

## Memorandum 2013-25

**Nonprobate Transfers: Creditor Claims and Family Protection  
(Introduction of Study)**

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At its December 2012 meeting, the Commission decided to begin a study of claims of creditors and surviving family members against a decedent's assets, when those assets are transferred at death outside of the statutory probate process. Memorandum 2012-45, pp. 12-13, 35-36; Minutes (Dec. 2012), p. 2. This first memorandum, purely informational in nature, introduces that study. It describes the scope of a limited study on the topic the Commission decided to initially pursue, explains why revision in this area is needed, and discusses how this initial study might proceed.

As an aid in this project, the Commission has available to it an extensive background study prepared by the Commission's former executive secretary, Nathaniel Sterling. See *Liability of Nonprobate Transfer for Creditor Claims and Family Protections* (June 2010) (hereafter, "Background Study"). See <http://www.clrc.ca.gov/pub/BKST/BKST-L4100-NPT-Creditors.pdf>.

The Commission is extremely grateful to Mr. Sterling for the preparation of the study, which was offered and provided on a pro bono basis.

## SCOPE OF INITIAL STUDY

As described in the background study, a decedent's assets at death may be distributed outside the statutory probate process in many different ways. Methods can include the use of an inter vivos revocable trust, an insurance policy, a joint bank account or safety deposit box, holding property in joint tenancy or as community property, and many other mechanisms and financial instruments. Background Study, pp. 11-19. Comprehensive statutory revision addressing creditor and surviving family member claims against assets

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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](http://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.

distributed by each and every one of these nonprobate transfers (assets that will hereafter be generically referred to as “NPTs”) would be an extremely significant undertaking for the Commission. Background Study, pp. 151-53, 154-60.

For that reason, the Commission decided that its initial study on this topic should focus only on a narrow preliminary issue: whether and how to add to existing law a generally applicable substantive principle establishing NPT liability for creditor and surviving family member claims. Memorandum 2012-45, p. 13; Minutes (Dec. 2012), p. 2. Simply clarifying that such liability exists – even as a general principle – should help resolve many ordinary claims, by saving a claimant from having to establish the principle in court. Background Study, p. 153.

Moreover, input from stakeholders and other interested persons that the Commission receives in the course of this initial study should help the Commission decide whether and how to propose more comprehensive statutory revision, in a subsequent more ambitious study. That subsequent study might consider broad reform, as proposed and described in the background study, establishing a detailed procedural scheme in which “all of a decedent’s at death transfers, probate and nonprobate, are equally subject to liability for the decedent’s debts and family protection.” Background Study, pp. 151, 154-60. Or, the Commission might choose to study and ultimately propose only one or several of the more modest alternative reforms suggested in the background study. Background Study, pp. 153-54.

**Throughout this study, the staff therefore strongly encourages stakeholders and other interested persons to offer their input, not only on issues presented in a particular memorandum, but also on revision in this area generally.**

Except as otherwise indicated, all statutory references in this memorandum are to the Probate Code.

#### NEED FOR REVISION

Notwithstanding society’s historic interest in facilitating a decedent’s donative freedom, public policy has long consistently dictated that claims of a decedent’s creditors, and short-term emergency needs of the decedent’s spouse and children, be satisfied before a decedent’s estate is distributed pursuant to the decedent’s expressed wishes. Restatement (Third) of Property: Wills and Other Donative Transfers (2003) § 10.1 Comment; see also discussion in Batts, *I Didn’t*

*Ask to Be Born: The American Law of Disinheritance and a Proposal for Change to a System of Protected Inheritance*, 41 Hastings L.J. 1197 (1990), pp. 1243-49 (lengthy background discussion of how law in multiple jurisdictions has historically balanced the tension between testamentary freedom and other legal interests, including the rights of creditors and surviving family members).

Prior to 1960, this public policy appears to have been adequately served in California by well-established legislation. Until that time, a decedent's assets were routinely distributed by either will or intestate succession, both of which are subject to probate administration. Background Study, pp. 6-7. And since at least 1931, the Probate Code has contained a relatively extensive body of law addressing creditor claims in a probate proceeding. See Section 9000 *et seq.* (superseding Section 700 *et seq.*, repealed by 1988 Cal. Stat. ch. 1199).

Further, over that same time period, various "family protection" claims have been statutorily available to surviving family members in conjunction with the probate process. See Section 6500 *et seq.* (superseding Section 660 *et seq.*, repealed by 1983 Cal. Stat. ch. 842); Background Study, pp. 137-39. Primary among these protections are the setting aside of a homestead and other personal property (Sections 6510-6528), and the granting of a reasonable "family allowance" (Sections 6540-6545).

