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 wh real estate brokers do. This function itself encompasses both representation a 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 dema 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.

Having determined the buyer's preferences, and being familiar with the homes for sale in the area, the broker's function then becomes a process of matching the buyer's preferences with the housing inventory.12/ Where the match is the best, for a given price, the sale will be the easiest.

3. Sellers' Demand

a. The Selling Process: What is Required?

Much of the information pursued by buyers also is sought by sellers. Sellers, too, benefit from knowing how the market values various characteristics of homes. In deciding what price to set, a seller must know the prices that other houses have recently obtained. By comparing the characteristics of such houses with those of his own, he or she attempts to establish a price range. Sellers, unassisted by brokers, might find the valuation of a particular house a formidable task. Not only are all houses different, both in their physical characteristics and location, but actual selling prices of comparable homes are not easily obtainable.

Showing a house can be burdensome. Buyers may want to come by at times which are inconvenient to the seller, necessitating schedule adjustments. Moreover, it is advantageous to be able to show the house on short notice in order to accommodate buyers. Compounding the annoyance of such intrusions, many potential buyers may not become actual buyers. Some may not be ready to buy if they have recently begun to search and are mainly interested in acquiring

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12/ An indication of the broker's functions and the relative amount of time spent in each function can be seen in the following survey results. This survey of real estate brokers and salespersons, consisting of 45 interviews (three each from 15 randomly chosen firms with ten or more licensees in the San Mateo-Burlingame, California, Board) resulted in the following estimates of actual hours spent by licensees assisting buyers:

Activity	Median Time	Average (Mean) Time
Interview Client	1 hour	2.5 hours
Locating Property	5 hours	14.5 hours
Discussing Terms of Offer	1.5 hours	2.75 hours
Conveying Offer	3 hours	4 hours
Negotiating Terms of Sale	1 hour	4.75 hours
Obtaining Financing	1.5 hours	3.5 hours
Arranging Escrow	1 hour	1.75 hours
Closing the Sale	1.5 hours	1.75 hours
Post Sale Follow-up	2 hours	2.75 hours
Total	17.5 hours	37.75 hours

Barry & Finley, Real Estate Agent Survey (August 28, 1980).

information. Others may simply not be interested in the seller's house once th see it. Buyers may find it hard to eliminate unsuitable houses from only the brief description in a newspaper ad or a look at the house from the outside. Still other buyers may be unable to afford the asking price.

We wish to reiterate that, in general, the more potential buyers the selle can reach with information relating to the sale of his or her house -- that is say, the greater the exposure of the house to the market -- the greater are the seller's chances of finding that buyer who most highly values the house and who also has the resources to pay for it. If a better marketing effort would yield higher net price, the seller must both recognize that fact and be able and willing to make such an effort. The seller unassisted by a broker may lack bot the expertise and the marketing tools needed to perform the necessary marketing functions.13/

b. What Can a Broker Offer?

A broker may show a house more effectively than a seller by virtue of his her role as well as his or her expertise. First, a broker can easily screen ou those buyers whose preferences are inappropriate and those who do not qualify financially. Second, some sellers may prefer not to deal directly with buyers.

A broker, due to his or her expertise, may be able to aid the seller in negotiating the most favorable terms of sale. Not only is the broker exper in such matters, but he or she is aware of the terms of other actual sales neighborhood.

Many sellers want help with the mechanics of the transaction. Filing the correct forms and arranging for escrow, title insurance and settlement can be intimidating to the uninitiated.14/ While some sellers engage an attorney to

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13/ The 1980 survey of licensees in San Mateo found that the following median and average times were spent by listing brokers and salespersons on the various services rendered:

Activity	Median Time		Average (Mean) T	
"Farming" (saturation solicitation in a neighborhood)	0	hour	.75	hours
Measuring Inventory	.75	hours	1	hour
Price Estimation	1	hour	1.75	hours
MLS Submission	1	hour	1.5	hours
Receiving Offers	4	hours	8.75	hours
Open House	16	hours	22.75	hours
Negotiating Sale Terms	2.5	hours	8.5	hours
Arranging Escrow	1.5	hours	3	hours
Closing the Sale	1	hour	1.75	ho
Post Sale Follow-up	1	hour	2	hours
Total	28.75	hours	51.75	hours

Barry & Finley, Survey, *supra* note 12.

draft the title report and to be present at settlement, these and other details usually are handled by the broker.

