#L-1010

0082b
2/5/86

Memorandum 86-23

Subject: Study L-1010 - Estates and Trusts Code (Opening Estate Administration--notice to creditors)

The Commission has reserved until now the issue of whether actual (as opposed to published) notice must be given to creditors at the opening of estate administration. The issue has assumed major importance because of recent high court decisions indicating a possible failure of due process where actual notice is not given to creditors whose claims are cut off in the probate process.

The Executive Committee of the State Bar Estate Planning, Trust and Probate Law Section is sharing with the Commission a report prepared for it concerning the constitutionality of California's creditor notification. The report is attached to this memorandum. The report analyzes the due process notice problem, and discusses the legal and practical aspects of three possible approaches to the problem:

(1) Require actual notice to known creditors, as well as investigation and discovery of such creditors as are reasonably ascertainable.

(2) Require actual notice only to creditors actually known to the personal representative.

(3) Do nothing.

Policy arguments concerning each approach are set out in the report.

The Editorial Board of the Uniform Probate Code has considered this matter and is recommending that the Uniform Law Commission adopt amendments to the Uniform Probate Code to require that the personal representative, in addition to publishing notice, "promptly send a copy of [the published] notice or a similar notice to any creditor known to him, or who should reasonably be known to him, at the time of publication." Under these amendments, a creditor's claim would be cut off, as usual, at the end of the 4-month creditor claim period following publication of notice. However, if actual notice was not

App. 2d 639, 645-46, 220 P.2d 805 (1950) (attorney and client); Committee of Missions v. Pacific Synod, 157 Cal. 105, 127, 106 P. 395 (1909) (church); Schwab v. Schwab-Wilson Machine Corp., 13 Cal. App. 2d 1, 3, 55 P.2d 1268 (1936) (corporate directors). See also Civil Code §§ 2322 (authority of agent), 5103 (spouses' duty in transactions with each other); Corp. Code § 309 (performance of duties by corporate director.

> Subdivision (b) is also intended to recognize that the courts have the inherent power to fashion appropriate remedies under the circumstances and that this power in the area of confidential relationships does not depend upon the particular language of former Civil Code Sections 2215-2244. See Civil Code § 22.2 (common law as law of state); see also Prob. Code § 15002 (common law as law of state). Of course, the effect of former law as to trusts now governed by the Trust Law is not continued. See Sections 82 ("trust" defined), 15001 (application of Trust Law).

As explained in the second and third paragraphs of the draft comment, subdivision (b) is needed to resolve any doubt that might arise in the future about the effects of repealing most of the Field Code provisions relating to trusts. While there should be no serious problem, it is possible without a provision like this one that someone involved in litigation may be tempted to argue that traditional fiduciary principles no longer apply to him.

If this proposed provision is approved, we will amend AB 2652 to implement the change and prepare a revised comment for approval by the legislative committee.

Respectfully submitted,

Stan G. Ulrich

Staff Counsel

11/12/85 draft

TO: Executive Committe

FROM: Janet L. Wright and Joe Click

RE: Constitutionality of California's Creditor Notification

CURRENT LAW

Cal. Probate Code § 333 requires notice by publication of probate proceedings. Cal. Probate Code § 700 provides that publication of notice pursuant to § 333 "shall . . . constitute notice to the creditors of the decedent, requiring all persons having claims against the decedent" to either file them with the Probate Court or present them to the personal representative of the estate "within four months of the first issuance of letters . . ." Cal. Probate Code § 707 provides that all claims by creditors against the decedent or the estate must be filed or presented "within the time limited in the notice . . ." or be forever barred, unless the claim falls within certain express statutory exceptions specified in § 707 (creditor out of state) and § 709 (claim based on pending action).

The above summary of present law applies only to a decedent's unsecured debt. Secured debt follows the asset, to which the security interest has properly attached, through the probate proceedings and into the beneficiary's hands.

Problems with Present Law

Mullane v. Central Hanover Trust Co., 339 U.S. 306 (1949) is regarded as providing the general due process standard for the adequacy of notice to parties whose interests may be affected with finality in judicial proceedings. The notice must be "reasonably calculated, under all of the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections."

