CHAPTER I: SUMMARY

This summary presents some basic information for the lay reader and a terse overview of the rest of the Report. It states general findings and conclusions. Readers interested in an exposition of the facts which support those conclusions should refer to the corresponding sections of the Report and to the Appendices.

A. Background: The Typical Residential Real Estate Sales Transaction

For those unfamiliar with housing sales transactions, a brief description may be a useful aid in following the Report and in understanding certain industry terms of art:4/

Most home sellers use the services of a real estate broker when they sell a home. The broker with whom they contract for service is referred to as the "listing broker," and is compensated according to the "listing contract" entered into. A listing contract typically might specify that, if the home is sold within a given period, the broker will receive 6 (or 7 or some other) percent of the selling price as a "commission" and as full compensation for achieving the sale. The listing contract will also specify the price which the seller hopes to obtain. This is the "asking price" or the "listing price." The actual "selling price" paid for the house may, of course, be less than the amount initially asked.

Listing brokers perform a number of tasks designed to facilitate the sale of a home. Commonly, one of the most important of these is listing the home with the local "multiple listing service" (or "MLS"). This service, generally owned and operated by a local association of brokers, is an information sharing or exchange mechanism, the use of which is reserved to its broker members. It is a means of informing the members, who are potentially "cooperating brokers," of the seller's desire to sell. The listing broker will describe the property, the asking price, any unusual features, outstanding mortgages, and so forth in the "MLS listing" and also indicate his or her willingness to "split" the commission with any cooperating broker who finds a suitable buyer, indicating the percent of the commission which will be given as a split (typically, this may amount to half of the total commission due on sale of the property).

Buyers often work with brokers to find suitable homes to buy. While a broker commonly will inform a prospective buyer of the broker's own listings first, he or she will then turn to the local MLS to find additional listings which may meet the buyer's needs. If the buyer makes a selection, the buyer makes an "offer" to purchase the home. This offer typically will be at a price below that originally asked by the seller. A process of negotiation often follows with "counter-offers" relating to price and other terms (who will pay for a termite inspection, for example) changing hands through the intermediation of the broker.

Once seller and buyer agree to price and terms, the transaction is put in

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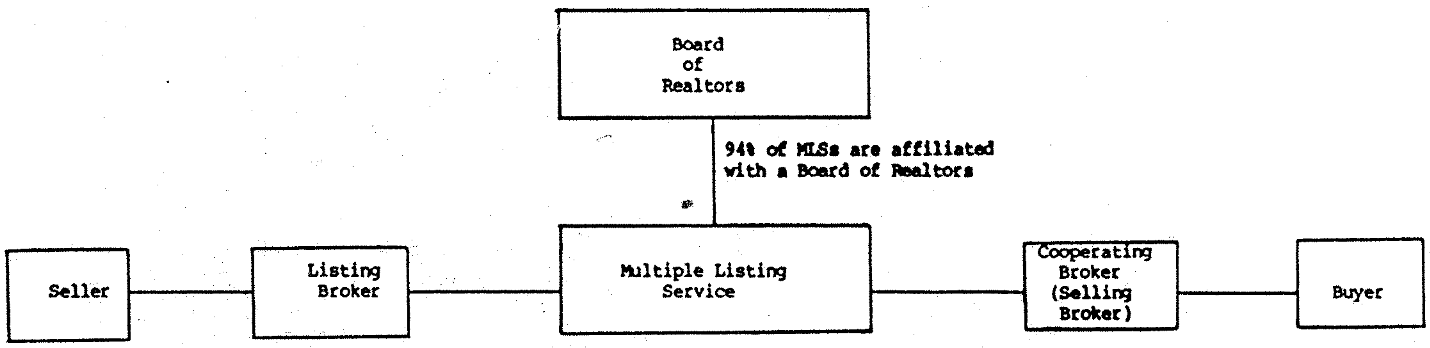
4/ Figure I-1 has also been provided in the text to help the lay reader visualize the steps in the basic brokerage tran-

Figure I-1



Useage:	81% of sellers of single family dwellings use brokers. This may vary with market conditions.	92% of sellers utilizing brokers have their homes listed on the MLS.	53% of sales involve 2 different firms.	66% of sales involve cooperating brokers.
Contract and Compensation:	Listing contract—Usually exclusive right-to-sell specifying 6-7% commission rate, depending on geographic market.		MLS listing specifies a commission split, often 50/50, to compensate the cooperating broker.	Buyers usually have no contractual relationship with the co-op broker.
Agency:	State law considers listing broker to be seller's agent.		Subagency—Traditional view is that cooperating broker is sub-agent of listing broker and has fiduciary du[illegible] to act in s[illegible]s best intere[illegible]	71% of buyers believe the co-op broker represents the buyer.

the form of a "contract" (the seller usually merely signs his or her name to the written offer of the buyer to indicate that a contract has been entered into) and enters a stage referred to in some states as "escrow." During this phase, an "escrow agent" typically will hold the contract and a specified "deposit" needed to "bind" the buyer during a period while the buyer seeks to obtain "financing" or funds needed to "close" the deal and buy the house. "Closing" is usually made contingent on financing being found during a specified number of days and the seller's then being able to "give a clear title" or sell the property free of other, outstanding claims. If financing is found, but the buyer backs out for any reason not provided for in the contract, the deposit typically is forfeited to the seller.

The listing and cooperating brokers (assuming there are two brokers involved) will both generally monitor the progress of the buyer in finding financing during the escrow period, and the cooperating broker often will help the buyer to obtain such financing in the form of a mortgage from some third party lender. At the close of escrow, if financing has been found and the other requirements in the contract met, title to the property is transferred to the buyer, and the funds, usually including the brokers' commissions, are distributed by the escrow agent.

While local laws and customs may vary somewhat, especially those that relate to the involvement of the escrow agent, the role of a "settlement attorney," and a "title search company" (a firm that will examine public records and verify that the seller is able to pass good legal title), the roles of brokers in searching for buyers and homes and in negotiating the terms of the transaction are similar throughout the country.