Perhaps the most important service the broker can offer is effective access to the local Multiple Listing Service. The Multiple Listing Service is the primary source of information about the prices of competing homes, the prices at which other homes have been sold, and in most communities, an essential marketing tool. In no community can sellers get direct access to this facility. In most communities, therefore, a broker is not just a luxury, but almost a necessity if the home is to be sold for the highest potential price and in the shortest potential time.

B. PROBLEMS IN MARKETING HOUSING INFORMATION

1. In General

Some goods and services lend themselves to simple and straightforward marketing arrangements, but information services often present problems.15/ The methods and procedures by which brokers collect and disseminate information have been influenced, if not determined, by two such problems.

2. The "Free Rider" Concern

Once information has been collected and sold, it can be resold again and again. If the original gatherer is to recoup the entire cost of gathering information, he or she must do so either on the first sale or by limiting the ability of others to fully exploit the information. Typical devices developed to deal with this problem of "free rider" are copyrights or contractual provisions restricting the redistribution or copying of informational materials.

Brokers, in their capacity as "information intermediaries," may invest time and money in advertising a home, listing it for sale on the MLS, and otherwise providing information to others about the home and its availability for purchase. Consumers and other brokers who receive this information might, in the absence of some form of contractual restraint, contact the seller and try to persuade him or her to sell the property directly, cutting the listing broker out of his or her commission.

To deal with this problem, brokers generally require that sellers sign a listing contract which provides that the broker will be paid a commission should certain specific conditions be met. Such contracts are a way of creating a "property right" — a contingent entitlement to a commission — for the listing broker, arising from the sale of the house during the duration of a listing period provided for in the contract.16/

14/ Brokers often are relied on to make referrals to, for example, title insurance companies. The Real Estate Settlement Procedures Act of 1975 forbids kickbacks to brokers making such referrals.

15/ See Consumer Information Remedies (Briefing Book for FTC Policy Review Session, June 1979), at 68-70.

There are three types of listing contracts commonly employed in this country. The overwhelming majority are of a variety known as the exclusive right-to-sell.17/ As its name implies, this type of contract guarantees the broker a commission in the event of a sale of the property by anyone, because only the listing broker has the right to sell.18/ Of all varieties of contracts in common use, the exclusive right-to-sell contract provides the broker with the most effective assurance of eventual compensation.

Fifty years ago, the predominant form of contract between sellers and brokers apparently was the open listing. This form of contract offers the individual broker a full commission only if he or she procures a buyer. It give the broker less guarantee of eventually recovering any expenditures made in trying to sell a property, because this variety of contract allows the seller to make similar contracts with any number of brokers.19/

An intermediate arrangement sometimes used is one which grants to a single broker an exclusive agency. It differs from the exclusive right-to-sell in that the seller reserves the right to compete against the broker. If the seller find a buyer on his or her own, no commission is due to the listing broker.

16/ The length of the listing period is specified in the contract. Brokers usually insist on a listing period long enough so that if a sale results (directly or indirectly) from a broker's marketing efforts, the broker will still be entitled to his or her commission. One or two weeks would not seem long enough and a year would seem unreasonably long. In most areas, 90-day listings are common.

17/ Most MLSs will accept and disseminate information relating only to exclusive right-to-sell listings. MLS Survey Question H.5.a.

18/ A sale is often not even necessary. Many listing contracts specify that once the broker has produced a buyer "ready, willing, and able" to meet the terms of sale enumerated therein or otherwise acceptable to the seller, payment of the commission becomes a legal liability of the seller. The broker is thereby protected should the seller change his or her mind during the listing period.

19/ Open listings are relatively infrequent today in the sale of residences. They remain, however, popular in sales of commercial property through brokers. Cooperating brokers in residential transactions, of course, still face a "free rider" problem of sorts. The listing broker may attempt to deal directly with the potential buyer and cut the cooperating broker out of his or her share of the commission. The cooperating broker faces the problem of demonstrating that he or she was the "procuring cause" of the sale. To lessen the expenses connected with bearing this burden of proof, most MLSs provide for arbitration of such disputes.

3. The Need for Pooled Listings

In order to create a match, a broker searches his or her available inventory of listings for those that appear closest to a buyer's preferences.

The unique aspects of real property make the marketing of residential real estate substantially different from most products. Each house for sale is unique. Its location and the many variables relating to the structure comprise a complex set of characteristics that may make the property more or less suitable for a particular buyer. Likewise, each buyer has a unique set of preferences, both rational and emotional. That buyer whose preferences most closely match the characteristics of the house will not only pay the most for the house, but may also be the most satisfied with his or her purchase.

