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Competition Policy in Regulated Sectors:
Focusing on the Institutional Design of the Relationship between
Competition Authority and Sectoral Regulators

규제산업의 경쟁정책:
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**Promoting Competition in the Professions: The U.S. Experience with Attorney and
Real Estate Agent Regulation**

**Maureen K. Ohlhausen
Director, Office of Policy Planning
U.S. Federal Trade Commission**

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Focusing on the Institutional Design of the Relationship
Between Competition Authority and Sectoral Regulators”**

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Introduction

In the United States, several industries are subject to regulation at the state or local level. In particular, the states play the primary role in regulating professions, such as attorneys and real estate agents and brokers. For example, state bar associations and state real estate commissions set minimum standards for licensure and promulgate and enforce codes of conduct. On occasion, these state regulatory entities enact rules that are likely to restrict competition: state bar associations often limit the ability of attorneys to advertise and, pursuant to unauthorized practice of law rules, restrict non-attorneys from performing certain tasks. Several state real estate commissions and legislatures recently have considered rules that would require real estate brokers to provide their clients certain services that some consumers may not want or need. Further, some real estate commissions have taken actions to prohibit brokers from rebating commission fees to their clients.

The Federal Trade Commission (FTC), often in conjunction with the U.S. Department of Justice (DOJ),¹ uses competition advocacy to try to persuade these state regulatory bodies to adopt policies that do not unnecessarily restrict competition. The agencies also undertake other efforts to promote increased competition in these areas, such as holding workshops and issuing reports. Further, depending on the circumstances, the Agencies may challenge actions taken by state bars and state real estate commissions under the antitrust laws.

¹ In the remainder of the paper, I collectively refer to the FTC and DOJ as “the Agencies.”

This paper discusses the relationship between the federal competition agencies and sectoral regulators in the context of state regulation of attorneys and real estate agents and brokers. It describes the actions undertaken by the FTC and the DOJ, the types of arguments and evidence on which the agencies rely, and the outcomes of these actions.

I. The Practice of Law

A. General U.S. Regulatory Framework

In the United States, states, rather than the national government, regulate the practice of law. Each state and the District of Columbia have adopted different standards for licensing attorneys to practice law.² Some states and the District of Columbia have entered into reciprocity agreements that allow individuals who have been admitted into one state's bar to qualify to become members of another state's bar.³ Attorneys are required to pay annual dues and, in some states, attend continuing legal education seminars to maintain their licenses. State supreme courts promulgate rules to govern the practice of law in their states. These rules cover the duties that attorneys owe their clients, including the treatment of confidential client information, handling of clients' money, and conflicts of interest. They also govern the manner by which attorneys may attract

² Every state determines the qualifications necessary to take the state bar exam, which typically include completing law school and meeting the state's requirements for character and fitness. Law school accreditation is done by the American Bar Association, which has established criteria to determine if a law school should be accredited. To be admitted to the bar, a person must pass the requisite state exam and swear an oath before the highest court of that state.

³ This type of qualification may involve several years of practice by the attorney, a letter of good standing from the state in which the attorney is already licensed, satisfying character and fitness requirements, and payment of an admission fee.

clients. For example, they limit the types of advertising attorneys can use and the means by which attorneys can provide and accept client referrals.

Although state supreme courts govern the practice of law within a state, they delegate administrative and enforcement responsibilities of regulating attorneys to the state bar. For example, the Supreme Court of Arizona established the State Bar

[i]n order to advance the administration of justice according to the law, to aid the courts in carrying on the administration of justice; to provide for the regulation and discipline of persons engaged in the practice of law; to foster and maintain on the part of those engaged in the practice of law high ideals of integrity, learning, competence and public service, and high standards of conduct; to provide a forum for the discussion of subjects pertaining to the practice of law, the science of jurisprudence, and law reform; to carry on a continuing program of legal research in technical fields of substantive law, practice and procedure, and to make reports and recommendations thereon; to encourage practices that will advance and improve the honor and dignity of the legal profession; and to the end that the responsibility of the legal profession and the individual members thereof may be more effectively and efficiently discharged in the public interest[.]⁴

State bars enforce rules compliance through disciplinary actions and also issue advisory ethics opinions to provide attorneys with guidance as to what type of conduct a state bar is likely to find in violation of the rules. Although state bars have some permanent government attorneys on staff, private attorneys for the most part run these regulatory organizations. For example, most state bars elect private attorneys to serve in leadership roles and ethics and disciplinary committees often are comprised of private attorneys. Thus, although state legislatures and state supreme courts enjoy ultimate oversight of the legal profession, for the most part attorneys regulate themselves.

⁴ AZ. S.CT. RULE 32(a)(1).

The information asymmetry between attorney and client may give rise to agency problems that prevent the market from producing the optimal level of attorney quality. For example, consumers may have difficulty accurately accessing the competency of attorneys *ex ante* or even *ex post*. Further, because attorneys both diagnose their clients' problems and provide the services to solve them, there is the potential of supplier-induced demand.⁵ Thus, some regulation of the legal profession is likely to be necessary to protect consumers.

Self-regulation, however, presents special risks to competition. Although it can make regulation more efficient by increasing technical knowledge and reducing monitoring and enforcement costs,⁶ allowing attorneys to control entry, advertising, and other competitive conduct, authorizes attorneys to engage in conduct that otherwise would be condemned under the antitrust laws.⁷ Thus, self-regulation provides the incentive to limit competition beyond what is necessary to correct market failures and instead to pursue anticompetitive restrictions that increase attorney income at the expense of consumers. Any efficiencies that arise from self-regulation must be weighed against the costs from the potential that members of the profession will act like a cartel.

The U.S. Supreme Court has made it clear that the antitrust laws apply to the legal profession. For example, in *Goldfarb v. Virginia State Bar*, the Supreme Court held that

⁵ See James H. Love & Frank H. Stephen, *Advertising, Price and Quality in Self-regulating Professions*, 3 INT'L J. ECON. BUS. 227, 229 (1996).

⁶ See Anthony Ogus, *Rethinking Self-Regulation*, 15 OXFORD J. L. STUD. 93 (1995).

⁷ See Frank H. Stephen & James H. Love, *Regulation of the Legal Profession* (1999); see also Remarks by Deborah Platt Majoras, Chairman, Fed. Trade Comm'n, Promoting a Culture of Competition (Apr. 10, 2006), available at <http://beijing.useembassy.gov/041006e.html>:

Engaging in private anticompetitive conduct is risky for firms: . . . collusive behavior has the risk of cheating on the cartel; and there is the risk of detection and legal punishment. By contrast, persuading the government to adopt an anticompetitive restriction is much less risky: the cost of lobbying are low; the government enforces the restriction, which reduces the likelihood of cheating; and the ability of the competition agency to intervene is limited.

State bar ethics opinions that warned attorneys to adhere to local bar price schedules were likely to discourage attorneys from charging prices below those recommended by the local bars, and constituted a violation of the antitrust laws.⁸ However, not all anticompetitive actions taken by state bars are subject to the antitrust laws.⁹ In the U.S., restraints imposed directly by the state sovereign – a state legislature or a state supreme court, acting in a legislative capacity – are protected from antitrust challenge under the state action doctrine.¹⁰ Further, the state action doctrine may shield actions taken by subsidiary government entities and even by private in some circumstances.¹¹

For example, in two separate cases, the Supreme Court held that the state action doctrine prevented antitrust challenges to anticompetitive rules promulgated by the Arizona State Bar. In *Bates v. Arizona State Bar*, the Supreme Court held that state supreme court promulgation and enforcement of ethics rules that prohibited advertising was the act of the sovereign and protected by the state action doctrine.¹² Similarly, in

⁸ 421 U.S. 773 (1975).

⁹ *Id.*, see also *Hoover v. Ronwin*, 466 U.S. 558, 568 (1984).

¹⁰ See *Parker v. Brown*, 317 U.S. 341 (1943) (creating the state action doctrine); *Hoover v. Ronwin*, 466 U.S. 558, 567-68 (1984) (“when a state legislature adopts legislation, its actions constitute those of the State . . . and *ipso facto* are exempt from the operation of the antitrust laws.” (citations omitted)). The Court also extended this *ipso facto* exemption to a state supreme court acting in a legislative capacity. *Id.* at 568.

¹¹ See, e.g., *Hoover v. Ronwin*, 466 U.S. 558, 568 (1984) (“Closer analysis is required when the activity at issue is not directly that of the legislature or supreme court, but is carried out by others pursuant to state authorizations.”); *Southern Motor Carriers Rate Conference v. United States*, 471 U.S. 48, 62-63 (1985) (public utility commission not the state itself); *Goldfarb v. Virginia State Bar*, 421 U.S. 773 (1975) (attorney fee schedule established by county bar association was not immune from antitrust liability). In *California Retail Liquor Dealers Ass’n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980), the Court set out a two-part test for an entity claiming state action immunity from federal antitrust laws: it must demonstrate that its actions are (1) pursuant to a clearly articulated state policy intentionally displacing competition with an alternative regulatory scheme and (2) actively supervised by the state or a qualified government agency or official). See also FTC OFFICE OF POLICY PLANNING, REPORT OF THE STATE ACTION TASK FORCE (Sept. 2003), available at <http://www.ftc.gov/os/2003/09/stateactionreport.pdf> (analyzing state action immunity doctrine).

