

Memorandum 2020-38

**Stock Cooperatives and Uniform TOD Security Registration Act:
Creditor Claims**

In this study, the Commission¹ is considering whether the Uniform TOD Security Registration Act (“Uniform Act”)² could be adapted for use in making a nonprobate transfer on death of an interest in a stock cooperative. The Uniform Act provides a relatively simple mechanism for the registration of securities in transfer on death (“TOD”) form. Securities registered in that form pass to a named beneficiary on the registering owner’s death, without probate administration.

The study is moving progressively through the issues that need to be addressed in adapting the Uniform Act for that purpose.

This memorandum discusses the extent to which a beneficiary who receives a nonprobate transfer of a stock cooperative interest should be liable for the debts of the deceased transferor.

Unless otherwise indicated, all of the statutory citations below are to the Probate Code.

THRESHOLD QUESTION

One of the issues that must be decided in this study is whether the beneficiary of a nonprobate transfer of stock cooperative property should be liable for the debts of the deceased transferor.

That is the general rule in *probate*. If a decedent’s property passes through probate, that property is liable for the payment of the decedent’s debts. There are detailed procedures for the allocation of that liability.

1. Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission’s website (www.clrc.ca.gov). Other materials can be obtained by contacting the Commission’s staff, through the website or otherwise.

The Commission welcomes written comments at any time during its study process. Any comments received will be a part of the public record and may be considered at a public meeting. However, comments that are received less than five business days prior to a Commission meeting may be presented without staff analysis.

2. Prob. Code §§ 5500-5512.

There is no equivalent rule that applies to all nonprobate transfers as a class.³ Some kinds of nonprobate transfers are liable,⁴ but others are not. That patchwork of rules reflects the gradual development of nonprobate transfer law over time, without consistent attention to the issue of creditor liability.

The Commission expressly recommended that the beneficiary of an RTODD be liable for the deceased transferor's unsecured debts. As the Commission explained: "Public policy should not enable a transferor to defeat creditors by the device of a revocable TOD transfer."⁵

In other words, if real property in a person's probate estate is available for the payment of that person's debts, there is no good policy reason to shield the asset from creditor liability simply because the decedent chose to transfer it outside of probate.

That principle would seem to apply equally to a real property interest in a stock cooperative. Given that such property would be liable for the deceased owner's debts if it were transferred in probate, the staff sees no reason for a different result if the property is transferred outside of probate.

As a matter of general policy, the staff recommends that the beneficiary of a nonprobate transfer of an interest in a stock cooperative be liable for the deceased transferor's debts, up to the value of the property received. That would parallel the treatment of real property transferred by RTODD. Does the Commission agree?

If so, then the Commission will need to draft provisions to establish that liability, define its scope, and provide for its enforcement. The simplest way to achieve this would be to borrow the provisions used in the RTODD statute (with the improvements that the Commission recommended in its recent follow-up study of that statute). That possibility is discussed further below.

If, instead, the Commission decides against imposing liability on the beneficiary of a nonprobate transfer of a stock cooperative, then the remainder of this memorandum can be set aside. The statute would remain silent on the issue of liability for the deceased transferor's debts.

3. See generally Memorandum 2017-7.

4. See, e.g., Section 19001 (liability of property in revocable trust).

5. See generally *Revocable Transfer on Death (TOD) Deed*, 36 Cal. L. Revision Comm'n Reports 103, 119 (2006).

RTODD BENEFICIARY LIABILITY PROVISIONS

This part of the memorandum provides an overview of the existing RTODD liability provisions, as modified and supplemented by the recommendations that the Commission made in its recent follow-up study of the RTODD statute. Those provisions were designed for application to a nonprobate transfer of an interest in real property. Aside from some minor technical issues, which could be easily addressed, the staff believes that those provisions would also be suitable for a nonprobate transfer of an interest in a stock cooperative.

Each of the liability provisions is summarized and set out below. A parenthetical in the heading states whether the provision is existing law, an existing provision that the Commission has proposed to amend, or a new provision that the Commission has proposed to add,

Section 5670 (existing). Priority of Transferor's Secured Creditors over Beneficiary's Creditors

Section 5670 establishes the priority of a deceased *transferor's* secured creditors over the *beneficiary's* creditors. This makes clear that a debt that is secured against real property will not be undermined by the transfer of that property by RTODD. Thus:

5670. Notwithstanding any other statute governing priorities among creditors, a creditor of the transferor whose right is evidenced at the time of the transferor's death by an encumbrance or lien of record on property transferred by a revocable transfer on death deed has priority against the property over a creditor of the beneficiary, regardless of whether the beneficiary's obligation was created before or after the transferor's death and regardless of whether the obligation is secured or unsecured, voluntary or involuntary, recorded or unrecorded.

The staff believes that Section 5670 reflects good policy and should be applied to a nonprobate transfer of property in a stock cooperative. Aside from the need to make some changes to the terminology used in the provision (e.g., replacing references to RTODDs), the staff sees no practical problem with including an equivalent provision in a stock cooperative statute.

