Market Trends 2020/21: Lock-Up Agreements

A Practical Guidance® Practice Note by Anna Pinedo, Mayer Brown LLP

Anna Pinedo
Mayer Brown LLP

This practice note discusses lock-up agreements between underwriters or placement agents, on the one hand, and issuers and their directors, officers, and control persons, on the other, in connection with offerings of securities.

A lock-up agreement with an issuer will require it to refrain during the agreed-upon lock-up period from issuing securities of the same class as the securities being offered or securities convertible or exchangeable into that class. The issuer also will agree to refrain from filing any registration statements for an offering, subject to certain exceptions as discussed further below.

Lock-up agreements with issuers' directors, officers, and control persons will provide underwriters and placement agents with some assurance that such persons' securities will not be sold immediately following the proposed offering, which could disrupt the trading market for the issuer's newly issued securities.

For additional information on lock-up agreements, see Top 10 Practice Tips: Lock-Up Agreements and IPO Key Documents. For a form of a lock-up agreement, see Lock-Up Agreement (IPO).

Length of Lock-Up Period

Underwriters in initial public offerings (IPOs) will typically seek to obtain lock-up agreements from all, or substantially all, the issuer's securityholders for 180 days (except in IPOs for special purpose acquisition companies (SPACs), which typically require 365-day lockups), subject to some limited carve-outs. However, some IPOs in recent years have not had 180-day lock-up periods. Instead, the lock-up periods have been tiered so that different parties are subject to different lock-up periods (e.g., directors, officers, and majority stockholders have been subject to somewhat longer lock-up periods than employees and other security holders).

In follow-on offerings (i.e., offerings following an issuer's IPO), the lock-up period may vary from 30 days to 90 days depending on several factors, including the company's status (e.g., as a large, well-known company vs. a small-cap company) and the liquidity of the trading market for the company's stock.

Several high-profile IPO issuers entered into lock-up agreements with tiered structures in 2020. In the three largest IPOs of 2020, Airbnb Inc., DoorDash Inc., and Snowflake Inc., all directors, officers, and principal stockholders agreed to longer lock-up periods than did the other stockholders. Certain other stockholders were permitted to sell specified percentages of their shares earlier than the standard 180-day lock-up period over staggered release dates.

In the Airbnb Inc. IPO, the largest of 2020, directors, executive officers, and certain other stockholders agreed to a lock-up period that ended on the later to occur of (1) the opening of trading on the second trading day immediately following the public release of earnings for the company's second fiscal quarter or (2) the 121st day after the date of the prospectus, assuming second quarter earnings were publicly released. However, up to 15% of the common stock held by former employees, consultants,

and contractors could be sold during a seven-day trading period beginning on the first trading day of the stock on The Nasdaq Stock Market, referred to as the "first release window." Additional shares held by these holders were released from lock-up restrictions on various subsequent specified dates subject to the company's stock having attained a specified price.

In the DoorDash Inc. IPO, directors, executive officers, and a substantial majority of its security holders agreed to a lock-up period ending on the earlier of 180 days following the date of the prospectus or just before the opening of the third trading day after the company filed its second earnings release on Form 8-K or second periodic report. However, the lock-up restrictions were released with respect to 40% of each stockholder's holdings, subject to certain qualifications, 90 days from the date of the prospectus and subject to the company's shares having reached a specified price.

In the Snowflake, Inc. IPO, lock-up restrictions were eased after the 91st day following the IPO for a specified percentage of shares held by then-current employees with a title below vice president, current contractors, and former employees and contractors (except for the former CEO and his affiliates).

The easing of lock-up restrictions seems likely to continue in 2021, especially for high-profile tech IPOs. Recently, in the Robinhood Markets, Inc. IPO, employees were permitted to sell 15% of their holdings, with subsequent releases being granted after the passage of time.

For information about IPOs generally, see Initial Public Offerings Resource Kit. For information about follow-on offerings generally, see Follow-On Offerings Resource Kit.

Lock-Up Parties

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

Lock-up agreements in follow-on offerings, which are often completed much more quickly than IPOs, will usually be obtained only from the issuer and its directors and officers. Issuers will typically not advise other stockholders about a contemplated offering since that itself may constitute material nonpublic information (MNPI), and stockholders generally would not want to receive MNPI as that would prohibit them from trading the issuer's securities.

Lock-Up Agreements and Carve-Outs

The customary lock-up will contain an acknowledgment and agreement that the lock-up party will not:

- 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 (Securities Act), and the Securities Exchange Act of 1934, as amended (Exchange Act), for the lock-up period –or–
- 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 securityholder 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.