The selling price of a home likely will vary according to its exposure. The more exposure it receives, the higher will be its probable selling price.[20/] That is, sellers, to maximize the probability of finding those buyers who will pay the most for their homes, need to inform the maximum number of potential buyers about their homes. Buyers, to maximize their chances of finding their best values, need to have access to information relating to the greatest number of potentially appropriate homes for sale.

Exposure of the home is, in turn, determined primarily by how long the home is on the market and by the number of potential buyers to whom it is effectively exposed. Obtaining maximum exposure, however, becomes theoretically more difficult as the number of separate brokers with separate lists of properties to sell increases. If there are many brokers, each with their own listings, buyers must go to each in order to know what is being offered. If there were just one broker in town, buyers would know that they could go there and obtain fairly complete knowledge of the houses for sale.

In a brokerage market which did not involve the use of a MLS or some other cooperative exchange mechanism, brokers with few listings would be at a considerable competitive disadvantage in satisfying the desires of buyers when compared with firms with larger inventories of houses to sell. In a market with many non-cooperating brokers, a seller would logically wish to list with a number of brokers in order to increase the exposure which his or her property would receive. But each broker would be in full competition with the others, and each would have no guarantee of recouping any portion of the expenses he or she might make in providing potential buyers with information.

When brokers pool their listings and give each other mutual access to their collective listings, they simultaneously do four important things — they expand the potential exposure of all sellers' properties to a larger number of buyers, reduce the search costs for those buyers, lessen the free rider risks for brokers, and diminish somewhat the competitive difference among brokers in terms of any advantage which accrues from a superior ability to attract new listings. In theory, cooperative marketing reduces the number of brokers — ultimately to one — that the buyer needs to visit in order potentially to obtain information that relates to the total stock of houses for sale in the market.

Historically, sellers and brokers have employed both the technique of multiple, open listings negotiated with wholly independent brokers, and the technique of an exchange system which provided for cooperative pooling of listings.[21/] Today, the exchange system dominates in most local markets.

20/ See, Section IV.C. for a discussion of Multiple Listing Services and how they accomplish this function.

Brokers prefer to use exclusive listings and to market those listings cooperatively. Today, this cooperative marketing is accomplished through the MLS, and the MLS pools the vast majority of listings in most local markets.22/

C. THE PRICING OF BROKERAGE SERVICES

1. The Apparent Paradox

Some analysts of the industry have argued that real estate brokerage commission rates must not be competitively determined, because brokers seldom deviate from a rate "standard" in their local market.23/ Our investigation did reveal a striking degree of commission rate uniformity within given local markets. It also suggests that the price of brokerage services may have risen more rapidly than the price of other services over the period of time for which statistics are available.24/ Furthermore, there is evidence that, in many communities, schedules of recommended commission rates circulated openly until recently.25/

On the other hand, a single real estate firm seldom accounts for as much as ten percent of residential sales in a locality,26/ and the large number of firms practicing brokerage in many communities make it appear that the coordination usually thought of as necessary for successful collusion would be difficult to maintain.27/ Some commentators also believe that relatively free entry at th

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21/ It should be noted that a very large number of listings could, in principle, raise search costs enough to impede the matching process. The relatively small size of the geographic market in which most buyers are interested and the use of computers, however, prevent such overload.

22/ See Ch. IV, Part C for a more complete history of the MLSs.

23/ See, for example, Boris W. Becker, Economic Aspects of Real Estate Brokerage (Berkeley, California: Center for Real Estate and Urban Economics, University of California, Berkeley, 1972), at 99-107; Bruce M. Owen, "Kickbacks, Price Fixing, and Efficiency in Residential Real Estate Markets," 29 Stanford Law Review 931 (1977), at 947-949; and William L. Trombetta, "Using Antitrust Law to Control Anticompetitive Real Estate Industry Practices" 14, Journal of Consumer Affairs 142 (1980).

24/ See Ch. III, Part A. Uniform prices can result from either coincidence, competition, active collusion or tacit price fixing. The relationship of brokerage commissions to costs does not appear to be consistent with price competition.

25/ See Ch. IV, Part G. While it appears that one rate is the tendency for most existing (i.e., used) home sales, each other type of listing -- e.g., farms, unimproved land, new homes, commercial property -- will have its own associated rate.

