

# Center for Real Estate and Urban Analysis

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## **Conflicts of Interest in Commercial Real Estate Transactions: Who Represents the Tenant?**

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## **ABSTRACT**

This study seeks to identify the potential conflicts of interest inherent in real estate transactions between a commercial tenant and a prospective landlord; evaluate the legal, regulatory, and industry mechanisms in place to protect the interests of commercial tenants through professional representation in these transactions; and where necessary, make recommendations for how such tenant protections might be strengthened to assure an arm's length transaction between the parties, thereby optimizing the functioning of the commercial real estate marketplace.

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**LEGAL DISCLAIMER:** Neither the content of any work product generated under any section of the Scope of Work, nor the Preliminary or Final Report, constitute legal advice to any party. The study is intended and will be undertaken as an academic research project, the fact that some components of the study involve the review and analysis of legal principles and case law notwithstanding. No participant in any aspect of the study or reader of the Preliminary or Final Report resulting from the study may rely on any study documentation, in whole or in part, as legal advice.

## I. INTRODUCTION

### **Corporate Facilities: From Executive Convenience to Strategic Asset**

Before corporate facilities came to be viewed as strategic assets of the corporation, a common approach undertaken by commercial brokerage firms in locating or relocating corporate facilities was to make life as easy as possible for the corporation's CEO. By locating a corporate headquarters (HQ) as close as possible to the CEO's home **and** the CEO's country club, locational decision-making was streamlined and simplified. If a corporation was relocating to a new part of the country, triangulating the new HQ, the CEO's new home, and the CEO's new country club was the formula for success as well. This approach dovetailed nicely with the proliferation of suburban office parks and corporate campuses, along with gated, golf-course communities, characterizing a 50-year development pattern that eschewed life in the city for a seemingly idyllic life "in the country." This approach may also explain why commercial office location searches at that time were more likely to be undertaken by human resources departments, which were also concerned with satisfying the needs of those in the Executive Suite. Very few companies at the time had fully staffed real estate departments because facilities were viewed simply as a means to an end, and not as strategic assets.

How times have changed. The selection of corporate facilities in latter part of the 20<sup>th</sup> century and now, in the 21<sup>st</sup> century, has become **much more strategic** and **much less focused on executive convenience**. As discussed below, a number of factors ushered in this evolution over more than three decades. Nonetheless, the one fundamental issue that has not changed during this evolution is the fact that in a majority of commercial leasing transactions, the tenant is represented by a full-service commercial real estate services ("full-service CRES") firm that routinely represents landlords, and may, in fact, have been representing the landlord in that tenant's lease transaction at the time.<sup>1</sup> Even as the customer base for leased premises (i.e. the universe of potential, commercial tenants) has become more consolidated and, consequently, more sophisticated in their approaches to corporate real estate, the CRES sector has gone through a period of consolidation of its own, with national and global full-service CRES firms acquiring traditional tenant-only CRES firms.<sup>2</sup>

If this growing and increasingly-sophisticated corporate real estate presence was truly concerned about conflicts of interest when represented by full-service CRES firms, such consolidations, resulting in a much smaller universe of tenant-only CRES firms, would not be occurring. And yet, it is hard to imagine any more-adversarial relationship than that between a tenant in search of premises and a landlord looking to lease vacant or soon-to-be-available space in the landlord's building. So, how do these adverse parties—prospective tenant and its potential, new landlord—avoid having their respective positions compromised in a transaction in which both are represented by the same broker?<sup>3</sup>

## Real Estate as a Strategic Corporate Asset

Viewing corporate operations from an asset management and financial analysis perspective, the acquisition of new facilities—including the location or relocation of headquarters, regional, and district offices, and warehouse and production facilities—are now commonly viewed strategically.<sup>4</sup> A particular office location may have a substantial, positive impact on a company's brand. For example, it may be imperative for a federal lobbying firm to locate its headquarters in the District of Columbia, the home of the federal government, versus the surrounding Maryland or Virginia suburbs. However, for a high-tech company the cost and other differentials, as well as greater proximity to universities with relevant graduate programs and research centers may make the suburbs of D.C. a much more strategic decision.

Locational choice will also have an impact on a corporation's recruitment and retention of qualified and engaged staff, on worker morale, and on the corporation's overall productivity, regardless of whether that choice also means a longer commute for senior executives. Access to necessary resources, including human capital (e.g. proximity to one or more university campuses); connectivity through multiple forms of transportation, including mass transit; and even locating near entertainment, recreational, and retail opportunities viewed by employees as "necessary amenities," may all factor into the equation.

Zappos, the global, internet footwear retailer, offers an excellent example of how corporate headquarters locations and relocations have become much more strategic, particularly in the age of high-tech workers and global, internet-based enterprises for which the HQ's time zone is completely irrelevant. Zappos relocated in 2004 from San Francisco to Henderson, Nevada, a suburb of Las Vegas in Clark County. Eight years later, in 2012, Zappos decided to again relocate its international headquarters, this time choosing downtown Las Vegas, eschewing dozens of shiny, new, and seemingly superior suburban enclaves in Clark County, like Summerlin. This second relocation decision was made primarily to provide Zappos' employees with the 24/7 vibrancy that only downtown Las Vegas could offer. Not surprisingly, Zappos was named one of **Fortune Magazine's** *Best Companies to Work For*. Clearly, then, work atmosphere and the surrounding environment were viewed as strategic criteria for Zappos's locational decision-making process.

Over the period during which corporate facilities searches and selections were becoming more strategic, approaches to the representation of corporate tenants evolved into more sophisticated enterprises as well. Local real estate companies became regional firms, and regional firms became national and, then, international, full-service organizations. Traditional, brokerage-only firms became full-service CRES firms, offering a variety of real estate-related services going well-beyond merely representing parties in commercial leasing transactions. Not long after the advent of "tenant representation" as a separate service or even division of full-service CRES firms, some brokers, feeling they could not adequately represent both landlords and tenants, expanded the niche market of **tenant brokerage**--firms devoted **exclusively** to representing tenants—following in the footsteps of CRES sector pioneer in this area, Julian J. Studley.<sup>5</sup>

This dichotomy between “tenant representation” or “tenant agency” through a full-service CRES firm, on the one hand, and “tenant-only representation” or, simply, “tenant brokerage,” on the other, was born of an effort to address the conflicts of interest in what is an inherently adversarial relationship. However, an **objective, academic analysis** of whether, and to what extent, the best interests of tenants in commercial real estate transactions are served by this bifurcation has yet to be undertaken. That is the underlying purpose of this study.

The third and final factor in this evolution involves a shift in in-house responsibilities for corporate tenants. Once the search for corporate facilities became part of a larger process of executing a corporation’s **comprehensive real estate investment strategy**, rather than merely serving as a means to an end, the gravity of the process and its outcome shifted the corporation’s in-house burden from human resources departments to finance and legal departments. Being familiar with conflicts of interest in their own, respective professional disciplines, chief financial officers and general counsels started placing an increasing emphasis on the **inherent conflicts of interest**—some easily understood while others were much more nuanced and subtle—that accompany a prospective tenant’s search and negotiation for commercial premises. Along these same lines, as companies have become bigger and with increasing facilities needs (think not just front office operations but also things like supply chain facilities), responsibilities have shifted from the CFO or General Counsel to fully staffed, in-house corporate real estate departments.<sup>6</sup>

It is within this context of a shifting emphasis among commercial tenants viewing and treating corporate real estate as a strategic asset, along with the consolidation of market share within the CRES sector, as top, full-service CRES firms absorb tenant-only brokerages, that this research study considers the fundamental question: **Who represents the tenant in commercial leasing transactions?**

## II. Summary of Findings and Recommendations

This research study poses a very basic and seemingly simple question: **In the search for and negotiation of commercial leased space, who represents the tenant in dual representation situations (i.e. where the Listing Broker and the Tenant Agent<sup>7</sup> both work for the same full-service, commercial real estate services (“CRES”) firm?**

This question also raises a more comprehensive question in a period, as is the case today, where the top, full-service CRES firms are growing rapidly by acquiring smaller competitors. As a consequence, several of the largest, full-service CRES firms may be involved in different aspects of the same transaction, with the respective interests of clients involved in the development and financing of commercial properties relatively aligned: **Do tenants represented by Tenant Agents employed by full-service CRES firms require specific disclosures and special protections to insure the Tenant Agent’s independent representation of their client’s best interests?**

The relative roles and respective interests of landlords, on the one hand, and tenants or prospective tenants, on the other hand, are by their very nature **adversarial**. The landlord wants the highest rent the premises can command in the marketplace, with as many of the operational responsibilities and liabilities resting on the tenant. For its part, the tenant wants the exact opposite: the lowest rent possible, with as many of the obligations falling onto the landlord without additional charge to the tenant.

Recognizing that conflicts of interest are inherent in the adversarial relationship between landlords and tenants, and the constraints such conflicts of interest impose on the representation of tenants in commercial real estate transactions when the landlord and the tenant are represented by the same full-service CRES firm, the question becomes: **“How can conflicts of interest in such situations best be avoided, assuming that their avoidance is both possible and practicable?”**<sup>8</sup>

In accordance with its Scope of Work (see Appendix A: Scope of Work), this research study sought to:

- **Define the relationships** between the various parties involved in a tenant’s search for and commitment to facilities, including the tenant, the prospective landlord, and the parties representing each. Other stakeholders’ interests, such as those of investors and lenders, were also examined, although somewhat tangentially, in this context.
- **Describe and, if possible, rank what a tenant’s priorities** should be in its representation.
- **Explain how conflicts of interest may arise** in the representation of commercial tenants **and the potential, adverse consequences** for tenants when conflicts of interest are resolved in favor of the landlord (treating separately the question of whether the existence of conflicts of interest, at a minimum, must be fully disclosed to tenants at the outset or, in specific circumstances, as and when they arise).
- **Identify and evaluate legal mechanisms** intended to protect tenants from conflicts of interest.
- **Offer policy prescriptions**, if appropriate, for how potential conflicts of interest may be ameliorated to better protect tenants in their representation in commercial transactions. In this particular, a preference has been given to policy prescriptions that may be more-easily yet credibly enforced by and within the commercial real estate industry itself, as opposed to through legislative means such as recent changes in state statutes impacting dual-agency relationships.<sup>9</sup>

## A. Findings

Within the foregoing framework, as described in greater detail in Appendix A: Scope of Work, referenced above, this research study resulted in the following general findings,

the basis for which, in each instance, is described in detail in various sections of this report, as supported by the Endnotes, Bibliography, and Appendices that follow the body of this report and are incorporated by reference herein.

1. Unlike other U.S. markets, including but not limited to the residential real estate market and the domestic capital markets, **the U.S. commercial leasing market lacks transparency and equal access to the same quantum of information by all parties.** The following are among the factors supporting this finding.
  - a. The commercial leasing market is characterized by asymmetric information, leading to inefficiencies and skewing outcomes in favor of those who control the gathering and selective dissemination of that information. Data regarding market characteristics is almost exclusively idiosyncratic to specific CRES firms. Competing CRES firms tout the **superiority** of their Research Departments as a market differentiator.
  - b. There is neither a centralized source nor an industry standard methodology for obtaining, tracking, and reporting critical data comprising “the market” for commercial office space. Contrast this with the Multiple Listing Service (MLS) in the residential sales market, which provides generally accessible and uniformly collected and reported data on residential sales and homes offered for sale. Similarly, the various stock exchanges making up the U.S. market for capital is even more standardized and accessible than the residential market is, primarily as a function of securities laws and regulations governing the capital market intended for the protection and benefit of investors.
2. To the extent there is a unifying influence over the U.S. commercial leasing market, that influence is consistently **supply side oriented** or **landlord-centric**. The market is driven by the supply of available premises for lease and not by the demand for such premises. As a consequence, the status quo, including asymmetrical information, supports the interests of landlords and their brokers, to the detriment of tenants. Markets always function most-efficiently when all information relevant to a purchasing decision—or in the context here, the decision to lease a particular premises, at a specific price, in accordance with detailed terms and conditions, all set forth in a lease agreement—is readily and equally available to all consumers and suppliers of the goods comprising that market. There is little incentive within the current system for the largest participants to create an efficient market for commercial leasing transactions.
3. **The CRES profession--**which provides an increasingly sophisticated depth and range of professional services to commercial clients, including real estate developers and other building owners, institutional and other investors, and lenders involved in various stages of commercial property development and ownership, as well as to prospective and existing tenants— **is loosely organized, such that the conflicts of interest issue has not been addressed in any systematic way benefiting tenants.**

- a. Contrast the CRES sector with the U.S. residential real estate market, where a centralized organization—the National Association of Realtors (NAR)—accounts for a majority of residential real estate brokers and agents, providing uniform and comprehensive procedures, requirements, and guidelines for how transactions are initiated and managed, and how the respective parties within that framework are represented.<sup>10</sup>
- b. Licensure requirements vary from state-to-state (see Appendix E: Comparison of Disparate Commercial Brokerage Regulatory Frameworks).
- c. The CRES industry lacks uniform, national standards of practice and professional ethics (see Appendix E: Comparison of Disparate Commercial Brokerage Regulatory Frameworks).
- d. The CRES sector is dominated by a small number (less than ten) of very large, full-service CRES firms accounting for the vast majority of annual, completed leasing transactions (see Appendix D: Profiles of the Largest Full-Service and Tenant-Only CRES Firms).
- e. The CRES industry has openly opposed legislative and regulatory reform efforts seeking to improve the quality of representation provided to tenants through mandatory disclosure of conflicts of interest in dual agency situations. Such public opposition has created at least the appearance that full-service CRES firms dominate the CRES sector, and that they would prefer not to have to make such disclosures before representing a tenant, despite countervailing, common law duties requiring full disclosure of such conflicts.
- f. Relationships between and among various principals in a real estate development or acquisition transaction, or in the course of the normal ownership and management of commercial property—developers, institutional and other equity investors, and lenders of various types—are increasingly complex yet obscured from the public.
- g. Similarly, the roles played by the respective agents of each principal party in a commercial property transaction—including commercial property sales brokers and agents, capital markets advisors, strategic planning consultants, transaction financing brokers representing equity and debt investments, and, of course, Listing Brokers—are sufficiently sophisticated and complex as to be obscured at the level of commercial leasing transactions. Consequently, it may be unrealistic to expect that the average office tenant, which is not in the commercial real estate business, could understand and fully comprehend the potential impact and negative consequences of such relationships for purposes of creating a meaningful and effective system of conflict of interest disclosures and advance, written waivers by all of the parties to these transactions.

4. The **fundamental relationship between landlords and tenants is inherently adversarial**, both in the negotiation and execution of lease agreements and in the tenant's occupancy of the landlord's premises. In other contexts, this has been deemed to be a conflict of interest that **may not be resolved** through full disclosure. In other words, the parties' respective interests are so inherently adverse that the conflict cannot be waived even with the fully-informed consent of both parties. This raises a fundamental question for the profession: **If legal ethics prohibit an attorney or a law firm from representing both the landlord and a tenant in the negotiations of a lease agreement or in a dispute over the interpretation of the terms and conditions in a lease agreement, how can the divergent interests of those same parties nonetheless be adequately represented by the same CRES firm through dual agency?**

## B. Recommendations

Based on the Findings the following recommendations are offered to the CRES sector.

### 1. Further Study

- a. Primary research into practices among full-service CRES firms and, in particular, their tenant clients, including but not limited to:
  - i. Further inquiry into the incidence and intensity of actual conflicts of interest in the CRES Sector (see Appendix B: Conflicts of Interest survey instrument and Appendix C: Conflicts of Interest survey results, respectively).
  - ii. Collection, review, analysis, and assessment of conflicts-of-interest policies, procedures, and compliance measures among full-service CRES firms to establish Best Practices that could be emulated by **all** full-service CRES firms.
  - iii. Primary research into the client group's (i.e. tenants') depth of understanding about the types of conflicts of interest occurring in commercial leasing transactions, how they arise, and the potential, adverse consequences for tenants when such conflicts are resolved against their best interests and in favor of the landlord.

### 2. Better and More Centralized Organization of the CRES Sector

There is a plethora of examples in the United States of how industry self-regulation can be very effective in protecting consumers and also improving the efficiency of markets. This is a pervasive model for how various professional disciplines endeavor to assure a uniform level of quality to consumers of that profession's services, including the AMA (American Medical Association), the ABA (American Bar

Association), the AICPA (American Institute of CPAs), the AIA (American Institute of Architects), and the APA (American Planning Association). As already mentioned, the NAR provides much of the regulatory and compliance framework for its members, who are then also licensed in the states in which they do business. The National Association of Securities Dealers (NASD) is another such example. The CRES sector could create its own framework for establishing uniform rules of conduct and the enforcement of those rules through the creation of a national organization devoted exclusively to the CRES sector. This organization would be open to CRES firms, as well as individual agents and Associate Brokers; public officials involved in the regulation of CRES providers; and—of course—tenants, including but not limited to corporate real estate executives. These various stakeholders would be invited and encouraged to participate actively and substantively in establishing uniform rules of conduct and the enforcement of those rules.