¹² 433 U.S. 350, 364 (1977). Although the Court held that the restrictions in *Bates* were beyond the reach of the antitrust laws, they were struck down as contrary to the First Amendment protection of speech. See *Bates*, 433 U.S. at 364. The U.S. Constitution does not protect deceptive and misleading advertising, but

Hoover v. Ronwin, the Court decided that designing a bar examination, which ultimately was approved by the state supreme court, constituted sovereign conduct, and therefore was beyond the reach of the antitrust laws.¹³

Because many restrictions imposed on competition in the provision of legal services may be covered by state action immunity, the FTC and DOJ have focused efforts on advocacy to prevent such restrictions from going into place in the first instance. In the remainder of this section, I examine the competitive effects of two of the most common forms of regulation – restrictions on attorney advertising and practice of law restrictions – and discuss the Agencies’ advocacy efforts related to these restrictions.

B. Advertising Restrictions

Advertising can provide consumers with information about the existence of competitors, the prices that competitors charge, and the relative characteristics of competitors. When consumers face large costs to discovering their marketplace options, firms can charge higher prices. This is because consumers rationally will visit an additional store only if the expected gain (from a better price/characteristic combination) is greater than the cost of additional search. By reducing the costs for consumers to compare competing suppliers’ offerings, price and non-price advertising increases firms’

truthful advertising is protected and any restrictions limiting such advertising must advance a significant state interest and be carefully tailored to advance the state interest. *See Central Hudson Gas & Elec. Corp.*, 447 U.S. at 566 (1980); *see also Florida Bar v. Went for It*, 515 U.S. 618, 632 (1995) (restrictions on commercial speech must be reasonable and narrowly tailored to achieve the state’s desired objective). Following this principle, the Supreme Court has struck down prohibitions on attorney advertising without sufficient evidence to support the state interest or that were not narrowly tailored to prevent the specific consumer harm. *See, e.g., Zauderer v. Office of Disciplinary Counsel Of the Supreme Court of Ohio*, 471 U.S. 628, 638 (1985) (restrictions rooted on bald assertions without evidence of deception were struck down), *see also Peel v. Attorney Registration & Disciplinary Commission of Illinois*, 496 U.S. 91, 106 (1990) (rejecting for lack of evidence of deception an argument that a form of advertising was misleading) *see also Bates*, 433 U.S. at 372-74 (Same); *Mason v. Florida Bar*, 208 F.3d 952, 956 (11th Cir. 2000) (explaining that the state must demonstrate that the harms it recites are real and that its restrictions will alleviate the identified harm).

¹³ 466 U.S. 558, 568 (1984).

demand elasticities, and thus reduces market-wide prices.¹⁴ Several empirical studies appear to confirm that that when consumers face large costs to discover market prices, firms charge higher prices and enjoy larger margins.¹⁵

Some, however, have proposed consumer protection rationales for limiting attorney advertising. For example, because consumers are likely to have difficulty judging the quality of the services they receive, they may not be able to detect deceptive claims. Further, the relative infrequency with which most consumers purchase legal services may drastically reduce the disciplining role that reputation plays. These market characteristics could lead to a “lemons” problem, in which consumers assume that all advertisements are misleading, leading to an overall reduction in the level of service provided.¹⁶

Empirical research generally has found a negative relationship between (price and non-price) advertising and prices for legal services,¹⁷ and that prohibitions on

¹⁴ See, e.g., G. Stigler, *The Economics of Information*, 64 J. Pol. Econ. 213, 220 (1961). In addition, several economists have developed models that predict firms will be able to charge higher prices when consumers face high costs of obtaining marketplace information. See, e.g., Dale O. Stahl, *Oligopolistic Pricing with Sequential Consumer Search*, 79 AM. ECON. REV. 700 (1989); Kenneth Burdett & Kenneth L. Judd, *Equilibrium Price Dispersion*, 51 ECONOMETRICA 955 (1983); John Carlson & R. Preston McAfee, *Discrete Equilibrium Price Dispersion*, 91 J. POL. ECON. 480 (1983); Steven C. Salop & Joseph E. Stiglitz, *Bargains and Ripoffs: A Model of Monopolistically Competitive Price Dispersion*, 44 REV. ECON. STUDIES 293 (1977). Using these models as a theoretical framework, several authors have found evidence that the Internet has led to lower prices by reducing consumers’ costs of comparing prices. See, e.g., Jeffrey R. Brown & Austan Goolsbee, *Does the Internet Make Markets More Competitive? Evidence from the Life Insurance Industry*, 110 J. POL. ECON. 481 (2002); Erik Brynjolfsson & Michael D. Smith, *Frictionless Commerce? A Comparison of Internet and Conventional Retailers*, 49 MGM’T SCIENCE 563 (2000); James C. Cooper, *Price Levels and Dispersion in Online and Offline Markets for Contact Lenses*, FTC Bureau of Economics Working Paper (2006), available at <http://www.ftc.gov/be/workpapers/wp283.pdf>.

¹⁵ This comports with theories that restrictions limiting truthful attorney advertising reduce the incentive for attorneys to compete. H. Beales, et al., *The Efficient Regulation of Consumer Information*, 24 J.L. & Econ. 492 (1981); see also R. Pitofsky, *Beyond Nader: Consumer Protection and the Regulation of Advertising*, 90 Harv. L. Rev. 661, 670 (1977).

¹⁶ See Love & Stephen at 229.

¹⁷ See Timothy J. Muris, *California Dental Association v. Federal Trade Commission: The Revenge of Footnote 17*, 8 Sup. Ct. Econ. Rev. 265, 293-304 (2000) (discussing the empirical literature on the effect of advertising restrictions in the professions and citing, among others: James H Love and Jack H. Stephen,

professional advertising tend to lead to higher prices for these services.¹⁸ At the same time, these studies tend to find that overall quality levels in markets that permit advertising tends to be higher than in markets that limit attorney advertising.

Recognizing the value of advertising in promoting competition and consumer choice, the FTC has a long history of advising regulators not to adopt overly broad attorney advertising restrictions. The FTC Staff believes that although deceptive advertising by lawyers should be prohibited, restrictions on advertising and solicitation should be specifically tailored to prevent deceptive claims and should not unnecessarily restrict the dissemination of truthful and non-misleading information.¹⁹ Several recent

Advertising, Price and Quality in Self-regulating Professions: A Survey, 3 Intl. J. Econ. Bus. 227 (1996); J. Howard Beales & Timothy J. Muris, *State and Federal Regulation of National Advertising* 8-9 (1993); R.S. Bond, J.J. Kwoka, J.J. Phelan, and I.T. Witten, *Effects of Restrictions on Advertising and Commercial Practice in the Professions: The Case of Optometry* (1980); J.F. Cady, *Restricted Advertising and Competition: The Case of Retail Drugs* (Washington, D.C.: American Enterprise Institute, 1976); J.F. Cady, *An Estimate of the Price Effects on Restrictions on Drug Price Advertising*, 14 Econ Inq 490, 504 (1976); James H. Love, et al, *Spatial Aspects of Competition in the Market for Legal Services*, 26 Reg Stud 137 (1992); Frank H. Stephen, *Advertising, Consumer Search Costs, and Prices in a Professional Service Market*, 26 Applied Econ 1177 (1994)); In *the Matter of Polygram Holdings, In., et al.*; FTC Docket No. 9298, at 38 n.52 (F.T.C. 2003), *aff'd* 416 F.3d. 29 (D.C. Cir 2005)(same). See also Timothy J. Muris & Fred S. McChesney, *Advertising and the Price and Quality of Legal Services: The Case for Legal Clinics*, 1 American Bar Found. Res. J. 179, 184 (1979) (discussing that attorney advertising results in the phenomena of increased consumer requests for legal services coupled with lower prices and higher quality of services, particularly in specialized areas of the law); see Frank H. Stephen & James H. Love, *Regulation of the Legal Professions*, 5860 Encyclopedia of L. & Econ. 987, 997 (1999), available at <http://encyclo.findlaw.com/5860book.pdf> (empirical studies demonstrate that restrictions on attorney advertising have the effect of raising fees).

¹⁸ Kwoka AER; Haas Wilson; Benham & Benham; Feldman & Begun.

