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NOT FOR PUBLICATION

SUSAN M. SPRAUL, CLERK
U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re:) BAP No. AK-14-1122-JuKiKu
)
 MARLOW MANOR DOWNTOWN, LLC,) Bk. No. 12-00421
)
 Debtor.)
)
)
 MARLOW MANOR DOWNTOWN, LLC,)
)
 Appellant,)
)
 v.) M E M O R A N D U M *
)
 WELLS FARGO BANK, AS SERVICING)
 AGENT FOR ALASKA HOUSING)
 FINANCE CORPORATION; CAG)
 DEVELOPMENT, LLC; ENVISION)
 INVESTORS, LLC; RISING STAR)
 INVESTMENTS, LLC,)
)
 Appellees.)

Argued and Submitted on January 22, 2015
at Pasadena, California

Filed - February 6, 2015

Appeal from the United States Bankruptcy Court
for the District of Alaska

Honorable Herbert A. Ross, Bankruptcy Judge, Presiding

Appearances: David Hollister Bundy argued for appellant Marlow
 Manor Downtown, LLC; Gary C. Sleeper of Jermain
 Dunnagan & Owens PC argued for appellee Wells
 Fargo Bank, as Servicing Agent for Alaska Housing
 Finance Corporation.

* This disposition is not appropriate for publication.
 Although it may be cited for whatever persuasive value it may
 have (see Fed. R. App. P. 32.1), it has no precedential value.
See 9th Cir. BAP Rule 8024-1.

1 Before: JURY, KIRSCHER, and KURTZ, Bankruptcy Judges.

2 In the third amended plan (TAP) filed by chapter 11¹ debtor
3 Marlow Manor Downtown, LLC, debtor classified the two unsecured
4 deficiency claims of its lender, the Alaska Housing Financing
5 Corporation (AHFC), in class 3 and 4 as secured and unimpaired
6 and placed them in different classes from the general unsecured
7 creditors. Prior to plan confirmation, Wells Fargo Bank, as
8 servicing agent for AHFC,² filed a motion under Rule 3013³
9 (Rule 3013 Motion) seeking an order that debtor's classification
10 of AHFC's deficiency claims was improper on the grounds that
11 (1) the deficiency claims were unsecured and impaired and
12 substantially similar to the claims of the general unsecured
13 creditor class and (2) debtor failed to provide a business
14 justification or economic reason for the separate
15 classification. Agreeing with AHFC, the bankruptcy court
16 entered an order granting the motion. Debtor appeals from that
17 order. Finding no error, we AFFIRM.

18
19
20 ¹ Unless otherwise indicated, all chapter and section
21 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and
22 "Rule" references are to the Federal Rules of Bankruptcy
23 Procedure.

24 ² Although Wells Fargo Bank, as servicer for AHFC, filed the
25 Rule 3013 Motion as well as other motions throughout this case,
26 for convenience we refer to AHFC as the movant.

27 ³ Rule 3013 entitled "Classification of Claims and
28 Interests" provides in relevant part:

For the purposes of the plan and its acceptance, the
court may, on motion after hearing on notice as the
court may direct, determine classes of creditors and
equity security holders pursuant to §§ 1122

1 I. FACTS

2 A. Prepetition Events⁴

3 Debtor is an Alaska limited liability company formed in
4 2002. Debtor's manager is Marc A. Marlow (Marlow) and its
5 membership interests are owned by the Marlow Family Perpetual
6 Trust (90%) and Marlow Manor Downtown TC, LLC, an Alaska limited
7 liability company (10%).

8 Debtor owns a portion of the McKinley Tower, a 14-story
9 high rise located in downtown Anchorage which was built in 1952
10 for residential use. At one point, the building was converted
11 to office space and leased to the State of Alaska. A subsequent
12 owner began converting the building into a hotel before
13 defaulting and the lender foreclosed. Another owner all but
14 abandoned the building before selling it to Marlow in 1998.

