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which had interpreted Section 1322(b)(2) as protecting only secured claims. Nonetheless, the Court acknowledged that such an interpretation was reasonable. The Court stated that Congress chose to use the phrase "claim secured by" in Section 1322(b)(2), instead of repeating the term of art "secured claim." The Court reasoned that the word "claim" was broadly defined in the Code as "any right to payment," whether secured or unsecured. In addition, the Court referred to Section 506(a) which used the phrase "claim secured by a lien" to encompass both the secured and unsecured portions of an undersecured claim. Following this analysis, the Court concluded that the phrase "a claim secured by only a lien on the debtor's home" referred to the entire claim, including both the secured and the unsecured portions of the claim.

The Supreme Court stated that this interpretation was the most reasonable because Section 1322(b)(2) would be impossible to administer using the approach suggested by the Nobelmans. The Nobelmans could not modify the terms of the unsecured portion of their loan without also modifying the secured portion. Preserving the interest rate and the monthly payments specified in the note after reducing the principal to $23,500 would dramatically reduce the term of the note. In addition, the Court held that since the loan was an adjustable rate mortgage, this fact alone indicated that Section 1322(b)(2) could not operate with Section 506(a) in the manner suggested by the Nobelmans. Neither the mortgage contract nor the Bankruptcy Code suggested any basis for recalculating the amortization schedule of adjustable rate mortgages.

As a result, the Supreme Court determined that dividing the undersecured homestead lender's claim into its secured and unsecured parts would modify the rights of the creditor whose claim was secured only by a lien on the debtor's home. In the Nobelman's case, American's interest was only secured by a lien on the Nobelman's home. Thus, the Supreme Court could not allow the Nobelmans to divide their mortgage into secured and unsecured parts because such a bifurcation would clearly violate Section 1322(b)(2) of the Bankrupcty Code. ❖

Kathie Yoo

Title Company Must Sustain Loss Caused By Closing Attorney's Theft of Mortgage Money

In *Sears Mortgage Corp. v. Rose*, 1993 WL 283309 (N.J.), the New Jersey Supreme Court found that a closing attorney retained by the purchaser in a real estate transaction was the agent of the title insurance company in its dealings with the purchaser in effectuating title insurance. Accordingly, the court held that the title insurance company was liable for the closing attorney's theft of money earmarked for the payment and satisfaction of an existing first mortgage on the property. The court also held that the title insurance company breached its duty of good faith and fair dealing by failing to make its insured aware that there was an insurable risk of attorney defalcation (the failure of one entrusted with money to pay over when it is due to another) and also by failing to expressly provide or offer insurance coverage for that risk.

One Party Must Ultimately Bear the Loss

In August 1987, Emery Kaiser contracted to buy Michael Rose's condominium. Kaiser provided the money to buy the condominium by selling his house. Kaiser retained Joseph Gillen, a real-estate attorney, to represent him in both transactions. Gillen wrote to Commonwealth Land Title Insurance Company (Commonwealth) requesting a title insurance policy for Kaiser. Gillen also wrote to Sears Mortgage Corporation (Sears) requesting a mortgage payoff statement on Rose's condominium. Commonwealth conducted a title search and sent Gillen its title insurance commitment which listed Gillen as an "applicant" and Kaiser as the "proposed insured." The commitment stated that the policy would be subject to certain requirements. Those requirements were: payment of the purchase price to the seller, payment of the premium for the policy, proper signing of a proposed deed from Rose to Kaiser, and that the mortgage from Rose to Sears be "paid and cancelled of record." Commonwealth only sent the policy to Gillen despite the policy's language specifically directing it to the insured.

On October 17, 1987, on a form provided by Commonwealth, Gillen informed the insurance company that the closing had taken place and asked it to perform its final search and issue a fee policy. Instead of sending Sears funds to pay off Rose's mortgage, Gillen misappropriated the closing funds from the Rose-Kaiser transaction as well as the closing funds from Kaiser's other transactions. Gillen absconded with the money and was later criminally convicted, imprisoned, and disbarred.

The trial court held that Commonwealth was liable to Kaiser for breach of its duty of good faith, fair dealing, and full disclosure. The court also found that Gillen had been Commonwealth's agent in its dealings with Kaiser and thus Commonwealth would be liable for Gillen's misconduct under the law of agency. The court ordered Commonwealth to pay off the Sears' mortgage and to issue Kaiser an owner's title-insurance policy free of the Sears' mortgage encumbrance.

