

Lessons learned from the 2023 Icahn – Illumina, Inc. proxy contest

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The high-profile proxy contest between Carl Icahn and Illumina, Inc. (“Illumina” or the “Company”) came to a head on Thursday, May 25 at Illumina’s 2023 stockholders’ meeting. Illumina stockholders voted to elect Andrew Teno, a portfolio manager at Icahn Capital LP who was one of Icahn’s three director nominees, in place of incumbent board chair, John Thompson. Illumina stockholders voted in the other eight incumbent directors, resulting in the board of nine now being composed of eight incumbents and one Icahn nominee.

This proxy contest represents the first contest at a large cap company that has gone all the way to a stockholder vote since the universal proxy rules went into effect on September 1, 2022. The contest is also notable as its origin ties back to the decision to close Illumina’s \$7.1 billion acquisition of GRAIL, Inc. (“GRAIL”) amidst ongoing antitrust and competition review by the US Federal Trade Commission (the “FTC”) and the European Commission (the “EC”). Below are some key takeaways for board members and practitioners from the high profile contest.

The board’s understanding of regulatory risks is critical

It is no secret that in today’s regulatory climate, parties to a potential transaction are laser-focused on performing a thorough antitrust analysis and gaining an understanding regarding potential regulatory risks and challenges. Icahn’s proxy contest with Illumina only further underscores the importance of a board’s understanding of these issues.

Illumina’s acquisition of GRAIL was first announced in September 2020, and it triggered in-depth reviews in both the United States and European Union. Despite the regulatory reviews remaining open and active, the parties closed the transaction on August 18, 2021.

Over a year later, on September 6, 2022, the EC issued a ruling prohibiting the acquisition, and by December, the EC had outlined steps for the parties to unwind the transaction. During this same time, the parties fought a back-and-forth battle with the FTC.

Icahn, however, seemingly did not own Illumina stock until about a year and half after the closing of the GRAIL transaction. On February 13, 2023, Icahn and his affiliates purchased around \$90 million of Illumina shares and soon thereafter notified the Company of their intention to nominate directors.

Icahn attributed the drop in value of Illumina stock since the closing of the GRAIL transaction to “the decision of the Company’s board to close the GRAIL transaction without the required regulatory approvals.”

Proxy advisory firm Glass Lewis also acknowledged the board’s treatment of antitrust and competition issues as the motivating factor behind the proxy contest: “[T]hat decision to preemptively close a transaction with clear knowledge of a turbulent regulatory environment, and the question of what to do now, are at the crux of the current battle.”

While ISS and Glass Lewis made different recommendations, Illumina stockholders voted in-line with the one overlapping recommendation issued by both ISS and Glass Lewis.

As of the date of this article, Illumina is appealing both the FTC and EC challenges.

Proxy contests are costly

Illumina’s definitive proxy statement disclosed that as of the time of its filing on April 20, 2023, the Company had incurred solicitation expenses of approximately \$16.5 million and anticipated its total expenditures to be up to approximately \$31.5 million, noting that the end amount could be higher or lower depending on circumstances.

This harkens back to the high price tag on Nelson Peltz’s Trian Fund’s 2017 proxy contest with Procter & Gamble (“P&G”), where P&G disclosed that it anticipated spending approximately \$35 million by the end of the proxy contest, having incurred approximately \$950,000 at the time of its definitive proxy statement filing.

Despite early predictions to the contrary, the universal proxy rules have not resulted in significantly cheaper proxy contests for dissidents. Icahn’s definitive proxy statement estimated the cost

of solicitation with respect to the Illumina proxy contest to be approximately \$700,000. Compare this to Icahn's pre-universal proxy 2019 contest with Occidental Petroleum Corporation, where Icahn's definitive proxy statement disclosed anticipated total expenditures to be approximately \$800,000.

There are of course instances pre-universal proxy where we've seen dissidents spend multimillions on their campaigns — such as Trian's 2017 proxy contest with P&G, where Trian disclosed that it anticipated total expenditures to be approximately \$25 million, with \$650,000 having been incurred at the time of the definitive proxy statement filing.

However, the varying price tag is more related to the facts and circumstances of a particular campaign than it is to any advantages dissidents are extracting from the universal proxy rules.

Proxy advisory firms ISS and Glass Lewis split their recommendations among dissident and company nominees; influence of proxy advisory firms continues to be key

Institutional Shareholder Services ("ISS") and Glass Lewis split their recommendations with respect to the contested director slots in the Icahn-Illumina proxy contest, with Glass Lewis recommending that stockholders vote for two of Icahn's nominees and for one of the Company's nominees, and with ISS recommending that stockholders vote for one of Icahn's nominees and two of the Company's nominees.

