

Memorandum 89-39

Subject: Study L-1025 - Assembly Bill 156 (Notice to Creditors--
opposition of California Bankers Association)

Background

Shortly before AB 156 was heard in the Senate Judiciary Committee, the California Bankers Association (CBA) sent a letter of opposition to the bill because of concerns they have with the proposed amendment of Probate Code Section 9053. See Exhibit 1. Because AB 156 is an urgency bill and in order to ensure its rapid passage, we simply deleted the objectionable provision from the bill. This gives the Commission an opportunity to review the concerns of CBA and make any revisions that appear appropriate, before reinserting the provision in another of the Commission's probate bills this session.

The Commission has recommended amendment of Section 9053 as follows:

Probate Code § 9053 (amended). Immunity of personal
representative

9053. (a) If the personal representative ~~or attorney for the personal representative in good faith~~ believes that notice to a particular creditor is or may be required by this chapter and gives notice based on that belief, the personal representative ~~or attorney~~ is not liable to any person for giving the notice, whether or not required by this chapter.

(b) If the personal representative ~~or attorney for the personal representative in good faith~~ fails to give notice required by this chapter, the personal representative ~~or attorney~~ is not liable to any person for the failure, unless the person establishes that the failure was in bad faith. ~~Liability, if any, for the failure in such a case is on the estate.~~

(c) Nothing in this chapter imposes a duty on the personal representative ~~or attorney for the personal representative~~ to make a search for creditors of the decedent.

Comment. Section 9053 is amended to make clear that the burden of proof of bad faith of the personal representative is on the person seeking to impose liability. The personal representative is otherwise immune from liability to a known creditor who was not given notice. The liability, if any, in such a case generally follows the property in the estate. Thus, if the estate remains open, the property is reached

through the late claim procedure. Section 9103 (late claims). If property has been distributed, distributees are liable to the extent of the property. Section 9392 (liability of distributee). The creditor's right to recover is subject to a one-year statute of limitations from the date of the decedent's death. Code Civ. Proc. § 353.

The section is also amended to delete the references to the attorney for the personal representative. This chapter imposes no duty on the attorney to give notice.

The reasons for the proposed amendment are adequately explained in the Comment.

The basis of CBA's opposition is two-fold:

(1) The amendments create a separate cause of action against the personal representative for "bad faith", which is undefined.

(2) The independent action does not contain a statute of limitations, which could subject the personal representative to liability well beyond the close of probate.

We will analyze each of these concerns below.

Cause of Action for Bad Faith

CBA views the amendments as creating a cause of action for bad faith, whereas we have always viewed the bad faith limitation as a protection or immunity of the personal representative from liability for failing to give a required notice.

The basic duty of the personal representative is stated in Section 9050—"the personal representative shall give notice of administration of the estate to the creditor" if the personal representative has knowledge of the creditor. What is the personal representative's liability, if any, for failure to perform this duty?

The general statute governing breach of a fiduciary duty by the personal representative charges the personal representative with any loss to the estate and any profit to the personal representative, plus interest, as a result of the breach. Section 9601(a). The court may excuse the personal representative from liability if the personal representative has acted reasonably and in good faith under the circumstances as known to the personal representative, and it would be equitable to excuse the liability. Section 9601(b).

This statutory provision does not prevent resort to any other remedy for breach of a fiduciary duty available against the personal representative under the statutory or common law. Section 9603. The potential scope of statutory or common law remedies is unclear. Historically, the creditor could recover on the bond of the personal representative for the amount of the claim if the personal representative failed to give notice as required by law. Former Section 955.

The intent of Section 9053 is to circumscribe the potential liability of the personal representative for breach of duty. The personal representative is not liable to any person for a good faith failure to give notice. This is narrower than the general "has acted reasonably and in good faith under the circumstances" standard stated in Section 9601(b) and overrides the potential open-ended common law liability under Section 9603.

Our intent in amending Section 9053 is to further immunize the personal representative by relieving it of the burden to show good faith and imposing on the creditor the burden of showing bad faith. Are we imposing a new liability by this change that is not already there, as argued by CBA?

An argument might be made that the general remedy for breach of a fiduciary duty does not apply to failure to give notice to creditors, since the personal representative owes a fiduciary duty only to beneficiaries. This argument would be incorrect, however, since the personal representative's duty is to all persons interested in the estate, and the personal representative's oath and statement of duties and liabilities make this clear to the personal representative.

