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Resource
January 2, 2024

This article discusses the difference between a secondary sale transaction and a tender offer, plus why the distinction matters.

KEY TERMS

First, it's helpful to define the types of transactions we're discussing.

- **Secondary Sale/Purchase**: A sale of securities by, or purchase of securities from, someone other than the company that issued the securities (i.e., a sale of shares from an existing stockholder or option holder to a third-party buyer who could be an existing stockholder or new stockholder)
- **Tender Offer**: An offer made by one or more purchasers to a broad group of stockholders, providing the stockholders with the opportunity to tender (i.e., sell) some or all of their shares for a set price

A tender offer is a specific type of secondary sale. Stated another way—all tender offers are secondary sales, but not all secondary sales are tender offers. This is why the terms are often used interchangeably. However (as we'll discuss in this article), there are specific rules and processes applicable to tender offers that don't apply to other secondary transactions, so it is helpful to understand the differences and use the terms correctly. But first some additional information about both deal types…

Company-Led or Investor-Led

In either type of secondary deal, the purchaser could be the company or a third-party investor. While the purchaser may seem like a fixed aspect of any deal, in practice, the parties often negotiate and structure a transaction to suit their goals. For example, if the secondary sale was happening alongside a primary investment (i.e., an investor's purchase of shares directly from the company), one option would be for the investor to purchase (for example) 100 shares from the company and then purchase 100 additional shares directly from existing stockholders. However, if the parties wanted the company to be the purchaser in the secondary transaction, another option would be for the investor to purchase 200 shares from the company, and then the company would use half of the proceeds to purchase 100 shares from existing stockholders. If the Company is the purchaser, it is often called a "repurchase" since the Company is repurchasing shares/equity it previously issued. In both examples, the investor ends up with 200 shares, and half of the purchase price for those shares is paid to existing stockholders. The calculations are often more complicated in reality, since the investor is typically purchasing preferred stock from the company but common stock from employee stockholders, and the share prices often vary accordingly. There can also be some meaningful tax consequences based on whether the deal is structured as a company-led or investor-led purchase (see *Tender Offers: Threshold Terms to Consider* for more details on tax implications).

Considering an Organized Liquidity Transaction

Whether a transaction is ultimately structured as a tender offer or just a secondary sale, the deals typically originate from the same set of driving forces and both involve certain benefits and risks for the companies involved.

Potential Benefits

- Provides liquidity to equity holders without a true exit
- Provides the company more time to build value with focus on long-term growth of business, before early employees get discouraged by lack of liquidity
- Allows early investors to exit the company, clearing an opportunity for the company to restructure the cap table so that management, including non-founder professionals, may be more aligned with the (newer) investor base

- Can slow down the timeline for M&A or IPO transactions if the company is not ready internally or if market conditions are not ideal; may provide the company with pre-IPO price discovery
- Investors can achieve ownership levels that would otherwise not be palatable for the company via dilutive primary issuances
- Employee morale boost from seeing incentive compensation pay off sooner
- Providing liquidity for multiple equity holders in one organized transaction may require less overall work for the company, compared to facilitating numerous individual sale requests

Potential Risks

- Resource-intensive process (especially for tender offers, which require disclosure materials) but proceeds go to sellers, not the company
- Targeted liquidity to individuals or a small group may not be appropriate for earlier-stage companies due to the potential 409A impact and high transaction cost-to-value ratio
- May drive employees to distraction as they wonder about further liquidity opportunities, and even seek out post-transaction “disorganized” secondary sales (can be mitigated with standstills or blanket transfer restrictions)
- No guarantee of broad participation in a tender offer, especially if company has widely dispersed ownership; can be difficult to assess appetite to sell ahead of offer without violating tender offer rules
- Fairness considerations when deciding who can participate, especially if company is the purchaser or if company must participate by waiving transfer restrictions, etc.
- If tender offer price is above the company’s current 409A, it could result in an increase in the next 409A valuation (making future option grants less attractive, accelerating 701 reporting and/or precipitating a need to switch to RSU grants)
- Transaction may require disclosure of sensitive company information to reduce anti-fraud risk; if the transaction is a tender offer, disclosure of at least some company information, including financial statements, is required.

- Deal leak may bring SEC scrutiny, which could impair a subsequent IPO process

WHAT MAKES A SECONDARY TRANSACTION A “TENDER OFFER”?

