

Minimum Service Requirements in Real Estate Brokerage: A Response to Maureen K. Ohlhausen

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In recent years, state legislatures and regulatory agencies have engaged in more aggressive supervision of the real estate market in an effort to protect consumers who undertake what for many individuals is the single largest and most important commercial transaction of their lives—the purchase of a home. The action at the state level is a response to the proliferation of real estate brokerage options. Consumers previously chose between either a full-service broker who handled every aspect of the purchase or sale of a home or no broker at all; now, however, there are a number of so-called Limited Service Brokers (LSBs) who offer à la carte brokerage services. Through an LSB, consumers can, for example, purchase for a flat fee a broker's listing capabilities, but handle the details of negotiating a deal with a potential buyer by themselves.

LSBs pose unique challenges to the consumer protection goals that have long animated much state legislation governing real estate transactions, and the recent activity at the state level is best seen as an effort to adapt pre-existing rules and regulations to these new circumstances. The states' efforts to ensure that their consumer protection laws keep pace with the rapidly evolving brokerage market have been resisted at virtually every turn, however, by federal antitrust authorities. As Maureen Ohlhausen explains in her recent article in *The Antitrust Source*, the Federal Trade Commission and/or the Department of Justice Antitrust Division have opposed state efforts in Alabama, Kentucky, Michigan, Missouri, South Dakota, and Texas either by filing suit against state agencies or, more commonly, by writing advocacy letters opposing proposed changes to state law or regulations.¹

The uniform actions by the FTC and the DOJ in these areas appear to reflect a conclusion that any legislation or regulation imposing duties or obligations on brokers is anticompetitive and thus in conflict with the policies underlying the federal antitrust laws. But this one-size-fits-all view fails to account for the vastly different approaches employed by the states. The appropriate analysis of price restrictions in Kentucky, for example, that prohibited brokers from offering rebates to consumers is vastly different from the appropriate analysis of regulations like those in Alabama, Missouri, and Texas that impose certain minimum obligations on individuals who have agreed to serve as a broker for a consumer.

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¹ See Maureen K. Ohlhausen, Competition Issues in Real Estate Brokerage, ANTITRUST SOURCE, Nov. 2005, at <http://www.abanet.org/antitrust/source/11-05/Nov05-Ohlhausen11=29.pdf>. The federal antitrust authorities more commonly resort to advocacy letters because legislation passed by states is protected from antitrust scrutiny by virtue of the state action doctrine. “[T]he general language of the Sherman Act should not be interpreted to prohibit anticompetitive actions by the States in their governmental capacities as sovereign regulators.” *City of Columbia v. Omni Outdoor Advertising, Inc.*, 499 U.S. 365, 374 (1991) (citing *Parker v. Brown*, 317 U.S. 341 (1943)). The state action doctrine even protects actions taken by state agencies and regulators if the actions are pursuant to a “clear articulation of a state policy to authorize anticompetitive conduct,” *id.* at 372, and the state is “actively supervising” this policy. *California Retail Liquor Dealers Ass’n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980). Thus, in one of the few lawsuits the agencies have filed on these matters, the DOJ alleged that the Kentucky Real Estate Commission acted contrary to state policy when it prohibited certain price rebates that LSBs had been offering there. See *United States v. Kentucky Real Estate Comm’n*, Civ. A. No. 3:05CV188-H (W.D. Ky. filed Mar. 31, 2005).

This article takes a closer look at the so-called “minimum service” regulations and explains why the federal agencies’ concerns with respect to these types of regulations are often misguided.

The Nature of the Real Estate Market

States have long seen the need to regulate their real estate markets to protect consumers.² Texas, for instance, has had a statute on the books since 1939 establishing the Texas Real Estate Commission, which has as its mission “to assist and protect consumers of real estate services, thereby fostering economic growth in Texas.”³ Among the principal justifications for this statute is the informational asymmetry between real estate professionals and individuals buying or selling a home.⁴ Consumers participate in the real estate market only a limited number of times in their lifetimes; in 2004, a recent survey found that 40 percent of home-buyers were first-time purchasers.⁵ Brokers, on the other hand, are regular, repeat participants in this market, and have extensive knowledge that most laypersons simply do not have. When a consumer enters into an agreement with a broker, the average consumer is at a distinct informational disadvantage, providing opportunities for abuse by disreputable brokers.

