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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, 2011.¹ The acquisition continued ON Semiconductor's transformation into a premier global supplier.² 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.³ This acquisition was made possible because of SANYO Electric's restructuring by demerging its unprofitable semiconductor unit into a wholly owned subsidiary.⁴ Prior to this acquisition, Hitachi and Mitsubishi Electric Corporation took advantage of special provisions under the Japanese Commercial Code for corporate reorganizations.⁵ They jointly established a new company, Renesas Technology Corp., and spun off both companies' semiconductor businesses into Renesas.⁶ At the time, Renesas became one of the top three semiconductor companies in the world.⁷

These successful demergers promoted the creation of the Japanese Bunkatsu Law, which eliminates impediments and facilitates corporate restructuring of Japanese companies.⁸ The term *bunkatsu* means demerger in Japanese and is similar to business transfers or asset sales in the United States.⁹ A demerger consists of a company splitting into two or more independent entities.¹⁰ In the United States, this is referred to as a spin-off.¹¹ The *kaisha bunkatsu* is a type of corporate division (demerger) in Japan.¹² It is a lawful way to restructure a failing

1. *ON Semiconductor Completes Acquisition of SANYO Semiconductor from SANYO Electric*, ON SEMICONDUCTOR (Jan. 3, 2011), <http://www.onsemi.com/PowerSolutions/newsItem.do?article=2458>.

2. *Id.*

3. *Id.*

4. *Sanyo Electric to Sell Semiconductor Unit to U.S. Firm*, IStockANALYST (July 2, 2010, 7:06 AM), <http://www.istockanalyst.com/article/viewiStockNews/articleid/4272805>.

5. *See Hitachi and Mitsubishi Electric to Establish Renesas Technology Corp., A New Company for Semiconductor Operations*, MITSUBISHI ELECTRIC (Oct. 3, 2002), http://www.mitsubishielectric.com/news/news_releases/2002/mel0553.html.

6. *See id.*

7. *See Hitachi, Mitsubishi Chip Merger Forms Powerhouse*, EXTREME TECH (Oct. 3, 2002, 3:38 PM), <http://www.extremetech.com/extreme/52106-hitachi-mitsubishi-chip-merger-forms-powerhouse>.

8. *Why Japan's New Corporate Separation Law is Increasing Restructurings*, IFLR (Jan. 28, 2003), <http://www.iflr.com/Article/2026997/Why-Japans-new-corporate-separation-law-is-increasing-restructurings.html>.

9. *See* Christopher T. Hines, et al., *Doing Deals in Japan: An Analysis of Recent Trends and Developments for the U.S. Practitioner*, COLUM. BUS. L. REV. 355, 388 (2006).

10. Thomas Kirchmaier, *Corporate Demergers: or is Divorce More Attractive than Marriage?* CENTREPIECE, 15 (2001), <http://cep.lse.ac.uk/centrepiece/v06i1/kirchmaier.pdf>.

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.¹³ 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.¹⁴ Many companies use the *kaisha bunkatsu* legitimately to further their position in the Japanese market.¹⁵ For example, the ON Semiconductor purchase agreement had specific provisions for contracts pertaining to the demerger.¹⁶ However, illegitimate use of the *kaisha bunkatsu* is apparent among mid-size and family owned Japanese companies.¹⁷ This presents an issue to the Ministry of Japan because business owners are successfully abusing the *kaisha bunkatsu*.¹⁸

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.¹⁹ 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.²⁰ The current construction of the *kaisha bunkatsu* allows creditors to be left with no recourse.²¹ In spite of this issue, the United States has recognized a *kaisha bunkatsu* (demerger): ON Semiconductor and SANYO Semiconductor in Arizona.²² The United States recognizes that the *kaisha bunkatsu* is a positive notion, but with the potential abuse of the *kaisha bunkatsu*,²³ states might not recognize or enforce the demerger because it conflicts with their corporate laws.²⁴

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.²⁵ Part III examines the issue between creditor’s protections in Japan and California.²⁶ Part IV creates an illustration of the potential problem a United

13. See Ko Wakabayashi & Yoshimune Muraji, *Abusive Company Splits: Use and Abuse*, IFLR (Apr. 1, 2012), <http://www.iflr.com/Article/3007268/Abusive-company-splits-Use-and-abuse.html>.

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.