¹⁹ See, e.g., Letter from FTC Staff to the Florida Bar (Mar. 23, 2007), available at <http://www.ftc.gov/opa/2007/03/fyi07225.htm><http://www.ftc.gov/be/V070002.pdf>; Letter from FTC Staff to Louisiana State Bar Association (Mar. 16, 2007), available at <http://www.ftc.gov/os/2006/09/V060020-image.pdf><http://www.ftc.gov/be/V070001.pdf>; Letter from FTC Staff to Office of Court Administration of the New York Unified Court System (Sept. 14, 2006), available at <http://www.ftc.gov/os/2006/09/V060020-image.pdf>; Letter from FTC Staff to Committee on Attorney Advertising, the Supreme Court of New Jersey (Mar. 1, 2006), available at <http://www.ftc.gov/be/V060009.pdf>; see also, e.g., Letter from FTC Staff to Robert G. Esdale, Clerk of the Alabama Supreme Court (Sept. 30, 2002), available at <http://www.ftc.gov/be/v020023.pdf>. In addition, the staff has provided its comments on such proposals to, among other entities, the Supreme Court of Mississippi (Jan. 14, 1994); the State Bar of Arizona (Apr. 17, 1990); the Ohio State Bar Association (Nov. 3, 1989); the Florida Bar Board of Governors (July 17, 1989); New Jersey Supreme Court's Committee on Attorney Advertising (November 9, 1987), and the State Bar of Georgia (Mar. 31, 1987). See also Submission of the Staff of the Federal Trade Commission to the American Bar Association Commission on

advocacies highlight this approach. In 2006 and 2007, the FTC Staff offered attorney regulators in New York, Louisiana, New Jersey, Florida, and Texas guidance on proposed attorney advertising policies that risk harming consumers. Below is an analysis of specific restrictions found in these proposals.

In June 2006, the New York Unified Court System promulgated draft rules to impose significant restrictions to attorney advertising, and, in October, 2006, the Louisiana State Bar, following the model of the rules proposed in New York, circulated similar proposed restrictions. The New Jersey Supreme Court's Committee on Attorney Advertising proposed a rule that would restrict the use of testimonials, and the Florida Bar proposed a rule that would require, among other things, regulatory screening of certain forms of advertising. Subsequently, the New Jersey Supreme Court's Committee adopted an attorney advertising ethics opinion enforcing a prohibition against comparative advertising. In these cases, the FTC and the FTC Staff were concerned that several provisions in the proposals were overly broad, would restrict truthful advertising, and may adversely affect prices paid and services received by consumers. The FTC Staff submitted comments to the policymaking body in each jurisdiction, and the FTC filed a Brief Amicus Curiae in New Jersey, recommending significant changes to the proposed rules.²⁰

Advertising (June 24, 1994) (available online as attachment to Sept. 30, 2002, Letter to Alabama Supreme Court, *supra*).

²⁰ See Letter from FTC Staff to Office of Court Administration of the New York Unified Court System (Sept. 14, 2006), available at <http://www.ftc.gov/os/2006/09/V060020-image.pdf>; Letter from FTC Staff to Louisiana State Bar Association (Mar. 16, 2007), available at <http://www.ftc.gov/os/2006/09/V060020-image.pdf>; <http://www.ftc.gov/be/V070001.pdf>; Letter from FTC Staff to the Florida Bar (Mar. 23, 2007), available at <http://www.ftc.gov/opa/2007/03/fyi07225.htm>; <http://www.ftc.gov/be/V070002.pdf>; <http://www.ftc.gov/be/V070001.pdf>; And Letter from FTC Staff to Committee on Attorney Advertising, the Supreme Court of New Jersey (Mar. 1, 2006), available at <http://www.ftc.gov/be/V060009.pdf>; See also Brief of the Federal Trade Commission as *Amicus Curiae*

The FTC filings identified four main areas of concern in the proposed rules. First, in New York and Louisiana, many of the proposed rules related to the style and content of media advertising but did not necessarily target deception. Specifically, the rules sought to prohibit voice-overs or images of non-attorney spokespersons recognizable to the public, depictions of courtrooms or courthouses, portrayals of judges and lawyers by non-lawyers, portrayals of clients by non-clients, re-enactments of events or scenes or persons that are not actual, and Internet pop-up advertisements. Such techniques can be useful to consumers in identifying suitable providers of legal services, however, and are effective ways to reach consumers. The FTC Staff comments advised that the proposed constraints would prevent the use of common advertising methods that were unlikely to hoodwink unsuspecting consumers, who are usually familiar with them. Concerns that, for example, actors may be more poised or otherwise more appealing than actual clients could be addressed by requiring clear and prominent disclosures that the advertising used actors in lieu of a prophylactic ban on such techniques.

Second, the FTC filings expressed concern about limitations on comparative advertisements. In 2006, the New Jersey Supreme Court Committee on Attorney Advertising, applying a rule that bans all comparative advertisements, issued an ethics opinion banning attorneys from disclosing their ranking by certain attorney rating programs. Comparative advertising, including certain attorney ranking programs,²¹ can be a source of useful information to consumers and thus assist them in making rational

Supporting Arguments to Vacate Opinion 39 Of the Committee on Attorney Advertising Appointed by the Supreme Court of New Jersey, *available at* _____.

²¹ See Brief of the Federal Trade Commission as *Amicus Curiae* Supporting Arguments to Vacate Opinion 39 Of the Committee on Attorney Advertising Appointed by the Supreme Court of New Jersey, *supra* note 13, at 3-4, 12-14 (ratings programs serve a demand of consumers seeking to compare lawyers on price and quality).

purchase decisions, encourage competition, spur innovation, and lead to lower prices in the marketplace. Similarly, the proposed rules in New York, Louisiana and Florida sought to prohibit comparative advertising unless such claims can be objectively verified. The FTC filings advocate that although requiring that material claims be substantiated can serve consumers by helping to ensure that claims are not misleading, if substantiation is demanded for representations that, though not misleading, concern subjective qualities that are not easy to measure (i.e. the “friendly law firm”) and for which substantiation may not normally be expected, then messages that consumers find useful may be unnecessarily barred.

Third, the proposed rules in New York and New Jersey would prohibit paid endorsements and testimonials and would place significant restrictions on testimonials and endorsements from existing clients. Testimonials and endorsements can convey valuable information to consumers and spur competition and thus should not be prohibited outright unless they are deceptive. There can be risk of deception when, as explained in the FTC’s Endorsement Guides, there is a connection between the endorser and the seller of the advertised product that might materially affect the weight or credibility of the endorsement.²² In such cases, however, the Commission suggests that requiring disclosure rather than prohibiting such endorsements protects consumers while encouraging the truthful flow of information to consumer

Lastly, the proposed rules in New York, Louisiana, and Florida required that copies of all or some advertisements and solicitations be placed on file with the bar or court, and in Louisiana and Florida, the proposals sought to require that attorneys receive

²² See Federal Trade Commission Guides Concerning the Use of Endorsements and Testimonials in Advertising, 16 C.F.R. Part 255.5.

prior or concurrent approval before being promulgating the advertisements. The FTC Staff expressed concern that, as with other regulations on attorney advertising, these types of requirements likely raise the cost of doing business for attorneys and thus likely raise prices for consumers without providing countervailing benefits to consumers.

Also, as expressed in the Louisiana and Florida comments, competitive concerns arise when state bars, composed of competing attorneys, regulate and screen attorney advertising. As noted above, legitimate and fair industry self regulation, when implemented properly, can provide efficiencies and other benefits to consumers.²³ The comment explained that attorneys on the advertising committee, however, may have the incentive, and would have the ability, to limit advertising by competitors to soften competition rather than to protect consumers. The FTC Staff comments recommended that state bars forego the filing and screening rules in favor of enforcing the general prohibition against deceptive and misleading claims through sanctions for violations.

In May 2006, the FTC Staff filed comments with the Professional Ethics Committed of the State Bar of Texas as it considered whether rules prohibiting attorneys from paying for referrals precluded participation in on-line legal matching services.²⁴ Presently, many states require attorneys who wish to obtain legal referrals to do so only through certain approved programs, typically those operated by the local or regional bar associations, thus giving the bar association a near monopoly in providing referrals.

²³ See Deborah Platt Majoras, "Self Regulatory Organizations and the FTC," Address to the Council of Better Business Bureaus (April 11, 2005), available at <http://www.ftc.gov/speeches/majoras/050411selfregorgs.pdf>.

²⁴ See Letter from the Federal Trade Commission to the Professional Ethics Committee of the Texas State Bar, May 2006; <http://www.ftc.gov/os/2006/05/V060017CommentsonaRequestforAnEthicsOpinionImage.pdf>

Several businesses have begun to provide Internet-based attorney/client matching platforms as a competitive alternative to such approved referral services.²⁵

Typically, these services recruit licensed attorneys who pay a fee to participate. In their applications, member attorneys may disclose their areas of practice, years of experience at the bar, affiliations, and any other pertinent information. The client can examine the service's Web site to learn how attorneys become members of the service and how the service can help the client identify an attorney to satisfy his or her legal needs. If the client would like to seek legal assistance from a member attorney, he or she usually completes a short online questionnaire describing the legal issues, the practice area of the attorney being sought, the amount of experience desired for the retained attorney, the geographic region or jurisdiction of the representation, and the requested fee range. The service sends the questionnaire to attorneys in the designated practice area, and interested attorneys may send a response, which typically contains information such as fees, experience, and other qualifications. With this information, the client determines which attorneys – if any – to contact and initiates the contact. In some instances, the client's application may invite an attorney to contact a client directly.

