Heart of America Fellows Institute

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Probate and Trust Codes, Required Notices, and Creditor Claims

David English

Introduction

My assignment is to speak about a vast topic, "Probate and Trust Codes, Required Notices and Creditor Claims." A proper presentation on these topics would take an entire day. To keep my presentation within manageable bounds, my focus will be narrower, addressing the following topics:

I. What are the Uniform Probate Code and Uniform Trust Code and why are they relevant even if you don't live in a UPC or UTC state?

II. What are the other significant probate and trust uniform acts?

III. What are the typical notice issues that arise in estate administration?

IV. What are the typical notice issues that arise in trust administration?

V. What is the law on payment of creditor claims against a decedent?

I. What are the UPC and UTC and Why Are They Relevant?

The Uniform Law Commission is an organization affiliated with the states that draft what are in essence model acts for states to consider for enactment. The Uniform Probate Code (UPC) was completed in 1969. It replaced an earlier Act, the Model Probate Code, which was drafted by the ABA Section of Real Property, Trust & Estate Law and which was completed in 1946. The UPC has been enacted in full in about 20 states, including Nebraska.

The Uniform Trust Code (UTC), which was completed in 2000, has been more successful. Through 2018, it has been enacted in 37 US jurisdictions and enactments are continuing. It replaced the Uniform Trustee Powers Act but is far more comprehensive.

The participants in this program are from Arkansas, Iowa, Kansas, Missouri, Nebraska, and Oklahoma. Of these six states, only Nebraska has enacted the UPC in full, but the UTC has been enacted in full in Arkansas, Kansas, Missouri, and Nebraska. But there are nuances here. Both Iowa and Missouri enacted the 1946 Model Probate Code and the 1980 Missouri reform added selected provisions of the 1969 UPC. Iowa didn't enact the UTC as completed in 2000 but instead enacted a preliminary draft of the UTC.

There are other nuances. Even when a state has a relatively complete enactment of a uniform act, there are always variations. On the other hand, when a state decides to reform its law, even in minor respects, the relevant uniform act is almost always a starting point.

II. What are other significant probate and trust uniform acts?

There are numerous other uniform acts that are relevant to estate and trust administration. The following is a top 10 list:

1. Directed Trust Act (2017)-supplements but does not supplant UTC-enacted in 15 states, including Arkansas and Nebraska.

2. Disposition of Community Property Rights at Death Act (1971)-enacted in 17 states, including Arkansas. A revised version of this Act was approved in 2021.

3. Revised Fiduciary Access to Digital Assets (2015)-enacted in all but three states. Enacted in Arkansas, Iowa, Kansas, Missouri, and Nebraska.

4. Powers of Appointment (2013)-enacted in 12 states, including Missouri and Nebraska.

5. Principal and Income Act (1997)-enacted in all but three states. An updated Uniform Fiduciary Income and Principal Act was approved in 2018. It has been enacted in five states, including Arkansas.

6. Prudent Investor Act (1996)-enacted in all but six states.

7. Real Property Transfer on Death (2009)-enacted in 19 states, including Nebraska, but derived from 1989 Missouri enactment

8. TOD Security Registration (1989)-enacted in all but two states.

9. Transfers to Minors (1983)-enacted in all but one state.

10. Trust Decanting (2015)-enacted in 12 states, including Nebraska, but trust decanting statutes predating the Act are in force in numerous states.

III. What are the typical notice issues that arise in estate and trust administration?

Numerous notice issues arise in estate administration, including:

The Issues

1. When must notice be given of the opening of the estate?

2. Who must receive notice of the opening of the estate?

3. Must notice be given of certain intermediate actions, such as the sale of assets?

4. Who must receive notice of the closing of the estate?

5. What happens if notice is not given?

Discussion

1. When must notice of the opening of the estate be given?

Probate is very state specific. Reference always should be made to the relevant state statute. States tend to divide into two camps on when notice must be given of the opening of the estate. In some states, notice must be given to the relevant parties prior to the court hearing on the opening of the estate. But the decided trend is to provide for notice of the estate opening to be given following the personal representative's appointment.