24. See Cal. Corp. Code §1107 (Deering 2014); see also Cal. Corp. Code § 1113 (Deering 2014).

25. See *infra* Part II.

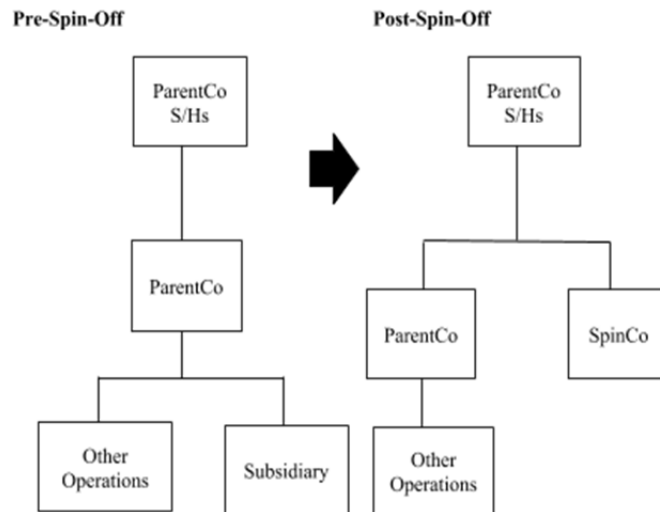
26. See *infra* Part III.

States creditor could face if Japan does not amend the *kaisha bunkatsu*.²⁷ 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.²⁸ Additionally, Japan should amend the *kaisha bunkatsu* in order to provide the same.²⁹

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.³⁰ The shareholders of the parent company are not required to surrender any stock in return.³¹ This transaction allows the business to operate in separate corporations.³² The split of the business will either form a parent-subsidary relation or two corporations with a common holding company.³³



27. See *infra* Part IV.

28. See *infra* Part V.

29. See *infra* Part V.A.

30. Edwards S. Adams & Arijit Mukherji, *Spin-offs, Fiduciary Duty, and The Law*, 68 FORDHAM L. REV. 15, 17 (1999-2000).

31. *Id.*

32. FRANKLIN A. GEVURTZ, BUSINESS PLANNING 863 (Thomson Reuters/Foundation Press, 4th ed. 2008).

33. *Id.*

A spin-off is attractive to companies for a variety of reasons.³⁴ 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.³⁵ Historically, a spin-off has been used to facilitate mergers and acquisitions by allowing a corporation to remove obstacles.³⁶

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.³⁷ Particularly, spin-offs can be potentially dangerous to creditors.³⁸ Abusive spin-offs are not common, but they can be used to defraud creditors by a fraudulent conveyance.³⁹ Creditors could lose their right to recourse because of this fraudulent transfer.⁴⁰ Legal safeguards for this potential abuse exist, but are dependent on what country’s law is being applied.⁴¹

B. The Kaisha Bunkatsu

The *kaisha bunkatsu* is an amendment originally adopted in the Japanese Commercial Code in 2001.⁴² Japan’s laws relating to companies were originally scattered throughout the Commercial Code.⁴³ Then, in 2005, Japan enacted the Companies Act (*Kaisha-hou*), which brought all the corporate legal provisions into one consolidated law.⁴⁴ The Companies Act came into effect on May 1, 2006⁴⁵ as the largest reform of its kind in 50 years.⁴⁶ The rules under the Companies Act are the responsibility of the Ministry of Justice in Japan.⁴⁷ The

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).

38. STEPHEN I. GLOVER, *BUSINESS SEPARATION TRANSACTIONS SPIN-OFFS, SUBSIDIARY IPOs AND TRACKING STOCK* 14-4 (ALM Properties Inc., 2006), available at http://books.google.com/books?id=Rxxhsmw8u6AC&printsec=frontcover&source=gbs_ge_summary_r&cad=0#v=onepage&q&f=false.

39. Adams & Mukherji, *supra* note 30, at 27 (discussing abusive spin-offs and fraudulent conveyance laws).

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.

43. Kenichi Osugi, *Companies Act-Overview*, TRANSPARENCY OF JAPANESE LAW PROJECT, <http://www.tomeika.jur.kyushu-u.ac.jp/corporate/>.

44. *Id.*; Hajime Lieno & Takashi Saito, *Whole Business Securitizations are Gaining Strength*, ASIALAW (Aug. 2007), <http://www.asialaw.com/Article/1989015/Whole-Business-Securitizations-Are-Gaining-Strength.html?Print=true&Single=true>.