Moreover, brokers in every major market have created an information exchange to facilitate transactions. This exchange, known as the Multiple Listing Services (MLS), consists of a database maintained by local realtor associations that collects properties available for sale by participating realtors and makes them available for viewing by fellow participants. Through the MLS, brokers communicate information and make offers to each other, and offer to pay each other a share of the commission. A broker who lists a property on the MLS exposes the property to a much wider array of brokers for potential buyers than one who does not, and likewise a broker who is representing a buyer has a much easier job finding properties if he or she has access to the MLS database of properties for sale. The realtor organizations generally require membership to access the MLS database, and membership is open to anyone who agrees to abide by the established requirements for participation. One common requirement, which exists in Texas among other places, is the requirement that the individual broker be the exclusive agent for the represented principal. This requirement ensures that a broker who sees a property listed on the MLS can be sure that the listing broker has full and exclusive authority to negotiate with respect to the property.

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² Fifty years ago, an article in *The Harvard Law Review* noted that “[p]ublic concern with the proper conduct of [real estate agents’] business activities is evidenced by the fact that more than thirty states and the District of Columbia have enacted statutes regulating their activities.” Recent Case, 69 HARV. L. REV. 559, 559 (1956).

³ See Texas Real Estate Commission, Mission of the Texas Real Estate Commission, <http://www.trec.state.tx.us/mission.asp>.

⁴ The Supreme Court has recognized that some restrictions may “have a net procompetitive effect” when they address informational asymmetries, especially “in a market characterized by striking disparities between the information available to the professional and the [consumer].” *California Dental Ass’n v. FTC*, 526 U.S. 756, 771 (1999). In that case, which involved dental services, the Court noted that “the quality of professional services tends to resist either calibration or monitoring by individual patients or clients, partly because of the specialized knowledge required, and partly because of the difficulty in determining whether, and the degree to which, an outcome is attributable to the quality of services (like a poor job of tooth filling) or to something else (like a very tough walnut).” *Id.* at 772. The Fifth Circuit has recognized in the real estate context that “most homeowners do not possess the necessary experience in the specialized field of effectively presenting to the public essential and enlightening information about property offered for sale” and that market imperfections “arise from the lack of knowledge . . . regarding property values and available sources and methods of financing.” *United States v. Realty Multi-List, Inc.*, 629 F.2d 1351, 1368 (5th Cir. 1980) (citation and internal quotation marks omitted).

⁵ Paul C. Bishop et al., *The 2004 National Association of Realtors Profile of Home Buyers and Sellers 4* (2004), available at [http://www.realtor.org/Research.nsf/files/HBSHilite2004.pdf/\\$FILE/HBSHilite2004.pdf](http://www.realtor.org/Research.nsf/files/HBSHilite2004.pdf/$FILE/HBSHilite2004.pdf).

The combination of the knowledge engendered by repeated participation in the real estate market and access to the MLS listings creates a powerful informational advantage for the broker over the individual consumer. State law, therefore, regulates the means and manner by which brokers deal with consumers, whether those consumers are the brokers' clients or whether they are on the opposite side of a real estate transaction. In Texas, as in many other states, the legislature has long prohibited a licensed broker from "negotiat[ing] or attempt[ing] to negotiate the sale, exchange, or lease of real property with an owner, landlord, buyer, or tenant with knowledge that that person is a party to an outstanding written contract that grants exclusive agency to another broker in connection with the transaction."⁶ In turn, Texas brokers are required "to negotiate the best possible transaction for the principal."⁷ Texas law does not, however, prohibit an unlicensed individual from offering advertising-only services to consumers, such as by contracting to market a property for sale in local newspapers and the like.

