

First Supplement to Memorandum 88-49

Subject: Study L-1025 - Probate Code (Notice to Creditors--State Bar team response to staff analysis of Tulsa problem)

Memorandum 88-49 presents an analysis of the constitutional issues raised by the Tulsa case, including a critique of the State Bar team approach and a reference to other possible approaches that should be reviewed by the Commission before making decisions in this area.

Attached is the Bar team's critique of the staff analysis. This supplementary memorandum briefly summarizes and responds to a few of the Bar team's points. See Exhibit 1 for the full Bar team critique.

(1) Search requirement. The key issue is whether the personal representative should be required to make a search for reasonably ascertainable creditors. The Bar team had argued that this would cause a number of problems. The staff noted that a search requirement could be imposed, with personal representative protection for good faith actions and omissions, and this would solve a number of problems.

The Bar team urges strongly that such a requirement should not be imposed. They point out that as a practical matter, imposing a search requirement, even with a good faith immunity for the personal representative as suggested by the staff, would still subject a personal representative to lawsuit by an omitted creditor whose claim has "settlement value" because the cost of litigation would be so great. They say this also would cause individual and public personal representatives to decline to act. They state that imposition of a new search duty will require cash reserves to protect against future lawsuit and will tie up estates for some time. Apart from the practicalities, they argue that, as a policy matter, an omitted creditor should recover from the estate and not from the personal representative; otherwise, there would be a windfall to the heirs at the expense of the personal representative.

The staff does not believe any additional lawsuits would be generated by a requirement of search and notification of reasonably ascertainable creditors. Even if the statute is limited by its terms

to "known" creditors as urged by the Bar team, an omitted but reasonably ascertainable creditor will sue the personal representative anyway on the ground that the creditor was actually known to the personal representative, and will prove this subjective fact by showing objectively that the creditor was reasonably ascertainable and should have been known to the ordinary personal representative. In fact, the Comment to Section 9050 (notice required to known creditors) states that "Inferences and presumptions may be available to demonstrate the personal representative's knowledge." It appears to the staff that all the problems of creditors suing personal representatives will occur regardless of whether the personal representative's standard of duty is limited to known, or is extended to reasonably ascertainable, creditors.

(2) Creditor who is not given notice but who otherwise has actual knowledge of administration. Should a creditor be barred if the personal representative fails to give the creditor actual notice of administration but the creditor was otherwise aware of the administration and failed to make a claim? The staff says such a creditor should be barred. The Bar team would like to cut off such a creditor, but thinks that due process may require that a creditor must also be aware of the requirement that a claim be filed. The staff disagrees; every person is presumed to know the law. We do not see the due process argument that a creditor must be personally informed of the contents of the state's probate code.

(3) Should creditor be required to follow late claim procedure? The staff argues that if an estate is still open, an omitted creditor should be required to follow the late claim procedure. Here again, the Bar team questions the constitutionality of such a requirement if the creditor is unaware of the requirement. Here again, the staff sees no due process issue--any creditor can read the published probate code and know what procedure it must follow if it wishes to assert its claim.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

EXHIBIT 1

ESTATE PLANNING, TRUST AND
PROBATE LAW SECTION
THE STATE BAR OF CALIFORNIA

Chair
D. KEITH BILTER, San Francisco
Vice-Chair
IRWIN D. GOLDRING, Los Angeles

Advisors
KATHRYN A. BALLSUN, Los Angeles
HERMIONE K. BROWN, Los Angeles
THEODORE J. CRANSTON, La Jolla
LLOYD W. HOMER, Campbell
KENNETH M. KLUG, Fresno
JAMES C. OPEL, Los Angeles
LEONARD W. POLLARD, II, San Diego
JAMES V. QUIJILINAN, Mountain View
WILLIAM V. SCHMIDT, Costa Mesa
HUGH NEAL WELLS, III, Irvine
JAMES A. WILLETT, Sacramento

Section Administrator
PRES ZABLAN-SORERON, San Francisco



555 FRANKLIN STREET
SAN FRANCISCO, CA 94102-4498
(415) 561-8200

July 1, 1988

Executive Committee
D. KEITH BILTER, San Francisco
OWEN G. FIORE, San Jose
IRWIN D. GOLDRING, Los Angeles
JOHN A. GROMALA, Eureka
LYNN F. HART, San Francisco
ANNE K. HILKER, Los Angeles
WILLIAM L. HOISINGTON, San Francisco
BEATRICE LAIDLEY-LAWSON, Los Angeles
JAY ROSS MacMAHON, San Rafael
VALERIE J. MERRITT, Los Angeles
BARBARA J. MILLER, Oakland
BRUCE S. ROSS, Los Angeles
STERLING L. ROSS, JR., Altamonte Springs
ANN E. STODDEN, Los Angeles
JANET L. WRIGHT, Fresno

Mr. Nathaniel Sterling
Assistant Executive Secretary
Law Revision Commission
4000 Middlefield Road; Suite D-2
Palo Alto, CA 94303

Re: Memorandum 88-49

Dear Nat:

The Special Creditor's Claim Team has reviewed Memorandum 88-49 and offers the following comments for consideration by Staff and the Law Revision Commission.

1. The Team concurs with Staff that a critical issue is whether to impose upon a personal representative a duty to search for creditors. The Team respectfully opposes the imposition of any such duty and the attendant exposure to personal liability for the following reasons.

