Kaisha Bunkatsu: Corporate Demergers in Japan and Challenges Faced by Creditors

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**Kaisha Bunkatsu: Corporate Demergers in Japan and Challenges Faced by Creditors**

*Samantha Pranatadjaja*

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I. INTRODUCTION

Recently, ON Semiconductor Company completed its acquisition of SANYO Semiconductor from SANYO Electric on January 3, 2011. The acquisition continued ON Semiconductor’s transformation into a premier global supplier. The Chief Executive Officer (CEO) of ON Semiconductor emphasized that the acquisition enabled them to expand into the Japanese market and capture growth on a global basis. This acquisition was made possible because of SANYO Electric’s restructuring by demerging its unprofitable semiconductor unit into a wholly owned subsidiary. Prior to this acquisition, Hitachi and Mitsubishi Electric Corporation took advantage of special provisions under the Japanese Commercial Code for corporate reorganizations. They jointly established a new company, Renesas Technology Corp., and spun off both companies’ semiconductor businesses into Renesas. At the time, Renesas became one of the top three semiconductor companies in the world.

These successful demergers promoted the creation of the Japanese Bunkatsu Law, which eliminates impediments and facilitates corporate restructuring of Japanese companies. The term bunkatsu means demerger in Japanese and is similar to business transfers or asset sales in the United States. A demerger consists of a company splitting into two or more independent entities. In the United States, this is referred to as a spin-off. The kaisha bunkatsu is a type of corporate division (demerger) in Japan. It is a lawful way to restructure a failing

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2. Id.
3. Id.
6. See id.
11. Id.
12. ABA Section of Antitrust Law, COMPETITION LAWS OUTSIDE THE UNITED STATES, FIRST SUPPLEMENT, 323 (Daniel G. Swanson et al. eds., 2005).
business or promote a healthy portion of a business. The law allows Japanese entities to split out business units and make them standalone entities by “operation of law,” meaning that any relevant consent of creditors or contract counterparties are not required. Many companies use the kaisha bunkatsu legitimately to further their position in the Japanese market. For example, the ON Semiconductor purchase agreement had specific provisions for contracts pertaining to the demerger. However, illegitimate use of the kaisha bunkatsu is apparent among mid-size and family owned Japanese companies. This presents an issue to the Ministry of Japan because business owners are successfully abusing the kaisha bunkatsu.

The future possibility of major corporations abusing the kaisha bunkatsu needs to be considered because the primary focus of the abuse pertains to the rights of creditors. Creditors remaining with the parent company are subject to the possibility of having no recourse in receiving payment from the debtor parent company and the newly formed company. The current construction of the kaisha bunkatsu allows creditors to be left with no recourse. In spite of this issue, the United States has recognized a kaisha bunkatsu (demerger): ON Semiconductor and SANYO Semiconductor in Arizona. The United States recognizes that the kaisha bunkatsu is a positive notion, but with the potential abuse of the kaisha bunkatsu, states might not recognize or enforce the demerger because it conflicts with their corporate laws.

This Comment addresses the potential conflict of laws issue with the enforceability of the kaisha bunkatsu in California. Part II describes the difference between the kaisha bunkatsu and the United States law governing spin-offs. Part III examines the issue between creditor’s protections in Japan and California. Part IV creates an illustration of the potential problem a United

14. See Why Japan’s New Corporate Separation Law is Increasing Restructurings, supra note 8.
15. See ON Semiconductor Completes Acquisition of SANYO Semiconductor from SANYO Electric, supra note 1; Hitachi and Mitsubishi Electric to Establish Renesas Technology Corp., A New Company for Semiconductor Operations, supra note 6; Wakabayashi & Muraji, supra note 13.
16. ON Semiconductor and SANYO Semiconductor Purchase Agreement
17. See Wakabayashi & Muraji, supra note 13.
18. See id.
19. See infra Part V.
20. See Wakabayashi & Muraji, supra note 13.
21. See KAISHA-HOU [Corporation Law] [Companies Act], Law No. 86 of 2005, art. 763 (Japan); Wakabayashi & Muraji, supra note 13.
22. ON Semiconductor Completes Acquisition of SANYO Semiconductor from SANYO Electric, supra note 1.
23. See Wakabayashi & Muraji, supra note 13.
25. See infra Part II.
26. See infra Part III.
States creditor could face if Japan does not amend the *kaisha bunkatsu*. This Comment will argue the *kaisha bunkatsu* is an effective tool for corporate restructuring and global economic development, and therefore California courts should recognize the *kaisha bunkatsu* and apply California corporation laws, providing protection to creditors. Additionally, Japan should amend the *kaisha bunkatsu* in order to provide the same.

II. SPIN-OFFS

A. Brief Overview

A spin-off is the distribution of stock in a subsidiary corporation by a parent corporation to its existing shareholders. The shareholders of the parent company are not required to surrender any stock in return. This transaction allows the business to operate in separate corporations. The split of the business will either form a parent-subsidiary relation or two corporations with a common holding company.

![Spin-off Diagram]

27. *See infra* Part IV.
28. *See infra* Part V.
29. *See infra* Part V.A.
31. *Id.*
33. *Id.*
A spin-off is attractive to companies for a variety of reasons. It can maximize shareholder value, unlock hidden value, increase revenue and attract investors, and make the corporation “fit and focused” by reorganization, to name a few. Historically, a spin-off has been used to facilitate mergers and acquisitions by allowing a corporation to remove obstacles.

