

The Need to Clarify Creditors' Rights in Probate

IMAGINE THAT A CLIENT has been solicited to loan a substantial sum of money on an unsecured basis to an individual residing in a mythical Third World country. On inquiring with foreign legal counsel, you learn that, under the law of the foreign jurisdiction, following the death of the individual, your client's ability to enforce its rights against the decedent's estate could be delayed between six months and three years, and that during this period, the decedent's heirs could be distributed a substantial part, if not all, of the estate's assets. Clearly, few clients would knowingly subject themselves to these risks.

Surprise! The law of the state of California does not differ materially from that of the mythical Third World nation, at least without careful lawyering. Many of the pitfalls facing California creditors attempting to collect following the death of an obligor were outlined in a previous article appearing in this magazine.¹ These include a one-year statute of limitations for commencing suit against a personal representative of the decedent,² the requirement for filing a claim in a probate and serving it on the personal representative prior to filing of suit,³ and, as a condition to filing a probate claim, the need to secure appointment of a personal representative through initiation of a probate if the heirs or legatees fail to do so.

The case of *Arluk Medical Center Industrial Group, Inc. v. Dobler*⁴ illustrates other potential impediments to enforcement of creditor claims when the decedent had established a revocable inter vivos trust. During the individual's lifetime, property held in a revocable inter vivos trust is liable to be applied in satisfaction of judgments against the individual. After the death of the individual trustor, matters are not so simple. Probate Code Section 19001(a) provides that trust property that was subject to a power of revocation at the time of the trustor's death "is subject to the claims of creditors of the deceased [trustor's] estate and to expenses of administration of the estate to the extent that the deceased [trustor's] estate is inadequate to satisfy those claims and expenses." The court in *Arluk* construed this language to prohibit action against a successor trustee until a claim in a pending probate has been reduced to judgment. And, while proceedings are pending, the trustee may without liability pay or distribute trust assets to beneficiaries, even if the remaining assets are insufficient to satisfy creditor claims. (The harshness of this rule may be mitigated by permissive recourse against distributees,⁵ subject to the one-year statute of limitations of Code of Civil Procedure Section 366.2.) This is a warning that, whenever a contract or guaranty provides for personal liability, the obligor should be required to sign both in the obligor's name as trustee of the trust, as well as in the obligor's name individually thus permitting direct action against the trust.

It is clear from *Arluk* that if a probate has been initiated, the creditor must establish its claim in that forum. The course a creditor should follow is also clear when a successor trustee provides optional notice to creditors to file claims. However, when no probate has been com-

menced and the successor trustee has not initiated the optional claims notice procedure, the recourse of the claimant is unclear.

A leading treatise states that in these circumstances "the creditor may file suit against the trustee to enforce a debt, claim, or action against the deceased settlor."⁶ However, the treatise does not indicate how long the creditor must wait, and it may be argued that the creditor must institute a probate proceeding, rather than suing the trustee, in order to establish the insufficiency of the probate estate.⁷

The law has doubtless reached this state of complexity for legitimate reasons. However, it would seem that many of the policies

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intended to be served by the present statutory scheme could be implemented by far simpler measures. Rather than requiring a creditor to institute a probate proceeding to preserve a claim from the bar of the statute of limitations, it would seem far more efficient for the state to maintain a statewide death registry in which creditors could file claims within one year of the reporting of a death. Filing a claim in the death registry would serve to toll any statute of limitations, pending receipt of a notice of rejection by a legally authorized successor, whether a personal representative in probate or the successor trustee of an inter vivos trustee.

Further, there would seem little justification in prohibiting suit against a successor trustee while probate is pending or while a successor trustee evaluates whether to provide optional statutory notice. By allowing a creditor to file suit against a successor trustee of a revocable trust at any time following the initial trustor's death, the creditor will be empowered to seek a prejudgment writ of attachment or preliminary injunction if appropriate. California is an acknowledged leader in areas such as science and technology. It is time that our probate laws reflect the twenty-first rather than the nineteenth century. ■

¹ Stacie S. Polashuk, *Death of a Litigant*, LOS ANGELES LAWYER, July/Aug. 2003, at 43.

² CODE CIV. PROC. §366.2.

³ PROB. CODE §9370.

⁴ *Arluk Med. Ctr. Indus. Group, Inc. v. Dobler*, 116 Cal. App. 4th 1324 (2002).

⁵ PROB. CODE §19400.

⁶ 2 CALIFORNIA TRUST AND PROBATE LITIGATION §22.51, at 798 (2008).

⁷ See PROB. CODE §§19001(a) and 19400 and the discussion in *Arluk*, 116 Cal. App. 4th at 1333-34.

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