Perhaps the real concern of CBA is deletion of the last sentence of Section 9053(b)—"Liability, if any, for the failure in such case is on the estate." This sentence was deleted for two reasons: (1) the sentence is no longer correct, since we impose liability on distributees; and (2) the sentence no longer fits with the restructured subdivision. The Comment states, more accurately, that "The liability, if any, in such a case generally follows the property in the estate."

In response to the CBA's concern about the bad faith standard, the staff would simply leave the good faith standard of Section 9053(b) alone and not shift the burden to the creditor to show bad faith. This would be consistent with the general good faith personal representative liability standard of Section 9601(b), and it places the burden where it really should stay--on the personal representative who is in the best position to be able to prove that its failure to give notice was a good faith failure. The liability is really aimed at personal representatives who are interested in the estate as beneficiaries and have some motivation to fail to notify creditors. It is hard to see how a professional personal representative of the type represented by CBA would ever run afoul of the notice requirements except by inadvertence, which the good faith immunity would cover.

The staff suggests that Section 9053 be amended as follows in AB 158:

9053. (a) If the personal representative ~~or attorney for the personal representative in good faith~~ believes that notice to a particular creditor is or may be required by this chapter and gives notice based on that belief, the personal representative ~~or attorney~~ is not liable to any person for giving the notice, whether or not required by this chapter.

(b) If the personal representative ~~or attorney for the personal representative~~ in good faith fails to give notice required by this chapter, the personal representative ~~or attorney~~ is not liable to any person for the failure. Liability, if any, for the failure in such a case is on the estate except to the extent provided in Section 9392.

(c) Nothing in this chapter imposes a duty on the personal representative ~~or attorney for the personal representative~~ to make a search for creditors of the decedent.

Comment. Section 9053 is amended to ~~make clear that the burden of proof of bad faith of the personal representative is on the person seeking to impose liability. The personal representative is otherwise immune~~ delete the good faith limitation from subdivision (a); the personal representative is encouraged to give notice as broadly as possible without having to be concerned about showing good faith cause for giving notice.

Subdivision (b) limits the general liability exposure of a personal representative that would otherwise be applicable under Section 9601. Subdivision (b) immunizes the personal representative from liability to a known creditor who was not given notice if the personal representative's failure was in good faith. The liability, if any, in such a case generally follows the property in the estate. Thus, if the estate remains open, the property is reached through the late claim procedure. Section 9103 (late claims). If property has been

distributed, distributees are liable to the extent of the property. Section 9392 (liability of distributee). The creditor's right to recover against the estate or distributees is subject to a one-year statute of limitations from the date of the decedent's death. Code Civ. Proc. § 353.

The section is also amended to delete the references to the attorney for the personal representative. This chapter imposes no duty on the attorney to give notice.

Statute of Limitations

CBA is also concerned about the statute of limitations on an action against the personal representative for failure to give notice. What is the applicable statute of limitations here?

The staff agrees with CBA that the law is not clear. The Probate Code contains no special statute of limitations for breach of duty by a personal representative, so general rules will apply. The general rule that would be applicable depends on the particular breach alleged. The statute of limitations for an action on a liability created by statute is three years. Code Civ. Proc. § 338(a). The statute of limitations for relief on the ground of fraud is three years after discovery by the aggrieved party of the facts constituting the fraud. Code Civ. Proc. § 338(d). The general statute of limitations for otherwise unspecified types of action (such as breach of fiduciary duty) is four years. Code Civ. Proc. § 343.

The staff believes the statute most likely to apply to the personal representative's failure to give the required notice is the three-year limitation on an action on a liability created by statute. Is this statute appropriate, or is there good reason to limit it in some way, as suggested by CBA, or possibly even to extend it? The policy considerations here are protection of an intentionally omitted creditor, inducement of the personal representative to give required notice, and limitation of open-ended liability of the personal representative.

A variety of alternate limitation periods might be appropriate. A number of the most likely ones are listed below:

(1) Four years after the discharge of the personal representative. This is the limitation period for an action against the sureties on the bond of the personal representative, and might be equally appropriate for an action against the personal representative, whether or not bonded.

(2) The limitation period that would have been applicable to the particular creditor if the decedent had not died, or one year after the date of death, whichever is later. This is attractive because it relates to what the creditor lost by the personal representative's failure to give notice--the right to recover on the creditor's cause of action while the cause of action was still alive. It does not in effect create a new and separate cause of action but simply puts the creditor in the position the creditor would have been in had notice been properly given.

