

ADAM L. STRELTZER

Attorney at Law

1875 Century Park East, Suite 700
Los Angeles, California 90067

Telephone: (424) 652-8010

Facsimile: (424) 652-2296

adam@streltzer.com

www.streltzer.com

The Basic Principles of Collecting from the Dead

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The Basic Principles of Collecting from the Dead

I. BASIC ESTATE PLANNING PRINCIPLES.

A. Authority.

California Law, primarily in the Probate Code (Prob. Code), Family Code (Fam. Code), Civil Code (Civ. Code), Code of Civil Procedure (Code of Civ. Proc.) governs the following: (1) the creation and administration of a probate estate; (2) non-probate transfers by summary administration; (3) informal procedures that do not require any court action or summary administration; (4) the creation and administration of a trust relationship; (5) the creation and administration of other fiduciary relationships; and (6) the liability of a decedent or other person in relation to a decedent.

The core provisions governing decedents' probate estates and trusts are set forth in the Prob. Code.

B. Wills and Probate Administration.

1. Definitions.

(a) A "Will" is the basic device used to direct disposition of a person's estate after their death. A will generally has no application during a person's life, and therefore has no impact upon creditor's rights.

(b) The "Decedent" is the person who has died.

(c) An "estate" is merely a term of art to describe a decedent's assets and liabilities as of the date of death, even though in ordinary conversation the term is frequently used as if it were a legal entity.

(d) The estate is subject to administration under the provisions of the Probate Code, hence it is commonly called a "Probate."

I. No person has the power to administer the decedent's estate until that person is appointed as a "personal representative," and that such appointment is "effective" only when Letters Testamentary (or Letters of Administration) are issued by the court clerk. Prob. Code §8400(a).

- ii. There are multiple 'flavors' of personal representatives, all of whom generally have the power to administer a decedent's estate as provided in Prob. Code §§9600-10382 (i.e., Executor, Administrator with the Will Annexed, or Administrators).

C. Trusts and Trust Law.

1. Nature of a Trust.

- (a) A trust is not an entity; rather it is simply a fiduciary relationship with respect to existing and ascertainable property.

2. Creation of a Trust.

- (a) Other than as may be established by a judicial remedy, a trust arises from a person's: (i) declaration that he or she holds certain property as trustee for the benefit of some beneficiary; (ii) conveyance or transfer of certain property to another person as trustee on behalf of some beneficiary; (iii) transfer of certain property by valid testamentary instrument to another person as trustee (or exercise of power of appointment); or (iv) enforceable promise to create a trust. See Prob. Code §15200.

- (b) Three parties are needed, although they need not be actual different persons:

- I. The person or persons who make a trust are the "settlor" or "settlers."
- ii. The person or persons who hold the property are the "trustee" or Trustees."
- iii. The recipients of the property held by the trustees are the "beneficiary" or "beneficiaries."

- (c) A trust generally cannot exist without property.

- (d) A trust is revocable by the settlor (or settlors) unless expressly made irrevocable by the trust instrument. Prob. Code §15400.

- (e) A revocable trust is a popular estate planning tool that can serve useful property management functions during a client's lifetime, but is primarily used as a convenient and efficient means to distribute a client's assets on his or her death.

3. Creditor's Rights.

- (a) During life, if the settlor retains the power to revoke the trust, in whole or in part, then trust property is subject to the claims of creditors of the settlor, and the settlor is entitled to claim all defenses and exemptions as if the trust does not exist. See Prob. Code §§18200-18201.
- (b) After death, property over which the settlor had power of revocation at the time of death is subject to creditors' claims, but only to the extent the settlor's estate is inadequate. See Prob. Code §§19000 et seq.
- (c) Thus, all of the assets of a revocable trust are available to satisfy the settlor's creditors, subject to certain restrictions. Consider a revocable trust to be, essentially, a "Will Substitute" ignored for creditor purposes. See Prob. Code §§ 18200-18201 & 19001.
- (d) A revocable trust generally becomes irrevocable upon the settlor's death.