45. The Japanese Institute of Certified Public Accountants, *Corporate Disclosure in Japan Overview* 5 (6th ed., 2010), available at <https://www.hp.jicpa.or.jp/english/about/publications/pdf/PUBLICATION-Overview2010.pdf>.

46. See *Japan’s New Corporations Law to Become Effective May 1, 2006*, O’MELVENY & MYERS LLP (Mar. 29, 2006), <http://www.omm.com/03-29-2006/>.

47. Osugi, *supra* note 43.

purpose of the Companies Act is to govern “[t]he formation, organization, operation and management of companies.”⁴⁸

The Companies Act permits several different types of corporate restructuring.⁴⁹ 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*).⁵⁰ 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.⁵¹ The assets and liabilities are transferred as an operation of law.⁵² There are two different kinds of incorporation-type company splits provided in the Companies Act.⁵³ 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.⁵⁴ Commonly, the first type is used in forming a newly incorporated company.⁵⁵

The *kaisha bunkatsu* has provided a lawful way for failing Japanese companies to restructure their company.⁵⁶ Also, it allows a target company to split the desired business into a separate company.⁵⁷ The splitting of a target company is useful when a bidder does not wish to acquire all of the target’s businesses.⁵⁸ 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,⁵⁹ followed by the splitting company selling the newly formed corporation’s shares to a third party.⁶⁰ 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.⁶¹ It is not a statutory

48. KAISHA-HOU, *supra* note 21.

49. *See id.* (discussing part of the Companies Act setting out the regulations for entity conversions, mergers, and company splits).

50. Wakabayashi & Muraji, *supra* note 13; HIDEKI KANDA, ET AL., TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA 53 (Routledge, 2008).

51. Hines et al., *supra* note 9, at 390.

52. *Id.*

53. *See* ABA Section of Antitrust Law, *supra* note 12.

54. KAISHA-HOU, *supra* note 21, at 763, 765.

55. Wakabayashi & Muraji, *supra* note 13.

56. *Id.*

57. Yoshihiko Fuchibe, et al., *Country Q&A Japan* 267 (Global Counsel Mergers and Acquisitions 2003/04), http://www.tmi.gr.jp/wp-content/uploads/pdf/GCH_Mergers_and_Acquisitions_200304.pdf.

58. *Id.*

59. KAISHA-HOU, *supra* note 21, at 763, ¶ v; Wakabayashi & Muraji, *supra* note 13.

60. Wakabayashi & Muraji, *supra* note 13.

61. *Id.*

requirement for the splitting company to consult with major creditors,⁶² but many do as a gesture of good faith.⁶³

There are statutory corporate restructuring methods that are subject to creditor protection procedures provided by the Companies Act;⁶⁴ however, under the *kaisha bunkatsu*, creditors who remain with the splitting company are not protected.⁶⁵ This results because the splitting company remains the guarantor⁶⁶ 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.⁶⁷ The company split differs from other merger methods⁶⁸ 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.⁶⁹ Thus, the splitting company is not required to obtain consent from or inform creditors during the company split process.⁷⁰

C. The Business Spin-Off in the United States

This kind of transaction described above implicates state corporate law,⁷¹ Internal Revenue Code (IRC) § 355,⁷² the 1933 Securities Act, and possibly Article 6 of the U.C.C.⁷³ The parent corporation spinning off a subsidiary distributes the stock of the subsidiary to its shareholders.⁷⁴ Even though the distribution occurs without consideration, it is held to be a sale that triggers the registration requirements of the 1933 Securities Act.⁷⁵ Certain conditions must be satisfied under IRC § 355 in order for the spin-off to be successful.⁷⁶

The spin-off may remove assets from the parent corporation, but it does not reduce the parent corporation's debt or capital.⁷⁷ Even if the spin-off company assumes part of the parent corporation's debt, the parent corporation is still liable

62. See KAISHA-HOU, *supra* note 21, at 763(2)(Corporation Law).

63. Wakabayashi & Muraji, *supra* note 13.

64. Hines, *supra* note 10, at 390; Wakabayashi & Muraji, *supra* note 13.

65. Wakabayashi & Muraji, *supra* note 13.

66. KAISHA-HOU, *supra* note 21, at 764(Corporation Law).

67. See *id.*

68. *Id.*

69. KAISHA-HOU, *supra* note 21, at 764, ¶v-vii.

70. See Wakabayashi & Muraji, *supra* note 13.

71. GEVURTZ, *supra* note 32, at 864.

72. Adams & Mukherji, *supra* note 30, at 17.

73. See GEVURTZ, *supra* note 32, at 863.

74. See Michael L. Schler, *Simplifying and Rationalizing the Spin-off Rules*, 56 SMU L. REV. 239, 241 (2003).

75. GEVURTZ, *supra* note 32, at 863-66 (explaining the different laws that regulate a spin-off in the United States, that are beyond the scope of this comment).

