LIENHOLDERS, BE VIGILANT

A Decision rendered by the Seventh Circuit Court of Appeals underscores the necessity of creditors, particularly junior lien holders, remaining vigilant during bankruptcy proceedings to protect their rights. In the case of In the Matter of Vincent and Barbara Lapiana, the Seventh circuit ruled that the IRS, a fully secured creditor, could recover post-petition interest at the expense of a junior lien holder even though the IRS, the senior lien holder, had dragged its feet in getting the trustee to pay its claim.

Prior to bankruptcy a judgment creditor and the IRS filed liens against the debtor's property. After the bankruptcy petition was filed, certain of the debtor's property was sold, but the Trustee failed to turn over the proceeds to the IRS, until 20 months after he was ordered to do so. The trustee was unable to turn over all the funds because he had misappropriated a portion of the proceeds.

Later, more of the debtor's property was sold and the IRS, whose claim had been growing because of interest charges, claimed all of the proceeds. The judgement creditor argued that the IRS should be estopped from recovering post petition interest, because it delayed in enforcing the Court's order directing the Trustee to turn over the proceeds from the sale. The bankruptcy Court agreed and ruled that the IRS forfeited its right to recover post-petition interest.

The Seventh Circuit disagreed, however, and ruled that it is the duty of junior lien holders to guard against a senior lien holder that is dragging its feet. It therefore held that the IRS could recover post-petition interest. ❑