

Memorandum 2017-23

**Nonprobate Transfers: Creditor Claims and Family Protections
(Discussion of Issues)**

The Commission¹ recently reactivated its study on nonprobate transfer liability. Memorandum 2017-7 reintroduced the study, summarizing the 2010 background report, *Liability of Nonprobate Transfer for Creditor Claims and Family Protections*,² prepared by Nathaniel Sterling (hereafter, “NPT Report”) and discussing known changes to the laws pertaining to nonprobate transfer (hereafter, “NPT”) liability.

The Commission previously endorsed an incremental approach to this study. After providing some additional background, this memorandum focuses on the preliminary first step that the Commission identified previously: “whether and how to add to existing law a generally applicable substantive principle establishing NPT liability for creditor and surviving family member claims.”³

NEW INFORMATION: RECIPIENT-BASED LIABILITY RULE

The memorandum reintroducing this study summarizes the asset- and property-based liability rules for NPT liability.⁴ Before proceeding further, it may be helpful to supplement that summary with some additional background on California’s current laws governing NPT liability.

After the NPT Report was prepared, a California appellate court considered the extent to which a surviving spouse who receives property via NPT

1. Any California Law Revision Commission document referred to in this memorandum can be. 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. The NPT Report is available at <http://www.clrc.ca.gov/pub/BKST/BKST-L4100-NPT-Creditors.pdf>.

3. Memorandum 2013-25, p. 2.

4. See Memorandum 2017-7.

(specifically, joint tenancy) from a deceased spouse is personally liable for the decedent's debts. The court's decision is discussed in detail below.

Spousal Liability for NPTs

The case in question is *Kircher v. Kircher*.⁵ This section describes what the court did, and then discusses some criticism of the court's analysis.

Kircher v. Kircher

In *Kircher*, the court was asked to interpret Probate Code Sections 13550 and 13551, which impose personal liability on the surviving spouse for a decedent spouse's debts. Sections 13550 and 13551 provide:

13550. Except as provided in Sections 11446 [regarding spousal liability for funeral expenses and expenses of last illness], 13552 [regarding timeliness of claims], 13553 [declaring spouse not liable if relevant property is administered in probate], and 13554 [allowing spouse to assert defenses, cross-claims and setoffs available to the decedent], upon the death of a married person, the surviving spouse is personally liable for the debts of the deceased spouse chargeable against the property described in Section 13551 to the extent provided in Section 13551.

13551. The liability imposed by Section 13550 shall not exceed the fair market value at the date of the decedent's death, less the amount of any liens and encumbrances, of the total of the following:

(a) The portion of the one-half of the community and quasi-community property belonging to the surviving spouse under Sections 100 and 101 that is not exempt from enforcement of a money judgment and is not administered in the estate of the deceased spouse.

(b) The portion of the one-half of the community and quasi-community property belonging to the decedent under Sections 100 and 101 that passes to the surviving spouse without administration.

(c) The separate property of the decedent that passes to the surviving spouse without administration.

Specifically, the court in *Kircher* was considering whether the surviving spouse's personal liability under Sections 13550 and 13551 includes the value of real property received by a surviving spouse via joint tenancy.⁶ As discussed in

5. 189 Cal. App. 4th 1105 (2010), *rev. denied*, 2011 Cal. LEXIS 1437.

6. See *id.* at 1112.

more detail below, joint tenancy property is traditionally not subject to claims of a decedent joint tenant's creditors.⁷

The court concluded that Section 13551 covers joint tenancy property held by spouses.⁸ More generally, the court stated that Section 13551 "broadly encompasses all community property interests held by the spouses, as well as all separate property interests held by the deceased spouse, and imposes personal liability on the surviving spouse up to the fair market value, at the time of the deceased spouse's death, of assets that can be so characterized."⁹

The court thus construed the Probate Code to include an expansive personal liability rule for spousal recipients of NPTs.¹⁰ Under that rule, it appears that a surviving spouse is personally liable for the decedent spouse's debts for *any* of the decedent's separate or community property that passes to the surviving spouse outside of probate administration.¹¹ In other words, the extent of the surviving spouse's personal liability includes the value of any NPT received from the decedent.