76. See, e.g., Schler, *supra* note 74, at 241 (providing a list of conditions, that are beyond the scope of my comment).

77. GEVURTZ, *supra* note 32, at 864.

to the creditor unless they receive a novation.⁷⁸ This is why a creditor's consent is required for contracts containing anti-assignment provisions.⁷⁹ A number of laws protect creditors in spin-offs in the United States.⁸⁰ Creditors can challenge the spin-off because of a fraudulent transfer.⁸¹ This is likely to happen when a creditor finds their option for payment is with the "bad" company.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.⁸³ Thus, planners should consider creditors' rights issues when preparing business spin-offs.⁸⁴

III. CREDITORS

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

A. *Transfer by Operation of Law in Japan*

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

78. *Id.*

79. See H. Justin Pace, *Anti-Assignment Provisions, Copyright Licenses, and Intra-Group Mergers: The Effect of Cincom v. Novelis*, 9 NW. J. TECH. & INTELL. PROP 263, 265 (2010).

80. See *infra* Part III.B for further explanation of the laws protecting creditors.

81. BUSINESS SEPARATION TRANSACTIONS SPIN-OFFS, *supra* note 38; Adams & Mukherji, *supra* note 30, at 33-38.

82. BUSINESS SEPARATION TRANSACTIONS SPIN-OFFS, *supra* note 38.

83. Wachtell, Lipton, Rosen & Katz, *Spin-Off Guide*, 13 (2013), available at <http://www.wlrk.com/files/2013/spinoffguide.pdf>.

84. BUSINESS SEPARATION TRANSACTIONS SPIN-OFFS, *supra* note 38.

85. Juzhong Zhuang, *Some Conceptual Issues of Corporate Governance*, 13 ASIAN DEVELOPMENT BANK 6 (June 1999).

86. *Id.*

87. *Id.*

88. *Id.*

89. Wakabayashi & Muraji, *supra* note 13.

90. *Id.*

91. *Id.*

differs from with other types of demergers in Japan that require disclosure and mandatory procedures to protect creditors.⁹²

The advantage of using the *kaisha bunkatsu* is the ability to transfer contractual rights and obligations as an operation of law without the consent of counterparties and creditors.⁹³ The Ministry of Japan's goal was to streamline the process and not require the company to negotiate consent from each contractual party.⁹⁴ However, the *kaisha bunkatsu* protects creditors by requiring the splitting company to provide notice to creditors being transferred to the newly formed company.⁹⁵ 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.⁹⁶ 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.⁹⁷ This protection is only available to creditors being transferred and not to such creditors who remain with the splitting company.⁹⁸

Unknowingly, with the enactment of the *kaisha bunkatsu*, the Ministry of Japan created separate protections for creditors.⁹⁹ 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.¹⁰⁰ The power given to the splitting company to choose which rights and obligations to keep and transfer inevitably creates a potential detriment to creditors.¹⁰¹ 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.¹⁰² A splitting company could file for bankruptcy or simply abandon the company leaving the creditor with few options.¹⁰³

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.¹⁰⁴ Basically, the splitting

92. Hines, *supra* note 10, at 390.

93. *Why Japan's New Corporate Separation Law is Increasing Restructurings*, *supra* note 8.

94. *Id.*

95. See KAISHA-HOU, *supra* note 21, at 764(2)(Corporation Law).

96. See *Id.* at §10(1) ¶ii (Corporation Law); *Why Japan's New Corporate Separation Law is Increasing Restructurings*, *supra* note 8.

97. *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).

