#L-3056 August 30, 1993

Memorandum 93-44

Subject: Study L-3056 — Miscellaneous Probate Issues

This memorandum presents for Commission consideration a number of unrelated probate and estate planning issues that the staff has collected over the past year. The object would be to propose any necessary changes, perhaps in an omnibus probate bill for the 1994 legislative session.

CONTENTS

Priority for Payment of Mortgage on Decedent's Property	1
Joinder of Estates of Spouses	4
Liability for Decedent's Property	6
Determination or Confirmation of Property Belonging or Passing to Surviving Spouse	7
Liability for Unmatured Debts	8
Accounting Duty for Living Trust Created Before 1987	11

PRIORITY FOR PAYMENT OF MORTGAGE ON DECEDENT'S PROPERTY

Richard A. Gorini of San Jose has brought to our attention a conflict between two provisions of the Probate Code. He has written a note on this conflict for publication, and has provided an advance copy for use of the Commission. See Exhibit pp. 1-7.

Property of a decedent may be sold during estate administration, for example to pay debts or make cash distributions to beneficiaries. If the property is encumbered by a mortgage, deed of trust, or other lien, Probate Code Section 10361 requires that the amount secured be paid first, and then expenses of sale, before any remainder is applied in the estate administration. See Section 10361(a):

> If encumbered property is sold, the purchase money shall be applied in the following order:

> (1) The payment and satisfaction of the amount secured by the lien on the property sold if payment and satisfaction of the lien is required under the terms of the sale.
> (2) The payment of the expenses of the sale.
> (3) Application in the course of administration.

This is a sensible provision. However, another provision, Probate Code Section 11420(a) appears to require a different order of application:

> Debts shall be paid in the following order of priority among classes of debts, except that debts owed to the United States or to this state that have preference under the laws of the United States or of this state shall be given the preference required by such laws:
> (1) Expenses of administration.
> (2) Funeral expenses.
> (3) Expenses of last illness.
> (4) Family allowance.
> (5) Wage claims.
> (6) Obligations secured by a mortgage, deed of trust, or other lien, including, but not limited to, a judgment lien, in the order of their priority, so far as they may be paid out of the proceeds of the property subject to the lien. If the proceeds are insufficient, the part of the obligation remaining unsatisfied shall be classed with general debts.
> (7) General debts, including judgments not secured by a lien and all other debts not included in a prior class.

There is an outright conflict between these two provisions, since the first says that secured obligations are to be paid before the sale proceeds may be applied to estate administration, and the second says that there are a number of estate obligations that are to be satisfied before secured obligations. The conflict is harmless except where the estate is insolvent and does not have sufficient assets to pay all priority debts.

The conflict was resolved by the Supreme Court in Estate of Murray, 18 Cal. 686 (1861), which reviewed the predecessor versions of current Probate Code Sections 10361(a) and 11420(a) and concluded that the provision requiring payment of the security obligation governs:

> This provision is express, and is not controlled by the general provisions of the statute in reference to distribution of assets and payment of debts. This is a special provision for the particular class of cases--that of mortgagees whose claims the Administrator collects by this process of sale; and it is no contradiction that a

> different provision is made in reference to a different class of claims; that is, a provision for mortgages, not a lien on the particular land sold, etc. The justice of the rule is as plain as the language. The creditor merely gets the benefit of the contract made with the deceased and is under no obligation to pay any other expenses than those incurred in the enforcement of the mortgage security. The expenses are directed to be retained by the act.

It is not a satisfactory state of affairs when the statutes conflict on their face and one must grope through the law of the 1850's and 1860's in order to answer a straightforward and common legal issue. The staff agrees with Mr. Gorini that the statutes should be revised to state the law clearly.

The staff believes that the policy espoused by both the Supreme Court and Mr. Gorini is correct. The security of an encumbrance should be protected, and the sale proceeds of encumbered property should go first to satisfy the encumbrance and the expenses of sale before it is devoted to any other estate purposes, including payment of preferred debts such as estate administration, last illness expenses, and wage claims. The death of a debtor should not raise general creditors to a higher priority than secured creditors.

The staff would amend the Probate Code to read:

Prob. Code § 11420 (amended). Priority for payment of debts

11420. Except as otherwise provided by statute:

(a) Debts shall be paid in the following order of priority among classes of debts ~~, except that debts owed to the United States or to this state that have preference under the laws of the United States or of this state shall be given the preference required by such laws~~ :

(1) Expenses of administration.

(2) Funeral expenses.

(3) Expenses of last illness.

(4) Family allowance.

(5) Wage claims.

(6) ~~Obligations secured by a mortgage, deed of trust, or other lien, including, but not limited to, a judgment lien, in the order of their priority, so far as they may be paid out of the proceeds of the property subject to the lien. If the proceeds are insufficient, the part of the obligation remaining unsatisfied shall be classed with general debts.~~

~~(7)~~ General debts, including judgments not secured by a lien and all other debts not included in a prior class.

(b) ~~Except as otherwise provided by statute, the~~ The debts of each class are without preference or priority, one over another. No debt of any class may be paid until all those of prior classes are paid

in full. If property in the estate is insufficient to pay all debts of any class in full, each debt in that class shall be paid a proportionate share.

Comment. The material formerly found in Section 11420(a) relating to government debts and secured obligations is relocated to Section 11420.5.

Prob. Code § 11420.5 (added). Exceptions to priority for payment of debts

11420.5. Notwithstanding Section 11420:

(a) Debts owed to the United States or to this state that have preference under the laws of the United States or of this state shall be given the preference required by those laws.

(b) Obligations secured by a mortgage, deed of trust, or other lien, including, but not limited to, a judgment lien, shall be paid in the order of their priority, so far as they may be paid out of the proceeds of the property subject to the lien. If the proceeds are insufficient, the part of the obligation remaining unsatisfied shall be classed with general debts.

Comment. Section 11420.5 relocates material formerly found in Section 11420(a) relating to government debts and secured obligations. Relocation of the material relating to secured obligations avoids the implication that proceeds of sale of an asset subject to a security interest may be used to pay other obligations of the estate before they are applied to satisfy the secured obligation. Sale proceeds of an asset subject to a security interest must be first applied to satisfy the security interest. Section 10361(a); Estate of Murray, 18 Cal. 686 (1861).

JOINDER OF ESTATES OF SPOUSES

Under the Probate Code a surviving spouse receives property from the deceased spouse without probate unless the surviving spouse elects probate. Probate Code Section 13502 also permits the surviving spouse to include in the probate of the deceased spouse's estate the surviving spouse's interest in community and quasi-community property. If the surviving spouse is deceased, the statute allows the survivor's personal representative to make the election.

This statutory scheme can be used where the spouses die in close succession to enable both estates to be probated in one proceeding. However, to achieve this result, it is necessary that an estate proceeding be commenced for the second spouse to die in order to appoint a personal representative to make the election to have the second estate probated with the first.

An alternate approach might be to open an estate for the surviving spouse but not for the deceased spouse. The surviving spouse's personal representative would then elect to administer the assets of the deceased spouse in the survivor's estate. This apparently was done in a case described in the attached letter from Wayland B. Augur, Jr., of Torrance (Exhibit pp. 8-10).

Mr. Augur points out that it is unclear this procedure is permitted under a literal reading of the statute, but he was able to convince a judge to allow it. He suggests that this procedure be codified, with proper protections for creditors and beneficiaries of both spouses:

> **Prob. Code § 13502 (amended). Property subject to administration upon election of surviving spouse**
>
> 13502. (a) Upon the election of the surviving spouse or the personal representative, guardian of the estate, or conservator of the estate of the surviving spouse, all or a portion of the following property may be administered under this code in the estate of the deceased spouse or in the estate of the surviving spouse:
>
> (1) The one-half of the community property that belongs to the decedent under Section 100, the one-half of the quasi-community property that belongs to the decedent under Section 101, and the separate property of the decedent.
>
> (2) The one-half of the community property that belongs to the surviving spouse under Section 100 and the one-half of the quasi-community property that belongs to the surviving spouse under Section 101.
>
> (b) The election shall be made by a writing specifically evidencing the election filed in the proceedings for the administration of the estate ~~of the deceased spouse~~ in which the property is to be administered within four months after the issuance of letters, or within any further time that the court may allow upon a showing of good cause, and before entry of an order under Section 13656.
>
> (c) The election may not be made in proceedings for the administration of the estate of the surviving spouse unless both of the following conditions are satisfied:
>
> (1) Proceedings for the administration of the estate of the deceased spouse have not been commenced at the time the election is filed.
>
> (2) Notice is given to the persons to which, and in the manner that, notice of proceedings for the administration of the estate of the deceased spouse would be given under Section 8110 and subdivision (a) of Section 9050.
>
> **Comment.** Section 13502 is amended to authorize both halves of the community property and quasi-community property to be

> administered in the estate of either spouse, and not just in the estate of the first spouse to die. However, this may only be done in the estate of the second spouse to die where an administration proceeding has not been commenced for the estate of the first spouse to die.
>
> In addition to ordinary notice of administration of the surviving spouse's estate, notice must also be given to known or reasonably ascertainable heirs, devisees, and executors of the first spouse to die, as well as to known creditors. Sections 8110 and 9050(a).

The staff believes this would be a useful procedure that would add flexibility to administration in cases of a type described in Mr. Augur's letter. We recommend that this suggestion be circulated for comment as part of a tentative recommendation on miscellaneous probate changes.

LIABILITY FOR DECEDENT'S PROPERTY

The surviving spouse may take the deceased spouse's property without probate, but if an estate is later opened for the deceased spouse, the personal representative can require the surviving spouse to restore the property to the estate. Prob. Code §§ 13560 to 13564. Valerie Merritt (Exhibit pp. 11-12) believes that this statute is too narrowly drawn—it allows the personal representative to recover community property and quasi-community property, but is silent about the right to recover separate property taken without probate.

The reason the statute is limited to community and quasi-community property is that is where the main problems have arisen. The surviving spouse has an undivided one-half interest in the property and may be in possession of it. The statutes allow the surviving spouse to deal with and dispose of the community and quasi-community property after the decedent's death, thereby creating the possibility that the decedent's estate will be dispersed before a devisee can make a claim for it.

These considerations do not apply to separate property to the same degree, since the separate property will be titled in the decedent's name, the statutes do not allow the surviving spouse unfettered discretion to deal with and dispose of separate property received from the decedent, and the surviving spouse may not have possession of it or the ability to transfer it.

The staff is inclined not to add separate property to the recovery statutes unless it is evident that this has become more than an occasional problem.

Determination or Confirmation of Property Belonging or Passing to Surviving Spouse

Probate Code Sections 13650 to 13660 provide a procedure for court confirmation of property passing to a surviving spouse without probate. Section 13657 states that such a court order "is conclusive on all persons, whether or not they are in being".

Valerie Merritt (Exhibit pp. 11-12) is concerned about this provision, since such an order may be made before creditors have asserted their claims. She notes that such creditors may recover directly from the surviving spouse to whom the property is confirmed, but suggests that a better procedure should be to pull the property back into the decedent's estate. "Restitution to the estate of the amount of property wrongfully distributed is a better remedy than requiring multiple lawsuits by each adversely affected creditor of the estate against the surviving spouse."