B. Summary of Chapter II: Residential Real Estate Brokerage: An Analytical Framework

1. The Brokerage Process: Selling Information and Service

The essence of the residential real estate brokerage function is the matching of buyers and sellers in the market for housing. The residential real estate broker offers services which include providing information about the steps in the purchase and sale transaction, negotiating the terms of sale and, most of all, the provision of information about the market and about what houses are being offered for sale. Brokers have expertise and information which consumers generally lack.

Sellers usually need assistance in determining the price at which to initially offer their homes for sale, in reaching potential buyers with information about their homes, and in presenting and showing those homes to potential buyers. Sellers also need assistance in finding the right buyer -- the right buyer being the one who will most value the characteristics of the seller's home and will pay the best price.

Buyers also need information to make their search for homes more efficient. This includes information relating to housing prices and to the identity of the houses which are for sale. The efficient broker working with a buyer quickly determines the buyer's taste and price preferences and tries to match those against the available inventory of properties.

2. Special Problems Which Can Arise in Brokering Information about Housing Which Is for Sale

As an information service, brokerage shares many problems common to other information industries but it also faces others which are peculiar to real estate brokerage.

As an example of the first category, brokers face the problem of the possible "free rider." Brokers may spend money and effort acquiring, advertising, and disseminating information about a listing. Buyers who receive that information have commonly paid nothing for it. They might, however, contact the seller directly who then might sell the property without the broker and avoid paying a commission to the broker. To avoid this danger, brokers have developed special listing contracts which protect their interests by providing that the seller will pay the broker a commission whenever specified conditions have been met. The form of listing contract which gives the most protection to the broker and therefore the form most commonly in use throughout the country, is called the "exclusive right-to-sell." Under this form of contract, the seller waives any right to sell the property during the contract period except through the listing broker. The listing broker is guaranteed a commission regardless of whose work or efforts result in a sale, as long as a sale is made.[5/]

A problem of the second category -- one which results from the nature of the real estate business — involves the difficulty of marketing heterogeneous products in a market composed mostly of "one-time" buyers through an industry composed of many small firms. Aspects of this problem are unique, at least in degree, to real estate brokerage. Every house for sale is a different product. Similarly, the preferences of each buyer are unique. That buyer who, because of his or her preferences and financial position, most values the characteristics of the seller's home will pay the most for that home. Sellers, therefore, in order to maximize the selling prices of their homes, need to maximize the exposure of those homes in the market. The more potential buyers a seller can reach with information relating to his or her home, the more likely he or she will reach that buyer whose unique preferences will cause him or her to pay the price asked for the home.

To maximize the exposure of a house and to minimize the search costs

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5/ Cooperating brokers receive an "open" right to compete against one another for selling properties listed on a MLS by listing brokers. An opportunity for "free riding" therefore exists between a listing broker and the cooperating brokers. The listing broker could ignore the cooperating brokers and negotiate directly with any prospective buyers the latter identify. Conflicts also could, and do, arise between two or more cooperating brokers each claiming to have found the same prospect. Cooperating brokers do not normally receive "exclusive" contractual protection from buyers against a fellow broker's "stealing" prospects. The arbitration system of MLS and certain requirements of brokers' codes of ethics have been designed to lower the costs of settling these disputes. Ultimately, of course, brokers may have to rely on their ability to prove a factual case in court to obtain the promised share of any commissions to which they may be entitled, a remedy which often may be too costly to justify its use.

involved, both sellers and buyers would be served best if they could reach all potential buyers or receive information relating to all homes for sale, through a single, convenient source. In order to achieve that goal in the fragmented brokerage industry, brokers in each market throughout the country generally pool their listing information and engage in cooperative marketing through the local MLS.

3. The Pricing of Brokerage Services

Critics of the industry have said that commission rates for the sale of residential real estate are so uniform in most markets that they must not be determined by competitive forces.

Our investigation indicates that while there is some variation in commission rates contracted for and paid in every local community surveyed, commission rates in all markets do tend to be roughly uniform from sale to sale. The gross dollar amount of fees collected on any individual transaction also have generally increased so much faster in recent years than the rise in both the general cost of living and in wages for other services as to suggest that the market for real estate brokerage service does not accord with the customary model of competitively functioning markets.

Pricing of brokerage services appears, on the surface, to present a paradox. There are so many firms in the industry and ease of entry is so simple, that coordinated price determination would seem to be very difficult. On the other hand, fee schedules often were successfully utilized by brokers' trade associations in the past. An apparent lack of much price competition persists and uniformity in commission rates is the general rule (except in cases such as the sale of an unusually expensive home or for a contract to sell multiple properties over time, situations where a flat or maximum fee may be arranged), whether a local market is characterized by increasing house prices and increasing demand for houses (and hence less time and effort needed to make a sale and greater profits per transaction) or decreasing house prices and decreasing demand for houses (and hence greater difficulty in finding buyers and less profits per transaction).

In examining the seeming paradox more closely, we find the brokerage industry presents a number of characteristics which might facilitate either coordination or collusion.

The real estate brokerage industry faces a market which may be characterized as one in which modest variations in the prices charged for services among individual brokers might serve primarily to shift market shares rather than to substantially expand the market. Even though as much as twenty percent of all properties currently sold are sold without a broker's assistance, a reduction or rise in the price of brokerage service by a percentage point or so is not likely to result in either a dramatic influx or outflow of property owners from the market for brokers.

There are very few fixed costs for most firms (salespeople being paid on a commission basis), and most firms may be able to match each other's cost structures rather closely.

Finally, given the cooperative nature of the industry, price-cutting is easily detected.

While these general characteristics may facilitate coordination, they do not necessarily lead to it. The one aspect of the residential real estate brokerage industry that may be unique, however, is the degree to which individual firms are interdependent. We believe that this interdependence may be the key to understanding the apparent paradox of in the prices charged for services.

Interdependence of brokerage firms and brokers is a function both of their need to cooperate with each other, usually through a MLS, in marketing houses and their individual incentives as established by the form of their compensation. Of homes sold through brokers, about 90 percent are listed on a MLS. Perhaps as many as 53 percent of all sales involve the services of two brokerage firms, and 66 percent of sales may involve two individual brokers or salespersons. Many observers believe that most firms, and especially small firms and new entrants, are dependent upon the MLS and cooperative sales and cannot take any risks that might lessen the cooperation they will receive.