The Potential Consumer Harm from the LSB Business Model

The advent of the LSB poses challenges to this regulatory system. On the one hand, as Ohlhausen notes, LSBs can allow consumers to save money "by allowing them to pay only for those services they want."⁸ No one disputes that LSBs can provide more choice to consumers to tailor their brokerage needs than exists in a market in which a customer can choose only between a full-service broker or no broker at all.

But, as with most things, there is a flip side to this coin, and the federal agencies have not given sufficient consideration to the problems that come with cafeteria-style brokerage services. The problems arise because of the informational asymmetry between the LSB and the consumer. When consumers used only full-service brokers, this problem could be addressed by imposing fiduciary-type obligations on the broker with respect to every aspect of the potential transaction. This is the case under most state regulatory systems today. This type of solution is obviously unworkable, however, when the very point of the brokerage relationship is for the parties to agree to only a limited subset of brokerage obligations, as is the case with LSBs.

Consider the home seller who decides she wants to engage an LSB to list her property on the MLS, but otherwise handle the negotiation of a sales contract herself. Once she begins negotiating with potential buyers, however, she realizes that there are a number of details she had not considered and decides it would be to her benefit to have a broker's assistance. At this point, the seller has no one to turn to. Her LSB may not even offer these services, or may offer them only at an exorbitant fee. Moreover, having already paid her LSB a fee for the listing, engaging a full-service broker at this time only results in the seller's incurring greater fees than if she had engaged a full-service broker at the outset. These problems are greatly exacerbated when, as is the case in Texas, the seller entered into an "exclusive agency" agreement with the LSB to have her property listed on the MLS in the first place. In this situation, no one other than the original LSB can provide these services to the seller, giving the LSB an opportunity for rent-seeking. In effect, the exclusive services agreement makes the LSB a monopoly brokerage provider to the particular customer, and she is subject to monopoly pricing if she seeks to purchase additional brokerage

⁶ TEX. OCC. CODE ANN. § 1101.652(b)(22) (Vernon 2004). A similar rule applies to lawyers, too. *See, e.g.*, Tex. Disciplinary R. 4.02.

⁷ 22 Tex. Admin. Code § 535.2(b) (2005).

⁸ Ohlhausen, *supra* note 1, at 3.

services after she had already entered into the limited service agreement and signed the exclusive agency agreement.

The practical impact of this unfortunate chain of events is often that the seller solicits assistance from the potential buyer's broker. Indeed, when considering a proposed regulation imposing minimum service requirements in Texas, the Texas Real Estate Commission heard testimony from buyers' brokers who had been approached for assistance by sellers who had engaged LSBs for listing of their property only. When this occurs, the broker is placed in a difficult position, not unlike that confronted by a lawyer litigating against a pro se opponent. And it goes without saying that the seller seeking this type of advice from even the most ethical broker on the other side of the transaction is soliciting advice from what might charitably be called the "second-best" source.

As this example demonstrates, the potential problem with LSBs arises from the severe informational disparity at the outset of a brokerage relationship. Consumers tempted by the low prices of LSBs may believe themselves capable of performing some brokerage-type services on their own at the outset of a relationship, only to discover as time goes by that they need a broker's assistance. Thus, while the additional choices provided by LSBs are undeniably beneficial in a world of fully informed consumers of brokerage services, in the real world in which state legislatures and regulatory agencies operate, the existence of informational asymmetries makes the LSB option a decidedly mixed blessing. Especially at the initial consummation of a brokerage relationship, the informational asymmetries create a serious potential for "buyer's remorse" on the part of the consumer of brokerage services as the consumer moves forward in the process of buying or selling a home.

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The Procompetitive Benefits of Minimum Service Requirements

One way that states have addressed buyer's remorse is by adopting minimum service requirements. These requirements set forth minimum services that a broker should be prepared to provide if and when consumers believe they need these services. As Ohlhausen notes, Alabama, Missouri, and Texas have implemented regulations or enacted statutes that obligate the broker to accept and present offers, assist in developing and communicating offers, and answer questions from the consumer.⁹ Properly understood, these requirements are essentially a real estate customer's bill of rights. Some customers may not need and may never make use of these services. But those who decide, once they have embarked on the process of buying or selling a home, that they do have questions or need assistance in preparing an offer should have someone to whom they can turn other than a rent-seeking broker.