The staff is sympathetic to this concern. However, one problem is that if the order confirming the surviving spouse's right is not conclusive, the ability of the surviving spouse to pass good title is drawn into question. This would jeopardize the concept of passage of property without probate.

The way suggested by Ms. Merritt to handle this concern is to subject the property to the restitution provisions of Sections 13560-13564 (liability for decedent's property), discussed above. Under these provisions, the surviving spouse is required to restore the property to the estate only to the extent the surviving spouse still has possession of the property. Otherwise the surviving spouse is only liable for its value.

This approach makes sense to the staff, and we would implement it thus:

Prob. Code § 13657 (amended). Effect of court order

13657. Upon becoming final, an order under Section 13656 (1) determining that property is property passing to the surviving spouse or (2) confirming the ownership of the surviving spouse of property belonging to the surviving spouse under Section 100 or 101 shall be conclusive on all persons, whether or not they are in being , subject to Chapter 3.5 (commencing with Section 13560) (liability for decedent's property) .

Comment. Section 13657 is amended to incorporate Sections 13560 to 13564, providing for restitution of the property (or its value) by the surviving spouse.

We have received a manuscript from Edna R. S. Alvarez of Los Angeles raising issues that she believes require resolution concerning treatment of "unmatured debts" in probate. Exhibit pp. 13-60. An unmatured debt, under her analysis, is a debt of the decedent that was not actionable at the date of death.

Must the Personal Representative Give Notice of Administration to a Creditor Whose Debt is Unmatured?

Ms. Alvarez notes that the statute requires notice to "known creditors", and raises the issue whether a potential creditor whose debt is unmatured is a known creditor who must be given notice. She observes that the statute provides that a personal representative has knowledge of a creditor if the personal representative "is aware that the creditor has demanded payment from the decedent or the estate". Prob. Code § 9050(a). Since a contingent creditor by definition will not have demanded payment, it could be argued that the personal representative does not have "knowledge" of an otherwise known but unmatured creditor within the meaning of the statute and therefore need not give notice.

This analysis is right on, and the Commission made this decision knowingly. The Commission felt it would be too hard to distinguish between contingent debts that are real and will mature in the future and those that are purely speculative, such as potential malpractice claims by a deceased professional's clients or patients. The Commission decided that there is plenty of time during administration for a contingent creditor to become aware of the administration and make a late claim, and that the burden should be on the creditor rather than on the personal representative.

The staff disagreed with that decision at the time. We do not know whether the Commission wants to reconsider it now. If so, the staff would propose something along the following lines:

Prob. Code § 9050 (amended). Notice required

9050. (a) If a general personal representative has knowledge of a creditor of the decedent, the personal representative shall give notice of administration of the estate to the creditor. The notice shall be given as provided in Section 1215. For the purpose of this subdivision, a personal representative has knowledge of a creditor of the decedent if the personal representative is aware that the creditor has demanded payment from the decedent or the estate <u>, or</u>

if the creditor has not demanded payment, that the payment will become due on the passage of time or on the occurrence of a stated event.

(b) The giving of notice under this chapter is in addition to the publication of the notice under Section 8120.

Comment. Section 9050 is amended to require notice to creditors who have not demanded payment if the personal representative is aware that the debt exists but is not yet due or contingent. Cf. Section 11460 ("contingent" and "not due" defined). This provision is not intended to require the personal representative to notify persons who are potentially creditors because of possible liability of the decedent, but only creditors whose debts are known to the personal representative. In a case where there is doubt whether notice to a particular person is required under this standard, the personal representative should give notice. The personal representative is protected from liability in this event. See Section 9053(a).

What Happens When Claim Matures After Expiration of the Claim Filing Period?

Ms. Alvarez points out that there is a conflict in the case law about treatment of a creditor whose claim matures after expiration of the statutory claim filing period. Is the creditor barred, or is the claim filing requirement excused? She suggests that further clarification of the law on this point is necessary.

It is the intent of the Probate Code to require a claim to be filed in probate regardless of whether the debt is matured or unmatured at the time of the decedent's death. The claim filing requirement is broadly-drafted and absolute. The cases cited by Ms. Alvarez arose under prior law. The new law is clear that it covers creditor claims of all types, and the Commission's Comment notes that this coverage is broader than under prior law. Section 9000 states that a "claim" includes a demand for payment for liability of the decedent, whether arising in contract, tort, or otherwise, whether due, not due, or contingent, and whether liquidated or unliquidated.

The staff thinks it is clear that later-maturing debts are covered under this provision notwithstanding the cases under prior law, and that the new provision should not be tinkered with.

Does Code of Civil Procedure Section 366.2 Cut Off Unmatured Debts After One Year?

Code of Civil Procedure Section 366.2 provides an absolute one-year bar for all debts of the decedent:

> If a person against whom an action may be brought on a liability of the person, whether arising in contract, tort, or otherwise, dies before the expiration of the applicable limitations period, and the cause of action survives, an action may be commenced within one year after the date of death, and the limitations period that would have been applicable does not apply.

Ms. Alvarez argues that this rule does not apply to unmatured debts—the decedent is not "a person against whom an action may be brought on a liability" since, at the date of death there was no basis for bringing an action on the unmatured debt.

The staff does not find this analysis particularly compelling. If necessary we could modify this section to state that it applies in a case where a person dies before <u>accrual of the cause of action</u> or expiration of the limitations period on the cause of action. However, we do not really believe the statute is unclear or in need of fine tuning on this point. The staff recommends no change in the text of the statute.

Does Section 366.2 Bar Derivative Liability of Spouse?

Ms. Alvarez raises the interesting question whether the one year bar on liability of a decedent also would bar liability of the decedent's spouse to the extent the community property interest of the spouse is also liable for the decedent's debt.

The staff agrees that the answer to this question is unclear under the statute, although the answer should be that the creditor is not barred as to the surviving spouse's interest. We could clarify this issue thus:

> **Code Civ. Proc. § 366.2 (amended). Limitations period after death of person against whom action may be brought**
>
> 366.2. (a) Subject to Part 4 (commencing with Section 9000) of Division 7 of the Probate Code governing creditor claims, if a person against whom an action may be brought on a liability of the person, whether arising in contract, tort, or otherwise, dies before the expiration of the applicable limitations period, and the cause of action survives, an action <u>under Section 377.40</u> may be commenced

within one year after the date of death, and the limitations period that would have been applicable does not apply.

(b) Subject to Chapter 8 (commencing with Section 9350) of Part 4 of Division 7 of the Probate Code, the limitations period provided in this section for commencement of an action is not tolled or extended for any reason.

(c) This section applies to actions brought on liabilities of persons dying on or after January 1, 1993.

Comment. Section 366.2 is amended to make clear that the one year limitations period is only applicable to actions against the decedent's legal representatives or successors. It does not apply to any independent liability of the decedent's spouse for the decedent's debts.

Does Probating the Surviving Spouse's Community Property Interest Discharge the Surviving Spouse's Liability?

A related issue raised by Ms. Alvarez is whether, if the interest of the surviving spouse in community and quasi-community property is probated along with the interest of the decedent, the surviving spouse's interest is relieved of liability for the decedent's debts. This is the intent of the law, although Ms. Alvarez makes an argument that the statutes are unclear and need clarification.

The staff cannot agree that the statutes are unclear. See Prob. Code §§ 13550-13554 (liability for debts of deceased spouse); see also Prob. Code §§ 11440-11446 (allocation of debts between estate and surviving spouse). Ms. Alvarez' argument is based on the incorrect assumption that the surviving spouse has a personal liability, apart from the community property interest liability, for the decedent's debts. The staff does not believe the statutes are in need of revision.

ACCOUNTING DUTY FOR LIVING TRUST CREATED BEFORE 1987

Valerie Merritt suggests revising Probate Code Section 16062(b) to apply the trustee's duty to account to certain trusts created before July 1, 1987. See Exhibit pp. 11-12. The basic rule is that the duty to account does not apply to a trust created before the operative date of the Trust Law. Ms. Merritt would refine this concept by applying the duty to account also to a trust that is amended or becomes irrevocable after the operative date of the Trust Law. The result would be to extend the duty to account, which Ms. Merritt believes to be beneficial, to certain trusts having an initial creation date before July 1, 1987.

The sections governing the duty to account are as follows:

Prob. Code § 16062. Duty to account to beneficiaries

16062. (a) Except as otherwise provided in this section and in Section 16064, the trustee shall account at least annually, at the termination of the trust, and upon a change of trustees, to each beneficiary to whom income or principal is required or authorized in the trustee's discretion to be currently distributed.

(b) A trustee of a living trust created by an instrument executed before July 1, 1987, is not subject to the duty to account provided by subdivision (a).

(c) A trustee of a trust created by a will executed before July 1, 1987, is not subject to the duty to account provided by subdivision (a), except that if the trust is removed from continuing court jurisdiction pursuant to Article 2 (commencing with Section 17350) of Chapter 4 of Part 5, the duty to account provided by subdivision (a) applies to the trustee.

(d) Except as provided in Section 16064, the duty of a trustee to account pursuant to former Section 1120.1a of the Probate Code (as repealed by Chapter 820 of the Statutes of 1986), under a trust created by a will executed before July 1, 1977, which has been removed from continuing court jurisdiction pursuant to former Section 1120.1a, continues to apply after July 1, 1987. The duty to account under former Section 1120.1a may be satisfied by furnishing an account that satisfies the requirements of Section 16063.

Prob. Code § 16064. Exceptions to duty to report and account

16064. The trustee is not required to report information or account to a beneficiary in any of the following circumstances:

(a) To the extent the trust instrument waives the report or account. Regardless of a waiver of accounting in the trust instrument, upon a showing that it is reasonably likely that a material breach of the trust has occurred, the court may compel the trustee to report information about the trust and to account.

(b) In the case of a beneficiary of a revocable trust, as provided in Section 15800 , for the period when the trust may be revoked.

(c) As to a beneficiary who has waived in writing the right to a report or account. A waiver of rights under this subdivision may be withdrawn in writing at any time as to the most recent account and future accounts. A waiver has no effect on the beneficiary's right to petition for a report or account pursuant to Section 17200.

(d) Where the beneficiary and the trustee are the same person.

The staff agrees with Ms. Merritt that the duty to account is beneficial, but there are some arguments against extending that duty to pre-operative date trusts. The Commission considered this issue when the Trust Law was under

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August 25, 1993

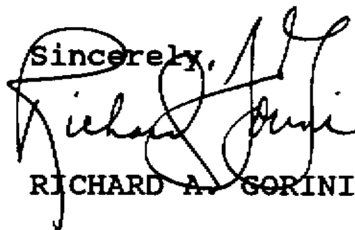
Nat Sterling, Esq.
California Law Revision Commission
4000 Middlefield Road, Room D-2
Palo Alto, CA 94303

Re: Probate Code Section 11420

Dear Nat:

Enclosed is a copy of my revised article for the Estate Planning and Probate News regarding Probate Code Section 11420. Thank you for providing me with copies of the previous code sections. I found the information extremely helpful. Thank you for your interest in this matter.