4. Spendthrift Provisions - a.k.a. "anti-alienation" or "restraint upon transfer of the beneficiaries' interest."

- (a) Generally, an interest in a trust can be assigned by a competent beneficiary. If the interest can be assigned, then it is available to a creditor for satisfaction of a debt owed by the beneficiary.
- (b) BUT, if trust provides that a beneficiary's interest is restricted and may not be transferred or assigned, then the beneficial interest may NOT be subject to creditor action or enforcement of judgment UNTIL it that interest is due and payable to the beneficiary.
 - I. Once paid to the beneficiary, it is no longer 'in trust.'
 - ii. Similar restrictions for trusts where the trustee is given broad discretion to make payment to a beneficiary.

(c) Spendthrift provisions are generally respected under California law. See Prob Code §§15300 & 15301.

- i. EXCEPT invalid when applied with respect to a "self-settled" trust (when a settler contributes money or property to the formation of a trust, for which that settler is also a beneficiary).
- ii. California public policy voids self-settled trusts to prevent individuals from placing their property beyond the reach of their creditors while at the same time still reaping the bounties of such property. See Prob. §15304(a).

Public Policy: It is against public policy to permit a person to tie up their property in trust in such a way that he can enjoy it but prevent his creditors from reaching it. Where the person makes himself a beneficiary of such a trust, then any restraints in the instrument on the involuntary transfer or alienation of the person's interest in the trust are invalid and ineffective. See *Nelson v. California Trust Co.*, 33 Cal.2d 501 (1949).

II. THE ONE (1) YEAR STATUTE OF LIMITATIONS.

A. One (1) Year Limitations Period is the Most Critical Issue for Creditors.

California provides for a special one (1) year statute of limitation for all claims (accrued or unaccrued) which could have been made against a decedent. This special statute of limitations arises automatically once a person dies, and is tolled only in compliance with the applicable provisions of the Prob. Code. **Virtually any action or claim based upon the liability of a decedent must be made by a creditor within 1 year of death. Code of Civ. Proc. §366.2.**

The text of Code of Civ. Proc. §366.2(a) provides:

If 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, an action may be commenced within one year after the date of death, and the limitations period that would have been applicable does not apply.

The official legislative comments:

This section applies a 1 year statute of limitations on all actions against a decedent on which the statute of limitations otherwise applicable has not run at the time of death. This 1 year limitations period applies regardless of whether the statute otherwise applicable would have expired before or after the 1 year period.

If a general personal representative is appointed during the 1 year period, the personal representative must notify known creditors, and the filing of a claim tolls the statute of limitations. See Prob. Code §§ 9050 (notice required), 9352 (tolling of statute of limitations). If the creditor is concerned that the decedent's beneficiaries may not have a general personal representative appointed during the 1 year period, the creditor may petition for appointment during that time. See Prob. Code §§ 8000 (petition), 8461 (priority for appointment); see also Prob. Code § 48 ("interested person" defined).

*The reference to the decedent's "representatives" was deleted from former Section 353(b). **This section is concerned only with the time within which an action on a liability of the decedent may be brought, not with the proper parties in such a case.** See Code of Civ. Proc. §377.40 (assertion of cause of action against decedent). **The 1 year limitation of Section 366.2 applies in any action on a liability of the decedent, whether against a personal representative under Probate Code §§9350-9354 or against another person, such as a distributee under Probate Code §9392, a person who takes the decedent's property and is liable for the decedent's debts under Probate Code §§13109 (affidavit procedure for collection or transfer of personal property), 13156 (court order determining succession to real property), 13204 (affidavit procedure for real property of small value), or 13554 (passage of property to surviving spouse without administration), or a trustee.** For cases where an action may be brought against the estate of the decedent, rather than the personal representative, see Section 377.50 and Probate Code §§ 550-555 (insured claims). See also Prob. Code §58 ("personal representative" defined). As to survival of causes of action, see Code of Civ. Proc. §377.20.*

