

Restructuring Agency Relationships in the Real



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Economic Analysis

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Abstract

Recent state legislative reforms of real estate agency relationships suggest that traditional agency law and practice are not meeting the needs of the parties involved in a residential real estate purchase and sales transaction. In this article, we argue that this is due, at least in part, to the bundling of information and representation services provided by brokers. This bundling results in a tradeoff between the benefits to buyers and sellers in sharing information prior to a match, and the cost to the parties individually of revealing information during bargaining. We conclude that, from an economic perspective, effective agency reform must solve this basic conflict, perhaps by unbundling the matching and representation functions.

Introduction

In the past five years, a majority of states have either proposed or passed legislation aimed at restructuring real estate brokerage relationships (see Pancak, Miceli and Sirmans, 1997). These efforts to redefine the agency laws governing the relationship between real estate brokers and their clients suggest that existing laws have not met the needs of the parties involved. Common criticisms of traditional agency law as applied to brokers are that: (1) buyers are unrepresented; (2) sellers are vicariously liable for the actions of unknown subagents; and (3) courts have imposed unintended dual agency status on brokers after the fact. More generally, there seems to be misunderstanding and uncertainty among buyers, sellers and brokers, as to what their legal duties are to one another and how these correspond to the traditional functions that brokers have played in the residential housing market.

Much of this uncertainty stems from an inherent conflict between the traditional roles of the residential broker as both an information provider and an advocate.

The broker best serves the former role when buyers and sellers freely share information prior to a match. However, once a match is made, the broker's fiduciary obligations reside with only one of the parties (historically the seller). As a consequence, the unrepresented party may be reluctant to share information with the broker up front in anticipation of the broker's agency obligations, thereby impeding the flow of information. Inevitably, this reduction in the exchange of information leads to higher transaction costs of completing real estate transactions, and therefore to a less efficient market for housing.

Our objectives in this article are the following. First, we review the traditional role that brokers have played in facilitating sales of residential real estate. Second, we review the law of agency as it has arisen around this traditional role. In doing so, we identify the problems that traditional agency law as applied to brokers seem to have created. Third, we argue that these problems are inherent to the residential brokerage industry as it has been traditionally structured. In particular, we argue that these problems stem from the bundling of brokerage information-providing services and representation (advocacy) roles. Some stylized facts about the commercial real estate brokerage market are instructive in this regard because these services appear to be unbundled to a large extent in commercial transactions. The animosity of traditional (full service) brokers to discount (limited service) brokers in the residential market, and the recent trend toward buyer brokers are also consistent with our analysis. Lastly, in view of the conclusions of the analysis, we evaluate potential alternative brokerage arrangements.

Traditional Brokerage Relationships and Agency Law: An Economic Perspective

The Common Law of Agency and Brokers

Most commonly, a seller of real estate contracts with a broker to sell his or her house.¹ An agency relationship is thereby established through a listing agreement whereby the broker agrees to seek a sale of the property at a price and on terms acceptable to the seller.² In exchange, the seller promises to pay the broker in the event of a sale, generally in the form of a percentage of the sale price.³

Under the common law of agency, the broker (agent) owes the seller (principal) the common law fiduciary duties of loyalty and good faith.⁴ These duties impose on the agent an obligation to act exclusively for the benefit of the principal in all matters connected with the agency.⁵ The broker that enters into this type of relationship is referred to as the "listing broker." Inasmuch as all salespeople employed by the listing broker are agents of the broker, they are deemed "subagents" of the seller.⁶ As a result, all salespeople employed by the broker owe the same common law duties of good faith and loyalty to the seller.

Most listing agreements permit (or require) the listing broker to market the seller's property with other brokerage firms through the Multiple Listing Service (MLS).

This “clearinghouse” for information allows brokers other than those employed by the listing broker (referred to as a “cooperating” or “selling” broker) to show the listed property to prospective buyers in return for a share (usually half) of the commission in the event of a sale. A cooperating broker who introduces a buyer to a property through the MLS is deemed to be a subagent of the *seller*, and therefore owes the common law duties of agency to the seller rather than to the buyer.⁷ All salespersons employed by the cooperating broker are therefore also subagents of the seller.

Problems Created by Traditional Agency Relationships

Traditional agency relationships in residential real estate have been blamed for several problems requiring remediation (see, for example, Collette, 1988; Black, 1994; Nelson, 1994; Grohman 1987; and Brown, Grohman and Valcarel 1995). The first and most fundamental problem stems from the designation of *subagency*. Because the listing and cooperating brokers and all of their affiliated salespeople are legally agents of the seller, the buyer, unless he hires his own agent, is unrepresented in the transaction.⁸ Worse than that, buyers often *perceive* that the cooperating broker, because she has been working with the buyer rather than the seller, is working in the best interests of the buyer.⁹ While this scenario may be true in fact, it is not true in law—as noted, the cooperating broker has a duty only to the seller. Consequently, buyers may systematically misperceive the loyalties of the brokers, which may lead to actions that are contrary to actual legal obligations.¹⁰ For example, a buyer may confide in and take the advice of a salesperson with whom he has worked closely, but who does not legally represent him.¹¹ Thus, if the salesperson protects the buyer’s interests, she is violating the law, whereas if she serves the seller’s interests in detriment to the buyer, the productivity of the relationship will be compromised.