UPC Article III provides for both approaches. In a formal opening, notice to the heirs and devisees is given prior to the court hearing and the order admitting the will to probate will generally bar a later will contest. But in UPC states, most estates are opened informally. In an informal probate, if the paperwork is in order, the clerk will automatically enter an order admitting the will to probate and appointing a personal representative. UPC § 3-705 requires that the personal representative then give notice of the estate openings to the heirs and devisees within 30 days following the appointment. However, in an informal opening a will contest is not barred until three years after the death.

As discussed later in the paper, upon the opening of an estate, notice also must be given to creditors.

2. Who must receive notice of the opening of the estate?

The probate statutes universally require that notice of the estate opening be given to the heirs and to the devisees under the will sought to be probated. Most statutes do not require that notice be given to devisees under prior wills although the giving of such notice should be considered.

3. Must notice be given of certain intermediate actions, such as the sale of assets?

The relevant state statute should be consulted. Also, the type of administration may make a difference. Under supervised administration, court approval is required for sales of assets and other significant actions. Under independent or informal administration, the estate can normally proceed without court intervention.

4. Who must receive notice of the closing of the estate?

Normally, the estate will not be closed until the issue of potential will contests and creditor claims have been resolved. Therefore, notice is the estate's closing is normally given only to the devisees. How notice is given to these devisees varies depending on the type of administration:

Supervised administration, prior notice must be given to the devisees (and unpaid creditors) of the hearing where the final account is expected to be approved.

Independent administration, no court hearing is required. The devisees (and unpaid creditors) must instead be given notice that a closing statement has been filed. The closing statement will recite that all estate administration steps have been accomplished. Should the devisees not object within some set period, such as six months or a year, the closing is final. Best practice is to obtain receipts and approvals from the devisees prior to the final distribution of assets.

Small estates proceedings, statutes vary widely. In most states, a small estate may be transferred by affidavit without judicial involvement.

5. What happens if notice is not given?

The leading case is *Tulsa Professional Collection Services, Inc. v. Pope*, 485 U.S. 478 (1988), which deals with creditor claims against decedent's estates. *Pope* holds that a creditor claim bar in probate cannot be applied to bar the claim of a creditor who is either known or reasonably ascertainable. The fact that the probate claim bar begins to run from an event in a judicial proceeding is sufficient state action to trigger due process protections. Consequently, the claim of a known or reasonably creditor can be barred only by an actual notice.

While the facts of *Pope* involve creditor claims, the logic of its holding has been applied more broadly to other types of claimants. For example, it has been held that a statute of limitations on contest of a will cannot be applied to bar the claim of an unnotified heir. *See* Kurtz, English & Gallanis, Wills, Trusts and Estates §13.1 (6th ed. 2021). A similar argument could be made by an unnotified devisee under a prior will. Consequently, to assure finality in estate administration, consideration should be given to providing actual notice of the proceeding to devisees under prior wills and to potential heirs who have plausible claims.

IV. What are the typical notice issues that arise in trust administration?

Because four of the six states in the Heart of America region are UTC states, and Iowa has a modified version, this part of the paper will use the UTC as a basis.

The following are the issues that will be addressed:

1. What is meant by a "qualified beneficiary"?

2. What is the default rule for notice under the UTC?

3. To what extent can an otherwise required notice be waived in the terms of the trust?

4. How are concepts of representation helpful in achieving finality?

Discussion

1. What is meant by a "qualified beneficiary"?

A key concept in the UTC is the definition of "qualified beneficiary," which is defined in Section 103(13). The term includes (1) current beneficiaries, which includes those to whom a discretionary distribution may be made, (2) more remote beneficiaries who would become distributees if the interest of another beneficiary terminated on the date in question, and (3) beneficiaries who would become distributees if the trust terminated on the date in question.

Under the UTC, the qualified beneficiaries have the greatest rights to notice. The other beneficiaries have lesser rights.

2. What is the default rule for notice under the UTC?

a) Section 813

The primary default provision on notice to beneficiaries is Section 813. Subsection (a) imposes an affirmative duty on the trustee "keep the *qualified beneficiaries* reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests." But the trustee must promptly respond to the request of *any* beneficiary for information related to the administration of the trust unless the request is "unreasonable under the circumstances" (emphasis added).

Section 813(a) establishes the general standard. Subsection (b) imposes several specific notice requirements, including (1) the right of any beneficiary to obtain a copy of the trust instrument, (2) notice to the qualified beneficiaries of a trustee's acceptance of office or when a formerly revocable trust becomes irrevocable, and (3) advance notice to the qualified beneficiaries of any change in the method or rate of the trustee's compensation.