(3) One year after the date of death. This period would serve little useful purpose except to immunize the personal representative from liability. An omitted creditor has one year after the date of death to file a late claim or seek recovery from distributees; the purpose of personal representative liability is to give the creditor a remedy where a late claim or recovery from distributees is no longer possible because of the personal representative's bad faith failure to notify the creditor. A limitation on the secondary liability of the personal representative that runs one year after death obviously would be of little help to an intentionally omitted creditor.

(4) One year after the date notice was supposed to have been given. This would be somewhat more useful to a creditor than a flat one year after date of death, while still narrowly limiting the personal representative's liability exposure. Even if probate proceedings were initiated very soon after death, the statute of limitations for the creditor would not run until about a year and a half after death due to notice periods, etc.

(5) Three years after the date of death. This would be a hybrid between the general statute of three years after breach of a statutory duty and one year after date of death. It would give the personal representative a time certain, yet still give most creditors plenty of time to learn of the breach and seek recovery. This could be a good compromise proposal.

The staff believes that because of the uncertainty over what statute of limitations in fact applies, it is worth codifying a rule. Of those considered above, the staff's preference is split between options (5) (three years from date of death hybrid proposal) and (2)

(the statute of limitations otherwise applicable to the creditor's claim, but not less than one year after death). Whatever the Commission decides, the staff will draft and add to AB 158.

Statute of Limitations on Creditor's Claim

All this talk about statutes of limitation brings to mind a separate limitations problem that the Commission should review. The Commission's basic recommendation on notice to creditors includes an across-the-board automatic one-year statute for all causes of action against a decedent that have not already been barred at the decedent's death. This statute of limitations applies to all causes of action and applies whether or not a probate is opened, a trust is created, etc. It is a self-executing statute of repose.

The Commission's Comment to Code of Civil Procedure Section 353 reinforces this concept:

The one year statute of limitations is intended to apply in any action on a debt of the decedent, whether against the personal representative under Probate Code Sections 9350 to 9354 (claim on cause of action), or against another person, such as a distributee under Probate Code Section 9392 (liability of distributee), a person who takes the decedent's property and is liable for the decedent's debts under Sections 13109 (affidavit procedure for collection or transfer of personal property), 13156 (court order determining succession to real property), 13204 (affidavit procedure for real property of small value), and 13554 (passage of property to surviving spouse without administration), or a trustee.

There are a number of special statutes of limitation designed for the situation where a person takes the decedent's property outside of probate and becomes liable for the decedent's debts. It has been the Commission's intent to override these special statutes with the general one-year statute, as stated in the Comment. It would be useful for the Commission to review these special statutes and repeal them where they appear to conflict with the one-year statute. The whole reason for the absolute one year statute is to achieve an operation free of state action, and therefore hopefully not in conflict with due process of law. Also, repeal of possibly inconsistent statutes in the law will avoid litigation over the question of which statute controls.

Notwithstanding these remarks, the staff notes that the Commission has previously decided to preserve a number of special statutes of limitation. Specifically, a proceeding to collect from an insurance company on a cause of action against the decedent may be brought as late as one year after expiration of the statute of limitations otherwise applicable to the claim. See Probate Code § 551 (included in AB 156). And tax and welfare claims of the state are governed by their own special statutes of limitation. See Probate Code § 9201 (also included in AB 156). The Commission should review the other nonprobate statutes before repealing them to make sure no further exceptions are necessary.

Small estate set-aside. Under the small estate set-aside statute (Probate Code §§ 6600-6615), persons who take title to the decedent's property are personally liable for the decedent's debts. The personal liability ceases one year after the date the court makes its order setting aside the small estate:

6611. (a) Subject to the limitations and conditions specified in this section, the person or persons in whom title vested pursuant to Section 6609 are personally liable for the unsecured debts of the decedent.

(b) The personal liability of a person under this section shall not exceed the fair market value at the date of the decedent's death of the property title to which vested in that person pursuant to Section 6609, less the total of all of the following:

(1) The amount of any liens and encumbrances on that property.

(2) The value of any probate homestead interest set apart under Section 6520 out of that property.

(3) The value of any other property set aside under Section 6510 out of that property.