B. Application of the 1 year Limitations Period to Non-Probate Administration

The 1 year limitations period under Code of Civ. Proc. §366.2 affects the liability of a number of actions which may otherwise permit the avoidance of formal probate proceedings, including those against:

1. Distributee of a Probate Estate - Prob. Code §9302
2. Distributee of Trust - Prob. Code §19400, 19401 & 19402
3. Transferee via Affidavit Procedure (Personal Property) - Prob. Code §13109
4. Transferee via Succession Procedure - Prob. Code §13156
5. Transferee via Affidavit Procedure (Real Property) - Prob. Code §13204
6. Surviving Spouse Who Takes Without Administration - Prob. Code §13554

C. Related Limitations Period.

An action to establish liability based upon a promise of the decedent regarding a distribution from an estate or trust is also barred if not made within 1 year. Code of Civ. Proc. §366.3

D. Limited Exceptions to 1 Year Statute.

1. Tolling for Creditor's Claims.
 - (a) The only statutory exceptions to the 1 year limitations period in Code of Civ. Proc. §366.2 are the tolling of the statute to file suit after a formal creditor's claim, or the making of a petition to file a late claim, is filed in a proceeding to administer an estate (or, alternatively, a claim is filed in a trust proceeding).
 - (b) The allowance or approval of the claim, either in whole or in part, further tolls the statute. See Prob. Code §§9352 (probate) and 19253 (revocable trusts).
2. Equitable Estoppel.

Notwithstanding the language of Code of Civ. Proc. §366.2 that the limitations period shall not be tolled or extended for any reason other than those specified,

the doctrine of "equitable estoppel" permits a lawsuit after the 1 year period has expired where a fiduciary has promised a creditor that it need not take action, or file suit, and would get the money or property claimed at a particular time (after the limitations period expired).

III. LIABILITY OF DIFFERENT TYPES OF PROPERTY FOR DEBTS OF DECEDENT.

A. Property Distinctions.

1. Real Property versus Personal Property (Tangible and Intangible).
2. Joint Tenancy versus Tenants In Common.
3. Spousal Property (Community and Separate Property).

B. Liability of Spousal Property.

1. Debtor Spouse's Separate Property.

The separate property of the debtor spouse is liable for his or her debts during life and after death. See Fam. Code §913(a).

2. Non-Debtor Spouse's Separate Property.

(a) The separate property of the surviving spouse is generally not liable for the debts incurred by the debtor spouse. Fam. Code §913(b).

(b) However, the surviving spouse's separate property (spouse personally liable) for necessities of life of the debtor. Fam. Code §914.

(c) There is a potential after death for the court to allocate the decedent debtor spouse's debt to his spouse's separate property. Prob. Code §§11440 et seq.

3. Community Property Is Generally Liable.

(a) Before death, the community property is liable for the debts of either spouse, whether incurred before or during marriage, with certain exceptions. See Fam. Code §910.

- (b) After death, the community property of the debtor spouse and the surviving spouse is also liable for the debts of each. *Dawes v. Rich* (1997) 60 Cal.App.4th 24.

4. Community Property with Right of Survivorship.

Community property may be held with right of survivorship when the right of survivorship is expressly declared in the transfer document. Upon the death of one of the spouses the property passes to the surviving spouse without administration, subject to the same procedures as property held in joint tenancy. See Civ. Code § 682.1.

C. Joint Tenancy Property.

- 1. Property held in Joint tenancy and joint tenancy equivalents are generally not available to creditors of the decedent.

- i. Avoids formal probate administration.

- ii. However, this does not avoid liability under other law, i.e., fraudulent transfer laws. See Code of Civ. Proc. §§3439.01 et seq.

- iii. Further, the successor may still have liability if deemed a "distributee" or "transferee" without administration.

