Market Trends 2017/18: Lock-up Agreements

A Lexis Practice Advisor® Practice Note by
Anna T. Pinedo, Mayer Brown LLP

Anna T. Pinedo

OVERVIEW

In connection with offerings of securities, the underwriters or placement agents negotiate a lock-up agreement with the issuer and its directors, officers, and control persons. Pursuant to the terms of the lock-up agreement, the issuer agrees that it will refrain from issuing for the agreed lock-up period securities of the same class as the offered securities and securities convertible or exchangeable into the same class as the offered securities. The issuer also will agree to refrain from filing any registration statement relating to the offer of securities, subject to certain exceptions as discussed further below. Similarly, the issuer's directors, officers, and control persons will enter into lock-up agreements. The lock-up agreements provide the underwriters or placement agents some assurance that new securities will not be sold immediately following the proposed offering which might disrupt the trading market for the securities that have been offered. For further information, see IPO Key Agreements — Lock-Up Agreements. For a form of lock-up agreement, see Lock-Up Agreement (IPO).

LENGTH OF LOCK-UP PERIOD

In the case of an initial public offering (IPO), the underwriters will seek to obtain lock-up agreements from all, or substantially all, the existing securityholders for a period of 180 days, subject to some limited carve-outs. In the case of a follow-on offering (i.e., an offering following an issuer's IPO), the lock-up period may vary from 30 days to 90 days depending on a number of factors, including the company's maturity and the liquidity of its stock.

In almost all recent IPOs, the lock-up period has been 180 days. To the extent that any IPO in recent years has not had a 180-day lock-up period, the lock-up period has usually been tiered, with different lock-up periods for different parties. For example, insiders may have been subject to a somewhat shorter lock-up period than option holders.

Two recent high-profile IPOs that have deviated from the 180-day customary lock-up are Snap, Inc. (March 2017) and Dropbox (March 2018).

In Snap, Inc., the company, its directors and officers, and holders of substantially all of the company's outstanding securities agreed that without the prior written consent of either of the representatives acting on the underwriters' behalf, they would not engage in sales or transfers for a 150-day period; provided, however, that the lock-up period would end ten business days prior to the scheduled closure of the company's trading window for the first full fiscal quarter completed following the prospectus if (a) the lock-up period ended during or within ten business days prior to the scheduled closure of the trading window and (b) the lock-up period would end at least 120 days after the pricing of the company's IPO.

In Dropbox, the company's executive officers, directors, and other holders agreed to a lock-up of 180 days provided that if (i) at least 120 days have elapsed since the IPO pricing, (ii) the company publicly released its earnings results for the quarterly period during which the IPO occurred, and (iii) the lock-up period is scheduled to end during or within five trading days prior to a blackout period, the lock-up period would end ten trading days prior to the commencement of such blackout period. For additional information on blackout periods, see "Blackout Periods and Trading Windows" in Insider Trading Policies Preparation — General Structure and Key Points.

LOCK-UP PARTIES

In almost all IPOs, the prospectus will disclose either that substantially all the pre-IPO shares have been locked up or will specify the percentage of the pre-IPO shares that have been locked up. An IPO lock-up also will apply to shares acquired through a directed share program. For more information on directed share programs, see Directed Share Programs.

In follow-on offerings, which often are undertaken in an abbreviated time period, lock-up agreements usually only will be obtained from the issuer, the directors, and the officers. Other significant stockholders will not be advised about the potential offering since the fact that the issuer is contemplating a potential offering may itself constitute material nonpublic information. Existing stockholders generally would not want to receive material nonpublic information since the receipt of that information would restrict their ability to trade in the issuer's securities. For additional discussion on what information may be material, see Materiality Determination Guidelines, Materiality: Relevant Laws and Guidance, and Determining Materiality for Disclosure Checklist.

LOCK-UP AGREEMENTS AND CARVEOUTS

The customary lock-up will contain an acknowledgment and agreement that the lock-up party will not: (1) offer, sell, contract to sell, pledge, or grant any option to purchase or otherwise dispose of (collectively, a disposition) any company securities or any securities convertible into or exercisable or exchangeable for, or any rights to purchase or otherwise acquire, any company securities held by or acquired by the lock-up party, or that may be deemed to be beneficially owned by the lock-up party (the lock-up shares) pursuant to the rules and regulations promulgated under the Securities Act of 1933, as amended (the Securities Act), and the Securities Exchange Act of 1934, as amended (the Exchange Act), for the lock-up period, or (2) exercise or seek to exercise or effectuate in any manner any rights of any nature that the lock-up party has or may have to require the company to register the lock-up party's sale, transfer, or other disposition of any of the lock-up shares or other securities of the company held by the lock-up party, or to otherwise participate as a selling security holder in any manner in any registration effected by the company under the Securities Act.

