

Memorandum 89-78

Subject: Study L-3015 - Debts that are Contingent, Disputed, or Not  
Due (Draft of Tentative Recommendation)

At the August-September meeting the Commission reviewed suggestions by Ken Klug relating to the effect of contingent and disputed debts on distribution and closing the estate. The Commission directed the staff to prepare a draft dealing with this matter along the lines outlined in Mr. Klug's letter to the Commission.

The staff draft of a tentative recommendation is attached. The draft is based almost entirely on the draft provided by Mr. Klug, although it also broadens Mr. Klug's draft in some areas and relies more on existing law in a few spots. While the staff draft also differs from Mr. Klug's draft in a number of organizational and formal respects, by and large the staff found Mr. Klug's draft to be well thought out and quite a good basis for the staff draft.

Respectfully submitted,

Nathaniel Sterling  
Assistant Executive Secretary

#L-3015

ns45q  
09/22/89

Tentative Recommendation  
relating to  
Probate Law and Procedure:  
DEBTS THAT ARE CONTINGENT, DISPUTED, OR NOT DUE

Ordinarily, debts of a decedent are paid during estate administration and, if there is any excess after all debts are paid, distribution is made to the beneficiaries. This standard pattern may be disrupted in a number of situations. A debt owed by the decedent may not be due and payable at the time when debts are ordinarily paid; this may occur, for example, where a loan is payable in installments, or where there is a balloon payment at a later time. The decedent's liability may be contingent and the contingency may not be resolved until much later; common examples of contingent debts include loan guarantees, deficiency liability on a secured loan, and concurrent liability with another person such as a partner or a joint maker of a promissory note. If a creditor commences an action on a debt where the personal representative denies liability, there may be substantial delay until the liability is resolved.

Keeping the estate open and not making distribution until all issues involving debts that are contingent, disputed, or not due are resolved is ordinarily not a satisfactory approach. The decedent's ultimate liability exposure on a contingent debt may be small but, until the matter is resolved, a large contingent debt can effectively tie up the estate. Likewise, there may be a disputed debt on which the alleged liability exceeds the value of the estate; in this case, no matter how unmeritorious the lawsuit appears, the full disputed amount must be held in court until the matter is resolved, which may be many years.

Estates normally have neither the ability nor right to discharge the entire indebtedness to satisfy the claim, and must therefore be kept open until the contingency which establishes the debt either occurs or fails. In these cases, the estate beneficiaries are not only deprived of enjoyment of their interests until the obligation is

paid, but estate expenses are increased by costs of complying with accounting and income tax filing requirements.

For these reasons existing law offers a few options:

(1) If a creditor whose debt is not yet due is willing to waive interest, the creditor may be paid immediately.<sup>1</sup>

(2) In the case of a contingent or installment debt, a trust fund may be set up to cover the potential liability, the trustee to pay the debt or distribute the fund to beneficiaries, as the circumstances ultimately require.<sup>2</sup>

(3) If neither of these two options is used, the full amount of a not due, contingent, or disputed debt must be paid into court and held until the liability is resolved.<sup>3</sup>

These remedies are quite limited. Other remedies should be provided that will enable the estate to be closed without compromising the rights of the creditor. The Law Revision Commission recommends enactment of procedures that will add flexibility to the remedies available to the court and help ensure that the creditor gets what is due without forcing the estate to be kept open until the debt is paid. Specifically:

(1) If all parties agree on a solution, whether it involves posting security, discounting or compromising a claim, or even keeping the estate open, the agreement should be honored and the court should be required to ratify the agreement if it reasonably protects the rights of all parties.

(2) The court should continue to have the authority it has under existing law to require that the estate be kept open, or that the amount of the liability be paid into court until the issue is resolved, if that appears most appropriate in the circumstances of the particular estate.

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1. Prob. Code § 11425. It is not clear from this section whether the face amount of the debt may be discounted if the debt is interest-free until the due date.

2. Prob. Code § 11426.

3. Prob. Code § 11427.

(3) The existing authority to appoint a trustee in the case of a contingent or installment debt should be expanded to cover other debts not yet due and disputed debts as well.

(4) The court should be permitted to order the property distributed and the estate closed after assuring adequate protection to the creditor by means such as requiring a bond or other security, imposing a lien on property, or requiring an assumption of liability by distributees.

The basic concept is that the court should have available a variety of different remedies and the flexibility to provide a reasonable accomodation of interests depending on the circumstances of the particular case.