While brokers might attract many listings by advertising low commission fees, those brokers might encounter problems in cooperatively selling their listings. Cooperating brokers usually are compensated by the listing broker's splitting his or her commission with the cooperating brokers. "Discount" or "alternative" brokers may offer potential cooperating brokers substantially less compensation than that provided by "traditional" brokers. For this reason (and also because a cooperating traditional broker who charges the higher prevailing commission rate will be a competitor of the listing discount broker for future listings) many traditional brokers are alleged to, quite understandably, steer potential buyers to homes listed by brokers charging the prevailing commission rate and offering the prevailing split.6/ Steering may make discount brokers less successful in selling their listings through the MLS. Alternative brokers charging less than the prevailing commission rate, therefore, may find that [illegible] competition in price facilitates the acquisition of listings, it often hampe[rs] efforts to sell those listings. This, in turn, may make price competition a potentially unsuccessful competitive strategy, and it is our belief that this is the most important factor explaining the general uniformity of commission rates in most local markets.

C. Summary of Chapter III: Industry Performance

This chapter discusses a number of measures of industry performance, presented first in terms of prices, costs, and resource utilization, and second in terms of the provision of information and services to consumers. It does not however, attempt to explain the causes for the performance characteristics noted

1. Prices, Costs, and Resource Utilization

The evidence available, while not conclusive, tends to support the hypothesis that prices (defined as commission rates charged to sellers by real estate brokers) are noncompetitively high in this industry. Studies of brokera[ge]

6/ Brokers buy both "listings" from sellers and service from other brokers. Reducing the commission rate charged to sellers reduces both the ability to pay for other brokers' cooperative services and could lessen those brokers' ability to successfully compete for primary listings. The traditional broker may anticipate injury on both counts and take fees nationwide also indicate that the commission rates contracted for and ultimately paid generally are highly uniform within any given geographic market. A survey of consumers conducted for the FTC in 1979 indicated that 85 percent of the sellers surveyed alleged they were quoted a commission rate either of 6 or 7 percent by the broker whom they used, and ultimately 78 percent paid either 6 or 7 percent. Our study of an extensive sample of forms collected by the U.S. Department of Housing and Urban Development for its own purposes indicated that in 11 out of 16 cities surveyed, 80 percent or better of the commission rates actually paid were either 6 or 7 percent. In all but one city, at least 50 percent of the transactions occurred at a single commission rate, and in most cases this rate was either 6 or 7 percent. In light of the significant variation in pricing and demand for homes in these communities the general uniformity of commission rates would not be expected in a market in which each broker is presumably free to bid for business on his or her own terms.

The rate of growth of aggregate commission fees is noteworthy. The dollar amount of gross commissions increased by an average of at least 615 percent between 1950 and 1979, a growth rate nearly twice that for all white-collar wages during the same period, and nearly three times the officially acknowledged increase in consumer prices (215%).

Because commissions are gross receipts, this obviously does not mean that individual brokers made $6.15 for every dollar earned thirty years before. Rather, statistics on licensing trends indicate a tremendous growth in the number of brokers and salespersons in the industry, and suggest that the average broker may be handling fewer successful transactions per year. Statistical evidence on the difference in the number of active real estate brokers and salespersons as contrasted with total sales of housing units between various periods of time is incomplete, but what there is suggests that brokerage productivity, measured as transactions per licensee per year, declined through 1980 as a result in large part of an influx of new entrants. The aggregate volume of labor services provided appears to have increased beyond even the growth in aggregate fees. The prospect of the skillful broker or salesperson's being able to earn high revenues paradoxically appears to attract more resources into the industry than apparently are necessary to accomplish efficiently the function of brokerage.

Inefficiently high brokerage commissions may have serious consequences both for consumers and for the industry.

If brokerage commissions were lower, labor resources might be allocated better. Consumers arguably might receive somewhat less service, but transaction costs would also diminish and overall efficiency, therefore, might increase. Consumers appear to pay more for brokerage service than they might if pricing were more vigorously competitive. A reduction of one percent in the prevailing commission rate nationwide might have yielded savings to consumers of as much as $1.3 billion in 1978. Supracompetitive prices may cause a misallocation of resources to brokerage. These are resources that might otherwise have been employed gainfully in other more productive activities in the economy as a whole.

2. Consumer Information and Service

Brokers help consumers by providing information and services as consumers search on the one hand for a broker and on the other to find either a buyer or a home.

Regarding the search for a broker, a sample of sellers and buyers surveyed for the Federal Trade Commission reported that they were largely unaware of facts which to the lay observer would appear necessary to deal with brokers in an informed way. For example, approximately half of all sellers who responded believed that commission rates are fixed and non-negotiable and that the fixing is done either by law or by "the Board of Realtors." Similarly, regarding transactions where two brokers were involved, 74 percent of the sellers and 71 percent of the buyers believed the cooperating broker (the broker working directly with the buyer) was, in some sense, "representing" the buyer. In fact, under a theory widely expounded by the National Association of Realtors, cooperating agents who show properties to buyers generally are viewed by the industry as representatives and agents of the seller with an enforceable, if somewhat murky, legal obligation to advance the interests of the seller against those of the buyer.

There are two aspects of the broker's role in the consumer search for homes: a market-making function (the gathering and applying of the information needed to match buyers with sellers), and a representational function (providing advice, negotiation services, and other efforts to their clients). Brokers provide many of the market-making functions consumers indicate they desire, especially knowledge about the market and access to a MLS.

Buyers who do not understand that the practice of steering (initially holding back from a buyer -- or not ever disclosing to a buyer -- the existence of listings which offer the broker a low commission rate or a lower aggregate rate of return) may be common, however, may feel that they have seen a complete range of offerings when far less has been shown in fact. There are, apparently, other problems with the brokerage representation function.