However, the 1960s witnessed a "nonprobate revolution," popularizing a variety of different financial instruments that allowed a decedent's assets to be distributed at death without the expense and delay of probate. See Langbein, *The Nonprobate Revolution and the Future of the Law of Succession*, 97 Harv. L. Rev. 1108 (1984). Chief among these vehicles was the inter vivos revocable trust (commonly known as a "living trust"), in which a settlor transfers assets into a revocable trust, names himself or herself as trustee, and identifies a successor trustee who is instructed to convey trust assets to specified beneficiaries upon the settlor's demise.

The use of living trusts and other methods that do not require probate to distribute a decedent's assets has become increasingly common. Background Study, p. 8 (noting that the percentage of probate filings in California has decreased by half over the past two decades). At the same time, statutory reform addressing whether and how creditor and surviving family member claims may be made against assets distributed outside of probate has lagged.

This gap in the law relating to the liability of NPTs for creditor and surviving family member claims was partially closed in 1991. Based on the popularity of

living trusts, the Legislature added a new statutory part to the Probate Code, addressing creditor claims against the property of a deceased settlor held in an inter vivos revocable trust. 1991 Cal. Stat. ch. 992; Sections 19000-19403. However, the primary “family protections” available in a probate proceeding (set asides of homestead and personal property, and family allowances) were not included in this new part, and there continues to be no statutory authority for bringing these claims against an inter vivos revocable trust. Background Study, pp. 9, 139; see also 24 Cal. Jur. 3d, *Decedents’ Estates* § 340 (2013).

With regard to the many other types of NPTs which continue to be used, law relating to claims of surviving family members or of creditors remains “unclear, inconsistent, and haphazard.” Background Study, p. 9. The background study summarizes that law as follows:

Roughly speaking, the law either (1) exempts the nonprobate transfer from liability, (2) subjects the nonprobate transfer to liability if the decedent’s probate estate is inadequate, or (3) is silent. The most common basis for liability of a nonprobate transfer under case law is that the transfer is fraudulent as to creditors — i.e., the nonprobate transfer renders the decedent’s estate insolvent. While there is nonprobate transfer liability in some circumstances, the procedural mechanisms for imposing that liability are often unclear.

Background Study, p. 19.

Section 5000 authorizes nonprobate transfers on death pursuant to many written instruments, and indicates that a transfer pursuant to that section does not limit any otherwise existing creditor right against such a transfer. Section 5000(c) (“Nothing in this section limits the rights of creditors under any other law.”) However, no commentary or case law has since construed that provision, and on its face Section 5000(c) grants creditors no affirmative rights at all. Background Study, p. 11. Creditors seeking to pursue claims against assets transferred under Section 5000(a) must continue to seek authority for claims based solely on the patchwork of law that exists specific to each type of transfer. See extensive discussion in Background Study, pp. 11-61.

With regard to “family protection” claims against NPTs, there appears to be *no* statutory authority for the primary protections available in probate (homestead and property set aside, family allowance). Background Study, p. 139.

## NEXT STEPS

In order for the Commission to develop a global rule establishing NPT liability for creditor and surviving family member claims, the Commission will first need to learn more about the historical policy considerations underlying the liability of a decedent's estate for these types of claims generally. The staff suggests that these policy considerations should initially be explored in the context of the probate process (where statutory authority governing this liability is most developed), with an accompanying focus on whether or not each identified consideration has a similar application to NPT liability.

A logical next step would be to examine each specific method by which a decedent's assets can be transferred outside probate, and evaluate whether policy considerations relevant to a particular type of transfer might dictate different statutory treatment when assets are transferred in that manner. For example, joint tenancy property has generally been held to pass upon a deceased tenant's death to the surviving tenant, free from any claims of the decedent's creditors. Background Study, pp. 14-15. To the extent considerations relevant to only a subset of NPTs were identified, the Commission would then need to decide whether to incorporate those considerations in a single global rule, or carve out limited exceptions for the NPTs requiring different treatment.

Next, the Commission should consider whether special rules governing the liability of a probate estate should be incorporated in a global rule governing NPT liability (e.g., abatement principles, hierarchy of claims).

Finally, the Commission should consider whether any aspect of a contemplated global rule would conflict with any existing statute governing NPT liability for creditor and surviving family member claims. If so, the staff would present revisions needed to eliminate that conflict.

**Does the Commission approve this proposed approach?**

Respectfully submitted,

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