The underwriters generally will agree to the following exceptions:

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. Transfers pursuant to a domestic order, divorce settlement, or other court order

5. Transfers of shares of common stock or any security convertible into or exercisable for common stock to the company under any company right of repurchase or right of first refusal over such securities, or transfers of shares of common stock to the company for the net exercise of options, transactions relating to American Depositary Shares, settlement of restricted stock units or warrants, or to cover tax withholding

6. Distributions of shares to members, limited partners, or stockholders of the lock-up party

7. Transfers to affiliates or to any investment fund or other entity controlled by or managed by the lock-up party

8. 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 under the company's equity incentive plans or under a net exercise or cashless exercise by the stockholder of outstanding equity awards pursuant to the company's equity incentive plan

However, this is only true provided that the transactions identified in (1), (2), (3), (4), (5), (6), and (7) 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 and agrees to be bound by a similar lock-up agreement. Any filing made under Section 16 of the Exchange Act (15 U.S.C. § 78p) for a transaction identified in (8) must state in the footnotes that the filing relates to the circumstances described in (8) and the lock-up party must not voluntarily make any other public filings or reports regarding any such exercises during the lock-up period.

The lock-up will usually apply only to pre-IPO shares and not to shares purchased in the open market in or 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 Carve-Outs

From time to time, underwriters have agreed to other lock-up carve-outs to address special situations. For example, if the lock-up party is a financial institution that is engaged in broker-dealer, investment advisory, or other financial services activities, 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 may also agree to exclude from the lock-up transfers made pursuant to a court or regulatory agency order. In recent offerings, underwriters have also been permitting carve-outs 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 the company's common stock involving a change of control. However, if the transaction is not completed, the shares remain subject to the lock-up agreement.

Less frequently, underwriters may allow holders to enter into trading plans established under Exchange Act Rule 10b5-1 (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.

Lock-Up Termination

Lock-up agreements will typically terminate, and the parties released from their obligations, if the underwriting agreement is terminated, the company elects not to pursue the offering, or a certain drop-dead date for the offering has passed.

Issuer Lock-Up Agreements

Issuers are also subject to lock-up agreements but may negotiate limited carve-outs. Underwriters will usually agree to carve-outs for the following:

- The sale of the securities to the underwriters
- Issuing shares under executive compensation plans, which, may, from time to time, be subject to a share limit
- Filing any registration statement on Form S-8 relating to securities granted or to be granted pursuant to any executive compensation plan in effect as of the date of the underwriting agreement or any assumed benefit plan pursuant to an acquisition or strategic transaction

- Issuing 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, issuing shares (or a specified number of shares) in connection with licensing arrangements
- Issuing shares under preexisting agreements

The issuer's lock-up agreement in a SPAC IPO will generally not contain carve-outs for stock-based compensation.

Lock-Up Releases

The lead book runner for an offering will usually have the right to release parties from their lock-up agreements. When there are joint book runners, as in many recent offerings, the book runners will often require that any release be granted jointly by the two (or more) co-book or joint book runners. It is less common, though, for a lock-up release to require the consent of all the underwriters. The right to release the lock-up is important, especially in an IPO, since releasing the lock-up may favorably position the co-book runners for roles as lead underwriters for any follow-on offerings by the issuer.

Under FINRA Rule 5131 the release of a lock-up in IPO requires that public disclosure through a major news service be made at least two business days before the effective date of the release. The rule does not require an announcement of a waiver for a transfer not made for consideration to a transferee who has agreed to be bound by the lock-up provisions.

From time to time, lock-up parties will negotiate for the right to be released from their agreements to the extent any holder of lock-up shares is granted an early release (a "most favored nation" provision). The release provisions may provide that if the maximum number of lock-up shares that could be released under 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 will also 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 the holder receiving the release. This early release provision for significant holders would not be triggered when the underwriters released the lock-up agreement of a holder due to an emergency or hardship affecting only such holder.

In some IPOs, the lock-up agreements may contain an automatic and staggered release of a specified percentage of the locked-up shares based on the issuer's stock performance. This is not typical, though, and may be limited to IPOs involving larger companies.

For a form of lock-up waiver, see Lock-Up Waiver (IPO).

Pre-IPO Private Placements

More and more often, companies are undertaking **private placements** shortly before 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 for the private placement. Generally, a cross-over fund investor will want to ensure that the IPO lock-up will be no more than 180 days and that it will cover only pre-IPO shares and not shares purchased by the fund in the open market. Cross-over investors will also want to ensure that all company directors, officers, and 1% stockholders will be subject to a substantially similar lock-up agreement. Correspondingly, cross-over fund investors will want a most-favored nation lock-up release provision, such as the one described above, that provides that they will be released from their lock-up agreements if, and to the extent that, any other stockholder is so released.

For a form of investor rights agreement with a most-favored nation lock-up agreement, see Investors' Rights Agreement (Series A Preferred Stock).

Anna Pinedo, Partner, 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.

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