As is inherent in any system in which a fiduciary agent is compensated by commissions based on sales, sellers are themselves represented by brokers with interests that often are in tension with the legal obligations that they owe to sellers. Both the ambiguities and the conflicts in the broker's role can lead to false consumer expectations and to possible abuses of the broker's fiduciary duties. There is anecdotal evidence that brokers sometimes may succumb to self-temptation and act in ways contrary to the interests of their clients. Self-dealing (undisclosed purchasing of undervalued property from a client through the use of a third party) and "vest-pocket listing" (undisclosed withholding of a house from listing on a MLS because the broker believes it to be undervalued and that he or she can obtain a sale without a cooperating broker's help) are, as industry spokesmen frequently acknowledge, occasional problems in the industry.

D. Summary of Chapter IV: Analysis of Industry Structure and Practices

This chapter describes and analyzes the structure of the brokerage industry. Performance characteristics outlined in Chapter III, including a general uniformity of commission rates from brokerage firm to firm and across properties of widely varying price and saleability, are not the result of unfettered price competition. Rather, they appear to be caused to a major extent by the interdependence of the local industry members. This interdependence results from the solutions the industry has used to overcome certain problems of marketing hetrogeneous properties through a fragmented brokerage industry. These industry solutions, including the institutional structures and many of the industry-imposed restrictions and rules of conduct, may improve service and the efficiency of the market, but they also may have the negative side-effects of fostering and encouraging a lack of price competition and restricting the nature and quality of the information that reaches consumers. (These defects may, of course, in particular cases, also be aggravated by actual collusion.)

Chapter IV is organized around, first, the basic structures in the industry and second, important problems and issues. Separate parts of Chapter IV are devoted to the following subjects: trade associations, state regulatory laws and agencies, multiple listing services, brokerage firms, alternative brokers, broker/consumer relationships, and fee stabilization.

1. Trade Associations

The principal trade association in the real estate brokerage industry is the National Association of Realtors (NAR) with its 50 affiliated state associations and over 1,800 affiliated local Boards of Realtors. The largest trade and professional association in the nation (it reached a high of more than 700,000 members in 1979), the NAR represents more than one-third of all licensed, and an overwhelming majority of all active, brokers and salespersons. The NAR organizations license the trademarked term "Realtor;" operate 90-95 percent of all of the nation's MLSs; enforce a Code of Ethics and other regulations; and perform a wide range of educational, political, legal, and public relations functions.

The history of real estate brokerage since the early 20th century has in large part been the history of the Realtor organizations. The Realtors were instrumental in developing a specialized industry devoted to residential real estate brokerage, in bringing about state licensing laws, and in developing the MLS and the cooperative system of brokerage. In doing so, Realtors traditionally have emphasized the values of mutual dependence, often, in the past, explicitly at the expense of the values of competition -- especially price competition.

Today, the NAR, by itself and through its state and local affiliates, continues to play a leading role in the brokerage industry. Their operation of most of the nation's MLSs gives the Realtors control over the most important aspects of brokerage practices, including the type of listing contracts likely to be used ("exclusive" vs. other forms of listing), manner of cooperation with other brokers, and ethical standards.

The NAR supports its system of national, state, and local trade associations by providing legal services to conforming affiliates and by participating actively and aggressively in the political process.

The Realtors also establish and enforce standards of practice in other ways. Realtor organizations used first mandatory, and later "suggested," fee schedules until the early 1970s. In recent years, schedules apparently have been abandoned almost universally, at least as far as we can determine. However, a stigma still seems to attach to competition in commission rates, and in most markets studied the prevailing rate appears to be the rate which appeared on the last schedule officially in effect.

Arguably more pertinent today is the important influence of the NAR Code of Ethics on standards of practice nationwide. The Code generally promotes the system of cooperative brokerage. Some provisions have pro-competitive and pro-consumer effects. For example, the cooperative marketing approach appears to improve the efficiency of the real estate market. Some Code provisions, or the official interpretations of them, however, tend to discourage comparative advertising, forbid solicitation of future business from most clients of other brokers, and promote the MLS/exclusive listing business format over possible alternatives. Code provisions also require submission of disputes among Realtors to arbitration and grievance proceedings before panels of their competitors, which, structurally at least, may allow for a certain amount of anti-competitive, coercive discipline.

The efficiencies realized by the Realtors, therefore, may be balanced against the disincentives to competitive freedom and innovation which their system may impose. Cooperative marketing, as fostered by the Realtors, for example, has solved a number of important problems connected with marketing real estate. On the other hand, cooperative marketing as presently done also implies a great deal of routinized interdependence among brokers. The extent of that interdependence, we believe, may be largely responsible for the performance problems which we identify and discuss in Chapter III. We feel that certain aspects of the current system, such as imprecise interpretations of already vague provisions in the Realtors' Code of Ethics and the mandatory arbitration of disputes before panels of competitors both add materially to a sense of dependence and interdependence among Realtor-brokers and may not be fully necessary to achieve the efficient marketing of properties.

2. State Law and Agencies

All states require brokers and salespersons to be licensed. Licensing statutes delineate licensure requirements (age, education, honesty, and experience), set forth prohibited practices (usually fraudulent or deceptive acts), establish affirmative standards of practice, and provide sanctions for violations of state law provisions and regulations.

Licensing statutes also establish state regulatory agencies to administer the licensing process and enforce the statutes. Industry members, who generally are members of the Realtors organization, predominate on virtually all state commissions. These commissions generally are granted the principal enforcement and rulemaking authority over brokerage activities.

Our preliminary findings indicate that the lack of price competition and barriers to the free flow of information to consumers are not caused in significant measure by state laws and agencies. However, while we found few overt restrictions on price advertising such as those often found in the laws which govern the practice of other professions, state statutes or regulations which discourage comparative advertising on grounds of "disparagement" do raise troubling issues to the extent they limit fair and non-deceptive competition. State anti-rebating laws may also be used to discourage innovative discount marketing and the efficient and cost-effective bundling of other services with real estate brokerage.

3. Multiple Listing Services

The growth of the MLSs during the last 60 years has been the most important development in the modern brokerage industry. The historical reasons for and effects of multiple listing give important insights into today's industry. Today, 92 percent of sellers using brokers have their homes listed on an MLS. A number of industry commentators have concluded that the MLS is essential for a broker to compete and effectively market homes in most areas.