26/ Bruce M. Owen, supra note 23, at 945.

firm level makes higher than competitively-determined pricing impossible.28/

2. Factors Facilitating Possible Coordination and Collusion

a. In General

While the fragmented market structure of the real estate brokerage industry may seem inconsistent with the evidence of rate uniformity among brokers and the history of the successful use of rate schedules, there are several possible explanations for this paradox.29/ First, the industry has a number of general

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27/ F.M. Scherer gives three reasons why the coordination necessary to agree on prices is more difficult with a large number of firms. First, as the number of (evenly matched) firms increases, each firm realizes that its own pricing decisions have a smaller influence on the overall level of prices. Hence, they are more likely to ignore the impact of their own pricing decisions on their rivals.

Second, the greater the number of dealers, the higher the probability that at least one will be a maverick, refusing to consider the interests of the group and competing aggressively.

Third, to the extent that sellers hold divergent views on what the industry price should be, the difficulty of reconciling these views into a single strategy rises with the number of firms. Not only is there likely to be more disagreement, but the number of actual physical communications required increases. F.M. Scherer, _Industrial Market Structure and Economic Performance_, Second edition (Chicago: Rand McNally, 1980). _See also_ Almarin Phillips, _Market Structure, Organization and Performance_ (Cambridge, Mass: Harvard University Press, 1962), at 29-30; and Oliver E. Williamson, "A Dynamic Theory of Interfirm Behavior," 79 _Quarterly Journal of Economics_ 600 (1965).

28/ Report of Interview with J. Singer, Manager, Research and Economics, California Association of Realtors (Oct. 16, 1980).

29/ This would not be the first instance of a large number of firms colluding successfully. George B. Hay and Daniel Kelley, "An Empirical Survey of Price Fixing Conspiracies", 17 _Journal of Law and Economics_ 13, 1974, report that of 65 Section 1 criminal cases that the Justice Department won in trial or settled by _nolo contendere_ pleas from January 1963 to December 1972, six cases involved more than 25 firms. Of these, four involved 50 or more and two involved more than 100. (Cases involving allegations of price fixing among professional such groups as Realtors, were excluded from the characteristics — low capital intensity, perceived homogeneity of services, long-run upward movement in housing prices, inelastic demand, and easy detection of price cutters — which might aid in maintaining prices. These are discussed briefly in this section. Second, the industry is perhaps unique in the degree to which the individual firms and brokers are interdependent. The interdependence among competitors is discussed in the next section.

b. Low Capital Intensity

Firms that exhibit high fixed costs, i.e., firms that are relatively capital intensive, generally are hurt by downturns in business conditions because they cannot achieve significant cost savings simply by laying off workers. Thus, in bad times, firms in capital-intensive industries have an incentive to cheat on any collusive arrangement be it a formal or a tacit one. By shading its price a bit below that of its rivals, a firm may be able to increase output sufficiently to cover its fixed costs and eliminate losses, making it difficult for cartel arrangements to work over time.

Real estate brokerage firms, on the other hand, exhibit very low fixed costs. The largest expense (more than 50% of gross income) comprises payments to salespersons, managers, and other personnel. About the only significant costs that might be termed fixed are those for office space and communications (less than 7% of gross income), and even these can be reduced.30/ In addition, brokerage firms can reduce their labor costs without the necessity of layoffs, since sales personnel generally are compensated only for production, i.e., on a commission basis.

c. Perceived Homogeneity of Services

Most real estate brokers offer a package of services similar to those of their competitors. Furthermore, the possibility that one broker can offer information not available from other brokers is limited. Through the local MLS, each member broker gains access to the same information available to all other members. To the extent there are quality differences among brokers, most sellers have little information with which to evaluate a broker before signing a listing contract. The result of this homogeneity is that the firms in the market may be functionally identical from the consumer's point of view.

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sample).

