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April 25, 2005

Ms. Loretta R. DeHay  
General Counsel  
Texas Real Estate Commission  
P.O. Box 12188  
Austin, Texas 78711-2188

Re: Proposed Amendments to 22 Tex. Admin. Code § 535.2

Dear Ms. DeHay:

Our firm has been retained by the Texas Association of REALTORS (the "Association") to respond to certain issues raised in the April 20, 2005 letter submitted to you by the Federal Trade Commission ("FTC") and the Department of Justice ("DOJ" and, collectively with the FTC, the "Federal Agencies") with respect to the proposed amendments to 22 Tex. Admin. Code § 535.2, which are currently pending before the Texas Real Estate Commission (the "Commission"). In particular, we write to correct certain misperceptions of both law and fact found in the letter's analysis.

**I. The Federal Agencies Ignore the Harms That Will Occur Without the Proposed Amendments**

The Federal Agencies repeatedly state that there is "no evidence" of harm to consumers under existing law,<sup>1</sup> but that is simply not the case. This error on the part of the Federal Agencies arises because they appear to misunderstand the legal context in which the proposed amendments arose, a misperception that unfortunately colors the entirety of their analysis. Unfortunately, we believe that the misperception contributes to reaching the wrong conclusions.

As the Commission knows, in recent years, brokers have begun to offer consumers a more diverse array of brokerage services, from which consumers can pick and choose the services they desire and pay only for those services. Such developments, however, brought to the surface some previously latent ambiguities in the existing regulatory scheme and fostered the opportunity for marketplace abuses that pose a very real threat of harm to consumers. It is undisputed that certain Limited Service Brokers ("LSBs") have entered into exclusive agency limited service agreements with property sellers, agreeing to place the property on the market for

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<sup>1</sup> See DOJ/FTC Letter at 1, 9, 10.

a fee but do nothing else on behalf of the seller. The core consumer concern, which the Federal Agencies nowhere address in their 13-page letter, arises after a seller has entered into such an agreement, when and if the seller determines that he or she needs additional assistance in completing the transaction.<sup>2</sup>

Under existing law, the seller's best recourse would be to turn to his LSB for this assistance. The LSB, as exclusive agent for the seller, has a duty "to negotiate the best possible transaction for the principal."<sup>3</sup> Indeed, the requirement stems directly from the statutory prohibition on a broker from negotiating directly with a principal who is represented by an agent.<sup>4</sup> But, the contours of this "duty to negotiate" are far from clear. If one examines the "plain meaning" or the dictionary definition of the word "negotiate", as courts are likely to do if this question were presented to them, the duty is a broad one. Indeed, in a different context, one court has employed precisely this reasoning and concluded:

"Negotiate" is defined as "to transact business; to bargain with another respecting a purchase and sale; to conduct communications or conferences with a view to reaching a settlement or agreement." It includes not only "conversation in arranging terms of contract" but also "that which passes between parties or their agents in the course of or incident to the making of a contract."<sup>5</sup>

Yet, certain LSBs have argued, and the Federal Agencies appear to support the view, that the duty to negotiate can mean simply putting the house on the market, leaving the seller with no one to turn to later. By placing the home on the market, the argument goes, the LSB has provided the only service he or she agreed to provide, and the consumer is not entitled to any additional help.

The consumer might then try to turn to the buyer's broker for assistance. But, under existing Texas law, the buyer's broker is not permitted to help because the seller has an appointed agent. As described above, § 1101.652(b)(22) prohibits the buyer's broker from "negotiat[ing] or attempt[ing] to negotiate" directly with the seller. Moreover, the buyer's broker owes fiduciary responsibilities to the buyer, who the broker has contracted to represent,

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<sup>2</sup> Similar concerns arise when the principal is a buyer but, for ease of analysis, this letter will focus primarily on sellers, as the FTC/DOJ Letter did.

<sup>3</sup> 22 Tex. Admin. Code § 535.2(b). The Texas Attorney General's office has supported the Commission's adoption of this rule, and the Federal Agencies do not challenge its propriety. In its letter approving the Commission's authority to enact the proposed amendments, the Attorney General stated with respect to the pre-existing rule that "[a]s a threshold matter, we believe that this rule is within the Commission's power to establish and enforce and it does not conflict with the statutory scheme created by the legislature." Letter from Hon. Greg Abbott, Texas Attorney General to Wayne Thorburn, Administrator, Texas Real Estate Commission, at 5 (Dec. 14, 2004).