All MLSs impose conditions of membership. These rules and regulations may have a substantial impact on the nature and degree of competition in the industry. Of the MLSs we surveyed for this Report, 94 percent were affiliated with a local Board of Realtors. Membership in the Board usually is required to obtain access to a Realtor MLS. However, even where Realtor membership is not a condition, 89 percent of the brokers who participate in the MLSs were, on average, Realtors. Realtor membership, in turn, means accepting a number of conditions, including compliance with the NAR's Code of Ethics and payment of membership dues (which include dues for membership in all three levels of the structure — local, state, and national).[7]

All MLSs require a real estate license in order to grant access to MLS information. Some critics of the industry believe that direct access by consumers to the MLS might substantially increase price competition. Industry members, however, often contend that such access would "destroy the MLS." Since we were unable to find any examples of MLSs which allow access other than through a broker, we have no evidence with which to evaluate the validity of either claim.

Most MLSs require that members submit their disputes to mandatory arbitration. Some brokers, including especially "alternative" brokers, claim that arbitration which takes place before a panel of competitors serves to suppress vigorous price competition or attempts at innovation.

The industry literature of the 1920's speaks openly both of the superior marketing abilities of the MLS and the MLS as a means of raising and stabilizing commission rates. The brokers' associations found that the MLS was a most effective tool to accomplish both goals. While MLS rules no longer require minimum commission rates, the industry literature of the past indicates that these facilities were successfully able to police and stabilize rates in an industry made up of numerous small competitors.

All MLSs charge their members a variety of fees. Some few, however, charge initiation fees that may substantially exceed the costs to the MLS of adding the new member. Some industry critics believe this is sometimes done to make entry by new brokers into a local market more difficult, and the matter has been the subject of several successful antitrust suits.

Most MLSs allow only exclusive right-to-sell listing contracts to be processed using their facilities. Only 18 percent of the MLSs which responded to an FTC survey of such institutions reported accepting exclusive agency listings, and only 11 percent would accept open listings. Most brokers presumably prefer exclusive right-to-sell listings. Such listings have two obvious effects. They prevent the seller from selling the property without paying the broker a commission when the broker has spent serious time and effort in trying to dispose of it. And they also prevent a seller from putting pressure on a dilatory broker during the listing period by threatening to find a buyer and sell the house him or herself. However, we were able to find an efficiency justification of only limited plausibility as to why a MLS might need to require the use only of exclusive right-to-sell listings or limit the options of its member brokers in deciding what form of contractual arrangements they offer to their clients. That justification is that possible disputes as to who had "procured" a buyer, the seller or a broker, might cause significant numbers of brokers to quit a MLS.

An examination of a sample of MLS listing books indicates that the "splits" offered to cooperating brokers by listing brokers are highly uniform within any local MLS market. In five metropolitan areas which we studied in some depth, a majority of the listing books examined showed that at least 90 percent of all listings were at a "prevailing" split rate. This uniformity may result in part from the knowledge that cooperating brokers may steer buyers away from listings which offer them lower splits.

7/ Although our data is limited, the degree of competition and uniformity of fees in a market does not appear to differ significantly between markets in which Realtor membership (as opposed merely to having a broker's license) is required for MLS access and those in which there is not such requirement. However, most MLSs which do not require Realtor membership have abandoned the requirement only in recent years, and even where they have done so, most member brokers apparently continue to retain their memberships in the

MLSs generally disseminate not only information about housing but also information of competitive use. This competitive information traditionally included the full commission rate contracted for with the client by the listing broker. In 1980, however, the NAR adopted a policy against disseminating such information. MLSs still, of course, routinely identify both the listing broker and the percent of the selling price being offered to cooperating brokers.

MLSs usually have rules that, directly or indirectly (by reference to the codes of ethics of affiliated Boards of Realtors), prohibit brokers from soliciting business from clients who have exclusively listed with other MLS members and disclose that fact. While these rules restrain competition on thei face, an argument is advanced that they may be necessary to encourage the cooperative marketing of real estate. The restriction on soliciting future business from listed sellers, for example, is defended as necessary to persuade brokers to cooperatively join a MLS and to maintain membership.

The MLSs play a central role in the modern brokerage industry, and rules o the MLSs that may restrict competition or injure consumers, if enforced general or if enforced in a discriminatory fashion, should be scrutinized carefully. (note that the extent to which the rules against solicitation are uniformly enforced is unclear. A number of "discount" or "alternative" brokers have alleged to us that "traditional" brokers have identified discounters' clients from the MLS and then disparaged the discount firms and solicited business from their clients with a seeming sense of impunity.)

MLSs, for example, are considered by the NAR to be formal systems of unilateral offers of subagency. As such, when a cooperating broker working a prospective buyer acts upon a listing, he or she is believed to become a "subagent" under the direction of the listing broker and seller and unable, fro a fiduciary point of view, to represent the interests of the buyer (although there is a somewhat vague responsibility not to leave the buyer entirely unprotected). However, there appears to be nothing inherent in the nature of a brokerage exchange that requires this notion of subagency. Cooperating brokers and buyers are, in fact, free by law to arrange their legal relationships as th see fit. Brokers may, for example, offer to serve as agents of buyers, bargaining at arm's length with listing brokers under contract to sellers, and sometimes do so -- for example in seeking commercial sites for a buyer or when hunting for investment opportunities for a client.

In one sense, the MLSs can be viewed as passive structures which, while producing significant joint-marketing and informational benefits, link competitors in such a way that price competition and the free flow of informat to consumers are both impeded. Steering of buyers away from listings which of cooperating brokers a lower "split" and price coordination could both be facilitated. The disciplining of those who deviate from standard practices co also be made both easy and effective.

The greatest impact of MLSs on inter-firm competition may result in large part not from formal rules, but from the interdependence among brokerage firms and from the customs and beliefs that have arisen in the course of the interdependent relationship the MLS institutionalizes. Nonetheless, the abser of a MLS from a local market may not result in a pattern of pricing or co information which differs markedly from markets where a MLS is in use, bec informal cooperation among brokers may still make the success of individual fi dependent on the actions of others.