The appellate division reversed the trial court's judgment. The appellate division refused to impose liability on Commonwealth because Kaiser's insurance policy did not include a provision protecting him from the risk of attorney misappropriation of funds. The Appellate Division also found that Gillen was Kaiser's, not Commonwealth's agent.

The Supreme Court of New Jersey reversed and reinstated the trial court's judgment against Commonwealth. The case turned on the specific relationships between the parties and their roles and responsibilities in completing a real estate title closing.

Relationships Between the Parties Implicate Principles of Agency

The New Jersey Supreme Court first considered whether the relationships implicated principles of agency. The court stated that an agency relationship is created when one party consents to have another act on its behalf with the principal controlling and directing the acts of the agent, although direct control of the principal over the agent is not absolutely necessary. As a result, the court examined the totality of the circumstances to determine whether an agency relationship existed.

Critical to the issue of agency in this case was the specific role and functions undertaken by Gillen and the extent to which those activities were authorized and directed by Commonwealth. The court noted that the closing took place in the northern part of the state. The court found the location significant because it shed light on the function of title insurance carriers in effectuating real estate closings, the role and responsibilities of the closing attorney, and the relationship between the attorney and the title insurance carrier. In southern New Jersey, many purchasers do not have their own attorneys. The title company's representative, a "title agent," attends the closing. Conversely, in northern New Jersey, title insurance carriers do not use their own employees or "title agents" to supervise real estate title closings. Instead, the title insurance companies rely on the purchaser's attorney to perform the functions of the title agent. The attorneys must be approved and perform the functions for the title insurer in the same way as a title agent in southern New Jersey.

The court found sufficient indicia of Commonwealth's control over Gillen to support an agency relationship. First, all communication was between Commonwealth and Gillen. Second, Commonwealth gave Gillen its blank forms to use. Third, in the title commitment, Commonwealth directed Gillen to pay off and cancel the Sears mortgage. Finally, Commonwealth sent Gillen the title insurance policy and billed him directly for insurance premiums.

Court Rejects Title Company's Arguments

Commonwealth counted the agency arguments by claiming that buyers do not rely on title insurers to protect them against losses caused by closing attorneys. The court responded by stating that while reliance is usually essential to establish an agency relationship based on apparent authority, it is not essential to an agency relationship predicated on actual authority, whether express or implied. The court also stated that reliance, to the extent it supports an agency relationship, need not be predicated on the title insurer's express assurances that it will protect the buyer against losses occasioned by an attorney's misconduct. Instead, reliance may be imputed when the title insurer does not deal directly with the purchaser, but conducts business through the attorney who is acting on the behalf of both the title insurance company and the client.

Commonwealth further argued that title insurance carriers are statutorily permitted to send insurance policies and all other papers to the attorney rather than to their prospective insureds. The court responded by stating that this statutory authority does not alter the status of the attorney as the agent of the title insurer with respect to the functions performed by the attorney for the insurer, nor does it alter the fact that the purchaser is compelled to rely on the attorney as the representative of the carrier. The court also noted that the practice by title insurers of interacting directly with attorneys was based on business judgment, convenience, and practicality, not simply on statutory authority.

In attempting to refute the finding of agency, Commonwealth further argued that it no longer required an application in order for an attorney to be "approved," nor did it perform an investigation of the attorney to check into his or her qualifications. The court responded that the argument did not demonstrate an absence of control over the approval of attorneys, but only that such control is not fully exercised by insurers.

Liability Based On Duty of Good Faith and Fair Dealing

The trial court held that Commonwealth was liable primarily on the grounds that it had breached its duty of good faith and fair dealing. The New Jersey Supreme Court reasoned that Commonwealth knew of the risk of attorney misappropriation of funds as evidenced by the protection it offered institutional lenders. Therefore, Commonwealth had a duty either to give Kaiser an opportunity to insure himself against the risk or, at the very least, to inform him that he was not covered against such a risk. In order to inform Kaiser of that coverage omission, Commonwealth would have had to undertake some form of direct communication with him. The court stated that Commonwealth's business reasons for communication only with attorneys cannot surmount its duty of good faith and fair dealing to its insured. The court held that because Commonwealth was liable for the attorney's misappropriation, it had to protect the purchaser against the loss. Commonwealth was ordered to pay off and cancel the existing Sears' mortgage as an equitable remedy.