Criticism of Kircher

In *Kircher*, the court concluded that "the Legislature clearly intended that section 13551 reach all property, including property held in joint tenancy, as long as it is properly characterized as community property or the decedent's separate property."¹² The *Kircher* court's expansive read of Sections 13550 and 13551 seems to be undercut by the history and context of these statutory provisions.

CEB commentary criticizes the *Kircher* analysis on that basis. The comment suggests that the historical and textual context of Sections 13550 and 13551 "indicates that the legislature never intended that the statute would apply with respect to joint tenancy property."¹³

In *Kircher*, the court is construing a liability rule contained in a division of the Probate Code establishing simplified administration procedures, as an alternative to probate.¹⁴ While Sections 13550 and 13551 broadly refer to property

7. See discussion of "Liability of NPT by Right of Survivorship" *infra*; see also *Kircher*, 189 Cal. App. 4th at 1110-1111.

8. 189 Cal. App. 4th at 1113.

9. *Id.* at 1115.

10. *Id.* at 1112-1116.

11. See *id.*; see also Prob. Code §§ 13550, 13551.

12. 189 Cal. App. 4th at 1113.

13. CEB, *Kircher v. Kircher*, 32 Est. Plan. & Cal. Prob. Rep. 85, 86 (Dec. 2010).

14. See generally Prob. Code §§ 13000-13666; see also NPT Report, pp. 39-43.

“that passes without administration,” the surrounding provisions suggest this phrase refers more specifically to property that passes to the spouse under the simplified administration procedure — i.e., property that passes by will or intestate succession *that would otherwise be probated*.¹⁵

Given the concerns about the reasoning of the *Kircher* court, it seems possible that a future court considering NPT liability under Sections 13550 and 13551 might reach a different result. In particular, a court could perhaps conclude that these sections are not intended to address NPTs by joint tenancy or beneficiary designation.

Non-Spouse Liability for NPTs

The staff did not identify any special rules that govern the liability of NPTs received by non-spouse beneficiaries.

PRIOR APPROACH IN CONTEXT

In the NPT Report, Mr. Sterling concludes that comprehensive legislative reform of the law governing NPT liability would be ideal.¹⁶ More specifically, the NPT Report includes lengthy lists of “Principal Recommendations,” “Secondary Recommendations,” and “Other Recommended Revisions” for the law governing NPT liability and enforcement.¹⁷ However, Mr. Sterling also identifies a number of more limited, helpful reforms that could be undertaken, if the comprehensive legislative reform is not immediately pursued.¹⁸ In particular, Mr. Sterling suggests:

At a minimum the law should clearly state the substantive liability of a nonprobate transfer for the decedent’s debts and family protections. That will save parties a trip to court to establish the rule. A clear rule will also facilitate out of court resolution of a liability dispute in the ordinary case.¹⁹

When assessing the scope of its study, the Commission preferred an incremental approach, rather than initially undertaking a comprehensive reform. As a general matter, an incremental approach will allow the Commission to

15. See generally 32 Est. Plan. & Cal. Prob. Rep. at 86-88; see also Prob. Code §§ 13500-13502, 13550-13551, 13553.

16. See NPT Report, p. 151.

17. *Id.* at 154-160.

18. See *id.* at 153-154.

19. *Id.* at 153.

assess the appetite for reform in this area, with a more modest investment of Commission resources.

Given that the substantive liability of NPTs is the fundamental policy question discussed in the NPT Report,²⁰ the Commission initially decided to focus its study on the question of whether to enact a substantive liability rule for NPTs (hereafter, “liability principle”).²¹

Although the Commission will focus initially on a narrow issue, the staff strongly encouraged, and continues to encourage, stakeholders and interested persons to provide input on revision of this area of the law more generally. We hope that such input could “help the Commission decide whether and how to propose more comprehensive statutory revision, in a subsequent more ambitious study.”²²

LIABILITY PRINCIPLE IN CONCEPT

Under California law, debts do not die with the debtor.²³ After death, a creditor with a valid claim against the decedent can still get the debt satisfied by the decedent’s probate estate or trust.²⁴

In this phase of the study, the Commission is considering whether to enact a rule imposing liability on NPTs for a decedent’s debts. As detailed in Memorandum 2017-7, a variety of liability rules potentially apply to NPTs. The applicability of those rules can depend on the asset transferred, the type of transfer, and the availability of other assets to satisfy the creditor. As discussed above, there is also a liability rule applicable to a surviving spouse who receives property from the decedent spouse via NPT.²⁵

