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Despite Staples Snub, Activist Has Flex In $6.3B Merger

By **Karlee Weinmann**

Law360, New York (February 4, 2015, 5:19 PM ET) -- When Staples Inc. confirmed Wednesday that it would swallow rival Office Depot Inc., it was careful to strip any credit from the activist investor that pitched the transaction after surfacing in both retailers' stocks in December.

The companies made clear they sidled up to the bargaining table to discuss the $6.3 billion cash-and-stock play in September, long before Starboard Value LP — one of the most prolific activist funds in today's marketplace — publicly pitched a mirror image of the transaction last month.

Staples and Office Depot didn't mention the activist by name in their deal announcement, instead taking pains to distance themselves from the fund's high-profile merger campaign and doing their best to push Starboard to the sidelines.

Staples CEO Ron Sargent said on a conference call discussing the merger that his company opened talks as part of its long-range strategic plan. Then, last summer, "our management team and our board analyzed the opportunity to accelerate our strategic reinvention through the acquisition of Office Depot."

It's the second time in a matter of days that a Starboard target has cast the fund aside. Last week, Yahoo Inc. made clear it decided months before the activist bit into its stock that it would spin off its $40 billion stake in Alibaba Group Holding Ltd. — another move that lined up, at least in part, with Starboard's well-publicized calls for change.

For a company caught in an activist's crosshairs but trying to chart its own course, perception can be everything, said Chris Pultz, portfolio manager of the merger arbitrage fund at Kellner Capital. Plus, he added, there's extra sensitivity when a targeted company — say, Staples or Yahoo — is already fighting to reverse stagnant sales and dwindling investor support.

“These companies don't want to feel like they're bullied and don't want to be perceived in the market as being bullied,” Pultz said.

That goes double for big outfits striking game-changing deals. For Staples, Office Depot and others like them, the long-term viability of their tie-ups depends heavily on shareholders' support for and investment in the combined outfit. Investors need to stay on board in the months and years after a deal clears a shareholder vote.

Taking full ownership of the transaction is one way for companies to set the tone from the get-go, said Blank Rome LLP partner Barry Genkin, who primarily defends companies targeted by activists. It lends a sense of accountability and integrity to the targeted company, sending a message that the board and management team can thrive on their own — even as shareholder activism reaches unprecedented heights.

"In a situation like this, a board obviously wants to come across as being really prudent and looking out for the best interests of shareholders," he said. "They want shareholders to understand that the board was acting prudently, independently and they didn't need any coaxing from any third party to make something like this happen."

Still, convincing the marketplace of that can be difficult. Starboard used its increasing clout to capture the spotlight with its Staples buy-in late last year, immediately igniting a fresh wave of tie-up chatter — especially in light of its existing minority holding in Office Depot. But confidential merger talks apparently already underway left Staples and Office Depot handcuffed.

Where Starboard, acting in its own interest as a Staples investor, can openly trumpet its case for a deal, a company must strike a more delicate balance in its interplay with its investor base to avoid operational risk, skepticism and problematic moves in its stock price. If they can help it, boards generally won't unveil a transaction until it's a sure thing.

"Those are important issues, but the activist may be less concerned about them and able to more freely put it on the table that two companies belong together and should be talking," said Keith Gottfried, head of the activist defense practice at Morgan Lewis & Bockius LLP.

Still, despite those restraints and word to the contrary from the Staples camp, it's tough to imagine an activist with Starboard's track record and clout was a complete non-factor in the deal.

"When a company knows that an activist is hot on its trail, it's easy to say it doesn't affect decision-making, but I think at some level it does," Genkin said. "It's not that boards are not accountable, but it's more in your face that you know somebody is watching over you and going to critique everything that you're doing, at least when it becomes public."

Especially when the activist is a fund like Starboard.

The fund for years has zeroed in on companies in the retail sector, and in a series of recent plays proved its ability to identify realistic large-scale shakeups. It cemented its place among the boldest activists in a particularly fierce proxy fight last year, ending when it claimed all 12 board seats at Olive Garden parent Darden Restaurants Inc.

Even without acknowledgment from its target, Wednesday's agreement adds to Starboard's cache of notable victories — a list that grew significantly over the past year.

Though it had no access to insider information from Staples or Office Depot, or any role in the pair's merger talks, the fund still came up with an idea that both companies thought attractive enough to independently pursue. Much like its push for change at Yahoo, Starboard proved itself a savvy investor with a well-developed feel for deal making.

"It's clearly another feather in the cap for Starboard," Gottfried said. "It's another example that

Starboard is going to be able to point to, where they were able to be a catalyst for change at a company."

And the fund's eagerness to slide into that role is paying off, with or without a hat tip from its targets. Based on the $11-per-share consideration attached to Wednesday's agreement, Starboard is in line to convert its Office Depot stake into a payout upwards of $580 million — profiting more than $450 million on that single investment.

"At the end of the day, [activists are] making billions on these deals," said Jonathan Morgan, a deals analyst at The Edge Consulting Group. "Even though they may have some egos, once the benefits come on the monetary side, that's the upside at the end of the day."

--Editing by John Quinn and Philip Shea.