- 3. There are a number of methods of holding title to various items of personal property which will have the same effect as holding title to real property in joint tenancy, i.e., avoiding the property being subject to claims of creditors after death. See Civ. Code §683; Prob. Code §§5000, 5302.

- (a) The Code provides specific language which may be used to create certain bank accounts, but the specific language is not necessary. Prob. Code §5203(b).

- I. Joint Account.

- ii. "Pay On Death" (P.O.D.) Bank Account.

- iii. Totten Trust Account.

- iv. "Transfer On Death" (T.O.D.) Security Registration.

- (b) Transfer-on-death is contractual, and it does not limit creditor rights under other law (i.e. fraudulent transfer). Prob. Code §5509.

D. Insurance Policy, Contracts, etc.

1. An instrument which contains a provision for a non-probate transfer on death is valid under California law, and does NOT need to comply with the requirements for execution of a will.
 - i. For example: an insurance policy, contract of employment, bond, mortgage, promissory note, certificated or uncertificated security, account agreement, custodial agreement, deposit agreement, compensation plan, pension plan, individual retirement plan, employee benefit plan, trust, conveyance, deed of gift, marital property agreement, or other written instrument of a similar nature.
2. These instruments generally provide that the property controlled by or owned by the decedent before death that is the subject of the instrument shall pass to a person whom the decedent designates either in the instrument or in a separate writing, including a will, executed either before or at the same time as the instrument, or later.
3. Transfer-on-death is contractual, and it does not limit creditor rights under other law (i.e. fraudulent transfer). Prob. Code §5000.

IV. PAYMENT AND THIRD PARTY LIABILITY FOR A DECEDENT'S DEBT.

A. Property in Administered Estate Subject to Claims of Creditors.

1. Property in an estate that is being administered is subject to properly and timely filed claims of creditors. Prob. Code §9000 et seq.
2. Distributee of Probate Estate Liable to Creditor Where Creditor Not Given Notice.
 - (a) When an estate is being administered, all creditors known or reasonably ascertainable to the personal administrator are to be given notice. Prob. Code §9050.
 - (b) When a creditor was required to be given notice and was not, the distributees of property of the estate are liable to such creditors, to the extent of the value of the property received. Prob. Code §9392.

- B. Property in Revocable Trust Subject to Claims of Creditors.
1. Property over which the debtor had power of revocation at the time of death is subject to creditors' claims. Prob. Code §§19000 et seq.
 2. A distributee is liable only to the extent the debtor's estate is inadequate. Prob. Code §19001(a).
- C. Distributee of Revocable Trust Property Liable to Creditor Where Creditor Not Given Notice In an Optional Trust Notice Procedure.
1. When there has been no filing of a petition for administration of a decedent debtor's estate, a trustee may elect to give notice to creditors. See Prob. Code §§19003 & 19010.
 2. When such a procedure is employed, and a creditor who was known or reasonably ascertainable to the trustee was not given notice, the distributees of trust property are liable to such creditors, to the extent of the value of the property received. Prob. Code §19401.
- D. Distributee of Revocable Trust Property Liable to Creditor Where No Probate and No Trust Notice Procedure.

When there has been no filing of a petition for administration of a decedent debtor's estate and no trust notice procedure, a creditor may sue the distributees of trust property to recover their claims. Prob. Code §19400.

- E. Person Receiving Property Without Administration Liable to Creditors.
1. Liability of Distributees Receiving Property Without Administration.

A person receiving property of a small estate, or a surviving spouse receiving property without administration, is liable to creditors. Prob. Code §§13000 et seq., 13500 et seq.
 2. Person Receiving Property in Small Estate Passing Without Administration Liable to Creditors.

(a) Small Estate Defined.

A small estate is generally one with assets of \$100,000.00 or less (excluding certain assets). Prob. Code §§13050, 13100 and 13151.

(b) Personal Property Received Via an "Affidavit Procedure" is Subject to Debts of Creditors.