In some cases, the different potentially applicable liability rules for an NPT can be in conflict. It may not be obvious which rule should govern the liability of a particular NPT.²⁶

20. Memorandum 2010-27, p. 2.

21. See Memorandum 2012-45, p. 13; Minutes (Dec. 2012), p. 2.

22. Memorandum 2013-25, p. 2.

23. See generally, e.g., Prob. Code §§ 9000-9399, 19000-19403; Recommendation Relating to Creditor Claims Against Decedent’s Estate, 19 Cal. L. Revision Comm’n Reports 299 (1988).

24. See Prob. Code §§ 9000-9399 (creditor claims in probate), 19000-19403 (creditor claims against trust).

25. See discussion of “Spousal Liability for NPTs” *supra*.

26. See discussions of “Kircher v. Kircher” and “Criticism of Kircher” *supra*.

As a general matter, absent some overriding policy issue, it is unclear why the decedent's property that is transferred by nonprobate means at death should not also be liable for a decedent's debts. The NPT Report states, "[t]he policy, if any, that supports immunization of nonprobate property from a decedent's creditors and dependents is not obvious."²⁷ More specifically, allowing a decedent to immunize certain property from creditor claims simply by using a different instrument to transfer the asset (e.g., a bank account passing to a beneficiary designated in a will vs. a bank account passing to a beneficiary on a pay-on-death designation) seems to favor form over substance.²⁸

As a general matter, the law does not permit a person to transfer away assets to avoid those assets being available to satisfy creditors.²⁹ To the extent that the decedent has prior obligations that have not been satisfied, the decedent's creditors seem to have a greater claim to the decedent's assets than an NPT beneficiary.

Does the Commission wish to develop an express statutory rule imposing liability on NPTs for a decedent's debts?

EXCLUSIONS FROM SCOPE OF LIABILITY PRINCIPLE

Assuming that the Commission decides to develop an express statutory rule imposing liability on NPTs for a decedent's debts, the next step is determining the scope of that rule. As an initial matter, there are two items that the staff believes should be excluded from any liability rule:

- (1) Federal liability rules that preempt contrary state regulation.
- (2) Medi-Cal estate recovery rules.

27. NPT Report, p. 10.

28. This discussion is simply considering whether NPTs should be immune from creditor claims altogether.

This discussion is not meant to suggest that liability should be imposed on the decedent's NPTs as if the assets were disposed of through the decedent's will or intestacy. It is possible that, for instance, the decedent intended that the beneficiary of a pay-on-death bank account receive property outside of probate, thereby avoiding the creditor claims process in probate. If so, effectuating the decedent's intent would require that the bank account only be available to satisfy creditor claims if the probate estate is insufficient. See, e.g., NPT Report, pp. 90-92. This issue — whether an NPT should be given a preference over the decedent's other property with respect to creditor liability — will be discussed in a subsequent memorandum.

29. See California's Uniform Voidable Transaction Act, codified at Sections 3439-3439.14 of the Civil Code. The NPT Report notes that attacking an NPT as a voidable transaction is "[t]he classic approach for a creditor to reach property that passes outside the probate estate." NPT Report, p. 22; see also Memorandum 2017-7, pp. 14-15.

Each of these is discussed briefly below.

Federal Preemption

As the NPT Report specifies, federal law includes rules that govern the liability of NPTs. In some cases, California may be preempted from adjusting those liability rules.³⁰ For instance, California would likely be precluded from adjusting the liability of NPTs for federal estate tax.³¹

The staff recommends that any liability principle considered by the Commission should expressly disclaim imposing or restricting liability on NPTs to the extent that federal law governs liability and preempts state liability rules.