98. Wakabayashi & Muraji, *supra* note 13

99. See KAISHA-HOU, *supra* note 21, at 764(2) (describing which creditors requires notice).

100. See *id.* at 763, ¶v; *Why Japan's New Corporate Separation Law is Increasing Restructurings*, *supra* note 8.

101. See Wakabayashi & Muraji, *supra* note 13.

102. See *id.*

103. See *id.*

104. See *id.*

company “foist[ed] 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

105. Hiroyuki Yagi & Masakazu Kaji, *Escaping your Debts in Japan*, ZJAPANR 259, 261 (2003).

106. *Id.*; Wakabayashi & Muraji, *supra* note 13.

107. *See How to buy a Japanese Company*, IFLR (Jan. 28, 2003), <http://www.iflr.com/Article/2026998/How-to-buy-a-Japanese-company.html>.

108. Cal. Corp. Code §1107 (Deering 2014); Cal. Corp. Code § 1113 (Deering 2014).

109. *See generally* 11 U.S.C.S. §548 (2014); Corp. §1107; Cal. Civ. Code §3439.04 (Deering 2014).

110. Corp. §1107; Corp. §1113.

111. Corp. §1107; Corp. §1113.

112. GEVURTZ, *supra* note 32.

113. *Economy Refining & Serv. Co., Inc. v. Royal National Bank of New York*, 20 Cal.App.3d 434, 439 (1st Dist. 1971).

114. Cal. Civ. Code §3439.04(a)(2) (Deering 2014).

115. *See* Civ. §3439.04(a)(1); *see also* Civ. §3439.04(b) for the factors to determine the actual intent of the debtor.

116. *See generally* Thomas H. Day, *Solution for Conflict of Laws Governing Fraudulent Transfers: Apply the Law That Was Enacted to Benefit the Creditors*, 48 BUS. LAW. 889, 900, (1992-1993) (describing how the bankruptcy code is used).

to avoid the fraudulent transfer under applicable state law.¹¹⁷ These legal safeguards protect against abusive spin-offs.¹¹⁸

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.¹¹⁹ There are a number of different ways the Japanese company can defraud a creditor.¹²⁰ 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.¹²¹ Then, the splitting company decides whether it will transfer some creditors, all creditors, or no creditors to the newly formed company.¹²² Normally, the creditors left with the splitting company are not informed of this process.¹²³

Once the newly formed company is established, the splitting company's owners begin the process of separating themselves from the newly formed company.¹²⁴ This part of the splitting process is where the defrauding of creditors occurs.¹²⁵ The owners of the splitting company will sell the newly formed company to one of their family members for a nominal value.¹²⁶ This method is simply used to legally relinquish control of the newly formed company,¹²⁷ thus allowing the original owners to maintain their ties to the valuable newly formed company without the encumbrances left with the splitting company.¹²⁸ 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.¹²⁹ 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.¹³⁰

117. See 11 U.S.C. § 548(a) (2014).

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.¹³¹ 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.¹³² 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.¹³³ Also, abandoning the splitting company would allow creditors to bring their claims for recourse against the newly formed company.¹³⁴ Conversely, in Japan, even with similar protections, the creditors left with the splitting company have limited recourse options dependent on certain courts.¹³⁵

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.¹³⁶ However, this provision does not apply to a statutory company split method (including the *kaisha bunkatsu*).¹³⁷ Certain Japanese courts have allowed creditors to avoid fraudulent transfers under the fraudulent acts and bankruptcy act of the Civil Code.¹³⁸ The courts recognize that the Companies Act does not provide any protection to creditors.¹³⁹ However, other courts argue the Civil Code is not applicable because the Companies Act has its own provisions.¹⁴⁰ Thus, a creditor with the splitting company is guaranteed protection in California, but is provided limited protection in Japan.¹⁴¹

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.¹⁴² A creditor evaluating its options looks to see if there is a difference between the United States and Japanese laws.¹⁴³ 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.

133. See 11 U.S.C. § 548(a) (2014).

134. See Cal. Corp. Code §1107 (Deering 2014); Cal. Corp. Code §1113 (Deering 2014).

135. See *supra* Part III.B.

136. Wakabayashi & Muraji, *supra* note 13.

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.¹⁴⁴ However, the choice of forum does not always dictate the choice of law.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).¹⁴⁶ Company A is not as profitable as it hoped to be, but one part of the business is profitable.¹⁴⁷ Company A decides to unlock the hidden value of this business and uses the *kaisha bunkatsu* to create Company B.¹⁴⁸ Company A chooses to use the *kaisha bunkatsu* because it wants Company B to be unencumbered, making it attractive to potential buyers.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.¹⁵⁰ The creditor has no recourse in Company A and decides to bring his claim against Company C who purchased Company B.¹⁵¹ Company C argues it should not be held liable because it acquired Company B free of encumbrances from Company A.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.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.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. Court's Discussion