4. Residential Brokerage Firms

The brokerage industry traditionally has been one of local markets served by numerous small, locally based firms. In 1977, more than fifty percent of all firms in the industry had ten or fewer brokers and salespeople, and two-thirds of all firms operated only one office. Most (73%) of these firms were corporate in organization, but almost all were closely held.8/

The continuing predominance of the small firm can be attributed to at least three factors:

> First, there reportedly are few significant economies of scale to be achieved through simple expansion of the number of people performing essentially identical tasks, and limited opportunities for fractionating or automating much of the broker's job -- a job that calls for individual judgment and discretion.9/
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> Second, the cyclical nature of the industry may prevent larger firms from adjusting quickly to reduced demand and give the small firm, with its lower fixed costs, a survival advantage.
>
> Third, there is relatively easy entry into the industry at the firm level in most markets. That is, it is easy to start a new firm. There are few capital costs or trade secrets, and the MLS provides an immediate inventory of properties to sell.

In addition to the apparent opportunities for small firms, there appear to be clear advantages to decentralization — operating through scattered offices. The geographic markets within which individual brokers operate are relatively

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8/ While real estate brokerage is characterized by numerous small firms and offices, some knowledgeable persons in the industry predict the eventual domination of the nation's principal real estate markets by eight to ten large corporations and chains of franchisees. As of 1977, Coldwell-Banker (now a division of Sears, Roebuck & Co.) had become the largest national firm in the industry. However, it was then receiving less than .5 percent of the total estimated residential sales commission revenues nationwide. Century 21, the largest of the franchise systems, has grown very rapidly, as have other franchise systems in this industry. Survey results suggest that up to 38 percent of national real estate brokerage transactions now involve a franchised broker and 48 percent of this 38 percent was handled by Century 21 franchisees in 1979. This growth of franchising appears to be based primarily upon the economies of scale associated with mass advertising to promote an "image" identification, and perhaps more important, the perception among smaller and medium sized firms that they must join a franchise system to obtain this sort of image.

9/ Advertising, which may involve significant scale economies, and which appears to be important as a means of attracting customers in some markets, apparently has not become crismall areas, and intense knowledge of the local market often represents the individual broker's most valuable expertise.

Brokerage is a labor intensive business. Fees and commissions paid to salespersons are by far the largest expense of firms and account on average for approximately 60 percent of gross revenues. Firms compete for quality salespeople. This is done in part through the percentage of the total commissio which is offered to prospective salespeople. Percentages often are progressive, with the most talented people retaining perhaps as much as 70 percent of the commissions they achieve by selling those properties for which they have personally obtained the listings. Nonetheless, due to the contingent nature of all commissions, many firms in the industry consider the service of sales labor to be essentially "free," as long as basic overhead expenses can be covered.

The importance of the individual broker and salesperson is highlighted by the fact that many firms have few assets other than their corporate name, a set of listings, and a shifting collection of brokers and salespeople. In analyzing certain aspects of the industry, firms therefore can be considered as essentiall equivalent to their individual brokers. Appreciating the incentives of individuals and their personal relationships as self-directed entrepreneurs within the context of such larger structures of the industry as the MLS system often is more important to understanding the performance patterns of the industr than any attempt to apply either "theory of the firm" or "theory of bureaucracies" learning.

5. Alternative Brokers

We use the term "alternative brokers" for those brokerage firms whose business practices differ substantially from the norm in either commission rate or in type, level, or variety of service offered. The survey of consumers undertaken to provide data for this Report revealed that approximately two percent of the reported transactions had involved the services of firms which t survey characterized as "discount" brokers. We conducted a special national survey of alternative brokers (including discounters) as part of our industry-wide investigation, in the belief that the experiences of such brokers might prove important in understanding the dynamics of the real estate brokerage mark and, in particular, why most brokers will compete in certain ways but rarely wi do so in terms of price.10/

Alternative brokers in communities throughout the country reported similar problems. The problem most frequently alleged was that of disparagement of the businesses by other, "traditional" brokers; the difficulty in overcoming consumers' belief that commission rates are fixed by law or trade rule and

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10/ We did not include the large national chains of brokerage offices or franchisees, such as Sears' Coldwell Banker or Century 21, in this survey, because at the time of the sur vey none of these operations were charging a commission t varied from that predominating in its local markets or offering any unusual varieties of contract terms. The advent of certain Coldwell-Banker offices offering discounts on goods tied to purchase of a house or able to arrange financing on their own is a development of the last couple of years, and suggests the possibility for a different order uniform from firm to firm; the refusal by traditional brokers to show homes listed with alternative brokers; and the cancellation and loss of listings due to direct solicitation of their clients by other brokers as part of disparagement efforts. Those alternative brokers who are members of MLS systems reported a higher average frequency of virtually every problem than did those alternative brokers who chose to operate exclusively on their own.

Among the alternative brokers surveyed, thirty-four percent indicated that they had experienced refusals by advertising media, most commonly newspapers, to run their advertisements. Alternative brokers frequently opined that these refusals were probably the result of threats by traditional brokers to boycott publications which run the ads of alternative brokers.

Alternative brokers reported that, on the whole, certain problems decreased in frequency after their first year in business. Other problems, however, were reported to continue unabated. Generally, the problems which remained as common after the first year as during it were those which involved a direct benefit for the problem-causer (for example, another broker's soliciting an alternative's clients to break their listing contracts and relist with the solicitor, or a potential cooperating broker preferring not to show an alternative broker's listings because other listings pay a larger commission or offer a better split).

Many traditional brokers, on the other hand, appear to believe that alternative brokers who "discount" cannot long survive in the marketplace because the "prevailing" commission rate is the rate which is objectively necessary to make an adequate living over the long run. Most of the alternative firms identified by our survey were, in fact, relatively young ones. Only ten percent of the 154 alternative firms surveyed had begun in business before 1974.

Some traditional brokers also indicated that they believed the interdependence among brokerage firms, especially as it is carried on through the facility of the MLS, makes price rather than service competition a futile strategy. This, as we have indicated, is because when a listing broker cuts the commission rate he or she usually asks cooperating brokers to absorb part of the price cut, and this moves the alternative listings to the bottom of the list of properties to be shown to a potential buyer. Even if a discounter offers the standard split, of course, some brokers may still prefer to cooperate with others who charge the standard rate, because all brokers compete for future listings.

