CLIENT ALERTS & INSIGHTS

SDNY Bankruptcy Court Offers Further Direction on Default Interest and Fee Recovery

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Authors: Michael J. Barrie, Kevin M. Capuzzi, Melissa Sobrepera

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Key Takeaways

- The SDNY Bankruptcy Court's written decision in *1300 Desert Willow* builds on the framework established in *Mako*, providing additional guidance on when a debtor can overcome the presumption that an oversecured creditor is entitled to post-petition default interest at the contractual rate.
- The court narrowed the circumstances in which the "fresh start" factor may weigh against default interest, holding that the consideration generally has little relevance in chapter 11 cases involving single-asset real estate entities and requires evidence of a meaningful bankruptcy-related interest in preserving the debtor's operations.
- The decision also clarifies that Section 506(b)'s reasonableness requirement does not apply to components of an allowed prepetition claim, reinforcing protections for oversecured creditors while confirming that post-petition default interest and late fees cannot both be recovered when they serve the same purpose.

On April 4, 2026, the Honorable Philip Bentley of the U.S. Bankruptcy Court for the Southern District of New York issued a bench decision in *In re Mako, LLC*, Case No. 25-11256 (PB) (Bankr. S.D.N.Y. April 4, 2026), establishing a framework for analyzing a debtor's burden to rebut the presumption that an oversecured creditor is entitled to post-petition default interest at the contractual rate under 11 U.S.C. § 506(b). This decision builds on the *Mako* framework, a summary and analysis of which can be found in the Benesch team's prior alert. On April 27, 2026, Judge Bentley issued another bench ruling in which he applied and clarified portions of the *Mako* framework in the case. SeeBench Decision on Debtor's Objection to Romspen's Secured Claim, *In re: 1300 Desert Willow Road, LLC*, Case No. 25-11375 (PB).

As it relates to 11 U.S.C. § 506(b), courts in the Second Circuit apply a rebuttable presumption that the appropriate interest rate is the default rate set forth in the contract giving rise to the claim. While this test is traditionally treated as a totality-of-the-circumstances analysis, Judge Bentley clarified that the debtor's solvency must be analyzed prior to considering the equitable factors: (i) whether the contractual default rate constitutes a penalty; (ii) whether there has been misconduct by the creditor; (iii) whether awarding post-petition default interest at the contractual default rate would put the reorganization at risk, thereby harming other creditors; and (iv) whether allowing such interest would adversely affect the debtor's fresh start. *See In re Mako*. He further explained that the Court may award either interest or late fees provided for under the contract under 11 U.S.C. § 506(b), but not both.

On July 20, 2026, Judge Bentley issued the written decision in *1300 Desert Willow*, in which he applied the *Mako* framework and further opined on the reasonableness standard set forth in 11 U.S.C. § 506(b), when a contractual default rate may constitute a penalty, and what effects on a debtor's fresh start are sufficient to overcome the presumption for contractual default interest.

I. Debtor's Fresh Start

The Court addressed whether allowing postpetition interest at the contractual default rate would adversely affect an insolvent debtor's fresh start. Here, the debtor argued that if default interest were disallowed, it would be able to raise funds sufficient to pay off the creditor's claim and avoid a sale of the collateral. However, the Court found no evidence that the debtor would actually be able to raise such funds, noting that the debtor had repeatedly promised, both before and during the bankruptcy, to obtain such financing-but these promises had never come to fruition.

The Court additionally focuses on who the "fresh start" factor applies to. Unless the debtor is a commercially operating business with multiple employees, the factor does not apply in a chapter 11 corporate case. Where the debtor is a single asset real estate company with one employee, as was the case here, the factor does not apply. The purpose of the equitable factor as it relates to businesses is to allow the debtor to continue to operate the business without causing harm to employees and, as it relates to real estate, tenants of the property. The Court further noted that the particular facts of this case reinforced the absence of any bankruptcy interest in preserving the debtor's ownership: the debtor's principal had a poor prepetition management track record (so poor that a receiver had been appointed to displace him), performed poorly during the bankruptcy, and had been indicted by a federal grand jury on six felony counts, including wire fraud and bank fraud.

As it relates to late fees, the Court reiterated that postpetition late fees in the Second Circuit "are per se unreasonable" if the creditor is also being paid postpetition default interest, because they are duplicative of the default interest.

II. Reasonableness under 11 U.S.C. § 506(b)

11 U.S.C. § 506(b) provides that "there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose." In contrast, 11 U.S.C. § 502(b) provides that claims are determined "as of the date of the filing of the petition" and should be allowed by the court "except to the extent that-(1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law." The question addressed here is whether the reasonableness standard set forth in § 506(b) similarly applies to fees, costs or charges provided for under an agreement that are part of a prepetition claim.

The answer is that it does not. The Court found § 506(b)'s reasonableness requirement to be ambiguous when read in conjunction with § 502(b), as it could plausibly be read either broadly (applying to all claims, prepetition and postpetition) or narrowly (applying only to postpetition charges).

Judge Bentley adopts the narrower construction for two reasons. First, there is no ambiguity under § 502(b) that prepetition claims are allowed under non-bankruptcy law regardless of reasonableness. An interpretation of § 506(b) which allows a court to analyze a claim's reasonableness would thus be inconsistent with the plain language of § 502(b). Second, if read broadly, oversecured creditors would be treated less favorably than undersecured creditors with respect to their prepetition claims because oversecured creditors would be subject to fees being deemed unreasonable while undersecured creditors' claims would undergo no such scrutiny.

The Benesch Restructuring & Bankruptcy team will continue to monitor developments affecting oversecured creditors and real estate restructurings. Our attorneys regularly advise lenders, debtors and investors in Chapter 11 proceedings, workouts and enforcement matters, and stand ready to help clients assess the impact of these developments on their recovery and restructuring strategies.