The FTC advocacy letter explained how banning online legal matching services could harm consumers. Relative to many bar-operated referral programs, the on-line legal matching format allows consumers to compare more easily the price and quality among several competing attorneys. By lowering consumers' costs of obtaining information about price and quality of legal services, online legal matching services are

²⁵ Although not all services are identical, many share the same general business model. *See, e.g.*, LexisNexis/Martindale Hubbel's Attorney Match (http://www.lawyers.com/find_a_lawyer/am/am_aop_list.php); Casepost (<http://www.casepost.com>); LegalConnection (FindLaw) (<http://www.legalconnection.com>); LegalMatch (www.legalmatch.com); and Legal Fish (www.legalfish.com).

likely to allow consumers to pay lower prices and/or obtain higher quality legal services than they would have had they used their next best alternative means for identifying a legal service provider.²⁶ The FTC staff concluded that online legal matching services have the potential to lower consumer costs of obtaining information about the price and quality of legal services, which is likely to lead to more intense competition among attorneys, ultimately benefiting Texas consumers and noted that there was indication that consumers are likely to suffer harm from online legal matching services that would justify banning them.

Following the FTC advocacies, the New York Unified Court system promulgated revised rules incorporating nearly all of the FTC Staff's recommendations,²⁷ and the Texas State Bar adopted an opinion that allows attorneys to participate in on-line legal matching services.²⁸ The rules proposed in New Jersey, Louisiana and Florida are still pending before the respective policymaking bodies in those jurisdictions.

C. Practice of Law Restrictions

State unauthorized practice of law ("UPL") statutes define the "practice of law" and provide attorneys licensed to practice in that state the exclusive right to perform these services. Thus, the breadth of the definition of the practice of law determines the scope

²⁶ A pair of studies find that consumers who use an online service that sends consumer requests to an affiliate car dealer that sells cars matching the consumer's inquiry pay approximately 2 percent less for the same car compared to those who did not. Also, the authors found that those who were likely to be poor negotiators were more likely to use these services to increase their bargaining power. See Fiona Scott Morton *et al.*, *Internet Car Retailing*, 49 J. INDUS. ECON. 501 (2001); Florian Zettelmeyer *et al.*, *Cowboys or Cowards: Why are Internet Car Prices Lower?* (2005), at <http://flomac.haas.berkeley.edu/~florian/Papers/selection.pdf>.

²⁷ The revised Rules of the Unified Court System of New York (with red-lined changes comparing the initial draft) are available at http://www.nycourts.gov/rules/attorney_ads_amendments.shtml.

²⁸ See Tex. St. Bar Eth. Op., No. 573, available at http://www.texasbar.com/Template.cfm?Section=texas_bar_journal1&Template=/ContentManagement/ContentDisplay.cfm&ContentID=15929

of the attorney monopoly. UPL statutes vary in the degree of specificity with which they to they define the practice of law, but tend to be vague, leaving to courts the primary task of determining what actually constitutes the practice of law.²⁹

The agencies have become increasingly concerned about efforts to prevent non-lawyers from competing with attorneys in the provision of certain services through the adoption of overly broad UPL opinions and laws by state bar associations, courts, and legislatures. Since 1996, the agencies have worked to address these concerns principally through advocacy efforts. The antitrust agencies jointly authored a series of advocacy letters opposing laws, regulations, and other proposals that would broaden the definition of “unauthorized practice of law” in ways that would foreclose competition from other professionals in rendering particular services.

The agencies use three primary tools to convey their arguments in this area, depending on the audience. The two primary advocacy instruments are letters addressed to the bar association or legislature and legal briefs before the state court. Both are often announced by a press release that summarizes the facts and arguments to the public, at times attracting news media attention in the local jurisdiction. While the letters and briefs contain similar arguments, briefs are more formally structured to match the rules of the court, containing relevant cites to past cases in the jurisdiction. Through these letters and filings, the FTC has urged several states, the American Bar Association, and many

²⁹ For example, in states such as Connecticut, Nebraska, Michigan, and Illinois, the legislatures prohibit non-attorneys from “practicing law,” but leave it entirely to the courts to determine precisely what constitutes the practice of law. In other states, such as New York, Georgia and Alabama, the relevant statutes define certain acts in representation of another’s rights from drafting documents to representation in public as the practice of law. Other legislatures, such as Alaska’s, merely define the practice of law as merely holding out one-self as an attorney. In still other In Indiana, it was left for the Bar Association to propose, and for the Court to adopt, the definition of the practice of law and what areas would be free from competition from non-attorneys.

state bar associations to reject or narrow such restrictions on competition between attorneys and non-attorneys.³⁰ Many of these advocacy efforts have been successful in preserving attorney/non-attorney competition.³¹

The agencies have been concerned particularly about attempts to restrict non-lawyer competition in real estate closings.³² In the majority of states, non-lawyers compete with lawyers to provide real estate closing services. However, in the last few years, several state bar associations and legislatures have sought to adopt opinions that

³⁰ See letter from the Justice Department and the FTC to New York Assemblywoman Helen Weinstein (Jun. 21, 2006); letter from the Justice Department and the FTC to Executive Director of the Kansas Bar Ass'n (Feb. 4, 2005); letter from the Justice Department and the FTC to Task Force to Define the Practice of Law in Massachusetts, Massachusetts Bar Ass'n (Dec. 16, 2004); letter from the Justice Department and the FTC to Unauthorized Practice of Law Committee, Indiana State Bar Ass'n (Oct. 1, 2003); letter from the Justice Department and the FTC to Standing Committee on the Unlicensed Practice of Law, State Bar of Georgia (Mar. 20, 2003); letters from the Justice Department to Speaker of the Rhode Island House of Representatives and to the President of the Rhode Island Senate, *et al.* (Jun. 30, 2003 and Mar. 28, 2003); letter from the Justice Department and the FTC to Task Force on the Model Definition of the Practice of Law, American Bar Ass'n (Dec. 20, 2002); letter from the Justice Department and the FTC to Speaker of the Rhode Island House of Representatives, *et al.* (Mar. 29, 2002); letter from the Justice Department and the FTC to President of the North Carolina State Bar (July 11, 2002); letter from the Justice Department and the FTC to Ethics Committee of the North Carolina State Bar (Dec. 14, 2001); letter from the Justice Department to Board of Governors of the Kentucky Bar Ass'n (Jun. 10, 1999 and Sept. 10, 1997); letter from the Justice Department and the FTC to Supreme Court of Virginia (Jan. 3, 1997); letter from the Justice Department and the FTC to Virginia State Bar (Sept. 20, 1996). Brief *Amicus Curiae* of the United States of America and the FTC in *Lorrie McMahon v. Advanced Title Servs. Co. of W. Va.*, No. 31706 (filed May 25, 2004), available at <http://www.usdoj.gov/atr/cases/f203700/203790.htm><http://www.ftc.gov/be/V040017.pdf>; Brief *Amicus Curiae* of the United States of America and the FTC in On Review of ULP Advisory Opinion 2003-2 (filed July 28, 2003), available at <http://www.ftc.gov/os/2003/07/georgiabrief.pdf><http://www.usdoj.gov/atr/cases/f201100/201197.htm>; Brief *Amicus Curiae* of the United States of America in Support of Movants Kentucky Land Title Ass'n *et al.* in *Ky. Land Title Ass'n v. Ky. Bar Ass'n*, No. 2000-SC-000207-KB (Ky., filed Feb. 29, 2000), available at <http://www.usdoj.gov/atr/cases/f4400/4491.htm>. Advocacy letters are available at <http://www.usdoj.gov/atr/public/comments/comments.htm> and <http://www.ftc.gov/be/advofileother.htm>.

³¹ For example, the bill that was the subject of recent joint FTC and Justice Department comments to the New York State Assembly on April 27, 2007 was rejected by the Committee on the Judiciary. Similarly, in Kansas, following a February, 2005 joint letter, the Bar has tabled the proposed rules limiting attorney/non-attorney competition in a wide array of services that do not require the skill or knowledge of lawyer. Also, comments provided to the North Carolina Bar in 2001 and 2002 resulted in the bar adopting an ethics opinion that allowed for non-attorneys to provide settlement services.

³² Real estate closing services can include the preparation and execution of a deed, including the examination and clearing of title, answering non-legal questions during the closing process, witnessing signatures at closing, and disbursing of funds. A number of states either require or are considering requiring the presence of attorney at all residential real estate closings - sometimes even including refinancing of existing mortgages, where no real estate changes hands.

declare real estate closing services to be the practice of law, and thus prevent non-lawyers from closing real estate transactions. The FTC and DOJ also have commented on proposed practice of law definitions that would have affected competition between attorneys and non-attorneys in areas other than real estate. For example, In December 2002, the agencies sent a joint letter to the American Bar Association's Task Force on the Model Definition of Unauthorized Practice of Law, which had drafted a definition of unauthorized practice of law for consideration by state legislators and regulators.³³ The model definition implicated consumer use of popular software programs for writing wills and preparing other legal documents, since these programs could be considered rendering legal advice if they provide suggestions in response to information input by the customer, and also the ability of non-lawyer advocates to compete with attorneys to give legal information and resolve problems for consumers.