Because buyers have traditionally believed themselves to be represented by the cooperating broker, there has not been a strong demand for true buyer representation. However, recent awareness of their lack of representation, brought about largely by means of mandatory state agency disclosure laws, has increasingly led buyers to seek agency relationships with brokers (see, for example, Marsh and Zumpano, 1988; and Colwell, Trefzer and Treleven, 1993). In addition, some courts have expanded the common law fiduciary duties of agents toward buyers, for example by creating a duty to inspect listed property for the purpose of disclosing defects to the buyer.¹² Generally, however, there is at present some uncertainty as to exactly what duties listing brokers owe to buyers who are unrepresented.¹³

The second problem created by subagency is the possibility of *unintended dual agency*. Under the MLS system, cooperating brokers and their salespeople represent the seller by contract, but an agency relationship can be created by *action* as well as by written agreement.¹⁴ Thus, if a cooperating broker’s actions appear to be based on the buyer’s interests, then the common law will deem the broker

to be an agent of the buyer. As a result, the cooperating broker is simultaneously an agent of the buyer and the seller (*i.e.*, she is a dual agent).¹⁵ Legally, dual agency is allowed only if the agent discloses her status to both the buyer and seller and receives informed consent from them.¹⁶ In many cases, however, dual agency is imposed after the fact, based on the broker's actions toward the buyer. Thus, many times dual agency is necessarily undisclosed and therefore illegal.

The final problem created by traditional subagency is that sellers are potentially vicariously liable for the actions of all subagents, even actions of which the seller is unaware.¹⁷ Clearly, this creates significant scope for seller liability, especially in the case of MLS transactions.

Explanations for Traditional Common Law Relationships

In analyzing traditional real estate brokerage relationships from an economic perspective, we must begin by answering two questions. First, why has the common law theory of agency been applied to brokerage? Second, why was subagency imposed on all salespersons working for or cooperating with the listing broker?

Under traditional agency theory, the creation of an agency relationship is a question of fact. The elements to be examined include whether: (1) the principal manifests his intent that the agent should act for him; (2) the agent consents; and (3) the principal has the right to control the agent's actions. When applied to the relationship between the real estate broker and seller or buyer, these elements can be found.

The concept of an agency relationship between a broker and a seller or buyer was also fostered by the policies of the National Association of Realtors (NAR). When the NAR was founded in the early 1900s, it adopted agency as part of its Code of Ethics to encourage professionalism (see Nelson, (1994:956 and notes 19–20). Since then, courts have consistently held that the role of a listing broker vis-a-vis a seller is one of agency rather than of a finder, middleman or independent contractor,¹⁸ and the chain of seller agency has been extended to salespersons and cooperating brokers. Courts have also now begun to look at the elements necessary to create an agency relationship in imposing such a relationship after the fact on brokers working with buyers.¹⁹

In reviewing the history of the MLS, however, some have argued that subagency was created by members of the NAR in order to restrict access to the MLS (Nelson, 1994:961–963). For example, one commentator has concluded that “subagency is not imposed by the function of the MLS, but by the policy of those who control it,” (Collette, 1988:431). Specifically, the designation of subagency in an MLS transaction allowed the NAR to argue that sellers and listing brokers would only want to extend subagency to ethical cooperating brokers. Brokers not bound by the NARs Code of Ethics therefore could not be trusted with the responsibility of subagency. Bundling the requirement of subagency with the MLS

therefore gave the NAR a justification for limiting access to the MLS to NAR members, and also provided a defense to any potential antitrust claim (Nelson, 1994:961–963).

The fact that the seller nominally pays the cooperating broker's compensation has also been used as an explanation for extending subagency to cooperating brokers.²⁰ Legally, however, the payment of fees or splitting of the commission has not been found to be determinative of whom a broker represents.²¹ With the seller's permission, a listing broker can split a commission with a buyer's broker as well as with a cooperating subagent.