The spin-off can raise issues such as: non-assignable assets, relief from liabilities, necessity of shareholder approval, fiduciary duties, tax, and securities law rules. Particularly, spin-offs can be potentially dangerous to creditors. Abusive spin-offs are not common, but they can be used to defraud creditors by a fraudulent conveyance. Creditors could lose their right to recourse because of this fraudulent transfer. Legal safeguards for this potential abuse exist, but are dependent on what country’s law is being applied.

B. The Kaisha Bunkatsu

The kaisha bunkatsu is an amendment originally adopted in the Japanese Commercial Code in 2001. Japan’s laws relating to companies were originally scattered throughout the Commercial Code. Then, in 2005, Japan enacted the Companies Act (Kaisha-hou), which brought all the corporate legal provisions into one consolidated law. The Companies Act came into effect on May 1, 2006 as the largest reform of its kind in 50 years. The rules under the Companies Act are the responsibility of the Ministry of Justice in Japan.

34. Adams & Mukherji, supra note 30, at 39.
35. Id. at 39–44.
36. Id. at 39.
37. See GEVURTZ, supra, note 32 at 862-68 (describing the potential issues and abuses of the transaction).
40. GLOVER, supra note 38; Adams & Mukherji, supra note 30, at 33–38 (discussing environmental fraudulent claims).
41. See infra Part IV.
42. ABA Section of Antitrust Law, supra note 12.
47. Osugi, supra note 43.
purpose of the Companies Act is to govern “[t]he formation, organization, operation and management of companies.”

The Companies Act permits several different types of corporate restructuring. The *kaisha bunkatsu* is a company split method whereby a company either transfers all or some of their rights and obligations to a receiving company (*Kyûshû Bunkatsu*) or a newly formed company (*Shinsetsu Bunkatsu*). The *Shinsetsu Bunkatsu* is an incorporation demerger, meaning the parent company incorporated a new company by the transfer of their assets and liabilities from the parent company. The assets and liabilities are transferred as an operation of law. There are two different kinds of incorporation-type company splits provided in the Companies Act. The first is a split by which a stock company is incorporated and the second is a split by which a membership company is incorporated. Commonly, the first type is used in forming a newly incorporated company.

The *kaisha bunkatsu* has provided a lawful way for failing Japanese companies to restructure their company. Also, it allows a target company to split the desired business into a separate company. The splitting of a target company is useful when a bidder does not wish to acquire all of the target’s businesses. The typical procedure of a company using the *kaisha bunkatsu* for legitimate purposes begins with the parent company (splitting company) transferring the healthy part of the business to the newly formed corporation, followed by the splitting company selling the newly formed corporation’s shares to a third party. Lastly, the splitting company pays the debts owed to creditors with the money from the sale, as does the newly formed corporation from the cash flow generated by the operation of the new business. It is not a statutory

49. See *id* (discussing part of the Companies Act setting out the regulations for entity conversions, mergers, and company splits).
51. *Hines et al., supra* note 9, at 390.
52. *id*.
53. See ABA Section of Antitrust Law, *supra* note 12.
55. *Wakabayashi & Muraji, supra* note 13.
56. *id*.
58. *id*.
59. *KAISHA-HOU, supra* note 21, at 763, ¶ v; *Wakabayashi & Muraji, supra* note 13.
61. *id*.
requirement for the splitting company to consult with major creditors, but many do as a gesture of good faith.

There are statutory corporate restructuring methods that are subject to creditor protection procedures provided by the Companies Act; however, under the *kaisha bunkatsu*, creditors who remain with the splitting company are not protected. This results because the splitting company remains the guarantor with no change to its financial situation, since the acquired shares of the newly formed company result in it becoming the splitting company’s wholly owned subsidiary. The company split differs from other merger methods because the splitting company has the authority to choose the rights and obligations transferred to the newly formed corporation and those that remain with it. Thus, the splitting company is not required to obtain consent from or inform creditors during the company split process.

C. The Business Spin-Off in the United States

This kind of transaction described above implicates state corporate law, Internal Revenue Code (IRC) § 355, the 1933 Securities Act, and possibly Article 6 of the U.C.C. The parent corporation spinning off a subsidiary distributes the stock of the subsidiary to its shareholders. Even though the distribution occurs without consideration, it is held to be a sale that triggers the registration requirements of the 1933 Securities Act. Certain conditions must be satisfied under IRC § 355 in order for the spin-off to be successful.

The spin-off may remove assets from the parent corporation, but it does not reduce the parent corporation’s debt or capital. Even if the spin-off company assumes part of the parent corporation’s debt, the parent corporation is still liable
to the creditor unless they receive a novation.\textsuperscript{78} This is why a creditor’s consent is required for contracts containing anti-assignment provisions.\textsuperscript{79} A number of laws protect creditors in spin-offs in the United States.\textsuperscript{80} Creditors can challenge the spin-off because of a fraudulent transfer.\textsuperscript{81} This is likely to happen when a creditor finds their option for payment is with the “bad” company.\textsuperscript{82} It is especially vital that care is given in allocating debt and liabilities during a spin-off to ensure that the splitting company and the parent company are viable and any solvency risks have been considered.\textsuperscript{83} Thus, planners should consider creditors’ rights issues when preparing business spin-offs.\textsuperscript{84}