The touchstone of the Agencies' analysis is consumer welfare. There may be circumstances requiring the knowledge and skill of a person trained in the law. For example, UPL statutes may be a means to address a market failure due to the information asymmetry between consumers and legal service providers discussed above. To the extent that consumers have difficulty assessing the quality of services they receive, requiring consumers to use attorneys, who are certified to possess some minimum level of qualifications – e.g., passing a state bar examination, graduation from an accredited law school – may solve a market failure. Further, only attorneys are subject to the state supreme court rules, which might be efficient ways to mitigate moral hazard problems that arise under such severe information asymmetries. We advise states, however, to

³³ Letter from FTC and Justice Department to the Task Force on the Model Definition of the Practice of Law, American Bar Ass'n (Dec. 20, 2002), available at <http://www.ftc.gov/opa/2002/12/lettertoaba.htm>;

view UPL restrictions through a consumer welfare lens and to consider not just the harm that consumers may suffer from allowing non-attorneys to perform certain tasks, but also the harm to consumers when they are deprived of the competition between attorneys and non-attorneys. Ultimately, a state should ban non-attorney competition to provide a service only if the proponents of such a restriction can demonstrate that it is necessary to provide consumers with something that they value more than the loss in competition from non-attorneys.

In advocacy letters and briefs, we explain how limiting non-attorney competition is likely to harm consumers in two ways. First, it deprives consumers of a low-price option. For example, UPL laws that prevent non-attorneys from providing real estate closing services reduce consumer choice and increase the price of closing services for consumers who otherwise would hire a non-attorney.³⁴ Some more general UPL proposals, moreover, would require an attorney for the selection or modification of legal forms, negotiating regarding any transaction involving property (real or personal), preparing documents related to the sale of property, performing real estate closing services, and other services. We have noted that such broad definitions of the practice of law are likely unnecessarily to restrain competition in service areas that do not necessarily require the skill or knowledge of a lawyer to perform.³⁵

³⁴ For example, in 1997 Virginia enacted the Consumer Real Estate Settlement Protection Act (CRESPA), which codified the right of consumers to use lay closing services. Proponents of lay competition pointed to survey evidence suggesting that lay closings in Virginia cost on average approximately \$150 less than attorney closings.

³⁵ See Letter from FTC Staff to Superior Ct. of Connecticut (May 17, 2007), at ___; Letter from FTC and Justice Department to Executive Director of the Kansas Bar Ass'n (Feb. 4, 2005) at 5-7 (discussing the types of non-attorney competition that may be restricted under a similar proposal in that jurisdiction.); see also <http://www.ftc.gov/be/v050002.pdf> joint letter from the FTC and Justice Department to Task Force to Define the Practice of Law in Massachusetts, Massachusetts Bar Ass'n (Dec. 16, 2004) at 6-9 (same).

Second, to the extent that non-attorneys provide competitive constraint on attorney pricing, these UPL restrictions also are likely to raise the price that consumers who prefer to hire an attorney pay for their services. For example, the available empirical evidence suggests that the availability of lay service providers for real estate closings puts competitive pressure on the fees attorneys charge for the same service.³⁶ Evidence gathered in a New Jersey Supreme Court proceeding that allowed lay closings indicated that, in parts of New Jersey where lay closings are prevalent, buyers represented by counsel paid on average \$350 less for closings and sellers represented by counsel paid \$400 less than in parts where lay closings were not prevalent.³⁷ Likewise, the Kentucky Supreme Court concluded that prices for real estate closings for lawyers dropped substantially as a result of competition from lay title companies, explaining that the lay competitors' presence "encourages attorneys to work more cost-effectively."³⁸

At the same time, the Agencies are not aware of any evidence of widespread consumer harm due to non-attorneys performing tasks that may fall within the scope of some of the broad UPL language on which we have commented. For example, we explain in our advocacy comments that empirical studies have compared attorney and non-attorney provisions of certain services and have found that consumers likely face little risk of harm from non-attorney competition in many areas.³⁹ A 1999 survey found

³⁶ See, e.g., *Countrywide Home Loans, Inc. v. Ky. Bar Ass'n*, 113 S.W.3d 105, 120 (Ky. 2003) ("before title companies emerged on the scene, [the Kentucky Bar Association's] members' rates for such services were significantly higher").

³⁷ See *In re Opinion No. 26*, 654 A.2d 1344, 1348-49.

³⁸ *Countrywide Home Loans, Inc.*, 113 S.W.3d at 120.

³⁹ See, e.g. Deborah Rhode, *Access to Justice: Connecting Principles to Practice*, 17 GEO. J. LEGAL ETHICS 369 (2004). See also HERBERT M. KRITZER, LEGAL ADVOCACY: LAWYERS AND NON LAWYERS AT WORK 50-51 (1998) (finding that in unemployment compensation appeals before the Wisconsin Labor and Industry Review Commission, "[t]he overall pattern does not show any clear differences between the success of lawyers and agents").

that complaints about the unauthorized practice of law in most states did not come from consumers, the potential victims of such conduct, but from attorneys, who did not allege any claims of specific injury.⁴⁰ Another study compared five states where lay providers examined title evidence, drafted instruments, and facilitated the closing of real estate transactions with five states that prohibit lay provision of these settlement services.⁴¹ The author found “[t]he only clear conclusion” to be “that the evidence does not substantiate the claim that the public bears a sufficient risk from lay provision of real estate settlement services to warrant blanket prohibition of those services under the auspices of preventing the unauthorized practice of law.”⁴²

Despite finding no evidence that consumers are harmed by non-attorney competition in certain areas, in advocacy comments the Agencies also have suggested less restrictive ways to protect consumers from perceived harm. For example, clarifying or adding commentary to proposed rules that are unnecessarily broad due to vagueness, can limit the scope of the attorney monopoly to those tasks that truly require legal skill and training. Further, rather than banning non-attorney closing services altogether, requiring disclosures to explain to consumers the risks involved in proceeding in a real estate transaction without an attorney can protect consumers from potential misunderstanding while preserving the benefits from competition between attorneys and non-attorneys.³⁰

⁴⁰ See Rhode, *supra* n. 32, at 408.

⁴¹ Joyce Palomar, *The War Between Attorneys and Lay Conveyancers – Empirical Evidence Says “Cease Fire!”*, 31 CONN. L. REV. 423 (1999).

⁴² *Id.* at 520.

³⁰ *In re Opinion No. 26*, 654 A.2d at 1363.

II. Real Estate Brokerage

A. General U.S. Regulatory Framework

Although the terms may vary by state, there are two principal categories of real estate brokerage professionals: “agents” and “brokers.” Generally speaking, agents work directly with consumers and brokers supervise agents. Typically, agents solicit listings, work with homeowners to sell their homes, and show buyers homes that are likely to match their preferences. Instead of working with customers directly, brokers often provide agents with branding, advertising, and other services that help the agents complete transactions. In terms of branding, the broker may invest in and create a brand or affiliate with a national or regional franchisor that provides a brand with certain reputational value and an advertising campaign.⁴³ As for services, brokers may provide agents with computers, website hosting, office space, training, and marketing. States establish licensing requirements for both agents and brokers, and state commissions, frequently composed of real estate brokers, enforce compliance with state laws and regulations.

States require real estate brokers and agents to be licensed. These licensing statutes form the framework for state regulation and oversight of the profession by establishing requirements for licensure (such as minimum age, education, and experience) and various requirements and prohibitions regarding business practices and conduct. Although real estate brokerage is not formally a self-regulated industry, state real estate commissions – which oversee drafting of and compliance with these laws and

⁴³ Century 21, ReMax, and Coldwell Banker are examples of national franchise brands.

regulations – typically are composed primarily of real estate brokers.⁴⁴ Local multiple listing services (“MLSs”) and the National Association of Realtors (“NAR”) also govern the conduct of real estate agents and brokers. NAR is the national organization of real estate brokers, and membership is mandatory to participate in NAR-affiliated MLSs. MLSs, are local or regional joint ventures of real estate brokers, typically operated by a local group of brokers affiliated with the NAR, who pool and disseminate information on homes available for sale in their particular geographic areas.⁴⁵ NAR promulgates a code of ethics that applies to all of its members, and NAR-affiliated MLSs adopt rules – many of which are developed by NAR – that govern how agents and brokers conduct business through the MLS.

Real estate agents and brokers are subject to the antitrust laws, and MLSs have come under significant antitrust scrutiny.⁴⁶ Indeed, recently the Agencies have sued several MLSs⁴⁷ and NAR⁴⁸ for developing rules that are likely to harm competition by disadvantaging non-traditional brokers and agents. As evidenced by recent DOJ actions discussed *infra*, anticompetitive rules adopted by real estate commissions can be subject

⁴⁴ See PATRICK WOODALL & STEPHEN BROBECK, CONSUMER FEDERATION OF AMERICA, STATE REAL ESTATE REGULATION: INDUSTRY DOMINANCE AND ITS CONSUMER COSTS 3 (July 2006), available at http://www.consumerfed.org/pdfs/CFA_Real_Estate_Commissioner_Report.pdf.

⁴⁵ NAR’s 1,600 local and state member boards control approximately 80 percent of the approximately 1,000 MLSs in the United States. See Amended Complaint at 5, *United States v. Nat’l Ass’n of Realtors* (N.D. Ill. Oct. 4, 2005).