Sincerely,



RICHARD A. GORINI

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Enclosure

CALIFORNIA PROBATE CODE SECTION 11420:
WHAT YOU SEE IS NOT WHAT YOU GET

Ambiguous statutes are occupational hazards for attorneys. A prime example is Section 11420 of the California Probate Code (all statutory references shall hereinafter refer to the California Probate Code unless otherwise specified).

With the decline in the value of real estate throughout California over the past three years, mortgages that are undersecured by real property (that is, where the principal balance of the mortgage exceeds the property's fair market value) are not uncommon. Not surprisingly, unsecured mortgages usually coincide with an insolvent estate and a mortgage that is or soon will be in default. Especially when accounting for brokers commissions and other expenses of sale, an executor can be faced with the difficult choice of abandoning an estate's real property or attempting to sell such real property in the face of an impending foreclosure.

An executor is generally obligated to take possession of and marshall the assets of an estate. While Section 9780 affords an executor a guideline for abandoning estate assets, that statute only applies to tangible personal property. Except for filing a petition for instructions, there appears to be no procedure available under the Probate Code to obtain review of and approval for the abandonment of real property.

Under these circumstances, Section 11420 would seem to offer an executor certain remedies that could be used as leverage against the mortgagee. Section 11420 creates a priority for payment of debts of an estate and provides in relevant part as follows:

> (a) Debts shall be paid in the following order or priority among classes of debts, except that debts owed to the United States or to this state that have preference under the laws of the United States or of this state shall be given the preference required by such laws:
> (1) Expenses of administration.

(2) Funeral expenses.
(3) Expenses of last illness.
(4) Family allowance.
(5) Wage claims.
(6) Obligations secured by a mortgage, deed of trust, or other lien, including, but not limited to, a judgment lien, in the order of their priority, so far as they may be paid out of the proceeds of the property subject to the lien. If the proceeds are insufficient, the part of the obligation remaining unsatisfied shall be classed with general debts. (emphasis added)

Giving literal interpretation to the language used, mortgages and other secured debts should be satisfied only after payment of the expenses set forth in categories (a)(1) through (a)(5), thereby allowing attorneys' fees and executor's fees to be paid first (a practice that even the IRS generally follows). Given the lower priority of secured claims and the full spectrum of the powers now afforded to probate courts under Section 7050, an executor could even obtain an injunction against the mortgagee to halt the foreclosure proceedings pending the sale of the real property. Under such a sale, the purchase money should accordingly be applied to the secured debts only after setting aside enough funds for debts of higher priority. Thus, the mortgagee would not receive full payment in many of these cases.

One could argue that such an interpretation of Section 11420(a)(6) could leave the decedent's estate in a better position (relative to the mortgage) than the decedent enjoyed before death. Aside from the priority which may be afforded by law to a secured debtor, the same argument hypothetically could be made by the hospital whose bills are unpaid because the last dollar of the estate is expended for funeral costs.

Add to this analysis the operation of Section 10361 which provides in relevant part as follows:

(a) If encumbered property is sold, the purchase money shall be applied in the following order:
(1) The payment and satisfaction of the amount secured by the lien on the property sold if payment and satisfaction of the lien is required under the terms of the sale.
(2) The payment of the expenses of sale.
(3) Application in the course of administration.

Section 10361 was added to the Probate Code effective July 1, 1988, as part of a comprehensive revision of that Code. Section 10361 restated former Section 762 with the relevant exception that Section 762 required the payment of "necessary expenses of the sale" first, the balance then applied to the satisfaction of any mortgage or other lien, and the remainder to be used "in due course of administration." Thus, Section 10361 reversed the order of priority of payments in the predecessor statute (Section 762) to give precedent to the payment of secured liens. Nothing in the California Law Revision Commission Comments to Section 10361 refers to Section 11420 and the interrelationship between these two statutes.

As a collateral issue, Section 10361(a)(2) refers to a category of "expenses of the sale," which expenses are to be paid before the remainder of the proceeds are applied "in the course of administration" [See Section 10361(a)(3)]. Does this language mean that brokers' commissions, escrow fees, and related expenses are paid before other expenses of administration like executor's commissions and attorneys' fees? If the property is renovated and the expenses of renovation are paid out of escrow, are they consequently converted from "expenses of administration" and given a new and perhaps higher priority of payment as "expenses of sale?" If the executor and attorney sell the property without using a broker, can their fees and commissions qualify as "expenses of sale" as would those of a broker or are such fees and commissions relegated irreversibly to being expenses of administration? This review reveals the need for, among other things, a definition of the term "expenses of sale" so that practitioners can distinguish those "expenses" from "expenses of administration."

In any event, the crux of the problem is the question of whether Section 11420 supersedes Section 10361, or vice versa. One could argue that Section 10361 is a statute of general application (applying to all sales of encumbered property), whereas Section 11420 by definition is only applied in insolvent

estates, and therefore Section 11420 should take precedence when the estate is insolvent. A counter argument would note that under federal bankruptcy law, certain claims given priority do not outrank claims secured by valid liens (11 U.S.C.A. §507). While a probate administration is not a bankruptcy proceeding, the governing California laws, especially Section 11420, do provide rules for the payment of creditors before any distribution to devisees or heirs. Unfortunately, there is very little law or commentary on this subject.

A review of case law reveals only one decision on point, and that decision dates back to the early years of California statehood. The California Supreme Court in Estate of Murray (1861) 18 Cal. 686 reviewed the question of whether proceeds from the sale of real property would be first applied for "general expenses of administration" or to the mortgagee. Citing Section 186 of Wood's Dig. 410 (which statute reads almost identical to the repealed Section 762), the Court, in a particularly brief and vague decision, seems to distinguish between the payment of debts secured by the property sold and the payment of mortgages on property of the estate not sold but nevertheless subject to payment or satisfaction (for example, due to exoneration). At this time it appears that California followed the common law theory allowing a specific devisee of encumbered property to have the encumbrance satisfied from estate assets not otherwise specifically devised, subject to a contrary intent stated in the Will (Estate of De Bernal (1913) 165 C. 223). In Murray, the Court held that the mortgagee was entitled to the benefit of his or her contract with the decedent when the encumbered property is sold. Theoretically the payment of secured debts for properties not being sold would have a lower priority, but the Court cites no relevant statutes or case law to explain its rationale.

While neither Section 11420 nor its predecessor statute Section 950 were before the Supreme Court in 1861, the Court did refer to "general provisions of the statute in reference to distribution of assets and payment of debts." Sections 239 and

240 of the Compiled Laws of the State of California (Chapter CXX of Settlement of the Estate of Deceased Persons Act, passed May 1, 1851) provides as follows:

> Sec. 239. The debts of the estate shall be paid in the following order: 1st, funeral expenses; 2d, the expenses of the last sickness; 3d, debts having preference to the laws of the United States; 4th, judgments rendered against the deceased in his lifetime, and mortgages in the order of their date; 5th, all other demands against the estate.
>
> Sec. 240. The preference given in the preceding section to a mortgage, shall only extend to the proceeds of the property mortgaged. If the proceeds of such property be insufficient to pay the mortgage, the part remaining unsatisfied shall be classed with other demands against the estate.

Essentially, the Court in Murray decided that the predecessor to Section 10361 superseded the predecessor to Section 11420. While this decision may have resolved the problem back in 1861, the pertinent statutes were never revised over these many years to clearly reflect the law as set forth in Murray. Instead, the inconsistency between the plain meaning of the two statutes have been carried over from consecutive legislative revisions to the present, with Murray as the only key to the revelation that Section 11420 may not mean precisely what it says. In light of the interim legislative revisions, one could and should reasonably and logically assume that language currently used would not be so twisted by prior case law so as to controvert its literal meaning.

Although not directly related, a bankruptcy case recently decided by the United States Supreme Court involved an undersecured mortgage under facts similar to those that have caused the problem between Sections 10361 and 11420. In Nobleman et ux. v. American Savings Bank (1993) 93 Daily Journal D.A.R. 6735, the Court, in interpreting the interplay between 11 U.S.C. Section 506(a) and 1322(b)(2), held that the rights of secured claimholders could not be impaired by a debt repayment plan that would treat the undersecured portion of the debt as unsecured

(and effectively worthless) and thereby allow the debtor to pay the secured lien only to the extent of the current fair market value of the encumbered property. The decision did not address the mechanics of how the creditor would receive payment for the portion of the secured debt exceeding the value of the encumbered property. However, even Nobleman does not reconcile the provisions of Section 11420(a)(6) with those who argue that the rights of a secured creditor are immune from the probate administration process.

From a practical (and political) perspective, if Section 11420 was given precedence over Section 10361, the mortgage industry would certainly be moved to act. One conceivable response would be to require life insurance on all new mortgagors. More likely, however, would be a lobbying effort to revise Section 11420. From the perspective of private practitioners, clarity of law is perhaps the most prized objective of whatever revision or interpretation the legislature or the courts ultimately choose to apply to this problem. Regardless of the fact that the study and revision of the Probate Code by the California Law Revision Commission has come and gone, the conflict between these statutes deserves the attention and review necessary to resolve the conflict and provide whatever related definitions are needed to minimize future litigation.

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November 9, 1992

Law Revision Commission
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File:____________
Key:____________

Mr. Nat Sterling
Law Revision Commission
4000 Middlefield Road, Suite D2
Palo Alto, California 94303

Re: Probate Code §13502

Dear Mr. Sterling:

On or about October 30, 1992, I telephoned you concerning a probate procedure I was attempting to use under Probate Code Section 13502. You were kind enough to discuss this matter with me, and asked me to advise you of the action taken by the court.

As you may recall, my factual situation concerned a husband and wife who died within a short time of each other. They had created a living trust, and had transferred most of their assets into the trust. However, they failed to transfer a block of community property stock, which had a total value of approximately $140,000.00. Since the one-half community property interest of each spouse exceeded $60,000.00, the stock could not be transferred pursuant to Section 13100 of the Probate Code. Also, since each spouse had a pour-over will, which specified that all probate assets be distributed to the trustee of their trust, it was not possible to use a spousal property petition in accordance with Section 13650 of the Probate Code.

I wanted to find a way to transfer both portions of the community property stock into the trust in a single probate proceeding. The technical problem with using Section 13502 was that the election was supposed to be filed by the surviving spouse or by the personal representative of the surviving spouse in the estate of the deceased spouse. Since the surviving spouse was also deceased, a literal reading of the statute would require opening probate administration for both the estate of the deceased spouse and, in order to appoint a personal representative for the surviving spouse, also open probate administration for the estate of the surviving spouse.

One intent of the statute appeared to be to allow a single probate proceeding for community property assets of a deceased spouse and a surviving spouse when the surviving spouse had died. But as noted above, a literal reading of the statute would clearly require two separate probate proceedings. It would also give rise to a rather peculiar result, as further described below. In the factual situation described above, literal application of Section 13502 could result in the following:

1. A regular probate administration would be opened for the estate of the deceased spouse, with normal notice to heirs, notice to creditors, etc.

2. A petition for probate and petition for special letters of administration would be filed for the estate of the surviving spouse. A special power would be requested for the special administrator and granted to permit the special administrator to file the election to permit the surviving spouse's estate to be administered in the estate of the deceased spouse, and this election would be filed in the estate of the deceased spouse.