### **3. Development of a Model Code of Conduct for CRES Firms, and Their Associate Brokers and Agents**

Short of creating a national CRES association to which all firms would belong and contribute, and which would—among other things—develop the regulatory framework for addressing conflicts of interest in commercial leasing transactions—the CRES sector could organize an effort to draft model legislation to be provided to state legislatures and interest groups, including consumer advocacy organizations, seeking to provide uniformity and consistency in the manner in which commercial real estate services are provided throughout the country (assuming eventual, widespread adoption of such model code).

## **III. Understanding Commercial Real Estate Transactions, Including Leasing, and the Role of the Commercial Real Estate Services (CRES) Sector in These Transactions<sup>11</sup>**

### **A. Commercial Property Development and Ownership: A Very Brief Primer**

#### **1. The Parties**

##### **a. Commercial Property Development**

The ground-up development and financing of a commercial property (the resulting improvements constructed upon the land being collectively referred to herein as the “Project”) may involve a very large cast of characters, including but not limited to the following parties relevant to this research study:

- i. The **Developer**.
- ii. One or more **special-purpose entities** (“SPE”) that will develop and own the Project (i.e., the land and improvements thereon).

- iii. **Equity Investors** are one or more investors, whether individuals or entities, assuming risk exposure on their investment, who may invest at various stages in the development process.
- iv. **Lenders** are one or more lenders, including but not limited to individuals or entities lending funds in any of the following stages in the development process:
  - a. Acquisition of the Subject Property;
  - b. Funding predevelopment costs;
  - c. Providing construction financing;
  - d. Providing bridge financing; and
  - e. Providing permanent financing.
- v. **Tenant** (and, collectively, **Tenants**), which is the ultimate end-user of the Project, the aggregate rent streams from which the Developer's and the SPE's ability to service any outstanding debt issued by the Lenders and provide a return to the Equity Investors depend.
- vi. **Commercial Sales Brokers and Agents** involved in site selection and acquisition.
- vii. **Commercial Property Investment Advisers** providing strategic guidance about various aspects, primarily financial, regarding the Project.
- viii. **Listing Broker** of the commercial brokerage firm representing the SPE and, possibly also, the Developer, engaged to list and promote the Project to its end-users (i.e. **Tenants**).
- ix. **Commercial Leasing Brokers and Agents** representing prospective Tenants, which may include both:
  - a. **Full-Service CRES Firms** that also routinely represent commercial real estate developers (and may, at the time they are representing prospective Tenants in the Project, also represent the **Developer** and the **SPE** for that Project).
  - b. **Tenant-Only CRES Firms** (also referred to herein as a **Tenant-Only Broker**) are CRES firms that **only** represent tenants in commercial leasing transactions.

**b. Portfolio Selection and Acquisition of Operating Commercial Properties**

The identification and purchase of existing, operating commercial real estate properties (either as individual acquisitions or as part of a portfolio of properties) involves substantially less risk than commercial property development and, arguably, a fundamentally different methodology and set of skills, whether delivered by in-house staff or outside experts. The portfolio selection and acquisition of operating commercial properties involves a substantially smaller cast of characters (e.g. no Construction Lender and no General Contractor, unless the acquisition strategy involves substantial rehabilitation of the Property being acquired), but may still include or involve the breadth of parties relevant to this research study:

- i. **The Property Purchaser and Owner.**
- ii. **Equity Investors**, which depending upon the ownership structure of the Property Purchaser and Owner, may be Institutional Investors (as in the case of a hedge fund or a portfolio developer with established relationships with institutional investors, such a life companies), shareholders (as in the case of a publicly traded portfolio developer or a real estate investment trust or **REIT**), or the Developer itself, in the case of a commitment of the Developer's own assets (as would be the case of a privately owned portfolio developer of commercial properties).
- iii. **Lenders**, which depending upon the organizational structure, and the return and risk assumptions underpinning the investment strategy, of the Property Purchaser and Owner, may be providing long-term debt may or may not play a critical role in the acquisition of operating commercial properties.
- iv. **Tenant** (and, collectively, **Tenants**) is the current and prospective end-user of an operating commercial property (e.g. the Project), the aggregate rent streams from which the Property Purchaser and Owner's ability to service any outstanding debt issued by the Lenders and provide a return to the Equity Investors depend.
- v. **Commercial Sales Brokers and Agents** involved in the identification and pricing of potential commercial properties meeting the Property Purchaser and Owner's, including but not limited to providing preliminary rent roll analysis of prospective properties for purchase
- vi. **Commercial Property Investment Advisers** providing strategic guidance about various aspects, primarily financial, regarding the Property Purchaser and Owner's overall investment strategy and how to best execute that strategy, which may or may not include the Commercial Property

Investment Adviser providing additional services to the Property Purchaser and Owner.

- vii. **Listing Broker, which is** the commercial brokerage firm representing the Property Purchaser and to list and promote one or more, or all, of the operating commercial properties to its end-users (i.e. Tenants).
- viii. **Commercial Leasing Brokers and Agents** representing prospective Tenants, which may include both:
  - a. **Full-Service CRES Firms** that also routinely represent commercial real estate developers (and may, at the time they are representing prospective Tenants in the Project, also represent the Property Purchaser and Owner for a Project or Projects it owns).
  - b. **Tenant-Only CRES Firms** (also referred to herein as a **Tenant-Only Broker**) are CRES firms that **only** represent tenants in commercial leasing transactions.

## 2. Anatomy of the Commercial Development Transactions

In order to fully understand and appreciate the various ways in which a CRES firm might represent the interests of a Developer or Property Purchase and Owner, as the case may be, one must first understand significant milestones in the development process (in the case of the development of a commercial property) and in the strategic acquisition of a portfolio property (in the case of the selection and acquisition of commercial properties).

### a. Developing and Implementing a Strategic Vision

For most regional and national Developers and Property Purchasers and Owners, respectively, the development or acquisition of an individual property will not be undertaken as a one-off transaction. Rather, these actions are generally one component of an overall real estate strategy. An understanding of geographic and asset class market dynamics, as well as the availability of debt and equity financing for various types of properties in different markets, is critical to developing a Strategic Vision. Identifying the options, if not actual sources, for the debt and equity financing necessary to implement this Strategic Vision is also a critical component of formulating a strategic approach to either development or acquisition of commercial properties

### b. Search, Identification, and Selection

In the case of the development of a commercial property, the Developer is seeking suitable land for development or redevelopment (in the case of real property that

is under-developed based on the current improvements on that property). In the case of the acquisition of a commercial property or portfolio of properties, the Property Purchaser and Owner is seeking existing, operating commercial properties, generally within specified geographic markets and submarkets (e.g. the Central Business District or “CBD” in Washington, D.C.) and representing specific sub-classifications of commercial properties, including but not limited to general office, mixed-use, retail, hospitality, and industrial. Inasmuch as some of the best-suited properties may not be listed for sale, this requires an intimate knowledge of the markets in which such properties are being sought on behalf of the Developer or the Property Purchaser and Owner, respectively.

**c. Property Pricing**

Whether it is determining what is an appropriate price for raw or underdeveloped land on which commercial improvements are planned as a means of extracting additional value from the site or the acquisition of an operating commercial property that may not be optimally positioned in the marketplace, the common denominator is the same: What is the projected net operating income (NOI) from the improvements or repositioned commercial property once it is fully leased. While the sales comparable method continues to be an acceptable methodology for valuing real property, in appraising or evaluating the “as built” value of commercial property, applying a capitalization rate to the projected NOI is the commonly accepted standard in commercial real estate. So, in other words, **everything comes down to the rent roll**. The entire financing structure, including meeting equity investors’ return models and satisfying lenders’ loan covenants and debt service and repayment of principal requirements all depend on the leases. Consequently, effectively pricing a commercial property, whether making that determination on behalf of the seller or the prospective purchaser requires an intimate knowledge of the commercial leasing market. This requires up-to-the-minute data on completed transactions, as well as general knowledge about transactions in the pipeline and the demand for particular property sub-classifications.

**d. Securing Project Financing**

Even if the sources or potential sources of debt and equity financing are identified in the creation of a Strategic Vision, and regardless of whether expressions of interest are provided, in advance, by any such sources, actually securing Project-specific, hard financing commitments from those sources may rely upon established relationships between each such source and the Developer or Property Purchaser and Owner, respectively, or someone representing them in the transaction. Additionally, a firm understanding of what terms and conditions are, at that time, commonly required by debt and equity providers, respectively, depending upon the scope and nature of the specific financing component being sought (e.g. a construction loan or debt financing for an operating commercial

property with a stabilized rent stream), is critical to managing the carrying costs of a Project.

**e. Property Listing**

For a commercial property that is going to be developed, the identification and engagement of a Listing Broker may begin as early as the concept development phase of the development process—if the Developer is getting strategic advice from the Listing Broker—but certainly not later than Closing on the construction financing for the project, so that pre-leasing may begin in earnest long before the building is completed and ready to receive a certificate of occupancy. Large, multi-floor tenants may begin their search for new premises 36 months or longer in advance of when they need to relocate, taking into account the time increments most likely to be required for the search, lease negotiation, and tenant build-out in a new building. In the case of the acquisition of an operating commercial property, the leasing strategy may be integral to repositioning that property or at least to assure that the NOI on which the purchase price is based will be preserved, if not enhanced, following its acquisition by the Purchaser. Depending on what the prospective Purchaser has planned for its new acquisition, the pre-leasing process may parallel that of new construction of a commercial office building, as would be the case of an existing, operating commercial building that can only be repositioned in the marketplace through a combination of façade and gut-and-rebuild interior improvements. For an operating commercial property not requiring such extensive improvements, the Listing Broker’s focus may be on some combination of renewing quality leases that could command a market rent upon renewal while allowing to expire, upon lease termination, those leases where the current tenants may not be able to renew at market. Depending upon the size of the commercial property and the termination dates of extant leases, the Listing Broker may be in a somewhat constant state of marketing the property, including to existing tenants where lease renewals are favorably viewed.

**f. Property Management**

Some purchasers of commercial property believe that property management is the key to everything: Poor property management creates acquisition opportunities in an otherwise constrained market and excellent property management adds considerable value to a commercial property. While excellent property management cannot make up for physical infirmities in a commercial building, such as extensive deferred maintenance or out-of-date electrical, mechanical, and conveyancing systems, it can mitigate the impact upon existing tenants of such capital improvements being made. Property management is responsible for the timely collection of rents and assessments under each lease, and to the efficient, day-to-day operations. The best way to think about property management is that its main goal is to preserve and enhance a commercial building’s principal asset: The rent roll.

**g. Property Sale or Refinancing**

Every commercial real estate enterprise, whether a development project involving new construction or the portfolio acquisition of an operating property, begins, or at least should begin, with an exit strategy: How does the Developer or the Purchaser/Property Owner expect to extract value from its efforts at the end of a period of time? With the exception of a fee developer, whose sole compensation is the agreed-upon development fee, the value created through the development of a property through new construction or acquisition and operation comes upon the sale or refinancing of that property. A good way to distinguish these two options is to analogize them to beef cattle and sheep. Beef cattle can be slaughtered only once; sheep may be shorn every season. The rate at which lease values rise in a particular market from year-to-year, as well as prevailing commercial, long-term interest rates, will largely determine how often a commercial property may be efficiently refinanced, although refinancing is just as likely to be determined by the expectations or requirements of equity investors and long and short-term (if any) lenders in the project.

**B. The Role of the CRES Sector in Commercial Real Estate Transactions**

**1. The Increasing Importance and Involvement of CRES Firms in the Development and Purchase of Commercial Properties**

As detailed in Appendix D: Profiles of the Top Ten Commercial Real Estate Services (CRES) Firms, just over the past nine (9) years, CRES firms have grown in size, geographic reach, breadth of services offered, and overall importance to and involvement in various aspects of the development and financing of commercial properties, both domestically and internationally. They have become increasingly global, and the more Landlord-focused CRES firms have expanded their tenant representation capabilities primarily by acquiring U.S. national, regional or local tenant-only brokerages: Local firms become or are swallowed-up by regional or national firms, while national firms have become or are swallowed up by international firms. In 2013, the five largest, full-service CRES firms were involved in 150,461 commercial property transactions<sup>12</sup> generating over half-a-billion dollars in commercial property transaction revenues (\$553.3 million in the aggregate).<sup>13</sup> The five largest, full-service CRES firms also generated over \$16 billion in aggregate, total revenues in 2013.<sup>14</sup> Whereas the traditional role of a CRES firm 40 years ago may have been to simply act as the Listing Broker for a single Developer or Property Owner with a single commercial property, today a full-service CRES firm might be involved in one or more of the following functions on behalf of Developers and Property Owners with multiple properties, all of which services are enumerated above in subsection III.A.1. However, only one of the services enumerated below is specific to tenants:

- a. Developing and Implementing a Strategic Vision
  - b. Search, Identification, and Selection
  - c. Property Pricing
  - d. Securing Project Financing
  - e. Property Listing
  - f. Representing Prospective Tenants in the Property<sup>15</sup>
  - g. Property Management
  - h. Property Sale or Refinancing
2. **The Consolidation Trend in the CRES Sector and the Assimilation of Tenant-Only CRES Firms into Full-Service CRES Firms**

Both JLL and CBRE expect to continue to capture market share in a highly competitive leasing conditions in most world markets. **"This business is rapidly consolidating down to a very small number of players,"** CBRE's [CEO Brett] White said, adding that **the two largest firms [CBRE and JLL] are "going to capture the vast majority of the available share going forward."** White was further quoted as saying "that trend is absolute, and I suspect that **the mid-tier firms and the smaller firms, you're just going to see them lose more and more share every quarter and every year** [emphasis added]."<sup>16</sup>

In the span of six years, three large, tenant-only CRES firms—Julian Studley, The Staubach Companies, and Newmark Real Estate Company, Inc. —have been acquired by much larger, global, full-service CRES firms.<sup>17</sup>

- a. Julian J. Studley, considered to be the first tenant-only brokerage firm in the U.S., was founded by its namesake in New York City in 1954. When it was acquired in 2012 by Savills, LLC, a global, full-service CRES firm, Studley had 25 offices in the U.S. and 400 commissioned brokers and 175 support staff.
- b. The Staubach Companies, founded in 1977 by former Dallas Cowboys quarterback Roger Staubach as a tenant-focused CRES firm, was acquired by JLL (formerly known as “Jones Lange LaSalle”) in July 2008. At that time Staubach had 50 offices in North America and 1,100 employees.
- c. In 2011, Newmark & Company Real Estate, Inc., a tenant-focused CRES firm formed in 1926, merged with U.K.-based, full-service CRES firm Knight Frank,

creating Newmark Knight Frank. Two years later, Newmark Knight Frank was purchased by BGC Partners in 2012. In 2013, BGC acquired Grubb & Ellis, a full-service, U.S.-based CRES, creating Newmark Grubb Knight Frank.<sup>18</sup>

These consolidations by merger or acquisition means there are far fewer tenant-only agents today than there were even six (6) years ago, increasing the potential for conflicts of interest in commercial leasing transactions.

### **C. How Conflicts of Interest May Manifest Themselves in Commercial Real Estate Transactions**

Given the increasing complexities of the real estate development and finance process and, to a lesser extent, the process of acquiring and positioning in the marketplace operating properties, as outlined in Subsection 1 above, and further considering the consolidation that has taken place in the past few decades within the CRES sector, as described in Subsection 2 above, it is perhaps easy to understand how the incidence of conflicts of interest in commercial leasing transactions may be on the rise, the fact that the majority of these conflicts of interest do not give rise to formal legal claims (the reasons for which are also described in this Subsection).

#### **1. Potential Conflict of Interest Scenarios Where the Leasing Transaction is Closed by a Listing Broker and Tenant Agent Employed by the Same Full-Service CRES Firm**

- a. The Listing Broker manipulates or otherwise influences the commission on the transaction to be paid to the Tenant's Agent to get the lease closed.
- b. Without manipulating or otherwise influencing the amount and payment of the Agent's commission, the Listing Broker offers incentives outside the commission structure but within the control of the CRES Firm, including but not limited to promised increases in base salary, benefits, and/or future advancement within the firm.
- c. Without manipulating or otherwise influencing the amount and payment of the Agent's commission or otherwise creating specific incentives within the CRES Firm's ordinary compensation structure, the Developer or Property Owner promises the Listing Broker additional property listings if the Subject Property is fully tenanted within a specified time frame, and the Tenant Agent is promised specific opportunities and/or remuneration if such additional property listings are awarded to the Listing Broker by the Developer or Property Owner.
- d. The Tenant Agent shares with the Listing Broker confidential information about the prospective Tenant that is not generally, publicly available, and which the prospective Tenant has shared with the Tenant Agent in confidence, which information may include but is not limited to:

- i. The prospective Tenant's current financial condition;
- ii. Changes in the Tenant's business or market position that could impact the prospective Tenant's future operating income and, consequently, its ability to pay rent for the Premises or cover Tenant's assumed portion of the overall budget for Tenant Improvements necessary to make the Premises tenantable;
- iii. Potential changes in the Tenant's business or industry sector;
- iv. The prospective Tenant's simultaneous negotiation of one or more comparable commercial leases as a hedge against not being able to secure from the Listing Broker the terms and conditions the prospective Tenant requires or prefers regarding the Premises.