15 Marlow, a developer, planned on restoring the building to
16 residential use. To that end, Marlow had the property legally
17 subdivided into a two unit condominium project. Unit A, owned
18 by EGAE, LLC⁵ and an unidentified investor, was reconstructed as
19 100 studio and one bedroom apartments and was financed through
20 HUD's 221 D 4 Urban Revitalization Program. Unit B, owned by
21 debtor, was to be converted to a fifty-two unit senior assisted
22 living home and was financed by a \$5.4 million construction loan
23 from Northrim Bank (Northrim).

24
25 ⁴ The underlying facts are undisputed. The facts were
26 mostly taken from the second amended disclosure statement and the
27 bankruptcy court's memorandum decisions entered October 9, 2013,
and March 24, 2014.

28 ⁵ EGAE, LLC is owned by the Marlow Family Perpetual Trust.

1 In 2007, AHFC refinanced the majority of Northrim's loan
2 through two long term loans in the total amount of \$5.450
3 million. The first loan for \$4.125 million was evidenced by a
4 promissory note (First Note) and secured by a first deed of
5 trust against Unit B and a security interest in the rents,
6 equipment, inventory, security deposits, and other personal
7 property. The original terms called for interest at 7.375% per
8 year in equal monthly payments of \$28,490 over a 30-year term
9 (or, to February 1, 2037). The second loan for \$1.325 million
10 was evidenced by a promissory note (Second Note) and was secured
11 by a second deed of trust against Unit B and a security interest
12 in the same personal property as the First Note. The Second
13 Note bore interest at 1.5% per year in annual installments of
14 40% of "available cash flow," as defined in the note, and due
15 and payable by February 1, 2037. Marlow guaranteed both loans.
16 After the refinancing, Northrim was left with an unsecured loan
17 balance of \$575,000.

18 Construction of Unit B into senior assisted living housing
19 began in 2005. Marlow's business plan depended on most of the
20 residents paying for their rent, meals and care through the
21 Medicaid program for lower income and disabled persons, using
22 federal and state funds administered by the State of Alaska.
23 Marlow thought he could collect \$127 per resident per day which
24 was the reimbursement rate from Medicaid at the time. After
25 food and care costs, Marlow expected that the excess income
26 would cover operating expenses and the debt service on the First
27 Note.

28 In May of 2007, the Alaska Department of Health and Social

1 Services reduced the Medicaid reimbursement rate to \$99.37 per
2 day, a \$28 reduction from the rate on which the project had been
3 budgeted. With an anticipated thirty residents (out of fifty
4 units) receiving Medicaid benefits, this translated to a
5 reduction of almost \$27,000 in monthly income, an amount almost
6 equal to the required debt service. Due to the decrease in
7 benefits, it was no longer practical to use the project for
8 assisted living.

9 Marlow decided to convert the property from assisted living
10 units to residential rentals offered on the open market.
11 Although the market for apartment housing without kitchens would
12 be limited, Marlow thought that the rent would cover the
13 operating costs with an appreciable amount remaining for debt
14 service and a reserve for insurance and capital replacements.
15 The assisted living residents were relocated, and Marlow began
16 converting the property to market rate studio apartments.

17 Conversion costs were approximately \$258,000 and it took
18 almost two years to stabilize the rent. The only source of
19 funds to convert Unit B to market rentals was the income from
20 the property as units were rented, which meant that for a number
21 of months debtor made no loan payments to AHFC.

22 In April 2009, AHFC agreed to a loan modification. Under
23 the First Note, the payment terms were modified to carve out a
24 \$1 million principal portion and provide payment on two tracks.
25 On the approximately \$3.125 million portion, payments were
26 reduced from \$28,490 per month to \$21,627 per month at 7.375%
27 annual interest, still in equal monthly payments, amortized to
28 fully pay off by February 1, 2037. On the \$1 million carve out,

1 interest remained at 7.375% annually, but payments were made
2 based on 30% of "available cash flow" as redefined in the
3 modification agreement. Any unpaid balance was due on
4 February 1, 2037. The modification did not make the \$1 million
5 carve-out junior to the \$3.125 million part of the first loan,
6 but merely described two different criteria for payment. The
7 terms of the \$1.325 million Second Note were modified to require
8 an annual payment of 70% of "available cash flow," as redefined
9 in the modification agreement. The interest remained at 1.5%
10 and a balloon payment was due on February 1, 2037.