A company that does not already have a provision staking a claim to its preferred proxy card color should consider including one in its bylaws.

The split in recommendations is a trend that has emerged post-effectiveness of the universal proxy rules, as proxy advisory firms acknowledge that stockholders can now easily mix-and-match from among dissident and company director nominees. We expect this trend to continue.

The results of Illumina's 2023 annual meeting underscore the continued influence of proxy advisory firms. While ISS and Glass Lewis made different recommendations, Illumina stockholders voted in-line with the one overlapping recommendation issued by both ISS and Glass Lewis — both proxy advisory firms recommended that stockholders vote in Icahn nominee, Andrew Teno, in place of incumbent board chair, John Thompson, which was the ultimate result of the stockholder meeting.

Settled practice on treatment of undervoting, overvoting, and executed but otherwise blank proxy cards

The proxy contest between Icahn and Illumina provides another data point under the universal proxy regime regarding parties'

treatment of "undervotes", "overvotes" and proxy cards that are executed and returned without any nominees marked.

When the universal proxy rules were first introduced, there was a question as to how parties would interpret Rule 14a-19(e)(7), which simply states that the proxy card must disclose the "treatment and effect" of a proxy that is marked as voting for the election of fewer ("undervoting") or more ("overvoting") nominees than the number of directors being elected, as well as the "treatment and effect" of a proxy card that is executed and returned but does not mark votes with respect to any nominees.

With respect to treatment on the three above topics, Illumina and Icahn followed the same approach, which was also in-line with the treatment used in two of the first proxy contests that occurred after the universal proxy rules went into effect — Capital Returns Management, LLC's proxy contest at Argo Group International Holdings, Ltd. and Land & Buildings Investment Management's proxy contest at Apartment Investment and Management Company, indicating that this is likely now settled practice. We expect to see parties continue to use this treatment going forward.

The approach taken in the proxy cards used in all of the above-mentioned proxy contests is as follows:

With respect to "undervoting": If a proxy card has voted "for" fewer than the total number of nominees that could be elected in such election, then such stockholder's shares will only be voted "for" those nominees as marked on the proxy card.

With respect to "overvoting": If a proxy card has voted "for" more than the total number of nominees that could be elected in such election, then all votes on such proxy card with respect to the election of directors will be invalid and will not be counted.

With respect to an executed and returned proxy card that is unmarked with respect to director nominees: If a proxy card is signed, dated and returned but not marked with respect to any director nominees, such stockholder will be deemed to have given direction to vote in-line with the recommendations such party (whether it be the company or the dissident) has set forth on such proxy card.

Illumina's bylaws hardwired its use of the "white" proxy card

After the Engine No. 1's successful 2021 proxy contest at Exxon Mobil, wherein the dissident won three board seats, and claimed the customary "white" proxy card before the company could, various companies have strategized ways to ensure that they will be able to use their customary color of proxy card in a contested election. A practice that has emerged after the effectiveness of the universal proxy rules is that certain companies have actually hardwired its use of a particular color of proxy card into its bylaws.

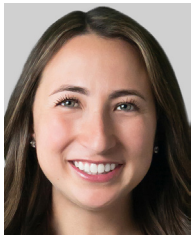
On February 1, 2023, Illumina filed amended bylaws that included such a provision, stating that any stockholder directly or indirectly soliciting proxies from other stockholders must "use a proxy card color other than white, which shall be reserved for the exclusive use of the board of directors." Illumina proceeded to use its customary

white proxy card in the 2023 contested election, and Icahn used a gold-colored proxy card.

This practice is especially relevant given that, as mentioned above, if a stockholder simply executes and returns a proxy card and does not mark votes with respect to director nominees, such stockholder will be deemed to vote in-line with the recommendations set forth on the proxy card.

Therefore, stockholders who are used to seeing the same color (typically, white) of proxy card year after year sent by the company in the context of an uncontested election, may be more likely to simply sign and return such a card. A company that does not already have a provision staking a claim to its preferred proxy card color should consider including one in its bylaws.

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Conclusion

The high profile proxy contest between Icahn and Illumina provides key insights into the importance of the board's understanding of transaction regulatory risks as well as costs associated with a potential proxy contest down the line.

While there are still only a handful of proxy contests that have gone to a stockholder vote in the era of the universal proxy rules, practices such as hardwiring bylaws for the company's use of the "white" proxy card and treatment with respect to undervotes, overvotes and executed but otherwise blank proxy cards make clear the importance of watching emerging trends as more proxy contests occur over the course of this proxy season and beyond.

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