**2. Potential Conflict of Interest Scenarios Where the Leasing Transaction is Closed by a Tenant Agent Employed by a Full-Service CRES Firm, which Firm is Offered Incentives by the Developer or Property Owner if the CRES Firm is Instrumental in Tenanting the Property**

- a. The Full-Service CRES Firm is not the Listing Broker on the Subject Property but is actively seeking to secure new business as the Listing Broker for the Developer or Property Owner on other properties, and the Firm creates incentives and/or other inducements to encourage its Tenant Agents to prioritize or otherwise favor the Subject Property with their tenant clients so that the CRES Firm may be successful in securing such new property listings from the Developer or Property Owner.
- b. The Full-Service CRES Firm is not the Listing Broker on the Subject Property but is actively seeking to secure other types of new business from the Developer or Property Owner of the Subject Property, including but not limited to the kinds of services described in Subsection III.B.1, a through d, inclusive, and g and h, inclusive, and the Firm creates incentives and/or other inducements to encourage its Tenant Agents to prioritize or otherwise favor the Subject Property with their tenant clients so that the CRES Firm may be successful in securing such new business from the Developer or Property Owner.

**3. Potential Conflict of Interest Scenarios Where the Leasing Transaction is Closed by Tenant Agents Employed by More than one Full-Service CRES Firm, Where Each Such Full-Service CRES Firm has Provided Professional Services to the Developer or Property Owner with Respect to the Subject Property**

- a. Roles played by full-service CRES Firms that are not mutually exclusive to another full-service CRES Firm serving as the Listing Broker for the Subject Property:
  - i. Developed and assisted in the implementation of a strategic plan that included the development or acquisition of the Subject Property and its subsequent lease-up on financial terms generally consistent with such strategic plan.
  - ii. Specifically represented the Developer or Property Owner in the development or acquisition of the Subject Property, including providing market research, financial analysis, and rate/period consistent with the investment and financing structure for the Subject Property.
  - iii. Specifically participated with the Developer or Property Owner in the financing of the development or acquisition of the Subject Property, including but not limited to representing one or more Equity Investors or Lenders necessary to support the Developer's or Property Owner's plans for the undertaking, the satisfaction of which Investor(s)' return and invested capital security expectations or the Lender(s)' debt service and repayment of principal requirements are dependent upon the lease-up of the Subject Property as and when projected by the Developer or Property Owner to the Investor(s) and Lender(s).

#### **D. What Constitutes an Actual, and Actionable, Conflict of Interest in a Commercial Leasing Transaction**

The foregoing scenarios, as well as any others that might be hypothesized, do not suggest that in each such instance there will always be a conflict of interest that is resolved adversely to the Tenant. **The potential that a conflict of interest could arise does not automatically mean that one will occur.**

1. For example, in the scenario set forth in Subsection III.C.3.a.iii, it is entirely possible, as well as plausible, that a Tenant Agent working for a full-service CRES Firm that assisted the Developer or Property Owner by putting together the package of equity investments necessary to finance the Subject Property can subsequently provide her undivided loyalty to the tenant she is representing and fully discharge all of the other duties an agent owes its principal in recommending the Subject Property and also assisting her client in the negotiation of the lease.
2. By the same token, not every act or omission by a Tenant Agent, regardless of whether it may be deemed to be a violation of an agent's duties to its principal, will be attributable to a conflict of interest resolved adversely to that tenant. Not every act or omission of a Tenant Agent that is potentially harmful to her client will be motivated by some countervailing benefit inuring to that Tenant Agent's full-service

CRES Firm that has an opposing interest in the transaction. Sometimes a Tenant Agent does not perform adequately and in their client's best interest due to incompetence, personal interests, or other reasons that do not give rise to an actionable claim for breach of the duty of an agent to its principal arising out of a conflict of interest.

3. In order to fully and completely understand the intersection between the Conflicts of Interest Scenarios presented in Subsection III.C and, whether or not an actual, actionable Conflict of Interest has actually occurred, the basic principles or Principal and Agent, or the Law of Agency, must be understood. These are covered in Section IV of the Report, below.

## IV. Law of Principal and Agent

### A. Basics of Principal and Agent

The definitive legal treatise on agency law, the American Law Institute's **Restatement of the Law of Agency** (hereinafter "**The Restatement of Agency**") defines agency as follows: [T]he **fiduciary relationship** which results from the **manifestation of consent** by one person to another **that the other shall act on his behalf** and subject to his control, and consent by the other so to act [emphasis added].<sup>19</sup>

A relationship between a "principal" and an "agent" may arise, under common law, between two parties based on a specific agreement between them to form such a legal relationship or from the conduct of one or both of those parties without an express agreement. Although the typical, contemporary agency relationships in the context of real estate transactions generally arises through the execution by the parties of specific, written agreements between a "principal" (e.g. a buyer or seller of real property, or a lessee or lessor of real property), and an "agent," other forms of agency occur more often than one might suspect.

For example, a developer who is in the business of identifying, purchasing, and upgrading a particular type of multifamily product (e.g. mid-priced, walk-up or garden apartments with limited common area amenities) to reposition and re-price it in the marketplace, could very easily create an agency relationship with a broker of such properties, simply through their course of conduct with one another over a period of time, without ever having entered into a prior written agreement or even having never discussed the fact that the broker will be acting as the potential buyer's agent in such transactions.<sup>20</sup>

The common law recognizes a variety of types of agency relationships depending upon the facts and circumstances in each instance.

## 1. Types of Agency

There are six different types of agency:

### a. Actual Express Authority

Principal and agent have entered into an express agreement creating the agency relationship, including describing the scope of the agency.

### b. Actual Implied Authority

Principal and agent have entered into an express agreement creating the agency relationship, and although the scope, extent, and powers of the agency relationship are not expressly stated in such agreement, they may be inferred from the nature of the agency relationship.

### c. Apparent Authority

There is no agreement between principal and agent creating an agency relationship but a third party may reasonably infer from the conduct of the principal that an agency relationship exists between them.

### d. Agency by Estoppel

A principal is estopped from objecting to or denying the veracity of a legal obligation entered into by the agent on behalf of the principal where the principal knew of such agreement as it was being made and failed, nonetheless, to intervene for his own benefit, and the third party reasonably relied on the authority of the agent.

### e. Ratification

Even in the absence of authority granted by the principal to the agent, express or implied, apparent only or by estoppel, if the principal accepts an act committed by the agent in the principal's name, then in so doing, the principal creates an agency relationship by that act of ratification.

### f. Inherent Agency Power

First introduced in the Second Restatement in 1958, and then left out of the Third Restatement of Agency Law in 2006, "inherent agency power" is neither grounded in any grant, express or implied, of agency authority, nor implied by the conduct of one party or the other. Rather, the inherent agency doctrine is one means by which a third party may subject principals to liability for their agents' conduct.

## 2. Duties of Agent to Principal

As the reference above, from the Restatement Second suggests, the agent is in a fiduciary relationship relative to the principal. Courts generally place great weight on the responsibilities of fiduciaries:

### Fiduciary relationship

“A relationship in which one person is under a duty to act **for the benefit of another** on matters within the scope of their relationship. Fiduciary relationships –such as...principal-agent...require an unusual duty of care [emphasis added].”<sup>21</sup>

“A fiduciary is: **1...one** who owes to another the duties of **good faith, trust, confidence, and candor...2.** [o]ne who must exercise **a high standard of care** in managing another’s money or property... [emphasis added].”<sup>22</sup>

## 3. Elements of the Duties Agents Owe to Their Principals

- a. Unbroken service and loyalty;
- b. Confidentiality;
- c. Full disclosure of information to allow well-informed decisions by principal;
- d. Acting in the best interest of the client; and
- e. Accountability to the principal.

## B. Agency Relationships in Real Estate Transactions

### 1. Brokers and Agents Defined

Both “agents” and “brokers” in the real estate industry are licensed professionals according to the state law in the state wherein their principal place of business is located, and according to any other state in which they do business, depending on such other states’ laws. The licensure and testing requirements, if and when applicable, for an “agent” are less-onerous than for a “broker.” Agents are allowed to engage in commercial real estate services such as office leasing only under the direction and supervision of a licensed broker. Someone who holds a broker’s license but is working under another licensed broker in a supervisory role is commonly referred to as an associate broker, to distinguish that associate broker from the role of the supervisory broker having liability over the associate brokers and agents in that office.<sup>23</sup> For a comparison of the testing and licensure requirements for real estate

agents and brokers in nine (9) states and the District of Columbia, see Appendix E. Comparison of Disparate Commercial Brokerage Regulatory Frameworks.

## **2. Agency in Residential Sales Transactions**

Residential real estate agents, whether agents or associate brokers, are treated as “agents” under the common law definitions for principal and agent, and may also have separate duties, obligations, and requirements under the licensure, testing, and continuing education/re-licensure statutes and regulations in the jurisdiction in which they are licensed as such. In addition to the common law duties of an agent to its principal described in Subsection IV.A. Basics of Principal and Agent, above, the state regulatory framework governing residential real estate agents should be consulted. In this regard, see Appendix E. Comparison of Disparate Commercial Brokerage Regulatory Frameworks.

## **3. Agency in Commercial Sales Transactions**

Commercial real estate agents, whether agents or associate brokers, are treated as “agents” under the common law definitions for principal and agent, and may also have separate duties, obligations, and requirements under the licensure, testing, and continuing education/re-licensure statutes and regulations in the jurisdiction in which they are licensed as such. Most state statutes do not make any distinction between commercial real estate agents involved in sales versus those involved in leasing. However, many do distinguish between commercial and residential real estate agents. In this regard, see subparagraph 1. Florida, of Subsection IV.C. Basics of Legal Duties of Agents to Principals in Real Estate Transactions, below. In addition to the common law duties of an agent to its principal described in Subsection IV.A. Basics of Principal and Agent, above, the state regulatory framework governing residential real estate agents should be consulted. In this regard, see Appendix E. Comparison of Disparate Commercial Brokerage Regulatory Frameworks.

### **C. Basics of Legal Duties of Agents to Principals in Real Estate Transactions**

The duties an agent owes to a principal in a real estate transaction may be a function of the common law of principal and agent in that state, as interpreted by judicial precedent, or may be codified in the licensure requirements and regulations, by state statute, which may take precedence over common law. This section examines two state statutes—California and Florida—which demonstrate the dichotomous treatment of commercial leasing agents.

#### **1. Florida**

Florida law exempts commercial leasing transactions from an otherwise comprehensive listing of duties that commercial real estate brokers owe to their principals.

- a. Florida Statutes, Section 475.278 – Subsection (2) sets forth the following duties of a landlord’s broker (what is commonly called a “listing broker” and, under Chapter 475 of the Florida Statutes, is referred to as a “transaction broker.”

(2) TRANSACTION BROKER RELATIONSHIP.—A transaction broker provides a limited form of representation to a buyer, a seller, or both in a real estate transaction **but does not represent either in a fiduciary capacity or as a single agent** [emphasis added]. The duties of the real estate licensee in this limited form of representation include the following:

- (a) Dealing honestly and fairly;
- (b) Accounting for all funds;
- (c) Using skill, care, and diligence in the transaction;
- (d) Disclosing all known facts that materially affect the value of residential real property and are not readily observable to the buyer;
- (e) Presenting all offers and counteroffers in a timely manner, unless a party has previously directed the licensee otherwise in writing;
- (f) Limited confidentiality, unless waived in writing by a party. This limited confidentiality will prevent disclosure that the seller will accept a price less than the asking or listed price, that the buyer will pay a price greater than the price submitted in a written offer, of the motivation of any party for selling or buying property, that a seller or buyer will agree to financing terms other than those offered, or of any other information requested by a party to remain confidential; and
- (g) Any additional duties that are mutually agreed to with a party.

- i. The foregoing could serve as a fairly comprehensive listing of the duties of an agent to its principal in the context of a commercial leasing transaction. However, in addition to exempting the relationship between a Listing Broker and the Landlord from what would otherwise, under common law, be characterized as a “fiduciary relationship,” this section of Florida law further **exempts** from this comprehensive list of duties owed by a transactional broker to its principal the representation of parties **in commercial leasing transactions**. Specifically in this regard, Florida Statute 475.278(5) – APPLICABILITY, Subsection (b) – Disclosure limitations. – provides, in pertinent part: “(2) The real estate licensee **disclosure requirements** of this section **do not apply to: nonresidential transactions; the rental or leasing of real property**, unless an option to purchase all or a portion of the property improved with four or fewer residential units is given;... [emphasis added].”
- ii It is curious that the Florida Legislature, in enacting these provisions, would expressly exempt commercial leasing activities from the same disclosure

requirements it imposes on brokers and agents (whether a Transaction Broker or Single Agent as those terms are defined under Florida Statutes Chapter 475) representing parties in a commercial property sales transaction, as well as exempting them from the enumeration of duties—California law, as of January 1, 2015, imposes upon commercial real estate brokers and agents, whether engaged in sales or leasing transactions, the same duties of disclosures to and securing waivers from prospective clients as have long been imposed on residential sales brokers and agents in any situation involving dual agency.

## 2. California

What ultimately became California Senate Bill 1171 in the California Legislature during its 2014 legislative session was conceived approximately two years earlier, and subsequently proposed to State Senator Ben Hueso for California's 40<sup>th</sup> District (D-San Diego) by Jason Hughes, founder and principal of Hughes Marino, one of California's largest, independent, tenant-only CRE firms.<sup>24</sup> Senator Hueso introduced what became S.B. 1171 in the California Senate on February 20, 2014; it was passed by the Senate on May 12, 2014, and by the General Assembly on July 3, 2014; Governor Jerry Brown signed the act into law on August 14, 2014, on which date it was also filed with the Secretary of State of California. The new law takes effect on January 1, 2015.<sup>25</sup> The Legislative Counsel's Digest for S.B. 1171 provides as follows;

*SB 1171, Hueso. Real property transactions: agents: obligations.*

*Existing law requires listing and selling agents, as defined, to provide the seller and buyer in a residential real property transaction, including a leasehold interest, with a disclosure form, as prescribed, containing general information on real estate agency relationships. Existing law also requires the listing or selling agent to disclose to the buyer and seller whether he or she is acting as the buyer's agent exclusively, the seller's agent exclusively, or as a dual agent representing both the buyer and the seller.*

*This bill would extend these disclosure requirements to include transactions involving commercial real property, as defined, including a leasehold interest [emphasis added].<sup>26</sup>*

### i. Testimony in favor of passage of S.B. 1171

In addition to receiving twenty verified letters of support for S.B. 1171,<sup>27</sup> the bill's author, Senator Hueso, offered the following in support of his bill on the Senate floor:

*As written, the protections outlined in Civil Code Sections 2079.14 to 2079.24 cover only residential real estate transactions and do not extend to commercial real estate transactions.*

*There is a common misconception that parties involved in commercial real estate transactions are (1) sophisticated; (2) of equal bargaining power; or (3) equally knowledgeable and experienced in real estate as the other party or the brokers involved. This is not always the case. For example, a small business owner whose only real estate transaction over the next five years will be his/her office lease is not going to be as sophisticated as a landlord whose primary business is real estate and who is negotiating multiple leases a year with the help of a team of sophisticated professionals. That business owner is at a severe disadvantage at the bargaining table and should be educated on the duties or limited duties the licensed real estate professionals involved in the transaction owe to all parties.*

*The objective of SB 1171 is clear and simple: to educate the parties to all real estate transactions as to the duties and responsibility of a listing agent, selling agent, landlord agent, tenant agent or dual agent [emphasis added].<sup>28</sup>*

## **ii. Testimony in opposition to S.B. 1171**

Writing in opposition to S.B. 1171, the California Association of Realtors,<sup>29</sup> which represents both residential and commercial real estate brokers and agents, stated:

*When our association sponsored the original agency disclosure legislation, including the written form requirement that now applies to residential agency, and commercial transactions were deliberately not required to use the same forms as residential transactions. The reason for the different rule is the different level of sophistication and complexity that exist in non-residential transactions. We believed, and experience seems to bear it out, that simply requiring disclosure of multiple agency relationships and allowing commercial practitioners to utilize their own contracts and forms is sufficient to protect the parties.<sup>30</sup>*

## **D. Analysis of an Agent's Conflicts of Interest in Real Estate Transactions**

### **1. Unbroken Service and Loyalty**

Arguably, an agent's duty of unbroken service and loyalty is an overarching one, from which all other fiduciary duties emanate<sup>31</sup> or, at a minimum, the prism through

which such other duties should be interpreted and evaluated. Additionally, the Restatement of the Law of Agency (Third) distinguishes between duties of loyalty and duties of performance.