⁴⁶ See, e.g., *Reifert v. South Central Wisconsin MLS Corp.*, 450 F.3d 312 (7th Cir. 2006); *Thompson v. Metropolitan Multi-List, Inc.*, 934 F.2d 1566 (11th Cir. 1991); *United States v. Realty Multi-List*, 629 F.2d 1351, 1370 (5th Cir. 1980); *Austin Bd. of Realtors v. E-Realty, Inc.*, No. Civ. A-00-CA-154 JN, 2000 WL 34239114, at *4 (W.D. Tex. Mar. 30, 2000).

⁴⁷ See *MiRealSource, Inc.*, FTC Dkt. No. 9321; *Austin Bd. of Realtors*, FTC Dkt. No. C-4167; *Information and Real Estate Services, LLC*, FTC File No. 061-0087; *Northern New England Real Estate Network, Inc.*, FTC File No. 051-0065; *Williamsburg Area Ass’n of Realtors, Inc.*, FTC File No. 061-0268; *Realtors Ass’n of Northeast Wisconsin, Inc.*, FTC File No. 061-0267; *Monmouth County Ass’n of Realtors, Inc.*, FTC File No. 051-0217.

⁴⁸ See *United States v. Nat’l Ass’n of Realtors*, 2006 WL 34344263 at *14 (N.D. Ill. Nov. 27, 2006), available at <http://www.usdoj.gov/atr/cases/f219800/219889.htm>.

to antitrust challenge as well. However, when states pass legislation that restricts competition, competition advocacy may be the only tool at our disposal to promote consumer welfare.⁴⁹

In the remainder of this section, I discuss agency actions related to two state-imposed restrictions on competition: minimum-service requirements and prohibitions on rebates.

B. Minimum-Service Requirements

Relatively recently, several states have enacted so-called minimum-service requirements. As the name suggests, these laws enumerate specific tasks that a real estate broker must provide his or her client. These laws typically require a broker to set up appointments for showings, provide assistance and advice on offers, counteroffers, and negotiations, although some also require a broker to provide assistance in closing the transaction as well. Currently, seven states have minimum-service requirements⁵⁰ and five recently have considered minimum-service provisions.⁵¹

These laws restrain consumer choice and are likely to harm competition in the real estate brokerage market. In certain discount listing packages, an limited-service broker (“LSB”) typically will not include assistance with offers and counteroffers or negotiations. Thus, minimum-service laws force LSBs either to cease providing the MLS-only package or increase the services provided with it, which will increase costs

⁴⁹ However, the Supreme Court has struck down laws that require parties to engage in conduct that is per se illegal under the antitrust laws. See *324 Liquor Corp. v. Duffy*, 479 U.S. 335 (1987); *California Retail Liquor Dealers Ass’n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 105 (1980).

⁵⁰ Alabama, Illinois, Indiana, Iowa, Missouri, Texas, and Utah.

⁵¹ Idaho, Kentucky, Michigan, Mississippi, and New Mexico.

and force LSBs either to accept lower profits or raise prices on packages that require additional services to meet state requirements.

The Agencies have explained in advocacy letters to several states that to the extent that minimum-service laws cause brokers to increase the price they charge for limited-service packages to cover costs for providing additional service that the state requires, they harm consumers in two ways.⁵² First, these laws frustrate consumer choice by reducing the options available to consumers in the marketplace; consumers who would otherwise choose a limited-service option that does not meet state minimum service requirements are harmed because they can no longer choose their preferred option.⁵³

Forcing consumers who would otherwise prefer a limited service option such as an MLS-only package that does not contain minimum services to choose a less preferred option can significantly increase the amount these consumers will pay for brokerage services. Consider the example of a consumer who is likely to sell his or her home for \$271,267⁵⁴ and, absent a minimum-service law, would have paid \$8,638 (\$500 listing fee plus a 3 percent commission for a cooperating broker) for a flat-fee listing. If, due to the minimum-service law, this home seller purchases full-service brokerage at a 5.1 percent

⁵² See Letter from FTC and Justice Department to Michigan State Sen. Alan Sanborn (Oct. 18, 2005), at <http://www.ftc.gov/os/2005/10/051020commmihousebill4849.pdf>; Letter from the FTC and the Justice Department to Governor Matt Blunt (May 23, 2005), at <http://www.ftc.gov/opa/2005/05/mrealestate.htm>; Letter from the FTC and the Justice Department to Alabama Senate (May 12, 2005), at <http://www.ftc.gov/os/2005/05/050512tralabamarealtors.pdf>; Letter from the FTC and the Justice Department to Loretta R. DeHay, Gen. Counsel, Texas Real Estate Comm'n. (Apr. 20, 2005), at http://www.usdoj.gov/atr/public/press_releases/2005/208653a.htm.

⁵³ In the face of minimum service requirements that increase the price of an LSB's base package, consumers may decide to purchase more or less brokerage services than they otherwise would. For example, a consumer may decide to perform the entire transaction on his or her own, sacrificing the brokerage services that he or she otherwise would purchase. Alternatively, a consumer may hire a traditional broker who will assist him or her with every aspect of the transaction or purchase a brokerage package that provides more service than an MLS-only listing, but less than a traditional package. Regardless of which alternative is chosen, home sellers are now worse off because they cannot choose their preferred combination of price and service.

⁵⁴ 2005 weighed average home price for new home and existing home sales.

commission rate, she will pay \$13,563 for brokerage services – \$4,924 more than she would pay for a flat-fee listing. Similarly, with minimum-service laws in place, the consumer may opt for an augmented MLS-only package that satisfies state requirements or a “flat-fee plus” package. This likely will require an additional expenditure of at least between \$100 and \$500.⁵⁵

Second, minimum service laws also are likely to reduce the competitive constraint LSBs impose on full-service brokers (“FSBs”). In states without minimum service laws, a consumer typically can choose an MLS-only package as the lowest price/lowest service level option. LSBs in minimum-service states now must include the enumerated additional tasks in their base-level packages, which often results in a higher price due to the increased costs and time commitments associated with each transaction.⁵⁶ A FSB who wants the business of a consumer who might otherwise consider limited-service brokerage will need to offer lower commissions and/or increased quality to induce the consumer to choose to purchase the additional services offered by an FSB. If LSBs are forced to raise their prices in response to minimum-service laws, consumers who choose

⁵⁵ See *supra* note 16.

⁵⁶ According to their Web sites, some LSBs located in Alabama, Texas, and Utah, for example, charge a normal flat fee for an MLS-only package, but also include an additional ½ percent commission due at closing. See, e.g., Crawford Realty, at http://www.crawfordrealtyofalabama.com/one_time_fee.htm; Discount Realty, at <http://www.discountrealty.biz/12.html>; Houston My Castle, at <http://www.mycastlefsbo.com>. Press accounts also indicate that LSBs have raised their prices or exited the market altogether in response to minimum-service laws. See Glenn Roberts Jr., *Flat-fee brokers adapt to new real estate law Texas' new minimum-service law enacted Sept. 1*, INMAN NEWS (Oct. 12, 2005), available at <http://www.inman.com/inmannews.aspx?ID=48325>; see also <http://www.texasdiscountrealty.com/laws.htm> (Web site of Texas Discount Realty explaining that “because of the added responsibilities forced on to you, the seller and us the broker, by [the Texas minimum service law], we are forced, as most brokers to adjust our prices); Tracy Donhardt, *New Law Provides Realtors and Edge*, INDIANAPOLIS BUSINESS JOURNAL (July 10, 2006), available at <http://indybiznow.com/Default.aspx?TabId=391&issueyear=2006&issuemonth=07&issueday=10&page=1&article=Ar00101> (noting that Indiana’s minimum service law has caused at least one limited-service broker to exit the market).

FSBs are also likely to pay higher prices for real estate brokerage due to a reduction in the competitive constraint provided by LSBs.⁵⁷ Finally, although decisions to buy or sell a home are likely to be driven to a large extent by exogenous factors (e.g., change in work or family situations), the supply and demand for homes are not likely to be perfectly price inelastic.⁵⁸

Advocates for minimum-service laws have raised several consumer protection concerns that they argue necessitate minimum-service laws. First, some contend that they are necessary to prevent consumers from being deceived into believing that an LSB will provide more services than they actually do.⁵⁹ Similarly, some have expressed concerns that consumers have certain expectations about the services a real estate broker will provide that are disappointed by limited-service contracts.⁶⁰ Others have taken a more paternalistic stance, arguing that minimum-service laws are needed because consumers

⁵⁷ An FSB that is unable to offer different prices to different home sellers will base its pricing decisions on those home sellers who are indifferent between hiring an FSB and an LSB. The degree to which LSB pricing constrains FSB pricing increases as the proportion of consumers who are indifferent between LSBs and FSBs at current prices becomes greater. If an FSB is able to offer different prices to different home sellers, an FSB is likely to offer lower prices only to those home sellers who are indifferent between FSBs and LSBs and those who prefer LSBs at current prices. If LSBs similarly are able to target price discounts to home sellers who prefer full-service brokerage at current prices, however, this could lead FSBs to lower the prices they charge to these home sellers as well. This sort of “competitive price discrimination” by differentiated home sellers can lead to lower prices for all consumers compared to a uniform price equilibrium. See James C. Cooper et al., *Does Price Discrimination Intensify Competition? Implications for Antitrust*, 72 ANTITRUST L.J. 327 (2005); Kenneth S. Corts, *Third-Degree Price Discrimination in Oligopoly: All-out Competition and Strategic Commitment*, 29 RAND J. ECON. 306 (1998).