1. Internal Affairs Doctrine

Applying the Internal Affairs Doctrine allows the court to determine which state's law applies in the case.¹⁵⁵ The Internal Affairs Doctrine says the state of

144. See *supra* Part III.A–B.

145. See *infra* Part IV.B.2 (illustrating different laws the courts consider with choice of laws).

146. See, e.g., Brian Shappell, *Japanese Manufacturer Moves to Protect Itself from U.S. Creditors*, NACME-SE, <http://blog.nacm.org/2012/03/japanese-manufacturer-moves-to-protect.html>.

147. Adams & Mukherji, *supra* note 30, at 15, 39–44.

148. *Id.*

149. See Yagi & Kaji, *supra* note 105; see also Wakabayashi & Muraji, *supra* note 13.

150. Yagi & Kaji, *supra* note 105.

151. See Wakabayashi & Muraji, *supra* note 13.

152. Yagi & Kaji, *supra* note 106; Wakabayashi, *supra* note 13.

153. See generally Willis L. M. Reese, *Conflict of Laws and the Restatement Second*, 28 *Law and Contemporary Problems*, 679, 697 (Fall 1963), available at <http://scholarship.law.duke.edu/lcp/vol28/iss4/2>.

154. See *supra* Part III.

155. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (1971).

incorporation governs the rights and liabilities of a corporation.¹⁵⁶ It is a conflict of law principle allowing only one state the authority to regulate a corporation's internal affairs.¹⁵⁷ However, courts differ on the application of this principal because of the distinction of what qualifies as an internal affair.¹⁵⁸ Thus, the creditor would need to prove its right is an internal affair in order for the principal to apply.¹⁵⁹

However, courts in California are not permitted to control the internal affairs of foreign corporations.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.¹⁶¹ It focuses on the organic structure or internal administration of a corporation.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.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 corporation¹⁶⁴ and the creditor would have no protective right to bring the suit against the California company.¹⁶⁵

However, California courts recognize there are certain exceptions to the Internal Affairs Doctrine.¹⁶⁶ In the interest of justice, a local court could apply the local law over the Internal Affairs Doctrine.¹⁶⁷ This could be done because California has an interest in protecting its residents against fraud with the sale of corporations.¹⁶⁸ The court could apply local law when it finds the foreign corporation has its principal place of business in the local state.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.¹⁷⁰ This deliberate act by Company A is a fraudulent action California courts would want to protect their residents from.¹⁷¹ Further, the

156. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (1971).

157. *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982).

158. *Id.*; *State Farm Mut. Auto. Ins. Co. v. Superior Court*, 114 Cal. App.4th 434, 442-44 (2d Dist. 2003); *Vaughn v. LJ Int'l, Inc.*, 174 Cal. App. 4th 213, 226-27 (2d Dist. 2009).

159. *Edgar*, 457 U.S. at 645; *State Farm*, 114 Cal. App. 4th at 442-44; *Vaughn*, 174 Cal. App. 4th at 226-27.

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

161. *Edgar*, 457 U.S. at 645.

162. *State Farm*, 114 Cal. App. 4th at 443.

163. *Id.*

164. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (1971).

165. *Supra* Part III.A.

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

167. *Friese*, 134 Cal. App. 4th at 708.

168. *Friese*, 134 Cal. App. 4th at 708.

169. 9 WITKIN, SUMMARY OF CAL. LAW (10th), Corp. § 239.

170. *Yagi & Kaji*, *supra* note 106; *Wakabayashi*, *supra* note 13.

171. 9 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.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.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.¹⁷⁴

2. *Applying California's Law*

The court will not necessarily apply California law.¹⁷⁵ The Internal Affairs Doctrine is one approach the court will consider when determining choice of law.¹⁷⁶ The court may additionally look at the First Restatement or the Second Restatement pertaining to conflict of laws.¹⁷⁷ The First Restatement follows a rules approach while the Second Restatement applies a balancing test.¹⁷⁸ The First Restatement does not seek to determine whether there is a valid contract until it determines the place of the principal event.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.¹⁸⁰ The Second Restatement allows for the contracting parties to include a choice of law provision in their contract.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.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."¹⁸³ Further, if the place of negotiation and performance are in the same state, then that state's law will apply.¹⁸⁴

172. *Supra* Part IV.A.