Alternative brokers reported relying more on advertising to obtain new listings and less on referrals than did traditional brokers. Their focus on advertising and the lower commission fees they offer apparently do make obtaining listings relatively easy for alternative brokers. Selling those same listings, however, appears to be relatively harder for the alternative as opposed to the traditional broker. Our consumer survey indicates that while eighty-eight percent of all sellers eventually sold through the broker with whom they had initially listed their homes, fewer than sixty percent of alternative brokers' listings ultimately are sold by or through them.

Alternative brokers reported, by more than two to one (68% vs. 32%), that they did not regularly use a MLS service. Of those alternative brokers who do not use a MLS, seventy-five percent reported that they charge their clients a flat fee rather than a percentage commission for handling a property. The average fee was $932 in 1979. Based on the average selling price of homes during this year, this was the equivalent of a 1.6 percent commission. However, eighty-four percent of the alternative brokers who did not use MLS service required the seller to assume the burden of showing his or her own home to prospective purchasers.

Of the thirty-two percent of alternative brokers surveyed who reported using MLS services, the majority claimed to be "full service" brokers. Most of these brokers charged a "discount" commission rate that averaged out to 4.2 percent of

None of the alternative brokers who used MLS services and who responded to our survey had begun business before 1970, and only eight out of a total subsample of 49 had begun before 1974. There was an interesting, and probably significant difference about these eight "long-term" survivors. They achieved a average of forty-nine percent cooperative sales, a rate far closer to the averag for traditional brokers (66%) than to that for the entire category of alternativ brokers who use MLS service (29%).

The facts behind the problems alleged by the alternative brokers cannot be verified in detail. However, the allegations are themselves suggestive, because they appear to relate to the very aspects of the industry which may tend to rigidify prices — the ability of other brokers in a community, because of the largely interdependent nature of the brokerage system, to withhold cooperation and thereby single out for harm the business of a "maverick." Whatever the case alternative brokers' businesses do appear to perform in ways that are different from the statistical norms for their more traditional rivals.

6. Broker/Consumer Relationship

Brokers generally are paid by the seller on a contingent basis, which gives them a strong motivation to quickly make a sale at a good price. Precisely articulating appropriate rules of conduct for brokers has been difficult be of two kinds of problems. The first kind arises from the potential conflict between the broker's function as a commission broker whose compensation depends on "making the sale," and his or her function as a source of neutral, disinterested advice upon whom consumers rely. The second kind of problem ofte arises from the ambiguity that may exist in both brokers' and consumers' — especially many buyers' — minds as to who the broker is "representing" and as what if any degree of fiduciary responsibility is owed to buyers and sellers.

The basic duties of real estate brokers are established by state law. Eve state licenses brokers, and licensing laws, as well as the common law, generall impose the fiduciary duties owed by an agent on brokers. They do not, however, specify what creates the agency relationship, when the duties attach, or to who duties must run.

Most real estate brokers in this country are also Realtors — members of t National Association of Realtors, the industry's primary trade association. Th Realtors' Code of Ethics contains numerous provisions which facilitate cooperation among brokers, define the ethical responsibilities of brokers to their clients, and establish general standards for honesty and fair dealing. T ethical provisions of the Code reiterate many agency duties. The Code, however because it is not a "50-state handbook," does not include details on the legal duties of brokers, or a discussion of to whom in each state those duties run.

It is to state agency law, therefore, and to case law relating specificall to brokers and their duties that we must turn. Brokers acting as agents of the principals are "fiduciaries" by definition. That means that the broker is required to act in the "best interests" of the principal — for example, by selling the principal's house for the highest price possible in the time specified and by disclosing to the principal all material facts, such as any financial involvement by the broker with a purchaser.

The broker who works directly for the seller (the listing broker) usually considered in law to be a direct agent of that seller and the listing contract generally held to be the source of the relationship. Three problem areas have been traditional areas of concern in the relationship between sellers and thei and double-dealing or failure to act entirely in the principal's behalf in negotiations relating to the sale of a property.

In self-dealing, the broker who believes that the price asked for a property is less than its fair market value fails to inform the principal of that fact and to give him or her a better assessment, but instead purchases the property, often through a third party.

In vest-pocket listing, the broker withholds a property from the MLS while the principal believes that it has in fact been listed. This may happen for a variety of reasons and often is a signal of a violation of fiduciary duty. One violation of common concern is where an uninformed seller places too low a price on his or her property. In such a case, a broker may be able to sell the property (or to buy it him or herself) easily without the use of the MLS, and chooses to do so, pocketing the entire commission and never giving the seller a fair appraisal of the property's true worth.

In double-dealing, the broker, in order to close a deal, engages in conduct which compromises the interests of the seller. For example, he or she may tell the buyer the seller's reserve price (the price below which the seller will not go) without receiving authorization to do so, or may disclose information about the time or financial pressures operating on the seller.

Behavior of all three sorts, self-dealing, vest-pocketing, and double-dealing are considered generally unethical and violations of fiduciary duty under most applicable state laws.

In most cases, a listing broker looks to the seller for remuneration. As we have noted, the National Association of Realtors has promoted the theory that when a broker undertakes to cooperate by showing the listings of another broker, he or she becomes a formal fiduciary "subagent" of the seller and/or the listing broker. Under this theory, when the broker working with a buyer obtains information from the MLS, that broker is accepting a "unilateral offer of subagency" by the listing broker that binds the cooperating broker both to advance the interests of the seller and not to act either as a neutral party or as a representative of the buyer's interests. According to this view, no broker operating by showing residential listings from the MLS can ever be the unqualified agent of a buyer.

The notion of a semi-automatic agent/subagent relationship is, in fact, one of convenience. The limitations it places on a broker's ability to act as buyer's fiduciary agent have not been tested in law, and it is not a necessary arrangement. A broker, as has been noted, retains the legal right to act as a buyer's agent, should he or she so choose. And a cooperating broker even though being paid by the listing broker may sometimes be the buyer's agent as a matter of law as some state courts have found. Consumers, even when they are aware that both the cooperating and listing broker in a particular transaction look ultimately to the seller for remuneration, may make the assumption that the cooperating broker is, in some sense, working for them rather than simply trying to make a sale. There is reason to believe that many cooperating brokers may, directly or indirectly, encourage such assumptions.

