Creditors' Claims and Insolvent's Estate

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The Commonwealth of Virginia does not have a notice of publication of the appointment of a personal representative of the estate that will limit the period for creditors to file a claim against the estate, like the District of Columbia or the State of Maryland does. If a personal representative wants to be protected against any future unknown claims, the personal representative will have to request a Debts and Demands hearing.

However, in Tulsa Professional Collection Services, Inc. v. Pope[1], the Supreme Court held that if the identity of a creditor is known or "reasonably ascertainable" by the personal representative of the estate, then the due process clause of the Fourteenth Amendment requires that the creditor be given notice by mail or such other means as are reasonable to ensure actual notice before the creditor's rights can be terminated.

[1] 485 U.S. 478, 108, S.Ct. 1340, 99 L.Ed. 2d 265 (1988)

1.) Regular Payment of Creditors

Please note first, that if there is a Last Will and Testament, the executor is usually requested under the said Will to pay the testator's debts and funeral expenses first, prior to any distributions.

One of the first responsibilities of a personal representative is to secure the assets of the decedent, then to assess the debts.

Va. Code Ann. §64.1-171 *et seq.* provides instructions on how creditors can secure their debts. Obviously, the creditor should submit the claim to the personal representative of the estate. Although there is no requirement that a claim be filed with the Commissioner of Accounts, creditors should file their claims or a written statement with the Commissioner of Accounts. There is no statutory format but some commissioners provide a form. See in Exhibit A the sample form posted on the website of Fairfax Commissioner of Accounts.

The Commissioner will endorse the date of filing on the claim and sign the endorsement.

It is recommended that the debt be corroborated. In Noland Co. v. Wagner[2], the Supreme Court denied the claim because there was no corroborated testimony. Mr. Wagner was a general contractor for the construction of buildings. The Noland Company Incorporated filed a claim against the administratrix of Mr. Wagner, deceased. The company argued that it has a claim as assignee for the value of an open account which had been assigned by the co-partner of Fred Hayes and J. Herbert Hayes. The Noland Company only provided the testimony of J. Herbert Hayes. The Court held that the "precise nature of the required corroboration or the weight to be given to the corroborating evidence depends upon the facts of each particular case." It further noticed that Mr. Hayes needed corroboration because Mr. Hayes could have been "the party

[2] 153 Va. 254 (Va., 1929)

plaintiff in the motion", and because of his present certain direct interest as he may "either gain or lose by the direct legal operation of the judgment."

In Bickers v. Pinnell[3], the Supreme Court affirmed that the creditor had provided corroboration of her claim. Mr. Bickers had borrowed $4,500 from his daughter, Mrs. Pinnell. After his death, Mrs. Pinnell filed a claim. She could not provide the evidence of the note alleging that she had lost or misplaced it. She provided testimony of her husband and several checks that had the mention: "Int. Bond $4,500, 4%." The Commissioner of Accounts allowed her claim. The executor of the estate excepted to the Commissioner's report allowing the claim, on the basis that the "note evidencing the debt was lost therefore Mrs. Pinnell was required to bring an action under Code §8-517 against the executor, and precluded from proving her claim before the Commissioner." The court noticed that "Mrs. Pinnell filed a written statement of her claim, setting forth clearly and fully its basis", notice was made, "…no motion was made that the report of the Commissioner be recommitted to him"… "or that a jury be empaneled to inquire into the claim." Therefore the Supreme Court affirmed the order of the trial court and allowed the claim.

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The vast majority of debts will be paid by the personal representative; however, sometimes the estate may be insolvent or certain claims are not ripen. In the situation of an insolvent estate, additional procedures should be followed by the personal representative.

2.) Insolvent Estate and Debts and Demands Hearing

If the personal representative is uncertain of the solvency of an estate, the personal representative should hold on paying any debts, request the Debts and Demands proceedings, and obtain an Order of Payment of the debts.

i. Debts and Demands Hearing

The personal representative shall start the Debts and Demands hearing by contacting the Commissioner of Accounts' office. The Commissioner will set a time and place for receiving proof of debts and demands against the decedent or the decedent's estate. The notice will be posted at least 10 days before the date fixed for the hearing at the courthouse, and published in a local newspaper. The Commissioner of Accounts does not require having an account of the estate, but the personal representative should inform the Commissioner of any known outstanding claims against the estate.

The personal representative shall give notice in writing to any claimant of a disputed claim at least 10 days prior to the hearing. The last known address of the creditor should be used. There is

[3] 199 Va. 444, 100 S.E.2d 20 (Va., 1957)

no specific form of notice. The notice shall inform the creditors of their right to attend and present their claims, and their right to obtain another date if the Commissioner finds that the initial date is inappropriate, and if the creditor would be bound by an adverse ruling. Finally, the notice shall inform the creditors of their rights to file exceptions with the judge in the event of an adverse ruling. The notice may be sent "by regular, certified or registered mail, or by personal service." I recommend sending the notice by certified mail with receipt requested because the personal representative will have to provide evidence of mailing a notice to the Commissioner.