11 In 2011 AHFC filed a state court lawsuit to impose a
12 receivership over the property. Debtor agreed to the
13 appointment of a receiver. The receiver began serving in April
14 2012 and has been collecting the rents and disbursing funds to
15 pay the operating expenses since then.

16 Early in 2012, AHFC declared debtor in default on the First
17 Note for lack of payments. AHFC commenced a non-judicial
18 foreclosure against the property after workout discussions
19 between the parties did not succeed.

20 **B. Bankruptcy Events**

21 Debtor filed its chapter 11 single asset real estate case
22 on July 9, 2012. In Schedule D, debtor listed AHFC's Second
23 Note as fully unsecured and the First Note as partially secured
24 by Unit B. In Schedule F, debtor listed unsecured claims in the
25 amount of \$1.5 million consisting of trade and other debt,
26 including the loan balance due Northrim in the amount of
27 \$575,000 and management fees owed to NANA Management Services
28 (NANA) in the amount of \$500,000.

1 Soon after the filing, AHFC moved for relief from stay. At
2 the preliminary hearing on its motion, AHFC agreed to waive the
3 ninety-day time limit for debtor to file a plan under
4 § 362(d)(3)(A). The bankruptcy court extended the time for
5 debtor to file its plan and disclosure statement. On
6 October 18, 2012, debtor filed its plan of reorganization.

7 Meanwhile, the parties attended a mediation which resulted
8 in a number of agreements. The parties agreed, among other
9 things, that the receiver would remain in place and continue to
10 disburse monies monthly to AHFC as set out in the receivership
11 order and in the cash collateral order entered by the bankruptcy
12 court. The parties also agreed to continue the final hearing on
13 AHFC's motion for relief from stay and the confirmation hearing,
14 both scheduled for November 7, 2012.

15 Debtor filed a first amended plan on March 30, 2013. The
16 scheduled confirmation hearing for that plan was vacated to
17 allow debtor to file a second amended plan (SAP).

18 **1. The SAP**

19 Debtor filed its SAP on July 7, 2013. In that plan, debtor
20 placed AHFC's various claims into classes 2, 3, and 4:

21 **Class 2 - AHFC's secured First Note claim.** As of the
22 petition date, AHFC's First Note claim had an outstanding
23 balance of \$4,391,545.20. Debtor assigned a present value of
24 \$2.7 million to the secured portion of AHFC's First Note claim
25 and gave AHFC the option to elect to have its class 2 claim
26 treated as fully secured under § 1111(b). This claim was
27 impaired.

1 **Class 3 - AHFC's unsecured deficiency First Note claim.** If

2 AHFC did not elect to have its class 2 claim treated as fully
3 secured under § 1111(b), debtor proposed making \$10,000
4 quarterly payments on the unsecured deficiency First Note claim
5 beginning October 1, 2018, and continuing for five years until a
6 total of \$200,000 was paid. The SAP stated that debtor would
7 not be required to make further payments on this claim. This
8 class was impaired.

9 **Class 4 - AHFC's unsecured deficiency Second Note claim.**

10 As of the petition date, the outstanding balance owed on the
11 Second Note was \$1.325 million. Debtor proposed to pay this
12 unsecured deficiency claim in the amount of \$250,000, without
13 interest, in quarterly installments of \$10,000 beginning
14 October 1, 2023. This claim was impaired.

15 Class 6 consisted of general unsecured claims. The allowed
16 class 6 claims would share pro rata a \$20,000 distribution on
17 the effective date of the plan and thereafter quarterly payments
18 of \$10,000 commencing October 1, 2013, for a period of five
19 years, with the final payment made on July 1, 2018.

20 AHFC voted to reject the plan as did class 6 unsecured
21 creditors, Northrim and NANA, who controlled the class vote. As
22 a result, debtor did not have an impaired class that accepted
23 the plan. After the voting, a business associate of Marlow's
24 purchased Northrim's claim. Debtor subsequently filed a motion
25 under Rule 3018 seeking to change Northrim's vote on the SAP.