Until recently, states have not considered the Fourteenth Amendment Due Process clause or Mullane as presenting any problems for noticing a creditors by publication in probate proceedings.[1] However, recent action by the United States Supreme Court has called into question the constitutional adequacy of notice by publication in probate proceedings. In Mennonite Board of Missions v. Adams, ___ U.S. ___, 130 S. Ct. 2706, 77 L. Ed. 180 (1983), the Court held that statutory provisions for notice by publication of a tax sale of real property were insufficient as to the holder of a properly recorded mortgage on the property.[2] The Court stated that "[n]otice by mail or other means as certain to ensure actual notice is a minimum constitutional precondition to a proceeding which will adversely affect the liberty or property interests of any party . . . if its name and address are reasonably ascertainable."[3] Shortly thereafter, the Court granted certiorari in Continental Insurance Co. v Moseley (a Nevada Supreme Copurt decision holding that notice by publication in probate proceedings satisfied the Mullane standard), vacated the judgment, and remanded the case for consideration in light of Mennonite.[4] On remand, the Nevada Supreme Court held that, in light of the estate's actual knowledge of the creditor's claim (the claim had been listed on the inventory by the adminstrator), due process required more than notice by publication.[5]

PROPOSED RESPONSES TO RECENT DEVELOPMENTS

A. Proposed Amendment of Probate Code — Option #1.

An expansive interpretation of the Mennonite/Moseley remand is that the personal representative is not only required to provide notice other than by publication to a decedent's known creditors, but also is required to investigate and discover such creditors as are reasonably ascertainable. To accommodate this interpretation, the following amendments of the Probate Code are proposed.

1) Amend § 600 to read:

> "(a) Three months . . . [keep all of the language currently found here] . . . if timely requested by the assessor.
>
> (b) The inventory shall include:
>
> (1) all the estate of decedent . . . [keep all of language of the rest of current § 600]; and

(2) all unsecured debts of the decedent, including the name and address of the entity to whom such debts are owed, of which the executor or administrator has acquired actual knowledge through the inspection of decedent's affairs while compiling the schedule of assets, unless such debt has been fully paid or has been filed with the court or presented to the executor or administrator."

2) Add § 700.2 or § 701 as follows:

"If, after the filing of the inventory and appraisal pursuant to section 600, there appears to be any creditor of the estate described in section 600(b)(2), the court may order notification of such creditor, by certified mail return receipt requested, within five (5) days of the filing of the inventory and appraisal. The notice shall inform the creditor that he or she has 30 days after receipt of the notice, as evidenced by the date of receipt posted on the return receipt, to file a claim with the court; and failure to file a claim within such period shall result in the claim being forever barred."

3) Add to § 707:

"(d) Any claim of any creditor who has received notice pursuant to [§ 700.2] [§ 701] which has not been filed with the court within 30 days of receipt of such notice, as evidenced by the date of receipt posted on the return receipt, shall be forever barred, notwithstanding the provisions of subdivision (a) of this section or § 709.

Option #1 is similar to the approach currently under study by both the State Laws Committee ("should reasonably be known to him") and the California Law Revision Commission ("reasonably ascertainable by him"). For comments on these variations of this proposed response, see Appendix.

B. Proposed Amendment of Probate Code -- Option #2.

A less expansive interpretation of the Mennonite/Moseley remand would not place an affirmative duty on the personal representative to search for creditors, but would require him only to provide notice (other than by publication) to those creditors whose claims are actually known to him. To accommodate this interpretation, the following amendments of the Probate Code are proposed:

1) Amend § 700 to add:

"(d) Notwithstanding subdivision (a) of this section, if the personal representative acquires actual knowledge of a debt of the decedent prio to [the expiration of the statutory filing period] **or** [the filing of th petition for final distribution], by means other than the filing of suc claim with the court by the creditor or presentation of the claim to th personal representative by the creditor, the personal representative shall, by certified mail return receipt requested, send notice to the creditor of decedent's death and the petition to administer the estate. The notice shall inform the creditor that he or she has 30 days after receipt of such notice, as evidenced by the date of receipt posted on the return receipt, within which to file a claim with the court; and failure to file a claim with the court shall result in the claim being forever barred."

2) Amend § 707 to add:

"(c) Any claim of any creditor who has received notice pursuant to § 70(subdivision (d) which has not been filed with the court within 30 days of receipt of such notice, as evidenced by the date of receipt posted o the return receipt, shall be forever barred, notwithstanding the provisions of subdivision (a) of this section or § 709."

For comments to this proposed Option #2, see Appendix.

C. Keep the Statutory Scheme In Tact — Option #3

A narrow interpretation of the remand would support the position that California's provisions for notice in probate proceedings are constitutionally adequate. This interpretation could be justified by the unusual facts of Mennonite and Moseley, the special circumstances surrounding the probate process, and features of current California Law.