What is especially compelling about minimum service requirements is how neatly they solve the information asymmetry problem that is otherwise exacerbated by LSBs. By establishing what a customer can expect from a broker, the minimum service requirements prompt brokers and customers to negotiate at the outset what the charges will be for these services. In essence, the LSB is forced to disclose in advance what he or she will charge for each of the required minimum services. The rent-seeking opportunities that currently exist when a locked-in customer experiences buyer's remorse and seeks additional help from his or her broker are eliminated because the price for these services is included in the initial contract. Thus, an LSB can charge the same flat fee for a listing-only service, and if the customer only uses the listing service, the transaction will occur just as it did before the minimum service requirements were implemented. But the LSB will also

⁹ See *id.* at 6; see also TEX. OCC. CODE ANN. § 1101.557(b) (Vernon Supp. 2005) (codifying minimum service requirements in Texas).

have included in the contract additional fees that will be incurred by the customer if he or she later elects to make use of the LSB to, for instance, answer questions. And by including these fees in the initial agency agreement, a customer can shop around when he or she has the maximum amount of options to minimize the costs of these additional services if they later become required.

By forcing the parties to negotiate for certain baseline services up-front, imposing minimum service requirements protects consumers from the problem of buyer's remorse. And it does so in a way that encourages vigorous competition for these additional services at a time when the consumer has maximum opportunity and options, before the customer has entered into an agreement with anyone. Indeed, with these protections in place, one should expect more consumers to make use of LSBs than do so currently. This is because those consumers who recognize their own lack of information at the outset of the relationship may fear use of a listing-only LSB currently, but may be more comfortable doing so with these protections in place and full disclosure of their potential total cost if they make use of all the services required to be available by state law.

The Federal Agencies' Flawed Analysis of Minimum Service Requirements

In light of these benefits, it is difficult to understand the opposition to minimum service requirements by federal antitrust authorities. That opposition appears to arise from a misunderstanding of the nature of the problem, compounded by a misunderstanding of the nature of the minimum service remedy.

In particular, the federal agencies appear to focus solely on the negotiation of the initial transaction, with little consideration for what might happen later.¹⁰ Ohlhausen makes this same mistake in her recent article. Nowhere does she give any consideration to the consumer with buyer's remorse. Her focus is entirely on whether the consumer has maximum choice at the outset of the relationship, and gives short shrift to the informational asymmetry that poses the very real possibility that consumers may often be making that choice with too little information to make a decision that maximizes consumer welfare.¹¹

Indeed, Ohlhausen mischaracterizes the concern of supporters of minimum service requirements by interpreting it in terms of an *ex ante* problem of consumer information. According to Ohlhausen, "proponents of [minimum service requirements] generally claim that such restrictions are necessary to protect consumers from receiving fewer services than they *expect*."¹² By characterizing the problem as one of expectation at the outset of the relationship, Ohlhausen is able to dismiss minimum service requirements as excessive, and argue that a less restrictive approach would be, for instance, to "require that brokers offering fee-for-service options specifically delineate in writing those services the client will *not* receive."¹³

¹⁰ In their letter to the Texas Real Estate Commission, for example, the DOJ and the FTC argued that the minimum service regulation proposed in Texas "would force home-sellers who prefer to market their house and to negotiate a transaction on their own in exchange for lower brokerage fees to purchase extra services, which necessarily raises the price of brokerage." Letter from Deborah P. Majoras, Chairman, Federal Trade Commission, and R. Hewitt Pate, Assistant Attorney General, Department of Justice Antitrust Division, to Loretta R. DeHay, General Counsel, Texas Real Estate Commission at 7 (Apr. 20, 2005), available at http://www.usdoj.gov/atr/public/press_releases/2005/208653a.htm. The agencies contend in the letter that any concerns about consumers' lack of information could be resolved through requirements that the brokers disclose what services they were and were not providing. *Id.* at 10.