The lock-up party also agrees not to engage in any hedging, collar (whether or not for consideration), or other transaction that is designed to or reasonably expected to lead or to result in a disposition of lock-up shares during the lock-up period, even if such lock-up shares would be disposed of by someone other than the holder. The prohibited hedging or other similar transactions would include any short sale or any purchase, sale, or grant of any right (including any put or call option or reversal or cancellation thereof) with respect to any lock-up shares or with respect to any security (other than a broad-based market basket or index) that includes, relates to, or derives any significant part of its value from the lock-up shares. For additional information on these kind of transactions, see Financial Derivatives.

The underwriters generally will agree to exceptions for the following:

1. Transfers of shares as a bona fide gift, including gifts to charitable organizations
2. Transfers of shares to a trust for the direct or indirect benefit of the lock-up party or such party's immediate family

3. Transfers by will or intestacy to legal representatives, heirs, or legatees
4. Distributions of shares to members, limited partners, or stockholders of the lock-up party
5. Transfers to affiliates or to any investment fund or other entity controlled by or managed by the lock-up party
6. Transfers of shares to the company as forfeitures to satisfy tax withholding and remittance obligations of the lock-up party in connection with the vesting or exercise of equity awards granted pursuant to the company's equity incentive plans or pursuant to a net exercise or cashless exercise by the stockholder of outstanding equity awards pursuant to the company's equity incentive plan

To the extent that the transactions identified in (1), (2), (3), (4), or (5) do not involve a disposition or transfer for value, do not require a filing with the Securities and Exchange Commission, and any donee, distributee, or transferee does not otherwise voluntarily effect any public filing or report regarding the transfer, each donee, distributee, and transferee agrees to be bound by a similar lock-up agreement. In the case of a transaction identified in (6), any filing made pursuant to Section 16 (15 U.S.C.S. § 78p) of the Exchange Act shall state in the footnotes thereto that the filing relates to the circumstances described in (6) and the lock-up party shall not voluntarily effect any other public filings or reports regarding any such exercises during the lock-up period.

Often, the lock-up will apply to pre-IPO shares and will not apply to shares purchased by the lock-up party in the open market following the offering (provided that such sales are not required to be reported in any public filing and the lock-up party does not otherwise voluntarily make any public filing regarding the sales).

The lock-up will not restrict any grant or exercise of options pursuant to the company's stock option plans or the exercise by the lock-up party of any warrant to acquire shares provided that such shares are not transferred during the lock-up period.

OTHER LOCK-UP CARVEOUTS

From time to time, the underwriters may agree to other lock-up carveouts to address special situations.

For example, if the lock-up party is a financial institution, which is engaged in broker-dealer, investment advisory, and other services, the lock-up is not intended to prevent the lock-up party or its affiliates from engaging in ordinary course lending or capital markets activities, such as brokerage, asset management, derivatives transactions, and other securities activities.

Also, the underwriters may agree to exclude from the lock-up transfers pursuant to an order of a court or a regulatory agency. In recent offerings, underwriters also have permitted a carve-out for transfers pursuant to a bona fide third-party tender offer, merger, consolidation, or similar transaction that in each case is made to all of the holders of the company's common stock involving a change of control; however if the strategic transaction is not consummated, the shares remain subject to the lock-up agreement.

Less frequently, the underwriters may allow a carve-out for holders to enter into a trading plan established pursuant to Rule 10b5-1 under the Exchange Act, provided that sales under the plan do not occur during the lock-up period and the entry into the plan is not required to be disclosed in any public filing. For further information on Rule 10b5-1 plans, see Rule 10b5-1 Plans and Advising on Their Use and 10b5-1 Plans Best Practices Checklist.

LOCK-UP TERMINATION

Usually, the lock-up agreement will have a termination date such that if the underwriting agreement is terminated, the company elects not to pursue the offering, or a certain drop-dead date has passed, the parties will be released from their lock-up agreement.

THE ISSUER'S LOCK-UP AGREEMENT

The issuer also will be subject to a lock-up agreement. The issuer may negotiate limited carveouts from its lock up agreement. Usually, the underwriters will accept carveouts for the following:

- The sale of the securities to the underwriters
- The ability to issue shares under executive compensation plans, which may, from time to time, be subject to a share limit
- The issuance of shares (or a specified number of shares or a percentage of the pre-transaction total shares outstanding) in connection with acquisitions or joint ventures
- In the case of life science companies, the issuance of shares (or a specified number of shares) in connection with licensing arrangements
- The issuance of shares pursuant to pre-existing agreements

Generally, the issuer's lock-up agreement in the IPO of a special purpose acquisition company (SPAC) will not contain carve-outs for stock-based compensation. For further information on SPACs, see Special Purpose Acquisition Company Offerings and Transactions.