3. As soon as the election by the special administrator for the surviving spouse had been filed in the estate of the deceased spouse, and prior to any publication of notice of death and prior to any notice of administration to heirs and devisees of the surviving spouse, the special administrator would petition to terminate the estate of the surviving spouse on the basis that no assets remained requiring probate.

This gives rise to the peculiar situation where two probates have been opened, but one remains open only briefly. No heir or creditor of the surviving spouse ever receives notice of the proceeding. The surviving spouse's one-half community property interest is administered in the estate of the deceased spouse, possibly escaping legitimate creditors claims of the surviving spouse.

Interestingly enough, a single probate administration of the estate of the surviving spouse, which includes the right of the personal representative of the surviving spouse to file an election to administer the community property of the deceased spouse in the estate, provides greater protection to creditors. The reason for this is that a surviving spouse is legally obligated for all community property debts of both the

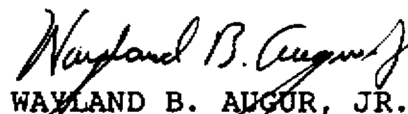
surviving spouse and deceased spouse, as well as being responsible for any separate property debts of the surviving spouse.

I argued most of the above to the court at the hearing in my matter. The judge was initially of the opinion that there should be two separate probate proceedings, (1) since heirs of the deceased spouse might not receive notice of what was going on, which would be of importance if the deceased spouse had different heirs or devisees than the surviving spouse, and (2) because separate property creditors of the deceased spouse might not be aware of any proceeding in which they could file claims. However, after holding the matter for a time for additional consideration, the judge did approve the procedure I was using. This was beneficial to my client, but probably lessens the motivation of the Law Revision Commission to modify Section 13502.

However, if the opportunity should arise in the future for the Law Revision Commission to review Section 13502, I would request that the statute be examined and possibly modified to show that community property assets could be handled in a single probate proceeding when a deceased spouse and a surviving spouse both die before any probate proceeding has commenced. In this regard, it seems to me that the following sentence might be added at the end of subparagraph (b) of Section 13502:

> "However, if the surviving spouse should die before probate administration of the deceased spouse's estate has commenced, the personal representative of the surviving spouse may file such election in the estate of the surviving spouse, provided that the personal representative gives notice of such election to all known and reasonably ascertainable creditors of the deceased spouse in accordance with §§9050(a) and 9051 to 9054, and also gives notice of such election to all known and reasonably ascertainable heirs and devisees of the deceased spouse."

Very truly yours,



WAYLAND B. AUGUR, JR.

WBA:jwl

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Law Revision Commission
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February 11, 1993

Nat Sterling, Esq.
California Law Revision Commission
4000 Middlefield Road, #D-2
Palo Alto, California 94303-4739

RE: Probate Code Revisions Suggested

Dear Nat:

As I told you on the telephone the other day, there are some portions of the Probate Code that appear to need further revision.

As I see it, now that separate property passes to a surviving spouse without administration, Probate Code §13560 should be amended to include "decedent's separate property which passes to the surviving spouse." Also, sections 13560-13564 were recently added to parallel the provisions of sections 13200-13210, but they do not precisely do so. It has recently come to my attention that while it is possible to interpret §13562 to give the court the authority to order restitution of property to an estate that was previously distributed to a surviving spouse under §13650 et seq., this is not crystal clear. There is a potential conflict with §13567, which should be resolved. I believe the resolution should clearly give the court the authority to make an order for restitution under §13562, even if there is a prior final order under §13657. This is because an order can be obtained under §13650 et seq. prior to the expiration of the period for filing creditors' claims and prior to the filing of any inventories. Thus, the order can wrongfully determine the amount of "property passing to the surviving spouse" for failure to have enough information to fully determine the amount. Restitution to the estate of the amount of property wrongfully distributed is a better remedy than requiring multiple lawsuits by each adversely affected creditor of the estate against the surviving spouse.

I also recommend a revision of Probate Code §16062(b). The current language is unclear and can create unintended results. If a revocable living trust is created by a document executed before July 1, 1987, and becomes irrevocable thereafter, the statute seems to say that it is not subject to the duty to account. If there were no amendments subsequent to 1987, that may be a fair result. However, when is the "living trust" created if the original instrument was

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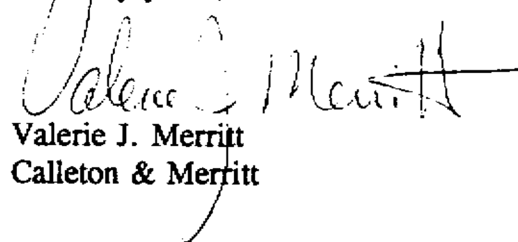
executed prior to July 1, 1987, but there are multiple amendments subsequent to that date? Since the "trust" is the creation of the totality of the documents, it is arguable that it is only "created" as of the date of the last amendment. However, there is no guidance in the statute on this issue. Related to that issue is the effect of the creation of multiple new trusts after the death of the settlor of a living trust and whether they are created as of the date of the first creation of the revocable trust, as of the date of the last amendment of the revocable trust, or as of the date the revocable trust became irrevocable. I prefer the last of those dates, but could see an argument for the date of the last amendment controlling. I believe to use the first of those dates would remove too many revocable trusts from the beneficial effects of these trust accounting statutes. I do not believe this to be good public policy. I strongly suggest that revisions to clarify intent be made in the legislation the Commission currently has before the legislature.

Sincerely yours,



Valerie J. Merritt
Calleton & Merritt

VJM:

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ESTATE CREDITORS: NEW STATUTES, EVOLVING DEFINITIONS, AND SHIFTING RIGHTS - HOW DO WE ADVISE CLIENTS IN A FLUID ENVIRONMENT?

AN INITIAL ANALYSIS

EDNA R. S. ALVAREZ
Los Angeles (Westwood), California

18th Annual USC Probate
and Trust Conference
Los Angeles, California
October 1992

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TABLE OF CONTENTS

Page

I. **INTRODUCTION** 1

II. **BACKGROUND - AN HISTORIC PERSPECTIVE** 2

A. Pre-Tulsa 2

B. The Rule of Tulsa 3

C. The California Response to Tulsa 4

1. Actual Notice to Known or Reasonably Ascertainable Creditors . 4
2. Published Notice 7
3. Self-Executing Statute of Limitation - CCP § 353 7

III. **THE UNMATURED DEBT** 8

A. The Problem 8

B. Itemization of Issues 9

C. Duty to Give Notice to and/or Duty to Search for Unmatured Creditors 13

1. General Response 14
2. The Personal Representative's Liability for the Unmatured Debt 19
3. The Matured Unmatured Debt 21
4. The Distributee's Liability for the Unmatured Debt 24
5. CCP § 353 As the "Great Protector" . 25
6. The Surviving Spouse's Liability for the Unmatured Debt 29

IV. **CONCLUSION** 38

Attachment A - Trust Procedure Regarding Creditors of Deceased Settlor

Attachment B - PC § 13550 et seq.

I. INTRODUCTION

There is significant uncertainty in the California estate administration legal community on certain aspects of a fiduciary's duty in the post-mortem context vis-à-vis creditors. The uncertainty results, in part, from: 1) the holding in Tulsa Professional Collection Services v. Pope 485 U.S. 478, 108 Sup. Ct. 1340 (1988) ("Tulsa"); 2) ambiguities in California statutes and 3) conflicting written and oral "pronouncements" by legal "pundits" on the state of the current law. This paper will analyze one such issue faced by the estate attorney in advising the fiduciary on creditor matters, namely, the "unmatured debt." For purposes of this paper, the term "unmatured debt" is a potential obligation of the decedent-to-be that was not actionable as of the date of decedent's death. This would include debts such as the following: 1) a guarantee made by decedent on an obligation under which the primary obligor has made all payments due as of the date of decedent's death; 2) a claim for malpractice on an error committed by decedent but not yet actionable by the injured party; 3) a right to contribution by a party under a contribution agreement between the party and the decedent for an obligation on which no payments are due or payable by the party on the underlying obligation as of the date of decedent's death; and 4) a margin account that has not been called as of the date of decedent's death.

This writer has spoken with many attorneys on the issues relating to decedents and unmatured debts, has read all of the commentary that she could locate and has concluded that there simply is no "right" answer under current law. Given this uncertainty, each attorney must undertake her own analysis of California law at the time of the proposed advice. This paper will point out some of the issues and discuss some approaches to be considered. This paper will not cover claims by public entities (PC §§ 9200-9205; §§ 19200-19205), claims secured by a judgment lien or attachment lien (PC §§ 9300-9304; §§ 19300-19304) or litigation involving decedent (PC §§ 550-555) or claims in litigation (PC §§ 9350-9399). This paper should be read as an initial analysis by one writer.

II. BACKGROUND - AN HISTORIC PERSPECTIVE

A. Pre-Tulsa

Until the arrival of Tulsa on the lawyer's desk in 1988, the issue of advising a client in the post-mortem arena on the handling of notice to creditors was, generally, a "non-issue." A notice of death and of petition to administer estate was published, a creditor was required to make a timely claim and a creditor who failed to make a timely claim was cut-off from access to estate assets. No actual notice was mailed to creditors. Having given notice by publication, the burden was shifted to the creditor to file a

timely claim. The state policy favored speedy administration of estates and security of title for distributees and required creditors to be knowledgeable about their debtors and to act promptly. Recent policy, as reflected in the holding of Tulsa, indicates a shift towards protectionism of creditors and an increased duty on the estate fiduciary to seek out creditors.

B. The Rule of Tulsa

The Supreme Court in Tulsa held that as a matter of constitutional due process, a state's "non-claim" statute providing a short claims-filing period cannot cut off the rights of known or reasonably ascertainable creditors who do not receive actual notice of the commencement of probate proceedings. Knowledge of the death of the decedent is irrelevant. Knowledge of commencement of administration is the critical element. The Court stated that requiring actual notice be given to known or reasonably ascertainable creditors is not inconsistent with the goals of a state's "non-claim" statute. On the other hand, due process does not mandate impractical and extended searches; only reasonably diligent efforts to uncover the identities of creditors. Those with mere conjectural claims need not receive actual notice.

In summary, Tulsa provides that the Constitution's due process protections permit a short claim statute that cuts off a known or reasonably ascertainable

creditor who is given actual notice of administration. Tulsa further stands for the proposition that published notice is sufficient for: a) an unknown and not reasonably ascertainable creditor and b) for a known and reasonably ascertainable creditor with a mere conjectural claim. See Clark v. Kerby 92 Daily Journal D.A.R. 4348 (March 31, 1992) as modified 92 Daily Journal D.A.R. 5312 (April 21, 1992), for an analysis and in-depth discussion of Tulsa and a holding that the pre-1991 California creditors' claim statute is unconstitutional with respect to "known" and "reasonably ascertainable" creditors.

C. The California Response to Tulsa

1. Actual Notice to Known or Reasonably Ascertainable Creditors

California statutory law now requires that actual notice of administration of the estate be given to a creditor if the personal representative has knowledge of the creditor. PC § 9050(a). It is important to note that nowhere in the statutory scheme is the term "creditor" defined. However, the statute does provide that a personal representative has "knowledge" of a creditor if "... the personal representative is aware that the creditor has demanded payment from the decedent or the estate." PC § 9050(a). Constructive knowledge is not sufficient. Law Revision Commission Comment to PC § 9050.

