

ESTATES

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Chapter 13

Creditors¹

[§13.01] Introduction

This chapter is intended to introduce the solicitor to advising the personal representative with respect to creditors' claims.

For further discussion of this topic see Chapter 11 of the *Probate and Estate Administration Practice Manual* (Vancouver: CLE).

[§13.02] General

1. General duties of the representative relating to creditors' claims

The personal representative has the following general duties:

- (a) to ascertain the liabilities of the estate and to retain sufficient assets to pay those liabilities before distributing the balance of the estate among the beneficiaries;
- (b) to perform all contracts made by the deceased and enforceable against the deceased's estate; and
- (c) to pay the liabilities with due diligence as is appropriate to the assets and, so far as the beneficiaries are concerned, in accordance with the terms of the will.

2. Types of creditors' claims

(a) Liabilities

As in any civil case, creditors in an estate administration case may be classified as secured, preferred, or unsecured. Claims may arise in three ways.

(i) Liabilities incurred by the deceased

Liabilities that were incurred by the deceased and were enforceable against the deceased immediately prior to death become the

responsibility of the personal representative.

The creditor who brings an action against the personal representative pleads as the cause of action the liability contracted by the deceased before death, in the same manner as if the deceased were still alive, but names as defendant the personal representative (Supreme Court Civil Rule 20-3(10)). Judgment on such a claim establishes the status of the claimant as a creditor of the deceased. The assets of the estate are liable for payment, but the judgment is not a personal liability of the personal representative.

(ii) Liabilities incurred in respect of death

The personal representative is personally liable for liabilities incurred in respect of the death, but will normally be entitled to claim indemnification from the assets of the estate. The most common liabilities of this type relate to funeral expenses.

(iii) Liabilities incurred in administering the estate

The personal representative likely will incur, and is entitled to incur, liabilities while administering the estate.

(b) Claims based on improper performance of duties

A creditor may also bring an action against the personal representative for the improper performance of his or her duties.

(i) Breach of trust

If the personal representative is obligated under the terms of a trust, express or implied, to pay a liability, but fails to apply the assets to make such payment, the personal representative is personally liable to the creditor for breach of trust. For example, if a will directs the executor to pay a specific debt or to pay just debts, funeral expenses, and burial expenses and the executor fails to do so, this is a breach of trust.

¹ Updated in June 2006 and January 2005 by **Kirsten H. Jenkins** of RBC Dominion Securities Ltd., Vancouver. Reviewed and revised annually from February 1997 to 2002 by Linda J. Yardley, Miller Thomson LLP., Vancouver. Reviewed for content relating to the *Indian Act*, in January 2002, by Roger D. Lee, Davis & Company, Vancouver.

(ii) Devastavit (Mismanagement)

If the personal representative fails to administer the estate with due diligence, he or she is personally liable to creditors or beneficiaries who sustain a loss as a result.

3. Defences to creditors' claims

The personal representative is entitled to deny the liabilities on any ground the deceased could have used if he or she was still alive.

The personal representative can also plead as a complete or partial defence that, even if the date-of-death creditor's claim is held to be valid, the deceased had no (or insufficient) assets at the date of death, or that the personal representative has duly administered the estate and no longer has any (or sufficient) assets. This plea is known as *plene administravit*.

In addition, s. 96 of the *Trustee Act*, R.S.B.C. 1996, c. 464 empowers the court to relieve the personal representative from personal liability arising out of breach of trust or *devastavit*. The court must conclude that the trustee acted honestly and reasonably and ought fairly to be excused for the breach and for failing to obtain directions from the court. The leading Canadian case is *Fales v. Canada Permanent Trust Company*, [1976] 6 W.W.R. 10 at 23 and 27 (S.C.C.), where the following questions were considered relevant:

- (a) was the personal representative paid for his or her services?
- (b) was the personal representative a one-time volunteer or a professional estate administrator?
- (c) was the breach of duty merely technical or was it a minor error in judgment?

[§13.03] Liabilities of the Deceased

1. Contingent or continuing

The personal representative must provide for all liabilities, including those that are contingent and continuing, before distributing the estate. Examples of contingent liabilities include the following:

- (a) a personal guarantee made by the deceased that is outstanding at the time of death;
- (b) a pending lawsuit against the deceased in which the deceased had disputed liability;
- (c) a claim against the deceased that was threatened or contemplated but not

admitted by the deceased or the personal representative.