- i. A person may, if 40 days have elapsed since the death of the debtor, upon presentation to those holding the decedent's assets of an affidavit regarding such claimant's rights to the decedent's assets, receive the debtor's personal property. Prob. Code §§13100 & 13101.
- ii. Any person receiving property of the decedent debtor in such manner is liable for the debts of the decedent, to the extent of the value of the property received. Prob. Code §§13109, 13112, etc.

(c) Real Property Received Via "Petition for Court Order" is Subject to Debts of Creditors.

- ii. A person may, if 40 days have elapsed since the death of the debtor, petition a court for an order determining succession to real property. Prob. Code §§13150 & 13151.
- ii. Any person receiving property of the decedent debtor in such manner is liable for the debts of the decedent to the extent of the value of the property received. Prob. Code §13156.

(d) Real Property Received Via an "Affidavit Procedure" is Subject to Debts of Creditors.

- i. Real property may also be received via an Affidavit procedure (without court order) when all real property in the debtor's estate is \$20,000 or less (subject to future statutory increase). Prob. Code §13200.
- ii. Such person is also liable to creditors, to the extent of the value of property received. Prob. Code §13204.

(e) Distributee of Small Estate by Public Administrator Liable.

A distributee of a small estate by a public administrator is liable for the debts of the decedent, to the extent of the value of the property received. Prob. Code §7664.

3. Surviving Spouse Liable To Extent of Property Received Without Administration.

(a) The decedent debtor's surviving spouse who receives the debtor's separate property or the couple's community property via will or intestacy may choose to receive such property without administration. Prob. Code §§13500, 13502.

(b) The debtor's spouse is liable to creditors of the decedent debtor to the extent of the value of the property passing to the surviving spouse without administration. Prob. Code §13550.

I. Miscellaneous Other Liability.

1. Property Subject to General Power of Appointment Property Liable for Debts.

Property over which the decedent held a "general power of appointment" at the time of death (or created by the donor in the donor's favor) is also subject to claims of creditors. Prob. Code §§682, 683.

2. Donee of Gift of Personal Property in View of Impending Death.

Gifts made when the donor expects to die imminently (death-bed gifting) may permit the recovery of such property if they are determined to be transferred in fraud of creditors. Prob. Code §§5700 et seq. & 9653.

V. METHODS OF COLLECTION OF DEBTS INVOLVING DECEDENTS.

A. Enforcement of Judgments Law Generally Not Applicable After Death.

1. After the death of the judgment debtor, a money judgment may not be enforced under the Enforcement of Judgments Law (with very limited exceptions). Instead, a creditor's collection efforts, whether or not the creditor has previously obtained a money judgment, are governed by the Prob. Code. See Code of Civ. Proc. §686.020.

(a) Creditors with money judgments do NOT priority over those with none, and all must submit claims. Prob. Code §§9300 & 19300.

(b) Non-money judgments, however, may still be enforced, with some restrictions. Prob. Code §§9302 & 19302.

2. Otherwise valid Pre-death liens generally retain their full legal significance.
 - (a) Pre-death liens in property of an estate have a priority over general unsecured claims. Prob. Code §11420.
 - (b) The holder of security interest, including a judgment lien, may file suit to enforce the lien if recourse to other estate property is waived. Prob. Code §9391.

B. Claims Procedures in Probate.

1. Prerequisites.

(a) Notice to Creditors.

Publication of notice under Prob. Code §8120 and the giving of notice of administration of the estate of the decedent under §§9050 et seq. constitute notice to creditors. Prob. Code §9001.

(b) Personal Representative's Duty to give Notice.

In addition to the publication of notice, the personal representative is required to give notice of administration of the estate to the known or reasonably ascertainable creditors of the decedent. Prob. Code §9050.

(c) Timing of Notice.

The notice shall be given within the later of: 4 months after the date letters are first issued; or 30 days after the personal representative first has knowledge of the creditor. Prob. Code §9051.

