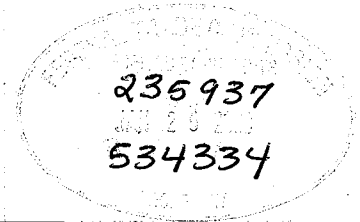


ORIGINAL



UNITED STATES OF AMERICA
BEFORE THE FEDERAL TRADE COMMISSION

DOCKET NO. 9320

PUBLIC VERSION

IN THE MATTER OF
REALCOMP II LTD.

APPEAL BRIEF OF COUNSEL SUPPORTING THE COMPLAINT

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I.
STATEMENT OF THE CASE

A. Introduction

The real estate brokerage industry has long exhibited a general lack of price competition¹ and has a history of traditional brokers taking steps to exclude competition from brokers offering innovative or discounted services.² These steps include limiting access to one of the most important competitive tools in the industry – the local multiple listing service (MLS). The MLS is a collaboration of competing local real estate brokers that aggregates and disseminates “listings,” information regarding homes for sale in a local area, enabling wide exposure for members’ listings.³ At first, traditional brokers simply excluded discount brokers from membership in the MLS.⁴ Later, after that tactic was condemned by the courts, traditional brokers allowed discounters to join the MLS but excluded the type of listing they used to offer discounts – the Exclusive Agency (EA) listing.

¹ See, e.g., FTC Staff Report, *The Residential Real Estate Brokerage Industry*, 11-13, 64 (Dec. 1983) (“1983 Report”) (noting uniformity in commission rates); *Competition in the Real Estate Brokerage Industry*, A Report by the Fed. Trade Comm’n and U.S. Dep’t of Justice, 45 (April 2007) (“2007 Report”) (“commission rates are relatively inflexible”). The Commission may be informed by its own reports and enforcement experience in the industry. See, e.g., *North Texas Specialty Physicians*, Dkt. No. 9312, Slip op. at 9 (F.T.C. Nov. 29, 2005).

² See, e.g., *United States v. Nat’l Ass’n of Real Estate Bds.*, 339 U.S. 485, 488-89 (1950) (broker association rules setting rates and barring discounting); 1983 Report at 20-21 (finding disparagement and steering by traditional brokers); 2007 Report at 63-70 (use of MLS rules and steering).

³ See, e.g., *United States v. Realty Multi-List, Inc.*, 629 F.2d 1351, 1370 (5th Cir. 1980); *Oates v. Eastern Bergen Multiple Listing Serv.*, 273 A.2d 795, 800 (N.J. Super. Ch. 1971) (broker without access to MLS at competitive disadvantage because consumers “naturally desire[] the widest market exposure” for their homes).

⁴ See, e.g., *Realty Multi-List*, 629 F.2d at 1370-71 (MLS membership rules excluding certain brokers held anticompetitive).

Through a series of enforcement actions, the Commission addressed this type of rule. An EA listing – unlike the Exclusive Right to Sell (ERTS) listing used by traditional brokers – provides a discount on the broker’s commission if the home is sold to a buyer who is not represented by another broker. By banning the use of EA listings in the MLS, traditional brokers penalized discounting through EA listings by denying the wide exposure only the MLS provided. To protect competition, the Commission issued a number of consent orders prohibiting MLSs from excluding EA listings.⁵

Advised by legal counsel not to entirely exclude EA listings from the MLS, the full service brokers who dominate Realcomp – the largest MLS in Michigan – found another means to stem this competitive threat. While allowing EA listings to be aggregated in the MLS database, Realcomp instituted two policies affecting the dissemination of those listings. First, Realcomp excluded EA listings from its Internet dissemination, which is the only means to reach three of the top four types of real estate websites (the “Website Policy”). Second, Realcomp set the default search within the Realcomp MLS database to include only ERTS listings, thereby limiting the exposure of EA listings to other brokers (the “Search Function Policy”). Finally, to ensure that brokers using ERTS listings in fact provide “full service,” Realcomp defined ERTS listings to include a minimum bundle of services.