LOCK-UP RELEASES

Generally, the lead book runner will have the right to release parties from the lock up. In recent deals, there are many instances in which there are joint book runners. Often, the book runners will make a point of negotiating that the release must be granted jointly by the two (or more) co-book or joint book runners. It is less common for a lock-up release to require the consent of all of the underwriters. The right to release the lock-up is important, especially in the context of an IPO since releasing the lock-up may enable the co-book runners to secure a role for themselves as the lead underwriters in a follow-on offering by the issuer.

Under applicable Financial Industry Regulatory Authority (FINRA) rules, the release of a lock-up in the context of an IPO requires that public disclosure through a major news service be made at least two business days prior to the effective date of the release. The FINRA rules do not require an announcement for a waiver relating to a transfer not made for consideration to a transferee that has agreed to be bound by the lock-up provisions. For forms related to lock-up releases and waivers, see IPO Lock-up Waiver Press Release and Lock-Up Waiver (IPO).

From time to time, the lock-up parties will negotiate for the right to be released from their agreement to the extent any record or beneficial owner of any lock-up shares is granted an early release. The release provisions may stipulate that if the maximum number of lock-up shares that could be released pursuant to such waiver in the aggregate is at least 1% of such owner's total lock-up shares, then certain significant holders of the company's securities also will be granted an early release from their lock-up obligations on a pro rata basis based on the maximum percentage of lock-up shares held by such holder. This early release provision for significant holders would not be triggered in certain instances where the underwriters released the lock-up agreement of a holder as a result of an emergency or hardship affecting only such holder.

In some IPOs, the lock-up agreement may contain a release that is automatic and staggered pursuant to which a specified percentage of the locked-up shares will be released from the lock-up in the event that the issuer's stock is performing well. This is not considered typical and may be limited to IPOs involving larger companies.

PRE-IPO PRIVATE PLACEMENTS

More and more often companies are undertaking private placements in close proximity to their IPOs. Investors in these pre-IPO private placements, especially cross-over fund investors (i.e., those that invest in both public and private equity), will address IPO lock-up provisions in the investors' rights agreement. Generally, a cross-over fund investor will want to ensure that the IPO lock-up will be no more than 180 days in length and that it will cover only pre-IPO shares and not affect shares purchased by such fund in the open market. Cross-over investors also will want to be certain that all company directors, officers, and 1% shareholders will be subject to a substantially similar lock-up agreement. Correspondingly, cross-over fund investors will want a "most-favored-nations" type of lock-up release provision, such as the one described above, which will provide that if any stockholder gets released from its lock-up agreement, then the cross-over funds will be released from their agreements to the same extent and in the same proportion. For a form of investor rights agreement, see Investor Rights Agreement.

Anna T. Pinedo
Partner at Mayer Brown LLP

Anna Pinedo is a partner in Mayer Brown's New York office and a member of the Corporate & Securities practice. She concentrates her practice on securities and derivatives. Anna represents issuers, investment banks/financial intermediaries and investors in financing transactions, including public offerings and private placements of equity and debt securities, as well as structured notes and other hybrid and structured products.

She works closely with financial institutions to create and structure innovative financing techniques, including new securities distribution methodologies and financial products. She has particular financing experience in certain industries, including technology, telecommunications, healthcare, financial institutions, REITs and consumer finance. Anna has worked closely with foreign private issuers in their securities offerings in the United States and in the Euro markets. She also works with financial institutions in connection with international offerings of equity and debt securities, equity- and credit-linked notes, and hybrid and structured products, as well as medium term note and other continuous offering programs.

In the derivatives area, Anna counsels a number of major financial institutions acting as dealers and participants in the commodities and derivatives markets. She advises on structuring issues as well as on regulatory issues, including those arising under the Dodd-Frank Act. Her work focuses on foreign exchange, equity and credit derivatives products, and structured derivatives transactions. Anna has experience with a wide range of transactions and structures, including collars, swaps, forward and accelerated repurchases, forward sales, hybrid preferred stock and off-balance sheet structures. She also has advised derivatives dealers regarding their Internet sites and other Internet and electronic signature/delivery issues, as well as on compliance matters.

Learn more

LEXISNEXIS.COM/PRACTICE-ADVISOR

This document from Lexis Practice Advisor®, a comprehensive practical guidance resource providing insight from leading practitioners, is reproduced with the permission of LexisNexis®. Lexis Practice Advisor includes coverage of the topics critical to practicing attorneys. For more information or to sign up for a free trial, visit lexisnexis.com/practice-advisor. Reproduction of this material, in any form, is specifically prohibited without written consent from LexisNexis.

MAYER • BROWN

LexisNexis, Lexis Practice Advisor and the Knowledge Burst logo are registered trademarks of RELX Inc.
Other products or services may be trademarks or registered trademarks of their respective companies. © 2018 LexisNexis