PC § 9053(d) expressly provides that

"[n]othing in this chapter imposes a duty on the personal representative to make a search for creditors of the decedent." It appears that California statutory law relating to notice fails the Tulsa requirement that notice be given to creditors who are "reasonably ascertainable."

Some have argued that the constitutional problem is perhaps resolved by PC § 9392 which provides for distributee liability where: 1) the identity of the creditor was known to, or reasonably ascertainable by, a general personal representative within four (4) months after the date letters were first issued to the personal representative, and the claim of the creditor was not merely conjectural; 2) notice of administration of the estate was not given to the creditor and neither the creditor nor the attorney representing the creditor had actual knowledge of administration of the estate before the time the court made an order for final distribution of the property and 3) the statute of limitations applicable to the claim under Section 353 of the Code of Civil Procedure has not expired at the time of commencement of an action under Section 9392. PC § 19400 et seq. provide a similar rule within the trust context except that the "actual knowledge" period is one (1) year from the date of first publication of the Section 19040 notice, rather than from the date of the order for final distribution of the property. The California Law Revision Commission Comment

regarding PC § 9392 states that this new provision "implements the rule of Tulsa ..., that the claim of a known or reasonably ascertainable creditor whose claim is not merely conjectural but who is not given action notice of administration may not be cut off by a short claim filing requirement." This "back door" approach to constitutionality cuts away at the policy in favor of permanently settling estate matters for beneficiaries.

The court in Kerby, supra, interpreted California's prior statute, which also did not expressly require notice to reasonably ascertainable creditors, to fail the Tulsa test and found that, in light of Tulsa, actual notice must be given to any known or reasonably ascertainable creditor.

Likewise, Los Angeles Probate Policy Memorandum § 11.04 states that every reasonably ascertainable creditor must be notified of the commencement of administration. A Los Angeles Superior Court Probate Commissioner has moved the fiduciary obligation even farther, stating, "[m]oreover, an accounting or petition for distribution must set forth in some detail the efforts of the personal representative to ascertain and notify the creditors and **potential** creditors of the decedent" (emphasis added). L.A. County Bar Probate and Trust Law Section 1992 Probate Symposium.

Thus, by interpretation, but not by express statutory language, the rule that is developing is that actual notice must be given to known or reasonably ascertainable creditors.

2. Published Notice

If a creditor is not known (or reasonably ascertainable), publication of the notice of hearing bars a creditor after four (4) months from the date letters are first issued to a general personal representation. PC §§ 8100, 8120, 9001 and 9002. There is also a creditor notice procedure for trusts of decedents dying on or after January 1, 1992. This is discussed in detail in Attachment A to this paper.

3. Self-Executing Statute of Limitation - CCP § 353

CCP § 353 provides for an absolute one (1) year statute of limitations that is not dependent on the giving of notice or the existence of a court proceeding. The statute cuts off all claims one (1) year after the date of death " ... if a person against whom an action may be brought ... dies ...," subject to being tolled under Chapter 8 (commencing with Section 9350) of Part 4 of Division 7 of the Probate Code.

Many have hailed this as the cure-all to California's Tulsa "problem." It is discussed later in this paper.

III. THE UNMATURED DEBT

A. The Problem

The attorney representing a fiduciary must advise the fiduciary in regard to "obligations" of the decedent that are not due. The law in this area comprises a collection of confusingly non-integrated statutory pronouncements which, along with case law, do not give the attorney firm ground upon which to rest her advice. Until these matters are clarified, the attorney will not be assured that the advice she is giving is proper.

Unmatured debts can arise in many different contexts including the following factual areas:

1. Potential professional malpractice claims that have not ripened to the point of a demand. For example, those relating to a deceased attorney, physician, contractor or architect.

2. Potential claims of partners under partnership agreements providing for joint and several liability as to partnership obligations that are not in default at the date of death.

3. Guarantees on loans or on leases where the principal obligation is not in default at the date of death.

4. Claims against proprietors by employees and past employees for worker's compensation, labor department claims, wrongful termination claims, sexual harassment claims,

for which no claim has been communicated to the proprietor at the date of death.

5. Margin accounts where there has been no call as of the date of death.

6. So called "Marvin" claims that have not ripened prior to death.

7. Miscellaneous tort claims that have not ripened as of the date of death.

B. <u>Itemization of Issues</u>

It is critical for the attorney to consider the issue of unmatured debts <u>prior</u> to accepting an engagement as the attorney for the estate (and, in fact, as a part of pre-mortem planning). If a claim is made in regard to an unmatured debt during the administration of an estate, the closing of the probate administration may be delayed for years.

In the process of making her decision, the attorney would do well to initially identify the prospective estate administration as "friendly" versus "ferocious," "ordinary" versus "extraordinary," "clean" versus "why did I even take this estate?" In addition, the attorney may want to categorize the estate into: 1) an estate with significant known unmatured debts (e.g., significant guarantees); 2) an estate with unknown unmatured debts but a "high risk" decedent or 3) an estate with unknown unmatured debts and a "low risk"

decedent.

Once having accepted the engagement, the attorney needs to develop a specific strategy for dealing with unmatured debts.

Some of the issues faced by counsel in the context of a decedent with unmatured debts are as follows:

1. Should I take this matter?

2. Should probate be commenced or deferred until after one (1) year has expired from the date of death? does CCP § 353 provide protection in the context of the unmatured debt?

3. Should the PC § 19003 trust notice procedure be initiated? Should a full probate administration be initiated instead? If there is no PC § 19003 procedure initiated, should the trustee defer distribution for one (1) year?

4. Is there a fiduciary duty to make a reasonable search for persons to whom the decedent was potentially liable for an unmatured debt? ("unmatured creditor")

5. Is there a fiduciary duty to give notice to an unmatured creditor known to the fiduciary or to an unmatured creditor who becomes a matured creditor during administration?

6. What is the liability of:

a. the fiduciary;

b. the surviving spouse;

c. a distributee, other than the surviving spouse, and/or

d. the attorney for the fiduciary for failing to search for unmatured creditors and/or for failing to give notice to known unmatured creditors and/or to unmatured creditors who become known?

7. Is there fiduciary liability for giving notice to an unmatured creditor and/or to an unmatured creditor who becomes a matured creditor? Is there attorney liability for advising the fiduciary to give notice to an unmatured creditor and/or to an unmatured creditor who becomes a matured creditor?

8. May an unmatured creditor whose claim has matured ("matured creditor" and "matured debt" as the context requires) make a potentially successful claim in any of the following situations:

a. Against the estate or trust assets after the four (4) month statutory claim period has expired, but before the late claim period has expired and before the one (1) year period from the decedent's date of death (CCP § 353(b)) has expired.

b. Against the estate or trust assets after the statutory period has expired <u>and</u> after the late

claim period has expired but before the CCP § 353(b) one (1) year period has expired?

c. Against an estate distributee or a trust distributee, as distributee, i.e., not as surviving spouse - before the CCP § 353(b) one (1) year period has expired?

d. Against the "bad faith" fiduciary before the CCP § 353(b) one (1) year period has expired?

e. Against the attorney for the fiduciary before the CCP § 353(b) one (1) year period has expired.

f. If the answer to any of the aforesaid is "yes", is the answer modified if the CCP § 353 one (1) year period has expired?

9. What protections from liability are available to a surviving spouse in regard to an unmatured debt? Does the answer change if there is a probate rather than a spousal set aside/confirmation? Does the answer change if the spouse's community property and quasi-community property are included in the probate?

10. Should the PC § 19003 trust procedure be initiated to protect non-spouse trust beneficiaries?

11. Should the PC § 19003 procedure be initiated to protect the spouse?

12. In pre-mortem planning, should the attorney advise clients who are likely to have unmatured debts to a)

have a plan that results in significant assets subject to probate; b) avoid a probate through use of a fully funded living trust; or c) place all or a significant portion of assets in joint tenancy?

13. In both the pre-mortem and post-mortem context, how are the following issues resolved:

a. Are transfers that are made to protect assets from unmatured claims transfers in fraud of creditors?

b. Is advising such transfers in the pre-mortem context or advising non-notice in the post-mortem context a violation of the attorney's ethical duties and/or duties of professional responsibility?

c. Is advising such transfers in a pre-mortem context or advising non-notice in a post-mortem context a violation under RICO resulting in exposure for triple damages?

d. Is advising such transfers in a pre-mortem context or advising non-notice in the post-mortem context a so-called "Kaye Scholer Fierman Hayes and Handler" violation?

All of these issues will not be discussed in this paper.

C. Duty to Give Notice to and/or Duty to Search for <u>Unmatured Creditors</u>

The attorney must advise the fiduciary as to the fiduciary's duty to give notice to creditors and the

fiduciary's duty to search for creditors. In the context of the unmatured debt, current law does not permit advice to be given with assurance.

1. General Response

Tulsa requires that notice be given to any known or reasonably ascertainable creditor whose claim is not merely conjectural. Although it is not certain, it appears that an attorney advising a fiduciary in regard to California law could take the position that the personal representative of an estate need not search for unmatured creditors and does not need to give notice to known unmatured creditors, but may need to give notice to unmatured creditors that become mature during the course of the administration of the estate. Advising universal "search and notice" may breach the fiduciary's duty to preserve the estate and the attorney, in turn, may face liability for advising a universal "search and notice."

a. PC § 9053(d) expressly provides that nothing in the chapter imposes a duty on the personal representative to make a search for creditors.

b. Even if this standard is constitutionally flawed under Tulsa, Tulsa only requires reasonably diligent efforts to uncover the identity of creditors. Mullane v. Central Hanover Bank and Trust Co. 339 U.S. 306 (1950), cited in Tulsa, provides that constitutional

due process does not mandate "impracticable and extended searches ... in the name of due process" and provides that those with mere conjectural claims need not receive actual notice.

c. Although PC § 9050(a) requires that notice be given if the personal representative has knowledge of a creditor, the term creditor is not defined. However, PC § 9050(a) does provide that a personal representative has knowledge of a creditor of the decedent if the personal representative is aware that the creditor has demanded payment from the decedent or the estate. Under the definition of unmatured debt, as of the date of death there would have been no demand for payment and, therefore, no statutory "creditor" and, therefore, no duty to search and no duty to give actual notice. Such search and/or notice, for example, to all the patients of a doctor, would be "impracticable" and based on "conjecture."

Counsel may find the comment to PC § 9050 by the Law Revision Commission to be enlightening:

> Section 9050 continues Section 9050 of the repealed Probate Code without substantive change. This section is designed to satisfy due process requirements by ensuring reasonable notice to creditors within the practicalities of administration of the estate of a decedent ....

The personal representative is not required to make a search for possible creditors under this section. See Section 9053(d). The personal representative is required only to notify creditors who are actually known to the personal representative either because information comes to the attention of the personal representative in the course of administration or because the creditor has demanded payment during administration. Information received by the personal representative may be written or oral; but actual, as opposed to constructive, knowledge is required before a duty to give notice is imposed on the personal representative. The personal representative is protected by statute from a failure to give notice unless the failure is in bad faith. See Section 9053(b). However, the personal representative may not willfully ignore information that would likely impart knowledge of a creditor. For example, the personal representative may not refuse to inspect a file of the decedent marked "unpaid bills" of which the personal representative is aware. Inferences and presumptions may be available to demonstrate the personal representative's knowledge. Recommendation Proposing New Probate Code, 20 Cal.