The Commission's recommendations would be implemented by enactment of the following measure.

An act to add Chapter 4 (commencing with Section 11460) to, and to repeal Sections 11425, 11426, and 11427 of, the Probate Code, relating to probate law and procedure.

The people of the State of California do enact as follows:

§ 11425 (repealed). Payment of debt not due

SECTION 1. Section 11425 of the Probate Code is repealed.

~~11425.---If a creditor whose debt is not due waives interest for the time until the debt is due, the creditor is entitled to payment of the debt.~~

Comment. Former Section 11425 is not continued. It is superseded by Section 11462 (agreement of interested persons).

§ 11426 (repealed). Trust for installment or contingent debt

SEC. 2. Section 11426 of the Probate Code is repealed.

~~11426.---(a) Notwithstanding any other statute, the court may in its discretion appoint a trustee to whom payment of a debt that is contingent or is payable in installments shall be made, with the direction that the trustee invest the payment in investments that would be proper for a personal representative or as authorized by the court.---The court in determining the amount of the payment shall compute the present value of the debt, giving consideration to a reasonable interest rate on the amount to be invested.~~

~~(b) The trustee shall pay the debt as ordered by the court.---On completion of payment, any excess in possession of the trustee shall be paid or distributed in accordance with the order for distribution.~~

Comment. Former Section 11426 is continued in Section 11466 and broadened to apply to debts that are disputed or otherwise not due as well as debts that are contingent or payable in installments.

§ 11427 (repealed). Disputed and contingent debts

SEC. 3. Section 11427 of the Probate Code is repealed.

~~11427. Except as otherwise provided in this part, if a debt is not due or is contingent, or if a claim is disputed, the amount of the debt or claim or the part that would be payable if the debt were due or absolute or the claim established, shall be paid into court. The amount paid into court shall remain there, to be paid to the creditor when the debt is due or absolute or the claim is established or, if the claim is not established, to be paid or distributed as the circumstances of the estate require.~~

Comment. Former Section 11427 is continued in Section 11464 (payment into court) without substantive change.

§§ 11460-11467 (added). Debts that are contingent, disputed, or not due

SEC. 4. Chapter 4 (commencing with Section 11460) is added to Part 9 of Division 7 of the Probate Code, to read:

CHAPTER 4. DEBTS THAT ARE CONTINGENT, DISPUTED, OR NOT DUE

§ 11460. Definitions

11460. As used in this chapter:

(a) A debt is "contingent" if it is established under Part 4 (commencing with Section 9000) in either a fixed or an uncertain amount and will become absolute on occurrence of a stated event other than the passage of time. The term includes an obligation secured by a mortgage, deed of trust, or other lien for which there may be recourse against other property in the estate if the security is insufficient.

(c) A debt is "disputed" if it is a claim rejected in whole or in part under Part 4 (commencing with Section 9000) and is not barred as to the part rejected under Section 9353.

(b) A debt is "not due" if it is established under Part 4 (commencing with Section 9000) and will become due on the passage of time. The term includes a debt payable in installments.

Comment. The definitions in Section 11460 vary the definition of "debt" in Section 11401. See Section 11400 (definition in 11401 does not govern if provision or context otherwise requires).

Subdivision (a) is new.

Under subdivision (b), a rejected claim is not barred if within three months after the notice of rejection is given or after the claim becomes due the creditor commences an action on the claim or the matter is referred to a referee or to arbitration.

Subdivision (c) incorporates the aspect of former Section 11426 that related to installment debts.

Note. Ken Klug's draft does not distinguish between contingent debts and debts that are not due, including installment debts. The staff believes it is useful to maintain this distinction even though it makes the drafting more awkward, and has done so in this draft.

#### § 11461. Court order

11461. When all other debts have been paid and the estate is otherwise in a condition to be closed, on petition by an interested person, the court may make or modify an order or a combination of orders under this chapter that the court in its discretion determines is appropriate to adequately provide for a debt that is contingent, disputed, or not due if the debt becomes absolute, established, or due.

Comment. Section 11461 is correlative with Section 11640 (order for final distribution when all debts have been paid or adequately provided for). The term "interested person" is defined in Section 48.

#### § 11462. Agreement of interested persons

11462. Notwithstanding any other provision of this chapter, if the court determines that all interested persons agree to the manner of providing for a debt that is contingent, disputed, or not due and that the agreement reasonably protects all interested persons, the court shall approve the agreement.

