Top 10 Practice Tips: Lock-Up Agreements

A Lexis Practice Advisor® Practice Note by Anna Pinedo and Ryan Castillo, Mayer Brown LLP

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This practice note provides 10 practice points to consider in drafting and negotiating lock-up agreements. In connection with securities offerings, the underwriters or placement agents generally negotiate a lock-up agreement with the issuer, as well as with the issuer's directors, officers, and, in the case of initial public offerings, control persons and other stockholders. The lock-up agreements provide the underwriters or placement agents with some assurance that new issuer securities will not be sold immediately following the proposed offering the sale of which might disrupt the trading market for the offered securities.

For additional information on lock-up agreements, see Market Trends 2019/20: Lock-Up Agreements, IPO Key Documents, Lock-Up Agreement (IPO), and Lock-Up Waiver (IPO).

Pursuant to the lock-up agreement, the issuer agrees to refrain from issuing securities of the same class as the offered securities, as well as securities convertible or exchangeable into the same class as the offered securities, and from filing a registration statement relating to a securities offering, subject to certain exceptions discussed further below. The directors, officers, control persons, and other stockholders similarly agree in their lock-up agreements to refrain from selling securities of the issuer that are of the same class as, or exchangeable or exercisable for the same class as, the offered securities.

1 **Form of Lock-Up Agreement**. When acting as underwriter's counsel, a good starting point for drafting a lock-up agreement would be the form of lock-up agreement of the lead underwriter, which will contain the customary lock-up provisions generally sought by the underwriter. The form can then be tailored to address the specific facts and circumstances, and can be negotiated with the issuer's counsel, which may request customary carve-outs, many of which we discuss below, as well as specific carve-outs to address the concerns of directors, officers, and other stockholders. Issuer's counsel may want to review the forms of lock-up agreements that have been filed as exhibits to underwriting agreements entered into in other recent offerings led by the same underwriter in order to gauge the willingness of the underwriter to accede to requests for specific carve-outs.

2 **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. It is unusual to depart from the 180-day lock-up period; however, in some IPOs, there may be staggered lock-up periods that differ depending on the type of holder (i.e., whether the holder is an employee or other option holder, or a director, officer, or other insider). From time to time, although it is exceptional, in an IPO, the lock-period may be shortened to 120 or 150 days to allow holders an opportunity to sell securities prior to the issuer's quarterly

earnings blackout period, or a release from the lock-up agreement provided that the issuer's common stock is trading above a specified price. 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 various factors, including whether the issuer is a seasoned issuer and the liquidity of its stock.

3 **Lock-Up Parties and Securities Subject to the Lock-Up Agreement.** As early in the process of preparing for the transaction as possible, the issuer should discuss and negotiate with the underwriters or placement agents which parties will be subject to lock-up agreements, especially if large shareholders, who are not directors or officers, may be required to sign lock-up agreements. In almost all IPOs, substantially all the pre-IPO shares, including shares acquired through a directed share program, will be subject to a lock-up agreement. In follow-on offerings, which often are undertaken in an abbreviated time period, lock-up agreements will usually only be obtained from the issuer, directors, and officers. Other significant stockholders usually are not advised of the possibility that a follow-on offering may be undertaken given that information regarding a potential offering may itself constitute material nonpublic information. Existing stockholders generally would not want to receive material nonpublic information that would restrict their ability to trade in the issuer's securities. In some cases, any donee, distributee, or transferee that received lock-up securities in transfers permitted to be made pursuant to lock-up carve-outs (as further described in tip #5 below), may be required to be subject to the lock-up agreement as well. The issuer also will want to discuss with the underwriter the class or classes of securities that will be subject to the lock-up agreement. For example, the issuer will want to consider whether it will be, or its directors or officers will be, subject to lock-up restrictions on other classes of equity securities, such as preferred stock, in connection with an offering of common stock.

4 **Customary Lock-Up Restrictions.** Customary lock-up agreements require lock-up parties to agree not to (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; (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; or (3) 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.