L. Revision Comm'n Reports 1001 (1990), at 1565.

d. If counsel agrees that it is unnecessary to search for or give actual notice to an unmatured creditor, published notice under PC §§ 8100 and 8120-8125, rather than actual notice, would seem to meet the constitutional test for the unmatured creditor.

Even without notice, the unmatured creditor may file a claim. PC § 9000(a) defines "claim" to include a demand for payment whether due, not due, or contingent and whether liquidated or unliquidated and goes on to specify specific types of claims, including liability of the decedent, whether arising in contract, tort or otherwise.

PC § 11460 et seq., entitled "Debts That Are Contingent, Disputed or Not Due," provides alternative methods within the estate administration process for dealing with these types of debts for which a claim is filed. However, the existence of these statutory provisions should not result in counsel concluding that searches must be undertaken or notice given.

e. Some commentators have stated that, if there is any doubt whether or not to give notice, notice should be given. Otherwise, there is a risk of surcharge on the part of the personal representative and malpractice on the part of the attorney. Ross, Probate, (Rutter) 8:5.5. Ross goes on to state that, if in doubt, notice should be given and

final distribution not made for the sixteen (16) month personal representative liability period (or distribution can be made earlier with a holdback of substantial funds. Ross, Probate, (Rutter) 8:76. See also H. Neal Wells, III, "The Check's in the Mail; Creditor's Claims after Tulsa" in Estate Planning, Trust and Probate News, Vol. 9, No. 2, Winter 1989 recommending broad "search and notice." If wide range notices are given - e.g., to all partners; to all "well clients" - a costly "standard of care in the community" will begin to be established. The preferable answer may be for the personal representative not to give notice to the unmatured creditor and to wait out the sixteen (16) month personal representative statutory liability period.

However, an argument could be made that giving overly broad notice that results in claims, litigation and/or delay violates the personal representative's duty to the estate and its beneficiaries. For discussions of the duty of the personal representative to protect the legal rights of heirs against creditors, see Nathanson v. Superior Court (1974) 12 Cal 3d 355; Estate of Smith (1953) 122 Cal App 2d 216; Estate of Cross (1975) 51 Cal App 3d 80; and Estate of Erwin (1953) 117 Cal App 2d 203. Does "modern" estate administration theory create a fiduciary obligation to creditors?

Although PC § 9053(a), discussed infra,

protects the personal representative who gives notice believing notice is required, there is no such statutory protection for counsel. If counsel advises notice in a situation where notice is not required, is counsel liable for the resulting damage? But see Goldberg v. Frye 217 Cal App 3d 1258 (1992); 266 Cal Rpt'r 483 (1990) - counsel not liable to estate beneficiary - duty is to personal representative and not to beneficiary and Bily v. Arthur Young & Co. 92 Daily Journal D.A.R. 11971 (Aug. 27, 1992) - based on a narrow rule of liability based on privity of contract, the California Supreme Court held accountant may not be sued by investors and lenders for negligence in the auditing of a client's financial statement. But see Pierce v. Lyman 3 Cal. Rptr. 2d 236 (Cal. App. 2d Dist. 1991) holding that, normally under California law, an attorney for a trust would have no liability to a beneficiary for advice given to the trustee because of lack of an attorney-client relationship, but if an attorney assisted the trustee in breaching the trustee's fiduciary duty to the beneficiaries and "actively colluded" with the trustee, then a beneficiary would have a cause of action against the attorney. The case under consideration involved accountings filed with the court designed to conceal imprudent investment schemes.

2. The Personal Representative's Liability for the Unmatured Debt

If the attorney advises the personal

representative not to give notice and this advice is determined to be erroneous and it is determined that the personal representative had a duty to give notice, the personal representative may be exposed to liability for failing to give notice, and the personal representative's counsel may also be exposed.

a. PC § 9053(b), in general, provides for personal representative liability for failing to give notice if the failure was in 1) bad faith; 2) neither the creditor nor the attorney representing the creditor had knowledge of the administration before expiration of the time for filing a claim and payment would have been made if the claim had been properly filed; and 3) the action is filed within 16 months after letters were first issued.

Until the law as to the fiduciary's duty to search for and give notice to unmatured creditors is determined by case law or statute, the only absolute protection to the personal representative who does not search for unmatured creditors and/or does not give notice to known unmatured creditors (e.g., all lenders to whom a guarantee was given by the decedent, all the deceased lawyer's partners; all the deceased lawyer's clients for whom a will was drawn), is to wait for the lapse of the 16 month safety period.

b. On the other hand, PC § 9053(a) provides that the fiduciary is not liable to any person for

giving notice if the personal representative believes that notice to a particular creditor is or may be required. If the term "creditor" includes an unmatured creditor, PC § 9053(a) would seem to provide absolute protection to the fiduciary and lead to advice that the fiduciary should search widely and give notice widely. However, if the term "creditor" does not include unmatured creditors, and, therefore, the PC § 9053(a) protection does not apply in that it is not a "creditor" to whom notice has been given, then the fiduciary may incur liability for unnecessarily giving notice to an unmatured creditor who then files a claim for a not due debt which holds up the closing of the estate for many years.

c. In making a decision as to whether to give notice, the fiduciary should consider the best interests of the estate. One approach to consider would be to obtain a written agreement from all of the beneficiaries as to the proposed approach to be taken by the personal representative, including an agreement to indemnify for any loss to the fiduciary, including defense costs.

3. The Matured Unmatured Debt

If the unmatured creditor becomes a matured creditor - i.e., a demand for payment is made - PC § 9051 provides that actual notice must be given within the time frame outlined in PC § 9051 - i.e., within the four (4) month notice period but if knowledge is obtained less than thirty

(30) days before the expiration of the four (4) month period or after the expiration of the four (4) month period, then within thirty (30) days after knowledge is first acquired unless: 1) the creditor has filed a claim or 2) the creditor demanded payment and the personal representative elects to treat the demand as a claim. The creditor must file a claim within the time provided in PC § 9100 or PC § 9103. Under PC § 9103(b), which deals with late claims, no late claim is allowed after the first to occur of: 1) the order for final distribution, 2) one (1) year after the issuance of letters to the general personal representative or 3) barring under CCP § 353. This would tend to lead the personal representative to try to obtain an order for final distribution as soon as possible. However, consideration must be given to the personal representative's potential liability under the "sixteen (16) month bad faith" rule discussed infra and to the distributee's potential liability discussed infra.

It is not clear whether the unmatured creditor who becomes a matured creditor after the claim period needs to file a claim. The case of Borba Farms Inc. v. Acheson 197 Cal. App. 3597 (1988) is instructive. This case related to a matter that arose under prior PC § 707(a), which provided that "... all claims arising on contract, whether they are due, not due or contingent ... must be filed or presented within a four (4) month period." The court held

that the plaintiff's claim as a judgment debtor, for contribution against joint debtors, did not have to be filed within the four (4) month period since the judgment debtor's right to contribution only came into existence upon his actual payment of a portion of the judgment in excess of his proportionate share of the liability. This payment by the judgment debtor did not occur until two (2) years after the joint debtor's death. See also Newberger v. Rifkind 28 Cal. App. 3d 1070, 104 Cal. Rptr. 663 (1972) - claims required to be filed under the Probate Code are only those for debts or demands against decedent as might have been enforced against him in his lifetime by personal actions for recovery of money and upon which a money judgment could have been rendered. When liability arises after death of decedent, it does not constitute a claim against the estate which is required to be presented for allowance - and Romo v. Estate of Bennett 97 CA3d 304, 158 CR 635 - decedent's medical malpractice was not discovered until nine (9) years after death - allowed under prior PC § 721). But see Newhall v. Newhall 39 Cal. Rptr. 144, 227 CA 2d 800 (1964) - wife was required to file creditor's claims against divorced decedent's estate not only for child support payments but also for payment of her own support, even as to payments which were not yet due or were contingent. See also Pitzer v. Smith 123 CA3d 73, 176 CR 407 (1981) - no creditor claim required for cause of action

arising after decedent's death. This case was strongly criticized by the court in Nunez v. Superior Court 143 CA3d 476, 191 CR 893 (1983) requiring a creditor's claim for all claims for damages for injuries to or death of a person. Pitzer and Nunez related to claims for wrongful death and arose under prior PC § 707 and PC § 720 relating to litigation involving a decedent and to claims covered by insurance that are now found in PC § 550 et seq. and PC § 9350 et seq. Further clarification is needed on the issue of the matured unmatured debt and the need to file a creditor's claim. Perhaps a distinction can be made between non-tort claims (Borba), tort claims involving insurance (PC § 550 et seq.) and claims in litigation not involving insurance (PC § 9350 et seq.).

4. The Distributee's Liability for the Unmatured Debt

Potential distributee liability exists in two (2) situations.

If liability for a late-filed claim on an unmatured debt that has become a matured debt or on an unmatured debt for which a claim has been filed is established under PC § 9103, PC § 9103(d) provides that nothing in the subdivision limits the liability of a person who receives a preliminary distribution of property to restore to the estate an amount sufficient for payment of the distributee's proper share of the claim, not exceeding the amount distributed.

PC § 9392 also provides for distributee liability for the claim of a creditor, without a claim first having been filed, if: 1) the identity of the creditor was known to, or reasonably ascertainable by, a general personal representative within four (4) months after letters were first issued and the claim was not merely conjectural; 2) the PC § 9050 *et seq*. notice was not given and neither the creditor nor the creditor's attorney had actual knowledge of administration before the court made an order of final distribution and 3) the CCP § 353 statute of limitations has not expired. PC § 19400 *et seq*. provides similar rules within the trust context. In obtaining a beneficiary's approval in advance for a course of action vis-à-vis unmatured creditors, the beneficiary needs to be advised of potential distributee liability. Likewise, the personal representative needs to be advised that a distributee may proceed against the personal representative if the distributee suffers loss due to the personal representative's failure to give a required notice.

If the context suggests the likelihood of maturing creditors who could pursue a distributee, counsel will want to advise fiduciaries to advise beneficiaries of this possibility.

5. CCP § 353 As the "Great Protector"

CCP § 353(b) provides as follows: " ... if a person against whom an action may be brought on a liability

of the person, whether arising in contract, tort, or otherwise, dies before the expiration of the time limited for the commencement thereof and the cause of action survives, an action may be commenced within one (1) year after the date of death, and the time otherwise limited for the commencement of the action does not apply." The only way the statute of limitations may be tolled is as provided in PC § 9350 et seq. CCP § 353(d). The CCP § 353(b) statute of limitations does not apply to claims of public entities (PC § 9201), to actions to enforce liens (PC § 9391) or actions against the decedent's insurer which runs one (1) year from the date that the statute of limitations period would have expired without the death (PC § 553).