30/ National Association of Realtors, Real Estate Brokerage 1978, at 6. All of the data in this report comes from a sample of 490 firms surveyed by the NAR. The sample may be biased because it was comprised of firm representatives that had attended a course on successfully managing a real estate office. Hence, the brokers in the sample may be more interested in management techniques than the general population of brokers. Such brokers may represent larger, urban firms.

d. Inelastic Industry Demand

The more inelastic the market demand for an industry's product, the less output falls when price is raised above the competitive level and the larger the gains to collusion.31/ That is, if demand is inelastic a fall in price will not be offset by a proportionate increase in quantity sold; therefore, total revenues decrease. Such demand inelasticity thus provides a strong incentive not to compete. While we know of no formal estimate of demand elasticity for residential real estate brokerage, industry observers feel it is small.32/

e. Long-run Upward Movement in Housing Prices

Since commissions are usually levied as a flat percentage of selling price, commission revenues increase automatically with the price of housing. This allows industry members to offset inflationary cost increases or adjust for other changes in business conditions without doing the calculations needed to closely adjust prices to actual changes in costs.

f. Ease of Detection

Coordination might be facilitated if it were easy to detect cheating. A broker who adopts rate cutting as a standard policy will be discovered as a matter of course. First, advertising inevitably accompanies the practice of "discount" brokerage. Therefore, other brokers cannot help but learn of a discounter. Second, cooperating brokers can detect reduced commissions at the closing, where both brokers are paid. Third, and most direct, the MLS in and of

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31/ Elasticity of demand is a way of summarizing how the quantity of a good demanded by consumers responds to changes in a good's price. It is defined to be the percentage change in the quantity of a good purchased associated with a one-percent change in the good's price. Formally:

$$\text{Elasticity of Q with respect to P} = E_{Q,P} = \frac{\text{percent change in Q}}{\text{percent change in P}}.$$

32/ Bruce Owen advances two reasons why consumers may likely be insensitive to the level of brokerage fees. First, the amount of the commission is small relative to the total price of a home, so there is not much sensitivity to small changes. Second, because of the infrequency of real estate transactions in the lives of most people, they find it difficult to make judgments about the price and quality of brokerage services. Bruce M. Owen, *supra* note 23, at 935. *See also* James Gillies and Frank Mittlebach, "The Real Estate Commission Rate," *California Real Estate Magazine* (June 1959), at 28.

itself serves a monitoring function. Most MLSs in the past required that listings reveal not only the percentage commission offered to cooperating brokers, but also the total commission rate being charged the seller.33/

3. Interdependence among Competitors

a. In General

While the above characteristics are factors that could facilitate coordination and collusion, they do not necessarily lead to it. Yet, commission rate uniformity and alleged retaliatory practices against "alternative" brokers who have tried to charge less than prevailing rates are reported to occur in virtually all communities we have examined.34/

The number of firms in most local markets and the relatively free entry of new firms into the industry do not seem consistent with a pattern of true cartels. If there is some system of coordinated pricing, the questions arise whether the mechanism for such coordination is an integral part of the industry structure and whether the policing of a "cartel-like" arrangement may not be a natural consequence of the system of brokerage that has evolved throughout the country.

One means of achieving a truly dramatic increase in any individual brokerag firm's efficiency and a decrease in its transactional costs is cooperative selling. Access to cooperation, therefore, is seen by most real estate brok firms to be critical. While the structure which ties competitors together for competitive purposes in most markets is a MLS, cooperative selling is common in virtually every locality. Behavior which will increase the likelihood of a firm's securing cooperation, therefore, has become the norm. It is the cooperative system, coupled to the commission method of compensating cooperating brokers that may be key to understanding the apparent paradox of coordinated pricing in a fragmented industry made up of apparently rivalrous firms. In most markets, cooperation, and the brokerage firms which depend on it, creates, in effect, a single system for selling homes.

Individual brokers, we hypothesize, police the system by withholding cooperation in selling listings which carry a lower than customary "split" or commission. In doing so, they engage both in typical profit-maximizing (refusin

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33/ Although MLS listings generally will not reveal commission reductions made by the broker subsequent to obtaining the listing, such concessions do not usually constitute price competition for listings, since they are made after the listing has been acquired. Their usual purpose is to promote a sale by bringing buyer and seller closer together.

Recently, the NAR instituted a policy which forbids its affiliated MLSs from disclosing the total commission charged by the listing broker. Executive Officer (April 1980), at 4.

34/ See Ch. III, Part A for a description of rate uniformity. See Ch. IV, Part E for a description of the experiences of the "alternative" brokers who try to compete by charging less.

to sell their services for less than the going rate) and also prevent a collective lowering of commissions generally.