\section*{III. Creditors}

Creditors play an important role in corporate governance because they have control rights in a company.\textsuperscript{85} They influence major decisions of a company through controls when a company either defaults or violates a debt covenant.\textsuperscript{86} For example, creditors could impose sanctions over a company’s restructuring such as mergers and acquisitions and spin-offs.\textsuperscript{87} However, the effectiveness of creditors’ rights depends on their rights being enforceable in courts.\textsuperscript{88}

\subsection*{A. Transfer by Operation of Law in Japan}

Japanese companies have used abusive company splits (\textit{ranyouteki-kaisha-bunkatsu}) to protect the interest of their equity holders to the detriment of their creditors.\textsuperscript{89} They are successful by using the \textit{kaisha bunkatsu} in an evasive manner.\textsuperscript{90} The company isolates the healthy business, out of reach of creditors, into the newly formed company without informing creditors.\textsuperscript{91} This maneuver

\textsuperscript{78} Id.
\textsuperscript{80} See infra Part III.B for further explanation of the laws protecting creditors.
\textsuperscript{81} BUSINESS SEPARATION TRANSACTIONS SPIN-OFFS, supra note 38; Adams & Mukherji, supra note 30, at 33-38.
\textsuperscript{82} BUSINESS SEPARATION TRANSACTIONS SPIN-OFFS, supra note 38.
\textsuperscript{84} BUSINESS SEPARATION TRANSACTIONS SPIN-OFFS, supra note 38.
\textsuperscript{86} Id.
\textsuperscript{87} Id.
\textsuperscript{88} Id.
\textsuperscript{89} Wakabayashi & Muraji, \textit{supra} note 13.
\textsuperscript{90} Id.
\textsuperscript{91} Id.
differs from with other types of demergers in Japan that require disclosure and mandatory procedures to protect creditors.\footnote{Hines, supra note 10, at 390.}

The advantage of using the \textit{kaisha bunkatsu} is the ability to transfer contractual rights and obligations as an operation of law without the consent of counterparties and creditors.\footnote{Why Japan’s New Corporate Separation Law is Increasing Restructurings, supra note 8.} The Ministry of Japan’s goal was to streamline the process and not require the company to negotiate consent from each contractual party.\footnote{Id.} However, the \textit{kaisha bunkatsu} protects creditors by requiring the splitting company to provide notice to creditors being transferred to the newly formed company.\footnote{See KAISHA-HOU, supra note 21, at 764(2)(Corporation Law).} The creditor has the right to object to the transfer during the notice period, but failing to object results in the consent from the creditor.\footnote{See Id. at §10(1) ¶ii (Corporation Law); Why Japan’s New Corporate Separation Law is Increasing Restructurings, supra note 8.} Creditors who object are provided alternative measures such as: repayment, appropriate collateral to secure their obligation, or sufficient assets are placed in a trust to secure repayment.\footnote{Shareholder and Creditor Protection in Japanese Mergers, THE JAPAN TAX SITE (Feb. 7, 2011), http://japantax.org/?p=4355; KAISHA-HOU, supra note 21, at 789(5), 799(5).} This protection is only available to creditors being transferred and not to such creditors who remain with the splitting company.\footnote{Wakabayashi & Muraji, supra note 13.}

Unknowingly, with the enactment of the \textit{kaisha bunkatsu}, the Ministry of Japan created separate protections for creditors.\footnote{See KAISHA-HOU, supra note 21, at 764(2) (describing which creditors requires notice).} It is debatable whether there is a practical value in the notice requirement because the splitting company’s rights and obligations are succeeded and not assigned to the newly formed company.\footnote{See id. at 763, ¶v; Why Japan’s New Corporate Separation Law is Increasing Restructurings, supra note 8.} The power given to the splitting company to choose which rights and obligations to keep and transfer inevitably creates a potential detriment to creditors.\footnote{See id.} As explained in more detail below, a creditor remaining with the splitting company could lose recourse to the newly formed company when a splitting company sells the newly formed company to a third party.\footnote{See Wakabayashi & Muraji, supra note 13.} A splitting company could file for bankruptcy or simply abandon the company leaving the creditor with few options.\footnote{See id.}

The creditor remaining with the splitting company could sue or force the splitting company into bankruptcy, but the valuable assets will be untouchable because they are with the newly formed company.\footnote{See id.} Basically, the splitting company could file for bankruptcy or simply abandon the company leaving the creditor with few options.
company “foisted all [its] debt on an empty shell” while the valuable business continues to make money free of debt. 105 This is profitable for the splitting company because it can now sell the newly formed company free of encumbrances. 106 This is important because usually buyers only want to acquire the profitable division of the Japanese company. 107

B. Transfer by Operation of Law in California

Conversely, California corporate law specifically protects against this potential abuse of power by a splitting company. 108 A number of laws in the United States such as state fraudulent conveyances laws, the Bankruptcy Code, and the Uniform Fraudulent Conveyance Act also protect creditors in a spin-off. 109 Upon a merger, all the rights of creditors and all liens are preserved and unimpaired. 110 Further, if a corporation disappears, any action or proceeding against it will be prosecuted and the judgment will bind the surviving corporation. 111 The parent company remains liable to a creditor without a novation despite the transfer of obligations to the newly formed company. 112