Comment. Section 11462 is new. Regardless of the other techniques provided in this chapter for securing payment, if all interested persons agree and the agreement reasonably protects them, the court must ratify the agreement. The agreement may require, for example, immediate payment of a debt that is disputed, contingent, or not due, if the interested persons are able to work out a satisfactory discount, compromise, or settlement. Cf. former Section 11425 (right of creditor to payment of debt not due if interest is waived). The term "interested person" is defined in Section 48.

§ 11463. Continuation of administration

11463. The court may order that the administration of the estate continue until the contingency, dispute, or passage of time of a debt that is contingent, disputed, or not due is resolved.

Comment. Section 11463 gives the court authority to order continuation of administration, if appropriate. This is a specific application of the general authority of the court to order continuation of administration for a reasonable time. Section 11640(c); see also Section 12201.

§ 11464. Payment into court

11464. The court may order that an amount be paid into court that would be payable if a debt that is contingent, disputed, or not due were absolute, established, or due. The amount paid into court shall remain there, to be paid to the creditor when the debt becomes absolute, established, or due, or to be distributed in the manner provided in Section 11642 if the debt does not become absolute or established.

Comment. Section 11464 continues former Section 11427 without substantive change. The reference to Section 11642 incorporates any omnibus order for final distribution or subsequent court order for distribution.

§ 11465. Distribution subject to assumption of liability

11465. (a) The court may order property in the estate distributed to a person entitled to it under the final order for distribution, if the person files with the court an assumption of liability for a contingent or disputed debt as provided in subdivision (b). The court may impose any other conditions the court in its discretion determines are just, including that the distributee give a security interest in all or part of the property distributed or that the distributee give a bond in an amount determined by the court.

(b) As a condition for an order under subdivision (a), each distributee shall file with the court a signed and acknowledged agreement assuming personal liability for the contingent or disputed debt and consenting to jurisdiction within this state for the enforcement of the debt if it becomes absolute or established. The personal liability of each distributee shall not exceed the fair



market value on the date of distribution of the property received by the distributee, less the amount of liens and encumbrances. If there is more than one distributee, the personal liability of the distributees is joint and several.

(c) If the debt becomes absolute or established, it may be enforced against each distributee in the same manner as it could have been enforced against the decedent if the decedent had not died. In an action based on the debt, the distributee may assert any defense, cross-complaint, or setoff that would have been available to the decedent if the decedent had not died.

(d) The statute of limitations applicable to a contingent debt is tolled from the time the creditor's claim is filed until 30 days after the order for distribution becomes final. The signing of an agreement under subdivision (b) neither extends nor revives any limitation period.

Comment. Section 11465 is new.

A bond requirement under subdivision (a) may be satisfied by a cash deposit. Code Civ. Proc. § 995.710 (deposit in lieu of bond).

Tolling of the limitation period for contingent claims under subdivision (d) supplements Section 9352 (tolling during administration). The limitation period applicable to a disputed claim is governed by Sections 9353 and 9870.

Note. Ken Klug's draft limited this section to contingent debts, but the staff believes it would be useful for disputed debts as well, and has so expanded it.

#### § 11466. Appointment of trustee

11466. (a) The court may order that a trustee be appointed to receive payment for a debt that is contingent, disputed, or not due. The court in determining the amount paid to the trustee shall compute the present value of the debt, giving consideration to a reasonable return on the amount to be invested. The trustee shall invest the payment in investments that would be proper for a personal representative or as authorized in the order.

(b) The trustee shall pay the debt as provided in the order. On completion of payment, any excess in possession of the trustee shall be distributed in the manner provided in Section 11642.

Comment. Section 11466 continues former Section 11426 without substantive change and broadens it to apply to debts that are disputed or otherwise not due as well as debts that are contingent or payable in installments. The reference to Section 11642 incorporates any omnibus order for final distribution or subsequent court order for distribution.

§ 11467. Distribution subject to bond

11467. The court may order property in the estate distributed to a person entitled to it under the final order for distribution, if the person gives a bond conditioned on payment by the person of the amount of a contingent or disputed debt that becomes absolute or established. The amount of the bond shall be determined by the court, not to exceed the fair market value on the date of distribution of the property received by the distributee, less the amount of liens and encumbrances. In the case of a disputed debt, the cost of the bond is recoverable from the unsuccessful party as a cost of litigation.

Comment. Section 11467 is new.

Note. Ken Klug applied this section only to disputed debts. The staff has given it broader application, except for the cost provision.