173. 9 Witkin, *supra*, note 169.

174. *See* Western Airlines, Inc. v. Sobieski, 191 Cal. App. 2d 399, 409-11 (2d Dist. 1961).

175. *See id.*

176. *See generally* RESTATEMENT (SECOND) OF CONFLICTS OF LAWS (1971); RESTATEMENT OF CONFLICT OF LAWS (1934).

177. *Id.*

178. *See generally* William M. Richman & David Riley, *The First Restatement of Conflict of Laws on Twenty-Fifth Anniversary of its Successor: Contemporary Practice in Traditional Courts*, 56 MD. L. REV. 1196 (1997) (comparing the First and Second Restatements differences).

179. RESTATEMENT (FIRST) OF CONFLICT OF LAWS § 311 cmt. d (1934).

180. *Id.*

181. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 cmt. a (1971).

182. Reese, *supra* note 153, at 697.

183. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188(2) (1971).

184. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 188(3) (1971).

If the court looks to either of the conflict of law Restatements,¹⁸⁵ the creditor might be left with no recourse because it would apply Japan's laws.¹⁸⁶ The First Restatement analysis focuses on where the right vested, and particularly with contracts, the place of the creation of the contract.¹⁸⁷ Thus, Japan's law would apply because the contract was created in Japan, thereby vesting the creditor's rights in Japan.¹⁸⁸ The Second Restatement analysis provides a complex balancing test of different factors,¹⁸⁹ 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.¹⁹⁰ 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.¹⁹¹

Assuming the court determines California's corporation law applies (local law),¹⁹² 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.¹⁹³ The *kaisha bunkatsu* allows for Company A to create Company B without encumbrances.¹⁹⁴ However, California law does not permit Company A to create Company B to the detriment of creditors.¹⁹⁵

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.¹⁹⁶ Company A used the *kaisha bunkatsu* to unlock the hidden value of its company by creating Company B and retaining all the debt.¹⁹⁷ 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.¹⁹⁸ Company A deliberately sold Company B to hinder the creditor.¹⁹⁹ Thus, the creditor is left without many options because of this fraudulent conveyance.²⁰⁰ 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.

196. Beatrice Co. v. State Bd. of Equalization, 6 Cal. 4th 767, 778 (1993).

197. See *supra* Part IV.A.

198. See Wakabayashi & Muraji, *supra* note 13.

199. Fox v. MGM Grand Hotels, Inc., 137 Cal. App. 3d 524, 527 (1982).

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.

202. See Cal. Corp. Code §1107(a) (West 2007); Cal. Corp. Code §1113(i)(3) (West 2006).

203. See Cal. Corp. Code §1107(d) (West 2007); Cal. Corp. Code §1113(i)(3) (West 2006).

204. Yagi & Kaji, *supra* note 105, at 261.

205. See *supra* Part I.

206. See *supra* Part IV.

207. See *supra* Part IV.

208. *Why Japan's New Corporate Separation Law is Increasing Restructurings*, *supra* note 8.

209. See Wakabayashi & Muraji, *supra* note 13.

210. See *id.*

211. See Takashi Toichi & Takeshi Fukatsu, *Japan's New Corporate Governance Considerations*, IFLR (Mar. 20, 2013), <http://www.iflr.com/Article/3187448/Japans-new-corporate-governance-considerations.html>.

212. *Id.* (discussing the recent amendments made to the Companies Act).

213. See Wakabayashi & Muraji, *supra* note 13.

the newly incorporated company.²¹⁴ The Ministry of Japan should adopt this amendment because it will aid in ending the abusive company splits by businesses using the *kaisha bunkatsu*.²¹⁵

B. Options for the California Courts

1. Do Not Recognize the Demerger

California courts are not required to enforce international law.²¹⁶ The courts have the authority to determine the choice of law to apply determined by the Internal Affairs Doctrine.²¹⁷ In this event, California has an interest in protecting their creditors and its public policy would be offended if it applied Japanese law.²¹⁸ If the court holds the Internal Affairs Doctrine inapplicable then it will apply California's corporation laws.²¹⁹ 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.²²⁰ Applying California corporate law would invalidate the demerger because it was created to the detriment of creditors.²²¹ Thus, the court would not recognize the newly incorporated company from the splitting company.²²²