Avoiding Future Risks of Attorney Misappropriation

In addition to resolving the issues affecting the parties, the court also announced several broad rules or standards, the purpose of which is to avoid or reduce the risk of attorney misappropriation committed in the course of real estate title closings. First, in its communications, the title insurance carrier must inform the attorney that he will be performing essential functions on behalf of the carrier, will be deemed the agent of the carrier, and that the carrier will prescribe the procedures for all disbursements. This communication must be sent to the purchaser. Second, the carrier may prescribe requirements for the approval and control of closing attorneys that will reduce the risks that irresponsible or unqualified attorneys will misappropriate, misuse, or mishandle closing funds. Finally, if the purchaser insists on retaining his or her own attorney, regardless of approval by the insurer, the title-insurance carrier shall advise the purchaser of the risk of attorney misappropriation, and indicate that it is a risk that is or may be covered by the title-insurance policy.

The court realized that these directives were new, and that the matters addressed were complex, controversial, and relatively unsettled. Therefore, the court directed the Supreme Court's Committee on Civil Practice to confer with experts in the legal profession and the real estate field, to review and study the espoused directives and to provide the court with its recommendations. ❖

Joyce E. Raupp

Physician Cannot Deduct Home Office That Is Not Principal Place of Business

In *Commissioner v. Soliman*, 113 S.Ct. 701 (1993), the United States Supreme Court held that a self-employed physician was not entitled to tax deductions for a home office which did not qualify as his principal place of business. The Court, in reversing the Court of Appeals for the Fourth Circuit, limited the definition of a principal place of business to that location where the physician spent the most time providing actual medical treatment.

Physician's Use of Home Office

Nader E. Soliman, an anesthesiologist, spent thirty to thirty-five hours per week administering anesthesia and post-operative care in three hospitals. None of these hospitals provided him with an office. In addition, he spent two to three hours per day at home working in a room used exclusively as an office. While Soliman did not meet with patients in this office, he performed a variety of business tasks there, including preparation, billing, professional phone contacts, and continuing education.

In 1983, Soliman claimed federal income tax deductions for the portion of his household expenses attributable to his home office. The Internal Revenue Service Commissioner (Commissioner) disallowed these deductions, ruling that the home office was not Soliman's principal place of business under 26 U.S.C. Section 280A(c)(1)(A).

Soliman petitioned the Tax Court for review of the Commissioner's decision. The Tax Court reversed, holding that Soliman's home office qualified as his principal place of business. In so doing, the court abandoned the "focal point" test which identified the place where services were performed and income generated as the principal place of business. The Court of Appeals for the Fourth Circuit affirmed, adopting the Tax Court's test. This test involved evaluating the home office as the principal place of business in terms of its essential functions to the taxpayer's business, the amount of time the taxpayer spent there, and the availability of other locations for performing the business office functions.

The Commissioner appealed this ruling to the United States Supreme Court. Due to the different interpretations of the statute among circuits, the Court granted *certiorari* in order to address the issue of whether a home office qualifies as a taxpayer's principal place of business under 26 U.S.C. Section 280A(c)(1)(A).

Principal Place of Business Requires a Comparative Analysis

The Supreme Court first looked to the language of the revenue statute. Section 162(a) of the Internal Revenue Code allows a taxpayer to deduct all ordinary and necessary business expenses. However, Section 280A(c)(1) qualifies this provision, prohibiting deductions attributable to the taxpayer's residence. To deduct expenses attributable to the business use of the their homes, taxpayers must qualify for one of the three exceptions contained in Section 280A(c)(1). Section 280A(c)(1)(A) allows for a deduction if the home office qualifies as the taxpayer's principal place of business. In examining the statute, the Court noted that the applicable language does not refer to the principal office. Instead, it refers to the principal location, suggesting a comparative analysis of all the places where business is transacted.

The Court rejected the application of an objective formula, known as the focal point test, for deciding whether a home office is the principal place of business. The focal point test determines the principal place of business as that place where business contacts occur. Nevertheless, the Court found this test misleading as it did not consider all of the relevant facts on a case by case basis.

The Court recommended two primary considerations in deciding whether a taxpayer's home office is his principal place of business. In making its decision, the trier of fact must consider the relative importance of the functions performed at each business location, as well as the amount of time spent at each location.

The Court stated that the first consideration requires a comparative analysis of functions performed at each business location. The site where goods are delivered and services rendered is necessary, but not sufficient, in determining whether the home office is the principal place of business. Furthermore, if the nature of the business requires that the services be rendered or the goods be delivered at a facility with unique or special characteristics, additional weight is given to the facility as the principal place of business.

Second, the Court stated that if the comparative analysis yielded no definitive answer as to the principal place of business, the factfinder should compare the amount of time spent at the