



Lowenstein Bankruptcy Lowdown Video 34 – Section 506(c) Waivers: Where Are Courts Drawing the Line?

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Erica G. Mannix:

Today we are talking about a hot-button DIP financing topic that comes up in virtually every large Chapter 11 case: Bankruptcy Code Section 506(c) waivers. In particular, we want to focus on how some courts routinely allow a debtor to waive its rights under Section 506(c) as part of a comprehensive DIP financing package that includes a carve out, while others are more reluctant to grant a waiver if the case may be administratively insolvent.

Carolyn M. Gauvin:

Let's start with the big picture. Section 506(c) is meant to prevent a windfall to a secured creditor by permitting the debtor's estate to surcharge a secured creditors collateral for the reasonable, necessary costs of preserving or selling such collateral. In cases where the primary purpose is to allow a lender to monetize, dispose of, and or preserve its collateral through the bankruptcy process, Section 506(c) theoretically ensures the estate isn't footing the entire bill.

Erica G. Mannix:

Exactly, which is why the waiver fight matters. Allowing a blanket 506(c) waiver can shift meaningful administrative risk from a secured lender to the estate, impacting all other stakeholders.

Carolyn M. Gauvin:

And like other legal issues, venue makes a big difference. For example, in the Southern District of Texas, courts relying on a debtor's business judgment oftentimes approve DIP financing that includes a Section 506(c) waiver without conditioning the waiver on objective markers like administrative solvency or guaranteed funding beyond interim draws. Instead, courts in this district focus on how the Section 506(c) waiver is just one aspect of a heavily negotiated DIP financing package that gives a debtor a chance to sell or reorganize its assets.

Erica G. Mannix:

By contrast, Delaware courts appear to be more cautious and have pushed back on Section 506(c) waivers, particularly one if the DIP budget is tight and does not include subrent. Section 503(b)(9) claims and other administrative claims to the DIP rolls up prepetition debt without providing a commensurate amount of new money or three. The case looks like a lender driven sale, which could have a credit bid component.

For example, courts in this district have refused to grant a waiver where the DIP rolled up prepetition debt, contemplated a sale, but clearly did not provide sufficient funding to pay administrative and priority claims, including subrent in Section 503(b)(9) claims. The message in this jurisdiction is if you're liquidating a lender's collateral through Chapter 11, you need to fund the costs for doing so. In other words: pay the freight.

Carolyn M. Gauvin:

The Southern District of New York seems to land in the middle. Courts will entertain 506(c) waivers when there are meaningful carve outs and a credible budget that funds the case through a sale or plan. However, if the DIP looks like it will result in a backdoor foreclosure with minimal liquidity and questionable administrative insolvency, expect pushback and a narrower or conditional waiver.

Erica G. Mannix:

That's the lowdown. So when it comes to 506(c) waivers, know your venue.

Thanks for joining us. We'll see you on the next episode of [Lowenstein Bankruptcy Lowdown](#).