<sup>4</sup> TEX. OCC. CODE § 1101.652(b)(22).

<sup>5</sup> *Onofre v. State*, 836 S.W.2d 807, 809 (Tex. App.--Houston [1st Dist.] 1992, write ref'd) (quoting Black's Law Dictionary 934 (5th ed. 1979)).

and is placed in an untenable conflict if the seller seeks advice on the transaction from the buyer's broker.

The seller's final option is to try to engage an additional broker. This option is foreclosed as well, however. Because the seller's original contract was an exclusive agency listing agreement, the seller is contractually barred from engaging an additional broker on the seller's behalf, absent consent of the original listing broker. One need not be overly cynical to recognize the potential for a broker to withhold consent as leverage over the seller, to extract additional fees.

The Commission has heard testimony, which the Federal Agencies fail to mention, from brokers who have encountered sellers in just such a position. The testimony included brokers, representing buyers, who had knowledge of LSBs refusing to assist the seller, leading the seller to request help from the buyer's broker. The brokers testified to the difficulties encountered, where the broker feels unable to assist the seller due to his obligations under state law and his fiduciary obligations to his own client, but who simultaneously fears that the seller's inability to obtain assistance may create uncertainties as to the validity of any transaction ultimately completed. The fact that buyers' brokers are being asked by sellers for assistance is strong evidence that these sellers are being refused such service by LSBs. Responsible LSBs, on the other hand, may be forced to provide more services than they intended due to the potentially broad definition of "negotiate" under existing law.

In addition to relying on this testimonial support for the presence of this harm, the Commission is surely empowered to be proactive and rely on its own judgment in fulfilling its obligation to protect the public. Indeed, it is the Commission which is in the best position to evaluate the real-world implications for consumers of real estate services of certain courses of conduct. No doubt, this is why the Legislature created a Commission constituted of real estate professionals and public citizens rather than, say, antitrust lawyers and economists.<sup>6</sup>

## **II. The Federal Agencies Wrongly Suggest that the Proposed Amendments Harm Consumers**

In the wake of the problems identified above, the Commission carefully considered the concerns, analyzed the ambiguity in the existing regulatory regime, and crafted a narrowly tailored clarification that preserves maximum consumer choice and allows ample room for LSBs to compete effectively in the marketplace. The proposed amendments add three subsections to § 535.2(b). Proposed subsection (d) defines the duty to "negotiate" that already exists under Texas law. Notably, the duty is defined much more narrowly than the common, dictionary definition of the term, and includes only the obligation that the broker: (1) accept and present offers; (2) assist in developing and communicating offers; and (3) answer questions. Subsection

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<sup>6</sup> The Federal Agencies assert that the Commission is "substituting its own judgment for the competitive process." DOJ/FTC Letter at 7. In fact, it is actually the Federal Agencies which are attempting to substitute their speculation about the market for real estate for the Commission's real-world experience with that market.

(e) essentially restates existing state law against a broker negotiating directly with a party known to be represented by a broker, and spells out the obvious implication that a broker may not instruct another broker to violate this provision. Subsection (f) clarifies that a broker is not negotiating with a represented principal, and is thus not violating state law, merely by delivering a copy of an offer to the represented principal as long as the offer is also delivered to the principal's broker and as long as the delivering broker does not attempt to discuss it with the principal.

The Federal Agencies contend, however, that this modest remedy will harm competition in the marketplace. The DOJ/FTC Letter purports to identify three types of "consumer harm" that will result from adoption of the proposed amendments: (1) forcing sellers to purchase additional services, and thereby raising prices from LSBs; (2) eliminating LSBs as a competitive restraint on the pricing of full service brokers; and (3) requiring LSBs who want to only provide a MLS listing to incur additional costs due to the need to be able to offer the additional services, if requested. The first two harms are non-existent, and the third is a red herring.

The Federal Agencies' first two identified harms from the proposed amendments are in fact the same thing. The contention is that defining the term "negotiate" as has been done by the proposed amendments will force LSBs to provide, and therefore charge for, additional services, even when consumers do not want them, and that the result of the higher prices will be to force LSBs out of business. The first fallacy in this argument is that it presumes that LSBs have no obligations whatsoever at this time, such that the duties identified in the proposed amendments will increase LSBs' existing responsibilities. The Federal Agencies argue that "under a limited-service brokerage contract, the seller often agrees to negotiate directly with buyers or their agents" and that the proposed amendments "would make it a violation of TEX. OCC. CODE §§ 1101.652(b)(22), (27)" for a broker to instruct another broker to negotiate directly with the broker's principal. As explained above, however, this is *already* a violation of TEX. OCC. CODE §§ 1101.652(b)(22) and (27). A buyer's broker may not negotiate with a represented principal under those provisions, under Texas law as enacted by the Legislature and as it exists today. The duty to negotiate thus already exists under Texas law, and the proposed amendments define that duty extremely narrowly, in a way that may allow LSBs to actually charge less for their services than under the existing regime and increase, rather than decrease, their competitiveness.

The second fallacy in the Federal Agencies' reasoning is that it assumes that LSBs will be forced to provide these services to customers who do not want them, thereby raising costs.<sup>7</sup> This, too, is incorrect.<sup>8</sup> If a customer does not want the additional assistance that the proposed

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<sup>7</sup> DOJ/FTC Letter at 5.

<sup>8</sup> As the Federal Agencies note, the Commission informed the Federal Agencies that the proposed amendments "would allow an LSB to enter into a contract to provide only MLS listing as long as the agreement contained a proviso allowing the home seller to request the LSB to provide the additional services." DOJ/FTC Letter at 5. It is hard to understand how the Federal Agencies could read this provision any other way. Of course the broker cannot force the principal to accept such services; the question is, can the principal force the broker to perform such services, if and when the principal believes he or she needs professional assistance?

amendments make available to him or her, he need not make use of them, and the broker incurs no extra costs. Thus, a rational LSB in implementing this rule will include conditions in the initial contract that account for the possibility that the principal may later decide he or she wants the additional services. The broker can continue to charge the identical flat fee for merely listing the property as before, with the only change being that the broker and principal will negotiate at the time of the initial agency agreement what fees will be charged in addition, should the principal later decide he or she wants the additional services provided for in the proposed amendments.

The third identified harm is a red herring. As the Commission is no doubt aware, many brokers are members of community associations that make listings available to member-brokers through the MLS system. Often, these private organizations allow listings only if the member-broker placing the listing is the “exclusive agent” for the principal. In the DOJ/FTC Letter, the Federal Agencies repeatedly express the concern that imposing the minimal duties of the proposed amendments on LSBs will prevent them from offering a service in which they agree to list the property on MLS but nothing else.<sup>9</sup> Any such consequence, however, stems not from Commission action, but from private regulations. The import of the Federal Agencies’ letter is that the Commission’s authority to implement the Legislature’s regulatory scheme can be limited by a private entity’s rules. Respectfully, that is precisely backwards. The Commission derives its authority from the Legislature, and is the state agency statutorily-charged to implement the Legislature’s plan; that plan would be thwarted if the Legislature’s grant of authority could be arbitrarily circumscribed by the actions of private entities.<sup>10</sup>

Moreover, this concern is not merely misdirected; it is also grossly overstated. For all the reasons described above, the impact of the proposed amendments on LSBs will be minimal. The brokers’ ability to contract for desired services at the outset will allow them to continue to provide a la carte brokerage services, just as they do today.

### **III. The Proposed Amendments Will Actually Encourage Greater Competition in the Marketplace**

As shown above, the contentions by the Federal Agencies that there is no potential for harm under the existing regime, and that the proposed amendments themselves may cause harm, are incorrect. Indeed, understood correctly, the proposed amendments will actually increase competition in the marketplace for two reasons.

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<sup>9</sup> See DOJ/FTC Letter at 3, 5 & n.15, 6, 9, 12.

<sup>10</sup> If the Federal Agencies quarrel with the MLS regulations, they should take up their concerns with those entities who set those regulations, rather than attempt to convince the Commission to ignore its legislative mandate. It is worth noting, however, that courts have regularly upheld the rights of local brokerage organizations to set parameters for access to the MLS listing service. See, e.g., *Pope v. Mississippi Real Estate Commission*, 695 F. Supp. 253 (N.D. Miss. 1988). The Federal Agencies are surely aware of these decisions. Thus, the FTC/DOJ Letter might best be understood as an effort by the Federal Agencies to achieve its desired ends through the backdoor, by encouraging the Commission to ignore violations of law and refuse to enforce the Legislature’s plan.

