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#L-1028 4/18/85

Second Supplement to Memorandum 85-50

Subject: Study L-1028 - Probate Code (Independent Administration)

Attached is a letter from Peter L Muhs, San Francisco probate lawyer, in support of the 1984 legislation that permits sales of real property under independent administration authority. This letter is one you must read.

Respectfully submitted,

John H. DeMoully
Executive Secretary

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April 9, 1985

California Law Revision Commission
4000 Middlefield Road, Room D-2
Palo Alto, California 94306

Re: Proposal to Reinstitute Mandatory Confirmation of Estate Sales of Realty - Probate Code Section 591.3, et al

Dear Commission Members:

I am a partner in the San Francisco law firm of Cooper, White & Cooper and have specialized in the fields of estate planning, probate and taxation for over ten years. I understand from information circulated by Jerome Sapiro, Esq., of San Francisco that a proposal (of which he is a principal supporter) is on the calendar for your May 16-17, 1985 meeting to rescind the amendments to The Independent Administration of Estates Act allowing action without court supervision for certain real property sales, exchanges, and grants of option in probate matters.

I strongly support the Probate Code changes in this area which were made in 1984, removing court supervision in the circumstances which meet the new provisions, and oppose the attempt to return to the former system of mandatory court supervision. My reasons for opposition are as follows:

1. Most sales of real property are financed by institutional lenders. In my experience, most offers to buy real property, whether within or without probate, initially are presented subject to a financing contingency. A sale subject to a financing contingency for a probate property is almost never presented to the court for approval because of the danger that the buyer may not meet such a contingency (thereby requiring another noticed proceeding to vacate the sale order). Instead, the estate normally insists that any financing contingency be removed prior to return of a sale for confirmation. Institutional lenders, on the other hand, normally refuse to make any commitment until a firm sale

contract is in place. In the probate situation under court confirmation, such a contract occurs only after the court has confirmed the sale. As a result, either the buyer must be overqualified financially (in which case he or she may not object to assuming the financing risk), or the buyer must assume the risk, even though not advisable for him to do so. The buyer in the latter situation may very well decide to withdraw his offer. This has a tendency to limit the market on probate sales (including potential overbidders) by eliminating those buyers who might qualify for the necessary financing but who cannot afford to risk that, for some undetermined reason, they will not qualify for the loan in their lender's eyes or the property will not be appraised at a sufficient value to qualify for the loan needed to close the sale.

2. Other contingencies which would be unacceptable for court confirmation, but which might be workable without confirmation, include the situation where a contract is made contingent upon the sale of another property at a specified price, but with a limited time ("48 hour") escape clause in favor of the seller within which the buyer must waive the contingency or else allow the seller to sell the property to another, new prospect. Again, this type of contingent sale contract is never, in practice, confirmed in court because of the costs of vacating an uncompleted sale.

3. The overbidding process in court, when expected by all potential purchasers, tends in my observation to reduce the price which a purchaser is willing to pay on a negotiated basis. I believe this occurs because buyers psychologically believe they can obtain a bargain in a probate sale and because, in the overbid situation, the original buyer usually may increase an overbid by a relatively nominal percentage and still obtain the property. Thus, if the original bid is so low as to attract overbids, the original bidder may still have the opportunity to make his highest offer. While there is no guarantee that a negotiated sale will in fact result in a higher price, there is no necessary reason why a negotiated sale, which is the way most real property is sold, should prove inferior to sellers than a court confirmed one.

4. In the event that either the personal representative or any of the affected beneficiaries desires court confirmation, with the resulting overbid process, that party now can require the estate to use court confirmation process. Thus, the 1984 amendments do not prohibit court confirmation proceedings. The advice of proposed action, under Section 591.4 as amended, must be specific and must indicate to the affected beneficiaries that court

confirmation may be requested either directly of the executor or through filing of a more formal court document. To the extent that an executor breaches an obligation to confirm a sale in court when a beneficiary requests such confirmation, the appropriate remedy is surcharge of the executor (for which the law provides for protection of the beneficiary through the surety bond procedures). It is overkill to use beneficiary complacence to justify requiring every probate sale of real property to be subject to court confirmation. Incidentally, in light of the amendments to Section 591.2 et seq., the bond amount in Section 541 should be increased to include real as well as personal property, at least in those situations where the estate is administered under independent administration.

5. In many estates, an informal alternative to probate court confirmation has been preliminary distribution of the real property followed by private sale by the beneficiaries. While sometimes workable, this is less desirable than private sales under independent administration because the latter can be accomplished more expeditiously and also can be done prior to the period for which preliminary distribution is allowable (two months after Letters are issued for distributions with bond, or four months without bond). With private sales under independent administration, the selling expenses remain the estate's and thus potentially deductible for federal estate tax purposes if the sale is necessary to raise funds for debts, death taxes or administration expenses. In addition, the funds remain in the estate for general estate purposes, including payment of debts, death taxes and funeral expenses. Previously, with sales following preliminary distribution, if funds were needed by the estate, they were often loaned back to the estate by the beneficiaries on a Crown (interest-free) loan basis. With the 1984 changes in the Internal Revenue Code, instituting Section 7872, the income tax consequences of any below-market loans are significant. Loans bearing market-rate interest cause the estate additional negative cash flow and income tax problems in its administration.

6. The questions of unethical, illegal or improvident action by an executor, raised in support of subjecting all estates to court supervised sales, are better addressed in provisions dealing with unethical, illegal or improvident acts. To the extent that there is any question, the new advice of proposed action form clearly states that the beneficiary may require court-supervised proceedings. If this remains an area of concern, a form of notice explaining the rights of beneficiaries could be statutorily enacted and included either with the initial probate notice or in an expanded advice of proposed action.

The foregoing comments, while phrased in connection with real property sales, also apply to exchanges and to grants of options. In an area where the trend is toward expeditious private settlements at more moderate cost, it is inappropriate to reverse the 1984 legislation allowing sales without confirmation by re-instituting a relatively expensive and time consuming process on a mandatory basis.

Thank you for your consideration of my comments.

Sincerely,

Peter L. Muhs

PLM:wpc

cc: Jerome Sapiro, Esq.
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