(c) The personal liability under this section ceases one year after the date the court makes its order under Section 6609, except with respect to an action or proceeding then pending in court.

(d) In any action or proceeding based upon an unsecured debt of the decedent, the surviving spouse of the decedent, the child or children of the decedent, or the guardian of the minor child or children of the decedent, may assert any defense, cross-complaint, or setoff which would have been available to the decedent if the decedent had not died.

(e) If proceedings are commenced in this state for the administration of the estate of the decedent and the time for filing claims has commenced, any action upon the personal liability of a person under this section 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:

(1) Creditors who commence judicial proceedings for the enforcement of the debt and serve the person liable under this section with the complaint therein prior to the expiration of the time for filing claims.

(2) Creditors who have or who secure an acknowledgment in writing of the person liable under this section that that person is liable for the debts.

(3) Creditors who file a timely claim in the proceedings for the administration of the estate of the decedent.

The general one-year after death limitation period would render subdivision (c) meaningless. The staff suggests that subdivision (c) should be repealed. It should be noted, however, that there is no notice to creditors, published or otherwise, required under the small estate set-aside procedure.

Disposition of estate without administration. A person who takes property under the affidavit procedure for collection or transfer of personal property (Probate Code §§ 13100-13116) is personally liable for the decedent's debts. The liability is subject to defenses the decedent would have had. Section 13109.

Since the statute of limitations defense that would have been available had the decedent not died is different from the general one-year statute applicable at death, it may be helpful to clarify this matter by a specific cross-reference to Code of Civil Procedure Section 353:

13109. A person to whom payment, delivery, or transfer of the decedent's property is made under this chapter is personally liable, to the extent provided in Section 13112, for the unsecured debts of the decedent. Any such debt may be enforced against the person in the same manner as it could have been enforced against the decedent if the decedent had not died. In any action based upon the debt, the person may assert any defenses, cross-complaints, or setoffs that would have been available to the decedent if the decedent had not died, subject to Section 353 of the Code of Civil Procedure.

Similar treatment should be given to the comparable provisions of Section 13156 (court order determining succession to real property) and 13204 (affidavit procedure for real property of small value). All of these sections are referred to in the Comment to Code of Civil Procedure Section 353.

Passage of property to surviving spouse. A surviving spouse who takes property of the decedent without administration (Probate Code §§ 13500-13660) is liable for the decedent's debts. Section 13554, like the provisions noted immediately above, states that the surviving spouse may assert defenses that would have been available if the decedent had not died. In addition, however, Code of Civil Procedure Section 353.5 includes an extension of the statute of limitations that otherwise would have been applicable if the statute expires within four months after death:

353.5. If a person against whom an action may be brought dies before the expiration of the statute of limitations for the commencement of the action and the cause of action survives, an action against the surviving spouse of the person which is brought pursuant to Chapter 3 (commencing with Section 13550) of Part 2 of Division 8 of the Probate Code may be commenced within four months after the death of the person or before the expiration of the statute of limitations which would have been applicable to the cause of action against the person if the person had not died, whichever occurs later.

This is in plain conflict with the Commission's general policy to extend the statute to one year if it would expire earlier, and reduce it to one year if it would expire later. The staff sees no reason for special treatment here; the staff would repeal Code of Civil Procedure Section 353.5 and amend Probate Code Section 13554 to add a specific cross-reference to Code of Civil Procedure Section 353.

Obligation secured by mortgage, deed of trust, or other lien. As a general rule, secured creditors file claims and are paid during the course of administration. Where a claim is not filed, for example because the creditor does not want to relinquish the security to preferred claims or for some reason is unaware of the probate, the creditor may foreclose on the property directly outside of probate. Probate Code § 9391 (formerly Section 716). This rule applies to judgment liens as well as to voluntary liens. The statute of limitations applicable to the foreclosure is four years after breach of the underlying obligation. Code Civ. Proc. § 337. However, a creditor holding a deed of trust (as opposed to a mortgage or other lien) is not barred by the statute of limitations since "a deed of trust never outlaws."

What is the effect of the one-year limitation period on this situation? The underlying obligation owed to a secured creditor will be barred one year after the decedent's death. Under the principles stated above, the secured creditor will still have a remedy if the security interest is a deed of trust, but may not have a remedy if the security is a mortgage or other lien.

