#L-1025 nsl2
11/19/86

Third Supplement to Memorandum 86-202

Subject: Study L-1025 - Creditor Claims (Comments on Notice to Creditors)

Sections 9050-9054 of the creditor claims draft implement a procedure for service of notice of death on creditors the personal representative has actual knowledge of. Comments concerning this draft are analyzed following the provisions to which they relate in the draft.

Before the Commission prepared the creditor claims draft, however, the Commission publicized (in connection with the opening estate administration tentative recommendation) its proposal that actual notice be given to creditors and solicited comments and suggestions concerning this proposal. The Commission has received a number of comments and suggestions in response to this solicitation, though not directed to the creditor claims draft. The comments and suggestions are summarized in this supplementary memorandum.

General Reaction

Of the 35 letters we received commenting on the opening estate administration tentative recommendation, 22 either generally approved the tentative recommendation without singling out the creditor notice proposal or criticized other aspects of the tentative recommendation (implying approval of the creditor notice proposal).

Oppose. Of the 13 letters that addressed the creditor notice proposal specifically, 4 were opposed to drafting implementing legislation:

--A subcommittee of the Probate Section of the San Mateo County Bar Association states, "We believe the proposed recommendations put an entirely unnecessary burden on the personal representative."

--David B. Flinn of San Francisco states that in the vast majority of estates "the family is solvent, it is everyone's intention to pay all of the creditors, they do get paid, and the cost and confusion of sending a special notice of probate to them is totally unnecessary.

--John G. Lyons of San Francisco is inclined to do nothing, since his hunch is that the Supreme Court would distinguish probate from the Mennonite situation, which involved a tax sale where the mortgage was recorded with the name of the mortgagee visible on the record.

--Ian D. McPhail of Santa Cruz is also strongly opposed since probate reform should streamline and simplify the system and make it less mysterious and less expensive. "Creditors are already too well protected under probate rules. I suggest that they do not need any added protection which makes even more difficult and more time consuming the work of the attorney and executor."

Support. The other 9 letters specifically addressing the issue either supported actual notice outright, or saw it as a necessary evil and suggested ways to make it workable.

Unqualified support included:

--Charles E. Ogle of Morro Bay. "I specifically endorse the procedure regarding notice to known creditors and to creditors who become known, etc."

--Elizabeth R. McKee of Richmond. "I would also recommend that actual notice, as opposed to relying only on published, be given to known creditors ... a lot of creditors do not read legal notices usually published in newspapers that have a limited general circulation and customarily used by attorneys."

Beryl A. Bertucio's (Matthew Bender) comment adequately sums of the views of the reluctant supporters: "Personally, I agree with the dissent in Mennonite Board of Missions v. Adams (1983) 462 US 791, 77 L Ed2d 180, 103 S Ct 2706, especially for commercial creditors who normally have search services checking legal notices. Nevertheless, since the majority opinion is now the law, it seems imprudent not to change the notice requirements to reflect it."

We also received a reminder from California Newspaper Service Bureau, Inc., that there can be no question that actual notice is superior to a notice published in a newspaper (constructive notice) when everyone entitled to notice can be reached by mail or personal service and that the Bureau does not question the Mennonite opinion; however, "it is important that all creditors, especially where there may be unknown creditors, have an opportunity to read a notice in their newspaper, either directly themselves, or indirectly because a friend brought the notice to their attention."

Analysis. The staff agrees with the general comments in support of actual notice and disagrees with the general comments opposed to actual notice. We think there is no question that due process of law requires reasonable efforts to notify creditors and that mere publication of notice is not a reasonable effort if the personal representative has actual knowledge of a creditor. We agree with the opponents that actual notice will complicate probate and make it more expensive, and that in most cases the notice is not necessary. Our task must be to devise a system that will hold down the complexity and cost as much as possible while still satisfying due process requirements. Most of the commentators offered suggestions on how this could be accomplished, which are reviewed below. We believe the the draft statute the Commission has developed comes close to achieving these objectives, and that the opponents might not be so opposed when they see the draft that finally evolves.

Specific Comments

Persons to whom notice must be given. How is a "known creditor" defined to whom notice must be given? Initially, as the Kern County Bar Association Probate and Estate Planning Section points out, the creditor must be known to the personal representative; the decedent's knowledge is irrelevant. The Commission's draft does this.

There was some sentiment in the letters to except certain creditors from the notice requirements. As Beryl A. Bertucio of Matthew Bender points out, trade creditors normally have search services checking legal notices. The Kern County group discussed this possibility also, on the basis that publication would likely constitute sufficient notice for trade creditors. They note, however, that Mennonite required actual notice even though many mortgagees would be considered sophisticated creditors. "Trade creditors, however, might well be considered to constitute a class entirely composed of sophisticated creditors, for whom published notice might be sufficient."

The staff does not believe a trade creditor exception should be made, for several reasons:

(1) Trying to define "trade creditor" in an adequate manner will be difficult, and will probably cause more trouble than it saves.

(2) Under the Commission's draft, notice need not be given to any creditor that makes a claim in probate. Since trade creditors are the type of creditor which will make a claim in the ordinary course of administration after publication of notice, it will not be necessary to give them notice. Hence, they are already excepted, in effect, though by an indirect means.

(3) It is not clear that a trade creditor exception would be constitutional in any event.