Section 5672 (existing). Personal Liability of Beneficiary

As a general rule, the beneficiary of an RTODD is personally liable for the deceased transferor's unsecured debts. Those debts can be enforced against the

beneficiary in the same way that they could have been enforced against the transferor during the transferor's life. However, there is a time limit on enforcement, based on the time provided for filing a creditor claim against the decedent's estate or for bringing a civil action against a deceased person. Thus:

5672. Each beneficiary is personally liable to the extent provided in Section 5674 for the unsecured debts of the transferor. Any such debt may be enforced against the beneficiary in the same manner as it could have been enforced against the transferor if the transferor had not died. In any action based on the debt, the beneficiary may assert any defense, cross-complaint, or setoff that would have been available to the transferor if the transferor had not died. Nothing in this section permits enforcement of a claim that is barred under Part 4 (commencing with Section 9000) of Division 7. Section 366.2 of the Code of Civil Procedure applies in an action under this section.

The staff sees no reason to deviate from that provision in this study.

Section 5674 (amended). Scope of Personal Liability

Section 5674 defines the scope of a beneficiary's personal liability. It expresses two principles.

- The beneficiary's personal liability ends if the beneficiary has used other specified mechanisms for the payment of a share of the decedent's debts (discussed below).
- The beneficiary's total liability is capped at the value of the property received.

Thus:

5674. (a) A beneficiary is not liable under Section 5672 if proceedings for the administration of the transferor's estate are commenced and the beneficiary satisfies the requirements of Section 5677 or 5678.

(b) The personal liability of a beneficiary under Section 5672 shall not exceed the fair market value at the time of the transferor's death of the property received by the beneficiary pursuant to the revocable transfer on death deed, less the amount of any liens and encumbrances on the property at that time.

In addition to making minor terminology changes, Section 5674 would require one substantive modification if it were to be applied to a nonprobate transfer of a stock cooperative. The reference to "fair market value" would need to be replaced with language that would accommodate the special rules in a limited equity housing cooperative ("LEHC"). An LEHC is a type of affordable housing

community where the price of a unit is kept artificially low, by limiting the purchase and sale price of a unit to a specified “transfer value.”⁶

That modification could be achieved using the term “transfer value” in place of “fair market value” and then defining the new term along the following lines:

(1) Except as provided in paragraph (2), “transfer value” means the fair market value.

(2) In a limited equity housing cooperative, the transfer value is the sale price specified by law and in the governing documents.

Section 5677 (added). Personal Liability to Estate

If the deceased transferor’s estate is being probated, Section 5677 provides a mechanism by which the beneficiary of an RTODD can pay a calculated share of the decedent’s debts directly to the estate. Doing so negates the beneficiary’s personal liability to the decedent’s creditors.

One benefit of Section 5677 is that the beneficiary only pays the amount that would have been owed had the transferred property been probated. That will often be less than the beneficiary’s personal liability under Section 5672, which extends to the full market value of the property received.

Thus:

5677 (a) If proceedings for the administration of the transferor’s estate are commenced, a beneficiary of a revocable transfer on death deed is personally liable to the estate for a share of the transferor’s unsecured debts.

(b) In calculating the beneficiary’s share of liability under subdivision (a), the abatement rules provided in Part 4 (commencing with Section 21400) of Division 11 shall be applied, using all of the following assumptions:

(1) The property that was transferred to the beneficiary by revocable transfer on death deed shall be treated as if it were a specific gift made by the decedent’s will.

(2) The value of the property received by the beneficiary pursuant to the revocable transfer on death deed shall be deemed to be the fair market value of the property at the time of the transferor’s death, less the amount of any liens and encumbrances on the property at that time.

(3) Any unsecured debts of the transferor that were paid by the beneficiary pursuant to Section 5672 shall be treated as if they were claims made against the transferor’s estate.

6. See Civ. Code § 817.

(c) The personal representative shall provide a written statement of liability to the beneficiary, which specifies the amount that must be paid to the estate.

(d) The beneficiary is personally liable to the estate for the amount specified in the statement of liability. Any amount that the beneficiary paid toward the unsecured debts of the transferor pursuant to Section 5672 shall be credited against the amount that the beneficiary owes the estate under this subdivision. If the amount that the beneficiary paid pursuant to Section 5672 exceeds the amount specified in the written statement of liability, the estate shall reimburse the difference to the beneficiary. For the purposes of Section 11420, this reimbursement shall be deemed an expense of administration.

(e) In the event that the beneficiary and the personal representative cannot agree on the reimbursement or liability due under this section, the beneficiary or personal representative may petition the court for an order determining the amount of the reimbursement or liability.

(f) The reasonable cost of proceeding under this section shall be reimbursed as an extraordinary service under Sections 10801 and 10811. The beneficiary is liable for the payment of that cost, which shall be separately identified in the statement of liability.

The staff believes that this provision is beneficial and should be included in any liability provisions drafted in this study.

