First Supplement to Memorandum 91-10

Subject: Study L-3041 - Procedure for Creditor to Reach Nonprobate Assets (Policy Issues--Should this project be undertaken?)

The Commission has decided to pursue the matter of liability of nonprobate assets for debts of a decedent. This has been a continuing and growing concern as more and more assets pass outside of probate and as the Commission has had to confront issues involving rights of the decedent's creditors against many of these types of assets. The Commission has now decided to look into comprehensive legislation dealing with the problems, rather than struggling with individual assets on a case by case basis.

Memorandum 91-10 presents for Commission resolution various policy issues the Commission should resolve in the course of preparing a recommendation to deal comprehensively with creditors' rights against nonprobate assets. However, we have received a letter from individuals (acting individually) comprising the Executive Committee of the State Bar Estate Planning, Probate and Trust Law Section, opposed to this project. See Exhibit 1. The basis of their opposition is:

(1) This is not a major problem in practice.

(2) The procedural cost of the solution outweighs any problem.

(3) Many nonprobate assets are subject to special federal and state laws that could conflict.

The staff does not find these arguments particularly persuasive. As to the first argument, that creditors are generally paid anyway, there are a number of weaknesses. First, probate practitioners do not really know whether creditors get paid, since an estate that passes outside probate has no mechanism for identifying and paying creditors, and creditors have no mechanism for identifying and claiming payment from nonprobate beneficiaries. Second, while it may be true that commercial creditors can write off their losses against the cost of extending credit, noncommercial creditors cannot; a paraplegic injured by the decedent cannot arrange credit insurance or establish a bad debt

reserve. Finally, if payment of creditors is no problem, why do we bother to have a probate system geared to payment of debts? Why not just allow the decedent's assets to pass and rely on the integrity of the beneficiaries to pay the decedent's just debts?

As to the second point--that the procedural burden of collecting from nonprobate assets outweighs the benefit of providing for this--that may appear true from the perspective of the beneficiaries (and their lawyers), but we doubt that viewpoint appeals much to a creditor whose just debt goes unpaid because the decedent who owes the money elects to pass assets through nonprobate rather than probate devices. In fact, a creditor might well argue with some success that leaving a minimal probate estate and passing assets through protected channels amounts to a transfer in fraud of creditors. The whole point of the proposal is to provide a clearly articulated procedural path to resolve problems that may arise, rather than leaving it to makeshift procedural devices, confusion, and random court improvisation. The fact is, at least five California statutes already subject various nonprobate transfers to creditor claims:

--small estates taken by affidavit (Probate Code § 13109)

--community funds taken by a surviving spouse without probate (Probate Code § 13550)

--living trust property to the extent the decedent's probate estate is insufficient (Probate Code § 18201)

--property fraudulently transferred during lifetime and gifts made in view of impending death (Probate Code § 9653)

--general powers of appointment if the estate is inadequate (Civil Code § 1390(b))

Other statutes are being added to the codes. But the statutes do not give any procedural guidance. The whole point of the proposed new statute is to specify the rules in order to clarify the rights of the parties and simplify the court's burden if a case arises. The approach of the individuals comprising the committee is to avoid dealing with the problem until the law reaches a crisis point. Thus they ignored the Tulsa due process problem until it was forced on them by the United States Supreme Court and the MacDonald donative transfer problem until

it was forced on them by the California Supreme Court. Nonprobate transfers are another area where the problems are obvious and should be dealt with, but the individuals decline to confront this.

Their final point is that federal and state statutes may conflict. This could be true if we were to work in ignorance of the statutes. But we will have those statutes before us, and will not build in conflicts. We do not see the problem.

The staff recommends that the Commission proceed with this project.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

GIBSON, DUNN & CRUTCHER
LAWYERS
200 PARK AVENUE
NEW YORK, NEW YORK 10166-0193

(212) 351-4000
TELEX: 177920 GIBTRASK NYK
FACSIMILE: (212) 949-7606

JAS. A. GIBSON, 1852-1922
W. E. DUNN, 1861-1925
ALBERT CRUTCHER, 1860-1931

LOS ANGELES
333 SOUTH GRAND AVENUE
LOS ANGELES, CALIFORNIA 90071-3197

CENTURY CITY
2029 CENTURY PARK EAST
LOS ANGELES, CALIFORNIA 90067-3026

ORANGE COUNTY
800 NEWPORT CENTER DRIVE
NEWPORT BEACH, CALIFORNIA 92660-6395

SACRAMENTO
1010 F STREET
SACRAMENTO, CALIFORNIA 95814-0626

SAN DIEGO
750 B STREET
SAN DIEGO, CALIFORNIA 92101-4605

SAN FRANCISCO
ONE MONTGOMERY STREET, TELESIS TOWER
SAN FRANCISCO, CALIFORNIA 94104-4505

SAN JOSE
50 WEST SAN FERNANDO STREET
SAN JOSE, CALIFORNIA 95113

SEATTLE
701 FIFTH AVENUE
SEATTLE, WASHINGTON 98104-7089

WASHINGTON
1050 CONNECTICUT AVENUE, N.W.
WASHINGTON, D.C. 20036-5306

DALLAS
1717 MAIN STREET
DALLAS, TEXAS 75201-4605

DENVER
1801 CALIFORNIA STREET
DENVER, COLORADO 80202-2694

BRUSSELS
AVENUE LOUISE 222, BTE 4
B-1050 BRUSSELS, BELGIUM

PARIS
104 AVENUE RAYMOND POINCARÉ
75116 PARIS, FRANCE

LONDON
30/35 PALL MALL
LONDON SW1Y 5LP

HONG KONG
1 DUDDELL STREET
HONG KONG

TOKYO
1-1-3 MARUNOUCHI CHIYODA-KU
TOKYO 100 JAPAN

AFFILIATED SAUDI ARABIA OFFICE
CHAMBER OF COMMERCE BUILDING
P.O. BOX 15670
RIYADH 11454, SAUDI ARABIA

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WRITER'S DIRECT DIAL NUMBER

(212) 351-3903

OUR FILE NUMBER

99999-01596

VIA TELECOPIER

Mr. John H. DeMoully
Executive Secretary
California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303-4739

Re: Memorandum 91-10

Dear Mr. DeMoully:

The following presents the position of the individuals comprising the Executive Committee of the State Bar Estate Planning, Probate and Trust Law Section (acting individually) with respect to LRC Memorandum 91-10 with respect to creditors' claims against non-probate assets.

The Memorandum presents a well-thought out and comprehensive statutory response to coordinate liability for debts of a decedent. It addresses a perceived potential unfairness that could result for creditors and beneficiaries if certain assets lie beyond the reach of creditors while others bear more than a pro rata share of debts. Nonetheless, the members of the committee, by a substantial majority vote, oppose the legislation, on three principal grounds:

1. Lack of Identified Problem. First, the committee members almost uniformly report that they do not encounter instances in which creditors go unpaid. In many cases the family makes good on the debt even if this means dipping into an asset that would otherwise be exempt from claims or if it reduces the probate estate to the detriment of another beneficiary. Second, even in cases where the committee members have dealt with such a problem, the amounts involved -- which are largely consumer credit accounts, borrowed short term -- are so small that they do not warrant the imposition of a new statutory scheme. The committee followed this up with interviews (on an anonymous basis) with selected representative consumer credit agencies, and found that collection from decedents is not a problem for them. Indeed, they have already covered any anticipated problems either by credit card insurance, solicited with the credit card statement, or by a practice of regular debt writeoffs which includes a small fraction of uncollectible decedent debts. (We should note that the latter results primarily from inability to locate a decedent, not from lack of assets for payment, and that this problem would not be solved by the proposed legislation in any event.)

2. Procedural Difficulties. This raises the second objection to the proposal, shared by a majority of committee members. Even if it is assumed that there is a real problem existing with respect to non-probate creditors, the proposal itself engenders more difficulties than the perceived problem warrants. It provides a wholly new and complex task for the probate court: the identification of non-probate assets; their valuation; supervision of collection of those assets, or amounts equal to them, and valuing those assets collected; and monitoring and resolving disputes with respect to creditors' rights to those assets. Assuming the problem exists, we believe that to burden the probate court with a vast array of new responsibilities in this manner would produce an overwhelming increase in hearings that would result from creditor (and beneficiary) disputes, and a vast number of new probates forced by creditors and beneficiaries who would otherwise claim or inherit through revocable trusts.

3. Conflicting Statutes. Third, the imposition of a state scheme of liability could create numbers of serious conflicts with federal law. Benefits accrued in qualified plans under federal law, IRAs, and Keogh plans are all subject in some measure to federal regulation. In numbers of states life insurance and certain joint tenancy assets have been historically exempt from creditors claims. Such a sweeping statute would risk serious imbalance with federal statutes and cause numerous conflicts of laws problems as persons with multistate affiliations die leaving their estates, in whole or in part, subject to the new plan.

We respectfully object to the proposed legislation.

Sincerely,

Anne K. Hilker

cc: Bruce S. Ross, Esq.
William V. Schmidt, Esq.
H. Neal Wells, III, Esq.
Melitta Fleck, Esq.