4. Deadline for Filing Probate Creditors' Claims.

(a) Pursuant to Prob. Code §9100, a creditor's claim must be filed in the probate case within the "later" of the following deadlines:

- i. 4 months after the date letters are first issued to a general personal representative; or
- ii. 60 days after the date notice of administration is mailed or personally delivered to the creditor.

(b) Furthermore, a claim that is filed before expiration of the time for filing the claim is timely even if acted on by the personal representative or by the court after expiration of the time for filing claims. Prob. Code §9102.

(c) Late-filed claims may be allowed by court order. Prob. Code §9103.

5. Filing and Service.

The claim must be filed with the probate court and served on the personal representative by the creditor (or a person acting on behalf of the creditor). Prob. Code §9150.

5. Allowance or Rejection of Claims; Suit; Payment.

(a) The personal representative should allow or reject the claim pursuant to Prob. Code §§9250 et seq.

(b) If within 30 days after the claim is filed, the personal representative has failed to act, the creditor may deem the claim rejected. Prob. Code §9256.

(c) If the claim is rejected, then the creditor must commence a civil action on the rejected claim within 90 days after the notice is given if the claim is due; or 90 days after the claim becomes due. Prob. Code §9353.

(d) If accepted, or if rejected but thereafter established by judgment, then the claim is paid in the regular course of administration. Prob. Code §9300, 9301, 11401 & 11420.

6. Failure to File Claim.

If the creditor fails to file and serve the claim, the claim is invalid and is barred. Prob. Code §9150(d) and §9002.

C. Claims Procedures in Trusts.

1. Optional Trust Notice Procedure.

(a) After the death of a settlor, the trustee may file with the probate court for the appropriate county, a proposed notice to creditors if

the trustee does not have actual knowledge of a petition to administer the settlor's estate in this state. Prob. Code §19003.

- (b) The procedure is optional, and may not proceed if a probate administration is pending.
- (c) The optional trust notice procedure generally operates in conformity with the formal probate procedures, above, resulting in the requirement to file claims with the trust within same time limits, and barring claims not so filed.
 - i. Note that the standard is different for 'notice to creditors' by the personal representative in a formal probate proceeding versus the trustee of a trust. The personal representative must give notice to 'reasonably ascertainable creditors,' while the trustee merely has to give notice to the 'known creditors.' Compare Prob. Code §§9053(d) with 19053(d). Thus, not all creditors may get notice in the optional trust notice claims procedures.

D. Litigation.

1. Litigation Against Personal Representative of Probate Estate May NOT Be Filed or Continued Without First Filing Claim.
 - (a) An action may not be either 'commenced' or 'continued' against decedent or personal representative unless a claim is filed and rejected. Prob. Code §§9351 & 9370.
 - (b) No recovery shall be allowed unless proof is made that the creditor/plaintiff has complied with the probate claims procedures.
2. Litigation Against Decedent's Successor (Distributee/Transferee) May NOT Be Filed or Continued Without First Filing Claim.
 - (a) An action may not be either 'commenced' or 'continued' against the successor of a decedent unless a claim is filed and rejected. Code of Civ. Proc. §§377.40 & 377.41; Prob. Code §§9351 & 9370.
 - (b) A 'successor' refers to a beneficiary or other person who receives a decedent's money or property. See Code of Civ. Proc. §§377.10 & 377.11.

2. Actions Covered by Insurance Do Not Require the Filing of a Claim.
 - (a) An action may be commenced or continued against the decedent's estate without the need to join as a party the personal representative or successor in interest. Prob. Code §550.
 - (b) A judgment within the limits or coverage may be enforced against the insurer, without first filing a claim. Prob. Code §9390.

3. Actions Against Trust May NOT Be Filed Without First Filing Claim If Trustee Employs the Optional Trust Notice Procedure.
 - (a) If the trustee files, publishes, and serves notice the creditor may not maintain an action on the claim against the trust unless the claim is first filed with the trust. Prob. Code §19004.
 - (b) The creditor must commence an action on the rejected claim within 90 days. Prob. Code §19255.