Demorest, Notice Requirements in California Probate Proceedings, 66 Cal. L. Rev. 1111 (1978), raises the issue of the administrative burden of providing creditors with mailed notice, and the argument that sophisticated lenders are not constitutionally entitled to mailed notice. "The statute might provide that banks, licensed personal property brokers, and other commercial lenders be entitled only to published or posted notice, while other creditors must be given mailed notice." 66 Cal. L. Rev. at 1124. The article concludes that such a scheme would be undesirable, for the basic reasons noted in connection with trade creditors generally. "The statute should not attempt to differentiate creditors." 66 Cal. L. Rev. at 1124.

Rawlins Coffman of Red Bluff suggests that actual notice not be required for any of the following: public utilities serving the decedent's home, debts less than $20, unliquidated claims, and secured creditors.

As to utility bills, the staff sees no need for an exception; such bills will be presented monthly or bimonthly, and the personal representative will have the option to give notice or simply pay them informally without requiring a claim, which the Commission's draft permits for small bills. See Section 9153 (waiver of formal defects).

As to debts less than $20, the argument evidently is that the transactional cost of sending notice is too great compared with the amount of the debt. This argument has some attraction, though the small creditor is likely to be just the person we are trying to protect through the actual notice requirement--one who doesn't see the published notice but to whom the debt may be important. At some point it becomes de minimis, however, and perhaps $20 is not a bad place to draw the line on notice.

In this connection it is worth noting that the Demorest article also raises the possibility that "A dollar threshold might require mailed notice only to creditors with claims of, for example, $1,000 or less." 66 Cal. L. Rev. at 1124. The article notes, however, that this would force the personal representative to classify creditors or to liquidate all of their claims. "This would create a large administrative burden. Because the reason for distinguishing between creditors in the first place was to ease the administrative burden of giving notice, the revision would be counterproductive." 66 Cal. L. Rev. at 1124.

Unliquidated debts have given the Commission some trouble in the past--potential malpractice claims, etc. We have tackled this problem in the draft by defining a creditor as one who has demanded payment. Thus unliquidated debts would be included, but only if the creditor has made the debt known. The staff believes this is a sound solution to the problem.

Secured creditors are as worthy of protection as unsecured creditors, in the staff's opinion. The security may be inadequate, or the creditor may waive the security and be classed with general creditors. The staff would not create this exception.

Time within which notice must be given. The Commission's general proposal was that the personal representative give notice to creditors who became known "in the course of preparing the inventory." A number of commentators found this standard unsatisfactory, and suggested instead that notice be given to creditors who became known within the standard 4 month claim period. This point was made by both Charles G. Schulz of Palo Alto ("I am in favor of requiring the personal representative to mail a Notice of Hearing to creditors the names of which come to the representative's attention in the ordinary course of dealing with the decedent's affairs until the time for filing Creditor's Claims is closed. ... I would delete the reference to 'preparing the Inventory' because this is too vague.") and Florence J. Luther of Fair Oaks ("limit the definition of a 'known creditor' to someone who is known to the personal representative within four months from the date of the appointment of the personal representative.") In fact, the Commission's draft in Section 9050 does just this, requiring notice to creditors known to the personal representative within four months after issuance of letters.

Manner of service of notice. Charles G. Schulz of Palo Alto and Elizabeth R. McKee of Richmond both suggest that service of notice be by mailing. The Commission's draft does not specify the manner of service required, but it assumes or anticipates that mailing is perfectly adequate and personal service is not required. The general notice provisions will make clear that notices such as this may be mailed. If the general notice provisions do not make this clear, we will supplement the creditor notice with a provision that states expressly that service may be by mailing.

Proof of service. Elizabeth R. McKee of Richmond suggests that proof of service accompany the notice to the creditor so that the creditor will know the precise date on which the time to make a claim will expire. The Commission's draft already incorporates this concept. See Section 9052 (form of notice).

George F. Montgomery, II, and Dena Burnham Kreider of San Francisco comment, "It seems unduly burdensome to require the personal representative to report the names and addresses of all the creditors to the court along with proof of service of notice to those creditors. One possible improvement would be to require that the personal representative (1) file a list of the known, unpaid debts of the decedent and (2) give actual notice to the creditors listed there." The staff believes, however, that because property rights may be cut off by the giving of notice, proof of service should be required.

Time for creditor to make claim. The proposal concerning which the Commission solicited comments included the following feature--"Creditors given actual notice would have 30 days in which to make a claim before being barred." The 30-day cutoff caused substantial concern among commentators. Beryl A. Bertucio of Matthew Bender observes that most companies are on 30 day billing cycles, and that for some creditors it would be impossible to ascertain the balance owing within 30 days. "For instance, hospitals often must await bills from staff physicians or do await insurance reimbursement before they make up their own bills; airlines are notoriously slow in forwarding charges to credit card issuers." Charles G. Schulz of Palo Alto also remarks that "a creditor should not have to respond within 30 days."

Both Bertucio and Schulz, as well as the Kern County Bar and George F. Montgomery, II, and Dena Burnham Kreider of San Francisco, propose that the 30 day response requirement be integrated with the 4 month standard creditor claim period, so that "the response should be before the end of 4 months, or 30 days after notification, whichever is longer." This is the system the Commission has adopted in its draft. See Section 9100 (claim period).

Role of publication. The Commission's draft preserves newspaper publication along with actual notice. The staff believes that due process requires publication along with actual notice in order to cut off claims of unknown creditors. We agree with the California Newspaper Service Bureau, Inc., on this point.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary