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THE INTERFACE BETWEEN COMPETITION AND CONSUMER POLICIES

Contribution from the United States

-- Session IV --

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THE INTERFACE BETWEEN CONSUMER PROTECTION AND COMPETITION POLICIES

-- United States--

1. Competition policy and consumer protection policy are key elements of the American economic system. Together, they enhance consumer welfare by fostering a vigorous, competitive marketplace that gives consumers greater informed choice and leads to greater availability of products with the qualities desired by consumers at the lowest prices. Strong competition benefits consumers by encouraging new market entrants, creating incentives for innovation, and by motivating sellers to provide more truthful, useful information about their products. Consumer protection policy supports those goals by ensuring the empowerment of consumers to participate in the marketplace by enabling them to make well-informed decisions about their choices. The interplay between protecting competition and ensuring that consumers can make effective choices among competing offerings is a constant feature of competition and consumer policy in the United States. The market for residential real estate provides a prime example.

2. A home is typically the single most expensive and complicated purchase consumers make in their lifetimes. Individual consumers purchase real estate infrequently, and many are relatively uninformed about the process. Consequently, most consumers must engage real estate service providers, including real estate brokers, mortgage lenders, and settlement services, to help them. Established service providers, however, have found opportunities to capitalize on consumer inexperience and exclude new forms of competition from the market, both through coordinated private conduct and attempts to secure favorable governmental regulation. The Federal Trade Commission (FTC) and the Department of Justice (DOJ) have found that they can help to promote real estate markets that deliver the benefits of competition to consumers through addressing both the supply and demand components of market failure by: eliminating anticompetitive barriers to competition through enforcement and advocacy, and providing consumers with the information they need to take advantage of a competitive marketplace. This paper focuses on how competition, which addresses the supply component, and consumer protection, which addresses demand side issues, have interacted to achieve these goals in the United States.[1]

1. Background on the Real Estate Market in the United States

3. Consumers typically work with brokers to buy and sell residential real estate.[2] A seller, offering a home for sale, normally contracts with a listing broker to market the home. Most listing brokers are "full service brokers" who offer a wide range of services in return for a fixed percentage of the selling price. The commission rate is negotiable, although in fact, it is rarely negotiated. In recent years, home sellers in the United States have paid around 5 percent on average. Among the most important brokerage service is listing the seller's home on a "Multiple Listing Service" (MLS), a local or regional joint venture of real

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[1] *See generally*, T. Leary, *Competition Law and Consumer Protection Law: Two Wings of the Same House*, 72 ANTITRUST L.J. 1147 (2005).

[2] This section summarizes a more detailed U.S. Submission to Working Party No. 2 on Improving Competition in Real Estate Transactions, DAF/COMP/WP2/WD(2007)5 (February 15, 2007) (hereinafter 2007 U.S. OECD Submission), *available at* http://www.ftc.gov/bc/international/docs/improvingcompin_Real_Estate_Transactions.pdf.

estate brokers who gather and disseminate information on properties offered for sale in their geographic area. An MLS listing will include the compensation, typically half of the commission paid by the seller, offered to any broker who finds the successful buyer for a listed property. Buyers, for their part, ordinarily obtain their own brokers to identify and show them properties that meet their specifications. A buyer's broker nominally is compensated by the home seller out of the selling broker's commission, but in fact buyers share this expense to the extent that the seller builds his or her commission fee into the price of a home.

4. In recent years, the Internet has enabled new forms of real estate brokerage that allow consumers to substitute some of their own efforts for those of brokers, which consequently cost less than traditional full-service brokerage.[3] These include "limited service brokers" who provide a limited range of services, often for a reduced commission or on a fee-for-service basis, "virtual office websites" through which brokers give clients direct access to MLS listings, and services for sellers who market their homes without a broker.

5. Most consumers must also obtain financing for a real estate transaction. A wide array of financing options are available, ranging from the traditional fixed-rate mortgage payable over 30 years to five-year adjustable rate mortgages that leave the bulk of the principal of the loan payable at the end of five years. Interest rates vary widely, depending in part on the buyer's creditworthiness, the size of the fees paid to the lender, and how the rate changes during the life of the loan.

6. Transactions then are "closed" in a settlement proceeding in which the mortgage is signed, money is paid, and legal title conveyed. The transaction costs related to the financing process, the closing process, transfer taxes and recording fees, brokerage fees, and miscellaneous expenses are paid through the settlement process. In most states, consumers can choose between attorneys and non-attorneys for settlement services. However, a minority of states prohibit non-attorneys from performing settlement tasks.

7. Thus, consumers purchasing a house often turn to others for three principal services: locating a suitable house, obtaining financing to purchase the house, and closing the transaction. While market forces are sufficient to protect consumers in most cases, the market brings the benefits of competition to consumers only to the extent that they have adequate information with which to make informed choices among competing brokerage models, mortgage options, and closing services. Attempts to restrict competition and consumer information in all three of these areas have required intervention by the DOJ and FTC.

2. Real Estate Brokerage Services

8. In any community, hundreds or thousands of homes may be offered for sale by many brokers. It would be extremely inefficient for a consumer to contact every broker in town to identify the properties that meet the consumer's specifications. Accordingly, the brokerage industry developed the MLS concept to collect all local property listings in a single database. The MLS offers benefits to sellers, who obtain wider exposure for their homes, and to buyers, whose information search costs are significantly reduced. Buyers and sellers normally access the MLS through real estate brokers.

9. However, as alternative forms of lower-cost real estate brokerage have emerged, some traditional brokers collectively have sought to exclude lower cost brokerage options by imposing requirements that

[3] The effect of these new forms of business on competition are discussed in an FTC/DOJ report issued in 2007 entitled *Competition in the Real Estate Brokerage Industry, available at* http://www.ftc.gov/reports/realestate/V050015.pdf.

effectively excluded them from using the MLS to sell properties. Given the importance of the MLS as a tool for buying and selling real estate, these requirements seriously threaten consumer access to low-cost brokerage options.

10. The antitrust agencies have challenged several of these MLS operators on the grounds that such requirements constituted anticompetitive horizontal agreements among competing brokers. Early cases challenged requirements that, among other things, permitted MLS listings only when the seller agreed to pay the listing broker a commission regardless of whether the home was sold through the broker's efforts, fixed the amount of commission that would be shared with a buyer's broker, and prevented part-time brokers and brokers from outside the area from participating.[4] More recently, the agencies intervened when MLS operators took steps to prevent MLS listings by limited service brokers from appearing on the Internet.[5] The DOJ recently challenged the largest real estate trade association in the United States over rules that permitted brokerages to restrict listings from Virtual Office Websites offered by brokers using innovative web-based marketing systems.[6]

11. Traditional realtors and their associations have also turned to lawmakers and regulators to block the emergence of innovative firms that seek to compete by offering a reduced level of brokerage services in return for a lower commission. While listing properties on the MLS and the Internet are tools that many buyers and sellers find indispensable, other services traditionally performed by brokers could be competently performed by many sellers themselves. These include showing the house to prospective buyers, negotiating price and preparing sales contracts, arranging for financing, arranging for home inspections, and the like. Certain broker associations, however, have sought to persuade states to require that all brokers offer a minimum level of service that would include these and other services, undermining the ability of limited service brokers to offer limited services for a low cost. Advocates of these laws claim that they are justified on grounds of protecting consumers from deception, but they have not been able to articulate how excluding low cost competitors serves this purpose.

12. Because the "state action doctrine" in United States law protects state laws from antitrust challenge in most cases,[7] the FTC and DOJ have focused their efforts on competition advocacy to persuade legislators that minimum service requirements and rebate bans reduce choice, increase price, and fail to offer them any meaningful level of protection.[8] The U.S. antitrust agencies have argued that consumers are

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4 *E.g.*, United Real Estate Brokers of Rockland Ltd., 116 F.T.C. 972 (1993).

5 *E.g.*, United States v. Multiple Listing Serv. of Hilton Head Island, (D.S.C. filed Oct. 16, 2007), *available at* http://www.usdoj.gov/atr/cases/mlshilton.htm; Multiple Listing Serv., Inc., (FTC File No. 061 0090, Dec. 12, 2007), *available at* http://www.ftc.gov/opa/2007/12/mls.shtm; Austin Board of Realtors, (FTC Docket C-4167, Sept. 5, 2006), *available at* http://www.ftc.gov/os/caselist/0510219/0510219.shtm. Similar cases are still being resolved within the FTC's administrative process. *See* Realcomp II, Ltd, (FTC Docket 9320, Initial Decision of Administrative Law Judge, December 13, 2007), *documents available at* http://www.ftc.gov/os/adjpro/d9320/index.shtm. The initial decision, which preliminarily determined that the policies of Realcomp II, Ltd. did not unreasonably restrain competition and that there was no "actionable consumer harm" in violation of Section 5, is being appealed to the full FTC.

6 United States v. National Ass'n of Realtors (N.D. Ill, Amended Complaint Oct. 4, 2005), *available at* http://www.usdoj.gov/atr/cases/nar.htm.

7 Regulations enacted by non-sovereign components of state governments, such as real estate commissions, do not enjoy the same protection from antitrust challenge as statutes passed by state legislatures. The DOJ, for example, recently challenged the Kentucky Real Estate Commission's restrictions on offering rebates to consumers. *See* U.S. v. Kentucky Real Estate Comm'n (W.D. Ky., Complaint, Mar. 31, 2005), *available at* http://www.usdoj.gov/atr/cases/krec.htm.

8 *See, e.g.*, letters from FTC and DOJ cited in 2007 U.S. OECD Submission at footnote 97.

better protected when they can choose between high cost/high service and low cost/low service providers rather than requiring them to pay for services they may not want or need. The FTC/DOJ Real Estate Study, cited above, indicates that the difference between a full service and a limited service commission for a consumer who bought a house at the 2005 average price of $271,267, for example, could be between $4,000 and $5,000.

13. In two recent competition investigations, the FTC explored suspected horizontal agreements to suppress the advertising of low-cost brokerage services to consumers. These cases highlight the complementary relationship between competition and consumer protection when suspected anticompetitive practices threaten to restrict consumer access to information. In these matters, trade associations of real estate brokers disciplined discount brokers on the grounds that their low-price claims misled consumers in violation of association ethics codes. Analysis of these matters required not only an assessment of whether the associations engaged in anticompetitive practices, but whether the advertising claims were in fact misleading under Section 5 of the FTC Act, which prohibits deceptive practices, including commercial communications that are likely to mislead a reasonable consumer. Moreover, these cases also required the FTC to strike an appropriate balance between consumer protection interests in promoting effective industry self-regulation and competition interests in ensuring that industry self-regulation does not effectively create anticompetitive barriers to entry by low-cost competitors. The investigations ultimately were closed, but they effectively illustrate the importance of considering cases that implicate restrictions on consumer information from both a competition and consumer protection point of view.[9]

14. Preventing restrictions on competition goes only so far, however, in making sure that consumers receive the benefits of a competitive real estate market. Even in the absence of anticompetitive restrictions, consumer choice will flourish only when consumers know and understand the choices competition makes available to them. For example, many consumers do not understand that real estate commissions are negotiable; nor do they appreciate the nature of and differences among the types of brokerage services available. In response, through their consumer education functions, the FTC[10] and DOJ[11] have undertaken to educate consumers about the choices open to them in selecting from among the different types of real estate professionals who compete for their business.[12]

3. Mortgage Financing

15. Most consumers do not have the funds necessary to purchase real estate without using a mortgage loan to finance the purchase. The U.S. market for mortgages is competitive. However, significant consumer confusion exists about many credit terms that implicate, for example, the annual percentage rate and the ultimate cost of the loan. Among the key federal laws governing mortgage lending is the Truth in Lending Act (TILA),[13] which requires lenders to prominently reveal credit terms with the intent of

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9 Under FTC Rules, 16 CFR 4.10 (a)(8)(i), investigations of firms that do not result in law enforcement action are not normally disclosed.

10 *E.g.*, "Buying a Home: it's a Big Deal," FTC Consumer Alert, *available at* http://www.ftc.gov/bc/edu/pubs/consumer/alerts/zalt001.pdf (in English) and *at* http://www.ftc.gov/bc/edu/pubs/consumer/alerts/zsalt001.pdf (in Spanish.).

11 Competition and Real Estate, *available at* http://www.usdoj.gov/atr/public/real_estate/index.htm.

12 "Selling Your Home? Tips for Selecting a Real Estate Professional," FTC Facts for Consumers, available *at* http://www.ftc.gov/bc/edu/pubs/consumer/homes/zrea01.pdf (in English) and *at* http://www.ftc.gov/bc/edu/pubs/consumer/homes/zsrea01.pdf (in Spanish.).

13 15 U.S.C. § 1601-1666j (requiring disclosures and establishing other requirements in connection with consumer credit transactions). TILA is enforced by the FTC with respect to non-depository institutions and by the federal banking regulators against depository institutions.

facilitating informed consumer choice among competing lenders. The FTC adds to those efforts through enforcement of the Home Ownership and Equity Protection Act (HOEPA), which amended TILA to provide additional protections for consumers who enter into certain high-cost refinance mortgage loans[14] and Section 5 of the Federal Trade Commission Act itself (FTC Act), which generally prohibits unfair and deceptive acts and practices in the marketplace as well as unfair methods of competition.[15] In addition, the FTC conducts research on home mortgage lending issues, including two recent studies of consumer mortgage disclosures,[16] and has provided comments to the banking agencies suggesting improvements to the requirements for mortgage disclosures to consumers.[17]

16. The real estate mortgage market is one in which consumer choice can easily be subverted by deceptive marketing practices that obscure the true cost of credit. The FTC has targeted deception and other illegal practices used in the marketing, advertising, and servicing of mortgage loans, focusing in particular on the subprime mortgage market. In recent years, the agency has brought 21 actions against companies and principals in the mortgage industry.[18] Several of these cases have resulted in large monetary judgments, collectively returning more than $320 million to consumers.

17. In addition, the FTC has engaged in extensive consumer education on the topic and as the nation's consumer protection agency, takes an active role in educating American consumers about how to make choices in the competitive mortgage marketplace that will best serve their financial interests.[19] The FTC has more than 20 mortgage and homeownership-related publications for consumers, covering topics including buying and selling a home, getting a mortgage or home equity loan, understanding the role of a mortgage servicer, and recognizing and avoiding foreclosure scams.

18. Consumer education components are included with announcements of FTC enforcement activities (both competition and consumer protection) in the real estate field. For example, the FTC in September warned mortgage brokers and lenders, and the media outlets that carry their advertisements for home mortgages, that some of the advertising claims appearing in Web sites, newspapers, magazines, direct mail, and unsolicited e-mail and faxes may violate federal law. In warning letters, the agency

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14 15 U.S.C. § 1639.

15 15 U.S.C. § 45(a).

16 FTC, Bureau Of Economics Staff Report, J.M. Lacko and J. K. Pappalardo, Improving Consumer Mortgage Disclosures: An Empirical Assessment Of Current And Prototype Disclosure Forms (2007), *available at* http://www.ftc.gov/os/2007/06/P025505mortgagedisclosurereport.pdf; FTC, Bureau Of Economics Staff Report, J.M. Lacko & J.K. Pappalardo, The Effect Of Mortgage Broker Compensation Disclosures On Consumers And Competition: A Controlled Experiment (2004), *available at* http://www.ftc.gov/os/2004/01/030123mortgagefullrpt.pdf.

17 FTC Staff Comment to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve Board System, Regarding Proposed Illustrations of Consumer Information for Subprime Mortgage Lending (Nov. 1, 2007), *available at* http://www.ftc.gov/be/v080000.pdf.

18 FTC Testimony On Home Mortgage Disclosure Act Data and FTC Lending Enforcement, Presented by Lydia B. Parnes, Director, Bureau of Consumer Protection, Before the Subcommittee on Oversight and Investigations of the Committee on Financial Services, United States House of Representatives (July 25, 2007), *available at* http://www.ftc.gov/os/testimony/P064806hdma.pdf.

19 Education materials on mortgage issues are available at the Commission's web page. FTC, Credit and Loans (2007), *available at* http://www.ftc.gov/bcp/menus/consumer/credit/mortgage.shtm. The materials include brochures such as "Mortgage Payments Sending You Reeling? Here's What to Do," "High-Rate, High-Fee Loans (HOEPA/Section 32 Mortgages)," and "Reverse Mortgages: Get the Facts Before Cashing In On Your Home's Equity."

advised more than 200 advertisers and media outlets that some mortgage ads are potentially deceptive or in violation of the Truth in Lending Act. The advertisements, including some in Spanish, were identified several months earlier during a nationwide review focusing on claims for very low monthly payment amounts or interest rates without adequately disclosing other important loan terms. The consumer education component to the effort was a new publication, "Deceptive Mortgage Ads: What They Say; What They Leave Out."[20] The publication provides information to help consumers spot mortgage offers that may be less than complete, and lists buzz words that should trigger follow-up questions.

4. Settlement Services

19. The settlement process can be both confusing and expensive. The FTC and DOJ have sought to reduce the expense by increasing competition for settlement services, while the FTC has worked with other government agencies to improve the information given to consumers during the process.

20. After paying for the home and/or mortgage and brokerage fees, buyers are frequently faced with a dizzying and unfamiliar array of fees and costs at settlement. These fees and costs are presented on a standardized form under regulations implementing the Real Estate Settlement Procedures Act (RESPA). Through RESPA, the Department of Housing and Urban Development (HUD) strives to improve the settlement process for consumers and to enhance competition in several respects. The process has not always proven effective, however, in part because consumers usually do not see the form until they arrive at the settlement table. FTC has participated in initiatives aimed at reducing consumer confusion about the process. For example, in 2002 the FTC responded to a request by HUD for comments on proposed amendments to its regulations implementing the Real Estate Settlement Procedures Act (RESPA).[21] The FTC staff strongly supported HUD's initiatives to simplify the settlement process and to foster competition in the market for settlement services, but urged HUD to consider carefully whether the information disclosed would provide consumers with useful information, and if so, whether it could easily be understood. For example, experience and research at the FTC indicate that consumers likely would benefit from a comprehensive review and reform of federal mortgage disclosures, including giving serious consideration to creating a single disclosure document that summarizes all the key features and costs of a mortgage.[22]