¹¹ See *California Dental Ass'n*, 526 U.S. at 773 (noting the "significant challenges to informed decisionmaking by the customer for professional services").

¹² Ohlhausen, *supra* note 1, at 6 (emphasis added).

¹³ *Id.*

The problem, however, is not one of expectation *ex ante*. Rather, it is a problem related to information learned during the course of the relationship, based upon which the consumer determines he or she would like services in addition to those for which the consumer initially contracted. Under Ohlhausen's approach, and that of the federal antitrust agencies generally, this consumer is out of luck. Requiring disclosure of the services provided ahead of time simply cannot address these informational asymmetries anymore than providing an individual with an advance copy of *Gray's Anatomy* could solve the informational asymmetries between a doctor and a patient.

Moreover, Ohlhausen and the federal agencies misinterpret the minimum service remedy that states are implementing in a way that exaggerates competitive concerns. As Ohlhausen describes it, "[o]ne effect of these restrictions would be to force consumers to choose between purchasing a larger bundle of real estate services than they would otherwise desire or forgoing the help of a real estate agent altogether."¹⁴ Under this view, minimum service obligations require a broker to provide services whether the customer likes it or not—the broker will answer questions, even if the customer does not have any—and so LSBs will be forced to charge higher prices than they otherwise would. But these laws are better understood, as described above, as providing a customer's bill of rights, rather than forcing services upon an unwilling customer. Customers need not make use of these rights, but they are protected if, upon learning additional information, they decide they need the minimal services covered by the regulation. Put differently, if a customer approaches his or her broker with a question, the broker must answer the question, a not unreasonable obligation for which the price has been negotiated up front should that service be required.

Moreover, as the preceding section explains, these requirements do not mean that customers will necessarily face higher brokerage prices to cover the costs of services they do not need. Ohlhausen assumes that the result of these requirements is that brokers will charge a flat fee that will be high enough to cover the provision of all of these services, which would necessarily be higher than the flat fee a broker could charge without being required to make these services available. A rational broker would not do so, however. Instead, the broker would charge the same flat fee for the services offered prior to the minimum service regulations. The difference would be that the broker would also provide in the contract for additional fees if the customer actually uses the additional services the broker is required to provide by virtue of the minimum services obligations.

Thus, the parties to the transaction can negotiate for the exact same bundle of real estate services as before minimum service requirements were imposed, but their contract must make plans for the contingency that the customer may need additional services later; the customer need not ever be required to purchase more services than needed. Importantly, however, the customer is protected by the terms of the contract from rent-seeking if the customer later determines he or she would like to make use of the additional services.

The Federal Agencies' Concern with Minimum Service Requirements Is Misplaced

As the preceding sections show, the federal agencies' analysis of minimum service requirements fails to appreciate the informational asymmetries in the real estate brokerage context and as a consequence overlooks the competition-enhancing aspects of these regulations. In truth, much of their concern appears to be driven not so much by the impact of minimum service requirements

¹⁴ *Id.*

in and of themselves, but instead by the potential interaction of these requirements with the private regulations of MLS exchanges. Thus, Ohlhausen discusses the theoretical customer who engages a broker solely to have access to the MLS.¹⁵

Some of the opportunities for abuse that have prompted states to enact minimum service requirements would be diminished if LSBs did not enter into exclusive agency agreements with their customers. But private MLS regulations frequently require a broker to be the “exclusive agent” for the property being listed, so an LSB who wants to provide a “listing-only” service must sign up a customer to an exclusive agency agreement. States are understandably concerned about the consequences of these exclusive agreements on consumers of real estate services, who risk being taken advantage of by disreputable brokers.

