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SDNY Bankruptcy Court: Solvent Debtors Face Higher Hurdle to Avoid Default Interest Under 11 U.S.C. § 506(b)

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Key Takeaways

- 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), a court must first find that the debtor is insolvent.
- If the debtor is solvent, meaning that the sum of its debts is less than a fair valuation of the sum of its assets, the presumption is effectively irrebuttable.
- An oversecured creditor may claim either post-petition default interest or late charges under 11 U.S.C. § 506(b).

Following a recent decision from the U.S. Bankruptcy Court for the Southern District of New York, solvent debtors may find it significantly harder to avoid paying contractual default interest to oversecured lenders under section 506(b). On April 4, 2026, the Honorable Philip Bentley issued a bench decision clarifying the debtor's burden to rebut the presumption that an oversecured creditor is entitled to post-petition default interest at the contractual rate and reasonable late charges pursuant to 11 U.S.C. § 506(b). See *In re Mako, LLC*, Case No. 25-11256 (PB) (Bankr. S.D.N.Y. April 4, 2026).

Background: Post-Petition Interest, § 502(b)(2) and § 506(b) for Oversecured Creditors

A key principle of the Bankruptcy Code is that post-petition default interest may not be collected by a creditor (11 U.S.C. § 502(b)(2)). However, under 11 U.S.C. § 506(b), an oversecured creditor is entitled to post-petition default interest and reasonable post-petition fees, costs and charges as part of its secured claim, up to the value of its collateral. 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.

The Second Circuit Framework: Rebuttable Presumption for Contract Default Rate

To determine whether the debtor has successfully rebutted this presumption, courts in the Second Circuit look to the following factors:

a. Whether the debtor is solvent, and

b. The equitable factors of:

    a. Whether the contractual default rate constitutes a penalty

    a. Whether there has been misconduct by the creditor

    a. Whether awarding post-petition default interest at the contractual default rate would put the reorganization at risk, thereby harming other creditors

    a. Whether allowing such interest would adversely affect the debtor's "fresh start."

This test is traditionally treated as a totality-of-the-circumstances analysis comprising five non-dispositive factors. Judge Bentley clarified that solvency operates as a threshold question that must be resolved before the equitable factors are considered.

How the Court Defines Solvency (Fair Valuation of Assets vs. Total Debt)

A debtor is considered solvent when the fair market value of its assets, meaning the value if such assets were sold in a prudent manner and reasonable time frame, exceeds the value of the debtor's total debt. As Judge Bentley illustrates, if the proceeds from the sale of all the debtor's assets were sufficient to pay each of its creditors in full, the debtor would be considered solvent.

For a solvent debtor, the burden to overcome the presumption in favor of the contractual default rate is so high that the presumption is effectively irrebuttable. Any subsequent analysis of the equitable factors is thus moot. Accordingly, the solvent debtor will be required to pay interest at the contractual default rate. Conversely, an insolvent debtor may rebut the presumption by establishing at least one of the equitable factors.

How *Mako* Changes the Default-Interest Analysis

The court further clarified that, in analyzing whether the contractual default rate constitutes a penalty, it may consider the intention of the parties in establishing the default rate, whether the rate was negotiated by sophisticated parties, whether the rate is generally consistent with the applicable state usury rate for a similar loan, and whether the rate falls within the range generally accepted by the court.

Additionally, with respect to how awarding default interest may harm other creditors, the court reframed the analysis. Under the court's approach, this factor may be established by demonstrating that applying the default interest rate would cause harm to other creditors, for example, by putting the reorganization at risk, rather than by simply showing that an increased payment to a secured creditor necessarily decreases the amount available to unsecured creditors.

Finally, Judge Bentley opined on the court's ability to grant interest and fees provided for under the applicable contract pursuant to 11 U.S.C. § 506(b). Particularly, the court may award an oversecured creditor either post-petition default interest or late fees, but not both.

Summary and Practical Implications

This decision turns the rebuttable-presumption analysis in the Second Circuit into a practical two-step inquiry: (1) whether the debtor is solvent, and only if it is not, (2) whether equitable considerations justify departing from the contractual default rate. For oversecured lenders, *Mako* strengthens the leverage associated with a bargained-for default-rate provision where the estate ultimately proves solvent; solvency may effectively end the debate and shift attention to confirming the amount of the secured claim and the value of the collateral.

For debtors and other constituencies, the decision underscores that solvency evidence, and the timing of solvency determinations, can drive economics in chapter 11 cases involving oversecured debt. A debtor anticipating a solvent outcome should expect heightened scrutiny when attempting to avoid a contractual default rate and should focus early on valuation methodology, sale process assumptions and the proof needed to demonstrate insolvency if it intends to preserve room for equitable arguments. Conversely, where insolvency can be shown, the traditional equitable factors remain available, including arguments that the default rate operates as a penalty or that applying it would materially jeopardize a reorganization to the detriment of other creditors.

The ruling also provides a practical reminder for oversecured creditors evaluating recovery under § 506(b): the court indicated that the creditor may seek post-petition default interest or late charges, but not both. That limitation may affect how lenders document and present their § 506(b) claims and how parties negotiate adequate protection, sale proceeds allocations and plan treatment when the estate appears to have enough value to pay secured claims in full.