5 **Customary Carve-Outs.** Underwriters or placement agents will generally agree to exceptions from the lock-up restrictions for (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. In addition, 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 ownership reporting filing and the lock-up party does not otherwise voluntarily make any public filing regarding the sales) will typically be allowed. In connection with the issuer lock-up agreement, underwriters and placement agents typically allow for (1) sale of securities to the underwriters or placement agents; (2) issuance of securities pursuant to executive compensation plans subject to certain limits (unless the lock-up agreement is for an IPO for a special purpose acquisition company, in which case, carve-outs for stock-based compensation are typically not given); (3) issuance of shares in connection with acquisitions or joint ventures; (4) in the case of life science companies, the issuance of shares (or a specified number of shares) in connection with

licensing arrangements; and (5) issuance of shares pursuant to preexisting agreements.

6 **Restrictions on Public Filings.** Given that lock-up agreements provide the underwriters or placement agents some assurance that issuances or sales of new securities will not disrupt the trading market for the offered securities, typically, transactions in the issuer's securities that trigger an SEC filing, such as a filing under Section 16 of the Exchange Act, will be prohibited. Lock-up agreements will also generally prohibit voluntary public filings regarding sales. However, underwriters or placement agents may agree to exceptions from the lock-up restrictions in connection with transfers of shares to the company as forfeitures to satisfy tax withholding and remittance obligations as described in tip #5 above, which are subject to a public filing, as long as the reporting person states in the footnotes thereto that the filing relates to the circumstances described in tip #5 and the lock-up party shall not voluntarily effect any other public filings or reports regarding any such exercises during the lock-up period. In addition, under the issuer lock-up agreement, the issuer typically will agree not to file any registration statements relating to the offer of securities during the lock-up period.

7 **Special Considerations.** From time to time, the underwriters or placement agents may agree to other lock-up carve-outs in order 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. The underwriters or placement agents may also agree to allow transfers during the lock-up period pursuant to an order of a court or regulatory agency. In recent offerings, underwriters and placement agents have also 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 holders of a 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. Underwriters and placement agents may also 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 such a plan do not occur during the lock-up period and entry into the plan is not required to be disclosed in any public filing. Some lock-up parties may also request a "most-favored-nations" type of lock-up release provision that provides for the right to be released from the agreement to the extent any record or beneficial owner of lock-up shares is granted an early release (see tip #8 below). Private equity and venture capital funds may also request carve-outs for distributions to their limited partners, stockholders or other corporation, partnership, or other business entities that controls or is controlled by or is under common control with the lock-up party. Last, more and more often companies are undertaking private placements in close proximity to their IPOs. Investors in these pre-IPO private placements, especially crossover fund investors (i.e., those that invest in both public and private equity securities), 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. Crossover 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. Crossover fund investors will also request a most-favored-nations type of lock-up release provision, such as that described above, which will provide that if any stockholder gets released from its lock-up agreement, then the crossover funds will be released from their agreements to the same extent and in the same proportion.

8 **Release from Lock-Up Agreement.** Generally, the lead book-runner will have the right to release parties from the lock-up agreement. In transactions with joint book-runners, the book-runners may negotiate to require the consent of two (or more) co-book or joint book-runners for any lock-up agreement releases. The right to release the lock-up agreement is important, especially in an IPO, since releasing the lock-up may enable co-book runners to secure a role for themselves as lead underwriters in the issuer's follow-on offering. From time to time, 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 lock-up 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 restrictions 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 if the underwriters released the lock-up agreement of a holder as a result of an emergency or hardship affecting only such holder. As mentioned above, in some IPOs, the lock-up agreement may contain a release that is automatic and staggered such that a specified percentage of the lock-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 for larger companies.

9 **Announcement of Release from Lock-Up.** Under applicable Financial Industry Regulatory Authority (FINRA) rules, the release of a lock-up in 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. The issuer typically agrees in the underwriting or purchase agreement to issue the press release.

10 **Termination.** Usually, lock-up agreements will terminate if the underwriting or purchase agreement is terminated, the issuer elects to not pursue the offering, or a certain drop-dead date has passed.

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