Practical Guidance

Top 10 Practice Tips: Lock-Up Agreements

A Practical Guidance® Article by Anna Pinedo and Ryan Castillo, Mayer Brown LLP

Anna Pinedo
Mayer Brown LLP

Ryan Castillo
Mayer Brown LLP

This Top 10 Practice Tips provides key practice points to consider in drafting and negotiating lock-up agreements. In 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 (IPOs), control persons and other stockholders. 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, 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).

Under an issuer lock-up agreement, the issuer agrees during the term of the agreement 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, during the term of the agreement. 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 underwriters' counsel, a good starting point for drafting a lock-up agreement is the lead underwriter's form of lock-up agreement, which will contain the lock-up provisions generally sought by the underwriter. The form can then be tailored to address the specific facts and circumstances of the offering, and can be negotiated with the issuer's counsel, who may request customary carve-outs, many of which we discuss below, as well as carve-outs to address any other concerns of directors, officers, and other stockholders. Issuer's counsel may review the forms of lock-up agreements filed as exhibits to underwriting agreements for other recent offerings led by the same underwriter to gauge the underwriter's willingness to agree to specific carve-outs.
2. **Length of Lock-Up Period.** The underwriters for an IPO will typically seek to obtain lock-up agreements covering 180 days, subject to limited carve-outs.

   It is unusual to depart from the 180-day lock-up period; however, in some IPOs, there may be different lock-up periods for different types of holders (i.e., employees or other persons holding options, or directors, officers, or other insiders). This is increasingly common in high-profile IPOs, especially tech IPOs; in these offerings, there is often a longer lock-up period for directors, officers, other insiders, and substantial security holders, and a shorter period for employees and other option holders. However, IPOs for special purpose acquisition companies (SPACs) generally have a 365-day lock-up period.

From time to time, although it remains unusual, an IPO lock-up period may be shortened to 120 or 150 days to allow holders to sell their securities prior to the issuer's quarterly earnings blackout period, or a release from the lock-up may be granted if the issuer's common stock is trading above a specified price. For a follow-on offering (i.e., an offering following an issuer's IPO), the lock-up period generally varies 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. **Parties and Securities Subject to Lock-Up Agreements.** As early as possible when preparing for the transaction the issuer should discuss and negotiate with the underwriters or placement agents which parties will be subject to lock-up agreements, especially large stockholders who are not directors or officers. In almost all IPOs, substantially all the outstanding pre-IPO shares, and shares acquired in the offering through a directed share program, will be subject to lock-up agreements.

   In follow-on offerings, which often are undertaken in an abbreviated time period, lock-up agreements will usually only be obtained from the issuer and its directors and officers. Other significant stockholders are usually not advised that a follow-on offering may be undertaken given that information regarding a potential offering may constitute material nonpublic information (MNPI), and stockholders generally would not want to receive MNPI that would restrict their ability to trade the issuer's securities. In some cases, donees, distributees, or transferees that received lock-up securities in transfers permitted to be made under prior lock-up agreements (as discussed in tip #5, below) may be required to sign lock-up agreements as well.

   The issuer also will want to discuss with the underwriters the class or classes of securities that will be subject to the lock-up agreement (i.e., whether classes of the issuer's equity securities, such as preferred stock, will also be subject to lock-ups).

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 (lock-up shares) pursuant to the rules and regulations promulgated under the Securities Act of 1933, as amended (Securities Act), and the Securities Exchange Act of 1934, as amended (Exchange Act), for the lock-up period; (2) exercise or seek to exercise or enforce 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 securityholder 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 option 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.

   As noted above, under an issuer 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, during the lock-up period.

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; and (6) transfers of shares to the issuer 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 issuer's equity incentive plans or pursuant to a net exercise or cashless

exercise by the stockholder of outstanding equity awards pursuant to the issuer's equity incentive plan. In addition, sales of 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 issuer lock-up agreements, 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 a SPAC IPO, in which case carve-outs for stock-based compensation are not typical); (3) issuance of shares in connection with acquisitions or joint ventures; (4) issuance of shares (or a specified number of shares) by life science companies 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, transactions in the issuer's securities that trigger a filing with the Securities and Exchange Commission, such as an insider report under Section 16 of the Exchange Act (15 U.S.C. § 78p), typically are prohibited.

   Lock-up agreements also generally prohibit voluntary public filings regarding sales. However, underwriters or placement agents will generally agree to exceptions for transfers of shares to the issuer as forfeitures to satisfy tax withholding and remittance obligations, as described in item 6 of the first paragraph of 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 item 6 of tip #5 and the lock-up party agrees to not voluntarily effect any other public filings or reports regarding any such transfers of shares during the lock-up period.