From an information cost perspective, agency duties can be seen as a response to the lack of information that sellers, as infrequent participants, have about the housing market, a situation which forces them to rely on advice and information from those who advertise themselves as experts. The duties of agency provide sellers (principals) with some legal protection against opportunistic behavior by brokers (specifically, failure to act in the seller's best interests), given the asymmetric information of the parties. Although state licensing of brokers provides similar protection, the common law functions to fill in "gaps" in statutory protection of buyers and sellers. From an economic perspective, the agency duties of salespersons economize on the contracting and monitoring costs of sellers by allowing them to presume that all persons under the employ of the listing broker are acting in the seller's best interest without the need for multi-lateral contracts. In the absence of such duties, the only way sellers could enlist the assistance of multiple brokers would be to contract separately with each one. The automatic extension of agency to all salespersons working on behalf of the seller economizes on this contracting cost while allowing maximal exposure of the seller's property to the market. Prior to the advent of the MLS in the United States, sellers often did contract with multiple brokers through open listing contracts (Miceli, 1988). Thus, elimination of subagency might increase the attractiveness of open listings in the residential market.

The marketing of properties through the MLS has created the further need to expand the definition of agency duties to cooperating brokers. This is because a seller's property is being marketed by multiple *firms*, not just multiple salespersons within the listing broker's firm. The extension of agency to all cooperating brokers through the MLS thus allows the seller even wider exposure of the property without the need to negotiate with every broker in the MLS. Thus, while the creation of the MLS in residential brokerage serves the valuable *economic* function of economizing on the costs of obtaining market information, it also has created a set of *legal* obligations whereby all cooperating brokers and their salespeople are deemed to be subagents of the seller.

According to the FTC, however, there appears to be nothing inherent to the functioning of the MLS that necessitates the creation of subagency (FTC Report, 1983:142). This view is consistent with NAR's revised MLS policy which makes offers of subagency optional rather than mandatory, and with our economic

analysis, that views the information and agency functions of brokers as distinct services that have been bundled by the residential brokerage industry. The problem is that these two functions are fundamentally in conflict. To see why, we need to examine the nature of the real estate brokerage function.

The Conflict between the Information and Agency Functions of Brokers

In a recent survey of the economic literature on residential real estate brokerage, Yavas (1994) noted that imperfect information in the housing market creates two sources of uncertainty: (1) uncertainty about finding a trading partner; and (2) uncertainty about completing a trade once a partner is found (see also the FTC Report (1983:70). The first source of uncertainty involves imperfect information on the part of buyers and sellers about the location of suitable trading partners and is present in what we will call the “matching stage.” The second source involves uncertainty about whether the buyer’s valuation exceeds the seller’s reservation price, what the bargaining abilities of the two parties are, and any other issues relevant to the transaction (*e.g.*, quality of the house, closing date, and the like). This source of uncertainty arises once a buyer and seller have been matched and they are bargaining over the terms of a sale (Yavas, 1994). We will call this the “bargaining stage” (see Yavas, Miceli and Sirmans, 1998).

As noted, in the residential real estate market brokers have traditionally participated in both of these stages. In the matching stage, the role of brokers is primarily one of economizing on information. As several authors have noted, this function is most efficiently provided when brokers pool their information since this eliminates the need for buyers and sellers to visit several brokers to ensure sufficient coverage of the market (see Wachter, 1987; Miceli, 1988; and Yavas, 1994). Notice therefore that a fundamental aspect of the MLS during the matching stage is the *pooling and sharing* of information for the purpose of making better quality matches between buyers and sellers. The better the information that brokers obtain from buyers and sellers during this stage, the higher will be the quality of the matches that they can arrange.

Once a buyer and seller have been matched, the bargaining stage begins during which the parties seek to complete a sale. This involves setting the price and other terms of the transaction. During this stage, the interests of the buyer and seller are in direct opposition. Because most buyers and sellers are infrequent participants in the housing market, brokers have traditionally played an important role during the bargaining stage in order to facilitate negotiations over the terms of the sale. We have referred to this as their representation function. It is here that the fiduciary duties of the broker, if any, are crucial, given the conflicting interests of the parties. In particular, it is important that the parties be clear about whom the broker is representing so that they do not inadvertently reveal information that compromises their bargaining position.

The point that we wish to emphasize is: the interests of traders in not revealing certain information during the bargaining stage for fear of compromising their bargaining position is in direct contrast to their gains from shared information during the matching stage. In our view, this conflict is the principal source of the agency problems that brokers face, given that residential brokers generally provide a bundled good to buyers and sellers that includes both information provision and assistance in completing sales (representation) (see, for example, Wachter (1987)). The problem with this bundled good is that the economies from shared information in the matching stage create an environment where buyers and sellers—who, prior to a match, are “strangers”—pursue a common interest—namely, finding a high quality match. Consequently, the agency role of the broker in this stage is not important and therefore may not be clearly delineated up-front. Indeed, as noted, there is evidence that buyers commonly believe that cooperating or selling brokers are their agents, a belief that is a natural consequence of the common goal of buyers and sellers (and their agents) to locate one another (FTC Report, 1983:9, 14).