Medi-Cal Estate Recovery

The NPT Report and Memorandum 2017-7 suggest excluding Medi-Cal estate recovery. Medi-Cal estate recovery “refers to state action to reclaim certain Medi-Cal costs from the estates of beneficiaries after their death.”³² Under federal law, states are required to seek recovery of certain Medicaid costs, while authorized to seek recovery for other covered services.³³

The NPT Report suggests that “[i]f a comprehensive statute on nonprobate transfer liability is developed, the Medi-Cal claims recovery process should be excluded from it because it is largely a creature of federal law and is circumscribed by federal law.”³⁴ Since the NPT Report was prepared, California made significant changes to the scope of recovery for Medi-Cal reimbursement,³⁵

30. See, e.g., NPT Report, pp. 17 (social security benefits), 62-66 (liability for federal estate tax).

31. See *id.* at 62-66.

32. California HealthCare Foundation, Issue Brief: Estate Recovery Under Medi-Cal 1 (Sept. 2014), available at <http://www.chcf.org/~media/MEDIA%20LIBRARY%20Files/PDF/PDF%20E/PDF%20EstateRecoveryMediCal.pdf>.

33. *Id.* The Issue Brief cited here was prepared before California’s changes to the scope of Medi-Cal estate recovery. See 2016 Cal. Stat. ch. 33 (SB 833 (Committee on Budget and Fiscal Review)); see also *infra* note 36.

34. NPT Report, p. 61.

35. The policy justification for these changes appears to be specific to the Medi-Cal context. See generally Assembly Committee on Health Analysis of SB 33 (July 2, 2015). In that analysis, the purpose of the change to Medi-Cal estate recovery is described, in part, as follows:

Medi-Cal estate recovery is unfair to Medi-Cal beneficiaries, is a deterrent to signing people up for Medi-Cal, and is counter to state and federal efforts to enroll people into health care coverage. ... The author contends that by recovering for health care services beyond those required by federal law, California forces low income individuals age 55 and older to choose between signing up for basic healthcare services, and passing on their home and other limited assets they possess to their children. ... The author maintains California’s estate recovery program undermines the idea of Medi-Cal as a health care entitlement program by

apparently eliminating NPTs from the scope of assets subject to Medi-Cal estate recovery.³⁶ As explained in Memorandum 2017-7, it would be inappropriate to make changes to the liability of NPTs for Medi-Cal expenses, given the recent legislation directly addressing this issue.³⁷ **The staff therefore recommends that Medi-Cal estate recovery be expressly excluded from any general liability principle for NPTs.**

RIGHT OF SURVIVORSHIP

As a general matter, a right of survivorship in jointly-owned property results in the surviving joint owners acquiring ownership of the whole property upon the death of one joint owner, effectively dispensing of the decedent's interest outside of probate.³⁸

Joint tenancy is a long-standing form of property ownership that allows joint owners to hold property jointly in undivided equal shares with a right or survivorship.³⁹ When one joint tenant dies, the decedent's share of the property is divided equally among the surviving joint tenants by operation of the right of survivorship.⁴⁰ The right of survivorship

... attaches as a result of the original grant that created the joint tenancy, and not as a result of the death of a joint tenant. On the joint tenant's death, the surviving joint tenant or tenants continue

essentially turning Medi-Cal coverage for basic medical services into a loan program, with collection taking place at death; this unfairly places part of the burden on financing the cost of health care in Medi-Cal on the estates of deceased Medi-Cal beneficiaries with limited assets. The author further explains that by using a broader definition of estate than is federally required, California forces people on Medi-Cal to choose between leaving something for their heirs and surrendering their property while they are still living. The author maintains estate recovery is inequitable as it primarily applies to individuals age 55 and over, and does not apply to tax-subsidized health care coverage in Covered California or to the broadly financed federal Medicare program.

36. See California Department of Health Care Services, Changes to Estate Recovery effective January 1, 2017 due to Legislation SB 833, available at http://www.dhcs.ca.gov/services/Documents/Changes_to_Estate_Recovery_effective_January_1.pdf; see also http://www.dhcs.ca.gov/services/Pages/TPLRD_ER_cont.aspx.

37. Memorandum 2017-7, p. 17.

38. See Miller & Starr, California Real Estate (4th ed.) § 11.22; NPT Report, pp. 14-15.

39. See Miller & Starr, *supra* note 38, § 11.21 ("Joint tenancy was favored in early English law because the incident of survivorship preserved feudal property holdings until the death of the last survivor."); see also Civ. Code § 683 (originally enacted in 1872).