7. **Special Considerations.** The underwriters or placement agents may agree to other lock-up carve-outs to address special situations. For example if the lock-up party is a broker-dealer, investment adviser, or other financial services company, the lock-up is not intended to prevent it or its affiliates from engaging in ordinary course lending or capital markets activities, such as brokerage transactions, asset management, derivatives transactions, and other securities activities. The underwriters or placement agents may also agree to allow transfers during the lock-up period under a court or regulatory agency order.

   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 is made to all holders of a company's common stock involving a change of control; however if the transaction is not consummated, the shares will remain subject to the lock-up agreement.

   Underwriters and placement agents may also agree to a carve-out allowing holders to enter into a trading plan established pursuant to Rule 10b5-1(c) under the Exchange Act (17 C.F.R. § 240.10b5-1) provided that sales under the 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-nation" lock-up release provision that provides the right to be released from the agreement to the extent any other lock-up party 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 any corporation, partnership, or other business entity 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 crossover fund investor will want to ensure that the IPO lock-up does not exceed 180 days and that it covers only pre-IPO shares and not shares purchased by the fund in the open market. Crossover investors also will want to be certain that all company directors, officers, and 1% stockholders will be subject to substantially similar lock-up agreements. Crossover fund investors will also request a most-favored-nation lock-up release provision, which will release the fund from its lock-up agreement to the same extent and in the same proportion as any other stockholder so released.

8. **Release from Lock-Up Agreement.** Generally, the lead book-runner will have the right to release parties from their lock-up agreements. 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 position co-book runners to secure roles as lead underwriters in the issuer's follow-on offering.

As mentioned in tip #7, lock-up parties will sometimes negotiate for the right to be released from their agreement to the extent any other lock-up party is granted an early release. The release provisions may stipulate that if the maximum number of lock-up shares released pursuant to such early release in the aggregate is at least 1% of the released holder'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 number of lock-up shares held by such holder. This early release provision for significant holders will sometimes not be triggered if the underwriters release a stockholder because of an emergency or hardship affecting only such holder.

Additionally, as mentioned in tip #2, in some IPOs the lock-up agreement may provide for a release of a specified percentage of the lock-up shares if the issuer's stock is performing well. The release will be staggered to release more shares on hitting higher prices. This is not typical, but when it happens it is usually limited to IPOs for larger companies.

9. **Announcement of Release from Lock-Up.** Under Financial Industry Regulatory Authority, Inc. (FINRA) Rule 5131, the release of a lock-up in an IPO must be publicly disclosed through a major news service at least two business days prior to the effective date of the release. The rule does not require an announcement for a release for a transfer not made for consideration to a transferee who 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.** Lock-up agreements typically terminate if the underwriting or purchase agreement is terminated, the issuer elects to not pursue the offering, or a certain drop-dead date for the offering has passed.

Anna Pinedo, Partner, Mayer Brown LLP

Anna Pinedo is a partner in Mayer Brown's New York office and co-leader of the Global Capital Markets 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 and specialty 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.

Anna regularly speaks at conferences and participates in panel discussions addressing securities law issues, as well as the securities issues arising in connection with derivatives and other financial products. She is the co-author of the leading capital markets treatise, Corporate Finance and the Securities Laws, published by Wolters Kluwer (6th Ed., updated 2020); co-author of A Deep Dive Into Capital Raising Transactions, published by the International Financial Law Review (2020); co-author of JOBS Act Quick Start (International Financial Law Review, 2013; updated 2014, 2016); contributor to OTC Derivatives Regulation Under Dodd-Frank: A Guide to Registration, Reporting, Business Conduct, and Clearing (Thomson Reuters, first ed. 2014, second ed. 2015, third ed. 2016, fourth ed. 2017); co-author of Considerations for Foreign Banks Financing in the US (International Financial Law Review, 2012; updated 2014, 2016); co-author of Liability Management: An Overview (International Financial Law Review, 2011, updated 2015); co-author of Structuring Liability Management Transactions (International Financial Law Review, 2018); co-author of Covered Bonds Handbook, published by Practising Law Institute (2010, updated 2012-2014); co-author of the treatise Exempt and Hybrid Securities Offerings, published by Practising Law Institute (2009, second ed. 2011, updated 2014, third ed. 2017); and co-author of BNA Tax and Accounting Portfolio: SEC Reporting Issues for Foreign Private Issuers (BNA Accounting Policy and Practice Series, 2009, second ed. 2012, third ed. 2016, fourth ed. 2020). Anna is also a contributing author to Broker-Dealer Regulation (2011, second ed. 2012, updated 2020), published by Practising Law Institute. She co-authored "The Approaches to Bank Resolution," a chapter in Bank Resolution: The European Regime (Oxford University Press, 2016). Anna contributed to The Future of Bank Funding and Capital: Solutions for Issuers, Opportunities for Investors (IFR Market Intelligence, 2009). Additionally, Anna co-authored "The Ties that Bind: The Prime-Brokerage Regulation," a chapter in Global Financial Crisis (Globe Law and Business, 2009); "The Law: Legal and Regulatory Framework," a chapter in PIPEs: A Guide to Private Investments in Public Equity (Bloomberg, 2006); and "The Impact Security: Reimagining the Nonprofit Capital Market," a chapter in What Matters: Investing in Results to Build Strong, Vibrant Communities (Federal Reserve Bank of San Francisco and Nonprofit Finance Fund, 2017). Anna is a contributor to Practising Law Institute's "BD/IA: Regulation in Focus" blog.

