THE CAPITOL FORUM Vol. 9 No. 34 February 1, 2021

GlobalWafers/Siltronic: 'High-Risk' Deal Faces Uphill Fight for U.S., German Approvals, Experts Say

As Taiwan's GlobalWafers (TPEX: 6488) struggles to win investors over to its $5.3 billion bid for German rival Siltronic (FRA: WAF), another fight is shaping up—the battle to gain national security clearances. Victory may prove elusive, national security experts told *The Capitol Forum*.

The acquisition will likely meet stiff resistance at the Committee on Foreign Investment in the United States (CFIUS) and Federal Ministry for Economic Affairs and Energy in Germany, where authorities worry about the economic and military consequences of the West losing its edge in silicon wafers crucial to 5G networks and Internet-connected devices, the experts said.

"GlobalWafers' buyout of Siltronic is a high-risk deal" given the nationality of the buyer and the sensitive nature of the technology being acquired, said one expert who requested anonymity due to past involvement in similar mergers.

Munich-based Siltronic produces wafers for the aerospace and defense industries as well as for 5G networks, autos and web-connected devices. The buyout would create the world's second-biggest producer of 300-millimeter silicon wafers used to make chips for computers, sensors, switch devices and antenna tuners, giving it a market share of about 30%, just behind the 33% commanded by Japan's Shin-Etsu, according to Siltronic. Demand for those wafers is growing and supplies are already tight, according to Semico, a semiconductor marketing, consulting and research group.

Not all investors have gotten on board with the deal, and last week GlobalWafers increased the all-cash offer to 145 euros ($176) a share, cut the minimum acceptance threshold to 50% and extended its offer deadline until February 10.

GlobalWafers and Siltronic have said they intend to file the transaction with CFIUS, an interagency panel that vets deals for security risks. GlobalWafers has already filed for clearance at the ministry in Germany, where legislators began tightening the nation's foreign-investment controls after Chinese investor Midea purchased German robotics company Kuka in 2016.

Power to prohibit. Both investment-review regimes wield considerable clout. CFIUS has the power to block deals, unwind them or force divestitures. The German ministry can, in coordination with other ministries, prohibit transactions or impose remedies on them. Increasing the risk for GlobalWafers is the reality that U.S. and German case handlers routinely cooperate when a transaction poses security concerns for both NATO members, the experts said.

CFIUS can assert jurisdiction over the transaction because Siltronic owns a plant in Portland, Oregon. The factory specializes in 200mm wafers, which remain in demand because they cost less to produce than 300mm wafers, the experts said. The panel's review is likely to be lengthy, given that Taiwanese buyers are deemed vulnerable to political and economic pressure from Beijing, they said.

Hsinchu, Taiwan-based GlobalWafers didn't respond to requests for comment, and a Siltronic spokesperson declined to comment. CFIUS is forbidden by law to discuss its investigations, and the German ministry declined to comment.

Colder regulatory climate. GlobalWafers might take comfort from CFIUS's decision in October 2016 to clear its purchase of SunEdison Semiconductors, a Singaporean producer of silicon wafers with U.S. headquarters in St. Peters, Missouri.

Since then, however, the regulatory climate in the U.S. and Germany has chilled, which will likely complicate GlobalWafers' bid for Siltronic, the experts said.

In December 2016, President Barack Obama blocked an attempt by China's Fujian Grand Chip Investment Fund to buy German chip-equipment maker Aixtron, citing risks relating to "military applications of the overall technical body of knowledge and experience of Aixtron."

That decision followed a CFIUS assessment and came amid rising American complaints about China snapping up strategic technology companies abroad even as it stymied similar deals at home. In Germany, the Aixtron deal heightened political concerns about transfers of technological know-how to China, prompting successive amendments to the Foreign Trade and Payments Act, which governs foreign direct investments (FDI) in the country.

The latest revision came in response to the Covid-19 pandemic and expanded the scope of the investment-review regime to cover the healthcare sector. Unlike the original act, the amendment allows the government to restrict or prohibit investments that will "likely affect" public safety and security—not just those that present an "actual and serious" risk. The changes went into effect in July 2020.

"The German approach to FDI has changed in the course of the last [few] years," said Michael Ulmer, a Frankfurt, Germany-based partner at Cleary Gottlieb who focuses on mergers and acquisitions.

Ulmer was referring to Germany and other European countries recently amending their laws to prevent investors and companies backed by foreign governments from buying economically distressed domestic businesses in security-sensitive industries.

The economic crisis brought on by the pandemic has only added to concerns that a foreign state-backed entity will go bargain hunting for companies, he said. "Now, enforced by the pandemic, there is the increasing fear that German technology and know-how might be 'sold out,'" Ulmer said.

Germany's regime has teeth: When the ministry threatened to veto a takeover of German toolmaker Leifeld Metal Spinning in 2018, Chinese buyer Yantai Taihai dropped its bid. The German government saw a security risk in allowing Leifeld to fall under the control of Yantai Taihai, which provides metal processing, forging and smelting for China's nuclear sector.