*...duties of loyalty have distinctive functions and consequences, ones distinct from duties and consequences defined by other bodies of law. Within common law agency, an agent owes the principal fiduciary duties of loyalty as well as duties of performance. Although an agent owes both types of duties, distinctive legal consequences follow a breach of a duty of loyalty. These include but are not limited to an enhanced range of remedies available to the principal. The distinctive consequences triggered by an agent's breach of a duty of loyalty are a helpful vantage point from which to assess whether and how an agent's fiduciary duties of loyalty are themselves distinct from duties defined by other bodies of law—in particular, contract law and tort law principles. ...an agent's fiduciary duties of loyalty serve functions related to but distinct from the agent's duties of performance and that these functions, in turn, assist in identifying how best to resolve questions about the consequences that should follow an agent's breach of a duty of loyalty.*<sup>32</sup>

*It's conventional to distinguish among an agent's duties. **Restatement (Third) of Agency** uses the terminology of **duties of performance** and **duties of loyalty**. An agent's duties of performance include the duty to act only as authorized by the principal; to fulfill any obligations to the principal defined by contract; to act with the competence, care, and diligence normally exercised by agents in similar circumstances; and to use reasonable effort to provide the principal with facts material to the agent's duties to the principal. An agent's duties of performance are often defined by agreement between principal and agent [emphasis added; footnotes omitted].*<sup>33</sup>

*An agent's duties of loyalty stem from the agent's basic obligation to act loyally for the principal's benefit in matters connected with the agency relationship. An agent's more specific duties of loyalty include **a duty not to acquire a material benefit from a third party in connection with transactions or other actions taken on behalf of the principal or otherwise through the agent's use of position; a duty not to deal with the principal as or on behalf of an adverse party; a duty not to compete with the principal or assist the principal's competitors during the duration of the agency relationship; and a duty not to use property of the principal, and not to use or communicate confidential information of the principal, for the agent's own purposes or those of a third party. A principal may consent to conduct by the agent that would otherwise breach a duty of loyalty, but in obtaining the principal's consent, the agent must act in good faith and fully disclose material information to the principal.***

*Although **open-ended advance consents** to disloyal conduct **are not effective**, the fact that a principal may consent to conduct that would otherwise breach an agent's duties of loyalty mitigates the stringency associated with the fiduciary regime of remedies and other consequences that follow breach, as does the agent's power to terminate the relationship [emphasis added; footnotes omitted].<sup>34</sup>*

## 2. Confidentiality

*An agent is obligated to safeguard his principal's confidence and secrets. A **real estate broker, therefore, must keep confidential any information that might weaken his principal's bargaining position if it were revealed**. This duty of confidentiality precludes a broker representing a seller from disclosing to a buyer that the seller can, or must, sell his property below the listed price. Conversely, a broker representing a buyer is prohibited from disclosing to a seller that the buyer can, or will, pay more for a property than has been offered [emphasis added].*

***CAVEAT:** This duty of confidentiality plainly does not include any obligation on a broker representing a seller to withhold from a buyer known material facts concerning the condition of the seller's property or to misrepresent the condition of the property. To do so would constitute misrepresentation and would impose liability on both the broker and the seller.<sup>35</sup>*

## 3. Full Disclosure of Information to Allow Well-Informed Decisions by Principal<sup>36</sup>

*An agent is obligated to disclose to his principal all relevant and material information that the agent knows and that pertains to the scope of the agency. The duty of disclosure obligates a real estate broker representing a seller to reveal to the seller:*

- *All offers to purchase the seller's property.*
- *The identity of all potential purchasers.*
- *Any facts affecting the value of the property.*
- *Information concerning the ability or willingness of the buyer to complete the sale or to offer a higher price.*
- *The broker's relationship to, or interest in, a prospective buyer.*
- *A buyer's intention to subdivide or resell the property for a profit.*
- *Any other information that might affect the seller's ability to obtain the highest price and best terms in the sale of his property.*

*A real estate broker representing a buyer is obligated to reveal to the buyer:*

- *The willingness of the seller to accept a lower price.*
- *Any facts relating to the urgency of the seller's need to dispose of the property.*

- *The broker's relationship to, or interest in, the seller of the property for sale.*
- *Any facts affecting the value of the property.*
- *The length of time the property has been on the market and any other offers or counteroffers that have been made relating to the property.*
- *Any other information that would affect the buyer's ability to obtain the property at the lowest price and on the most favorable terms.*

**CAVEAT:** *An agent's duty of disclosure to his principal must not be confused with a real estate broker's duty to disclose to non-principals any known material facts concerning the value of the property. This duty to disclose known material facts is based upon a real estate broker's duty to treat all persons honestly and fairly. This duty of honesty and fairness does not depend on the existence of an agency relationship.*

#### **4. Acting in the Best Interest of the Client<sup>37</sup>**

*An agent is obligated to obey promptly and efficiently all lawful instructions of his principal. However, this duty plainly does not include an obligation to obey any unlawful instructions; for example, an instruction not to market the property to minorities or to misrepresent the condition of the property. Compliance with instructions the agent knows to be unlawful could constitute a breach of an agent's duty of loyalty.*

##### ***Reasonable care and diligence***

*An agent is obligated to use reasonable care and diligence in pursuing the principal's affairs. The standard of care expected of a real estate broker representing a seller or buyer is that of a competent real estate professional. By reason of his license, a real estate broker is deemed to have skill and expertise in real estate matters superior to that of the average person. As an agent representing others in their real estate dealings, a broker or salesperson is under a duty to use his superior skill and knowledge while pursuing his principal's affairs. This duty includes an obligation to affirmatively discover facts relating to his principal's affairs that a reasonable and prudent real estate broker would be expected to investigate. Simply put, this is the same duty any professional, such as a doctor or lawyer, owes to his patient or client.*

#### **5. Accountability to the Principal<sup>38</sup>**

*An agent is obligated to account for all money or property belonging to his principal that is entrusted to him. This duty compels a real estate broker to safeguard any money, deeds, or other documents entrusted to him that relate to his client's transactions or affairs.*

## **E. Avoiding Conflicts of Interest**

### **1. How the Legal Profession Handles Conflicts of Interest**

The legal profession has had very clear guidance about identifying, disclosing, and avoiding conflicts of interest. This guidance, which is currently codified in the American Bar Association’s Model Rules of Professional Conduct, has been adopted, largely in its entirety, by the state bar organizations of all 50 states and the District of Columbia. State and the District of Columbia bar organizations have authority over, among other things, the licensure to practice law of, and disciplinary actions against, lawyers in each state.<sup>39</sup>

#### **a. Rules 1.7, 1.8, and 1.9 of the American Bar Association’s Model Rules of Professional Conduct**

These three rules cover conflicts of interest in different contexts, specifically involving a “current client,” “prohibited transactions,” and conflicts of interest with a “former client,” respectively. These rules are simple and straightforward regarding the avoidance of conflicts of interests with existing clients. When interpreted in the context of other Rules of Professional Conduct, these three conflicts of interest rules may be summarized as follows, although their interpretation has been the subject of various disciplinary proceedings and court challenges.

- i.** A lawyer should always err on the side of “avoiding even the appearance of impropriety” in the representation of a client whose interests might not be zealously represented due to a real or potential conflict of interest.
- ii.** A lawyer is responsible for identifying and evaluating conflicts of interest that may adversely impact a client being represented by that lawyer, and is further required to do any one or more of the following:
  - a.** Disclose the existence of the conflict of interest or potential conflict of interest to the client.
  - b.** If the conflict or potential conflict is deemed to be susceptible to a waiver by the client, then secure a signed, written waiver.
  - c.** If the conflict or potential conflict is so glaring that it cannot be remedied by disclosure and a written waiver by the client, then the lawyer must withdraw from representation.

**b. Rule 1.7 – Conflicts of Interest; Current Clients<sup>40</sup>**

*(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a **concurrent conflict of interest**. A concurrent conflict of interest exists if:*

*(1) the representation of one client **will be directly adverse to another client**; or*

*(2) there is a **significant risk** that the representation of one or more clients **will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer**.*

*(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), **a lawyer may represent a client if:***

*(1) the lawyer reasonably believes that the **lawyer will be able to provide competent and diligent representation to each affected client**;*

*(2) the representation is not prohibited by law;*

*(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and*

*(4) **each affected client gives informed consent, confirmed in writing** [emphasis added].*

**c. Interpretations of Rule 1.7 of the Rules of Professional Conduct by State Bar Organizations, as the Rule Relates to Real Estate Transactions**

Two examples, from North Carolina and Illinois, are provided below regarding how state bar organizations have interpreted Rule 1.7 to members of their respective bars, in the context of a lawyer's proposed representation of two parties in the same real estate transaction.

**i. North Carolina Bar Association**

*Whether a conflict is consentable [sic] depends on the circumstances. See Comment [15]. For example, **a lawyer may not represent multiple parties to a negotiation whose interests are fundamentally antagonistic to each other**, but common representation is permissible where the clients are generally aligned in interest even though there is some difference in interest among them. Thus, a lawyer may seek to*

*establish or adjust a relationship between clients on an amicable and mutually advantageous basis; for example, in helping to organize a business in which two or more clients are entrepreneurs, working out the financial reorganization of an enterprise in which two or more clients have an interest or arranging a property distribution in settlement of an estate. The lawyer seeks to resolve potentially adverse interests by developing the parties' mutual interests. Otherwise, each party might have to obtain separate representation, with the possibility of incurring additional cost, complication or even litigation. Given these and other relevant factors, the clients may prefer that the lawyer act for all of them [emphasis added].<sup>41</sup>*

## ii. Illinois State Bar Association

In a 1991 ISBA Advisory Opinion on Professional Conduct, the Illinois State Bar Association (“ISBA”) interpreted Rules 1.6 and 1.9(a) of the Illinois Rules of Professional Conduct as prohibiting an ISBA-licensed attorney from representing a client in a negotiation of a lease against a former client when the representation is of the same or substantially related matter (in this case, commercial leasing of retail premises), unless the former client consents after disclosure. In this instance, an ISBA-licensed attorney, who had previously represented a national mall operator through his former firm, asked ISBA for advice regarding his ability, after leaving that law firm, to represent a national retail tenant in its negotiation of leases with the former client, without the advance, written consent of that former client. Inasmuch as Advisory Opinion 91-11 interprets ISBA’s analog to ABA Model Rules of Professional Conduct Rule 1.9, and not Rule 1.7, which relates to concurrent conflicts of interests, it is questionable, given the conclusion in Advisory Opinion 91-11, that ISBA would permit such dual representation contemporaneously, even if both parties consented, in advance, and in writing. Advisory Opinion 91-11, which was affirmed by the ISBA Board of Governors in May 2010, holds, in pertinent part, as follows:

*The facts before us are very similar in that the negotiation of the lease is a substantially similar matter even though the retail property which is being negotiated is not the same property subject to the prior negotiations. In addition, it appears obvious that the representation of a party in negotiations of the lease would often require the sharing of confidences. It is very likely that the inquiring attorney, through his prior representation of Client X, became aware of certain portions of the lease that were subject to compromise.*

*Two of our current Illinois Rules of Professional Conduct apply to the present fact situation. Rule 1.9 states as follows:*

- (a) a lawyer who has formerly represented a client in a matter shall not thereafter:
- 1) represent another person in the same or substantially related matter in which that person's interests are materially adverse to the interests of the former client, unless the former client consents after disclosure; or
  - 2) use information relating to the representation to the disadvantage of the former client, unless:
    - A) such use is permitted by Rule 1.6; or
    - B) the information has become generally known.

*Even though the negotiation of the leases may not have been the same matter, it is a substantially related matter and therefore the attorney in this case does have a conflict that can not [sic] be cured without the consent of the former client. Since the former client will not consent, the conflict can not [sic] be cured and the inquiring attorney must withdraw from representing the new client in connection with the lease negotiation with his former client.*

*In addition to being a conflict of interest pursuant to Rule 1.9, it also appears that there could be a violation of Rule 1.6(a) if the representation would be allowed to continue. Rule 1.6(a) of the Illinois Rules of Professional Conduct states as follows:*

*(a) Except when required under Rule 1.6(b) or permitted under Rule 1.6(c), a lawyer shall not, during or after termination of the professional relationship with the client, use or reveal a confidence or secret of the client known to the lawyer unless the client consents after disclosure.*

*Under the facts as stated, it appears that during his prior employment, negotiating leases for the former client, he acquired certain confidences. Therefore, if the confidences were either used or revealed, without the consent of the former client he would also be in violation of Rule 1.6(a). Since no consents from the former client are forthcoming, it is the Committee's opinion that the inquiring attorney must withdraw from the representation of the new client, as it pertains to negotiating leases with his former client.<sup>42</sup>*

**d. Applying the ABA's Rules of Professional Conduct Regarding Avoidance of Conflicts of Interest to the Commercial Leasing Context**

If the ABA's Rules of Professional Conduct 1.7, 1.8, and 1.9, respectively and collectively, as they have been adopted and interpreted by state and the District of

Columbia bar organizations throughout the U.S., are treated as analogous to the issue of avoiding conflicts of interest in dual-representation in commercial leasing transactions, at a minimum, a rigorous requirement for informed, written consent in advance of the commencement of such representation should be required in all jurisdictions. However, such guidance by analogy necessarily raises the larger issue as to whether such direct conflict of interest is, indeed, susceptible to securing advance written waivers from both the landlord and the tenant, respectively, or is a non-waivable, dual representation scenario where such dual representation should be strictly prohibited. In other words, this raises a fundamental question:

**If legal ethics prohibit an attorney or a law firm from representing both the landlord and a tenant in their negotiations of a lease agreement or in a dispute over the interpretation of the terms and conditions of an extant lease agreement, how can the divergent interests of those same parties nonetheless be adequately represented by the same CRES firm?**

## 2. Conflicts of Interest in Financial Services

### a. Identifying Conflicts of Interest Problems in Financial Services

In his July 2003 paper, **Policy Remedies for Conflicts of Interest in the Financial System**, Professor Frederic S. Mishkin of Columbia University's Graduate School of Business explored conflicts of interest in the financial services sector in the context of consequential failures of the sector and the U.S. Securities and Exchange Commission to prevent a number of conflicts of interest that adversely impacted a number of investors and the overall confidence that all investors had in the capital market.

#### i. The Context for Conflicts of Interest in Financial Services

Specifically, Professor Mishkin offered the following context for his conflicts of interest work in the financial services sector:

*With the end of the stock market boom in 2000, financial markets have been jolted by one corporate scandal after another. The cycle began with the spectacular bankruptcy of Enron Corporation in December 2001, once valued as the seventh largest corporation in the United States, and the indictment of Enron's auditor, Arthur Andersen, one of the big five accounting firms. Subsequently, there have been revelations of misleading accounting statements at numerous other corporations, including WorldCom Tyco Industries and more recently Ahold, which have added to the doubts about the quality of accounting information in the corporate sector. Criminal cases have also been brought against investment banks for encouraging their stock*

*analysts to hype stocks that they had serious doubts about and which turned out to be disastrous investments.*

*These scandals have received tremendous public attention, both because resulting bankruptcies have cost employees of these firms their jobs or their pensions, but also because of the subsequent stock market decline of over 40% (S&P500) and 65% (Nasdaq) from March 2000 to March 2003. At the root of these scandals may be conflicts of interest in which agents who were supposed to provide the investing public with reliable information had incentives to hide the truth in order to further their own goals. What are these conflicts of interest and how serious are they? Have they been the source of the woes in financial markets recently? What should be done about them?*

*This paper seeks to provide some answers to these questions and is a summary of a larger study that I have written with Andrew Crockett, Trevor Harris and Eugene White (Crockett, et. al., 2003). **This paper provides a framework for answering these questions by first discussing the crucial role of information in financial markets.** This provides an understanding of what conflicts of interest are and why we should care about them. The paper then briefly provides a survey of the different types of conflicts of interest in the financial system. The paper concludes by developing a framework for thinking about policies to remedy conflicts of interest and outlining specific policy recommendations to remedy these conflicts of interest [emphasis added].<sup>43</sup>*

## **ii. The Impact of Asymmetrical Information on Market Efficiency**

Of particular relevance in understanding the comparative value of the U.S.'s capital markets to the domestic marketplace for commercial premises (i.e. leased and leasable commercial space) is Professor Mishkin's discussion of "asymmetric information,"<sup>44</sup> which he introduces as follows:

*In order to understand why conflicts of interest are important, we need to step back a bit and think about the function of financial markets in the economy. Well-functioning financial markets perform the essential economic function of channeling funds from individuals and firms who lack productive investment opportunities to those who have such opportunities. By so doing, financial markets contribute to higher production and efficiency in the overall economy. Reliable information is the key to financial markets performing this function.*

*A crucial impediment to the efficient functioning of the financial system is asymmetric information, a situation in which one party to a financial contract has much less accurate information than the other party. For example, managers of corporation usually have much better information about the potential returns and risk associated with the investment projects they plan to undertake than do potential purchasers of the corporation's stock. Asymmetric information leads to two basic problems in the financial system: adverse selection and moral hazard [emphasis added].<sup>45</sup>*

### **iii. Four Examples of Relationship-Driven Conflicts of Interest in Financial Services**

In his Policy Remedies paper, Professor Mishkin identifies four (4) main conflicts of interest in the financial services sector that negatively impact the efficiency of the capital markets.