This, we believe, is exacerbated by the fact that the inherent economies connected with information exchanges almost requires a firm to be a member if it is to compete effectively and also gives a virtually unchallengable advantage to the first MLS system to enter a market. At the MLS level, there is, in fact, no effective competition at the present time, and almost all brokers are, therefore, members of one system in each local community.

b. Marketing Interdependence

(1) The Necessity of Cooperation

As discussed in Section C.2., above, there are substantial economies in pooling listings and in cooperative marketing. Maximizing the seller's price, the buyer's satisfaction, and the broker's profits calls for maximizing the exposure of properties for sale. To accomplish this efficiently in the fragmented brokerage industry, the industry has chosen to market cooperatively. This cooperative marketing is now formalized in most markets though the MLS. The MLS has become the typical centralized market mechanism for the industry.

Today, approximately 81 percent of sales of single family dwellings involve a broker.35/ Where a broker is involved, 92 percent of homes are listed on the MLS.36/ Approximately 53 percent of sales involving a broker involve two different firms, and approximately 66 percent involve more than one broker.37/ Smaller firms, having fewer listings, have less chance of having an in-house listing which is appropriate for a prospective buyer, and also less chance of contacting on their own the optimal buyer for those listings they do have. Thus their need for a MLS may be greater than that of larger firms.

It is now generally acknowledged by real estate commentators that real estate firms in general, and especially smaller firms and new entrants, depend on the MLS in those markets where MLS systems exist.38/ This dependence is also a measure of the interdependence among "competitors," for the MLSs are not facilities separate from the industry members. The brokerage function, when performed through a multiple listing system, is accomplished by a system composed virtually of the entire local industry. The MLS system with the individual local firms as a group form the basic structure of the industry in most local

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35/ FTC Consumer Survey, Screener sample of 1,333 sellers, cross tab of Screener Question 9 by Screener Question 11, NFO preliminary report, at 14.

36/ FTC Consumer Survey, Screener Question 13.

37/ FTC Consumer Survey, Seller Question 52.

38/ N. Miller, "The Changing Structure of Residential Brokerage," California Real Estate (September 1979), at 22, 25. See also W. Milligan, "The Legalities of Broker Cooperation," California Real Estate (August 1976), at 43; H. Miller, M. Starr, Current Law of California Real Estate (1975), at § 2.14. This will be discussed further in Ch. IV, Part C, dealing with the multiple listing system.

markets.[39/]

(2) Steering

Dependence upon a common facility and the cooperation of all the competitors in the local market gives the appearance of the power to establish and maintain prices.[40/]

While much of the competition in the industry is non-price competition for the seller's exclusive listing, these exclusive listings give the listing brokers a commission only if the property is sold within the listing period. However, not all listings are sold within the listing period.[41/] Because brokers receive nothing if a buyer is not produced, anything that lowers the chance that a particular broker's listings will sell puts that broker at a competitive disadvantage.

Buyers generally contact the broker before they have identified the specific home that they wish to buy. Common ways by which buyers choose brokers include referrals and newspaper advertising.[42/] The high percentage of cooperative sales also indicates that the broker is identified first, and then the house is identified with the aid of and under the influence of that particular broker. Brokers are the intermediaries who are relied upon to aid the buyer in accessing the market for housing.

Given the position of brokers as intermediaries between the buyers and the housing market, brokers can substantially influence the search behavior of the buyers.[43/] Buyers cannot, nor would they want to, receive knowledge of the entire inventory of homes for sale. The mark of a good broker is the ability to

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39/ Historically, in many Boards which had multiple listing services the listing contract was not even a contract between the seller and the firm. Rather, it was a contract between the seller and the local Board. See, e.g., California Real Estate (December 1923), at 22, 26.

40/ See Ch. IV, Part G for a discussion of overt fee stabilization.

41/ The FTC MLS survey indicated that slightly fewer than 50% of disseminated listings were sold. However, Consumer Survey, Screener Question 14 indicated 25% of sellers lower their price, perhaps during the listing period. This would show up in MLS statistics as a new listing. Therefore, eliminating these listings, it appears that approximately 75% of listings are sold.

42/ FTC Consumer Survey, Buyer Question 15.

43/ "[P]romotional efforts of the broker . . . are a significant determinant of the number and type of buyers who are exposed to the property." Generally, brokers influence time on the market in a number of ways. D. Hempel, J. Belkin, D. McLeavey, Duration of the Listing Period: An Empirical Study of Housing Market Dynamics (University of Connecticut, 1977), at 45.

for if a "discount" broker is prepared to offer a cooperating broker a "standard" percentage and absorb the entire reduction in commission him or herself. This, of course, severely limits the amount of discount which a broker can offer and still cover operating costs.