Anna is a member of the American Bar Association's (ABA) Committee on the Federal Regulation of Securities, a member of the subcommittee on Disclosure and Continuous Reporting, chair of the subcommittee on Securities Registration, chair of the subcommittee on Annual Review, and a member of the task force on the future of securities regulation.

She has participated in the drafting committee for the ABA's comment letters on such topics as securities offering reform, revisions to the definition of accelerated filer and smaller reporting company, amendments to the accredited investor definition; amendments to the exempt offering framework; and various JOBS Act-related and disclosure effectiveness related matters. Anna also is a member of the ABA Committee on the Regulation of Futures and Derivatives Instruments. Anna is a chair of the Structured Products Association Legal, Regulatory and Compliance Executive Committee. She is a member of the Mortgage Bankers Association's Mortgage REIT Council and a member of the MBA's Secondary & Capital Markets Committee.

Anna is an adjunct professor at the George Washington University School of Law and member of the George Washington University Center for Law, Economics & Finance Advisory Board. She is a member of the Visiting Committee of the Law School of the University of Chicago. Anna was a member of the University of Chicago Legal Forum during her time at the University of Chicago Law School.

Ryan Castillo, Partner, Mayer Brown LLP

Frederick Ryan Castillo is a partner in Mayer Brown's New York office and a member of the Capital Markets practice. His work focuses on securities and corporate finance transactions. Ryan advises issuers, investment banks and sponsors in connection with public offerings and private placements of debt, equity and hybrid securities, including initial public offerings, follow-on offerings, investment grade and high-yield debt offerings, private investment in public equity, tender and exchange offers, consent solicitations, medium term note programs and other capital markets transactions in the United States, Canada and the Euro markets. He represents companies and financial intermediaries involved in a broad range of industries, including financial services, technology, telecommunications, retail, life sciences, real estate and energy.

Ryan earned his Master of Laws degree with a concentration in international finance from Harvard Law School, where he served as an editor of the Harvard Business Law Review. He earned his JD with honors from the Ateneo de Manila Law School, where he served as captain of the World Champion team in the 45th Philip C. Jessup International Law Moot Court Competition. He holds a BA in Economics, with honors, from the Ateneo de Manila University. Ryan was previously an associate in the capital markets group of another global law firm in New York. Prior to that, he was a corporate associate in a regional law firm headquartered in Singapore, where he worked on capital markets and cross-border transactions for clients across the Asia-Pacific.

Ryan is co-author of A Deep Dive Into Capital Raising Alternatives (2020) and author of Non-GAAP Explained (2017), published by the International Financial Law Review. He regularly writes on securities law issues and has authored a number of capital markets-related pieces, including Debt Capital Markets in the United States: Regulatory Overview (2019) published by Practical Law, Top 10 Practice Tips: Comfort Letters (2018) published by Lexis Practice Advisor and The Coconundrum (2011) published by the Harvard Business Law Review.

Ryan is named a "Rising Star" for the Americas in the Capital Markets category in Euromoney's Expert Guides: Rising Stars 2021. He was also named a "Rising Star" in the capital markets category by Euromoney in its Rising Stars Americas Awards 2020. Ryan is ranked as a "Rising Star Partner" by IFLR1000 2022 for Capital Markets: Debt and Capital Markets: Equity in the United States, and had previously been ranked as a "Rising Star" for the same by IFLR1000 2021, 2020, and 2019. The Legal 500 US also named him a "Next Generation Partner" (2021), "Rising Star" (2020), and he is a recommended lawyer for Capital Markets: Debt. Ryan is recognized by Best Lawyers: Ones to Watch 2021 for his work in Securities and Capital Markets law in the United States.