Thus, to the extent the federal agencies are concerned about the ability of brokers to provide listing-only services, their concern is better directed to the private regulations of the MLS, and not to state regulators trying to protect consumers acting in the market as it exists. It should not pass unnoticed, however, that the concern for the listing-only broker rests on a misperception of the nature and purpose of the MLS. As one court has pointed out, “[t]he MLS is a cooperative facility operated by and for real estate brokers which is designed to pool resources so as to enhance the value of brokerage services to the public. Because it increases the efficiency of those services, the MLS has a significant procompetitive effect as well.”¹⁶ The federal agencies and Ohlhausen rightly recognize the substantial benefits that inure to brokers’ customers as a byproduct of the MLS. It is important to note, however, that the MLS is not the real estate corollary to a common carrier, much less to an essential facility, to which all must be given access.¹⁷ The MLS was created by brokers, for their benefit, and they have chosen the rules of participation in the MLS and sharing in those benefits. As courts have recognized, as long as those restrictions are reasonably necessary to the legitimate goals of providing an effective MLS, the antitrust laws interpose no objection.¹⁸

The Department of Justice has taken on some of the participation requirements imposed by local MLS services in its recent suit against the National Association of Realtors.¹⁹ To the extent

¹⁵ See *id.* at 3; see also Letter from Majoras and Pate, *supra* note 10, at 3 (“Some consumers may want to sell their house without the assistance of a broker but desire the additional exposure of listing their home in the local MLS.”).

¹⁶ *Supermarket of Homes, Inc. v. San Fernando Valley Bd. of Realtors*, No. CV 80-1888, 1983-2 Trade Cas. (CCH) ¶ 65,718 (C.D. Cal. Sept. 1, 1983), *reprinted at* 1983 WL 2199, at *9.

¹⁷ See *id.* (“The real issue here is whether the antitrust laws confer upon the public (and plaintiff) the right to convert an informational service compiled and maintained by brokers for their own benefit into what would amount to little more than another advertising medium. The Court concludes that the antitrust laws confer no such right.”). Moreover, the Supreme Court recently cast substantial doubt on the viability of the essential facility doctrine in antitrust law. *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 411 (2004) (noting that the Supreme Court has “never recognized such a doctrine” and finding in any event an “indispensable requirement” of such a claim to be “unavailability of access to the ‘essential facilities’”).

¹⁸ See *United States v. Realty Multi-List, Inc.*, 629 F.2d 1351, 1374–75 (5th Cir. 1980) (applying this standard and concluding that certain regulations did not pass the test); *Pope v. Mississippi Real Estate Comm’n*, 695 F. Supp. 253, 269–72 (N.D. Miss. 1988) (finding MLS requirement that participant be a member of local board of realtors, which established and ran the MLS, did not violate antitrust laws). But see *Thompson v. Metropolitan Multi-List, Inc.*, 934 F.2d 1566, 1581–82 (11th Cir. 1991) (finding general requirement of membership in local board of realtors too broad under antitrust laws, but recognizing right to impose specific membership requirements with procompetitive justifications). In connection with the requirement that a broker be the exclusive agent, it is worth noting that the Fifth Circuit in *Realty Multi-List* appears to assume that the requirement of exclusive agency is a fundamental requirement for the formation of an MLS. See *Realty Multi-List*, 629 F.2d at 1355 (noting that the MLS at issue in that case was formed by members who “obligated themselves to attempt to obtain from sellers ‘exclusive’ rather than ‘open’ listings of real estate and to pool their exclusive listings”).

¹⁹ See Ohlhausen, *supra* note 1, at 5–6 (describing lawsuit).

the DOJ's efforts to protect LSBs reflect a fundamental concern with access to the MLS, these types of actions are the proper forum for resolving those concerns. But certainly the states should not be limited in their ability to address proactively the problems that arise when an LSB secures an exclusive agency from a customer and then turns its back on that customer later. The minimum service requirements are an effective, procompetitive tool that should be encouraged.

Conclusion

Recent state efforts to adapt their regulations protecting consumers in the real estate market have taken a variety of forms, but the federal antitrust authorities appear to treat any new regulation as an effort to hinder the competition of LSBs, while ignoring the new forms of consumer harm that can accompany the LSB business model. While restrictions on price that have been adopted by some states may deserve more searching scrutiny, the minimum service requirements implemented in Alabama, Missouri, and Texas protect consumers and simultaneously enhance competition. Of all the federal agencies, the Federal Trade Commission, with its twin missions of consumer protection and promotion of competition, should appreciate and support such a win-win solution. ●