26 At the same time, AHFC filed an objection to confirmation
27 of the SAP arguing, among other things, that debtor's placement
28 of AHFC's class 4 unsecured deficiency Second Note claim in a

1 different class from the class 6 unsecured claims was improper.
2 AHFC asserted that its Second Note unsecured claim was
3 substantially similar to the general unsecured claims and that
4 debtor had no business or economic justification for the
5 separate classification.

6 AHFC also filed a Rule 3013 Motion, seeking an order that
7 the classification of AHFC's unsecured deficiency Second Note
8 claim in class 4 was improper on the same basis. Debtor opposed
9 the motion, arguing that AHFC's unsecured debt in connection
10 with the Second Note was not substantially similar to the
11 general unsecured claims on the basis that the payment terms
12 under the Second Note distinguished the debt from the debt owed
13 to the general unsecured creditor class. According to debtor,
14 the Second Note, as modified in 2009, did not require any debt
15 service unless the property had sufficient cash flow. If there
16 was not adequate cash flow, then no payment was required and the
17 deferred interest would be added to the balloon payment due in
18 2037. Citing several tax cases, debtor maintained that the
19 payment terms under the Second Note had the character of a
20 redeemable preferred stock or similar equity investment which
21 receives a dividend only if the issuer has the ability to pay.

22 On October 9, 2013, the bankruptcy court issued a
23 memorandum decision granting AHFC's Rule 3013 Motion. The
24 bankruptcy court found that the separate classification of
25 AHFC's Second Note deficiency was not proper for several
26 reasons.

27 First, the court decided that debtor's attempted separate
28 classification of the unsecured deficiency Second Note claim was

1 a "disfavored attempt to manipulate the voting on the plan to
2 meet the confirmation standard of having at least one class of
3 non-insider claims approve the plan" - i.e., gerrymandering.

4 Second, the court found no special circumstances that
5 warranted the separate classification under the holding in
6 *Steelcase Inc. v. Johnston (In re Johnston)*, 21 F.3d 323, 327
7 (9th Cir. 1994). In *In re Johnston*, the Ninth Circuit affirmed
8 the separate classification of an unsecured creditor's claim
9 because its claim was partially secured by collateral of a
10 nondebtor company. Further, the creditor was embroiled in
11 litigation with Johnston and therefore its claim might be offset
12 or exceeded by Johnston's own claim against the creditor, and if
13 the creditor was successful in litigation, it could be paid in
14 full before all other unsecured creditors. *In re Johnston*,
15 21 F.3d at 327. The bankruptcy court effectively distinguished
16 *In re Johnston* from the facts in this case stating:

17 Although Marlow was a guarantor on the loan, he is
18 apparently not personally solvent and has many unpaid
19 money judgments against him. He is not like the
20 creditor in *Johnston*, which had viable guarantors to
21 collect from, at least in part. Nor is there any
22 other collateral than the real and personal property
23 securing the two loans owed to AHFC, valued at no more
24 than \$2.7 million.

25 Next, relying on *Barakat v. The Life Ins. Co.*
26 (*In re Barakat*), 99 F.3d 1520 (9th Cir. 1996), the bankruptcy
27 court noted that while it was possible to classify similar
28 claims in different classes, there were limits to that right.
Separate classification cannot be used to "gerrymander an
affirmative vote on a reorganization plan" and, if claims are
substantially similar, there must be a valid business or

1 economic reason for the separate classification. *Id.* at 1527.
2 The bankruptcy court concluded that AHFC's unsecured deficiency
3 Second Note claim was substantially similar to the separately
4 classified, noninsider unsecured creditor claims:

5 The claim on the second promissory note is very
6 similar to a garden variety unsecured claim,
7 notwithstanding its 'easy terms.' [Section] 502(b)(1)
8 makes the claim presently allowable despite being an
9 unmatured claim, the balance of which is due in 2037.
10 Also, under the terms of the second loan agreement,
11 the second promissory note can be accelerated due to
12 the default under the first promissory note. And,
13 even if [sic] second promissory note had been
14 nonrecourse (which it is not), in chapter 11 it is
15 treated as a recourse claim.