#### **a. Underwriting and Research in Investment Banking**

The main concern here is that analysts in Research Departments of investment banks will be pressured to skew their research and attendant recommendations so that it will promote underwriting and brokerage, which tend to be profit centers for investment banks. Specifically, Professor Mishkin offers the following description of this conflict of interest:

*The information synergies from underwriting, research, and market making provide a rationale for combining these distinct financial services. However, this combination of activities leads to conflicts of interest. The conflict of interest that raises the greatest concern occurs between underwriting and brokerage, where investment banks are serving two client groups, issuing firms and investors. Issuers benefit from optimistic research while investors desire unbiased research. If the incentives for these two activities are not appropriately aligned, there will be a temptation for employees on one side of the firm to distort information to the advantage of their clients and the profit of their department.<sup>46</sup>*

#### **b. Auditing and Consulting in Accounting Firms**

In the early 1980's, traditional accounting and auditing firms—what were commonly referred to as the Big 6—began branching out into management advisory services including tax advice, management

information systems or MIS consulting, and strategic guidance. The natural tension between accounting and auditing, on the one hand, and management advisory services, on the other, manifests itself in two types of conflicts according to Mishkin:

*The most commonly discussed conflict is **the potential to pressure auditors to bias their judgments and opinions to limit any loss of fees in the “other” services.** The second more subtle conflict is that **auditors often evaluate systems or structuring (tax and financial) advice that were put in place by their non-audit counterparts within the firm.** Both conflicts may lead to biased audits, with **the result that less information is available in financial markets which will make it harder for them to efficiently allocate capital** [emphasis added].<sup>47</sup>*

**c. Credit Assessment and Consulting in Rating Agencies**

Investors, specifically, and the capital markets as a whole, rely upon the various rating agencies to provide an impartial evaluation of the key components of debt instruments, which are assigned ratings in a somewhat fine-grained fashion, from high quality investment grade debt to “junk bonds.” Accordingly, the integrity of this part of the capital markets relies upon the objectivity and integrity of the rating agencies and their underwriting processes. However, much as in the evolution of purely accounting and audit firms migrating into management advisory services has created conflicts of interest between those two functions within the same firm, rating agencies have come under considerable scrutiny for two different types of conflicts of interest.

*Because issuers pay to have their securities rated, there is a fear that **credit agencies may bias their ratings upwards in order to get more business.** A more serious concern is that **rating agencies have begun to provide ancillary consulting services in recent years.** Rating agencies are increasingly asked to advise on the structuring of debt issues, usually to help secure a favorable rating. In this case, **the credit rating agency would be in the position of “auditing its own work” raising conflicts of interest similar to those in accounting firms when they provide both auditing and consulting services.** Furthermore, providing consulting services creates additional incentives for the rating agencies to deliver more favorable ratings in order to further their consulting business [emphasis added].<sup>48</sup>*

#### **d. Universal Banking**

Similar to the expansion of services that accounting and audit firms, and rating agencies, respectively, have felt compelled to offer to their clients in order to generate new revenue streams; commercial banking has undergone its own evolution. Now banks typically offer a broad range of services that go well beyond providing checking and savings account options. Among the services banks offer their existing customers, or offer to new customers as a way to expand their overall customer base, are portfolio and trust management, insurance sales, stock brokerage, and more. As the variety of services that banks offer their customers has grown, the potential for taking a position that favors one customer increases the likelihood that something will negatively impact another customer whose goals and objectives diverge.

*If the potential revenues from one department surge, there will be an incentive for employees in that department to distort information to the advantage of their clients and the profit of their department. For example, issuers served by the underwriting department will benefit from aggressive sales to customers of the bank, while these customers are hoping to get unbiased investment advice. A bank manager may push the affiliate's products to the disadvantage of the customer or limit losses from a poor public offering by placing them in the bank's managed trust accounts. A bank with a loan to a firm whose credit or bankruptcy risk has increased, has private knowledge that may encourage it to use the bank's underwriting department sell bonds to the unsuspecting public, thereby paying off the loan and earning a fee. A bank may make loans on overly favorable terms in order to obtain fees from activities like underwriting securities. To sell its insurance products, a bank may try to influence or coerce a borrowing or investing customer.*

#### **iv. Positing Policy Remedies for the Avoidance of Conflicts of Interest in Financial Services**

Of the five policy remedies Professor Mishkin offers in his Policy Remedies paper, at least three may bear relevance to conflicts of interest in commercial leasing transactions. These three policy remedies are: Regulate for transparency; supervisory oversight; separation of functions. The two remaining policy remedies offered by Professor Mishkin—let the market correct the bad behavior and socialization of the information (i.e. all a government regulatory body to correct the information asymmetry by assuring all parties have

access to uniformly collected information—appear to represent the far ends of the spectrum and, in the context of commercial leasing transactions reflect either an ineffective policy prescription in the former remedy or complete overkill in the latter. The three viable policy remedies are described briefly below.

**a. Regulate for Transparency**

In this policy remedy, a more-rigorous regulatory framework would be needed to assure greater transparency and, consequently, a reduction in the asymmetry. Specifically, Professor Mishkin offers the following:

*A competitive market structure does not always adequately reduce information asymmetries. The gathering of information is costly, and any individual economic agent will only gather information if the private benefit outweighs the cost. When the information collected immediately becomes available to the market, the free-rider problem may become serious. Information has the attribute of a public good, which will be undersupplied in the absence of some public intervention. To some extent, mandatory information disclosure can alleviate information asymmetries and is a key element of regulation of the financial system.*

*Mandatory disclosure of information that reveals whether a conflict of interest exists may help the market to discipline financial firms that engage in conflicts of interest. In addition, if a financial institution is required to provide information about potential conflicts of interest, the user of the institution's information services may be able to judge how much weight to place on the information this institution supplies.*

**b. Supervisory Oversight**

Under certain circumstances, described below, regulating for transparency may not be effective or may cause other problems that may destabilize the sought-after symmetry in the market. In such cases, increasing supervisory oversight may be the better solution for addressing conflicts of interest.

*If mandatory disclosure does not work because firms are still able to hide relevant information, because the free-rider problem is severe or because mandatory disclosure would reveal proprietary information, supervisory oversight can*

*come to the rescue and contain conflicts of interest. Supervisors can observe proprietary information about conflicts of interest without revealing it to a financial firm's competitors so that the firm can continue to profitably engage in information production activities. Supplied with this information, the supervisor can take actions to prevent financial firms from exploiting conflicts of interest. As part of this supervisory oversight, standards of practice can be developed, either by the supervisor, or by the firms engaged in a specific information-production activity. Enforcement of these standards would then be in the hands of the supervisor.*

*Supervisory oversight of this type is very common in the banking industry. In recent years, bank supervisors have increased their focus on risk management. They examine bank's risk management procedures to ensure that the appropriate internal controls on risk-taking are in place at the bank. In a similar fashion, supervisors can examine the internal procedures and controls to restrict conflicts of interest. When they find weak internal controls, they can require the financial institution to modify them so that incentives to engage in conflicts of interest are eliminated.*

### **c. Separation of Functions**

When neither regulating for transparency nor providing greater supervisory oversight are or will be effective in reducing the incidence of conflicts of interest, then separating the functions that are the source of the conflicts may be the best solution.

*Where the market cannot get sufficient information to constrain conflicts of interest because there is no satisfactory way of inducing information disclosure by market discipline or supervisory oversight, the incentives to exploit conflicts of interest may be reduced or eliminated by regulations enforcing separation of functions. There are several degrees of separation. First, is separation of activities into different in-house departments with firewalls between them. Second, is to conduct different activities in separately capitalized affiliates. Third, is prohibition of the combination of activities in any organizational form.*

*Separation of functions has the goal of ensuring that "agents" are not placed in the position of responding to multiple "principals" so that conflicts of interest are reduced. Moving*

*from less to more stringent separation of functions, conflicts of interest are reduced. However, more stringent separation of functions reduces synergies of information collection, thereby preventing financial firms from taking advantage of economies of scope in information production. Deciding on the appropriate amount of separation thus involves a tradeoff between the benefits of reducing conflicts of interest and the cost of reducing economies of scope in producing information.*

### 3. Conflicts of Interest in Accounting and Advisory Services

As mentioned, above, in Subparagraph b.2 of Subsection IV.D, Avoiding Conflicts of Interest, once the national accounting firms started expanding their service offerings from their core businesses of accounting and audit services to management advisory services, including tax advice, management information systems consulting, and strategic guidance, conflicts of interest were created by the natural tension between accounting and auditing, on the one hand, and management advisory services, on the other. As proposed by Professor Mishkin in his 2003 academic paper, **Policy Remedies for Conflicts of Interest in the Financial System**, manifests itself in two types of conflicts:

*The most commonly discussed conflict is the potential to pressure auditors to bias their judgments and opinions to limit any loss of fees in the “other” services. The second more subtle conflict is that auditors often evaluate systems or structuring (tax and financial) advice that were put in place by their non-audit counterparts within the firm. Both conflicts may lead to biased audits, with the result that less information is available in financial markets which will make it harder for them to efficiently allocate capital [emphasis added].<sup>49</sup>*

#### a. The Sarbanes-Oxley Act of 2002<sup>50</sup> (“SOX”)

Introduced in the U.S. House of Representatives by Rep. Mark Oxley (R-OH) on February 14, 2002, and passed on April 24, 2002, as the “Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002” (H.R. 3763), and passed by a 97-0 voice vote in the U.S. Senate as the “Public Company Accounting Reform and Investor Protection Act of 2002,” the Sarbanes-Oxley Act of 2002, was passed by both houses of Congress on July 25, 2002, after being reported out by the joint conference committee of the House and Senate, and was signed into law by President George W. Bush on July 30, 2002. SOX grew out a series of high-profile, catastrophic financial failures of very large, publicly traded companies—most-notably ENRON and WoldCom—ushering in a series of regulatory oversight reforms for the boards of directors and managements of all publicly traded companies, and for the public accounting profession, which was seen as complicit in these catastrophic financial failures. Among other things, SOX imposed federal regulatory oversight of auditors and auditing of public

companies, which previously had been left to the accounting profession, and created the Public Company Accounting Oversight Board.

**b. The Public Company Accounting Oversight Board (PCAOB)**

Among other things, the PCAOB is charged with oversight authority over public companies providing auditing services to public companies and it has authority to set auditing, quality control, ethics, independence and other standards relating to the preparation of audit reports of issuers. In order to provide audit services to public companies, audit firms must first register with PCAOB to become a “registered public accounting firm.”

**c. PCAOB Ethics Rules for Registered Public Accounting Firms**

PCAOB has promulgated rules regulating the activities of registered public accounting firms. ET 100 covers Independence, Integrity, and Objectivity; ET Section 101 covers Independence, and provides, in pertinent part the following rule regarding conflicts of interest caused by providing nonattest services to public companies for which audit services are also being performed:

ET 101-3—Performance of other services. A member or his or her firm (“member”) who performs an attest engagement for a client may also perform other nonattest services (“other services”) for that client. Before a member performs other services for an attest client, he or she must evaluate the effect of such services on his or her independence. In particular, care should be taken not to perform management functions or make management decisions for the attest client, the responsibility for which remains with the client’s board of directors and management.

Before performing other services, the member should establish an understanding with the client regarding the objectives of the engagement, the services to be performed, management’s responsibilities, the member’s responsibilities, and the limitations of the engagement. It is preferable that this understanding be documented in an engagement letter. In addition, the member should be satisfied that the client is in a position to have an informed judgment on the results of the other services and that the client understands its responsibility to—

1. Designate a management-level individual or individuals to be responsible for overseeing the services being provided.
2. Evaluate the adequacy of the services performed and any findings that result.
3. Make management decisions, including accepting responsibility for the results of the other services.

4. Establish and maintain internal controls, including monitoring ongoing activities.

Rule 3520. A registered public accounting firm and its associated persons must be independent of the firm's audit client throughout the audit and professional engagement period.

**Note 1:** Under Rule 3520, a registered public accounting firm or associated person's independence obligation with respect to an audit client encompasses not only an obligation to satisfy the independence criteria applicable to the engagement set out in the rules and standards of the PCAOB, but also an obligation to satisfy all other independence criteria applicable to the engagement, including the independence criteria set out in the rules and regulations of the Commission under the federal securities laws.

**Note 2:** Rule 3520 applies only to those associated persons of a registered public accounting firm required to be independent of the firm's audit client by standards, rules or regulations of the Board or Commission or other applicable independence criteria.

**d. PCAOB Third Report on the Progress of the Interim Inspection Program Related to Audits of Brokers and Dealers, August 18, 2014**

In its latest Inspection Report on PCAOB's efforts to audit the compliance of registered public accounting firms with PCAOB rules and regulations, it appears that registered public accounting firms are doing a poor job of meeting PCAOB's requirements for independence:

**Failure to Satisfy Independence Requirements**

In 21 of the 90 audits selected for inspection, it appeared to Inspections staff, that contrary to the requirements of SEC independence rules, auditors were involved in the preparation of the financial statements they audited. This conduct was observed in 19, or approximately 48 percent, of the 40 audits selected for inspection that were performed by firms that did not also audit issuers. Further, independence findings were observed in two, or four percent, of the 50 audits selected for inspection that were performed by firms that also audited issuers. Apparent independence violations have been, and will continue to be, reported to the SEC as such violations may have implications to the broker's or dealer's compliance with the requirements of Securities Exchange Act of 1934 ("Exchange Act") Rule 17a-5 ("Rule 17a-5").

#### **4. Conflicts of Interest in Real Estate Transactions**

##### **a. Dual Agency in Residential Sales Transactions**

Dual agency relationships in residential sales transactions, also known as “designated agency,” are generally permitted provided the agent makes the necessary disclosures and secures the client’s written consent in accordance with state law. Dual agency in residential sales transactions, which—for potential purchasers of residential real estate—includes the search for a home to buy, is prohibited in three states: Colorado, Florida, and Kansas.

##### **i. Dual Agency in Maryland**

###### **a. Presumption that Agent Only Represents One Party**

Maryland Code § 17-533 states that a prospective buyer or lessee can assume the licensee providing assistance has no agency relationship with any other party in the transaction .

A licensee who assists a prospective buyer or lessee in locating residential real estate for purchase or lease and is neither affiliated with nor acting as the listing real estate broker for any real estate shown or located, is presumed to be acting as the buyer's or lessee's agent representing the buyer or lessee unless either the licensee or the buyer or lessee expressly declines to have the licensee act as a buyer's or lessee's agent.

###### **b. Early Disclosure of Agent’s Status Representing the Seller**

Before the agent (licensee) may show or assist the buyer or lessee in locating real estate listed for sale by the broker with whom the licensee is affiliated, the licensee shall disclose to the prospective buyer or lessee that the licensee represents the seller or lessor for that real estate.

At the first meeting of the licensee and the buyer or lessee, the licensee shall:

(1) orally advise the prospective buyer or lessee that the licensee will act as the buyer's or lessee's agent in locating residential real estate unless the buyer or lessee declines the agency; and

(2) provide the prospective buyer or lessee with a copy of the disclosure form required by § 17-530 of this subtitle, but the licensee is not required to obtain the signature of the buyer or lessee before or during the presumed agency relationship.

**c. Required Disclosure to Seller or Lessor**

A licensee acting as a presumed buyer's agent shall orally disclose that fact to the seller or lessor or the licensee acting as the agent of the seller or lessor at their first contact.

The state defines a dual agent as “a licensed real estate broker, licensed associate real estate broker, or licensed real estate salesperson who acts as an agent for both the seller and the buyer or the lessor and the lessee in the same real estate transaction.”