This confusion, however, may prove detrimental once the bargaining stage commences. For example, a buyer may relate private information to the cooperating broker with whom he has established a close relationship, but who is not *legally* his agent. More fundamentally, the parties may have previously revealed information to the cooperating brokers during the matching stage in hopes of increasing the probability and quality of a match (see Marsh and Zumpano, 1988). Thus, the ability of the brokers to act as advocates may already have been compromised before the bargaining stage begins.

One might argue that these problems can be resolved simply by better defining the agency relationships up-front in anticipation of the conflicts in the bargaining stage. While this may indeed reduce or eliminate revelation by the buyer of private information to the seller’s legal agent, the efficiency of the matching stage may be compromised as a result because information may not be shared as freely. Thus, the cost of well-defined legal obligations up-front is that the expected number and quality of matches may fall. In other words, clearer legal obligations may lower costs at the bargaining stage but increase costs at the matching stage. This is why we believe that there is a basic tradeoff when brokers provide both information and representation services.

One reason why brokers bundle services, other than to retain market share, may be to prevent opportunistic behavior by clients when full service and discount brokers co-exist in a market area.²² For example, Wachter notes that when traditional full-service brokers co-exist with discount brokers, “clients may take the information provided by a full-service firm and purchase a desired house through a limited service firm, with impunity,” (Wachter, 1987:199). The client in this case free rides on the full-service broker’s information-providing function, and then purchases separately other services (including representation) from a

discount broker and/or a real estate lawyer. Perhaps full service brokers see the maintenance of bundled services and the exclusion of discount brokers as their best defense against this sort of opportunism.²³

The Analysis Applied to Commercial Brokerage

In contrast to residential brokerage, there is very little literature on the structure of the commercial brokerage market. Nevertheless, it will prove instructive to offer some stylized facts about the commercial market both to provide support for our argument, and to suggest why current concerns over agency problems seem to be less evident in commercial brokerage.²⁴

The commercial brokerage market differs most fundamentally from the residential market in that there does not appear to exist an analog to the MLS for sharing market information. Instead, commercial brokerage firms share information about their listings much more informally, for example through newsletters and periodic meetings and conferences. Apparently, the benefits of shared information are not large enough in this market to offset the cost of establishing a formal institution.²⁵

A second key difference between the residential and commercial markets is that the information and representation functions of brokers seem to be more “unbundled” in the commercial market. Specifically, in many commercial transactions, the broker who locates a buyer carries the transaction only to the point where a “letter of intent” is signed. (This is equivalent to the residential broker’s finding of a “ready, willing and able buyer.”) At this point, the information function is basically complete. In commercial transactions, different parties—generally lawyers representing the two parties—take over and carry out the representation function by assisting in the negotiation of the final terms of the sale. In contrast, residential brokers generally remain involved in the transaction until the closing, assisting in setting the price, arranging financing and the like.

This difference between the two markets shows the sort of unbundling of the information and representation functions that seems to occur in the commercial market, but that does not occur in the residential market. This may partially explain why there appears to be less concern over agency problems in the commercial market. It also points to a natural solution to the problems in the residential market (one that the common law seems to have been promoting)—namely, separation of the information and representation functions in mediated transactions.²⁶ In the next section, we apply this insight to various proposals for reform of residential brokerage.

Implications for Alternative Brokerage Relationships

The era of seller-only agency relationships in residential brokerage is quickly eroding. In the past five years, the majority of states have either proposed or passed legislation aimed at restructuring brokerage relationships (Pancak, Miceli and

Sirmans, 1997). Theoretically, restructuring approaches fall into three categories: (1) encouraging buyer agency as an addition to seller agency; (2) facilitating non-agency brokerage relationships, thereby allowing brokers to provide the matching function alone; and (3) facilitating non-brokered matching, which would allow brokers to provide the representation function alone. In this section, we briefly examine these alternatives and suggest to what extent each of them addresses the fundamental economic problems associated with the bundling of the information and representation functions of brokerage.

Encourage Buyer Agency

Various legislative approaches have encouraged the use of buyer agency and simultaneously the elimination of subagency. One such approach has simply been to require brokers to disclose the party whom they represent, a provision that nearly all states have adopted. While not by itself addressing the fundamental problem that buyers are unrepresented in traditional sales, this mandatory agency disclosure has served to increase buyers' awareness of their lack of representation, and has led to an increased demand for buyer brokers.

A second legislative approach has been to limit or eliminate subagency in cooperative transactions. The practical effect of this action has been that in cooperative sales, the listing broker represents the seller and the cooperating broker represents the buyer.²⁷

The question then becomes, does buyer agency increase the economic efficiency of the transaction? While buyer agency appears to solve the conflict of interest in the representation function, the analysis in the previous section suggests that it will also likely lead to a decrease in the efficiency of the information function since the sharing of information prior to a match will necessarily have to be curtailed when the cooperating brokers are advocates of parties with opposing interests. Thus, this straightforward solution to the problems with traditional brokerage relationships again illustrates the unavoidable tradeoff between the information and representation functions of residential brokers.