Code of Civil Procedure § 353(b) has been hailed as the "great protector" - i.e., as providing an absolute bar from claims upon the expiration of one (1) year from the date of death. In the context of the unmatured debt, the suggestion has been made that if there are, or may be, significant unmatured debts, the commencement of probate should be postponed until the expiration of one (1) year in order to acquire absolute protection from risk on such claims. Recommendation Relating to Notice to Creditors in Estate Administration, 20 Cal. L. Revision Comm'n Reports 507 (1990) at page 512, footnote 10 states as follows: "It should be noted that such an absolute one (1) year statute of

limitations creates the potential for the decedent's beneficiaries to wait for one (1) year after death in order to bar creditor claims, and then proceed to probate the estate and distribute assets with impunity. However, if the creditor is concerned that the decedent's beneficiaries may fail to commence probate within the one (1) year period, the creditor may petition for appointment during that time. Prob. Code §§ 8000 (petition), 8461 (priority for appointment)". See also CCP 353(b) Comment. One practitioner suggested delaying the publication of the obituary notice for a year.

In analyzing the scope of the § 353 protection, note must be taken that CCP § 353(b) speaks in terms of "... a <u>person against whom an action may be brought on a liability of the person</u> ..." (emphasis provided). In the context of the unmatured debt, the decedent would not appear to be a person against whom an action could be brought on a liability since, at the date of death, there was no basis for bringing an action. Although drafters of the proposal for the statute have informally stated to this writer that the intent was to include unmatured debts within the absolute one (1) year bar, this writer does not read the statute as written to apply since, at the date of death, the holder of an unmatured debt could not have brought a cause of action against the decedent-to-be. The Commission discussion in Recommendation Relating to Notice of Creditors in Estate Administration 20

Cal. L. Revision Comm'n Reports 507 (1990) at page 513, in discussing the scope of CCP § 353, states that the one (1) year limitation period "... would not apply to special classes of debts where public policy favors extended enforceability. These classes are (i) secured obligations, (ii) tax claims, and (iii) liabilities covered by insurance. The rare claim that may become a problem more than a year after the decedent's death is likely to fall into one of these classes." Thus, the Commission was aware that there could be a "rare" claim that becomes a problem after the one (1) year period. Note should be taken that, under PC § 551, CCP § 353 is expressly inapplicable to a decedent if the limitations period for liability covered by insurance has not otherwise expired.

If counsel concludes that CCP § 353(b) does not provide an absolute bar to the unmatured debt because the unmatured debt does involve an action that could have been brought against the soon-to-be decedent, then it will be important to close the estate as soon as the sixteen (16) month personal representative period expires or, in the alternative, as soon as the four (4) month claim period expires, subject to the fiduciary obtaining a secured indemnification agreement.

If counsel determines that CCP § 353(b) cuts off liability after one (1) year, will counsel want to defer

closing the estate for one (1) year? for sixteen (16) months?

The CCP § 353 bar is a critical issue. It should be clarified by the legislature.

6. The Surviving Spouse's Liability for the Unmatured Debt

The attorney advising the fiduciary on the issue of notice and unmatured claims (and on the parallel issue of whether, in the trust context, to initiate the PC § 19003 notice procedure), that involves an estate of a deceased married person, needs to consider the issue of the surviving spouse's liability for the "decedent's debts".

a. Funeral and Last Illness

In regard to the administration of estates, PC § 11446 provides that, notwithstanding any other statute, funeral expenses and expenses of last illness shall be charged against the estate of the decedent and shall not be allocated to, or charged against, the community share of the surviving spouse, whether or not the surviving spouse is financially able to pay the expenses and whether or not the surviving spouse, or any other person, is also liable for the expenses. In the trust context, PC § 19326 provides that, notwithstanding any other statute, funeral expenses and expenses of last illness, in the absence of specific provisions in the will or trust to the contrary, shall be charged against the deceased settlor's probate estate and, thereafter, against the deceased settlor's share of the trust

and shall not be allocated to, or charged against, the community share of the surviving spouse, whether or not the surviving spouse is financially able to pay the expenses and whether or not the surviving spouse or any other person is also liable for the expenses.

Query: If the surviving spouse pays these expenses and the beneficiary of the decedent's estate is someone other than the surviving spouse, has the surviving spouse made a taxable gift?

Query: If the soon-to-be decedent has significant medical expenses, should the soon-to-be decedent be advised to make a pre-mortem gift of all assets to the surviving spouse in order to protect the assets from the obligation to pay last illness expenses? Is such action in fraud of creditors?

Query: Does the soon-to-be surviving spouse waive the statutory protection as to his or her interest in the community property and quasi-community property and separate property by signing standard hospital agreement-to-pay forms?

b. Decedent's Debts

Chapter 3, entitled "Liability for Debts of Deceased Spouse," at PC § 13550 et seq., deals with the issue of the liability of the surviving spouse for the debts of the deceased spouse. This chapter falls under Part 2 entitled "Passage of Property to Surviving Spouse without Administration" of Division 8 entitled "Disposition of Estate

without Administration." See Attachment B for a copy of PC § 13550 et seq.

In an overly broad summary, PC § 13550 et seq. provide that the surviving spouse is liable for the debts of the deceased spouse to the extent of the deceased spouse's quasi-community property, community property and separate property that pass to the surviving spouse and the surviving spouse's quasi-community property and community property that belong to the surviving spouse, except to the extent these assets are subjected to administration and except for the PC § 13552 bar - e.g., creditor files timely claim in the decedent's estate.

More specifically, Chapter 3 provides as follows:

(1) PC § 13550 provides that, except for PC § 11446 funeral and last illness expenses, the surviving spouse is personally liable for debts of the deceased spouse chargeable against the property described in PC § 13551.

(2) PC § 13551 limits the surviving spouse's liability to the fair market value at decedent's date of death, less liens and encumbrances, of the assets that pass without administration - i.e.,:

(a) the surviving spouse's one-half (1/2) of the community property and quasi-community

property belonging to the surviving spouse and that isn't administered in the estate of the deceased spouse;

(b) the deceased spouse's one-half (1/2) of said property that passes to the surviving spouse without administration; and

(c) the separate property of the deceased spouse that passes to the surviving spouse without administration.

(3) PC § 13552 provides that, if there is a probate proceeding, any PC § 13550 action upon the liability of the surviving spouse is barred to the same extent as provided for under PC § 9000 <u>et</u> <u>seq</u>. except: a) creditors who commence judicial proceedings for the enforcement of the debt and serve the surviving spouse with a complaint prior to the expiration of the time for filing claims; b) creditors who have or who secure the surviving spouse's acknowledgement in writing of liability of the surviving spouse for the debts and c) creditors who file a timely claim in the proceedings for the administration of the estate of the deceased spouse. In the trust context, PC § 19330 has a similar barring provision.

(4) PC § 13553 provides that the surviving spouse is not liable under Chapter 3 - i.e. the chapter commencing with § 13550 and entitled "Liability for Debts of Deceased Spouse" if the surviving spouse administers the decedent's community property, quasi-community property

and separate property and the surviving spouse's interest in the community property and quasi-community property in the decedent's administration.

(5) PC § 13554 provides that, except as otherwise provided in Chapter 3, and subject to CCP § 353, any debt described in PC § 13550 may be enforced against the surviving spouse in the same manner it could have been enforced against the deceased spouse if the deceased spouse had not died.

Also relevant is PC § 11440 et seq., entitled "Allocation of Debts between the Estate and the Surviving Spouse," which, as its title indicates, provides a methodology for marital debt allocation. Interestingly, PC § 11440 refers to "a debt of the decedent" and "a debt of the surviving spouse."

The statutory scheme of Chapter 3 derives from former PC § 13550 et seq., added in 1986, and former PC § 649.4, added in 1983, and former PC § 205, added in 1974.

California estate administration "lore" suggests that, by undergoing a full probate of the decedent's assets and the surviving spouse's community property and quasi-community property assets, significant protections run to the surviving spouse. However, from a strict reading of the statute, the protection of the community property and

quasi-community property assets of the surviving spouse, is only for "... the debts of the deceased spouse" (emphasis provided). Chapter 3 does not speak in terms of the surviving spouse's separate and independent liability for "community property" debts and for torts arising out of a community activity. Therefore, although a "full probate" might cleanse assets as to the "debt of the deceased spouse," it is not certain that it would cleanse assets as to the surviving spouse's independent liability. For rules in the lifetime context governing the liability of spouses, see "Liability of Marital Property" CC § 5120.110 et seq. and § 5113, Nelson, Edward P., Creditors' Claims - Appendix entitled "Statutory Liability of Separate and Community Property for Debts Enforced after 1984" - in CEB, Decedent Estate Practice, and the new California Family Code, Chapter 162 of Statutes of 1992 and confirming revisions in Chapter 163 of Statutes of 1992, Part 3 - § 900 et seq. "Liability of Marital Property" effective January 1, 1994.

Former PC § 205 provided that the community property was liable for all valid and enforceable debts existing at the time of dissolution of marriage by death as were chargeable against the community property by the provision of Title 8 (commencing with § 5100) of Part 5 of the Civil Code. Such debts were to be chargeable proportionately against the interest of the surviving spouse in the community

property, the interest of the deceased spouse passing without administration and the interest of the deceased spouse subject to administration. The approach of PC § 205 was much clearer than that of PC § 13550 et seq. in that it spoke in terms of liability of the property rather than liability of the person and, importantly, it referred specifically to the Civil Code, which also speaks in terms of liability of property.

The case of Marriage of D'Antoni (1981) 125 CA3d 747, 178 CR 285 arose under former PC § 204. The case involved a claim by a former spouse of the decedent for a pre-marital alimony and child support obligation. The community property was confirmed to the surviving spouse. The trial court held that the debt was not incurred during marriage and, therefore, an action would not lie as to the community property. The appellate court reversed holding that the debt was a debt chargeable against the community property and, unless the interests of both spouses in the community property were administered, the entire community interest of decedent and a limited part of the surviving spouse's community interest (i.e. value of property at the date of death less the amount of any liens and encumbrances, to the extent not otherwise exempt from execution) were subject to decedent's debts.

Similar to the issue raised by PC § 13550 et seq. is one raised by CCP § 353. CCP § 353 only

speaks of a "deceased person's" liability being barred. Does this mean that CCP § 353 only bars the deceased spouse's liability and not the separate and independent liability of the surviving spouse for "community" debts and tort liability arising out of a community activity?

If the terms "debts of the deceased spouse," as used in PC § 13550, and "deceased person's liability" as used in CCP § 353 are interpreted to include the surviving spouse's separate and independent liability, then Chapter 3 would appear to afford protection to the entire community property and quasi-community property if the surviving spouse's interest in the community property and quasi-community property is administered with the decedent's entire community property and quasi-community property estate and CCP § 353 would appear to bar creditors from the surviving spouse's assets after the expiration of the one (1) year period.

Until there is an interpretation of the terminology "debts of the deceased spouse" as used in PC § 13550 and of "deceased person's liability" as used in CCP § 353, it is unclear what protection, if any, is achieved in regard to debts for which the surviving spouse is separately and independently liable by: 1) probating the deceased spouse's community, quasi-community and separate property; 2) probating the surviving spouse's community property and quasi-

community property and/or 3) using the trust settlement procedure except perhaps to provide protection to the surviving spouse as to debts and tort liability chargeable to the deceased spouse's separate property.