Examples of continuing liabilities include the following:

- (a) liability under a separation agreement to pay spousal or child support;
- (b) a lease under which the deceased is a lessee in occupation;
- (c) liability of the deceased on a mortgage (depending on the terms of the mortgage);
- (d) guarantees. At common law, death of a surety does not of itself terminate his or her liability under a continuing guarantee for advances made afterwards by the creditor to the principal debtor. The creditor must have notice, actual or constructive, of death in order for the estate to avoid liability for such advances. The terms of the contract of guarantee may vary the common law rule. The personal representative should therefore examine the terms of any guarantees to determine whether there is a legal right to terminate liability for future advances. Failure to do so will amount to *devastavit*.

2. Unenforceable or statute-barred

A claim that is unenforceable (e.g., a guarantee not in writing or an illegal contract) or barred by the statute of limitations should not be admitted or paid by the personal representative.

3. Family creditors

Often, a relative or household member who provides domestic services to the deceased will assert a claim under a contract with the deceased. That creditor must prove that a contract existed. For example, the creditor may have to satisfy the court that the claim is an honest one and rebut the presumption that service was rendered out of affection or familial duty rather than in consideration of a contractual promise. A relative or household member who is unable to establish an enforceable contract may still be able to recover on the basis of quantum meruit (that is, implied contract) or unjust enrichment.

4. Pledges

An outstanding commitment by the deceased to make a gift or donation is unenforceable and must be dishonoured by the personal representative unless it is under seal or supported by such consideration as to make the commitment a contract. For a recent case on enforceability of

pledges see *Brantford General Hospital Foundation v. Marquis Estate*, [2004] O.J. No. 1705 (C.A.), affirming (2003), 67 O.R. (3d) 432 (Sup. C. J.) where a charitable organization unsuccessfully attempted to enforce payment of the balance of a one million dollar pledge that the deceased had made but had only paid partially.

5. Spousal and child support

If the deceased was, immediately prior to death, liable for payments to an estranged spouse or child under a separation agreement or a court order, any arrears outstanding immediately prior to death will be a debt payable out of the estate. The personal representative will also have to determine whether the estate is liable for ongoing support in respect of the period following death. If so, the estranged spouse or child will rank as an ordinary creditor of the estate for the future instalments, and the personal representative will be obliged to provide for that claim before distribution to beneficiaries. Failure to do so will render the personal representative personally liable to the claimant for *devastavit*.

The general rule is that liability to pay support is a personal obligation that does not survive the death of the paying spouse, but each case will be determined by interpretation of the separation agreement or court order.

6. Creditor or debtor a beneficiary or executor

(a) Creditor a beneficiary

If a debtor bequeaths to a creditor a legacy equal to or greater than the debt, the legacy is presumed to have been intended to satisfy the debt, subject to the contrary being shown. If the legacy is less than the debt, the presumption does not apply and there is no partial satisfaction. For the presumption to apply, the debt must exist when the will is made.

Where this presumption applies, the personal representative must pay the legacy but not the debt. Where the presumption does not apply, the personal representative must pay the debt, as well as the legacy.

Intention to satisfy the debt will not be presumed where the facts of the case indicate contrary intention; for example:

- (i) a declaration to that effect by words in the will; or

- (ii) a lack of identity between the debt and the testamentary gift, such as a testamentary gift that is contingent or deferred beyond the date the debt becomes due.

(b) Debtor a beneficiary

A bequest by a creditor to a debtor does not give rise to a presumption that satisfaction was intended. However, if it appears that the testator intended satisfaction, the debtor is entitled to receive the gift and the debt obligation is extinguished. Such intention may be expressed in the will, implied in the will, or proven by evidence from other sources.

(c) Creditor an executor

A personal representative who is also a creditor of the deceased is entitled to retain out of the estate full payment of any debt that was owing to him or her by the deceased.

However, if a defence exists against the creditor/executor that would be valid as against a creditor at arm's length, the personal representative must reject his or her own claim.

(d) Debtor an executor

Appointment of a debtor as executor extinguishes the debt but leaves the executor liable to account as if the debt had been collected.

[§13.04] Liabilities Relating to the Death: Funeral Expenses

The *Cremation, Interment and Funeral Services Act*, S.B.C. 2004, c. 35 seems to confirm the common law position that the executor bears primary responsibility and financial liability for the disposition of the remains.