A creditor left with the splitting company has the right to bring a suit against the newly formed company by claiming fraudulent conveyance. 113 The transfer without fair consideration to the splitting company is a fraudulent conveyance if the splitting company is insolvent or left without sufficient capital. 114 The transfer can also be found to be fraudulent if the debtor made the transfer of the splitting company with the actual intent to hinder, delay, or defraud the creditor. 115 Further, the Bankruptcy Code protects the creditor. 116 If the splitting company files bankruptcy, the bankruptcy trustee or debtor in possession has the authority

106. Id.; Wakabayashi & Muraji, supra note 13.
110. Corp. §1107; Corp. §1113.
111. Corp. §1107; Corp. §1113.
112. GEVRTZ, supra note 32.
115. See Civ. §3439.04(a)(1); see also Civ. §3439.04(b) for the factors to determine the actual intent of the debtor.
to avoid the fraudulent transfer under applicable state law. These legal safeguards protect against abusive spin-offs.

C. Abuse of Creditors in Japan

Small and mid-sized Japanese companies usually owned by individuals or family members have successfully utilized the *kaisha bunkatsu* in an evasive manner. There are a number of different ways the Japanese company can defraud a creditor. The Japanese splitting company decides to transfer its rights and creditor obligations pertaining to the valuable part of the business to the newly formed company. Then, the splitting company decides whether it will transfer some creditors, all creditors, or no creditors to the newly formed company. Normally, the creditors left with the splitting company are not informed of this process.

Once the newly formed company is established, the splitting company’s owners begin the process of separating themselves from the newly formed company. This part of the splitting process is where the defrauding of creditors occurs. The owners of the splitting company will sell the newly formed company to one of their family members for a nominal value. This method is simply used to legally relinquish control of the newly formed company, thus allowing the original owners to maintain their ties to the valuable newly formed company without the encumbrances left with the splitting company. This method of fraud can be taken one step further when the family members decide to sell a large number of the new shares to an equity sponsor, who could be a consultant or other family members, thereby allowing the owners of the splitting company to effectively shift economic control over the newly formed company. Finally, the owners of the splitting company will either commence bankruptcy proceedings or abandon the company, thus leaving the creditor with limited options for recourse.

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118. Adams & Mukherji, supra note 30.
119. Wakabayashi & Muraji, supra note 13.
120. See supra Part III.A.
121. Wakabayashi & Muraji, supra note 13.
122. KANDA, supra note 50; see also Wakabayashi & Muraji, supra note 13.
123. See supra Part III.A.
124. See Wakabayashi & Muraji, supra note 13.
125. See supra Part III.A.
126. Wakabayashi & Muraji, supra note 13.
127. Id.
128. Id.
129. Id.
130. See supra Part III.A.
Japan and California have similar fraudulent conveyance and bankruptcy laws when dealing with fraudulent acts of companies. In California, the creditors would be able to contest the transfer of the newly formed company to the owner’s family members under fraudulent conveyance laws. If the owner of the splitting company files for bankruptcy, the trustee or debtor in possession can deem the transfer of the newly formed company fraudulent allowing creditors recourse from the company. Also, abandoning the splitting company would allow creditors to bring their claims for recourse against the newly formed company. Conversely, in Japan, even with similar protections, the creditors left with the splitting company have limited recourse options dependent on certain courts.

The Companies Act contains a provision applicable to a business transfer that holds the transferee of the business transfer liable for the transferor’s obligations to creditors. However, this provision does not apply to a statutory company split method (including the kaisha bunkatsu). Certain Japanese courts have allowed creditors to avoid fraudulent transfers under the fraudulent acts and bankruptcy act of the Civil Code. The courts recognize that the Companies Act does not provide any protection to creditors. However, other courts argue the Civil Code is not applicable because the Companies Act has its own provisions. Thus, a creditor with the splitting company is guaranteed protection in California, but is provided limited protection in Japan.

IV. CONSIDERATION OF CONFLICT OF LAWS

A. Creditor Brings Suit

Creditors have no domestic solution in Japan when a company uses the kaisha bunkatsu and leaves the creditor with the splitting company. A creditor evaluating its options looks to see if there is a difference between the United States and Japanese laws. This could create a forum shopping issue because a creditor would want to bring a case in the United States since the law is more

131. See supra Part III.A–B.
132. See supra Part III.B.
135. See supra Part III.B.
137. Id.
138. Id.
139. Id.
140. Id.
141. See supra Part III.A-B (comparing the differences between California’s and Japan’s corporate laws).
142. See supra Part III.A.
143. See supra Part II.
favorable towards creditors compared to Japan.\textsuperscript{144} However, the choice of forum does not always dictate the choice of law.\textsuperscript{145} Thus, if a creditor brings a claim against a United States corporation the courts could be faced with a conflict of laws issue, which is illustrated by the hypothetical provided below.