16 The court also decided that debtor offered no satisfactory
17 business or economic reason for the separate classification of
18 the substantially similar claims. The bankruptcy court rejected
19 debtor's argument that AHFC should bear some of the
20 responsibility for the failure of Marlow's plan to develop
21 Unit B into an assisted living center. Noting that AHFC was a
22 completely distinct entity from the entity that changed the
23 Medicaid subsidies, the bankruptcy court observed that both
24 debtor and AHFC had the "rug pulled out from under them" due to
25 the change in projected Medicaid subsidies.

26 Finally, the bankruptcy court was not persuaded by debtor's
27 argument that the Second Note was akin to an equity
28 contribution.

29 Due to the court's ruling, it found it unnecessary to
30 address the merits of debtor's motion under Rule 3018 seeking to
31 change Northrim's vote on the SAP.

32 **2. The TAP**

33 On November 12, 2013, debtor filed the TAP. According to

1 debtor, the classification of AHFC's claims in the TAP
2 recognized that through the modification agreement, AHFC and
3 debtor in effect turned the original two loans into three:
4 (1) under the First Note, monthly installment payments were due
5 on \$3.125 million; (2) under the First Note, the \$1 million
6 carve out required payments only from cash flow; and (3) under
7 the Second Note, payments on the \$1.325 million were required
8 only from cash flow. Following these payment terms, debtor
9 placed AHFC's claims in class 2, 3, and 4:

10 **Class 2 - Secured Claim of AHFC.** Debtor stated AHFC's
11 secured claim was for \$3.125 million, with interest at 5.75%,
12 and payments would be made in monthly installments (after a
13 \$30,000 payment on the effective date), increasing at various
14 intervals to June 1, 2037 (this apparently represents the
15 \$3 million portion of the First Note, as defined by the
16 modification agreement). This claim was impaired.

17 **Class 3 - the \$1 million carve out from the First Note.**
18 Debtor labeled this claim as secured and if AHFC did not make an
19 election under 1111(b) then debtor would pay this claim in
20 accordance with the terms of the modification agreement. The
21 plan further provided that the maturity of this claim - as such
22 maturity existed prior to any default - "shall be reinstated."
23 In addition, the plan stated that no payment of any cure amount
24 or on account of any damages incurred as a result of any
25 prepetition default shall be required. Because debtor was
26 proposing to pay this claim according to its terms, debtor
27 labeled this class as unimpaired and deemed to have accepted the
28 plan.

1 **Class 4 - the \$1.325 million owed on the Second Note.**

2 Again, debtor labeled this deficiency claim as secured and
3 stated that it would be paid in accordance with the terms of the
4 modification agreement. This class was also described as not
5 impaired and "deemed to accepted the plan."

6 On January 17, 2014, AHFC filed its second Rule 3013 Motion
7 seeking to have the bankruptcy court find that its unsecured
8 deficiency claims in classes 3 and 4 were improperly classified
9 as secured and unimpaired. AHFC also argued that its deficiency
10 claims should be placed with the substantially similar general
11 unsecured claims in class 6 due to the bankruptcy court's
12 previous ruling in connection with the SAP.

13 Debtor opposed, arguing that it was offering to repay the
14 two loans exactly as required by the loan documents and thus
15 class 3 and 4 were not impaired and were not entitled to vote
16 for or against the TAP. Debtor further argued that the business
17 reason for separate classification was based on the specific
18 terms of the modification agreement, which carved out \$1 million
19 from the First Note, and the terms of the \$1.325 million Second
20 Note, neither of which required any debt service unless the
21 property had sufficient cash flow. By limiting debt service to
22 debtor's positive cash flow, debtor argued that AHFC
23 subordinated a total of \$2.325 million of its loans to debtor's
24 operating expenses and to debt service on the balance of the
25 First Note. The subordination of the two debts, according to
26 debtor, created a substantially different economic treatment of
27 the loans from that of the debts owed to general unsecured
28 creditors.