40. See Miller & Starr, *supra* note 38, § 11.22 ("The interest of a joint tenant has been described as a specialized form of life estate with what amounts to a contingent remainder in fee, the contingency being dependent on which joint tenant survives.") (citation omitted).

in the ownership of the entire property, including the former title of the deceased joint tenant.⁴¹

Joint tenancy offers a relatively easy, inexpensive way to transfer property at death. The survivorship feature of joint tenancy has led many to colloquially refer to joint tenancy as the “poor man’s will,” “poor man’s estate plan,” or “poor man’s probate.”⁴²

Both real and personal property can be owned in joint tenancy.⁴³ However, joint tenancy is not the only form of joint ownership with a right of survivorship. Real property can also be held as community property with a right of survivorship.⁴⁴

Liability of NPT by Right of Survivorship

For joint tenancy, the traditional rule is that the property transfers by right of survivorship *free of the claims of the decedent’s creditors*, including a lien or encumbrance against the decedent’s interest.⁴⁵ It seems possible, although not entirely clear, that this liability rule would also apply to personal property held in joint tenancy.⁴⁶

However, as indicated previously, the *Kircher* decision effectively circumvents this liability rule for joint tenancy between spouses and community property with a right of survivorship, by, instead, imposing personal liability on the surviving spouse for the value of the property received.⁴⁷

41. *Id.* (citations omitted).

42. See, e.g., William P. Streng, Estate Planning, p. 382 (2016); see also Second Supplement to Memorandum 93-32, p. 1 & Exhibit p. 8; Am. Acad. of Estate Planning Attorneys, The Trouble With Joint Tenancy 2, available at https://www.holmgrenestateplanning.com/wp-content/uploads/2017/01/2017_The_Trouble_With_Joint_Tenancy.pdf.

43. See, e.g., NPT Report, pp. 14-15, 18.

44. See *id.* at 13-14, 88.

45. *Id.* at 14-15; but see *Kircher*, 189 Cal. App. 4th at 1112 (surviving spouse who receives property as a surviving joint tenant of deceased spouse is personally liable for deceased spouse’s debt to extent of net value of property received, under Probate Code Sections 13550 and 13551).

46. NPT Report, pp. 14, 18; see also discussion of “Prior Commission Work Regarding Joint Tenancy Liability” *infra*.

47. See CEB, California Estate Planning § 7.28 (2016) (noting that creditor protection does not apply to community property with a right of survivorship).

Most jointly-owned property with a right of survivorship probably is held by spouses. See generally NPT Report, p. 88; see also Stephen S. Case, Joint Tenancy, ALI-ABA Course of Study Materials: Basic Estate and Gift Taxation and Planning, Course No. SG025 (Oct. 2001) (Joint tenancy noted as “[m]ost common form of co-ownership of assets between husband and wife, parent and child.”); Yale B. Griffith, Community Property in Joint Tenancy Form, 14 Stan. L. Rev. 87, 88-89 fn. 4, 5 (1961-1962).

NPT Report Recommendation

The NPT Report recommends reversing the rule of nonliability for the right of survivorship. Specifically, the NPT Report recommends that:

The law should make clear that the decedent's interest in joint tenancy property is liable for the decedent's debts on the same basis as any other nonprobate transfer.⁴⁸

However, the NPT Report goes on to say:

There is an emotional component to joint tenancy property. Populist sentiment may surface in the legislative process to maintain the preferred status of joint tenancy property. If that occurs, a possible middle ground would be to make the change to joint tenancy liability prospective only or to provide a grace period for reconfiguring titles and estate plans. That would undoubtedly cause confusion for a number of years but would be worth doing nonetheless.⁴⁹

The NPT Report also notes that the federal estate tax scheme and the Missouri⁵⁰ and Washington NPT liability statutes permit the imposition of liability on joint tenancy property.⁵¹ The Uniform Act, however, does not impose liability on real property held in joint tenancy, but leaves the treatment of a personal property joint tenancy to determination by the court.⁵²