In the U.S., meanwhile, strong bipartisan support emerged for laws and initiatives targeting Chinese investments. One was the Foreign Investment Risk Review Modernization Act (FIRRMA) of 2018, which empowered CFIUS to review a broader range of foreign investments that might pose threats to national security, including transactions in the semiconductor sector.

Regulatory alignment. Laws building on FIRRMA have since encouraged CFIUS to work closely with allied nations—a development that likely will play a role in the U.S. and German reviews of GlobalWafers/Siltronic.

"The new investment laws in the U.S. allow for the multilateral cooperation and coordination among U.S. allies when it comes to transactions that take place in multiple jurisdictions," said Giovanna Cinelli, a former Naval Reserve intelligence officer who leads the international trade and national security practice at law firm Morgan Lewis.

Regulators in Germany can, in turn, work with CFIUS to address national security concerns of both countries, she added.

One CFIUS chief outlined the scope of this cooperation during a videoconference hosted by the Center for Strategic and International Studies in October.

Since FIRRMA became law, CFIUS has had "300 or so engagements with about 60 different allies and partners," said Thomas Feddo, who was serving at the time as assistant secretary for investment security at the U.S. Treasury Department. The bulk of that cooperation involved the EU, he said on the call.

Distrust of Taiwanese buyers. Taiwan-based companies such as GlobalWafers depend heavily on mainland China for sales and cheap labor, making it hard to argue that they don't pose a U.S. security threat.

Festering concerns about Taiwanese corporations crystalized in 2018, when the U.S. Department of Justice charged Taiwan's United Microelectronics of acting in concert with Fujian Jinhua Integrated Circuits, a Chinese state-owned enterprise, to steal memory-chip technology from Micron Technology of Boise, Idaho. UMC ultimately pleaded guilty to stealing trade secrets; it was ordered to pay $60 million in damages and agreed to cooperate with the government to prosecute Fujian Jinhua Integrated Circuits.

Some Taiwanese companies have sought to ease concerns and score points with the U.S. government by pulling factories and research operations out of China, said Cinelli of Morgan Lewis.

"Taiwanese companies have made some attempts to relocate their production and R&D facilities back to Taiwan and the United States," she said. "Still, it will take a considerable amount of time for Taiwan-based firms to isolate themselves from Chinese economic and political influences fully."

Taiwan Semiconductor Manufacturing Company, for example, decided to shift some of its manufacturing capacity to the U.S. after finding itself smack in the middle of the trade war between Beijing and Washington. But when TSMC began building a $12 billion chip plant in Arizona after negotiating with the Trump administration, controversy ensued.

Democrat leaders voiced strong reservations about the arrangement in a letter to the secretaries of the Commerce and Defense departments last May, citing concerns about whether the project met national security requirements, relied on federal subsidies and aligned with a broader strategy for U.S. supply chains.

Dwindling domestic capacity. The letter reflected deepening concerns about America's growing economic and military dependence on foreign suppliers.

Taiwan remains the world leader in the fabrication of microelectronics components, accounting for 21.8% of all wafer capacity, according to market-research company IC Insights. U.S. domestic capacity has been declining, slipping to 12.8% of the global market in 2018, even as Chinese manufacturing ability grew 1.7% that year to 12.5%.

"Reduced U.S. capability in microelectronics is a particularly troublesome area," Defense Department official Ellen M. Lord said during a congressional hearing on supply-chain integrity this past October.

"Reliance on non-U.S. suppliers for microelectronics leaves DOD vulnerable," said Lord, the undersecretary of defense for acquisition and sustainment. She cited risks including embargoes that can make microelectronics unavailable, the "loss of U.S. intellectual property from offshore dependency" and the "loss of confidence the technology will function as intended due to possible malicious activity by foreign fabricators."

Just five wafer producers supply some 90% of the global market. Although most leading wafer producers—including SK Siltron of South Korea and Shin-Etsu of Japan—are based in countries allied with the U.S., GlobalWafers' acquisition of Siltronic could be seen as harming U.S. domestic production capabilities because it would further consolidate the chip sector, the experts said. Siltronic serves roughly 13% of total market demand, while GlobalWafers caters to 17%.

Timeline. Reviews of sensitive foreign-investment deals can be prolonged affairs. Depending on the circumstances, a review at the German ministry typically lasts two to six months from the announcement of the deal.

A CFIUS examination begins with a 30-day review, during which the panel decides whether to clear the transaction or commence an investigation, which can last as long as 90 days. The committee then sends its recommendations to the U.S. president, who has up to 15 days to suspend, prohibit or impose conditions on the deal.

Whether CFIUS and its German counterpart will have much time to scrutinize the deal remains to be seen. GlobalWafers' new cash offer that expires February 10 is final, CEO Doris Hsu said in announcing the new terms last week. If too few shares are tendered, the company intends to pursue "other growth options that are at an advanced stage of planning."