Suppose a creditor from California (creditor) decides to loan money to a Japanese company (Company A).\textsuperscript{146} Company A is not as profitable as it hoped to be, but one part of the business is profitable.\textsuperscript{147} Company A decides to unlock the hidden value of this business and uses the \textit{kaisha bunkatsu} to create Company B.\textsuperscript{148} Company A chooses to use the \textit{kaisha bunkatsu} because it wants Company B to be unencumbered, making it attractive to potential buyers.\textsuperscript{149} Company A then sells Company B to a corporation located in California (Company C). Company A is abandoned leaving with it all of its debts.\textsuperscript{150} The creditor has no recourse in Company A and decides to bring his claim against Company C who purchased Company B.\textsuperscript{151} Company C argues it should not be held liable because it acquired Company B free of encumbrances from Company A.\textsuperscript{152}

In the example above, the California court will be faced with a conflict of laws issue since Company B was incorporated in Japan, but was acquired by a California corporation.\textsuperscript{153} A creditor in California has a right to bring a fraudulent conveyance claim, but a creditor in Japan does not have this protective right.\textsuperscript{154} However, in this case it is a California creditor bringing the claim and the court must decide whether it will apply Japan’s or California’s corporation laws, and depending on whose laws apply, whether or not Company C is liable for Company A’s debt.

B. \textbf{Court’s Discussion}

1. \textit{Internal Affairs Doctrine}

Applying the Internal Affairs Doctrine allows the court to determine which state’s law applies in the case.\textsuperscript{155} The Internal Affairs Doctrine says the state of

\begin{itemize}
\item \textsuperscript{144} See \textit{supra} Part III.A–B.
\item \textsuperscript{145} See \textit{infra} Part IV.B.2 (illustrating different laws the courts consider with choice of laws).
\item \textsuperscript{146} See, e.g., Brian Shappell, \textit{Japanese Manufacturer Moves to Protect Itself from U.S. Creditors}, NACME-SE, http://blog.nacm.org/2012/03/japanese-manufacturer-moves-to-protect.html.
\item \textsuperscript{147} Adams & Mukherji, \textit{supra} note 30, at 15, 39–44.
\item \textsuperscript{148} \textit{Id.}
\item \textsuperscript{149} See Yagi & Kaji, \textit{supra} note 105; \textit{see also} Wakabayashi & Muraji, \textit{supra} note 13.
\item \textsuperscript{150} Yagi & Kaji, \textit{supra} note 105.
\item \textsuperscript{151} See Wakabayashi & Muraji, \textit{supra} note 13.
\item \textsuperscript{152} Yagi & Kaji, \textit{supra} note 106; Wakabayashi, \textit{supra} note 13.
\item \textsuperscript{154} See \textit{supra} Part III.
\item \textsuperscript{155} \textit{RESTATEMENT (SECOND) OF CONFLICT OF LAWS} § 302 (1971).
\end{itemize}
incorporation governs the rights and liabilities of a corporation.\textsuperscript{156} It is a conflict of law principle allowing only one state the authority to regulate a corporation’s internal affairs.\textsuperscript{157} However, courts differ on the application of this principal because of the distinction of what qualifies as an internal affair.\textsuperscript{158} Thus, the creditor would need to prove its right is an internal affair in order for the principal to apply.\textsuperscript{159}

However, courts in California are not permitted to control the internal affairs of foreign corporations.\textsuperscript{160} The internal affairs of a corporation have been recognized as matters relating to the relationships of the corporation and its officers, directors, and shareholders.\textsuperscript{161} It focuses on the organic structure or internal administration of a corporation.\textsuperscript{162} The creditor’s right would not be considered an internal affair because the right is not connected to the company’s incorporation steps such as: issuance of shares, holding director and shareholders’ meetings, charter amendments, etc.\textsuperscript{163} Based on this application of the Internal Affairs Doctrine the court would apply Japan’s law because the state of incorporation governs the liabilities of the corporation\textsuperscript{164} and the creditor would have no protective right to bring the suit against the California company.\textsuperscript{165}

However, California courts recognize there are certain exceptions to the Internal Affairs Doctrine.\textsuperscript{166} In the interest of justice, a local court could apply the local law over the Internal Affairs Doctrine.\textsuperscript{167} This could be done because California has an interest in protecting its residents against fraud with the sale of corporations.\textsuperscript{168} The court could apply local law when it finds the foreign corporation has its principal place of business in the local state.\textsuperscript{169} The creditor could make a strong argument using both exceptions. The creditor could prove Company A deliberately used the kaisha bunkatsu to create Company B without encumbrances.\textsuperscript{170} This deliberate act by Company A is a fraudulent action California courts would want to protect their residents from.\textsuperscript{171} Further, the

\textsuperscript{155} \textit{Supra} Part III.A.

\textsuperscript{156} \textsc{Restatement (Second) of Conflict of Laws} § 302 (1971).

\textsuperscript{157} Edgar v. MITE Corp., 457 U.S. 624, 645 (1982).


\textsuperscript{160} Western Air Lines, Inc. v. Sobieski, 191 Cal. App. 2d 399, 408 (2d Dist. 1961).

\textsuperscript{161} Edgar, 457 U.S. at 645.

\textsuperscript{162} \textit{State Farm}, 114 Cal. App. 4th at 443.

\textsuperscript{163} \textit{Id.}

\textsuperscript{164} \textsc{Restatement (Second) of Conflict of Laws} § 302 (1971).

\textsuperscript{165} \textit{Supra} Part III.A.

\textsuperscript{166} Western Air Lines, 191 Cal. App. 2d 399; Friese v. Superior Court, 134 Cal. App. 4th 693 (4th Dist. 2005).

\textsuperscript{167} \textit{Friese}, 134 Cal. App. 4th at 708.

\textsuperscript{168} \textit{Friese}, 134 Cal. App. 4th at 708.