A second category of behavior by cooperating brokers may reflect a long-run profit-maximizing behavior shared by almost all members of the industry. Many brokers appear to recognize that given the peculiarities of their market, reductions in commission rates by one or two percentage points is not likely to lead to a flood of sellers into the market. Virtually all competitors can come close to matching each others' costs on any particular transaction, and therefore are in a position to also match prices. If all firms were to compete with a discount broker on price the total amount of business done might grow little if at all and no firm, of course, might either lose or gain market share, but all could lose profits. Because most brokers can be presumed to realize these facts and because information on other brokers' pricing strategies is commonly available, even if a discount broker offers a cooperating broker the same total dollar amount for cooperating on a particular transaction as would a traditional broker, the discounter still may obtain a somewhat lower rate of cooperation than would a traditional broker. A traditional broker, in short, has at least some incentive to generally steer away from cooperating on a discount broker's listings. Brokers are aware of the inelastic demand for their industry's services, and commission cutting has informally been considered a problem or an evil practice within the industry.47/

One result of cooperating brokers' apparent tendency to steer buyers away from the listings of discount brokers is that discount brokers may be at a substantial disadvantage in marketing their listings. The industry view is that steering is the logical extension of the principle that the cooperating broker is a subagent of the seller and listing broker.48/ As a subagent of the various sellers in the MLS, the cooperating broker owes few duties to a buyer. Thus, steering the buyer away from a property which may be arguably more suitable than other properties, but which would pay the broker less than other properties, would not violate any duty recognized by the industry. The problem of commission uniformity and the alleged pattern of steering are, therefore, related to issues involving the relationship of cooperative brokers and buyers as discussed in Chapter IV.F., infra.

The structure of the MLS, the form of compensation of cooperating brokers, and the natural tendency to steer, therefore make the system self-policing and self-stabilizing. Each member, in pursuing his or her own individual interests, also pursues any group interest in stabilizing and maintaining the commission rate. The pervasiveness of the cooperative MLS coupled to the individual incentives of the brokers appear to be key to understanding the pricing

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reducing the asking price of the house in order to facilitate cooperative sales. However, the experience of the alternative brokers indicates that the relatively minor reduction in house price this savings might allow does not offset the substantial reduction in the cooperating broker's compensation.

47/ Reprint from "The Brokers Roundtable," California Real Estate (September 1965), at 32.

48/ M. Lasky, California Real Estate (October 1962), at 9. See also C. Wallace, California Real Estate (April 1979), at 25, 58 exercise discretion in selecting houses to be shown to the buyer, so that the buyer makes a choice to purchase after inspecting only a few homes.

Of course, brokers are interested not only in making the quickest possible sale. To maximize their income, they must also consider the financial rewards attached to selling the various houses which might be close to what the buyer wants. Rational brokers can be expected to show to the buyer, and expend their selling efforts on, those homes for which they will receive the highest compensation.

Brokers will initially, of course, check their own inventory of listings to see if they have an appropriate house for the buyer. If they have none, they will then go to the MLS books. In selecting MLS properties to show, they will consider both their short-run interest in receiving the maximum split and their long-run profit maximizing interests as a listing broker in competition with other listing brokers.

As discussed above, maximizing the sale price usually requires maximizing the exposure of the property. The MLS is generally used by brokers to do this. However, effective use of the MLS also requires giving the cooperating brokers the incentive to show the home. At a given price and in a given time period, a property listed on the MLS at the prevailing commission rate and split has a higher probability of selling than if that same property were listed at a lower commission rate and split. Alternative, discount brokers as a group have a substantially lower cooperative sales rate and overall sales-to-listings ratio than do the traditional brokers in their communities.44/ This may account for the opinions of industry spokesmen that while discount brokers have always existed to some degree in rising sellers' markets, they seldom survive recessionary market conditions.45/

Brokers' short-run profit maximizing interest relates to the amount of the split they will obtain if they are the procuring cause in the sale of the particular house. For example, a "discount" broker who charges 4 percent and splits 50/50 with the cooperating broker is, in effect, offering the cooperating broker 2 percent if he or she procures the buyer. A "traditional" broker who charges 6 percent and splits 50/50 is, in effect, offering the cooperating broker 3 percent of the transaction if he or she procures the buyer. From the cooperating broker's point of view, the traditional broker in this example is paying him or her 50 percent more than the discount broker. In many cases the differential is even greater. These differentials in the potential incomes of brokers who are dealing with prospective buyers appear to influence the showing patterns of such brokers. Brokers appear to steer buyers toward the house listed by the traditional, full-commission broker.46/ This tendency can be corrected

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44/ See Ch. IV, Part E for complete statistics relating to the performance of alternative brokers.