The issue for the practitioner to resolve is the meaning of the terminology "debts of the deceased spouse" as used in PC § 13550. In each case, counsel needs to determine the perceived protection and the potential risk of subjecting assets to administration and needs to discuss these matters with the fiduciary. Counsel will not want to have the surviving spouse unnecessarily subject assets to administration, particularly in the context of unmatured debts, or to initiate the PC § 19003 trust procedure with its mandatory notice provisions. On the other hand, if protection can be achieved, counsel will not want to overlook the opportunity to take advantage of the opportunity.

In order for attorneys to be able to advise their fiduciary clients and in order to advise surviving spouses, legislation should be enacted clarifying the following:

(a) whether the surviving spouse's independent CC § 5120.110 et seq. obligation for a debt, for which the deceased spouse was also liable, is discharged under Chapter 3 if the deceased spouse's estate assets and the surviving spouse's community property and

quasi-community property assets are probated?

(b) whether the surviving spouse's independent CC § 5120.110 et seq. obligation for a debt, for which the deceased spouse was also liable, is discharged under CCP § 353 if the deceased spouse's estate assets and the surviving spouse's community property and quasi-community property assets are probated?

It is critical to ascertain the degree of protection. If the surviving spouse's assets are not protected, then there would be no justification in the assets being administered as part of the deceased spouse's estate.

If the surviving spouse's interest in community and quasi-community assets can be protected through the trust administration creditor claim process, then this might justify the use of the discretionary PC § 19003 trust procedure.

IV. CONCLUSION

This writer believes that the arena of estate administration and the unmatured debt is a high-risk practice area. Counsel is urged to review the issues outlined in III.B supra and to develop her own "issue" lists and her own "strategies." The text of this paper has attempted to look at some tentative responses to the issues raised and at some possible strategies for counsel to consider. Before counsel

will be able to advise with some assurance and before fiduciaries/spouses and/or beneficiaries will be able to decide with some assurance, judicial and/or legislative answers are needed to the following basic questions:

A. does the fiduciary have a statutory duty to give notice to unmatured creditors?

B. does the bar of § 353 (b) apply to unmatured debts?

C. does the surviving spouse who engages in a "full" probate achieve protections as to the surviving spouse's separate and independent CC § 5120.110 et seq. liability for debts for which the deceased spouse was also liable?

D. does the bar of § 353(b) apply to the surviving spouse's independent CC § 5120.110 et seq. liability for debts for which the deceased spouse was also liable?

Without firm answers, counsel advising the fiduciary of an estate that has or may have significant unmatured claims may be creating unmatured claims of the estate against counsel.

ATTACHMENT A

APPENDIX

TRUST PROCEDURE REGARDING
CREDITORS OF DECEASED SETTLOR

A. Applicable Date

PC § 19000 et seq. applies to settlors whose death occurs on or after January 1, 1992.

B. Trust Asset Liability

PC § 19001 resolves to a limited extent the issue of trust asset liability in that it provides that, to the extent a trust is revocable by a settlor at the time of death, the corpus of the trust is subject to creditor claims and expenses of administration to the extent estate assets are inadequate. PC § 19008 provides that, if there is no probate administration and no PC § 19003 procedure (as hereinafter discussed), then the liability of the trust to creditors is "as otherwise provided by law." Thus, it would appear that, if there is no probate and no PC § 19003 procedure commenced by the trustee, a distributee of a trust would be liable if an action is brought within the CCP § 353 one (1)-year statute of limitations, subject to the exceptions to CCP § 353 or as a spouse.

C. Notice to Creditor Procedure - PC § 19003

PC § 19003 outlines a procedure whereby the trustee may activate a Notice to Creditor procedure ("PC § 19003

procedure"). Unlike the probate context, where notice to creditors is mandatory, the trust notice to creditor procedure is discretionary.

The procedure involves the trustee filing a Proposed Notice to Creditors with the court, obtaining a case number and publishing a Notice to Creditors and serving notice on creditors of the deceased settlor. PC § 19040 outlines the publication procedures. The procedure for giving notice to known creditors and for creditors filing or being barred, for the most part, tracks the probate procedure. The trust procedure may only be used if there is no probate procedure pending. Therefore, if the procedure is to be used, it must be commenced before probate is initiated. Only the trustee has the power to initiate the process. This should be compared with the probate procedure in which a creditor may initiate an estate proceeding. PC § 19006 provides that if there is a probate procedure, the estate protection from creditors runs to all trusts under which the decedent was the creator and to the beneficiaries, as well as to the estate.

PC § 19011 provides that the Judicial Council may prescribe the form and contents of the petition, notice, claim form and allowance or rejection form. The Los Angeles Daily Journal and the Metropolitan News have each developed PC § 19040 Notice to Creditors forms.

D. Trustee Liability

The trustee is not liable for failure to initiate a PC § 19003 proceeding. PC § 19010. Since there is no liability for failure to initiate the procedure and since the procedure is discretionary, it would seem that there could be liability exposure if a trustee initiates the procedure without the consent of all of the beneficiaries. Therefore, this author recommends that, before initiating a PC § 19003 proceeding, consideration be given to obtaining an indemnification agreement from each party who may be impacted. The reason for this will become more apparent from the discussion in this paper of the unmatured debt.

In addition, if a PC § 19003 proceeding is initiated, the trustee is exposed to personal liability to which the trustee would otherwise not be liable, as provided for in PC §§ 19050 and 19053. These provisions are similar to those in the context of an estate administration. If the PC § 19003 proceeding is initiated, the trustee is required to give notice to known creditors. PC § 19053 provides that the trustee is not liable to any person for giving notice if the trustee believe notice to a creditor is or may be required. The trustee is personally liable if the trustee fails to give a required notice and the creditor establishes: 1) that the failure was in bad faith; 2) that neither the creditor nor the attorney representing the creditor in the matter had actual knowledge of the proceedings and 3) within sixteen (16) months

after the first publication of notice under Section 19040, the creditor files a petition requesting the court to make an order determining the liability of the trustee and at least thirty (30) days before the hearing, serves the trustee with notice of the hearing. The trustee is not liable to the extent the claim is paid out of the trust estate.

As in the probate estate context, the statute relating to trusts expressly states that "nothing in this chapter imposes a duty on the trustee to make a search for creditors of the deceased settlor." In regard to the sixteen (16)-month rule, note should be taken that the period runs from the first publication, whereas in the probate context, the sixteen (16) months runs from the date letters were first issued to a general personal representative.

E. Filing Claims - PC § 19150 et seq.

The provisions for they timing of filing claims, including the filing of late claims, is similar to that in the estate administration context, except that the timing commences from the first publication of notice rather than from the issuance of letters.

F. Allowance and Rejection - PC § 19250 et seq.

These provisions spell out the power of the trustee to allow, reject, pay or compromise claims. The code specifically provides that, if the trustee or the attorney for the trustee is a claimant, the trustee has the power to allow,

reject, pay or compromise the claim. PC § 19252.

G. Petition for Approval and Settlement of Claims against Deceased Settlor - PC § 19020 et seq.

The statute outlines the procedure for the trustee or beneficiary to petition the court to approve the allowance, compromise or settlement of non-rejected claims and the allocation of amounts due among trusts. Note should be taken that this procedure is apparently not available if the claim has been rejected. This procedure cuts off late claims. Property distributed subsequent to the order settling claims is not subject to late claims. PC § 19103(d).

H. Petition for Instructions - PC § 17200

The trustee may petition for instructions in regard to matters relating to creditors. PC § 17200(20) specifically provides that the trustee may petition for instructions in regard to determining the liability of the trust for any debts of a deceased settlor. This procedure provides an alternative to the PC § 19003 petition proceeding and the PC § 19020 Petition for Approval and Settlement proceeding.

I. Summary

In summary, the PC § 19003 et seq. procedure seems to offer few benefits and creates potential problems. If initiated, notice must be given to creditors and this may result in the initiation of claims that otherwise would not be made.

The trustee is exposed to liability for failure to give notice that otherwise does not exist if the PC § 19003 procedure is not commenced. Finally, an estate administration procedure is more effective in that it protects the probate and trust assets, as well as any transfer on death property.

ATTACHMENT B

CHAPTER 3. LIABILITY FOR DEBTS OF DECEASED SPOUSE

Section
13550. Personal liability for debts chargeable against property.
13551. Limitation of liability.
13552. Limitation of actions.
13553. Exemption from liability.
13554. Enforcement of debt against surviving spouse.

§ 13550. Personal liability for debts chargeable against property

Except as provided in Sections 11446, 13552, 13553, and 13554, upon the death of a married person, the surviving spouse is personally liable for the debts of the deceased spouse chargeable against the property described in Section 13551 to the extent provided in Section 13551. *(Stats.1990, c. 79 (A.B.759), § 14, operative July 1, 1991.)*

§ 13551. Limitation of liability

The liability imposed by Section 13550 shall not exceed the fair market value at the date of the decedent's death, less the amount of any liens and encumbrances, of the total of the following:

(a) The portion of the one-half of the community and quasi-community property belonging to the surviving spouse under Sections 100 and 101 that is not exempt from enforcement of a money judgment and is not administered in the estate of the deceased spouse.

(b) The portion of the one-half of the community and quasi-community property belonging to the decedent under Sections 100 and 101 that passes to the surviving spouse without administration.

(c) The separate property of the decedent that passes to the surviving spouse without administration. *(Stats. 1990, c. 79 (A.B.759), § 14, operative July 1, 1991.)*

§ 13552. Limitation of actions

If proceedings are commenced in this state for the administration of the estate of the deceased spouse and the time for filing claims has commenced, any action upon the liability of the surviving spouse pursuant to Section 13550 is barred to the same extent as provided for claims under Part 4 (commencing with Section 9000) of Division 7, except as to the following:

(a) Creditors who commence judicial proceedings for the enforcement of the debt and serve the surviving spouse with the complaint therein prior to the expiration of the time for filing claims.

(b) Creditors who have or who secure the surviving spouse's acknowledgment in writing of the liability of the surviving spouse for the debts.

(c) Creditors who file a timely claim in the proceedings for the administration of the estate of the deceased spouse. *(Stats.1990, c. 79 (A.B.759), § 14, operative July 1, 1991.)*

§ 13553. Exemption from liability

The surviving spouse is not liable under this chapter if all the property described in paragraphs (1) and (2) of subdivision (a) of Section 13502 is administered under this code. *(Stats.1990, c. 79 (A.B.759), § 14, operative July 1, 1991.)*

§ 13554. Enforcement of debt against surviving spouse

(a) Except as otherwise provided in this chapter, any debt described in Section 13550 may be enforced against the surviving spouse in the same manner as it could have been enforced against the deceased spouse if the deceased spouse had not died.

(b) In any action or proceeding based upon the debt, the surviving spouse may assert any defense, cross-complaint, or setoff which would have been available to the deceased spouse if the deceased spouse had not died.

(c) Section 353 of the Code of Civil Procedure applies in an action under this section. *(Stats.1990, c. 79 (A.B.759), § 14, operative July 1, 1991. Amended by Stats.1990, c. 140 (S.B.1855), § 18.1.)*

Addition of this section by § 25 of Stats.1990, c. 79, failed to become operative under the provisions of § 36 of that Act.