1 On March 5, 2014, the bankruptcy court heard the matter.
2 The court questioned debtor's counsel about the purpose behind
3 classifying AHFC's deficiency claim separately in class 4 even
4 though it previously ruled that separate classification was
5 improper.

6 THE COURT: And the purpose of doing that is to take
7 it out of the voting so it would be deemed to be
unimpaired?

8 MR. BUNDY: Right. That is the purpose. And the same
9 with the Class 3 claim. As now indicated, the million
10 dollars would be treated as unimpaired and wouldn't
11 get to vote either. If the court rules that we can't
12 do that and we have to put all these claims together
because there's no collateral value for . . . Class 3
and 4 at this point, then, you know, the plan doesn't
work, and we concede that.

13 In the end, the court found that AHFC's deficiency claims
14 in class 3 and 4 were improperly classified as secured and
15 unimpaired when they were both unsecured and impaired. The
16 bankruptcy court entered an order granting AHFC's Rule 3013
17 Motion and debtor timely appealed.

18 On March 24, 2014, the bankruptcy court issued a memorandum
19 decision which elaborated on its March 5th oral ruling. The
20 court explained that class 3, the \$1 million carve out from the
21 \$4.125 million First Note and its collateral, and class 4, the
22 junior \$1.325 million Second Note with the same collateral, were
23 improperly classified as secured and unimpaired when they were
24 both unsecured and impaired. The court further stated that
25 AHFC's class 2 claim (the \$3.125 million portion of the First
26 Note) was listed as secured up to the full value of the
27 collateral and was classified by debtor as being impaired. As a
28 simple mathematical proposition, the bankruptcy court reasoned

1 that class 3 and 4 could not be secured under § 506(a) since
2 class 2 used up all the collateral value.⁶

3 The bankruptcy court also concluded that AHFC's classes 3
4 and 4 claims were improperly classified as unimpaired because
5 the rights of AHFC in each class were modified. Although debtor
6 claimed that the payment terms of classes 3 and 4 were left
7 unchanged, the court found that the TAP made changes in AHFC's
8 contract rights which ipso facto were an impairment.

9 Finally, the bankruptcy court observed that it had
10 previously ruled that separately classifying AHFC's general
11 unsecured deficiency Second Note claim from other general
12 unsecured creditors in debtor's SAP was improper gerrymandering
13 for the purpose of obtaining the affirmative vote of at least
14 one class so it could possibly confirm a cramdown plan. For the
15 same reasons set forth in its previous ruling, the court found
16 there was no business or economic reason to classify AHFC's
17 unsecured deficiency claims in class 3 and 4 in the TAP
18 separately from the other general unsecured class 6 creditors.

19 On April 22, 2014, the BAP clerk's office issued an order
20 regarding finality, indicating that the order on appeal did not
21 appear final and requiring a response from appellant. After
22 receiving the response, the Panel entered an order granting
23 debtor leave to appeal to the extent it was necessary.

24 **II. JURISDICTION**

25 The bankruptcy court had jurisdiction pursuant to 28 U.S.C.
26

27 ⁶ The bankruptcy court did not hold a valuation hearing nor
28 were appraisals submitted regarding the value of the property.

1 §§ 1334 and 157(b)(2)(L). We have jurisdiction under 28 U.S.C.
2 § 158.

3 III. ISSUES

4 Whether the bankruptcy court erred by finding that the
5 classification of AHFC's deficiency claims was improper on the
6 bases that:

7 A. The deficiency claims were unsecured and impaired;

8 B. The deficiency claims were substantially similar to
9 the general unsecured class 6 creditor claims; and

10 C. Debtor offered no business justification or economic
11 reason for the separate classification.

12 IV. STANDARDS OF REVIEW

13 Whether a claim is impaired under § 1124 is a question of
14 law, subject to de novo review. *Acequia, Inc. v. Clinton*
15 (*In re Acequia, Inc.*), 787 F.2d 1352, 1357-58 (9th Cir. 1986).

16 Whether claims are "substantially similar" under § 1122(a)
17 is a question of fact; a bankruptcy court has broad latitude in
18 making this determination, which is reviewed for clear error.
19 *In re Johnston*, 21 F.3d at 327. A factual finding is clearly
20 erroneous if it is illogical, implausible, or without support in
21 inferences that may be drawn from the facts in the record.
22 *Retz v. Sampson (In re Retz)*, 606 F.3d 1189, 1196 (9th Cir.
23 2010).