Realcomp therefore accomplished the same result the Commission sought to prevent in its previous enforcement actions; the arbitrary handicapping of discount brokers. Realcomp’s

⁵ See *Port Wash. Real Estate Bd., Inc.*, 120 F.T.C. 882 (1995); *United Real Estate Brokers of Rockland, Ltd.*, 116 F.T.C. 972 (1993); *Am. Indus. Real Estate Ass’n*, 116 F.T.C. 704 (1993); *Puget Sound Multiple Listing Serv.*, 113 F.T.C. 733 (1990); *Bellingham-Whatcom County Multiple Listing Bureau*, 113 F.T.C. 724 (1990); *Metro MLS, Inc.*, No. C-3286, 1990 WL 10012611 (F.T.C. Apr. 18, 1990); *Multiple Listing Serv. of the Greater Michigan City Area, Inc.*, 106 F.T.C. 95 (1985); *Orange County Bd. of Realtors, Inc.*, 106 F.T.C. 88 (1985).

Policies are plainly anticompetitive. EA listings offer significant savings if the buyer is not represented by a broker – commonly 3% of the sales price (the portion of the commission that would otherwise go to the buyer’s broker). By keeping EA listings off of the key websites and limiting their exposure within the Realcomp database, Realcomp’s broker members are penalizing EA listings and therefore discounting. An agreement to penalize discounting comes very close to a form of price-fixing.

In addition, Realcomp’s Policies are effectively an agreement among Realcomp brokers not to compete using certain packages of services. The Policies removed from the market a product that is highly desired by the consumers of brokerage services – namely, an EA listing that is marketed on key real estate websites.

By denying EA listings the wide exposure reserved for ERTS listings, the Realcomp Policies made EA listings less attractive to consumers. Consumers must either settle for an EA listing with the limited exposure allowed by the competitors of discount brokers or purchase a more expensive ERTS listing with the bundled services. As a consequence, discount brokers exited the market, were deterred from entering, incurred increased costs attempting to alleviate the disadvantage, suffered loss of reputation, and were forced to change their business models to conform more closely with traditional brokers. By 2006, EA listings were virtually non-existent in the Realcomp MLS, comprising less than 1% of all listings – far less than the percentage in MLSs without restrictive policies and far less than what the national figures would suggest. Full service ERTS listings therefore accounted for over 99% of the listings in Realcomp.

B. Summary of Argument

Despite this evidence, the ALJ dismissed the Complaint. The ALJ found that discount brokers use EA listings to offer unbundled services and commissions, thereby putting price

pressure on brokerage commissions. Although he found that the Policies were imposed by a combination of competitors with market power and that the Website Policy is by nature anticompetitive, the ALJ concluded that Complaint Counsel had not demonstrated a sufficient restraint on competition. The ALJ found that EA listings were “sufficiently available” on the Internet and the Realcomp MLS at a “nominal cost” and that the Website Policy is plausibly procompetitive. Although the ALJ found that the Search Function Policy is not anticompetitive by nature, he entered a stipulated order that eliminates the Policy and bars Realcomp from imposing a minimum set of services for a listing to qualify as an ERTS.

The Commission should reverse and enter the proposed order proscribing both Policies.

Although the ALJ found the Website Policy to be anticompetitive by nature, he failed to appreciate that the Policies come very close to a form of price-fixing and that they constitute an agreement among full service brokers to eliminate a valued product from the market. Nor did the ALJ fully recognize that the Policies are but another means to approximate the same stifling of competition as the outright ban of EA listings previously condemned by the Commission.

Instead, the ALJ concluded that EA listings are “sufficiently accessible” on Internet sites and in the MLS database. This is wrong as a matter of fact and also reflects a misunderstanding of the anticompetitive character of the restraint.

The ALJ’s conclusion is factually wrong. It is based largely on a single supposed “statistic” that lacks any foundation and that is contradicted by reliable industry studies, website statistics, and broker testimony. In addition, it ignores substantial evidence that the websites from which EA listings have been excluded are, by far, the most important for marketing properties in the relevant area. There are no adequate substitutes for these websites. Their importance is reflected in the record evidence of the impact on discount brokers using EA

listings, including market exit, entry deterrence, and substantially changed (and more expensive) business models. The ALJ also ignored the evidence showing that the Search Function Policy substantially reduced the exposure of EA listings within the Realcomp MLS.