While there are specific federal securities laws regulating tender offers—designed to protect less informed holders against high-pressure, coercive tactics by would-be buyers—the term “tender offer” is not defined in these rules. Consequently, two tests for determining whether a transaction constitutes a tender offer have been developed through case law: the “*Wellman* Test” and the “Totality of the Circumstances Test.”

The *Wellman* Test consists of eight factors to be weighed—not simply counted numerically—and not all factors are necessary for a transaction to constitute a tender offer. The Wellman factors indicating the presence of a tender offer are:

1. *Active and widespread solicitation of public shareholders
    a. There is no publicity in private company deals, so the number of offerees is the key factor
2. Solicitation is made for a substantial percentage of the company’s stock
3. Offer to purchase is made at a premium over the prevailing market price
4. Terms of the offer are firm rather than negotiable
5. Offer is contingent on the tender of a fixed number of shares, often subject to a fixed maximum number to be purchased
6. Offer is open only for a limited period of time
7. *Offerees are subject to pressure to sell
    a. Sophistication of offerees and availability of information about the offer and issuer are often considered as part of this factor.
9. Public announcements of the purchasing program precede or accompany rapid accumulation of large amounts of the company’s securities

The Totality of the Circumstances Test asks the question: in the absence of the disclosure and procedures required under the tender offer rules, is there a substantial risk that the offerees will lack the information needed to make an investment decision with respect to the offer?

In practice, we think of the determination as hinging on the eight factors cited in the *Wellman* Test, plus the level of sophistication of the offerees.

WHY DOES THE "TENDER OFFER" LABEL MATTER?

There are specific SEC rules that apply to any deal constituting a "tender offer." While most of these rules only apply to public companies, certain process-related rules and antifraud regulations apply to private company deals. The requirements applicable to private companies include:

- The offer must be kept open for at least 20 business days from the date it is announced.
- If certain terms of the offer are changed, a notice must be circulated and the offer held open for at least 10 business days (for changes to the price or maximum number of shares being purchased) or 5 business days (for other material changes) from the date of the notice.
- An offeror must promptly pay the purchase price upon expiration of the offer.
- An offeror may not buy (or arrange to buy) any similar company securities while the tender offer is pending.
- Persons with material, non-public information about the company may not buy or sell shares subject to the tender offer, unless the information is publicly disclosed. The offeror, the company and certain other persons may not discuss material, non-public information about a tender offer that would foreseeably result in a violation of the foregoing.
- An offeror may not make any material misstatements or omissions or engage in fraudulent, deceptive or manipulative acts in connection with the offer.

It is these last two requirements that drive the increased disclosure obligation for tender offers. There are no rules setting forth the specific disclosure requirements, but private companies typically provide potential participants with a thorough disclosure package designed to prevent information disparities between buyers and sellers. This includes a formal "Offer to Purchase" document describing the terms of the tender offer. Information provided in the Offer to Purchase or elsewhere in the disclosure package will typically include:

- Core terms (price, type and number of shares being purchased, timeline, etc.)
- How the offer price was determined and other price discovery data points
- Criteria for determining who may participate in the offer and how many shares they may sell

- (If the purchaser is a third-party) a description of the purchaser
- Closing conditions for the offer
- A summary of the company's business
- Any participation by founders, executives, board members or other insiders in the offer
- Risk factors related to both selling shares and not selling shares
- Tax consequences for sellers
- The company's current certificate of incorporation and bylaws and any other shareholder agreement that is relevant
- Summary capitalization table
- Company financial statements (full year and stub period)

Note that these materials are provided whether the tender offer is structured as company-led or investor-led. In either type of deal, the company will be heavily involved in contributing to disclosure materials and facilitating the offer process, either directly or by coordinating through a hired information and paying agent, such as Nasdaq Private Market. The agent can provide the disclosure materials on a secure platform, collect paperwork from participants, and process closing payments.

Given the complicated tax considerations involved in these deals, companies considering any type of secondary transaction should reach out to their tax advisors and legal counsel as early as possible in a deal. Given the breadth of disclosure information required and the need to comply with specific SEC regulations, working with experienced legal counsel is especially important if the transaction might constitute a tender offer.

Gunderson attorneys have represented clients in over 250 private company tender offers over the last five years, providing our team with unmatched experience and market intelligence on these unique deals. If your company is considering a tender offer and you are interested in hearing from our experts, we encourage you to reach out to a Gunderson contact to continue the discussion.

Related resources

Interested in additional information about tender offers? See also Tender Offers: Threshold Terms to Consider

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