1) Mennonite and Moseley

These cases involved peculiar facts. In fact, Mennonite did not even involve probate, but a tax sale. It only makes sense that in the context of a disposition of property conducted by the state itself, which purports to wipe clean all other interests in the property, due process requires the state to check its own efficiently kept records to determine just whose interest will be affected and notify affected parties. This is especially true when the party involved is a secured creditor and not an unsecured creditor, as in the probate context.

Likewise, the facts of Moseley were unusual. The creditor in that case (the plaintiff in a pending legal action) was not only known to the personal representative, but was listed as a creditor in the petition for probate. The personal representative made no attempt to settle this recognized claim. Although the Nevada court did not say so, one could argue that, since the personal representative had knowledge of the claim, there was constructive notification. In addition, the representative was using a recently enacted summary proceedings in which the period to file claims had been substantially reduced, which could be deemed to be "unreasonable under the circumstances."

These situations need to be contrasted with the special circumstances of probate and California notice provisions in particular..

2) Features of Current California

In Moseley, the Nevada statutory scheme did not contain a savings provision. Savings provisions are a current feature of California Probate law. § 707 itself saves claims of those who did not receive notice because they were out of state.[6] § 707 refers to § 709, which is a fairly liberal savings provision for claims based on actions pending against the decedent at the time of death.[7] Furthermore, California summary proceedings do not extinquish creditor rights. As a consequence of these two features, the problem in Moseley would be nonexistent in California.

3) Special Circumstances of Probate

The personal representative in probate usually has his or her hands full just determining what assets the decedent left. He or she is usually the person in the worst position to know of the decedent's debts. On the other hand, creditors know who owes them money, though they may not know, on their own, of a debtor's demise. Published notice in probate is the best way to accommodate the differences in knowledge of the personal representative and creditors. For the sophisticated creditor, such as a large lending institution, publication may often be effective:

the creditor's receivables department may generally read published legal notices and, by aid of computer, match debtors with decedents. As to less sophisticated creditors, the amounts due are likely to be small and short term; a monthly bill will be sent to decedent's address, and taken care of by the personal representative. Creditors not falling into either of these categories are not likely to be reasonably ascertainable. Thus, published notice sufficiently meets due process requirements.

1. Recently, the Nevada Supreme Court has held that notice by publication in probate proceedings satisfies the Mullane standard. See Continental Insurance Co. v Moseley, 98 Nev. 476, 653 P.2d 158 (1982). The Montana Supreme Court had gone even farther, holding that Mullane doesn't even apply to probate proceedings. See Baker National Bank v Henderson, 445 P2d 574 (Mont. 1968).

2. Petitioner Mennonite Board of Missions (MBM) was the holder of a properly recorded mortgage on real property located in Indiana. The purchase agreement required the owner to pay all property taxes. The owner failed to pay the taxes. Pursuant to Indiana law, the property was sold at a tax sale after notice by certified mail was sent to the owner, and published in a local newspaper. Indiana law provided that after a statutory two year redemption period, the tax sale purchaser acquired a deed free of all liens and encumbrances. Since the owner continued to make payments on the debt, MBM did not learn of the tax sale until after the redemption period had run. MBM contested the tax sale at a statutorily prescribed quite title action brought by the tax sale purchaser, contending that Indiana's statutory provision for published notice violated the Fourteenth Amendment's Due Process clause.

3. ___ U.S. at ___, 103 S. Ct. at ___, 77 L. Ed. at 188 (emphasis in original).

4. Continental Insurance Co. v. Moseley, ___ U.S. ___, 103 S. Ct. 3530, ___ L. Ed. ___ (1983).

5. Continental Insurance Co. v. Moseley, 683 P.2d 20 (1984).

6. The claim must be filed within one year of the expiration of the statutory filing period and before the petition for final distribution.

7. § 709 gives the court authority to allow the filing of these claims on just and equitable terms. The claimant must not have had actual knowledge of decedent's

death more than 15 days prior to the expiration of the statutory filing period, and must be filed within a reasonable time after discovery of death, up to one year after the expiration of the filing period and before the filing of the petition for final distribution.

APPENDIX

<u>Comments to Proposed Amendment of Probate Code — Option #1</u>.