An additional issue raised by the creation of buyer brokerage is the appropriate compensation scheme for buyer brokers. Traditionally, cooperating brokers have received a share of the commission in MLS sales. From the buyer's perspective, however, the incentives that this scheme creates are in the wrong direction because the broker still has an interest in obtaining a high rather than a low price. An important direction for future research, therefore, is the development of compensation schemes that align the interests of buyers and buyer-brokers (see, for example, Colwell, Trefzger and Treleven, 1993:16 and Yavas, 1994:181).

Finally, creation of buyer agency can lead to a dual agency situation if a buyer becomes interested in property listed with his or her broker. Theoretically, this sort of in-house transaction can be distinguished from cooperative sales transactions through the MLS in that the information function is somewhat

reduced in importance, thereby lessening the conflict between the information and representation functions. (The case of the commercial transaction is instructive here because of the diminished role of the MLS in that market.) Thus, for in-house transactions the emphasis can be placed on providing representation to both parties without seriously compromising the benefits of shared information. The obvious and significant drawback to dual agency, however, is that the broker cannot practically represent the interests of both parties to a transaction, thereby limiting the representation function.²⁸

Facilitate Non-Agency Brokerage Relationships

Not all buyers and sellers either want or need a broker's representation. One solution, then, to the conflict between the information and representation functions of brokers is to eliminate the representation function. Brokers would then become merely "facilitators" of the transaction.²⁹ In such a world, neither the buyer nor the seller would be legally represented by the broker working with them. In particular, the broker "would no longer be an advocate and would not be able to negotiate for the benefit of either parties, would not advise the buyer about the price or terms of the offer for the property, and would not advise the seller about what price or terms to accept for the property" (NAR, 1993). Only the information function of the broker would remain.

Clearly, eliminating the agency function of brokers would have serious consequences for the brokerage industry. First, it would probably be difficult in practice for brokers to remain impartial after working with one or the other party, often over a lengthy period of time. Second, the compensation of brokers would likely fall.³⁰ Finally, buyers and sellers would be more likely to hire attorneys if brokers were to become mere facilitators.³¹ Note that these last two consequences would make the residential market closely resemble the commercial market as described above, where the information and representation functions appear to be unbundled. Not surprisingly, NAR does not support this proposal because of the decrease in broker involvement in real estate transactions.

Moreover, a potentially devastating consequence of elimination of the representation function of brokers is that technology may eventually take over the matching function. Historically, the matching function has been controlled by the agents of sellers through the MLS, but real estate listing, sales and transaction data are increasingly available directly to buyers through the Internet. Theoretically, this means that buyers and sellers may not need the assistance of an agent in order to find a match.

Facilitate Non-matching Brokerage Relationships

Yavas (1994) has advocated elimination of the matching function of brokers by making MLS information available (at a fee) to all interested parties. He argues

that this is efficient because it would reduce duplicative search efforts by brokers and allow traders to unbundle the package of services provided by brokers. As just noted, the Internet and other technological changes may make this outcome inevitable. Therefore, perhaps the primary role for brokers in the age of cyberspace may be the representation function.³² Residential brokers could then concentrate only on the buyers' or sellers' side of the negotiations without conflict. Again, however, because one traditional brokerage function is replaced, the compensation of brokers would likely fall. Also, by unbundling the representation function and the brokerage-controlled matching function, the brokerage industry may forfeit some of the representation business to other qualified real estate industry participants, including attorneys, title companies and mortgage lenders.

Conclusion

This article has examined agency relationships between brokers and their clients in residential real estate transactions from a legal and economic perspective. Recent legislative efforts in many states to clarify and redefine these relationships suggest that traditional agency law is inconsistent with actual practice and/or perceptions. This state of affairs is due, at least in part, to the bundling of information and representation services provided by residential brokers, which results in a tradeoff between the joint interests of buyers and sellers in sharing information prior to a match, and the cost to the parties individually of revealing information during bargaining. Recognition of this basic economic conflict between the information and representation function of brokers is essential if sensible reforms are to be enacted. The types of reforms that would lead to a more efficient market for housing are those efforts that would allow a buyer or seller to contract with a broker for only those services they want and need; in effect unbundling the matching and representation functions. Of course, such unbundling may not be in the best interests of the brokerage profession since it would likely result in lower brokerage compensation. Further research on the extent of this effect is needed.