The ALJ's focus is also wrong legally because it ignores the reality that, regardless of how accessible EA listings are, Realcomp's Policies still constitute discriminatory treatment of discounting. When a group of competitors agrees to penalize the use of a lower-priced version of their product, regardless of the severity of the penalty, the conduct is equivalent to an agreement to avoid a form of discounting. Absent an overriding justification, such an agreement must be condemned.

There is no such justification here, the ALJ's ruling to the contrary notwithstanding. As the Commission has already explained in consent orders in similar matters, website policies "advance no procompetitive purpose" and do not address "free riding." The evidence here shows that the same is true for Realcomp's Website Policy; consumers using EA listings pay for the services they receive. The evidence in this case makes clear that Realcomp's full service brokers had no purpose in adopting the Policies other than protecting their "wages."

The ALJ's conclusion that the Realcomp Policies had no effect on consumers is also based on a misunderstanding of the facts and the law. The ALJ wrongly held that consumer injury could not be demonstrated absent a detailed and direct showing of higher prices. Given the nature of the restraint here, no such showing was necessary. In any event, the evidence firmly establishes that home sellers did pay higher prices because EA listings became far less available. The ALJ missed the wealth of qualitative evidence showing that the Policies reduced the effectiveness and value of EA listings, and he misunderstood the quantitative evidence that the Policies reduced the use of EA listings.

C. Statement of Facts⁶

The vast majority of relevant facts in this case are not in dispute. (See RPPF (reply findings stating “no specific response” to majority of Complaint Counsel’s proposed findings)).

1. Real Estate Brokers and Commissions

The essence of the real estate brokerage industry is matching willing sellers with willing buyers. (RRPF 1133; *see also* 1983 Report at 9). Listing brokers⁷ assist sellers to find buyers. (IDF 13 (over 80% of sellers use broker)). Their core service is marketing the home. In addition, listing brokers may provide a number of other services, such as helping set the initial list price, negotiating with potential buyers, and assisting in the “closing” of the transaction. (IDF 21; RPPF 149). These brokers traditionally receive a commission based on a percentage of the sale price of the home, though they may also be compensated by an up-front fee and commission combination. (IDF 28; RPPF 156). A 6% commission is common. (ID 1; IDF 53).

Cooperating brokers assist buyers to find a home.⁸ (IDF 31). Their core service is searching for and identifying properties that match the buyer’s preferences. (RRPF 158; *see also* 1983 Report at 26-27). They do this by searching MLS listings, advising buyers on the various offerings, and escorting buyers to view homes for sale – often providing access through a “lock

⁶ The following abbreviations are used throughout:

ID	Initial Decision
IDF	Initial Decision Finding
CCPTB	Complaint Counsel’s Post-Trial Brief
CCPF	Complaint Counsel’s Proposed Findings
CCRF	Complaint Counsel’s Response to Realcomp’s Proposed Findings
RRPF	Respondent’s Reply to Complaint Counsel’s Proposed Findings

⁷ We use “real estate broker” to encompass brokers and their agents.

⁸ Cooperating brokers may represent the buyer as a “buyer’s agent” or may act as a “sub-agent” for the seller as a “selling agent.” (IDF 32-39; RPPF 159-60).

box.” (RRPF 158). In addition, cooperating brokers may give advice to the buyer regarding the price to offer, the terms of the offer, responding to counter offers, and may assist in the closing. (RRPF 158).

Listing brokers seek to market homes to buyers working with cooperating brokers by making (in agreement with the seller) an “offer of compensation” to pay a portion of the listing broker’s commission to any cooperating broker who “procures” the buyer. (IDF 40-42; RRPF 166). The offer of compensation is typically a percentage of the selling price of the home; 3% is common. (IDF 54; RRPF 1141). In a brokered transaction in which both sides are represented, therefore, the seller essentially pays a commission to both the listing broker and the cooperating broker. (IDF 41; RRPF 167).

Listing brokers also seek to market homes directly to buyers. Some of these buyers are not working with a cooperating broker; thus, a transaction may involve only the listing broker. (CX 413 (Kersten, Dep. at 45-46) (sales to unrepresented buyers “happens all the time in open house”); CCPF 173). The commission paid to the listing broker under these circumstances depends on the type of listing agreement between the seller and the listing broker.

a. Exclusive Right to Sell Listings, Exclusive Agency Listings, and Commissions

Traditional brokers provide a bundled set of services to sellers that includes listing the property on the MLS, holding open houses, showing the property to potential buyers, and assisting with the closing of the transaction. (RRPF 149, 180, 333). Traditional brokers are thus “full service.” (RRPF 189, 1132).

Full service brokers use Exclusive Right to Sell (ERTS) listing agreements. (IDF 52; CX 32-003-004 (Answer)). In fact, until after it signed the stipulated order, Realcomp specifically

defined ERTS listings as “full service,” requiring a minimum bundle of five services. (CCPF 182). Under an ERTS listing agreement, the seller “agrees to pay the broker a commission when the property is sold, whether by the listing broker, the owner or another broker.” (RRPF 176). Thus, even “if the home seller finds the home buyer on his or her own (such as through a relative or a friend at work) rather than through the marketing efforts by the listing broker, the listing broker is still entitled to and will receive the entire negotiated commission.” (RRPF 177; IDF 54-55). In short, the seller receives no discount if the buyer is unrepresented. (RRPF 177). It is thus undisputed that the “significant economic factor of an Exclusive Right to Sell listing is that the home seller commits to pay the full amount of the negotiated commission (both the listing commission and the offer of compensation) if the house sells during the contract period, regardless of whether or not a cooperating broker is involved in the transaction.” (RRPF 1144).

Under an Exclusive Agency (EA) listing, by contrast, the listing broker agrees to give a contingent discount on the commission. If the property is sold to a buyer that is not represented by a cooperating broker, the listing broker agrees to discount the commission by the amount of the offer of compensation. (RRPF 183-85). EA listings therefore “allow sellers to save the cost of an offer of compensation to a cooperating broker – money that under an Exclusive Right to Sell listing would be paid to the listing broker – if the seller sells the property to an unrepresented buyer.” (RRPF 184).

Discount brokers use EA listings to break from the traditional model by unbundling commissions and services. (IDF 69-78; RRPF 191-98, 341). Instead of offering only the full bundle of services, these brokers allow consumers to select from a menu of brokerage services and to “self supply” the other services. (RRPF 192-93). EA listings unbundle the listing and

cooperating broker portions of the commission, thereby allowing for a contingent discount. (CCPF 202-03; IDF 77-78).

b. Competition Among Full Service and Discount Brokers

Real estate brokers compete in local markets to obtain listings. (IDF 79-87; RRPf 204-06). Historically, however, there has been very little price competition among brokers. (CCPF 1130-31; *see also* 1983 Report at 54; 2007 Report at 44-45).

Discount brokers have long faced obstacles created by traditional brokers. For instance, full service brokers have limited entry by steering buyers away from discount broker listings. (*See, e.g.*, 1983 Report at 40, 140, 156-57 (survey results showing that 49% of alternative brokers reported frequent steering); 2007 Report at 68). Thus, discount brokers have not, until recently, made significant entry into the real estate brokerage market. (IDF 90 (discount brokers accounted for only 2% of the market in 2003); *see also* 1983 Report at 20 (discount brokers were approximately 2% of the market)).

The growth of the Internet has mitigated some of these obstacles and contributed to the recent growth of discount brokers. (IDF 92). For instance, if discount broker listings are available on the Internet, full service brokers are less able to steer buyers away from those listings. (CX 421 (Whitehouse, Dep. at 131 (describing “problem” with feeding EA listings to the Internet is that “buyers can see them and then ask their agents to show them”)); 2007 Report at 70). National statistics show that the market shares of discount brokers have increased from 2% in 2003 to 15% of all home sales in 2005. (IDF 90; CCPF 214). Although one study showed that this figure declined to 8% of all home sales in 2006, a national survey conducted by the National Association of Realtors (NAR) shows that the market share of discount brokers was

17% of all brokered sales (approximately 15% of all sales) in 2006. (IDF 90; CX 373-080; RX 154-A-20).

