Danger – Beware of Probate Fees and Costs

By: T. Robert Finlay, Esq., Wright, Finlay & Zak, LLP for UTA Quarterly Summer 2011

Cases in Probate Court are generally overlooked, as they are commonly associated with the distribution of the deceased person's assets. Usually, the involvement of a beneficiary and trustee in a Probate action is limited to an estate's request for a Temporary Restraining Order to stop a foreclosure sale. More recently, however, probate attorneys have discovered a cocktail of statutes in the Probate Code with generous language that potentially give probate fees and costs lien priority over a first deed of trust. Thus, without a careful review of the probate pleadings, the estate may recover all its costs and fees on the foreclosing beneficiary's dime.

Typical Factual Scenario:

The borrower owns the Property subject to a Deed of Trust. When the borrower dies, the property is "probated," i.e., the deceased borrower's heirs open a probate to handle the borrower's estate, including the Property. Before or after opening the Probate, the loan falls into default and the beneficiary initiates foreclosure. If the Probate Estate has few assets, i.e., the underwater Property and some minor personal property, then the assets of the Estate will be insufficient to fully compensate counsel and the administrator for the fees and costs of opening the Probate. As a result, the Estate may turn to several Probate Code sections, including Sections 11420 and 10361, which enables them to have their fees and costs reimbursed by the unsuspecting beneficiary that is foreclosing on the Property.

Section 10361(a) provides that if encumbered property is sold, the purchase money shall be applied in the following order: (1) Expenses of administration which are reasonably related to the administration of the property sold as provided in paragraph (1) of subdivision (a) of Section 11420; (2) The payment of the expenses of the sale; (3) The payment and satisfaction of the amount secured by the lien on the property sold if payment and satisfaction of the lien is required under the terms of the sale; and, (4) Application in the course of administration.

Section 11420 classifies the order of priority in which debts are paid by the Estate.

"(a) Debts shall be paid in the following order of priority among classes of debts, except that debts owed to the United States or to this state that have preference under the laws of the United States or of this state shall be given the preference required by such laws:

(1) Expenses of administration. With respect to obligations secured by ... deed of trust … only those expenses of administration incurred that are reasonably related to the administration of that property by which obligations are secured shall be given priority over these obligations.

(2) Obligations secured by a mortgage, deed of trust, or other lien, including, but not limited to, a judgment lien, in the order of their priority, so far as they may be paid out of the proceeds of the property subject to the lien. If the proceeds are insufficient, the part of the obligation remaining unsatisfied shall be classed with general debts…."

Reading Sections 11420 and 10361 together enables the Estate to claim that its expenses of administration take priority over the obligations secured by a deed of trust, and without opposition, an Estate's Motion for fees and a senior lien are routinely granted.

However, despite these generous statutes, counsel and the administrators are not guaranteed a windfall at the expense of the beneficiary. There are certain procedural and equitable grounds on which to challenge an Estate's attempt to receive an order for a priority lien. First, the Notice of Hearing on a Petition for such an order must be personally served on the holder of the lien at least thirty (30) days before the hearing. Additionally, the Petition should be brought before the foreclosure sale, specifically, before payment is made to satisfy all liens on the encumbered property. Second, the amount of fees sought by the Estate must be "reasonably related to the administration of the encumbered property" and only given priority as to those expenses. Thus, the Estate is not necessarily entitled to any and all fees incurred by the opening of the Probate, just those reasonably related to the Property. (Note: if the Property is under water, arguably none of the fees are reasonably related to the Property.)

Finally, there is an equitable argument to be made when it appears that the only purpose of opening a Probate is to collect fees. In essence, when the Property is clearly underwater and would never have been able to sell on the market, the Estate and its Attorney should not be entitled to a windfall of the statutory compensation because they merely opened a Probate. Further, because the Estate lacks sufficient assets to cover those debts, the statutory scheme was not created to shift all the costs of probate to the only solvent entity involved, the beneficiary.

Unfortunately, we see far too many probates opened solely for the purpose of generating fees. More troublesome is the fact that many of the motions to be awarded fees in a senior position are granted without adequate notice to the beneficiary and without any opposition from the beneficiary. It is therefore imperative that beneficiaries and their trustees treat each Probate notice with the utmost care, or risk subordinating the Deed of Trust to the estate's attorney's fees.

1. Section 10361.6.
2. Prob. Code section 10361.5.
3. Prob. Code 11420.