The position of the administrator is less clear, but in reality an administrator would rarely be appointed before the time of the funeral.

In any event, the personal representative should decide which expenses are funeral expenses, then decide what is a reasonable amount for each expense in the circumstances (e.g., taking into account the size of the estate, the deceased's station in life, etc.). The person who instructs the funeral director is personally liable to pay all expenses incurred but is entitled to recover reasonable expenses.

If contention is foreseeable, the personal representative should be advised to seek approval, however informal, of the residuary beneficiaries (and perhaps senior

creditors) or an indemnity from next of kin who are eager to arrange a ceremony more costly than what might be considered reasonable.

[§13.05] Liabilities Incurred by the Personal Representative

A personal representative likely will incur, and is entitled to incur, liabilities while administering the estate.

A personal representative is personally liable on contracts he or she makes to carry out the responsibilities of the position. For example, the personal representative is personally liable for the full amount of his or her lawyer's proper account even if the assets of the estate are insufficient to provide the personal representative full indemnity.

The personal representative is entitled to be indemnified out of the assets of the estate for proper testamentary or administration expenses. The indemnity takes priority over all liabilities of the deceased except funeral expenses and *in rem* claims by secured creditors.

In anticipation of the indemnity, the personal representative usually pays liabilities incurred during administration out of the assets of the estate. Nevertheless, the personal representative must account for each such payment to the satisfaction of all residuary beneficiaries or, on a formal passing of accounts, to the court.

Although personally liable for new trade debts, the personal representative is entitled to indemnity out of the assets of the estate provided that he or she was authorized (i.e., directed or empowered by instrument or law) to carry on the business.

Issues of liability and indemnity similar to those in business situations may arise in non-business situations. For example, the deceased may have been engaged in a personal project (e.g., construction of a home or a boat) that was incomplete at his or her death. The personal representative must decide whether to finish the project and dispose of the finished product or to find a buyer on an as-is basis.

The lawyer advising the personal representative must be particularly careful in the advice he or she gives in this area.

[§13.06] Administering the Liabilities

1. Instructions and retainer

The initial meeting between the personal representative and lawyer usually includes a listing of all of the deceased's liabilities and the liabilities relating to death (for example, funeral expenses); see Chapter 7 of these materials. The lawyer should ask the personal representative to bring to

that meeting as much information as is then available.

2. Searches and inquiries

It is important that the personal representative be diligent in attempting to identify all of the deceased's liabilities (as well as keeping track of his or her own costs relating to the death and the administration of the estate). There are various methods that the personal representative and the lawyer should use. Each should share the results of his or her inquiries with the other.

(a) Lawyer's inquiries

Inquiries made by the lawyer are best handled by letter unless personal attendance is considered necessary or advisable.

(b) Searches

In certain circumstances it may be appropriate to search registries of record for liabilities, such as the Personal Property Registry (for car loans and evidence of a company's indebtedness or personally guaranteed corporate liabilities) and the court registry (pending lawsuits, maintenance orders, outstanding judgments).

(c) Advertising for claimants

Under s. 38 of the *Trustee Act*, R.S.B.C. 1996, c. 464 the personal representative may publish a notice requesting claimants against the estate to send their claims to him or her before a specified deadline. If notice of a claim is not so given, and the personal representative distributes the estate after the deadline, the claim is not enforceable against the personal representative unless

- (i) the personal representative had actual or constructive notice of the claim (that is, the advertisement does not free the personal representative from responsibility to make all searches and inquiries that would normally be made in order to determine the liabilities of the deceased); or
- (ii) the claim in question is not for a liability of the deceased (for example, a claim by lawful next of kin that the will naming the executor is invalid due to testamentary incapacity).

A date-of-death creditor who claims after the advertised deadline but before the claim is statute-barred can still enforce the claim

- (i) against the assets of the estate if they are still held by the personal representative;
- (ii) if the estate was, or would by the claim have been rendered, insolvent, by suing the other creditors to refund ratably the amount each received in excess of the rateable payment that would have been payable if the claim had been known to the personal representative; or
- (iii) against the beneficiaries or intestate successors. If barred against the personal representative by the advertising procedure, an unpaid or underpaid creditor has recourse against an overpaid beneficiary or successor.