\textsuperscript{169} 9 \textsc{Witkin, Summary of Cal. Law (10th)}, Corp. § 239.

\textsuperscript{170} Yagi & Kaji, \textit{supra} note 106; Wakabayashi, \textit{supra} note 13.

\textsuperscript{171} 9 \textsc{Witkin, supra}, note 169.
creditor could prove Company B’s principal place of business is in California since it was acquired by a California corporation.\footnote{172} The court would exercise jurisdiction because making the creditor bring suit against Company B in Japan would be an inappropriate and inconvenient forum since Company B’s business records are in California.\footnote{173} Based on this application of the Internal Affairs Doctrine the court would apply California’s law and the creditor would have a protective right to bring a fraudulent claim against Company C.\footnote{174}

2. Applying California’s Law

The court will not necessarily apply California law.\footnote{175} The Internal Affairs Doctrine is one approach the court will consider when determining choice of law.\footnote{176} The court may additionally look at the First Restatement or the Second Restatement pertaining to conflict of laws.\footnote{177} The First Restatement follows a rules approach while the Second Restatement applies a balancing test.\footnote{178} The First Restatement does not seek to determine whether there is a valid contract until it determines the place of the principal event.\footnote{179} The place of the principal event is vital because it is the law of the place of contracting that determines the validity of the contract.\footnote{180} The Second Restatement allows for the contracting parties to include a choice of law provision in their contract.\footnote{181} However, absent a choice of law provision, the choice of law is determined by which state has the most significant relationship to the transaction.\footnote{182} The factors the court balances are: “(a) the place of contracting, (b) the place of negotiation of the contract, (c) the place of performance, (d) the location of the subject matter of the contract, and (e) the domicil[e], residence, nationality, place of incorporation and place of business of the parties.”\footnote{183} Further, if the place of negotiation and performance are in the same state, then that state’s law will apply.\footnote{184}

\begin{itemize}
\item \footnote{172} Supra Part IV.A.
\item \footnote{173} 9 Witkin, supra, note 169.
\item \footnote{174} See Western Airlines, Inc. v. Sobieski, 191 Cal. App. 2d 399, 409-11 (2d Dist. 1961).
\item \footnote{175} See id.
\item \footnote{176} See generally RESTATEMENT (SECOND) OF CONFLICTS OF LAWS (1971); RESTATEMENT OF CONFLICT OF LAWS (1934).
\item \footnote{177} Id.
\item \footnote{179} RESTATEMENT (FIRST) OF CONFLICT OF LAWS § 311 cmt. d (1934).
\item \footnote{180} Id.
\item \footnote{181} RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 cmt. a (1971).
\item \footnote{182} Reese, supra note 153, at 697.
\item \footnote{183} See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188(2) (1971).
\item \footnote{184} RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188(3) (1971).
\end{itemize}
If the court looks to either of the conflict of law Restatements, the creditor might be left with no recourse because it would apply Japan’s laws. The First Restatement analysis focuses on where the right vested, and particularly with contracts, the place of the creation of the contract. Thus, Japan’s law would apply because the contract was created in Japan, thereby vesting the creditor’s rights in Japan. The Second Restatement analysis provides a complex balancing test of different factors, assuming the creditor and Company A did not have a choice of law provision in their contract. This is a case-by-case determination and a highly factual application. Thus, balancing the factors, the court could apply Japan’s law. However, policy reasons behind the Restatement—state of dominant interest and to seek justice—could move the court to apply California law.

Assuming the court determines California’s corporation law applies (local law), the court is left with the task to determine whether this conveyance was fraudulent and if Company C is liable for Company A’s debt. The kaisha bunkatsu allows for Company A to create Company B without encumbrances. However, California law does not permit Company A to create Company B to the detriment of creditors.

Company C typically does not assume Company A’s liability unless the transfer of Company B to Company C is for the fraudulent purpose of escaping liability for Company A’s debts. Company A used the kaisha bunkatsu to unlock the hidden value of its company by creating Company B and retaining all the debt. Company A then sold Company B to Company C, which prohibited recourse for the creditor because Company B held the valuable assets of Company A. Company A deliberately sold Company B to hinder the creditor. Thus, the creditor is left without many options because of this fraudulent conveyance. Company C argues it did not purchase Company B with the intent

185. See generally RESTATEMENT (SECOND) OF CONFLICTS OF LAWS (1971); RESTATEMENT (FIRST) OF CONFLICT OF LAWS (1934).
186. See supra Part III.A (discussing Japan’s laws pertaining to creditors).
187. See Richman & Riley, supra note 178, at 1197–98.
188. See supra Part IV.B.1.
189. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188(2) (1971).
190. See generally Reese, supra note 153 (describing the policy reasons of each factor considered in Restatement Second and providing examples of how different courts apply them).
191. See id. at 688 & 690.
192. See supra Part IV.B.1.
193. See supra Part IV.A.
194. See supra Part II.A.
195. See supra Part III.B.
197. See supra Part IV.A.
198. See Wakabayashi & Muraji, supra note 13.
200. See supra Part III.C.
to defraud the creditor since it believed Company B was free of encumbrances. The court is unlikely to accept this argument because Company A was abandoned.\(^{201}\) Company C will be held liable if the predecessor corporation disappears.\(^{202}\) Therefore, the creditor could potentially bring an action against Company A and the judgment would be binding on Company C.\(^{203}\) The court is likely to hold Company C liable for Company A’s debts because it acquired Company B, which was created with the intent to foist off Company A’s debts.\(^{204}\)

V. PROPOSED SOLUTION

The potential abuse of the *kaisha bunkatsu* by major corporations raises a significant issue.\(^{205}\) The above hypothetical illustrates the distinction between Japanese and Californian corporate laws.\(^{206}\) Japan’s law places the California courts in the difficult position of determining whether to adopt international law or to apply California law to protect a California creditor.\(^{207}\) Even though the *kaisha bunkatsu* benefits Japanese corporate restructuring,\(^{208}\) certain aspects of it should be amended or California courts need to determine how to enforce it.