**i. Dual Agency in Virginia**

**a. The Advent of “Single Dual Agency” in Residential Sales Transactions in the Commonwealth of Virginia**

As of July 1, 2012, the Commonwealth of Virginia implemented: *a comprehensive approach to enhance the agency relationship disclosure requirements between agents and those they represent. Accordingly, single dual agency is permitted, so long as the agent has provided the potential client the written consequences of such practice and obtains the written consent of the client.*

*What does the agent have to disclose?*

- *the agent will be unable to advise either party as to the terms, offers or counteroffers;*
- *that the agent cannot advise the potential buyer of the suitability or condition of the property;*
- *that the agent will be acting without knowledge of the client’s needs, or experience in real estate, and*
- *that either party may engage another agent if either requires additional representation.*<sup>51</sup>

**b. Required Dual-Agency Disclosures in Commercial Leasing in Virginia**

In addition to the foregoing requirements, applicable to residential sales transactions, also effective as of July 1, 2012, dual agency in commercial leasing transactions is permitted only with the requisite disclosures in advance of the representation. Specifically, Section 54.1-2139.01 of the Code of Virginia provides as follows:

§ 54.1-2139.01. Disclosed dual agency and dual representation in commercial real estate transactions authorized.

A. A licensee may act as a dual agent or dual representative in a commercial real estate transaction only with the written consent of all clients to the transaction. A dual agent has an agency relationship under the brokerage agreements with the clients. A dual representative has an independent contractor relationship under the brokerage agreements with the clients. Such written consent and disclosure of the brokerage relationship as required by this article shall be presumed to have been given as against any client who signs a disclosure as provided in this section.

B. Such disclosure may be given in combination with other disclosures or provided with other information, but if so, the disclosure shall be conspicuous, printed in bold lettering, all capitals, underlined, or within a separate box. Any disclosure which complies substantially in effect with the disclosure form shall be deemed in compliance with this disclosure requirement.

**DISCLOSURE OF DUAL AGENCY OR DUAL  
REPRESENTATION IN A COMMERCIAL REAL ESTATE**

**TRANSACTION**

The undersigned do hereby acknowledge disclosure that:

The licensee.....

(name of broker or salesperson)

associated with.....

(Brokerage Firm)

represents more than one party in this commercial real estate transaction as

follows:

Brokerage Firm represents the following party (select one):

Seller(s)  Buyer(s)  Landlord(s)  Tenant(s)

As a (select one):

standard agent  limited service agent  independent contractor

Brokerage Firm represents another party (select one):

Seller(s)  Buyer(s)  Landlord(s)  Tenant(s)

As a (select one):

standard agent  limited service agent  independent contractor

The undersigned understand that the foregoing dual agent or dual representative may not disclose to either client any information that has been given to the dual agent or representative by the other client within the confidence and trust of the brokerage relationship except for that information which is otherwise required or permitted by Article 3 (§ 54.1-2130 et seq.) of Chapter 21 of Title 54.1 of the Code of Virginia to be disclosed.

The undersigned by signing this notice do hereby acknowledge their informed consent to the disclosed dual representation by the licensee.

.....  
Date Name (One Party)

.....  
Date Name (One Party)

.....  
Date Name (Other Party)

.....  
Date Name (Other Party)

C. The obligation to make the disclosures required by this section shall not relieve the licensee of the obligations set out in subsection B of § 54.1-2137 requiring all brokerage

relationships to be set out in a written agreement between the licensee and the client.

D. No cause of action shall arise against a dual representative for making disclosures of brokerage relationships as provided by this article. A dual representative does not terminate any brokerage relationship by the making of any such allowed or required disclosures of dual representation.

E. In any real estate transaction, a licensee may withdraw, without liability, from representing a client who refuses to consent to a disclosed dual representation thereby terminating the brokerage relationship with such client. Such withdrawal shall not prejudice the ability of the licensee to continue to represent the other client in the transaction or to limit the licensee from representing the client who refused the dual representation in other transactions not involving dual representation.

**ii. Dual Agency in the District of Columbia:**

**a. Dual Agency in Commercial Sales Transactions**

Generally speaking, state statutes have not made regulatory and/or licensing distinctions between the types of commercial property transactions in which commercial agents and brokers engage. Accordingly, the treatment of a commercial agent or broker engaging exclusively in purchases and sales of commercial properties will be exactly the same as a commercial agent or broker engaging exclusively in commercial leasing transactions. The important dichotomy in the state regulatory and licensing frameworks has been between residential agents and brokers, on the one hand, and commercial agents and brokers, on the other hand. See, Paragraph iii below, regarding the latter, and Paragraph i, above, regarding the former. However, an argument may be put forth that the potential, adverse consequences for the purchaser of commercial properties resulting from dual agency and related conflicts of interest inherent may be substantially greater than in the commercial leasing context. For example, the purchaser's agent may be pressured by her employer, the CRES firm that also represents the owner of the subject property, not to reveal to her client any negative information about the subject property that the agent has learned, whether or not such information came to her through colleagues at the same CRES firm or otherwise.

**b. Dual Agency in Commercial Leasing Transactions**

**i. California's Approach to Protecting the Interests of Commercial Tenants**

As suggested in Section II, Summary of Findings and Recommendations, and discussed in greater detail in Section IV, Law of Principal and Agent, Subsection C, Basics of Legal Duties of Agents to Principals in Real Estate Transactions, and demonstrated in Appendix E, Comparison of Disparate Commercial Brokerage Regulatory Frameworks, not only is dual agency in commercial leasing transactions not treated uniformly by the CRES industry or the states and localities in which full-service CRES firms deliver their services, including but not limited to tenant agency, there is disparate treatment under the law and in practice from office to office in national and global full-service CRES firms with operations in the domestic U.S. The passage and enactment in California of S.B. 1171 made sweeping reform in what previously was the dichotomous treatment of residential brokers and agents, on the one hand, and commercial brokers and agents, on the other (the latter not being legally required to disclose conflicts of interest in dual agency situations). Moreover, the decision by the California Second District Court of Appeal in the **Horiike v. Coldwell Banker Residential Mortgage Company** case,<sup>52</sup> now on appeal to the Supreme Court of California, may greatly expand the legal liabilities of licensed brokers who oversee agents and associate brokers in the office(s) they manage.

**a. Forcing Commercial Agents to Choose Who They Will Represent**

As already suggested in subparagraph 4.a.ii.b. of Subsection IV.D., above, "single dual agency" relationships in commercial leasing transactions, at least in Virginia as of July 12, 2012, and in California as of January 1, 2015, mean that agents will be compromised substantially in the ability to represent their client's best interests. Although it is far too early to tell in Virginia, and certainly so in California, where the new law, enacted by S.B. 1171, has not even taken effect, it is possible, if not likely, that the magnitude of the required disclosures will give prospective clients considerable pause before engaging a single dual agent.

**b. The Horiike v. Coldwell Banker Residential Mortgage Company Case**

As suggested above, the final outcome in the **Horiike** case may have a dramatic impact on the liabilities of full-service CRES firms, holding that the brokerage firm is liable for the actions of their licensed agents and associate brokers in their representations of clients of the firms.

**i. The Facts in the Horiike Case**

The relevant facts in the Horiike case are that Plaintiff, Hiroshi Horiike, was working with an agent (referred to in the case as a “salesperson”) of a licensed California broker, Coldwell Banker Residential Brokerage Company (CB), which had the listing of the house which Mr. Horiike was interested in purchasing. Another CB salesperson, working, through CB, on behalf of the seller of the house, materially misrepresented to Mr. Horiike both the actual square footage of the house (overstating it by almost one-third), as well as the development disposition of adjoining lots on either side of the seller’s property (representing that no development was planned when that, in fact, that was not the case on either lot). Mr. Horiike closed on his purchase of the house, for \$12.25 million in cash, in reliance upon the representations made by the salesperson representing the seller through the broker, CB, including the sales brochure prepared by CB’s salesperson working on behalf the seller. The trial court dismissed the case in favor of seller’s agent, on the basis that the seller’s listing contract and buyer’s was with CB, and not with CB’s agent, and therefor Mr. Horiike did not have a basis upon which he would sue over the misrepresentations of the CB salesperson.

**ii. The Ruling of the California Court of Appeals (Second Appellate Division)**

The California Court of Appeals, hearing Mr. Horiike’s claims that the trial court incorrectly instructed the jury as well as wrongly dismissing his case (by granting the Defendant’s motion for nonsuit), held as follows:

*The buyer contends that the salesperson had a fiduciary duty equivalent to the duty owed by the broker, and the trial court incorrectly granted the nonsuit and erroneously instructed the jury. We agree. When a broker is the dual agent of both the buyer and the seller in a real property transaction, the salespersons acting under the broker have the same*

*fiduciary duty to the buyer and the seller as the broker*  
[emphasis added].

In its opinion overturning the lower court, the Court of Appeals also discussed the forms that were provided to Mr. Horiike by CB, through its salespeople (Mr. Horiike's buyer's agent and CB's seller's agent), and the three different types of agency relationships contemplated in accordance with those forms:

*The parties to the transaction signed a confirmation of the real estate agency relationships as required by Civil Code section 2079.17. The document explained that CB, as the listing agent and the selling agent, was the agent of both the buyer and seller. [The seller's agent for CB] signed the document as an associate licensee of the listing agent CB. [Horiike's agent] also signed the document as an associate licensee of the selling agent CB.*

*Horiike also executed a form required under Civil Code section 2079.16 for the disclosure of three possible real estate agency relationships. First, the form explained the relationship of a seller's agent acting under a listing agreement with the seller. The seller's agent acts as an agent for the seller only and has a fiduciary duty in dealings with the seller. The seller's agent has obligations to both the buyer and the seller to exercise reasonable skill and care, as well as a duty of fair dealing and good faith, and a "duty to disclose all facts known to the agent materially affecting the value or desirability of the property that are not known to, or within the diligent attention and observation of, the parties."*

*The second type of relationship, which is not at issue in this case, involves the obligations of an agent acting for the buyer only. An agent acting only for a buyer has a fiduciary duty in dealings with the buyer. A buyer's agent also has obligations to the buyer and seller to exercise reasonable care, deal fairly and in good faith, and disclose material facts.*

*The third relationship described was an agent representing both the seller and the buyer. "A real estate agent, either acting directly or through one or more associate licensees, can legally be the*

*agent of both the Seller and the Buyer in a transaction, but only with the knowledge and consent of both the Seller and the Buyer." An agent in a dual agency situation has a fiduciary duty to both the seller and the buyer, as well as the duties to buyer and seller listed in the previous sections.*

*Horiike signed the disclosure form as the buyer and [the seller's agent] signed as an associate licensee for the agent CB.*

**iii. The Appellate Court Ruling in the Horiike case is on Appeal before the California Supreme Court**

The California Supreme Court docket entry for the Horiike case is provided below. The responsive brief is due on December 8, 2014. The case has not been scheduled for hearing.

***Real Estate Broker As Dual Agent.** When the buyer and the seller in a residential real estate transaction are each independently represented by a different salesperson from the same brokerage firm, does Civil Code section 2079.13, subdivision (b), make each salesperson the fiduciary to both the buyer and the seller with the duty to provide undivided loyalty, confidentiality and counseling to both?*

**c. The Fallacy of “Client Sophistication” as a Defense to Dual-Agency Disclosure Requirements in Commercial Leasing Transactions**

In opposing S.B. 1171, the California Association of Realtors made the following argument, which the California legislators did not find compelling, in nonetheless passing Senator Hueso’s bill:

*When our association sponsored the original agency disclosure legislation, including the written form requirement that now applies to residential agency, **and commercial transactions were deliberately not required to use the same forms as residential transactions.** The reason for the different rule is **the different level of sophistication and complexity** that exist in non-residential transactions. We believed, and experience seems to bear it out, that **simply requiring***

*disclosure of multiple agency relationships and allowing commercial practitioners to utilize their own contracts and forms is sufficient to protect the parties* [emphasis added].<sup>53</sup>

**i. Residential Sales: An increasingly standardized transaction between adverse parties who, in general, are very evenly matched**

The fact of the matter is residential purchase and sales transactions are by far much more straight-forward, and less complex, than commercial leasing transactions. As already suggested, information in the residential sales market is much more symmetrical than it is in the commercial sales market. Moreover, due to the relative uniformity of state laws regarding both the duties of agents and the disclosure requirements in the case of conflicts of interest—thanks in part to the efforts of the NAR—and the overlay of federal laws where financing from federal agencies and GSE's is involved (e.g. FHA, Fannie Mae and Freddie Mac), the general body of knowledge in the public domain about selling and purchasing a personal residence is applicable to the vast majority of transactions, which have a number of cookie-cutter aspects to them. Finally, buyer and seller sophistication about residential purchases and sales, thanks in part to the success of programming like that provided on HGTV, a cable network devoted to home buying and homeownership, it is very hard to successfully make the argument, as CAR tried to do in opposing S.B. 1171, that residential buyers are unsophisticated and need the protections of upfront, written disclosures of dual agency.

**ii. Commercial Leasing: An inherently complex and adversarial, one-off transaction, between two parties with vastly different information, knowledge, experience, skill sets, and negotiating power**

Among other things, a commercial lease agreement may run in excess of 50 pages. The terms and conditions of a commercial lease agreement contain idiosyncratic legal provisions and plenty of jargon: “subordination, non-disturbance, and attornment,” “indemnification,” “subrogation,” “common area maintenance (CAM) charges,” and “events of default.” However, based on employment statistics, perhaps the best measure for gauging demand for commercial office space only **0.55%** of businesses in the United States is engaged in the real

estate.<sup>54</sup> Additionally, given the inherently complex nature of real estate development, financing, and ownership structures, outlined in Section III.A, Commercial Property Development and Ownership: A Very Brief Primer, above, it is highly unlikely that the average commercial tenant enters its search for commercial office space, beginning with the process of identifying and engaging a commercial real estate agent, truly understands the potential for conflicts of interest in hiring an agent employed by a full-service CRES firm. Accordingly, logic and experience dictate that the opposition made by CAR against S.B. 1171, claiming it to be totally unnecessary, could more-effectively be used to argue why—in a period where dual residential agency has been long-settled—commercial tenants should not receive at least the same scope and extent of protection as residential buyers receive in considering the engagement of a tenant representative working for a full-service CRES firm.

## **ii. How the Federal Government Handles Conflicts of Interest in Commercial Leasing Transactions**

The United States government is the largest single user of commercial office space in the U.S. In addition to the buildings owned outright by the federal government, through the General Services Administration, the federal government leases just under 200 million sq. ft. of commercial office space in the U.S.<sup>55</sup> This makes the federal government an extremely unique and valuable tenant client for full-service and tenant-only CRES firms alike, as well as a very attractive prospect for commercial Developers and Property Owners.

### **a. Required Disclosures by a Full-Service CRES Firm Proposing to Represent the Federal Government as a Tenant through the GSA**

In order to represent the federal government, through the GSA, as its real estate broker, a CRES firm must enter into a National Broker Services Contract administered by GSA's Public Buildings Service, Office of Real Estate Acquisition, Center for Brokerage Services.<sup>56</sup> Section H.5 of GSA's National Broker Services Contract<sup>57</sup> provides, in pertinent parts, procedures regarding the avoidance on conflicts of interest arising out of the organization of the Contractor (i.e. the CRES firm hired to represent GSA through the National Broker Services Contract). The aforementioned provisions in Section H.5 are provided in Exhibit II to the report. Additionally, *the Exhibit 7C – Dual Agency Disclosure Statement*,

*referenced in subparagraph (11) of subsection H.5.(d) of the National Broker Services Contract, which is required to be submitted to GSA in each case in which the Contractor (e.g. GSA's tenant-agent), upon accepting a Task Order from GSA, also represents the landlord in a proposed transaction, provides, in pertinent part, as follows:*

*EXHIBIT 7C  
DUAL AGENCY DISCLOSURE STATEMENT*

*Acknowledgement and Consent)*

*GSA Regional*

*CO: \_\_\_\_\_*

*Lessor(s): \_\_\_\_\_*

*Property*

*Involved: \_\_\_\_\_*

*Dual Agency: The General Services Administration's, National Broker Contract, number \_\_\_\_\_, allows a brokerage firm under this GSA contract to represent both the Government, as tenant, and the owner in this real estate transaction as long as this is disclosed to both parties and both agree. This is known as dual agency. Under this GSA Contract, a brokerage firm may represent two clients whose interest are, or at times could be, different or adverse. For this reason, the dual agent(s) may not be able to advocate on behalf of the client with the same skill and determination the dual agent may have if the brokerage firm represents only one client. Dual Agency under this GSA contract does not allow the same agent of the Brokerage Firm to represent both parties.*

*(b) Purpose. The purpose of this clause is to avoid, neutralize, or otherwise mitigate organizational conflicts of interest that might exist related to a Contractor's performance of work required by this contract. Such conflicts may arise in situations including, but not limited to: a Contractor's participation as an offeror or representative of an offeror, in a procurement in which it has provided assistance in the preparation of the Government's requirements and specifications; a Contractor's providing advisory assistance to the Government in a procurement in which the Contractor's firm, or one which the Contractor represents, is an actual or potential offeror; and a Contractor's participation, as*

*an offeror or representative of an offeror, in a procurement where the Contractor has obtained confidential or proprietary information relating to competing offerors as a result of the Contractor's work on prior task orders.*