24 V. DISCUSSION

25 **A. The bankruptcy court did not err in finding that AHFC's**
26 **deficiency claims were unsecured and impaired.**

27 In its opening brief, debtor concedes that AHFC's
28 deficiency claims under the First Note and Second Note are

1 unsecured under § 506(a). Section 506(a) divides a creditor's
2 claim into "secured and unsecured portions, with the secured
3 portion of the claim limited to the value of the collateral."
4 *Assocs. Commercial Corp. v. Rash*, 520 U.S. 953, 961 (1997).
5 Here, debtor assigned a value of \$2.7 million to AHFC's secured
6 First Note claim. Therefore, as noted by the bankruptcy court,
7 simple math confirms that AHFC's deficiency claims under the
8 First Note and the Second Note are unsecured. Accordingly,
9 debtor's classification of AHFC's unsecured claims as secured is
10 in direct violation of § 506(a).

11 As the holder of both a secured and unsecured claim, AHFC
12 is entitled to vote on debtor's plan in both capacities.
13 Because the TAP treats AHFC's unsecured deficiency claim on the
14 First Note as fully secured even though AHFC is an undersecured
15 creditor, the plan improperly treats AHFC as if AHFC had made
16 the § 1111(b)(2) election. However, the decision whether to
17 make the § 1111(b)(2) election is controlled solely by the
18 creditor. *Montclair Retail Ctr., L.P. v. Bank of the W.*
19 *(In re Montclair Retail Ctr., L.P.)*, 177 B.R. 663, 666 (9th Cir.
20 BAP 1995). Accordingly, debtor's classification of AHFC's
21 unsecured deficiency claim under the First Note as secured is in
22 direct violation of § 1111(b).

23 Debtor also maintains, without analysis, that AHFC's
24 deficiency claims in classes 3 and 4 are unimpaired under § 1124
25 on the basis that it is making the same payments to AHFC as
26 those required under the modification agreement.
27 Section 1124(2) states that a class of claims or interests is
28 impaired, and thus entitled to vote, unless the treatment in the

1 plan of those claims or interests, notwithstanding any right to
2 demand accelerated payment upon default: (A) cures the default,
3 (B) reinstates the maturity of the claim or interest,
4 (C) compensates the claim or interest holder for damages for
5 relying on the acceleration clause, (D) compensates for
6 nonmonetary defaults, and (E) "does not otherwise alter the
7 legal, equitable, or contractual rights to which such claim or
8 interest entitles the holder." If a plan can satisfy these
9 requirements, that claim or interest holder will not be
10 considered impaired.

11 Nowhere does debtor discuss these requirements, instead
12 arguing that the bankruptcy court did not explain how the
13 deficiency claims were impaired. However, the record shows that
14 the court supported its finding by citing AHFC's brief filed in
15 support of its second Rule 3013 Motion. There, AHFC argued that
16 debtor was in default on the First and Second Notes.
17 Accordingly, debtor was obligated to AHFC for missed payments
18 and for substantial costs and attorney's fees. As noted by
19 AHFC, the TAP specifically provides that the defaults will not
20 be cured. Thus, § 1124(2) (A) has not been met.

21 Moreover, the modification agreement entitles AHFC to
22 receive annual payments on the \$1 million carve out and Second
23 Note in an amount equal to 100% of debtor's available cash flow.
24 Instead of paying AHFC the available cash flow, the TAP will use
25 it to pay general unsecured creditors. Therefore, the TAP
26
27
28

1 alters AHFC's contractual rights under § 1124(2) (E).⁷

2 Accordingly, the bankruptcy court did not err in concluding
3 that AHFC's unsecured deficiency claims in classes 3 and 4 were
4 impaired under § 1124(2).