Endnotes

- ¹ For a detailed examination of the residential real estate brokerage industry, see FTC Report (1983). A seller's other alternative has been to market his property himself, a situation described as a "FSBO" (for sale by owner). See Salant (1991) for a discussion.
- ² While a seller typically works with a salesperson in the broker's office, it is the broker who legally enters into the listing agreement and is the seller's agent. The salesperson is then a subagent.
- ³ Several authors have examined the incentive properties of different compensation schemes for real estate brokers. See, for example, Zorn and Larsen (1986), Anglin and Arnott (1991), Arnold (1992) and Levmore (1993).
- ⁴ Restatement (Second) of Agency, §387 (1957).

- ⁵ A broker's fiduciary duties to a seller have been defined as follows (Grohman, 1987: 560, note 1): The agent must act, as to matters within the agency, primarily for the principal's benefit. This obligation includes: making reasonable efforts to accomplish the objectives of the agency; exercising the standard of care and skill common to the locality for the matters within the agency and utilizing any special skill that the agent possesses; accounting for profits arising from the agency's activities; not acting for or on account of one whose interests are adverse to the principals; not competing with the principal for the agent's benefit with respect to matters within the agency; dealing fairly with the principal in all matters between them; not acting contrary to the principal's reasonable instructions in agency matters; not disclosing confidential information given to him by the principal or with respect to matters within the agent's knowledge or which the agent may discover that may be material to the agency (citations omitted).
- ⁶ See Restatement (Second) of Agency, §5, (1957) at 27, and *Stortroen v. Beneficial Finance Co.*, 736 P.2d 391, 396 (Colo. 1987). In general, commentators are in agreement that all salespersons working for a broker are also agents of the broker's principal. See Reilly (1987: 78-83) and Nelson (1994). See also *Dolvin Realty Co. v. Holley*, 48 S.E. 2d 109 (GA 1948), where a salesperson in a broker's office was deemed to be the seller's subagent. But see *Moser v. Bertram*, 858 P.2d 854 (N.M. 1993), where the New Mexico Supreme Court held that salespeople employed by a given broker are not bound by the fiduciary relationship of that broker.
- ⁷ This has been the majority view, which is exemplified in *Stortroen v. Beneficial Finance Co.*, 736 P.2d at 395–401. There the court refused to find an agency relationship between the cooperating broker and the buyer, recognizing that “[t]he prevailing perceptions of the broker as an agent of the seller is too firmly embedded in the real estate business to permit a finding [of agency between the cooperating broker and the buyer] on the basis of conduct alone. *Id.* at 400. *But see* *Wise V. Dawson*, 353 A.2d 207 (Del. Super. 1975), where a cooperating broker was not automatically viewed as a subagent of the seller based on the MLS relationship alone. There the court held that the determination as to whether the relationship between the listing and selling broker is one of agency is based on the facts of each case.
- ⁸ See *Stortroen v. Beneficial Finance Co.*, 736 P. 2d at 396–400.
- ⁹ The 1983 FTC survey showed that 70% of homebuyers believed that the real estate salesperson showing them homes was working for them. Sellers may also perceive that the cooperating broker is acting in the buyer's interests. The same survey showed that 77% of sellers believed that the selling salesperson represented the buyer in in-house sales, and 74% believed that the cooperating salesperson represented the buyer in MLS sales (FTC Report, 1983). Also, see Marsh and Zumpano (1988).
- ¹⁰ “The strongest argument for eliminating sub-agency is that it does not reflect reality,” (Collette, 1988:419). “[T]he full effect of subagent's fiduciary duties to the seller may be difficult to comprehend because they are not accustomed psychologically to owing fiduciary duties to ‘someone else's seller’ as opposed to ‘my buyer’.”(Collette, 1988: note 101).
- ¹¹ For example, the FTC Report showed that 62% of buyers surveyed were told how low a price the seller would probably accept by the cooperating salesperson (FTC Report, 1983: 26).
- ¹² See, for example, *Easton v. Strassburger*, 199 Cal. Rptr. 383 (Cal. App. 1984) (the holding in this case was subsequently addressed by legislation, see Cal. Cir. Code Section 2079). For discussions of a real estate agent's duty to disclose material facts to

a buyer, see Pancak, Miceli and Sirmans (1997), Adler (1982) and Marsh and Zumpano (1988: 157).