Under s. 8 of the *Indian Estates Regulation*, C.R.C., c. 954, the superintendent issues notice on behalf of the estate, and if no response is received within eight weeks then the claim is not allowed unless the Minister otherwise orders.

3. Proof of claims

The *Estate Administration Act*, R.S.B.C. 1996, c. 122, s. 65 provides that an executor may pay or allow any liability or claim on any evidence he or she thinks sufficient. While the section does not refer to an administrator, s. 4 would appear to bring administrators within the provisions of s. 65 with regard to payment of debts.

In exercising the authority set out in s. 65, the personal representative must act in a reasonable and prudent manner and with the fidelity expected of a trustee.

Where the personal representative does not admit a claim, the *Estate Administration Act*, s. 66(1), (2), (3), (4) provides a method for limiting the time in which the creditor or other claimant can bring an action to enforce the claim: six months after giving notice, if part or all of the debt is due at the time of the notice; otherwise, six months after the debt or a part of it falls due. If the claimant does not commence an action within that period, the claim is forever barred.

The limitation periods do not apply to a claim against the estate by a beneficiary in his or her capacity as a beneficiary (s. 66(5)).

4. Compromise of claims

Often, the terms of a will give the executor the authority to compromise claims against the deceased or the estate. Otherwise, s. 65 of the *Estate Administration Act* expressly authorizes an executor to compromise a claim against the deceased. It appears that, at common law, an administrator is empowered to compromise claims (*Pennington v. Healey* (1833), 149 E.R. 455 (Ex.)). The risk involved in compromising a claim is that, on approval or passing of accounts, a beneficiary may object to the payment as being entirely unnecessary or more than is necessary. In anticipation of a dispute, the personal representative's lawyer should record the advice given regarding the validity of the claim, the projected costs of contesting the claim, and the projected delay in distribution that would result if the claim were litigated.

5. Payment of liabilities

(a) Power to sell assets

An executor's authority to sell is usually a trust for sale or a power of sale expressly set out in the will. An executor also has statutory authority to raise money to fund payment of lawful claims of creditors (*Estate Administration Act*, s. 67).

At common law, an administrator has power to sell estate assets to fund payment of lawful claims of creditors; beyond that, an administrator cannot sell assets without a court order or the consent of the intestate successors. The common law is not altered by statute (see *Estate Administration Act*, ss. 4, ss. 77-79).

(b) Assets charged with payment

The bequest of an asset may expressly or by implication of law impose on the beneficiary of that asset the responsibility to assume payment of a liability charged against it. This does not relieve the estate of any responsibility to creditors.

For example, the *Wills Act*, R.S.B.C. 1996, c. 489 provides that, where the deceased disposes of an interest in land subject to a mortgage, the interest carries with it the responsibility for paying the mortgage (s. 30). This is subject to a contrary intention. No contrary intention

is signified by a general direction for payment of liabilities (s. 30). The interest of the mortgagee is not affected by this provision.

The personal representative should be advised to seek a covenant from the beneficiary to assume and pay the mortgage and to indemnify the estate against the mortgage liability.

(c) Time for payment

Interest-bearing liabilities should be paid as soon as reasonably possible. Non-interest-bearing liabilities should be paid as soon as reasonably possible, but there is no fixed rule that such liabilities must be paid within one year.

6. Distribution under direction of court

Section 39 of the *Trustee Act*, R.S.B.C. 1996, c. 464 permits the personal representative to apply by petition for an order that the personal representative

- (a) be at liberty to distribute the estate having regard only to claims that he or she has been able to ascertain; and
- (b) shall have no liability with respect to any claims of which he or she had no notice at the time of distribution.

A notice of hearing should be given to all persons determined by the personal representative to be entitled to share in the estate who have not otherwise consented to the distribution.

The order provides the personal representative with protection against claims of which he or she had no notice; however, the protection does not extend to undisclosed claims of which the personal representative knew or should have known.

7. Insolvent estates

If the estate's liabilities exceed its assets, it can be handled as an insolvent estate either under the *Estate Administration Act*, R.S.B.C. 1996, c. 122, ss. 100-108, or under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3. Under the *Estate Administration Act*, the personal representative administers the estate. Under the *Bankruptcy and Insolvency Act*, a trustee in bankruptcy administers the estate. However, if the *Bankruptcy and Insolvency Act* is applied (for example, if a receiving order is made at the instance of a creditor), the federal statute will apply and the provincial statute will be pre-empted.