48. NPT Report, p. 90.

49. *Id.*

50. Missouri offers two forms of joint ownership of property with a right of survivorship: joint tenancy and tenancy by the entireties. Missouri's nonprobate transfer liability statute covers joint tenancy property "that was subject to the satisfaction of the decedent's debts immediately prior to the decedent's death ..., but only to the extent of the decedent's contribution to the value of the property." Rev. Stat. Mo. § 461.300(8). However, Missouri's statute does not appear to address tenancy by the entireties, which is a form of joint ownership limited to spouses. See NPT Report, pp. 66-67, App. pp. 28-31 (reproducing Missouri statute); see also Rev. Stat. Mo. §§ 461.005(7), 461.300(8), (10)(4); Robert J. Selsor, *Fattening Up the Skinny Estate – The Non-Probate Transfer Statute's Remedies for Pursuing a Decedent's Assets*, 67 J. Mo. Bar 286, 288 (Sept.-Oct. 2011) ("Likewise, although joint property can be reached if the decedent contributed to the value of such property, tenancy by the entirety property (i.e., property owned with a spouse), cannot be reached since Missouri does not allow collection against such property if a judgment is only against one of the spouses.") (citation omitted).

51. NPT Report, p. 88. The NPT Report also indicates that California's Medi-Cal Estate Recovery Act imposes liability on joint tenancy property. With the recent amendments to the Medi-Cal estate recovery laws, it appears that joint tenancy property is no longer liable for Medi-Cal reimbursement claims. See generally Memorandum 2017-7, pp. 16-17.

52. NPT Report, p. 71. The Uniform Act's commentary expresses "[n]o view ... as to whether a survivorship interest in personal or intangible property registered in two or more names as joint tenants with right of survivorship" would fall within the definition of "nonprobate transfer" in the Act. *Id.*

Prior Commission Work Regarding Joint Tenancy Liability

In 1980, the Commission proposed changes to the liability rule for joint tenancy with respect to personal property. In particular, the Commission recommended the adoption of the substance of the Uniform Multiple-Party Accounts Act (Article VI of the Uniform Probate Code).⁵³

As recommended, this Act would authorize three types of multiple-party accounts designed to transfer property at death: a joint account, a pay-on-death account and a Totten Trust Account.⁵⁴ The Act would also provide:

No multiple-party account is effective against an estate of a deceased party to transfer to a survivor sums needed to pay debts, taxes, and expenses of administration, including allowances to the surviving spouse, minor children and dependent children ..., if other assets of the estate are insufficient.⁵⁵

This Commission recommendation was not enacted by the Legislature. That result was due, in part, to concerns about imposing liability on joint accounts for a decedent's debts.⁵⁶ These concerns were not alleviated by an amendment to exempt a surviving spouse from that liability rule.⁵⁷

After the bill to implement its recommendation died, the Commission modified its recommendation to omit the provisions relating to the rights of a decedent's creditors in a multiple-party account.⁵⁸ The Legislature enacted the revised recommendation in large part.⁵⁹

This prior experience supports the cautionary note in the NPT Report, indicating possible resistance to changing joint tenancy's existing immunity from liability for a decedent's debts. On the other hand, the Commission's effort to change the rule for multiple party accounts was over 30 years ago. It is possible that views have changed since then, particularly because *Kircher* has largely

53. Recommendation Relating to Non-Probate Transfers, 15 Cal. L. Revision Comm'n Reports 1605 (1980).

54. *Id.* at 1613-1614.

55. *Id.* at 1653-1654 (proposed Prob. Code § 6107); see also *id.* at 1619-1620, 1654-1656.

56. See generally Memorandum 81-02, pp. 4-5; Memorandum 81-26, pp. 1-2; Memorandum 82-36, p. 1; see also Second Supplement to Memorandum 93-32, p. 1 (regarding effect of joint tenancy title on community property).

57. See Memorandum 81-26, p. 1.

58. See Memorandum 82-36; Recommendation Relating to Nonprobate Transfers, 16 Cal. L. Revision Comm'n Reports 129 (1982).

59. See generally 2001-2002 Annual Report, App. 3, 31 Cal. L. Revision Comm'n Reports 1, 52, 58 (2001).

undermined the traditional immunity rule in situations where the surviving spouse receives property by right of survivorship.

Commission Decision

If the Commission decides to develop a liability principle subjecting NPTs to a decedent's debts, the Commission needs to decide whether to include property that passes by right of survivorship within the scope of that rule, or carve it out as an express exception. **How would the Commission like to address this issue?**

ISSUES FOR FUTURE CONSIDERATION

If the Commission decides to develop a liability principle for NPTs, there are a few other issues that it will need to consider. Those issues are described briefly below and will be explored in more detail in subsequent memoranda.