With the rise of the Internet, therefore, discount brokers have “the potential to change the competitive landscape of residential real estate brokerage.” (CX 533-040; IDF 88; CX 403-009 (“Online brokerage models or low-service market discounters will put continuing pressure on broker or agent commissions”)). As one industry publication put it, “In the past, consumers faced a stark choice: engage a full-service broker or manage the entire process without a real estate professional. . . . The [limited service] model represents an additional choice for consumers who may be willing to perform some but not all of the tasks involved in selling a home.” (RRPF 193). Discount brokers “meet a ‘consumer demand for lower cost brokerage services.’” (IDF 73). Where they are present, discount brokers put price pressure on traditional, full service brokers. (IDF 99-101; RRPF 198, 221-26).

2. The Realcomp MLS

The local MLS facilitates wide exposure of listings. (*See, e.g.*, 1983 Report at 16; 2007 Report at 12-14). Wide exposure of real estate listings is critical to matching willing sellers with willing buyers. (RRPF 454-62, 1185-97; *see also* 1983 Report at 10, 31 (explaining sellers’ “need to maximize exposure”)). The local MLS aggregates and disseminates the listings of all MLS members, serving as the most comprehensive source of listings of homes for sale and providing by far the widest dissemination. (IDF 21; RRPF 466, 232 (only brokers who are members of the MLS can list properties); *see also* 2007 Report at 10-11).

In the past, MLSs disseminated listings only to members through a closed, nonpublic database system. (RRPF 232; *see also* 1983 Report at 16-17). It is in this closed, nonpublic database that listing brokers communicate the offer of compensation. In fact, the MLS requires

that listing brokers (and therefore sellers) make an offer of compensation, which is enforceable through binding arbitration, making the MLS unique among information sources about homes for sale by ensuring that cooperating brokers are paid for services provided to the seller. (IDF 45, 112-13; RRPf 234, 237-38, 314, 350, 362-63). More recently, as the Internet became a critical means of exposing listings (RRPF 536-98), MLSs began also to disseminate listing information from the MLS database to various public websites – enabling brokers to efficiently market their clients’ listings directly to consumers. (IDF 114; *see also* 2007 Report at 22).

Realcomp – which is owned and controlled by competing real estate brokers – operates the largest MLS in Michigan. (IDF 136-39, 142, 159; RRPf 253-56, 282). It has over 2,200 real estate office members and approximately 14,000 members (about one-half of the Realtors in Michigan), who “compete with one another to provide residential real estate brokerage services to consumers” in Southeastern Michigan, *i.e.*, Oakland, Wayne, Livingston, and Macomb counties. (IDF 157-59; CX 32-002 (Answer ¶ 4); RRPf 278-79, 282, 719-20). Realcomp disseminates listings to cooperating brokers through a closed database system, and it disseminates listing information from the MLS database to a network of public real estate websites – the “Approved Websites” – that fall into four categories:

- Realtor.com, NAR’s consumer website;
- MoveInMichigan.com, Realcomp’s own public MLS website;⁹
- Realcomp brokerage firm websites through the Realcomp IDX;¹⁰ and
- Realcomp agent websites, also through the IDX.

⁹ MoveInMichigan.com is the exclusive provider of listing information for the website of a local TV station, ClickOnDetroit.com, the most popular website in Southeastern Michigan. (IDF 237-40).

¹⁰ IDX (Internet Data Exchange) is the means by which the MLS disseminates listing information to member websites. (RRPF 245-47).

(RRPF 369, 405, 407). These are the top four categories of websites most visited by buyers. (CCPF 588-600). This dissemination allows listing brokers to achieve wide Internet exposure with minimal effort; Realcomp brokers' new listings and any updates are automatically forwarded to the Approved Websites. (RRPF 600). As Realcomp puts it, through the Realcomp MLS, listing brokers can reach:

- 1) Approximately 15,000 Realcomp II Ltd. MLS Subscribing REALTORS.
- 2) Millions of Internet users shopping for homes on MoveInMichigan.com, REALTOR.COM, and Realcomp Subscribing Brokers' IDX (Internet Data Exchange) websites.

(CX 272).