Section 5678 (added). Voluntary Return of Property to Estate

Section 5678 operates as a sort of reset button. If the beneficiary of an RTODD decides that the consequences of that form of transfer are undesirable, the beneficiary can elect to return the property to the decedent's estate, for probate administration. Doing so negates the beneficiary's personal liability to the decedent's creditors. The property is then administered as if it had been devised to the beneficiary in the decedent's will. Section 5678 includes rules for adjusting the value of the property based on changes that occurred between its transfer by RTODD and its return to the estate.

Thus:

5678. (a) If proceedings for the administration of the transferor's estate are commenced, a beneficiary who receives property from the transferor under a revocable transfer on death deed may voluntarily return that property to the transferor's estate for administration.

(b) Property returned to the transferor's estate under this section shall be treated as if it had been specifically devised to the beneficiary by the transferor.

(c) If the beneficiary's action or inaction increased the value of property returned to the estate or decreased the estate's obligations, the estate shall reimburse the beneficiary by the same amount. Actions or inaction that increase the value of returned property or decrease the estate's obligations include, but are not necessarily limited to, the following actions:

(1) A payment toward an unsecured debt of the decedent.

(2) A payment toward a debt secured against the returned property.

(3) A significant improvement of the returned property that increased the fair market value of the property.

(d) If the beneficiary's action or inaction decreased the value of property returned to the estate or increased the estate's obligations, the beneficiary is personally liable to the estate for that amount. Actions or inaction that decrease the value of the returned property or increase the estate's obligations include, but are not necessarily limited to, the following actions or inaction:

(1) An action or inaction that resulted in a lien or encumbrance being recorded against the property.

(2) The receipt of income from the property, if that income would have accrued to the estate had the property not been transferred to the beneficiary.

(e) The personal representative shall provide the beneficiary a written statement of any reimbursement or liability under this section, along with a statement of the reasons for the reimbursement or liability. For the purposes of Section 11420, any reimbursement under this section shall be deemed an expense of administration.

(f) In the event that the beneficiary and the personal representative cannot agree on the reimbursement or liability due under this section, the beneficiary or personal representative may petition the court for an order determining the amount of the reimbursement or liability. In making a decision under this subdivision, the court should consider the surrounding circumstances, including whether the parties acted in good faith and whether a particular result would impose an unfair burden on the beneficiary or the estate.

If that provision were borrowed for application to a nonprobate transfer of a stock cooperative interest, there would need to be minor changes of the type discussed above (i.e., adjustments to terminology and to the use of the term "fair market value"). Those technical issues aside, the staff believes that the provision would be a useful addition to the statute that is being developed in this study.

RECOMMENDATION

For the purpose of preparing a tentative recommendation, the staff recommends that the proposed law borrow the RTODD liability provisions discussed above, with the suggested adjustments to the terminology and to the concept of “fair market value.”

This would prevent an owner of an interest in a stock cooperative from shielding that asset from creditors, simply by making a nonprobate transfer of the property on death. It would also incorporate a well-developed set of enforcement rules, which were specifically designed for application to a nonprobate transfer of real property.

AFTERTHOUGHT

Having worked through all of the above, the staff had a further thought. Perhaps the Uniform TOD Security Registration Act could also be revised to make a beneficiary under that Act liable for the debts of a deceased transferor. The RTODD statutes discussed above could perhaps be adapted for that purpose as well.

That would be an entirely separate reform, with no necessary connection to the current study of stock cooperatives. It just occurred to the staff that the policy logic that supports the application of the RTODD statute’s liability regime to a nonprobate transfer of stock cooperative property might also support making a parallel reform to the statute that governs the nonprobate transfer of securities.

There is no limit on the dollar value of a stock portfolio that can pass under the Uniform TOD Securities Registration Act. The transferred assets could be the lion’s share of a person’s estate. As a matter of policy, there is no clear reason why such assets should be liable for transferor debts if they pass through probate, but not liable if they pass by TOD registration outside of probate.

The Commission could conduct a separate parallel study of that issue. Doing so would require very little extra effort.

However, there is one factor that may weigh against doing so. The Uniform TOD Security Registration Act was enacted on the Commission’s recommendation⁷ and the Commission has a presumption against recommending

7. *Uniform TOD Security Registration Act*, 28 Cal. L. Revision Comm’n Reports 577 (1998).

changes to statutes that were enacted on its recommendation.⁸ Deference to the Commission's prior recommendation may be particularly appropriate here, because the possibility of making a beneficiary liable for a deceased transferor's debts was specifically considered by the Commission in the development of its recommendation.⁹ The record does not explain why the Commission decided against doing so. The current staff has no recollection of the matter.

On the other hand, that decision was made over 20 years ago, before the Commission had developed the RTODD liability provisions discussed above. It may be that the ready availability of those provisions as a refined solution to the implementation of beneficiary liability may be a sufficiently "good reason" to revisit the issue.

How would the Commission like to proceed on this issue?

Respectfully submitted,

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8. Commission Handbook of Practices and Procedures § 70 ("Unless there is a good reason for doing so, the Commission will not recommend changes to laws that were enacted on Commission recommendation.").

9. That policy was proposed by the Executive Committee of the Trusts and Estates Section of the State Bar. See Memoranda 1998-17, pp. 6-8.