentralized," such that the GLA Tokens no longer qualify as securities; and
- What will happen if Gladius files a Form 15 to terminate registration, but the SEC disagrees and continues to view the GLA Tokens as securities.

Second, while Airfox and Paragon were each required to pay a $250,000 fine, the SEC stated that it did not impose civil monetary fines in Gladius' case because of the "significant steps" that Gladius undertook to remediate the alleged securities law violations. In particular, the SEC noted that Gladius self-reported its conduct to the SEC's Division of Enforcement, stated it would take necessary remedial actions, and cooperated with the SEC's investigation in a quick and helpful manner.

The full text of the settlement order is available here.

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