In the normal course of events, this will not be a real problem. First, the common practice in California is to use deeds of trust rather than mortgages for the very reason of the limitations problem. Second, most secured obligations are paid periodically, and the creditor will quickly become aware and take protective action if there is a sudden halt in the flow of payments. Finally, in the ordinary estate containing real property subject to a security interest, there will be a probate and the secured creditor will receive notice and file a claim.

The ordinary situation is no problem. What about the unusual situation? Suppose a probate is opened but for some reason the personal representative fails to notify the creditor. The creditor would have an action against the personal representative personally and on the bond in this situation. The personal representative could not very well plead good faith ignorance of the encumbrance when the law requires the personal representative to file both (1) an estimate of the value of the estate in the petition for administration and (2) an inventory and appraisal of property in the estate.

Suppose no probate is opened for a year, and the creditor is not aware the decedent has died because the underlying obligation is not due for more than a year, and the obligation is secured by a mortgage rather than a deed of trust. The security would not be worth much in that situation. Should special recognition be given to the security interest, or should we subject a secured creditor to the same limitation periods as unsecured creditors? We tell unsecured creditors to keep track of their debtors; if their claim is contingent we tell them they had better take steps to preserve it by opening a probate themselves.

If the Commission is inclined to protect secured obligations against the one-year statute of limitations, we would build in a special exception the same way we have built in one for actions on a liability of the decedent protected by insurance and actions by the state for tax and welfare claims:

9391. The holder of a mortgage or other lien on property in the decedent's estate, including but not limited to a judgment lien, may commence an action to enforce the lien against the property that is subject to the lien, without first filing a claim as provided in this part, if in the complaint the holder of the lien expressly waives all recourse against other property in the estate. Section 353 of the Code of Civil Procedure does not apply to an action under this section.

Comment. Section 9391 is amended to except an action to enforce a lien from the one-year statute of limitations in Code of Civil Procedure Section 353. The statute of limitations otherwise applicable to an action to enforce the lien continues to apply notwithstanding Section 353.

One problem with this section is that Section 353 is an extension of, as well as a limitation on, the statute of limitations, resulting in a flat one-year period. By writing out Section 353, we provide no margin of safety for a secured creditor where the statute of limitations otherwise applicable will expire within a short time after the decedent's death. The staff is not unduly concerned about this situation and is not inclined to construct an elaborate statutory scheme because, as we have noted above, we believe there is no real practical problem in the vast majority of cases.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary



California Bankers Association
Established 1891

March 13, 1989

The Honorable Terry B. Friedman
Member, California State Assembly
State Capitol, Room 4139
Sacramento, California 95814

RE: OPPOSITION TO ASSEMBLY BILL 156

Dear Mr. Friedman:

The California Bankers Association regrets to inform you that we must oppose your AB 156, as amended February 17, 1989. Our basis for opposition rests with the amendments to Probate Code Section 9053 relating to liability of the personal representative for failure to notify creditors of the period for presentation of claims against the decedent's estate. The amendments to Section 9053 create a separate cause of action of "bad faith" against the personal representative which is undefined.

We recommend withdrawing the amendment to Section 9053 so that the interested parties can address the issue. This action would allow the rest of the legislation to proceed unimpeded on an urgency basis. The amendments to Section 9053 were not addressed in the case of Tulsa Professional Collection Services, Inc. v. Pope, 108 S. Ct. 1340 (1988), the basis for the urgency of this bill, and would not adversely affect the holding of the case or the need for conforming changes on an urgency basis. We have discussed our opposition to the bill and recommendation for withdrawal with the California Law Revision Commission staff, the sponsor of the bill, who are willing to work with us and indicated that there is another committee bill in which agreeable amendments to Section 9053 may be made.

The concept of bad faith has not been judicially defined with certainty in California. Without a clearly defined standard of bad faith, the personal representative would have to take extraordinary steps in some probates to notice creditors which could further delay estate administration contrary to the purpose of statutory scheme.

In addition, the independent action does not contain a statute of limitations which could subject the personal representative to liability well beyond the close of probate.

The Honorable Terry B. Friedman
March 13, 1989
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We must urge the Senate Judiciary Committee to vote "NO" on AB 156 during the hearing set for March 14 unless the proposed amendments to Probate Code Section 9053 are dropped from the bill.

Thank you for considering our views on this important matter.

Sincerely,



MAURINE C. PADDEN
Legislative Counsel

MCP:mb

cc: The Honorable Bill Lockyer, Chairman, Senate Judiciary
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