⁵⁸ The 2005 NAR Homebuyers and Sellers report finds that forty percent of home sellers decided to sell their homes due to factors that are likely to be within their control: 22 percent of consumers listed wanting a larger house as the primary reason for selling, nine percent listed wanting to move closer to a family member, and nine percent listed the neighborhood having become less desirable.⁵⁸ Thus, an increase in transaction costs associated with selling real estate is likely to reduce the number of consumer real estate transactions that occur.

⁵⁹ Thorburn, tr. at 96.

⁶⁰ See, e.g., GAO REPORT at 16.

are unable to handle a real estate transaction without a brokers' assistance.⁶¹ Some commentators also have contended that consumers who hire limited-service brokers are subject to so-called hold-up, because once a consumer has entered into an exclusive agreement with an LSB, she effectively is locked into that broker to purchase all additional brokerage services that she subsequently may need.⁶²

Another line of argument is that these laws are needed to protect cooperating brokers who represent buyers in a transaction where the seller has entered into a limited-service contract. Such sellers foist external costs upon cooperating brokers by jeopardizing the transaction due to their inexperience. In this scenario, a cooperating broker may have to explain aspects of the transaction to the seller or perform some of the tasks related to removing contingencies and closing the transaction typically performed by the listing agent. Further, some brokers state that minimum service laws are necessary because they fear liability for undisclosed dual agency. In situations where the cooperating broker is an agent of the buyer, but provides assistance to a seller, he risks becoming an undisclosed dual agent, which can give rise to legal liability for both the broker and the buyer.⁶³ At the same time, however, refusing to help an unrepresented seller may jeopardize a transaction that the buyer wants to close.

⁶¹ Peter G. Baker, *Hiring a Broker: Should You Expect Less?* Available at http://realtymtimes.com/rtpages/20060411_hirebroker.htm (April 11, 2006).

⁶² Darryl W. Anderson, *Minimum Service Requirements in Real Estate Brokerage: A Response to Maureen K. Ohlhausen*, ANTITRUST SOURCE, Jan. 2006, at 3-4 (“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 services after she had already had entered into the limited service agreement and signed the exclusive agency agreement.”).

⁶³ See Katherine A. Pancak et al., *Real Estate Agency Reform: Meeting the Needs of Buyers, Sellers, and Brokers*, 25 REAL ESTATE L.J. 345, 350 (1997) (noting that agency relationships can be created by actions).

The Agencies have noted in advocacy letters that there does not appear to be an empirical basis for these concerns; there is a dearth of evidence to suggest that minimum service laws address any problem. For example, there is no indication that consumers who employ LSBs misunderstand the nature of the contractual relationship into which they enter.⁶⁴ Nor is there evidence of an increased prevalence of complaints with state agencies against LSBs. For example, a participant at a workshop on real estate competition that the Agencies hosted⁶⁵ reported that in 2004 there were over 3,500 complaints filed with the Texas Real Estate Commission against brokers and agents, but there has never been a complaint filed against an LSB.⁶⁶ This observation is consistent with what FTC and DOJ staff have learned in discussions with Texas and other states. Indeed, a recent NAR survey found the vast majority of LSB clients to be satisfied with the service they received.⁶⁷ Not surprisingly, testimony provided at the Workshop suggests that the impetus for these laws comes not from aggrieved consumers, but from state Realtor associations.⁶⁸

⁶⁴ The rhetoric sometimes compares entering into a real estate transaction to surgery. “[Government agencies] argue that with disclosures and waivers consumers should be able to refuse any brokerage service or obligation. . . . We do not, for example, allow consumers to save money by hiring doctors who cut costs by not sterilizing surgical instruments or washing their hands.” Peter G. Baker, *Hiring a Broker: Should You Expect Less?* Available at http://realtytimes.com/rtpages/20060411_hirebroker.htm (April 11, 2006).

⁶⁵ See *Competition Policy in the Real Estate Industry* (Oct. 25, 2005) at <http://www.ftc.gov/bc/realestate/workshop/index.htm>.

⁶⁶ Farmer, tr. at 73.

⁶⁷ See 2006 NAR Survey at__.

⁶⁸ See Farmer, tr. at 71-72 (“In Texas, the law was filed or the amendment was tacked onto the housekeeping law by a state representative who also happens to be a real estate broker out of El Paso and also happens to be a ranking member in the Texas Association of Realtors. . . . [I]n Utah, a minimum service law recently passed, and it was pushed through by a state senator out of Utah who also happens to be the President this year of the National Association of Realtors”). Consistent with brokers, not consumers, being behind minimum-service laws, the Consumer Federation of America, a long-standing consumers’ rights watchdog organization, issued a report that was critical of minimum-service laws,

The Agencies also are unaware of any increased incidence of undisclosed dual agency problems associated with limited-service brokerage and there is no indication that the marketplace is not adequate to address concerns that cooperating brokers may face special risks when dealing with sellers subject to a limited-service contract. Buyers use cooperating brokers because they have access to the MLS and experience in closing real estate transactions. Moreover, a cooperating broker's commission is protected by the MLS rules and regulations and cooperating brokers know exactly how much they will be paid if they procure a buyer for a home.

Because cooperating brokers can make a choice as to whether or not the compensation offered through a co-broke, or from their buyer, is worth the effort that it will take to close a transaction, there is no need for a minimum-service law to "protect" them from doing additional work. Cooperating brokers are free to take unilateral action to avoid listings that are likely to present special risks, and buyers may need to compensate brokers directly for any additional risk attendant to closing a transaction involving a limited-service listing.⁶⁹

Our advocacy in this area also suggests that concerns can be dealt with in far less-restrictive manners than a complete ban of this business model. For example, requiring disclosure appears to be a far less restrictive solution than a complete ban on limited-service brokerage to ensure that consumers understand the nature of the contract they

contending that they "discourage competition" by "making it difficult for internet-based or other limited service firms to function." CONSUMER FEDERATION OF AMERICA, HOW THE REAL ESTATE CARTEL HARMS CONSUMERS AND HOW CONSUMERS CAN PROTECT THEMSELVES (June 2006), *available at* http://www.consumerfed.org/pdfs/Real_Estate_Cartel_Study061906.pdf.

⁶⁹ Avoiding limited-service listings without disclosure to buyers may raise issues concerning the fulfillment of fiduciary duties. *See* Part 5.C. *infra* (discussing the issues related to steering).

have with their real estate broker. Further, such disclosure will inform the seller that they cannot expect any assistance from the cooperating broker. In fact, NAR has agreed that disclosure creates “appropriate expectations” for all parties in the transaction to avoid undisclosed dual agency.⁷⁰ Further, licensing laws or regulations could be amended to clarify that negotiation with a party who has chosen not to use his broker for such negotiations do not imply an agency relationship. Ohio,⁷¹ Virginia,⁷² and Wisconsin⁷³ recently have adopted this approach. Finally, although there is no reason to believe that consumers currently cannot ascertain LSBs’ prices in advance – they are clearly stated on most LSB Web sites and there appears to be no impediment to consumers asking – concerns over lock-in could be addressed through laws requiring LSBs clearly to disclose all of their prices for subsequent services up-front.

C. Prohibitions on Rebates

Rebates (*i.e.*, cash payments) and inducements (*e.g.*, gift certificates, coupons, vouchers, and discounted or free services relating to buying and selling property) are incentives that cooperating brokers offers to home buyers to encourage them to use that broker’s services. Rebates typically are cash payments from the broker to his or her

⁷⁰ Blanche Evans, *Where Real Estate Associations Stand On MLS-Entry-Only Listings*. Available at http://realtytimes.com/rta/pages/20050224_mlsentryonly.htm, (February 24, 2005).

⁷¹ OHIO CODE § 4735.75(B) (“A licensee who negotiates directly with a seller, purchaser, lessor, or tenant pursuant to a written authorization as described in division (A) of this section does not violate division (A)(19) of section 4735.18 of the Revised Code and negotiations conducted by a licensee pursuant to the authorization shall not create or imply an agency relationship between that licensee and the client of that exclusive broker.”)

⁷² See VA. CODE § 54.1-2132(C) (effective Jul. 7, 2007) (“A licensee engaged by a seller in a real estate transaction may, unless prohibited by law or the brokerage relationship, provide assistance to a buyer or potential buyer by performing ministerial acts. Performing such ministerial acts that are not inconsistent with subsection A shall not be construed to violate the licensee’s brokerage relationship with the seller unless expressly prohibited by the terms of the brokerage relationship, nor shall performing such ministerial acts be construed to form a brokerage relationship with such buyer or potential buyer.”).