21. As noted above, one of the settlement costs that are ultimately passed on to buyers is the cost of settlement services themselves. In some states, these services are offered by a variety of providers, including attorneys, real estate title insurance companies, real estate agents, and paralegals. Laws in other states, however, require that real estate settlements be conducted by licensed attorneys. The economic effect of these laws is to exclude lower-cost providers of settlement services from the market without preventing actual consumer harm or providing countervailing benefits. One empirical study compared five states where lay providers examined property titles, drafted real estate instruments, and facilitated the closing of real estate transactions with five states that prohibit non-attorney provision of identical settlement services. The author found "[t]he only clear conclusion" to be "that the evidence does not

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20 *See* www.ftc.gov/bcp/edu/pubs/consumer/alerts/alt023.pdf.

21 *See, e.g.*, FTC, Staff Comment to the Department of Housing and Urban Development on Proposed Amendments to the Regulations Implementing the Real Estate Settlement Procedures Settlement Act Claims (Oct. 28, 2002), *available at* http://www.ftc.gov/be/v030001.pdf.

22 FTC, Comment from the Commission to Federal Reserve Board on Proposed Illustrations of Consumer Information for Subprime Mortgage Lending, (October 30, 2007) *available at* http://www.ftc.gov/be/v080000.pdf.

substantiate the claim that the public bears a sufficient risk from lay provision of real estate settlement services to warrant blanket prohibition..."[23]

22. The FTC and DOJ have taken the position that these types of rules restrict competition by reducing consumer choice. Both agencies have urged state bar regulators to remove the conduct of real estate settlements from their definition of the practice of law.[24] In one instance, the agencies were asked to provide comments to legislators in New York about the likely effects of a proposed law that would eliminate competition between attorneys and non-attorneys for real estate settlement services.[25] The agencies advocated that such restraints are, "justified only by a showing that they are necessary to prevent significant consumer harm and are narrowly drawn to minimize their anticompetitive impact," and, "[a]bsent such a showing, restraining competition in a way that is likely to harm [consumers] by raising prices and eliminating their ability to choose among competing providers is unwarranted."[26] The legislation was ultimately dropped, and New York consumers still enjoy the benefits of attorney/non-attorney competition for these services.

5. Conclusion

23. Market imperfections in the residential real estate market can best be addressed by coordinating competition and consumer protection policy to ensure that both supply and demand side imperfections are addressed in a complementary manner. Competition tools are necessary to make sure that consumers realize the benefits of a competitive marketplace, whether in the form of alternate brokerage arrangements, real estate closing services, or financing options that might save them money. Consumer protection tools are necessary to ensure that the information that consumers need to take advantage of those choices is available to them.

24. There are operational benefits to having close communications between enforcers of competition and consumer protection laws. The FTC has found that enforcing both antitrust and consumer protection laws reinforces the consumer welfare orientation that it brings to accomplishing both of its missions. Regardless of whether both functions are combined in a single institution, consideration of competition and consumer protection as complementary policy goals can result in a collaborative and harmonized approach to competition and consumer policy that enhances consumer welfare by ensuring that consumers are able to make informed decisions about the choices presented to them by a competitive marketplace.

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23 Joyce Palomar, *The War Between Attorneys and Lay Conveyancers – Empirical Evidence Says "Cease Fire!"*, 31 CONN. L. REV. 423, 520 (1999).

24 *E.g.*, McMahon v. Advanced Real Estate Title Services of West Virginia, Case No. 31706 (brief of FTC and DOJ *amici curiae*, Sup. Ct. W. Va., May 25, 2004). *See generally*, U.S. Submission to Session 1 on Bringing Competition Into Regulated Sectors: The Legal Profession, Submission Of The United States, DAF/COMP/GF/WD(2005)35 (OECD Global Forum on Competition, Feb. 10, 2005), *available at* http://www.ftc.gov/bc/international/docs/compcomm/2005-Roundtable%20on%20Bringing%20Competition.pdf.

25 *See* two letters from the DOJ and the FTC to the Committee on the Judiciary of the New York State Assembly (June 21, 2006 and April 27, 2007), available *at* http://www.ftc.gov/os/2006/06/V060016NYUplFinal.pdf and http://www.ftc.gov/be/V070004.pdf.

26 *Id.*