3. Realcomp Adopted Policies to Limit the Exposure of EA Listings Because They Allow Consumers to Pay a Reduced Commission

Beginning in June 2001, the Realcomp Board of Governors – comprised entirely of full service brokers – adopted a set of rules targeting EA listings. (IDF 142, 349-414). Realcomp considered banning EA listings from the MLS altogether but was advised by “more than one” legal counsel not to do so. (IDF 416; CX 29). Instead, the rules adopted by Realcomp:

- (1) exclude EA listings from Realcomp's feed of listing information to the Approved Websites (the “Website Policy”), (IDF 349-60; RRPf 766, 780-783);
- (2) default “all searches” on the Realcomp MLS database “to include only Exclusive Right to Sell Listings” (the “Search Function Policy”), (CX 9-003; IDF 361; RRPf 793-796); and
- (3) define ERTS listings as “full service” listings, under which brokers must provide a minimum bundle of five services, (RRPF 330, 333).

Realcomp does not dispute that these Policies were adopted in response to limited service brokers entering the market. (RRPF 771). It is likewise clear that the reason Realcomp maintains its Website Policy is that EA listings allow consumers to pay a discounted commission

when no cooperating broker is involved. (*See, e.g.,* Kage, Tr. 1050-52 (Realcomp's CEO explaining "problem" with EA contracts is that "the seller has the option of selling a property themselves, without paying a commission"); CX 38 (Gleason, Dep. at 31-33); CX 421 (Whitehouse, Dep. at 151-52)). In fact, after the Commission filed its Complaint, Realcomp issued a "Call to Action" to its members that explained that the Website Policy is intended to protect brokers' "right to receive wages." (CX 89).

4. The Impact of Realcomp's Policies on the Exposure of EA Listings

There is no dispute that wide exposure is key to selling real estate. (RRPF 454-62, 1185-97; *see also* 1983 Report at 10). There is also no real dispute that the two most critical means of exposing listings are the MLS and the Internet. (RRPF 463-93, 536-98). Realcomp's Policies limit the ability of limited service brokers to expose their EA listings to both cooperating brokers through the MLS and directly to buyers through marketing on the Approved Websites.

a. The Website Policy Substantially Limits Exposure of EA Listings to Buyers

Internet marketing is critical to selling real estate – 80% of buyers now use the Internet as part of their home search. (RRPF 536). The importance of the Internet in marketing homes is confirmed by industry studies on buyer behavior, statistics on the usage of real estate websites, surveys on how brokers market their clients' homes, industry expert opinion, broker testimony and industry white papers. (RRPF 537-87; *see also* RRPF 543, 556, 580-87 (Southeastern Michigan data and broker testimony)). As the CEO of Realcomp admitted, the "majority of home buying and selling now begins on the Internet," so "if you miss that consumer connection, you miss a lot of potential commissions and fees." (RRPF 376).

It is also undisputed that “Internet marketing is only a competitive advantage to brokers to the extent that a significant number of buyers in the relevant geographic area are actually visiting the relevant site.” (RRPF 592). Reliable industry studies consistently identify the same four categories of websites as the ones most visited by buyers: Realtor.com, MLS websites, and broker and agent websites (or “IDX websites”). (RRPF 592-97). Forty to 53% of buyers report visiting each of these types of websites:

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EXHIBIT 3-23

WEB SITES USED IN HOME SEARCH BY FIRST-TIME AND REPEAT BUYERS
(Percent of Respondents Among Buyers Who Used the Internet)

	All Buyers	First-time Buyers	Repeat Buyers
Multiple Listing Services (MLS) Web site	53%	54%	53%
REALTOR.com®	52	46	55
Real estate company Web site	41	43	40
Real estate agent Web site	40	41	40
Newspaper Web site	14	16	12
Real estate magazine Web site	6	7	6
Other	10	9	10

(CX 373-046; *see also* RRPF 597 (data from the Realcomp area are consistent with national statistics)).

The exposure gained through the Realcomp dissemination to the Approved Websites is therefore competitively significant. Consumers in Southeastern Michigan specifically demand that their homes be posted on the Approved Websites and complain when their listings are not. (CCPF 870, 962-63, 981, 986, 991-92, 1042; RRPF 1164-73). The reason for this is simple: the Approved Websites are “where the buyers are.” (CCPF 675; *see also* RRPF 673-76). As recognized by the president of Realcomp’s largest shareholder board, “sellers want their information at the website that is going to best market them and best attract the consumer.” (RRPF 592).