The State Laws Committee has interpreted the cases broadly and recommended amendments to the Uniform Probate Code's notice provisions. Specifically, the Committee's report recommends adding an additional sentence to UPC § 3-801 [Notice to Creditors]:

> "The personal representative shall also promptly send a copy of the notice or a similar notice to any creditor known to him, or who should reasonably be known to him, at the time of publication."

We feel our proposal to accommodate such an expansive reading of the cases to be preferable to the proposed UPC changes for several reasons.

1) Requiring notice by mail to creditors "who should reasonably be known" to the personal representative implicitly places a duty to investigate the decedent's affairs for creditors. The problem raised is, "What or who is a creditor who should reasonably be known?" Another way of stating the problem is, "What is the scope of the duty to investigate placed on the personal representative?" The fear is that conservative personal representatives will drive up the cost of probate by leaving no stone unturned in their search for debts.

2) The proposed changes to the UPC require notice to be mailed "promptly." Thus, the requirement is not clear. One possibility is that the words "at the time of publication" work as an adverbial phrase to modify "promptly." The problem with this reading is that publication, in California, occurs shortly after the filing of the petition for probate. At this point the personal representative is likely to know of only a few, if any, creditors. The problem remains the same if "at the time of publication" works as an adjective phrase modifying known creditors, or creditors who should reasonably be known.

3) Assuming conservative personal representatives will do an extensive investigation for creditors, succeed in finding a number of creditors, and notice them "promptly . . . at the time of publication," this may be a waste of time and money.

We feel our proposal gives more guidance to personal representatives in all three problem areas.

1) Working on the theory that liabilities follow assets, our proposal is designed to limit investigation. The duty is to keep one's eyes open for debts that come to one's attention in the course of performing the sometimes immense task of searching for assets. The scope of the investigation for debts is co-extensive with the investigation for assets. One does not need to check the shoe boxes in the closet to see if there's a hidden promissory note.

2) Our proposal leaves no question as to when notice must be mailed: within X number of days of the filing of the inventory. There should not be any litigation by personal representatives and creditors as to whether notice was mailed "promptly." Our proposal does require the more costly use of certified mail. However, we feel this could actually be a money saver for several reasons. First, certified mail will provide proof of receipt of notice, thus eliminating litigation by creditors who received notice by regular mail, but claim they did not receive it. Second, it provides an easily verifiable way to determine the beginning and end of the 30 day filing period. Finally, since the parameters of the 30 day filing period are easily verifiable and eliminate the savings provisions of § 707 and § 709, creditors will be forced to move quickly, thus shortening the time of the probate process by having claims promptly filed or forever barred.

3) Under the UPC proposal, conservative personal representatives may drive up the cost of probate by mailing dozens of notices. Our proposal allows the published notice to do whatever service it can and allows monthly creditors to present bills before money is spent on notice.

Comments to Proposed Amendment of Probate Code — Option #2

The goals of these proposed amendments are to:

— Lighten the cost of probate administration by keeping intact the relatively less expensive provisions of published notice applicable;

— Facilitate the expediency of probate by keeping intact the claim barring provision of § 707 as to known creditors;

— Keep intact the equitable savings provisions of current § 707 and § 709 for the unknown creditors contemplated by those sections; and

— Provide the constitutionally required notice for those creditors who become known but could not have been expected to file claims with the court or present claims to the representative within the four-month filing period.

The alternate language of the proposed amendment to § 700 (on page 4 of the Memo) would provide notice either to creditors who become known during the four month statutory period or to creditors who become known prior to final distribution. Arguably, the provision for notice to these types of creditors should apply only to those creditors whose claims become known within the four month statutory filing period: if the creditor did not file a claim within that time and was not notified by mail because unknown, why give him the benefit of the doubt after the filing period has expired, but bar the claim of a creditor who presents a claim; i.e., bar the claim of a more diligent, albeit late-filing, creditor? Thus, it may be desirable to limit the requirement for notice by certified mail to those who become known during the four month period.

If the four month provision is adopted, it may be desirable to add another savings provision as to one certain type of creditor. The creditor that comes to mind here is the one who could not reasonably be expected to file a claim within the four-month period. For example, suppose a creditor loans money to debtor on January 1, taking back a promissory note for principal and interest due in full on December 31 of the same year. Debtor dies at any time before September 1 of the same year.

If the decedent threw away or lost his copy of the note, the personal representative might never discovery the debt. A savings provision might be added to § 707 to cover this narrow situation, much in the same manner as is currently available for an out of state creditor. If the alternate langague of the proposal is adopted (i.e. becomes known prior to final distribution) a savings provision is not necessary.