Not recognizing the demerger and invalidating the newly formed company creates a significant issue for the splitting company, purchasing company, and creditor.²²³ The newly formed company is left in limbo because it is acknowledged in Japan, but not in California.²²⁴ This action does not solve the creditor's problem because it will not have recourse in Japan or California.²²⁵ The creditor is left with the original problem of recovering debt from the newly incorporated company.²²⁶ Further, the purchasing company is left with an invalidated sale.²²⁷ The purchasing company cannot legally buy the newly incorporated company because the California court does not recognize the newly

214. *See id.*

215. *See id.*

216. *See generally* Vaughan v. LJ Int'l, Inc., 174 Cal. App. 4th 213 (2009) (discussing what law to apply in the circumstances).

217. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (1971).

218. *See generally* Vaughan, 174 Cal. App. 4th at 226 (explaining why California law did not apply).

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).

225. *See* Wakabayashi & Muraji, *supra* note 13.

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

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.

233. Wakabayashi & Muraji, *supra* note 13.

234. *Id.*

235. *Id.*

236. See *supra* Part IV (illustrating the results when a court recognizes the demerger).

237. *Econ. Ref. & Serv. Co., Inc. v. Royal Nat'l Bank of N.Y.*, 20 Cal. App. 3d 434, 439 (1971).

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.²⁴⁰ 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.²⁴¹ 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.²⁴²

C. Adopting the Kaisha Bunkatsu

The *kaisha bunkatsu* was created by the Ministry of Japan to streamline the demerger process.²⁴³ The Ministry's intentions were to allow failing Japanese companies to restructure quickly without having to negotiate with each individual creditor or counterparty.²⁴⁴ The enactment of the *Bunkatsu Law* led to more than 300 reported transactions utilizing the new *kaisha bunkatsu* process.²⁴⁵ Other countries should adopt the *kaisha bunkatsu* because it provides a statutory demerger,²⁴⁶ allowing companies to successfully restructure and unlock hidden value of their businesses without requiring third party consent.²⁴⁷ This process allows companies to quickly and successfully restructure their businesses, which furthers the country's economic development and lessens its bankruptcy cases.²⁴⁸ However, if a country decides to adopt the *kaisha bunkatsu* it should be aware of the potential abuse towards creditors.²⁴⁹

The Ministry of Japan unknowingly created separate protections for creditors depending on whether the creditor remained with the splitting company or newly formed company.²⁵⁰ This was an oversight by the Ministry of Japan because the Companies Act provides a protection to creditors applicable to a business transfer.²⁵¹ However, the *kaisha bunkatsu* is considered a statutory company split and not a business transfer, which leaves the creditors with the splitting company unprotected.²⁵² Japan's courts are trying to alleviate this situation by attempting to apply their fraudulent conveyance laws and bankruptcy laws, but the courts are

240. Cal. Corp. Code §1107 (West 2007); Cal. Corp. Code §1113 (West 2006) (acquiring company is held liable if the predecessor company disappears).

241. See *supra* Part III.B.

242. Vaughan v. LJ Int'l, Inc., 174 Cal. App. 4th 213 (2009).

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.²⁵³ 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.²⁵⁴ Thus, a country should focus on the legal mistakes made by the Ministry of Japan before it adopts the *kaisha bunkatsu*.²⁵⁵

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,²⁵⁶ the third parties' obligations should still be protected.²⁵⁷ Unlike in Japan, California protects creditors through its corporation laws, bankruptcy laws, and fraudulent conveyance laws.²⁵⁸ Japan has similar laws, but the protection provisions in the Companies Act trump them.²⁵⁹ 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.²⁶⁰ The legislature needs to focus on the potential defrauding of creditors in order to successfully adopt the *kaisha bunkatsu*.²⁶¹ Adopting the *kaisha bunkatsu* could eliminate impediments to business restructurings,²⁶² which in turn furthers the country's economic development.²⁶³

VI. CONCLUSION

The *kaisha bunkatsu* is an important tool for corporate restructurings in Japan.²⁶⁴ Unfortunately, the successful abuse of the *kaisha bunkatsu* by mid-size and family owned Japanese businesses establish the potential abuse by major corporations.²⁶⁵ Creditors left with the splitting company are subject to the possibility of no recourse in Japan.²⁶⁶ 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.²⁶⁷ 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.²⁶⁸ 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.²⁶⁹ 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.