A. Japan Amends the Kaisha Bunkatsu

Amending the *kaisha bunkatsu* is the best solution for the issues presented. The Ministry of Japan is aware of the statutory flaws regarding creditors with the *kaisha bunkatsu*.\(^{209}\) It considered amending the Companies Act to address these issues.\(^{210}\) However, other corporate scandals involving Japanese corporations occurred in 2011, which changed the Ministry of Japan’s focus to amending the Companies Act.\(^{211}\) The proposed amendments to the *kaisha bunkatsu* have not been approved.\(^{212}\) The Ministry of Japan’s proposed amendments focus on the rights of creditors left with the splitting company.\(^{213}\) The amendment provides creditors, harmed by the company split, the ability to exercise their rights against

\(^{201}\) See supra Part IV.A.
\(^{204}\) Yagi & Kaji, *supra* note 105, at 261.
\(^{205}\) See supra Part I.
\(^{206}\) See supra Part IV.
\(^{207}\) See supra Part IV.
\(^{208}\) See supra Part IV.
\(^{209}\) *Why Japan’s New Corporate Separation Law is Increasing Restructurings, supra* note 8.
\(^{210}\) See Wakabayashi & Muraji, *supra* note 13.
\(^{211}\) See *id.*
\(^{213}\) See Wakabayashi & Muraji, *supra* note 13.
the newly incorporated company. The Ministry of Japan should adopt this amendment because it will aid in ending the abusive company splits by businesses using the *kaisha bunkatsu*.

**B. Options for the California Courts**

1. Do Not Recognize the Demerger

California courts are not required to enforce international law. The courts have the authority to determine the choice of law to apply determined by the Internal Affairs Doctrine. In this event, California has an interest in protecting their creditors and its public policy would be offended if it applied Japanese law. If the court holds the Internal Affairs Doctrine inapplicable then it will apply California’s corporation laws. Since California’s corporation laws regarding spin-offs are in conflict with Japan’s Companies Act regarding *kaisha bunkatsu*, the court could focus on the legality of the demerger in Japan. Applying California corporate law would invalidate the demerger because it was created to the detriment of creditors. Thus, the court would not recognize the newly incorporated company from the splitting company.

Not recognizing the demerger and invalidating the newly formed company creates a significant issue for the splitting company, purchasing company, and creditor. The newly formed company is left in limbo because it is acknowledged in Japan, but not in California. This action does not solve the creditor’s problem because it will not have recourse in Japan or California. The creditor is left with the original problem of recovering debt from the newly incorporated company. Further, the purchasing company is left with an invalidated sale. The purchasing company cannot legally buy the newly incorporated company because the California court does not recognize the newly incorporated company.

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214. See *id.*
215. See *id.*
219. See *supra* Part IV.B.1.
220. See *supra* Parts II, III.
221. See *supra* Part III.B.
222. See *supra* Part III.B.
223. See *supra* Part IV (illustrating how the *kaisha bunkatsu* affects the splitting company, purchasing company, and creditor).
224. See *supra* Part III (comparing the difference between Japan and California law).
226. See *id.*
227. See *id.*
incorporated company (as if the company does not exist).228 This extreme action by the California courts would affect the global economy because California corporations will not be able to purchase demerged Japanese companies.229 However, this action could create an economic incentive for Japan to amend the _kaisha bunkatsu_ because it limits the number of potential purchasers and creditors.230

2. Recognize the Demerger

The _kaisha bunkatsu_ has been used successfully for Japanese corporate restructuring by major corporations.231 If the California courts decide to not recognize the _kaisha bunkatsu_ this would negatively impact future valid Japanese corporate restructurings.232 The purpose of the _kaisha bunkatsu_ is to facilitate corporate restructurings not to defraud creditors.233 However, the statutory flaws in the _kaisha bunkatsu_ allow for potential abuse from the splitting company.234 This is an important distinction because the Ministry of Japan did not knowingly create this potential for abuse.235 Therefore, the California court should recognize the _kaisha bunkatsu_ but create a protection to creditors regarding the recourse of debt.