*(d) Restrictions. The Contractor agrees:*

*1. As a condition of its award of this contract and in addition to other requirements of this contract regarding Contractors ethics program and reporting requirements, and the safeguarding of information, to establish a "conflict wall", in form and manner satisfactory to the Contracting Officer. Any such "conflict wall" shall, at a minimum:*

- Inform all members of the Contractor of the existence of the "conflict wall" and the restrictions set forth in this Clause;*
- Ensure the establishment and maintenance, during the term of this Contract, of separate electronic file servers and other electronic safeguards to prevent access to documents, files and information related to Contractor's work under this Contract to other than Contractor personnel working under this Contract, including Contractor personnel representing building owners or lessors;*
- Ensure that paper files and documents are kept, safeguarded and maintained in separate, secure locations that will preclude access to Contractor personnel not working under this Contract, including Contractor personnel representing building owners or lessors;*
- Be maintained at all times during the term of this Contract*

*2. To remain subject, during the term of the Contract, to periodic inspection and verification of the "conflict wall" and the processes and procedures to be maintained in connection therewith.*

*3. To execute, in connection with any awarded Task Order under this Contract, such certifications as the Contracting Officer may deem necessary and appropriate confirming the continuing existence of the "conflict wall" and the processes and procedures included thereunder, including but limited to, Exhibits 7A, 7B, and 7C.*

*4. That none of the Contractor's personnel, (including without limitation employees, consultants or subcontractors) may participate as both a GSA representative and as a representative of an offeror on a GSA lease transaction. Such ban shall be in effect for the duration of the lease transaction.*

*5. That none of the Contractor's personnel, (including without limitation employees, consultants or subcontractors), who have a personal financial interest in a potential or actual offeror for a lease transaction, may participate as a GSA representative on that GSA lease transaction.*

*6. That none of the Contractor's personnel (including without limitation employees, consultants or subcontractors) performing work under this Contract will participate, in any capacity, in providing any advice or representation to a building owner, representative, lessor or other third-party in connection with any GSA leasing transaction in the same market while an individual is performing service under this contract and for an additional period of six (6) months following conclusion of an individual's work under the Contract.*

*7 That any person performing services under this Contract shall be and remain, during the term of this Contract, ineligible to share in any fees or commissions received by or payable to Contractor by virtue or Contractor's representation of a building owner, representative, lessor or other third-party in a lease transaction involving the Government; provided, any such person shall be entitled to share in any payment made to Contractor under this Contract.*

8. *That all personnel performing work in connection with an awarded task order under this Contract may be required to execute such Confidentiality and Non-Disclosure Agreements, or other documents which the Contracting Officer, in his/her sole discretion, may require in order to protect the proprietary nature or confidentiality of information provided by the Government or otherwise received by the Contractor in connection with its work under this Contract. Such Agreements or documents may provide that violations of their terms may result in criminal and civil penalties in accordance with, among other laws and regulations, 41 U.S.C. §423. Failure of the Contractor to provide required Agreements or documents under this paragraph from all required personnel may result in termination of Contractor's work under the task order at issue at no cost to the Government. Repeated violations may result in the termination of this Contract.*

9. *That the Contractor and all personnel performing work in connection with an awarded task order under this Contract are required to execute the agreements contemplated by Section 9.505-4(b) of the Federal Acquisition Regulation, 48 C.F.R. §9.505-4(b).*

10. *That all personnel performing services under this Contract will treat any and all information generated and received in connection with their work as proprietary and confidential, continue to do so in perpetuity, and disclose and utilize such information only in connection with their work under the Contract.*

11. *That upon receipt of a task order request, to immediately notify the Contracting Officer of any potential organizational or individual conflict of interest that would prevent or limit the Contractor's ability to perform the work requested. If any such conflict is identified, consistent with the other requirements and restrictions of this Clause, the Contractor shall provide the certification that the conflict wall is in place and any other documents that may be required by the Contracting Officer pursuant to paragraph (d).3 above. Contractor shall continue performance of the request, unless notified in writing by*

*the Contracting Officer; provided that the Contracting Officer shall have the right to impose such restrictions as he/she deems appropriate on Contractor's performance based on the existence of such a conflict or, if the Contracting Officer determines that such restrictions would not adequately address the conflict of interest at issue, to terminate the Contractor's performance of work under the task order at no cost to the Government. At the lease solicitation phase, Contractor shall provide executed dual agency notifications and agreements from any interested parties affected by the Contractor's performance of work related to the task order. See Exhibit 7C.*

*12. To immediately notify the Contracting Officer of any organizational or individual conflict of interest discovered during Contractor's performance of work pursuant to a Government-issued task order; provided that the Contracting Officer shall have the right to impose such restrictions as he/she deems appropriate on Contractor's performance based on the existence of such a conflict or, if the Contracting Officer determines that such restrictions would not adequately address the conflict of interest at issue, to terminate the Contractor's performance of work under the task order at no cost to the Government. If at or after the lease solicitation phase, Contractor shall provide executed dual agency notifications and agreements from any interested parties affected by the Contractor's performance of work related to the task order.*

*13. That in the event that the Contractor knowingly withholds the existence of a conflict of interest from the Government, that the Contracting Officer may terminate this Contract or an individual task order at no cost to the Government; provided that the foregoing shall be in addition to all other remedies and causes of action which the Government may have against the Contractor, including the suspension and/or debarment of the Contractor.*

*14. To include this Conflict of Interest clause, including this subparagraph, in all of Contractor's subcontracts at all tiers (appropriately modified to preserve the Government's interests hereunder) which involve the*

*performance of work by subcontractors in support of this Contract.*

*15. That, in addition to the remedies enumerated above, the Government may terminate this Contract for cause in the event of Contractor's breach of any of the above restrictions.*

**b. Findings of Conflict of Interest in Representing the Federal Government**

On June 12, 2013, the Office of Inspector General (OIG) of the United States Postal Service (USPS) issued its Audit Report entitled “Contracting for Management Services,” Report Number SM-AR-13-001,<sup>58</sup> in connection with a contract between USPS and full-service CRES firm CB Richard Ellis, Inc. (now known as “CBRE Group, Inc.” and hereinafter simply referred to as “CBRE”), as the sole provider of management services to USPS. That OIG Audit Report is hereinafter referred to as the “USPS OIG Audit Report.” Then, on February 12, 2014, the USPS OIG issued “Management Alert – Risks Associated With CB Richard Ellis, Inc.,” Report Number SM-MA-14-003<sup>59</sup>, regarding “*potential financial risks associated with the U.S. Postal Service’s real estate management services contract with CB Richard Ellis, Inc. (Project Number 12YG018DA001).*” That OIG report is hereinafter referred to as the “USPS OIG Management Alert.” In both the USPS OIG Audit Report and the USPS OIG Management Alert, the OIG was very critical of USPS’s contractual arrangements with CBRE, and CBRE’s performance of that contract for USPS.

**c. The contract between USPS and CBRE**

USPS entered into a contract with CBRE in 2011 provide USPS with management services regarding all of its facilities, including the valuation of existing USPS properties, disposing of or leasing to third-parties existing USPS facilities no longer devoted are efficient for USPS operations, and leasing new facilities for USPS’s use where needed. Because the contract between USPS and CBRE was awarded directly by USPS, CBRE was not required to enter into and be bound by GSA’s National Broker Services Contract. In the USPS OIG Management Alert, the OIG noted the rationale for CBRE’s selection by USPS as follows:

*The U.S. Postal Service awarded a contract in June 2011 to CB Richard Ellis, Inc. (CBRE) to be **the sole***

*provider of Postal Service real estate management services. The Postal Service believed that **leveraging the capabilities of a national real estate firm** would allow for a **more effective use of limited resources**. As the largest real estate owner in the world, CBRE has one of the broadest industry platforms. In 2012, CBRE was responsible for more than \$189.8 billion in property sales and lease transactions globally and managed more than 3.3 billion square feet of commercial properties and corporate facilities [emphasis added].*

**d. CBRE's Conflicts of Interest Policies.**

CBRE has a publicly available document entitled “Managing Conflicts of Interest” dated December 2011.<sup>60</sup> That policy statement provides, in pertinent part regarding conflicts of interest, as follows:

*We do not sell any tangible product, and daily depend of our reputation for service excellence as the foundation of our business franchise. We have only one reputation, and yet each day thousands of individuals are taking actions that may impact it. While, to an outsider, incentives to exploit a particular conflict of interest for our own short-run gain may appear to be strong, our firm's reputation is paramount and we manage our firm to create longterm value for our stakeholders. Therefore, exploiting conflicts of interest—in addition to being at odds with our firm's “RISE” values of Respect, Integrity, Service and Excellence—would be harmful to our profitability because we would have great difficulty continuing to sell our services. It is therefore critical for us to have an effective conflict management and business selection process that is overseen by experienced, senior people and embedded in the core decision-making of the firm.*

*CBRE is sensitive to potential engagements that might be legally permissible and not technically posing conflicts of interests, but problematic from a client relations perspective. These business selection issues, if not promptly identified and properly managed, may lead to ill-will and a loss of business. The principles we employ to manage these business selection issues are*

*similar to those involved in the management of conflicts of interest.*

In addition to the foregoing, general firm policy regarding conflicts of interest, CBRE's "Managing Conflicts of Interest (December 2011)" enumerates the parameters used to internally identify conflicts of interest:

***How do we define conflicts of interest?***

*There is no single universally recognized definition of a conflict of interest. For us, a conflict of interest arises whenever CBRE or its employee:*

- could make a financial gain, or avoid a financial loss, at the expense of the client;*
- has an interest in the outcome of a service provided to the client or of a transaction carried out on behalf of the client, which is distinct from the client's interest in that outcome;*
- represents or seeks to represent two or more parties whose interests are actually or potentially in conflict with each other;*
- represents a client and CBRE has a financial or other incentive to favor the interest of another client, or group of clients, over the interests of the client;*
- carries on the same business as the client; or*
- expects to receive a benefit from a person other than the client in relation to a service provided to the client other than a market-based commission or fee for that service, for example in the form of a discount, monies, goods or services.*

*We have created an Appendix to this policy that lists examples of where conflicts may be expected to arise in our business. The list is not intended to be exhaustive and CBRE personnel must consider all services and activities carried out by the firm in order to identify any conflicts that may arise.*

**V. Understanding U.S. Commercial Leasing as a Marketplace**

**A. Basics of Efficient Markets**

## 1. How Markets Function: Workable Market Platforms

A market that functions efficiently serves all parties by facilitating the initiation and completion of transactions. There are two components to understanding how markets function: Understanding the fundamentals of a “workable market platform” and the concept of market “efficiency.”

In **Reinventing the Bazaar: A Natural History of Markets**,<sup>61</sup> author John McMillan posits five essential elements of a “workable market platform”

- **Information flows smoothly**
- **Property rights are appropriately protected**
- **People can be trusted to honor their promises**
- **Externalities are minimized**
- **Competition is fostered**<sup>62</sup>

### a. Free Exchange of Information

High “search costs,” comprised of time, money, opportunity costs (i.e. opportunities lost while pursuing something else), and the like imposed on the process of finding a particular good in a market, impedes and sometimes even prevents a transaction from being completed, and sometimes even started.

- i. Lack of essential information available to all consumers of products offered in a market is a critical contributor to high search costs.

*Bazaar merchants sometimes actively increase search costs by hiding price information. Negotiations are done discretely, so that the merchant can offer a bargain to a favored customer without other shoppers learning the price. In Yemen, a merchant and customer sometimes conceal their bargaining, it is reported, by covering their hands with a cloth. They bargain by moving their fingers, using each finger to symbolize a number, and using their eyes to indicate assent or disagreement.*<sup>63</sup>

- ii. Although McMillan does not describe it as such, asymmetrical information (“the uneven supply of information”), causes two types of friction in a market, impeding and sometimes precluding transactions, and thereby skewing pricing.

*Two kinds of market friction arise from the uneven supply of information. There are search costs: the time, effort, and money spent learning what is available where for how much. And there are evaluation costs, arising from the difficulties buyers have in assessing quality. A successful market has mechanisms that hold*

*down the costs of transacting that come from the dispersion of information.*

- iii. Consumer knowledge, essential for the free flow of transactions in market, depends upon the availability, and consumer access to, information. McMillan points out that anthropologist Clifford Geertz describes information in the bazaar in Marrakech, Morocco, as “poor, scarce, maldistributed, inefficiently communicated, and intensely valued.”<sup>64</sup>

*Information is the lifeblood of markets. Knowledge of what is available where, and who wants it, is crucial. A market works badly if information does not flow through it. Rarely does information flow absolutely freely, but well-functioning markets have various mechanisms to aid its movement, and thus to solve the problems you would encounter while shopping in the bazaar in Marrakech. Usually we take these devices so much for granted that we do not notice them, although we do notice their absence when they cause a market malfunction.*<sup>65</sup>

#### **b. Property Rights Are Respected**

Without a robust, easily understandable, commonly understood, and uniformly applied system of creating and enforcing property rights, there can be no market. If the true ownership of a thing that’s offered for sale is left largely to conjecture, there cannot be an effective market for its purchase and sale: Uncertainty as to the true ownership of property is, at best, an unstable basis for creating and maintaining a market for such property. In addition to McMillan’s observations on the importance of property rights in providing the foundation for a workable market platform, consider the recent and ongoing work of the Center for International Private Equity (CIPE) in developing its International Property Markets Scorecard, evaluating real estate markets in selected foreign countries. Integral to CIPE’s Scorecard methodology is an examination of the subject country’s legal mechanisms for creating ownership interests in real property and supporting the legal transfer of such interests. “*Property rights that are legally protected, secure, recorded in a single, accurate, widely accessible electronic registry and that lead to high levels of formal ownership for all citizens.*”<sup>66</sup>

*Only where there exists property can there be a market. Assurance against expropriation is needed if markets are to operate successfully. People will invest if they have some assurance that they will reap the returns on their investment. The defining feature of a market, noted earlier, is the participants’ autonomy. People are free to make decisions to buy or to sell that reflect their own preferences, constrained by the rules of the marketplace and by the extent of what*

*they own. The freedom of actions that is the essence of markets calls for property rights so people control their own resources.*<sup>67</sup>

**c. Promises Are Honored**

Mark Twain once remarked, “*Honesty is the best policy — if there’s money in it.*”<sup>68</sup> If the intentions of the parties to be honest cannot be objectively and quickly determined in a marketplace, then transactions will not occur without market mechanisms that assure the parties that the terms of their transaction will be honored by each side. This is one of the key components of a workable market platform.

*Some people are innately honest; some are not. Well-designed markets have a variety of mechanisms, formal and informal, to ensure there is, indeed, money in being honest. Marketplace confidence rests on rules and customs that give even the most unscrupulous reason to keep their word.*<sup>69</sup>

**d. Third-party Impacts Are Mitigated**

When an activity or transaction has consequences—positive or negative—on others not directly involved in such activity or transaction, such third-party impacts, referred to by economists as “externalities,” may need to be mitigated to prevent those unintended consequences. McMillan describes externalities this way:

*I harm others merely by driving my car. Contributing to traffic congestion, I add a little to the other drivers’ lateness, not to speak of their blood pressure. My car’s presence on the road, even if I drive carefully, slightly increases others’ chances of being in an accident. My car’s exhaust fumes pollute the air others breathe.*

An externality occurs every time one person’s decisions subject any non-decision maker to consequences, whether those consequences are beneficial or harmful to the non-decision maker. Although it is impossible to eliminate entirely these externalities, a workable market platform should mitigate against externalities to the extent possible.

**e. Competition is Fostered**

Competition changes the balance of the parties’ relative bargaining power while also reducing transaction costs.<sup>70</sup> The lower the transactions costs, the more efficient the market becomes. McMillan uses the example of the Tsukiji fish market in Tokyo to demonstrate how competition establishes pricing quickly and efficiently. In the early morning hours of each day, the Tsukiji fish market trades

approximately \$25 million in freshly caught seafood. Fisheries auction their catch to wholesalers who then take their purchase to another part of the fish market to sell them to retailers, including restaurants. In two hours, including an approximately 30-minute inspection period, \$10 million worth of fresh tuna is sold by the fisheries, through affiliated intermediaries, and purchased by the wholesalers. Through an auction process, the sale of a single, whole tuna can go for up to \$15,000.<sup>71</sup>

*If the [Tsukiji fish market] did not exist, the buyers and sellers would have to separately negotiate one-on-one deals, a cumbersome way to transact. For buyers, Tsukiji shows the range of goods available from the various fishery companies. For sellers, the auctions speedily reveal how much the buyers are willing to pay. **The competitive market provides an efficient way of arranging trades** [emphasis added].<sup>72</sup>*

## 2. Efficient Market Theory

Although Eugene Fama's paper "Efficient Capital Markets: A Review of Theory and Empirical Work," alternatively known as "the Efficient Market Theory" or "Efficient Market Hypothesis," is often cited as the genesis of the ongoing debate among financial economists about the validity of Fama's theory, the seeds of this hypothesis may be traced back as far as, Girolamo Cardano *Book of Chance and Games*, in 1564.<sup>73</sup> The Efficient Market Theory posits that an "informationally efficient"<sup>74</sup> market will always arrive at the correct price. At issue in Fama's work, as well as in those works that preceded his paper, and that have ensued either challenging or validating his Efficient Market Theory, is whether or the extent to which pricing in capital markets is predictable. Put more simply, do markets operate rationally, such that in the face of perfect information prices reflect all such information, or are they also susceptible to other forces, such as investors' hopes and fears (i.e. a behavioral approach to understanding how markets move)?