Section 813(c) establishes an obligation to send the *current distributees* or *permissible distributees* an annual account, although under the UTC it is termed a "report." Consequently, there are three levels of beneficiaries under the UTC, (1) the current beneficiaries (equivalent of "distributees or permissible distributees"), (2) the qualified beneficiaries, a broader group which also includes the holders of certain successor or remainder interests, and (3) all beneficiaries.

Section 813(d) clarifies that a beneficiary may waive the right to a trustee's report or other information otherwise required to be furnished.

b) Other Sections

There are several other provisions of the UTC that require notice to beneficiaries:

1) Section 108(d)-the trustee must notify the qualified beneficiary of a proposed transfer of a trust's principal place of administration.

2) Section 414(a)-after notice to the qualified beneficiaries, the trustee may terminate a trust having a value of less than $50,000. Most UTC states have increased this amount to $100,000 or more.

3) Section 417-after notice to the qualified beneficiaries, a trustee may combine two or more trusts into a single trust or divide a trust into two or more separate trusts under specified circumstances.

4) Section 705-a trustee may resign upon at least 30 days' notice to the qualified beneficiaries, the settlors, if living, and all cotrustees.

5) Section 817-upon the termination or partial termination of the trust, the trustee may send the beneficiaries a proposal for distribution.

3. To what extent can an otherwise required notice be waived in the terms of the trust?

The UTC is primarily a default statute, meaning that what would otherwise be required may be modified in the terms of the trust. But there are exceptions. These exceptions to waiver are listed in Section 105(b). Two of the exceptions, (b)(8) and (b)(9), relate to notice, but both provisions have been placed in brackets. The insertions of brackets in a uniform act indicate that enactment of the particular provision is optional. Sometimes provisions are made optional because the provision is unimportant but in this case it was made optional because of a lack of consensus on the extent to which the Code's notice requirements may be waived

Perhaps a consensus will emerge in time. But the states are currently all over the map on the issue of waiver although several trends have emerged. The first is to enact Section 105(b)(8) and (b)(9) in its original form or with minor tweaks. *See, e.g.*, Neb. Rev. Stat. § 30-3805; N.M. Stat. Ann. § 46A-1-105. Consequently, regardless of what the trust instrument might say, the trustee, at a minimum, must respond to a beneficiary's request for information and must inform the qualified age 25 or older of the existence of the trust, of the identity of the trustee, and of their right to request trustee reports. The second alternative is to retain (b)(8) and (b)(9) but to then add language providing that a settlor may designate a surrogate to receive notice or request information on behalf of a beneficiary. *See, e.g.*, D.C Code § 19.1301.05; Me. Rev. Stat. Ann. tit. 18B, § 105; Mo. Rev. Stat. § 456.1-105. A third alternative is to allow a settlor to totally waive notice but not the obligation to respond to a beneficiary's request for information. *See, e.g.*, Ala. Code § 19-3B-105. A fourth alternative, which has gained the widest adherence, is to delete both (b)(8) and (b)(9), thereby theoretically allowing a settlor to dispense with all information reporting to the beneficiaries, whether by trustee initiative or in response to a beneficiary request. *See., e.g.*, Kan. Stat. Ann. § 58a-105; N.C. Gen. Stat. § 36C-1-105; Va. Code Ann. § 55-541.05; Wyo. Stat. § 4-10-105. Such a legislative intent to allow "secret" trusts may not be enforceable. In *Wilson v. Wilson*, 690 S.E.2d 710, 711 (N.C. Ct. App. 2010), the court, noting that it is impossible for a beneficiary to enforce a trust without information, adopted the position of Restatement (Second) of Trusts § 173 (1959). The Restatement provision provides that "the beneficiary is always entitled to such information as is reasonably necessary to enable him to enforce his rights under the trust or to prevent or redress a breach of trust." The court in *Wilson* justified its holding by noting that "Any notion of a trust without accountability is a contradiction in terms." 690 S.E.2d at 715.