- ¹³ States have recently begun to address this problem by enacting statutes that specify what duties a listing broker owes to the buyer. For a general discussion, *see* section III below.
- ¹⁴ *Duffy v. Setchell*, 347 N.E. 2d at 221, *Fickling & Walker Const. Co. v. Giddens Const. Co.*, 376 S.E. 2d at 655, *Proctor v. Holden*, 540 A. 2d at 142 (there the court recognized that an agency relationship can be “inferred from the parties conduct,” although did not find that a broker was the agent of a buyer since there was not “any evidence from which a reasonable inference could be drawn that an agency relationship had been created”); *Groh v. Shelton*, 428 S.W. 2d, 911 (Mo. Ct. App. 1968) (broker found to be buyer’s agent through the parties actions, even though neither party may have intended to create an agency relationship).
- ¹⁵ Some states have defined dual agency by statute. For example, Alabama defines dual agency as “[a]n agency relationship in which the same brokerage firm represents both the seller and the buyer in the same transaction.” ALA. CODE § 34-27-81(9) (1995). Alabama further delineates circumstances that may establish a dual agency as including:
- a. When two or more licensees [defined as a broker or salesperson] licensed under the same broker each represent a different party to the transaction.
 - b. When one licensee, represents both the buyer and the seller in a real estate transaction.
- ¹⁶ Restatement (Second) of Agency § 381, comment d (1958). *Cogan v. Kidder, Mathews & Segner, Inc.*, 648 P.2d 875, (Wash. 1982) (a broker who failed to disclose his dual agency status forfeited his commission).
- ¹⁷ Restatement (Second) of Agency §162 (1958). *Foster v. Cross*, 650 P. 2d 406, 408 (Ala. 1982) (misrepresentation made by an agent are attributable to the agent’s principal).
- ¹⁸ See *Hercules v. Robedaux, Inc.*, 329 N.W. 2d 240, 242 (Wis. 1982) (the “essential and basic feature underlying the relation of a broker to his employer is that of agency, and the principles of agency law apply throughout”); *Batson v. Strehlow*, 441 P. 2d 101 (Cal. 1968) (a broker has duties beyond merely bringing the parties together, as distinguished from a finder or middleman).
- ¹⁹ See *Fickling & Walker Co. v. Giddens Const. Co.*, 376 S.E. 2d 655 (Ga. 1989) (a listing broker representing the seller was found to also be an agent of the buyer since the broker held the buyer’s deposit money); *Duffy v. Setchell*, 347 N.E. 2d 218 (Ill. App. 1976) (“If a buyer requests a broker’s assistance in obtaining a particular piece of property, the broker may be held to be the buyer’s agent for that transaction, even though the broker is paid nothing by the buyer and it is expected that he will receive a fee from the seller.”). *But see* *Proctor v. Holden*, 540 A. 2d 133 (Md. App. 1988) (the court refused to establish an agency relationship between the broker and the buyer on the basis of a “mutually understood inference” that the broker was working on the buyer’s behalf, in the absence of a verbal or written agreement).
- ²⁰ Several empirical studies show, however, that a fraction of the commission is shifted to the buyer in the form of a higher sale price. See, for example, Doiron, Shilling and Sirmans (1985) and Jud and Frew (1986).
- ²¹ See, for example, *Brean v. North Campbell Professional Building*, 548 P.2d 1193 (Az. 1976); *Duffy v. Setchell*, 347 N.E. 2d at 221.
- ²² The FTC Report defines alternative, or discount, brokers to be “those who charge and promote a commission rate or fee that is at least 2 percent lower than the fee prevailing in their geographic area, or who offer and promote services that differ significantly from those generally offered in their geographic area.” (FTC Report, 1983: 150).

- ²³ See FTC Report, (1983: 150–172) for a more detailed discussion of the conflicts between full service (traditional) and discount (alternative) brokers.
- ²⁴ These stylized facts are derived from the authors' own observations of commercial real estate brokerage activities as well as from an interview with Bruce Cagenello, President of the Greater Hartford Board of REALTORS® and a commercial broker with Prudential Connecticut Realty, in Rocky Hill, CT (June 4, 1996).
- ²⁵ As a result of the absence of an MLS, open listing contracts (a contract whereby the broker is only entitled to compensation if the broker finds a buyer, as opposed to an exclusive right to sell contract where the broker is entitled to compensation no matter who finds the buyer) are used much more frequently in the commercial market than in the residential market. See Wachter, (1987:201). Open listings in the residential market are also common in England where the MLS is less developed than in the U.S. See Miceli, (1988).
- ²⁶ Another stylized fact about commercial brokerage is that the commission rate is on average lower than in residential sales. For example, a recent national survey found the average selling expenses for various types of commercial properties in the U.S. ranged from 2.5% to 4%. See MacIntosh, (1996). In contrast, residential commission rates average 6–7% (FTC Report, 1983). This difference may be due to the unbundling of services—brokers are paid only for the information function while other agents are paid for the representation function. However, it may also be due to the higher average price of commercial sales. Another observation is that the commission rate is more variable in commercial as compared to residential sales. See Wachter, (1987: 200). This may reflect greater variability in the level of services commercial brokers provide, again evidence of unbundling.
- ²⁷ For example, Connecticut recently enacted legislation that prohibits the practice of subagency without the written consent of the person being represented. Connecticut P.A. 96-159: An Act Concerning Real Estate Brokerage Practices (1996). Such consent must list the name and license number of the subject to be appointed. Other examples of this type of legislation include Nebraska which creates a presumption that a cooperating broker is an agent of the buyer rather than a subagent of the seller, Iowa prohibits an offer of subagency through the MLS, Vermont prohibits sub-agency, and Washington which has created a presumption that a broker who works with a buyer represents the buyer. NEB. REV. STAT. § 76-2401-2430 (1995); IOWA CODE § 543B.55-.64 (1995); VT. STAT. ANN. tit. 26, § 2296 (1995); 1995 Wash. House Bill 1659. Some practitioners believe that the practical effect of this limitation on subagency will be that the listing broker will represent the seller, and the cooperating broker will represent the buyer, an arrangement, as noted above, that is in keeping with the traditional beliefs of most parties.
- ²⁸ Recent legislation by some states allows the broker and salespersons in a firm to be disclosed dual agents, provided that the parties being represented execute a statutorily prescribed dual agency consent form. In Connecticut, if the parties execute a statutorily prescribed “Dual Agency Consent Agreement,” there is a presumption that the parties have given their informed consent to dual agency representation. Conn. P.A. 96–159. Examples of other states that allow dual agency for in-house sales include Oregon and Rhode Island. OR. REV. STAT. §§ 696.010-.490 (1994); R. I. GEN. LAWS §§ 5-20.6-1-8 (1995). If a broker is a dual agent, however, the representation services he can provide are limited by statute. For example, the Connecticut law limits a dual agents from disclosing any personal, financial, or other confidential information to either party,