5 **B. The bankruptcy court did not err in finding that the
6 separate classification of AHFC's unsecured deficiency
7 claims was improper.**

8 Section 1122(a) provides that, except as provided in
9 subsection (b), which is not relevant here, "a plan may place a
10 claim or an interest in a particular class only if such claim or
11 interest is substantially similar to the other claims or
12 interests of such class."

13 The Ninth Circuit has a two-step analysis for determining
14 whether claims have been permissibly separated into different
15 classes. *Wells Fargo Bank, N.A. v. Loop 76 LLC (In re Loop 76,
16 LLC)*, 465 B.R. 525, 536-37 (9th Cir. BAP 2012). First, the
17 trial court should determine whether the claims are
18 substantially similar, and second, if so, whether there is a
19 business justification for separately classifying them. *Id.* If

20
21 ⁷ Debtor's third amended disclosure statement provides that
22 payments and distributions under the plan will be funded by the
23 following:

24 Payments to creditors will come from cash on hand,
25 collections of receivables, and ongoing revenue.
26 Payments on the Class 3 and 4 claims will come mostly
27 from refinancing or sale of the Property on maturity of
28 the Claims in 2037.

The financial projections show that the Debtor will
have sufficient income to make the required payments on
the Class 2 claim of AHFC and the Class 6 unsecured
claims. . . .

1 the claims are not substantially similar, their separate
2 classification is not only permissible, but required under
3 § 1122(a). If the claims are substantially similar, that
4 implicates the gerrymandering concern, but the debtor may still
5 separately classify them "if the debtor can show a business or
6 economic justification for doing so." *Id.* The bankruptcy court
7 has broad discretion in classifying claims under § 1122.
8 *In re Johnston*, 21 F.3d at 327.

9 Here, the bankruptcy court evaluated AHFC's deficiency
10 claims under the same analysis as the Ninth Circuit did in
11 *In re Johnston* and *In re Barakat* and found no distinguishing
12 characteristics rendering them dissimilar to the general
13 unsecured claims. The court found Marlow, the guarantor, was
14 not a source of recovery for AHFC's deficiency claims because he
15 was insolvent and had multiple judgments against him. Finding
16 no special circumstances, the bankruptcy court concluded that
17 AHFC's unsecured deficiency claims were "garden variety"
18 unsecured claims.

19 Debtor's attempt to use the contract payment terms under
20 the modification agreement as a distinguishing characteristic
21 for classification purposes is disingenuous at best when debtor
22 proposes to use its available cash flow to pay unsecured
23 creditors rather than AHFC. Further, the contractual payment
24 terms under the modification agreement do not alter the legal
25 character of AHFC's unsecured deficiency claims warranting
26 separate classification. AHFC's unsecured deficiency claims and
27 general unsecured trade claims enjoy similar rights and
28 privileges within the Bankruptcy Code. Accordingly, the

1 bankruptcy court's factual determination that AHFC's unsecured
2 deficiency claims were substantially similar to those of the
3 unsecured creditors in class 6 was not clearly erroneous.

4 We also agree with the bankruptcy court's assessment that
5 debtor has pointed to no legitimate business or economic reason
6 for the separate classification of AHFC's deficiency claims.
7 Debtor has all but admitted that the separate classification of
8 AHFC's deficiency claims as secured and unimpaired was to
9 prevent AHFC from voting against the plan.

10 [S]eparate classification for the purpose of
11 preventing the undersecured creditor from rejecting
12 the plan is contrary to the principles underlying the
13 Bankruptcy Code, that is, that creditors holding
14 greater debt should have a comparably greater voice in
15 reorganization. . . . Although [this] will
16 effectively bar single asset debtors from utilizing
17 the Bankruptcy Code's cramdown provisions, the court
18 was not persuaded that a single-asset debtor should be
19 able to cramdown a plan that disadvantages the largest
20 creditor. Thus, absent a legitimate business or
21 economic reason, separate classification is not
22 permitted.

23 *In re Barakat*, 99 F.3d at 1526 (internal citations omitted).
24 Accordingly, the bankruptcy court did not err in finding that
25 debtor's classification of AHFC's deficiency claims in classes 3
26 and 4 was improper.

27 **VI. CONCLUSION**

28 For the reasons stated, we AFFIRM.