Family Protections

Existing law provides certain financial protections to a decedent's surviving spouse and dependents in probate.⁶⁰ Those protections are prioritized over the payment of decedent's debts. If the Commission decides to expressly extend liability for a decedent's debts to assets that pass outside of probate, the Commission should consider whether to establish family protections that apply outside of probate.

Exemptions from Enforcement of Money Judgments

Under California law, certain assets are exempt from the enforcement of money judgments. These exemptions are codified in the Code of Civil Procedure, in the Enforcement of Judgments Law.⁶¹

Under current law, the application of these exemptions to NPTs is unclear. Much of the uncertainty about the application of the Enforcement of Judgments Law to NPTs arises from the different sets of rules in the Code of Civil Procedure and Probate Code.⁶²

The Enforcement of Judgments Law seems to focus on situations in which a creditor is seeking to enforce a debt against a debtor *during the debtor's life*, while

60. See generally discussion of family protections in NPT Report, pp. 137-151; see also Memorandum 2017-7, pp. 21-23 (summarizing NPT Report discussion of family protections).

61. See generally Code Civ. Proc. §§ 703.010-704.995.

62. See generally Code Civ. Proc. §§ 680.010-709.030; Prob Code §§ 9000-9399, 19000-19403.

the Probate Code focuses on enforcing money judgments against a *decedent*.⁶³ The Probate Code offers clear rules for creditor claims in probate and trust administration,⁶⁴ but generally does not address creditor claims against other forms of NPT.⁶⁵

If the Commission decides to proceed with creating a liability principle that would permit the decedent's creditor to proceed against an NPT beneficiary, the Commission should consider whether an NPT beneficiary should be permitted to claim exemptions that are available under the Enforcement of Judgments Law.

Administrability of NPT Liability Principle

Probate administration can serve an important function when the decedent has significant debts. With a multiplicity of creditors and heirs, the probate court can determine which creditors get paid and how much, as well as which heirs have their gifts reduced to pay creditors and by how much. The Probate Code includes rules for priority of creditors and a default order of abatement for gifts.⁶⁶ The Probate Code also subjects the trust claims procedure to such rules.⁶⁷ However, implementation of such rules seems to require a proceeding that marshals the assets and allocates the assets appropriately.⁶⁸

In the absence of centralized administration, a liability rule could result in significant inefficiency and inequity. NPT beneficiaries could face a multiplicity of creditor claims. The disproportionate burden of those claims may fall on NPT beneficiaries who are easier to reach or who received larger gifts. The Commission should consider the complications that may result from a lack of centralized administration.

63. See Code Civ. Proc. § 686.020; Prob. Code § 9300(a) ("Except as provided in Section 9303, after the death of the decedent all money judgments against the decedent or against the personal representative on a claim against the decedent or estate are payable in the course of administration and are not enforceable against property in the estate of the decedent under the Enforcement of Judgments Law."); see also former Code Civ. Proc. § 686.020, as enacted by 1982 Cal. Stat. ch. 1364, § 2; 16 Cal. L. Revision Comm'n Reports at 1237 (Comment to proposed Code Civ. Proc. § 686.020).

64. See Prob. Code §§ 9000-9399; 19000-19403.

65. But see *id.* § 9653(a)(3).

66. See generally NPT Report, pp. 55-57, 93-94, 112-114.

67. *Id.* at 46, 55; but see *id.* at 56.

68. See, e.g., *id.* at 56 ("Although the abatement scheme is intended to apply to both probate and nonprobate transfers, it is not clear how that can actually work other than in administration proceedings. A trustee could sensibly apply abatement principles during trust administration.") (citations omitted).

CONCLUSION

The staff needs guidance on the following questions:

- Does the Commission wish to develop an express statutory rule imposing liability on NPTs for a decedent's debts?
- If so, should there be an express exemption for federal preemption? For Medi-Cal estate recovery?
- If the Commission decides to develop a liability rule, should that rule apply to real property that passes by right of survivorship? To personal property that passes by right of survivorship?

The staff welcomes stakeholder input on the issues presented in this memorandum.

If the Commission decides to proceed with a liability rule for NPT, future memoranda will address family protection, the application of exemptions from money judgments, and administrability concerns.

Respectfully submitted,

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Staff Counsel