45/ Clark Wallace, President, California Association of Realtors, California Real Estate (April 1979), at 25; FTC Alternative Brokers Survey, Section II.2.

46/ In addition to the commission revenues attached to the particular sale, a rational broker would also consider the cost of selling the particular house in order to maximize his or her hourly income. The major factor here is the relative price of the house compared to other comparable houses for sale. Alternative brokers often try to convince sellers to split their commission savings with buyers by (Continued) peculiarities of the present system.49/

c. Consumer Search Problems

(1) Overview

Consumers undertaking a real estate transaction are interested primarily in selling or finding a home. Secondarily, however, they hope to rationally select a broker. While the prices charged by brokers can be determined with reasonable objectivity, the subjective "quality" of the broker, like that of other infrequently used professionals, is generally beyond the ability of the consumer to judge directly. The inability of consumers to judge quality in their selection of brokers gives rise to two problems. First, there is the individual competitor's susceptibility to damage from disparagement, and second, there is a need to use labor-intensive techniques to cultivate sellers in order to obtain listings.

(2) Disparagement and Harassment

The consumer's housing transaction is generally the largest financial transaction of his or her life. Perhaps for this reason, consumers consider the most important characteristic of a broker to be the broker's "honesty and integrity."50/ Because of the importance of honesty and integrity and the difficulty of judging those qualities, unfair disparagement of a competitor can sometimes be an effective strategy in obtaining particular listings.

The Realtors seek to suppress disparagement through their Code of Ethics. Article 23 of that Code, for example specifies that:

> The Realtor shall not publicly disparage the business practice of a competitor nor volunteer an opinion of a competitor's transaction. If his opinion is sought and if the Realtor deems it appropriate to respond, such opinion shall be rendered with strict professional integrity and courtesy.51/

While the Realtors may have been somewhat successful in discouraging this form of criticism among traditional brokers, they allegedly have been less successful in discouraging traditional brokers from disparaging discount brokers. A primary problem reported by discount, alternative brokers has been the disparagement of their business by other brokers.52/ Consumers appear to consider discount

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49/ *See* Ch. IV, Part F for further detail concerning the buyer/broker relationship.

50/ FTC Consumer Survey, Seller Question 20, Buyers Question 29.

51/ NAR, *Interpretations of the Code of Ethics* (1976), at 179.

52/ FTC Alternative Broker Survey, Part V.

brokers less reputable and ethical than traditional brokers.53/ We were unable to determine an objective reason for this belief. It may be, however, that consumers use "standard price" as a surrogate measure for "ethical behavior" or the belief may be the result of the disparagement alleged by alternative brokers

(3) Non-Price Competition

While price competition generally is not considered a useful method of competing in this industry, non-price competition for an increased share of the business being done in the market is intense.

As discussed above, the public finds it difficult to differentiate among brokers.54/ Because of this inability to differentiate, and the consumer's concern for honesty and integrity, friends, relatives, and referrals always hav been primary methods by which brokers acquire listings.55/ A result is that brokerage firms, in their effort to acquire listings, continuously add or drop brokers and salespersons in order to expand the firm's network of personal contacts. Competition for listings becomes, in part, a competition for those salespersons with the widest list of contacts.56/

Because of the "independent contractor" status of salespersons and the contingent form of their payment, firms traditionally have thought of sales lat as almost free.57/ However, the addition of these resources and the entry of n people into the industry does not appear to increase significantly the total number of housing transactions. Rather, with an increase in the sales forc the market, the number of transactions per licensee appears to have decreas

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53/ FTC Consumer Survey, Buyer Question 27, Seller Question 27. See Ch. IV, Part E for more detail.

54/ N. Miller, California Real Estate (July 1979), at 22, 25.

55/ See, e.g., FTC Consumer Survey, Seller Question 17.

56/ Report of Interview With Sol Rabin, Ph.D., Coldwell Banker (August 24, 1979).

57/ See, e.g., Fred E. Case, Residential Brokerage: History, Characteristics, Problems (1979), Part 5, at 5.

58/ William Brock, Preliminary Report to the FTC: Brock to Serber Tape II (1979), at 1.