In certain situations where there is sufficient evidence of the claim, the Commissioner may direct the personal representative or the creditor to start a procedure to establish the validity or invalidity of a claim. Even though the Commissioner is not given explicit authority to summon and compel the attendance of witnesses and take depositions, such powers are implied from the power to receive proof and demand. However, the *Manual for Commissioners of Accounts*[4] points to the facts that the Commissioner is "not equipped to handle a hotly contested claim with many witnesses on both sides and complicated facts or law." The Commissioner will report to the court that it is his/her recommendation that this claim needs to have a separate procedure.

Va. Code Ann. §64.1-173 provides that creditors shall file their claim or a written statement before the Commissioner. This filing tolls the statute of limitations but only for the period of the Debts and Demand hearing. Therefore, in order to prevent the claim from being barred by the statute of limitations, the creditor should bring an action for recovery or enforcement of such claim.

Within 60 days after the hearing, the Commissioner of Accounts will file a report of sufficiently proven debts and demands with the court. Creditors have 15 days from the filing to file exceptions. There is no particular form or formality. The creditor must specify with reasonable certainty the particular grounds of the objections.

If there is an exception[5], the court examines it and may choose to confirm the report in whole or in part, return the report to the same or another Commissioner, or empanel a jury to inquire into any matter which it deems appropriate.

If no exception has been filed, the report is confirmed. However, the creditor has a right to appeal the confirmation[6]. Finally, a creditor or a beneficiary who did not file exceptions to the report may file "a suit to surcharge and falsify the report."

[4] Virginia Practice Handbook, 4th Edition, by VA CLE

[5] See Va. Code Ann. §26-33

[6] See Va. Code Ann. §26-34

If the report shows that some debts have not been paid, then the court may order the payment of the debts. However, if the personal representative learns of a claim during this period, meaning before the order of distribution is entered, this order shall not be entered until after expiration of 10 days, and notice to the creditor shall be given. If the creditor within that 10-day period confirms his/her claim, the Commissioner shall schedule a date for hearing the claim and for reporting the claim.

ii. What kind of debts?

Verification of Debt. It is important to note that the personal representative should only pay the debts that exist. The personal representative shall ensure that the statute of limitations has not run, because it would eliminate the debt.

Claim not yet due. Va. Code Ann. §64.1-174 set the rules for claims that are not yet due. After the account of the personal representative has been approved and the Debts and Demands Hearing, the court may request that the personal representative reserve an amount "to meet any other claim not finally passed upon."

Compromise of Claim. Va. Code Ann. §64.1-57(g) gives the personal representative authority to compromise claims.

Election of a Legacy. Finally, under Swan v. Swan[7] the Supreme Court held that a legacy given by a testator who is a debtor to his creditor, "equal to or greater than the debt", is in absence of proof of the contrary intent, "deemed to be in satisfaction of the debt." The facts were the following: Under the second clause of the separation agreement of the Swan couple, Mr. Swan promised to pay $166.67 a month to Mrs. Swan until she died provided that she remained unmarried. Mr. Swan died testate. His Last Will and Testament provided a bequest of his ex-wife. After his death, Mrs. Swan asked that the executor be required to account to her the annuity of $2,000 a year provided under the separation agreement. The executor and the Commissioner of Accounts considered that the bequest should be considered as a satisfaction and performance of the separation agreement and that the ex-wife "could not have the benefit of both instruments, but must elect between the separation agreement and the provision in the will." It was further held that "…it seems clear to us that, when these two provisions are considered in the light of the testator's situation and surroundings, and the general plan which he had in mind in making his will, as disclosed by its various provisions, he did not intend to include the annuity among his debts, but designed to satisfy that claim by the gift in the sixth clause." The Court referred to the maxim "He who

[7] 117 S.E. 858 (Va., 1923)

seeks equity must do equity.[8]" As a result, two principles of law were set: (1) "the general rule that a legacy given by a debtor to his creditor equals to or greater than the debt is, in the absence of proof of a contrary intention, deemed to be a satisfaction of the debt" [9]; and (2) "the principle of equitable election whereby an obligation is imposed upon a party to choose between two inconsistent or alternative rights or claims in cases where there is a clear intention of the person from whom it derives one that he should not enjoy both.[10]"

Mortgages. Depending on the type of mortgage and the language in the Last Will and Testament, the mortgage may be a debt of the estate or not. It depends upon whether the testator has made himself personally liable for the debt. If the decedent is personally liable for the mortgage and died intestate, the mortgage is the liability of the decedent's personal estate. The surviving joint owner or the legatee has the right to demand the payment of the mortgage from the estate.