4. How are concepts of representation helpful in achieving finality?

The UTC strives to keep administration of trusts outside of the courts. Numerous actions are allowed solely upon notice to the beneficiaries. These actions include: transfer of a trust's principal place of administration to or from another country or American state (UTC § 108); combination of separate trusts into one, or the division of a single trust into two or more separate trusts (UTC § 417); resignation of a trustee (UTC § 705); submission of a trustee's report (UTC § 813); and a trustee's notice of proposed plans of distribution (UTC § 817). Other actions can be accomplished upon consent of the beneficiaries. These include selection of a successor trustee (UTC § 704) and release of a trustee from potential liability (UTC § 1009).

But achieving notice to or the consent of all of the beneficiaries is frequently difficult. Trusts commonly last for decades. In an increasing number of US jurisdictions, trusts, in theory, can last in perpetuity. The current beneficiaries of the trust are frequently minors or are adults who lack capacity. Future beneficiaries may not yet be born. To achieve notice to or the consent of the beneficiaries incapable of representing themselves, others must be empowered to act on their behalf. This is the function of rules on representation. Concepts of representation are not new, but the UTC addresses the subject in more detail than previous efforts. The UTC also makes representation available for actions taken outside of court. The UTC provides not only for representation by fiduciaries (guardians, conservators, personal representatives, trustees of another trust, or agents under a durable power of attorney) (UTC § 303), but also for what is known as virtual representation, under which an otherwise unrepresented person (such as a child not yet born) may be represented and bound by another beneficiary with a substantially identical interest with respect to the particular matter or dispute (UTC § 304).

The representation provisions of the UTC can be utilized not only for purposes of achieving notice (UTC § 301(a)) to or the consent (UTC § 301(b)) of the beneficiaries for the matters detailed above, but also to settle any dispute, whether in or out of court. Section 111, the Code's nonjudicial settlement provision, is broad. The parties may enter into a nonjudicial settlement agreement with respect to any matter involving a trust (UTC § 111(b)). The settlement agreement can contain any term or condition that a *court* properly could approve (UTC § 111(c)). This standard is less stringent than one requiring that the nonjudicial settlement contain terms and conditions that the court *would* have approved. Among the issues under the UTC that may be resolved by a nonjudicial settlement agreement are the:

- interpretation or construction of the terms of the trust;
- approval of a trustee's report or accounting;
- direction to a trustee to refrain from performing a particular act, or to grant a trustee any necessary or desirable power;
- resignation or appointment of a trustee;
- determination of a trustee's compensation;
- transfer of a trust's principal place of administration to another jurisdiction; and
- liability of a trustee for an action relating to the trust.

(UTC § 111(d)).

Although the representation provisions provide practitioners with an added tool that will solve many practical problems, they should not be used without thought. Notice to and the consent of a representative is not binding if there is a conflict of interest between the representative and those ostensibly represented (UTC §§ 302-304). If conflict of interest is a possibility, the practitioner should consider requesting the court to appoint a guardian ad litem (termed a *representative* under the UTC) to represent the otherwise unrepresented beneficiary. Under the UTC, the appointment of a representative is available whether the matter to be resolved is in or out of court. In making decisions, a representative may consider general family benefit accruing to living members of the individual's family (UTC § 305).

V. What is the law on payment of creditor claims against a decedent?

Although most of the attendees at the Heart of America Institute are not from states that have enacted the UPC in full, the creditor claims provision of the UPC are an appropriate model. The UPC creditor claims provisions have been widely enacted in states that have not otherwise enacted the UPC. They are also comprehensive and therefore provide a useful list of issues to examine.

1. Claim bars

All but a few states have enacted what is known as a *claim bar*. The UPC is typical. Prior to amendments triggered by *Tulsa Professional Collection Services, Inc. v. Pope*, 485 U.S. 478 (1988), the UPC provided that all creditor claims were automatically barred four months after the publication of notice to creditors. UPC §§ 3-801, 3-803. But *Pope* held that a claim bar relying on publication alone cannot be applied to bar a claim by a known or reasonably ascertainable creditor. The claim of such a creditor can be barred only by an actual notice.

The states responded to *Pope* by enacting two types of statutes. First, most but not all states enacted statutes specifying when and how actual notice is to be given to creditors. In other states the original statute remains in place subject to the caveat that it is overridden in part by *Pope.* Second, and perhaps more significantly, numerous states enacted statutes automatically barring all claims unless filed within a definite time limit following the decedent's death, typically one year. *See, e.g.,* UPC § 3-803(a)(1). Such self-executing statutes of limitation are not subject to due process notice requirements because they don't run from an event in a judicial proceeding. Consequently, unlike the statute in *Pope*, these self-executing statutes do not involve sufficient state action to trigger constitutional protections. *See, e.g., State ex rel. Houska v. Dickhamer*, 323 S.W. 3d 29 (Mo. 2010). These self-executing statutes are absolute. A claim not filed within the specified time period, such as one year after death, is barred even if an estate has not been opened.