In their responses to the FTC survey of consumers, seventy-one percent of buyers who had worked with a cooperating broker indicated that they believed the broker had, in some way, "represented" them. Considering that approximately sixty-six percent of real estate transactions today involve the services of a cooperating broker and that these brokers often are the buyer's principal available source of information, however, many buyers may run several risks of injury if they identify as "their broker" a person who is not in fact intending to act as their agent.

First, non-disclosure of the status of the cooperating broker vis-a-vis the seller's broker may cause a buyer to reveal information he or she might otherwise brokers using any information disclosed to them to assist listing brokers in obtaining the highest price for a home. Of the buyers we surveyed, seventy-thre percent had told the broker with whom they were dealing the highest price they were prepared to pay and eighty-three percent were under the notion that such information would be kept confidential. Sixty-six percent of the sellers which we surveyed, however, indicated that brokers told them how high they thought particular buyers were prepared to go.

Second, buyers may be injured by receiving less service than they believe they are. For example, buyers may believe that a cooperating broker is "scourin the market" for them as a "representative," when, in fact, he or she is picking out those properties upon which to cooperate which both meet the buyer's criter and which also will bring in a large commission.

Third, a buyer may assume that the broker will use his or her expertise to discover defects in a house, when, without a contractual agency relationship, th broker may feel he or she has no duty to do so.

While cooperating brokers could, in legal theory, be given the role of dua agents (agents for both buyer and seller), that might involve very serious conflicts of interest. We repeat that agency law permits a broker to function a a buyers' agent, and may in fact imply such a relationship in spite of a cooperating broker's personal understanding of his or her role. The present pattern of brokers simply assuming that a cooperating broker in a residential transaction legally represents the interests of the seller and the listing broke has become firmly ingrained in the minds of many in the industry. And unle entire system of real estate brokerage is shifted to a new set of formal arr ments, both the possibility of consumer injury and of brokers being found by courts to be unwitting agents of buyers suggest that a greater, and perhaps mor conscientious, effort might be appropriate to alert buyers to the role which a broker sees himself or herself playing in the brokerage transaction. In light brokers' common misconception that agency law prohibits them from being representatives of buyers once they learn the facts needed to begin cooperating on a listing, it might be appropriate to better alert brokers themselves to both the possibilities and dangers inherent in the fact that they may nonetheless be treated by the law as agents of buyers.

7. Fee Stabilization

Until the early 1970's agreements among real estate brokers to fix or stabilize commission rates and the terms of trade upon which they would deal we commonplace, in large part because the industry was not believed to fall under either state of Federal antitrust laws. Published, mandatory schedules of fees — and later "suggested" schedules — were widely used. Formal recommended schedules apparently were abandoned in the late 1960s and early 1970s. A long record of investigations, antitrust settlements, and prosecutions for covert conspiracies suggests that informal local price-fixing remained common in the industry for some time, however.

The industry today appears more aware of the illegality and risks of p fixing. Nonetheless, given the structure of the industry, localized attemp raise or stabilize rates can be expected to occur from time to time.

Our conclusion is that price-fixing is not a primary cause of local uniformity in commission rates, although there probably are residual effects le over from the era of fee schedules. Commission rates prevalent in a local mark often are the same as those which were recommended in the last formal schedule fees in effect in that market. There may also be a residual stigma in many "traditional" norms.

Evidence occasionally comes to light that brokers in some communities have included provisions in the rules of their local trade association or MLS that have the effect of fixing the terms of trade in unlawful and anticompetititve ways or that may otherwise step over the line drawn by the antitrust laws. When such evidence is obtained, the enforcement authorities are, as they should be, quick to act. Nonetheless, the degree to which local brokers are interdependent, due to their need to market properties efficiently, may explain the pattern of uniform, stable prices much more than do formal rules or an occasional price-fixing conspiracy.

II. RESIDENTIAL REAL ESTATE BROKERAGE: AN ANALYTICAL FRAMEWORK

A. BROKERAGE SERVICES

1. In General

Matching buyers and sellers in the market for housing is the essence of wha real estate brokers do. This function itself encompasses both representation ar the provision of information. Representation is sometimes provided by others such as attorneys, but the personalized provision of information -- the actual finding of a house for a buyer or of a buyer for a house -- is generally the domain of real estate brokers.

An obvious but important fact about real estate brokerage is that the demar for it derives from the demand for and supply of housing. Buyers seek information about the available housing stock and sellers about the demand for housing in order to make informed decisions. Brokers develop expertise in the acquisition, processing, and transmission of such information, and they therefo perform these tasks more easily and more efficiently than buyers and sellers ca for themselves.

2. Buyers' Demand for Brokerage

Buyers benefit from information about how the market values (on average) various housing characteristics and about which homes are for sale. Sellers commonly post "for sale" signs, but houses for sale which roughly meet the buyer's requirements might be geographically dispersed. Newspaper ads also identify some houses for sale. But most sellers leave it to their brokers' discretion when and whether to advertise, and brokers in fact choose to adverti only a small portion of their total inventory.

The process by which a buyer searches for a home can be expected to affect the rate at which he or she accumulates information and the quality and quantit of information obtained. This, in turn, may affect the price of whatever home ultimately is purchased and the satisfaction and financial returns yielded by that purchase. A broker, by being familiar with homes for sale in an area of interest to the buyer and by keeping abreast of which homes have and have not moved and what values the market appears to be putting on various characteristi of homes, can help a buyer search more productively.

Brokers try to ascertain the relative values that a potential home buyer places on the various characteristics that define a home. That is, brokers mus determine the buyer's preferences, including price. For a given buyer, the lis of such preferences is, potentially at least, quite long. It will include not only the myriad of physical attributes that characterize a house, but also thos characteristics of the neighborhood (*e.g.*, access to facilities, ambiance, quality of local schools, zoning restrictions) that affect the value of a house both as a residence and as an investment.11/

11/ Although a particular characteristic of a house or neighborhood might be of no value to a buyer -- *e.g.*, quality of school to a childless couple -- it would affect the value of the house as an investment because of its potential value to future buyers.