⁷³ WI. CODE § 452.133(6).

client after closing. Rebates and inducements (collectively referred to as “rebates”) are important under the traditional structure of real estate transactions because the seller and seller’s broker, not the buyer’s broker, determine the amount of the commission via the listing agreement. Without the ability to rebate, the buyer’s broker has no direct control over the amount of the commission. If the buyer’s broker were simply to reduce his commission, the savings would go to the seller’s broker, not to the home buyer. Rebates, in contrast, go directly to the buyer; for example, a buyer’s broker can offer a prospective home buyer \$1,000 (payable from the broker’s commission), if the buyer agrees to hire that broker. Some brokers rebate up to half of their commission to their buyers. Because cooperating brokers typically receive 50 percent of the overall commission, returning half of their commission to their client represents a 25 percent discount on the overall commission payment. This direct-to-consumer benefit means that rebates become powerful tools for price competition between brokers.⁷⁴

Rebates are permitted in most states, and brokers in these states may freely advertise their willingness to offer rebates that save consumers hundreds and often thousands of dollars per transaction. Rebates currently are prohibited by law, however, in ten states.⁷⁵ Rebate bans inhibit price discounting and thereby harm consumers. For example, in states allowing rebates, some brokers operate business models pursuant to which they rebate up to one-third or one-half of their commission to their buyers. Because cooperating brokers typically receive 50 percent of the overall commission, a

⁷⁴ All such rebates and inducements will be referred to generally as “rebates,” and state laws and regulations prohibiting rebates will be referred to generally as “rebate prohibitions” or “rebate bans.”

⁷⁵ Alabama, Alaska, Kansas, Louisiana, Mississippi, Missouri, New Jersey, North Dakota, Oklahoma, and Oregon. In addition, Iowa prohibits rebates when the customer uses the services of two or more brokers during a real estate transaction.

broker who returns half of his or her commission to the client provides a 25 percent discount on the overall commission payment; rebating one-third provides approximately a 16 percent discount. For example, if a cooperating broker were to earn half of a 5.1 percent commission and offer a 50 or 33.3 percent rebate, a consumer would save \$3,459 or \$2,306 in commission payments, respectively, on the sale of a \$271,263 home.⁷⁶ Consumers in states with rebate bans could enjoy a similar level of savings only if such bans were eliminated.

Although action by a state through legislation is generally immune from federal antitrust enforcement, when actors other than the state itself (*e.g.*, the legislature or state supreme court) unreasonably restrict competition under the guise of state authority, those actions may be subject to antitrust scrutiny.⁷⁷ Accordingly, when state real estate commissions have imposed rebate bans, DOJ has investigated, and where appropriate challenged, these restrictions. For example, in March 2005, DOJ filed a civil antitrust lawsuit against the Kentucky Real Estate Commission, alleging that its regulations prohibiting Kentucky real estate brokers from offering rebates restricted competition and caused consumers to pay higher prices for real estate brokerage services.⁷⁸ The lawsuit was settled on July 13, 2005. Under the terms of the settlement, which was approved by

⁷⁶ Based on weighted average sales price of new and existing homes in 2005 (\$271,263), the buyer's broker's share of a \$13,834 commission would be \$6,917. A buyer who is rebated half of this would receive \$3,459. See HUD REPORT, *supra* note 201.

⁷⁷ See, *e.g.*, *Hoover v. Ronwin*, 466 U.S. 558, 568 (1984) ("Closer analysis is required when the activity at issue is not directly that of the legislature or supreme court, but is carried out by others pursuant to state authorizations."); *Southern Motor Carriers Rate Conference v. United States*, 471 U.S. 48, 62-63 (1985) (public utility commission not the state itself); *Goldfarb v. Virginia State Bar*, 421 U.S. 773, 791-92 (1975) (attorney fee schedule established by county bar association was not immune from antitrust liability).

⁷⁸ See Complaint, *United States v. Kentucky Real Estate Comm'n*, Civil Act. No. 3:05CV188-H (filed Mar. 31, 2005) (hereinafter "Kentucky Complaint"), at <http://www.usdoj.gov/atr/cases/f208300/208393.htm>.

a federal judge, the Kentucky Real Estate Commission agreed to cease enforcement of its rebate prohibitions,⁷⁹ allowing Kentucky consumers to avail themselves of the benefits of increased competition through broker-offered rebates, discounts, and other inducements.⁸⁰

During the course of the investigation, DOJ found evidence that brokers wanted to restrict rebates because they understood that rebates are a form of price competition. As noted in the Complaint, in response to a survey asking brokers whether the Kentucky Real Estate Commission should retain the rebate ban, one broker predicted “[I]f we give rebates and inducements, it would get out of control and all clients would be wanting something. The present law keeps it under control.”⁸¹ Another broker predicted: “This [lifting the rebate ban] would turn into a bidding war, lessen our profits and cheapen our ‘so-called’ profession.”⁸² Another broker observed: “If inducements were allowed, they

⁷⁹ See Amended Final Judgment and Order, *United States v. Kentucky Real Estate Comm’n*, Civ. Action No. 3:05CV188-H, available at <http://www.usdoj.gov/atr/cases/f210100/210142.htm>.

⁸⁰ Since the consent decree was entered, consumers in Kentucky have benefited from new reduced price business models. For example, one realty company offers a 1% cash back rebate program for home buyers; another offers rebates worth up to \$2,250 in the form of HomeDepot or American Express gift cards; and another offers to pay moving costs of up to \$1,500 to consumers who buy particular properties. Two other companies together operate a program that rebates up to \$3,000 for the sale or purchase of a home, which can yield a combined maximum rebate of \$6,000 when a customer buys one property and sells another through the program when he or she moves. For more on types of rebates offered in Kentucky and nationwide, see, e.g., Mariwyn Evans, *Law: Consumer Rebates*, REALTOR MAGAZINE ONLINE (Jan. 1, 2006), available at <http://www.realtor.org/rmoprint.nsf/pages/lawjan06>; Jessica Swesey, *Internet stock brokerage pioneers enter online real estate*, INMAN NEWS (Apr. 6, 2006), available at <http://www.inman.com/inmannews.aspx?ID=50907>.

⁸¹ Kentucky Complaint at 3.

⁸² *Id.* at 3.

could lead to competitive behavior, which would make us look unprofessional in the eyes of the public.”⁸³

DOJ also investigated rebate bans by the South Dakota Real Estate Commission, the West Virginia Real Estate Commission, and the Tennessee Real Estate Commission. In response to these investigations, the South Dakota and West Virginia Real Estate Commissions rescinded their regulations prohibiting rebates, thereby enabling consumers in those states to receive more benefits of competition.⁸⁴ The Tennessee Real Estate Commission voted to suspend its rules and is in the process of rescinding them entirely.⁸⁵

Proponents of such provisions claim that they protect consumers from false and misleading offers of rebates and help ensure that consumers choose brokers on the basis of the quality of the service, rather than price. While states properly are concerned with issues of consumer fraud, the Agencies have found no evidence that rebates have harmed consumers or that rebate bans improve service quality. It is clear, however, that rebate prohibitions harm consumers by preventing price competition.

⁸³ *Id.* A few brokers surveyed supported eliminating the rebate ban, recognizing some of the procompetitive benefits that repeal of the ban would foster. One broker observed: “Rebates will increase competition and give consumers more choices in service.” *Id.* at 3.

⁸⁴ DOJ, *South Dakota Real Estate Commission Permits Real Estate Brokers To Offer Rebates And Inducements* (Aug. 17, 2005), available at http://www.usdoj.gov/atr/public/press_releases/2005/210637.htm; DOJ, *West Virginia Real Estate Commission Permits Real Estate Brokers To Offer Rebates And Other Discounts* (May 4, 2006), available at http://www.usdoj.gov/atr/public/press_releases/2006/215961.htm.

⁸⁵ In response to DOJ’s investigation, the Tennessee Real Estate Commission voted to suspend enforcement of its rebate ban on July 13, 2006, and subsequently voted to repeal the offending regulation. *See* Commission Minutes at 4 (July 12-13, 2006) (suspending enforcement); Commission Minutes at 3 (Aug. 9-10, 2006) (repealing rule). Pursuant to the state’s administrative proceedings, the Tennessee Real Estate Commission scheduled a public hearing regarding the rebate ban’s final repeal for May 2007. *See* Tenn. Admin. Reg. vol. 33, no. 3 (Mar. 2007), Notice of Rulemaking, available at http://www.tn.gov/sos/rules_hearingnotices/2007/1260/1260.20070228.02-37-07.notice.pdf (last updated Feb. 28, 2007).

Conclusion

In the United States, the states have primary responsibility for regulating the professions. Although some forms of regulation can be necessary to ameliorate consumer harm from market failures that arise, for example, due to information asymmetries, the Agencies have found that often state regulation of attorneys and real estate brokers unduly restricts competition. Because state regulation often can be beyond the reach of the antitrust laws, the Agencies often rely on competition advocacy to educate state governments on the likely competitive effects of certain professional regulation and suggest less restrictive alternatives to achieve purported consumer protection goals.