2. Creditor priority

Assuming a claim has been filed, it need not necessarily be paid even if it is otherwise valid. If an estate is insolvent, only claims with the appropriate priority may be paid. State probate statutes vary but UPC § 3-805 is typical. The following categories of claims are entitled to priority in the following order: (1) costs and expenses of administration; (2) reasonable funeral expenses; (3) debts and taxes with preference under federal law; (4) reasonable and necessary medical and hospital expenses of the last illness; and (5) debts and expenses with preferences under other laws of the state. Pursuant to UPC § 3-807, a personal representative can be held liable for paying claims outside the order of priority.

3. Secured creditors

A secured creditor is always entitled to enforce its security interest but is entitled to a personal judgment against the decedent's estate for a deficiency only if the creditor files a claim. The personal representative may elect to pay down a security interest even if the creditor has not filed a claim. UPC §§ 3-809, 3-814

4. Claims not due and contingent claims

There is a distinction between claims not due and contingent claims. A claim not due is where a decedent was obligated to make a payment in the future but the due date had not yet arrived at the decedent's death. A common example of a contingent claim would be a personal guarantee. Until the primary obligor defaults, the decedent owes nothing. UPC § 3-810 applies the same rules to claims not due and contingent claims as it does to ordinary current claims. The creditor must file its claim within the specified claims period, whether notice was by publication or by an actual notice. Assuming a claim is filed, such claims are ordinarily settled for a fraction of the underlying obligation although UPC § 3-810 empowers the court to create an escrow or other security arrangement to assure a possible future payment.

5. Non-probate assets

As stated in McGovern, Kurtz, English & Gallanis, Wills, Trusts & Estates § 13.6 (6th ed. 2021): "Traditionally, non-probate assets were not reachable by general creditors of the decedent even if the probate estate was insufficient to pay claims. But as the growing use of non-probate transfers decreases the pool of probate assets, state legislatures and courts have increasingly subjected non-probate assets to creditor claims."

The statutes can be divided into two categories. One category provides that a decedent's creditor can reach non-probate assets if a claim was timely filed in probate and it is established that the probate estate is insufficient to pay claims. These statutes also typically provide that the non-probate assets can be reached to pay statutory allowances (*e.g.*, homestead, exempt property, family allowances). For examples of typical statutes, see UPC § 6-102; Mo. Rev. Stat. § 461.300.

The second set of statutes are asset specific and are best discussed that way:

Revocable trusts-UTC § 505(a)(3), consistent with UPC § 6-102, provides that the assets of a revocable trust are subject to the claims of the decedent's creditors and statutory allowances to the extent the assets of the probate estate are insufficient. The UTC drafters did not attempt to specify the extent of the trust's liability if the settlor has other non-probate assets that are also subject to creditor claims.

Joint tenancy-The courts are split on whether a surviving joint tenant can be held liable for debts of a deceased joint tenant. *See* McGovern, Kurtz, English & Gallanis, Wills, Trusts & Estates § 13.6 (6th ed. 2021).

Tenancy by the entirety-About half the states recognize tenancy by the entirety title for a married couple, most commonly in real property. Protection against creditors varies, with some states providing more creditor protection than others, but in many states TBE property is totally exempt from the claims of creditors of either spouse.

Multiple-person bank accounts-The UPC multiple-person bank account statute, which has been widely enacted in the states, subjects joint and POD bank accounts to liability for claims against a deceased owner to the extent the owner's probate estate is insufficient to pay claims. UPC § 6-215. Similar liability is imposed under Section 15 of the Uniform Real Property Transfer on Death Act.

Life insurance-Many states exempt the proceeds of life insurance from creditor claims unless the proceeds are paid to the decedent's estate.

Pension, IRA benefits-IRAs and pensions belong to the designated beneficiary upon the owner's or employee's death and are not subject to the claims of the decedent's creditors. Some states extend creditor protection to inherited IRAs.