A. So long as an estate is open and solvent, any creditor entitled to be paid by reason of Tulsa v. Pope would be compensated from the estate rather than from the personal representative.

B. If an estate is closed or insolvent, any creditor entitled to be paid by reason of Tulsa v. Pope should likewise be compensated from the assets which would have been used to pay the creditor had the estate been open (i.e., the assets distributed from the estate) rather than from the personal representative. Otherwise, the late claim would produce a windfall for the distributees at the expense of the personal representative.

CA LAW REV. COMM'N

JUL 05 1988

RECEIVED

C. A personal representative who acts in good faith in searching for creditors may nonetheless be sued for an alleged breach of that duty by a creditor who was not given notice. A presumption of "good faith" will do little to prevent a suit by a creditor whose claim has "settlement value" or is large enough to be undertaken by an attorney on a contingent fee basis. The defense of such a suit could cost the personal representative in excess of \$25,000 in attorneys' fees, deposition expenses and other costs. To make matters worse, the personal representative would be without funds with which to settle the litigation unless the personal representative used the personal representative's own money, thereby incurring a personal loss while providing a windfall to the distributees of the estate.

D. Creditors who send periodic bills to the decedent will be actually known to the personal representative. So will creditors whose identity are shown by the decedent's payment books and like documents. Moreover, attorneys will be advising personal representatives to make a diligent search for creditors and to be liberal in the giving of notice in order to avoid the potential delays and expenses to an estate which would be involved in Tulsa v. Pope type claims and litigation. As a result, the persons most likely to sue the personal representative for an alleged breach of a duty to search are tort claimants who contend that their claims were "ascertainable and not conjectural", and the holders of continuing personal guaranties who were not secured and took no steps to renew the guaranty on an annual basis.

E. Statutory compensation is inadequate to cover the risk aforesaid. The statutory commission on a \$200,000 estate is only \$5,150. The cost of defending but one suit brought by a creditor seeking to recover from the personal representative may be three times that much. A cross action for indemnity against the distributees by the personal representative who is found blameless may not be economically viable.

F. The exposure to liability that the Staff recommendation would thrust upon personal representatives may well cause them to decline to act. Who, other than a major beneficiary, would be willing to serve as a personal representative of a small or modest estate when one suit after distribution could cost \$25,000 to defend? Would public administrators be subject to the same exposure as everyone else? If so, the counties have no alternative but to oppose the Staff recommendation. If not, would a dispensation for public officials be fair, and how could the dispensation satisfy Tulsa v. Pope?

G. The Law Revision Commission, the legislature and the Estate Planning Trust and Probate Law Section of the State Bar have worked for years to simplify the probate administrative process and to expedite the distribution of decedent's estates in a fair and equitable manner. To this end, the creditor's claim period was shortened from six months to four months, effective today, actual notice is required to all known creditors, and attorneys and personal representatives are subjected to a reduction in compensation if estates are not concluded within specified periods of time. The creation of a cause of action in favor of creditors against the personal representative for breach of a new duty to search for them will necessitate substantial cash reserves upon distributions of estates by corporate fiduciaries and other persons who are not so intimately aware of the decedent's affairs that the exposure to the new liability is de minimis. These reserves and the administrative and tax burdens they will entail are not desirable from a beneficiary's point of view and will subject our probate procedures to extreme criticism by heirs whose inheritance has been "tied up".

2. The Team concurs with the Staff respecting the desirability of barring a "creditor who had actual knowledge of administration by any means during the four month claim period, whether or not a notice was sent." In fact, the Team considered making a like recommendation. However, the Team is concerned that mere knowledge of a probate proceeding does not apprise a creditor of any necessity to present a claim. Tulsa v. Pope and Mullane Special Guardian vs. Central Hanover Bank and Trust Company, (339 U.S. 306 at page 314) probably require notice to the creditor of both the existence of a probate proceeding and of the necessity to act in connection therewith by filing a claim.

July 1, 1988
Page 4

Due process aside, should a creditor be barred if he knows of a probate administration, but does not know where it was commenced, when it was commenced, the necessity of filing a creditor's claim, where to file the creditor's claim, and when the period for filing claims expires? All of the foregoing are considered requisite in the giving of formal notice. Should informal knowledge require less?

3. The Team concurs with the Staff respecting the desirability of "requiring a creditor to follow the late claim procedure if the creditor becomes aware of the administration proceeding while the estate is still open." However, this requirement may be constitutionally infirm unless the personal representative is permitted to give notice to the creditor of late claims procedure requirements or the creditor otherwise had actual knowledge of both the administration of the decedent's estate and the necessity of filing either a claim or late claim. This is because the requirement of filing a late claim should be subject to the same due process notice protections as the requirement of filing a timely one.

4. The Team concurs with the Staff that the legislation being considered in Memorandum 88-49 will render obsolete subdivision (b) of Section 9103.

5. The one year statute of limitations pertaining to decedents' estates and distributees is a critical element of the Team proposal. Without it, most trade and other creditors of the decedent would have four or more years from date of death to file suit. Creditors holding claims the statute of limitations upon which does not commence to run until discovery of damage (e.g., malpractice claims against professionals) might not be barred for decades. Exposure of the personal representative and/or the distributees of the estate for such periods of time are contrary to the long standing public policy of California and all of the other states of the Union that have adopted probate claims bar procedures.

Sincerely yours,

H. Neal Wells III P.R.

H. Neal Wells III