If the decedent dies testate without any provision regarding the mortgage, there is a presumption that the mortgage passes with the bequest of the property unless the testator specifies otherwise[11]. This does not apply when the property passes by right of survivorship. In Dolby v. Dolby,[12] the Court held that the mortgage was a personal liability of the estate and did not pass to the surviving tenant. Mr. Dolby had purchased a real estate property in his sole name and executed a promissory note secured by a deed of trust. He later married and retitled the property into his name and his wife's, as tenants by the entirety with the right of survivorship. Mrs. Dolby was not added as a joint obligor on the note. His Last Will and Testament provided that the personal representative shall pay "all legally enforceable debts" but also said that the "executor shall not be required to pay prior to maturity any debt secured by mortgage, lien or pledge of real or personal property owned by me at my death, and such property shall pass subject to such mortgage, lien or pledge." The executors filed a complaint for aid and direction regarding the payment of the mortgage. The Court considered that two questions were to be answered: (1) whether decedent Dolby had a personal obligation to pay the debt, (2) whether the mortgage debt is secured by real property own by decedent upon his death. The Court considered that decedent was personally and solely liable for the note that he signed. For the second question, the Court noticed that because the real estate property was held jointly with right of survivorship, the real estate property was not owned by the decedent upon his death, because the real estate property passed by operation of

[8] 1 Pom. Ea. Jur. (2d Ed.) §465.
[9] Stewart v. Conrad's Adm'r, 100 Va. 128, 135, 40 S. E. 624
[10] Allison v. Allison, 99 Va. 472, 476, 39 S. E. 130
[11] Va. Code Ann. §64.1-157.1 (A)
[12] 694 S.E.2d 635 (Va., 2010)

law. Therefore, the debt could not follow the real estate property. If Mrs. Dolby would have been jointly liable for the note, then only half of the note would have been part of the estate[13].

If the decedent was not personally liable for the encumbrance, the estate is not liable for the obligation and the land remains the primary source for the payment of the debt.

If the estate is insolvent, the Commissioner will want to have an interim accounting to be filed as soon as practical.

iii. Order of Payment

Va. Code Ann. §64.1-157 provides the order of payment in case of an insolvent estate, as follows:

1. Cost and expenses of administration
2. Family allowance, exempt property, and homestead allowance
3. Funeral expenses not to exceed $3,500
4. Debts and taxes with preference under federal law
5. Medical and hospital expenses of the last illness of the decedent, including compensation of persons attending to him not to exceed $400 for each hospital and nursing home and $150 for each person furnishing services of goods
6. Debts and taxes due to the State of Virginia
7. Debts due as trustee for persons under disabilities: personal representative, guardian, conservator
8. Debts and taxes due to localities of the state of Virginia
9. All other claims

There is no preference within a class.

The rights are fixed at death. There is no interest or attorney's fees upon insolvency[14].

There is an exception to his order of payment. Va. Code Ann. §64.1-157.1 provides that existing liens at the date of death of the testator have priority over the payment of other creditors and legatees. This does not apply to liens that would be granted in the Will.

Va. Code Ann. §64.1-158 provides that creditors shall be paid in the order of their classification. If there is not enough to pay a class, the class will be paid ratably.

iv. Show Cause Order

After six months of qualification, the personal representative may motion the court to make an order to show cause against the Order of Payment of the estate to creditors and legatees of the estate. Under Va. Code Ann. §64.1-179, this action can also be brought by a legatee or distributee. Usually, a Debts and Demands hearing will first take place.

This will provide an Order of Payment of the creditors and to all other persons interested in the estate of the decedent. Any

[13] See Brown v. Hargraves, 198 Va. 748, 751, 96 S.E.2d. 788, 791 (1957)

[14] Virginia Surety Co. v. Hilton, 181 Va. 952 (Va., 1943)

person interested in the estate will "show cause" to be named in the order "against the payment and delivery of the estate of the descendent to his legatees or distributees."

Va. Code Ann. §64.1-180 provides a form of notice for show cause. The order of show cause must be published once a week for two successive weeks in one or more newspapers as the court may direct.

The court will then order the distribution with or without a refunding bond. The statute requires a refunding bond if the distribution is made before the expiration of a one-year period. Depending on the statute, beginning of the one-year period starts from: (1) the date of death (for the family allowance, exempt property and homestead allowance, (2) the date of the filing of the Will (for a newly discovered Will and its challenge), or (3) the date of the appointment of the personal representative (when no Will was probated). This one-year period corresponds to the right to challenge the Last Will and Testament probate. The statute provides that to be protected, the personal representative shall have contacted the surviving spouse to ascertain that the surviving spouse will not renounce the will and such intent shall be in writing.

A contingent claim will not prevent from distributing the estate. The court will set aside enough reserve for such a claim.

Please note that this procedure protects the personal representative against creditors but not against an improper distribution of the estate to legatees or distributes. H. Michael Deneka, Esq. in *Winding Up and Settlement of an Estate*[15] addresses this issue and recommends that in order to be totally protected, the personal representative should seek an action for aid and direction. Actually, Va. Code Ann. §64.1-179 provides that "every legatee or distributee …may, in a suit brought against [the personal representative] within **five years** afterward".

I also recommend that the personal representative obtain a letter from the IRS and a letter from the Virginia Department of Taxation stating that the decedent and the estate of the decedent do not owe any taxes.

[15] Estate and Trust Administration in Virginia, 3rd ed., by VA CLE publications