including information that the seller will accept less than the asking price or that the buyer will pay more than the offered amount. Conn. P.A. 96-159.

Other states have adopted the practice of “designated agency,” where one agent in the firm acts as an agent of the buyer and another acts as an agent of the seller, with neither regarded as a dual agent. Such states include Georgia, Illinois, Indiana, Iowa, Kansas, Maine, Maryland, Massachusetts, Montana, Nebraska, Nevada, North Dakota, Ohio, Oregon, Tennessee, Texas, Utah, Virginia, and Washington. GA. CODE ANN. §§ 10-6A-3 et seq. (1995), ILL. REV. STAT. ch. 225, para. 455, §§ 38.1-.65 (1996), IND. CODE ANN. §§ 25-34.1-10 (West 1995), IOWA CODE §§ 5431//B.55-543B.64 (1995), KAN. STAT. ANN. 58-3001-3075 (1995), ME. REV. STAT. ANN. tit. 32 §§ 13271-13281 (West 1995), MD. CODE ANN., Real Prop. § 17-528 (1995); 254 CODE MASS. REGS. 205 (1995); MONT. CODE ANN. §§ 37-51-102,-314 (1995); NEB. REV. STAT. § 76-2401-2430 (1995); NEV. REV. STAT. §§ 645-.251-.259 (1995); N.D. CENT. CODE § 43-23-01-17 (1995); TEX. REV. CIV. STAT. ANN. § 15C (1996); UTAH CODE ANN. § 61-2-10 (1995); VA. CODE. ANN. § 54.1-2130-2144 (Michie, 1995); 1995 Wash. House Bill 1659.

From an economic perspective, the designated agency solution appears to be superior to the dual agency solution in this regard because both parties are represented under the former whereas the latter offers only limited representation to each party.

- ²⁹ Non-agency relationships in real estate have recently been legislatively recognized in a few states, including Alabama (“contract broker”), Colorado (“transaction broker”), Michigan, (“transaction coordinator”), Minnesota, Montana (“statutory broker”), Tennessee (“facilitator” or “transaction broker”), and Virginia (“independent contractor”). ALA. CODE §§ 34-27-81 et seq. (1995); COLO. REV. STAT. §§ 12-61-801 et. seq. (1995); MICH. STAT. ANN § 339.2517 (Callaghan 1995); 1996 Minn. Laws 439; MONT. CODE ANN. §§ 37-51-102,-314 (1995); TENN. CODE ANN. §§ 62-13-102, 62-13-403-405 (1995); and VA CODE ANN. § 54.1-2130-2144 (Michie, 1995).
- ³⁰ A 1993 NAR survey found that 72% of sellers and 44% of buyers felt that facilitators should be compensated less than traditional agents. National Association of REALTORS, Facilitator PAG Research Study: Consumer and Realtor Perceptions About the Facilitator Concept (October 1993).
- ³¹ The NAR survey found that with facilitators, 74% of sellers and 57% of buyers would be more likely to hire an attorney. Market Research Study, (1993).
- ³² It appears as if most state licensing laws would already allow for this, as the licensing aspect of brokerage is primarily concerned with a broker’s representation, rather than matching, role.

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