The California court should validate the demerger by the splitting company using the _kaisha bunkatsu_ even if it applies California’s corporation laws after the choice of law determination.236 The court should apply California’s corporation laws to protect the creditor from the splitting company’s fraudulent conveyance.237 The creditor should be allowed to make a claim against the newly incorporated company even though it has been sold to an acquiring company.238 This is fair to the acquiring company because it should have done its due diligence in forming the newly incorporated company before completing the purchase.239 The acquiring company should not be protected against the creditor because Japan allowed the newly incorporated company to be formed without

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228. GLOVER, supra note 38.
229. Id.
230. See generally Why Japan’s New Corporate Separation Law is Increasing Restructurings, supra note 8 (explaining the benefits of the _kaisha bunkatsu_).
231. See supra Part I.
232. Why Japan’s New Corporate Separation Law is Increasing Restructurings, supra note 9.
234. Id.
235. Id.
236. See supra Part IV (illustrating the results when a court recognizes the demerger).
238. See supra Part IV (applying California’s corporate laws regarding when a corporation disappears).
239. Why Japan’s New Corporate Separation Law is Increasing Restructurings, supra note 8.
encumbrances. The acquiring company in California is aware of the laws to protect a creditor from a disappearing corporation and how a newly incorporated company cannot be formed to hinder creditors. The California court has to apply California’s corporation laws to protect creditors because if it were to apply only Japan’s law, public policy would be offended.

C. Adopting the Kaisha Bunkatsu

The kaisha bunkatsu was created by the Ministry of Japan to streamline the demerger process. The Ministry’s intentions were to allow failing Japanese companies to restructure quickly without having to negotiate with each individual creditor or counterparty. The enactment of the Bunkatsu Law led to more than 300 reported transactions utilizing the new kaisha bunkatsu process. Other countries should adopt the kaisha bunkatsu because it provides a statutory demerger, allowing companies to successfully restructure and unlock hidden value of their businesses without requiring third party consent. This process allows companies to quickly and successfully restructure their businesses, which furthers the country’s economic development and lessens its bankruptcy cases. However, if a country decides to adopt the kaisha bunkatsu it should be aware of the potential abuse towards creditors.

The Ministry of Japan unknowingly created separate protections for creditors depending on whether the creditor remained with the splitting company or newly formed company. This was an oversight by the Ministry of Japan because the Companies Act provides a protection to creditors applicable to a business transfer. However, the kaisha bunkatsu is considered a statutory company split and not a business transfer, which leaves the creditors with the splitting company unprotected. Japan’s courts are trying to alleviate this situation by attempting to apply their fraudulent conveyance laws and bankruptcy laws, but the courts are

241. See supra Part III.B.
243. See supra Part II.B; see also Why Japan’s New Corporate Separation Law is Increasing Restructurings, supra note 8.
244. Why Japan’s New Corporate Separation Law is Increasing Restructurings, supra note 8.
245. See id.
246. See supra Parts II.A, II.B.
247. Why Japan’s New Corporate Separation Law is Increasing Restructurings, supra note 8; Adams & Mukherji, supra note 30, at 43.
248. Why Japan’s New Corporate Separation Law is Increasing Restructurings, supra note 8.
249. See supra, Part III.
250. See supra Part III.
251. Wakabayashi & Muraji, supra note 13.
252. Id.
lacking in uniformity. Some courts hold the newly formed company can be held liable for the splitting company’s creditor obligations, but others hold the fraudulent conveyance and bankruptcy laws cannot apply since the Companies Act provides its own protection provisions. Thus, a country should focus on the legal mistakes made by the Ministry of Japan before it adopts the kaisha bunkatsu.

If a country chooses to adopt the kaisha bunkatsu, the legislature needs to modify the procedure. Even though the kaisha bunkatsu allows a company to demerge without the consent of third parties, the third parties’ obligations should still be protected. Unlike in Japan, California protects creditors through its corporation laws, bankruptcy laws, and fraudulent conveyance laws. Japan has similar laws, but the protection provisions in the Companies Act trump them. A country with a similar legal system to Japan should provide creditors, whether with the splitting company or newly formed company, harmed by the demerger the right to bring a claim against the newly formed company. The legislature needs to focus on the potential defrauding of creditors in order to successfully adopt the kaisha bunkatsu. Adapting the kaisha bunkatsu could eliminate impediments to business restructurings, which in turn furthers the country’s economic development.

VI. CONCLUSION

The kaisha bunkatsu is an important tool for corporate restructurings in Japan. Unfortunately, the successful abuse of the kaisha bunkatsu by mid-size and family owned Japanese businesses establish the potential abuse by major corporations. Creditors left with the splitting company are subject to the possibility of no recourse in Japan. Creditors from California who invest in Japanese companies will be unprotected if the Japanese company utilizes the

253. Id.
254. See supra Part III.C.
255. See supra Part II.C.
256. Why Japan’s New Corporate Separation Law is Increasing Restructurings, supra note 8.
257. See supra Part III.
258. See supra Part III.B.
259. Wakabayashi & Muraji, supra note 13.
260. See generally Cal. Corp. Code §1107; See generally Cal. Corp. Code § 1113 (which provide an example of how to protect creditors in a similar situation).
261. See supra Part III.C.
262. Why Japan’s New Corporate Separation Law is Increasing Restructurings, supra note 8 (explaining the benefits of the kaisha bunkatsu).
263. Id.
264. Id.
265. See supra Part I.
266. Wakabayashi & Muraji, supra note 13.
kaisha bunkatsu. The Ministry of Japan should pass amendments to the kaisha bunkatsu allowing creditors harmed by the splitting company the right of recourse against the newly formed company. Nevertheless, if Japan does not amend the kaisha bunkatsu, the California courts should recognize the newly formed company but allow creditors the right to a claim against the newly formed company. In order for the kaisha bunkatsu to continue to be a legitimate Japanese corporate restructuring tool, these suggestions should be taken into account.

267. See supra Part IV.
268. See supra Part V.
269. See supra Part V.