

Probate Department Newsletter

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Upcoming CLE Presentations of Interest

August 23, 2019: The Exam and You - Estate Planning Through Administration and Litigation by California Lawyers Association

October 10-12, 2019: 39th Annual Tax & Estate Planning Forum formerly known as The Southern California Tax & Estate Planning Forum

October 10-12, 2019: 2019 Annual Meeting of California Lawyers Association

Nov 4-7, 2019: 56th Annual Hawaii Tax Institute by Hawaii Tax Institute Foundation

November 13, 2019: 40th Annual Inland Empire Estate Planning Seminar

November 22, 2019: 45th Annual Trust and Estate Conference presented by USC Gould School of Law

January 11, 2020 Estate Planning/Probate Update CDTA College of Law

Handling Debts of a Deceased Trustor* By Jeremy J. Ofseyer & Lisa K. Berkeley**

This article provides an overview of the rights and duties of trustees and trust beneficiaries, under California law, in handling the late trustor's debts, when there is no decedent's estate administration proceeding in probate court.

Trust-Imposed Duties. As always, a trustee must follow the terms of the trust instrument. Probate Code § 16000. Some trusts direct the trustee to pay the trustor's debts. More commonly, trusts will direct paying only certain debts, e.g., expenses of final illness and burial, and taxes. Trusts very often contain no such direction. Handling claims where the debt is undisputed and the trust instrument directs payment is straight-forward -- if the trust is solvent.

Generally Limited Trustee Duty to Creditors. Where, however, the trust imposes no duty to pay a debt, California law generally imposes a trustee duty of loyalty only to the beneficiaries (Probate Code § 16002), and not others, including creditors. (This is quite different than a decedent's estate administration in probate court, where the personal representative owes various duties to creditors. *See* Probate Code §§ 9000-9399.) Instead, absent trust language to the contrary, prior to any judgment binding a trustee, a trustee has no duty to prefer the trustor's creditors over the interests of the trust beneficiaries, and may distribute trust assets to the beneficiaries where a disputed creditor's claim is pending. *Arluck Med. Ctr. Indus. Group, Inc. v. Dobler* (2004) 116 Cal.App.4th 1324, 1335. Before the creditor obtains judgment, the trustee's only duty is to "refrain from affirmative misconduct that defeats the creditors' reasonable expectation for a recovery from trust assets." *Id.* at 1328. A trustee and trustee's counsel should take care

not to advise or assist a trust creditor in enforcing its claim, lest they breach a duty they do have to the beneficiaries.

Liability of Trust Beneficiaries to Creditors. A trust beneficiary who receives trust property may be personally liable for the trustor's debts, subject to key limitations. First, if assets remain in the trust, beneficiary liability is limited to amounts that cannot be satisfied from the as yet undistributed trust estate. Probate Code § 19402(b). Second, the beneficiary's liability is limited to a pro rata portion of the claim, and cannot exceed the value of the property distributed to the beneficiary. *Ibid.* Therefore, where there are multiple beneficiaries, the creditor may need to sue all beneficiaries to fully satisfy the claim. Third, the creditor must bring the claim against the beneficiary within the 1-year period allowed under Code of Civil Procedure § 366.2.

Given a trustee's duty to keep beneficiaries informed (Probate Code § 16060), if a trustee distributes assets to the beneficiaries and knows of a claim against the trustor that is not time-barred, the trustee should notify the beneficiaries of the existence of the potential claim.

If the trust lacks clear direction regarding the payment of a debt and the trustee knows of an alleged debt that is not time-barred, the trustee may also use a well-drafted notice of proposed action, under Probate Code §§ 16500 et seq., to insulate the trustee from liability to the beneficiaries, for paying a debt which the trust may not be legally obligated to pay or for not paying a debt which may later subject a beneficiary to personal liability.

One-Year Statute of Limitations. Code of Civil Procedure § 366.2 provides a one-year statute of limitations from date of death where "a person against whom an action may be brought on a liability of the person, whether arising in contract, tort, or otherwise, and whether accrued or not accrued, dies before the expiration of the applicable limitations period, and the cause of action survives. . . ." This statute of limitations applies to claims brought either against the estate or against the trustor's trust. *Levine v. Levine* (2002) 102 Cal.App.4th 1256.

Optional Trust Claims Procedure. Probate Code §§ 19000 et seq. authorize a trustee to initiate a trust claims procedure, which formally handles trust creditor's claims and allows a creditor to toll the one-year statute of limitations of § 366.2 by timely filing a claim. The process is optional, however, and trustees rarely use it, for various reasons, including because it may invite creditors to make a claim. Trustees often prefer to wait and see if the creditor has the know-how, time, motivation, and resources to otherwise satisfy § 366.2.

Creditor Options for Tolling or Meeting Statute of Limitations. The creditor can toll the § 366.2 limitations period by either timely filing a claim in a trust creditor's claim proceeding (in the rare instance there is one) or by timely filing a claim in the probate proceedings (if any). If neither is pending, the creditor does not have the option of initiating a trust claims proceeding (which can only be initiated by the trustee), but can petition to open probate and file a probate creditor's claim to toll the one-year statute of limitations. If there are ultimately no assets subject to probate, per Probate Code § 19001(a), the assets of a trust revocable at the time of trustor's death is subject to the claims of trustor's creditors.

A creditor can sue under Probate Code § 850(a)(3), authorizing a petition by "any interested person," (A) "[w]here the trustee is in possession of, or holds title to, real or personal property, and the property, or some interest, is claimed to belong to another" and (C) "[w]here the property of the trust is claimed to be subject to a creditor of the settlor of the trust." Probate Code § 17000(b)(3) provides for concurrent probate court jurisdiction for "[a]ctions and proceedings by or against creditors or debtors of trusts." The § 850 and § 17000 procedures do not toll the statute of limitations, but they can meet it by timely filing.

The creditor, however, could be barred from recovering from the trust, if the creditor later learns there were probate assets sufficient to pay the claim and did not timely file a probate creditor's claim, because Probate Code § 19001(a) only allows the creditor to recover from the trust where the probate assets are "inadequate to satisfy [the] claims".

Final Thoughts on Timing. The various rules suggest some strategic or tactical considerations. Speedy trust administration can thwart creditor's claims against the trust assets, by distributing them out before the creditor can get a judgment against the trustee – who will be blameless for doing so absent trust language imposing a duty for the creditor's benefit. The creditor would then have to file a claim within the 1-year statute of limitations against the beneficiary distributees.

Alternatively, if practicable, "laying low" and stalling distribution until the one-year statute of limitations expires can thwart creditors, who may not file a timely suit against the trustee, and will then be time-barred to sue the distributees. But care should be taken not to inadvertently equitably toll the limitations period by fraud or other impropriety.

*The views and opinions expressed in this article are those of the authors only.

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