*THE PRIMARY ROLE of the capital market is allocation of ownership of the economy's capital stock. In general terms, the ideal is a market in which prices provide accurate signals for resource allocation: that is, a market in which firms can make production-investment decisions, and investors can choose among the securities that represent ownership of firms' activities under the assumption that security prices at any time "fully reflect" all available information.*

*A market in which prices always "fully reflect" available information is called "efficient." This paper reviews the theoretical and empirical literature on the efficient markets model. After a discussion of the theory, empirical work concerned with the adjustment of security prices to three relevant information subsets is considered. First, weak form tests, in which the information set is just historical prices, are discussed. Then*

*semi-strong form tests, in which the concern is whether prices efficiently adjust to other information that is obviously publicly available (e.g., announcements of annual earnings, stock splits, etc.) are considered. Finally, strong form tests concerned with whether given investors or groups have monopolistic access to any information relevant for price formation are reviewed. We shall conclude that, with but a few exceptions, the efficient markets model stands up well.*<sup>75</sup>

While admittedly an over simplification of Fama's Efficient Market Theory, the market for commercial leased properties should facilitate **both** commercial property owners (Developers and portfolio owners, respectively) making "production-investment decisions," and tenants choosing from among the all available commercial leasing opportunities, selecting the one that best meets that tenant's specific, programmatic requirements, in a transparent transaction where the value of the lease in the hands of each party "fully reflects" all available information. Regrettably, the nature of the commercial market for leased properties, as well as the process through which commercial tenants make their leasing decisions, is more like McMillan's descriptions of transactions taking place in the bazaars of Marrakesh or Yemen and less like U.S. capital markets or the residential real estate market.<sup>76</sup>

A further thought worthy of mention, relative to both Fama's Efficient Market Theory and McMillan's analysis of the functioning of various types of markets, is whether, over time, transaction costs would be lowered (e.g., a dramatic reduction in the time and expense of lengthy lease negotiations between landlord's and tenant's respective real estate counsel) if the market for commercial leased properties could be improved in these ways, with the benefits flowing to all participants, including the CRES sector.

## **B. Who Benefits from Inefficient Markets**

It is well-established that in a market characterized by asymmetrical information, that the party in possession of and controlling the flow of that information gains a superior bargaining position as a result. Among other disadvantages to which the tenant subjected by asymmetrical information in the U.S. commercial leasing market is the lack of a comprehensive understanding of what all relatively comparable options might be at any given point in time without exclusive reliance on the tenant agent. This is only one, specific area in which conflicts of interest may occur. If a tenant agent, who presumably has access to constantly updated information about the commercial real estate market in her firms' market area, intentionally withholds such updated information with the client, that is a breach of fiduciary duty by the agent, as well as a breach of at least two of the enumerated duties real estate agents owe their clients, according to the NAR.<sup>77</sup>

## **C. Comparing the Commercial Real Estate and Capital Markets in the U.S.**

One similarity between the capital markets and the commercial leasing market in the U.S. is that the former is also dominated by a relatively small number of investment banks,

which themselves have gone through a period of consolidation, as well as the demise of some of the weaker investment banks, as a result of the Great Recession of 2008.

*The advantages of scale are already evident in the growing dominance of the biggest banks. Concentration on the debt side of the business is increasing even more rapidly than in equities. [Matt] Spick [Deutsche Bank] reckons that **within three years the five biggest banks will control more than 55% of total revenue, up from less than a third in 2008.** “Trading is becoming a game of attrition as weaker players shrink capacity,” says [C. Bradley] Hintz [Sanford C. Bernstein and Co., Inc.]. “Decisions to call it quits appear to be accelerating.” Most banks are being forced to cut back and shut businesses in those areas where they do not have scale. That is offering ample opportunity for the biggest banks to grow bigger still [emphasis added].*

Another similarity between these two markets is that the issuers of securities and debt instruments are very large, powerful, and dominant relative to the purchasers of those securities and debt instruments, although that purchasing group has shifted away from individual investors to pension funds, hedge funds, and mutual funds, shifting somewhat the relative bargaining power of sellers and buyers.

However, there are at least two, big differences between these two markets. First, as a consequence of the Securities Act of 1933, the Securities Exchange Act of 1934, and a host of additional, federal legislation and myriad federal regulations promulgated by the Securities and Exchange Commission (SEC) and many others, capital markets offer symmetrical information and, consequently, a relatively level playing field. Most everything a publicly traded company does in business is **public**. Annual and quarterly reports must be filed, as well as episodic reporting of material events. Second, the SEC is merely one of a host of federal watchdog agencies—although its effectiveness in that role may be legitimately debated—along with agencies of much more-recent vintage, such as the CFPB (the Consumer Financial Protection Bureau). Consequently, there are formal enforcement mechanisms and agencies to hold issuers of equity and debt accountable for their compliance with this vast array of disclosure requirements.

*Comparing this comprehensive, capital markets framework with the market for commercial leasing, other than private rights of action (e.g. breach of contract or tort claims for breach of fiduciary duty in the event of a tenant’s agent dealing serving a landlord, to the detriment of that tenant) there is no oversight, much less enforcement. Moreover, because information in the commercial leasing market is asymmetrical, tenants are at a distinct disadvantage in even discovering actions taken by their “tenant representative” contrary to the tenant’s best interests, such that a civil complaint might be launched.*

#### **D. Comparing Commercial Leasing and Residential Sales Markets in the U.S.**

In the context of commercial leasing transactions, Developers and Property Owners control the “supply” of, and Tenants provide the “demand” for, commercial office space, which is the “product.” This product is made available through Listing Brokers providing a variety of services to Developers and Property Owners, primary among them being marketing specific versions of the same product type (i.e. generally multiple “Premises” in one or more Properties owned by the Developers and Property Owners being represented by the Listing Broker). At the same time, agents representing the Tenants—whether Tenant Agents employed by full-service CRES Firms or Tenant Brokers, who represent Tenants exclusively—are the conduit through which the “demand” for specific Premises meeting each, respective Tenant’s needs, is matched up with the “supply” of commercial spaces at any given point in time. However, there is

This market for commercial space would appear to be ideally suited for some type of clearinghouse market mechanism, similar in nature to the MLS in the residential sales context, where all of the essential information about each Premises available for lease is readily discernable by all Tenant representatives, with flow-through of that market information from the Tenant representatives to the Tenants themselves, through a system similar to the Internet Data Exchange (IDX) in the residential context.

In the residential sales context, prospective buyers have limited access to MLS data through IDX, which makes MLS-listed properties available to be searched and found by consumers. Additionally, directly competing technology companies, such as that developed and administered by Zillow, an internet-based, residential real estate valuation and service company, have put a considerable amount of information about the residential real estate market into the hands of consumers.

This access to data does not appear to have dampened consumers’ need for the representation of a real estate professional, such as a Realtor (i.e. a member of the NAR), in the search for and closing the purchase of a residential property. Similarly, the lack of material traction among sellers of residential property using the FSBO (For Sale By Owner) approach—purported to save Sellers the 5%-6% sales commission normally charged in a brokered transaction—suggests that, even when buyers of products in the marketplace are provided with near-perfect information, that does not obviate the need for professional expertise in guiding both buyers and sellers through the selection and purchase process.

### **VI. The Commercial Real Estate Services Sector in the United States**

#### **A. The U.S. CRES Sector Generally**

This Subsection IV.A provides summary information only from Appendix D: Profiles of the Largest Full-Service and Tenant-Only CRES Firms. Those interested in a more in-

depth look at the CRES Sector, based on the five largest full-service CRES firms, and the five largest tenant-only CRES firms, are referred to Appendix D for more information.

### Summary of Appendix D Regarding the State of the CRES Sector

Over the past nine (9) years, CRES firms have grown in size, geographic reach, breadth of services offered, and overall importance to and involvement in various aspects of the development and financing of commercial properties, both domestically and internationally. They have become increasingly global, and the more Landlord-focused CRES firms have expanded their tenant representation capabilities primarily by acquiring U.S. national, regional or local tenant-only brokerages: Local firms become or are swallowed-up by regional or national firms, while national firms have become or are swallowed-up by international firms. In 2013 the five largest, full-service CRES firms were involved in 150,461 commercial property transactions<sup>78</sup> generating over half-a-billion dollars in commercial property transaction revenues<sup>79</sup> (\$553.3 million in the aggregate). The five largest, full-service CRES firms also generated over **\$16 billion** in aggregate, total revenues in 2013.<sup>80</sup> As demonstrated by the table, below, excerpted from Appendix D to the report, there is a substantial disparity between the size and scale of the five largest, full-service CRES firms and the five largest full-service CRES firms operating in the U.S. in 2013.

The table at the beginning of Appendix D is reproduced, below, for convenience:

	Company	Service	Ownership	2013 Rev. (\$ billion)	Leasing Volume (# of transactions)	Leasing Value (\$1,000)
1	CBRE Group	Full Service	Publicly Traded	7.2	54,225	223.2
2	JLL*	Full Service	Publicly Traded	2.49	35,669	115
3	Cushman & Wakefield	Full Service	Privately owned	4.46	15,000	162.1
4	Colliers International	Full Service	Publicly Traded	1.31	42,100**	53
5	NGKF***	Full Service	Publicly Traded	0.57	N/A****	N/A***
6	Savills Studley*****	Tenant-only	Publicly Traded	0.23	3,467	58
7	Cresa	Tenant-only	Privately owned	0.24	8,400	8.5
8	Fischer & Co.	Tenant-only	Privately owned	N/A	N/A	N/A
9	Johnson Controls (JCI)	Tenant-only	Publicly Traded	N/A*****	N/A	N/A
10	Mohr Partners	Tenant-only	Privately owned	N/A	2400	1

\* Formerly Jones Lang LaSalle

\*\*Including lease and sale transactions

\*\*\* Newmark Grubb Knight Frank

\*\*\*\*Newmark Grubb Knight Frank's financials was reported in BGC Partners' annual report. Leasing transactions and dollar volume of transactions are not enclosed in BGC Partners' annual report.

\*\*\*\*\* Depending upon how the various Savills Studley offices are operated, and the extent of the exchange of information between the Studley tenant-only brokerage staff and the full-service Savills staff on a regular basis, characterizing Savills Studley as a "Tenant-only" CRES may not be an entirely accurate characterization of the firm's operations in the U.S.

\*\*\*\*\* The portion of JCI's annual revenues attributable to CRES is very small compared with either total revenues or revenues from the core business to which such revenues relate, i.e. Building Efficiency. Revenues from CRES activities are included within segment revenue reported under Global Workplace Services, one of five reportable business segments of the company's Building Efficiency core business. However, this reportable business segment only includes but is not comprised exclusively of, revenues from providing occupier services for domestic U.S. customers. The majority of JCI's global revenues are from the sales and maintenance/service of products, primarily equipment and equipment components.

## B. Recent Trends in the U.S. CRES Sector

### 1. The Consolidation Trend in the CRES Sector

As referenced elsewhere in the report, in a February 2012 report in CoStar News, CBRE's CEO Brett White made clear that the market dominance of the top two full-service CRES firms in the U.S., JLL and CBRE, would continue into the foreseeable future.

Both JLL and CBRE expect to continue to capture market share in a highly competitive leasing conditions [sic] in most world markets.

"This business is **rapidly consolidating down to a very small number of players**," CBRE's [CEO Brett] White said, adding **that the two largest firms [CBRE and JLL] are "going to capture the vast majority of the available share going forward."**

"That trend is absolute, and I suspect that **the mid-tier firms and the smaller firms, you're just going to see them lose more and more share every quarter and every year** [emphasis added]."<sup>81</sup>

### 2. Assimilation of Tenant-Only CRES Firms into Full-Service CRES Firms

In the span of six years, three large, tenant-only CRES firms—Julian Studley, The Staubach Companies, and Newmark Real Estate Company, Inc., have been acquired by much larger, global, full-service CRES firms, removing a substantial component of tenant-only representation from the CRES sector in the United States, by making formerly tenant-only agents employees of full-service CRES firms:

- a. Julian J. Studley, the first tenant-only brokerage firm in the U.S., was founded by its namesake in New York City in 1954. When it was acquired in 2012 by Savills, LLC, a global, full-service CRES firm, Studley had 25 offices in the U.S. and 400 commissioned brokers and 175 support staff.
- b. The Staubach Companies, founded in 1977 by former Dallas Cowboys quarterback Roger Staubach as a tenant-focused CRES firm, was acquired by JLL (formerly known as "Jones Lange LaSalle") in July 2008. At that time Staubach had 50 offices in North America and 1,100 employees.
- c. In 2011 Newmark & Company Real Estate, Inc., a tenant-focused CRES firm formed in 1926, merged with U.K.-based, full-service CRES firm Knight Frank, creating Newmark Knight Frank. Two years later, Newmark Knight Frank which was purchased by BGC Partners in 2012. In 2013 BGC acquired Grubb & Ellis, a full-service, U.S.-based CRES, creating Newmark Grubb Knight Frank.<sup>82</sup>

### C. Evidence of Conflicts of Interest in Practice

The legal research undertaken in connection with this study failed to turn up **any** cases directly on-point. So, the question must be posed: If dual-agency conflicts of interest in commercial leasing are really a problem, why are there not more law suits? The Project Team was unable to identify any cases in which a tenant claimed that the full-service CRES firm that represented that tenant in a commercial lease transaction breached the firm's duties of an agent to its principal by virtue of resolving a conflict of interest presented in the leasing transaction in favor of a landlord and contrary to the best interests of the tenant. However, the lack of claims generally may **not** necessarily serve as an indicator of the incidence of conflicts of interest in dual-agency scenarios resolved against the best interests of the tenant and in favor of the landlord. In fact, in order for there to be a claim for a breach of a tenant agent's duties to its principal, the allegedly aggrieved principal, there must be four essential elements:

1. The tenant **must know there was a conflict of interest** in the first place;<sup>83</sup>
2. the tenant must also know that the conflict of interest was **resolved in favor of the landlord** and against the tenant;<sup>84</sup>
3. the tenant must have **suffered some consequence** as a result of the alleged breach of the agent's duties to the tenant; and<sup>85</sup>
4. the tenant must be able to **prove monetary damages** attach to the consequences suffered.<sup>86</sup>

### D. Perspectives about Conflicts of Interest in Practice<sup>87</sup>

#### A. Tenant's Perspectives about Conflicts of Interest Issues as a Criteria for Selecting A CRES Firm

The Scope of Work for this research study (see Appendix A: Scope of Work<sup>88</sup>) originally required only the gathering of "Consumer Sentiments" through anecdotal information, to be elicited in a consistent manner from a small number of tenants. While the Project Team was formulating an approach and methodology for eliciting such anecdotal information, the Research Director became aware of a biannual, private research study undertaken by Watkins Research on behalf of a small group of CRES firms. Through this contact, CREUA was given limited access to the 2013 study, as well as permission to refer to relevant, limited sections of that 2013 Watkins Research study, provided that there be no attribution to the CRES firms that commissioned that study, to the extent their names are embedded in specific responses elicited in the survey instrument designed by Watkins Research.<sup>89</sup> The relevant responses from the 2013 Watkins Research study are as follows:

- a. Factors in selecting a CRES firm: The 2013 Watkins Research study asked clients of CRES firms to rank the CRES firms according to a set of ten evaluation factors including:
  - i. Has rational pricing
  - ii. Has a strong reputation and is respected in the industry
  - iii. Is a financially strong company
  - iv. Monitors performance with metrics
  - v. Understands and avoids conflict of interest
- b. The factors for the “Understands and Avoids Conflict of Interest” provided in the 2013 Watkins Research study are:
  - i. Ability to impartially align their interests with mine
  - ii. Strives to stay independent from landlords or developers or any chain of ownership
  - iii. Adheres to fiduciary duties to client if and when the company represents the client and landlord
  - iv. Agrees not to compete for services with our competitors without our permission
- c. “Understands and Avoids Conflict of Interest” ranked fourth overall in importance, among the ten evaluation factors provided in the 2013 Watkins Research study, with only the following three factors being ranked ahead of the conflicts of interest factor.
  - i. Is business savvy
  - ii. Delivers results on-time and within agreed upon budget
  - iii. Adapts their services to fit your firm's needs/culture

## **B. Brokers and Agents Perspectives about Conflicts of Interest as an Issue in Commercial Leasing Transactions**

An informal survey of “Consumer Sentiment” on the subject of conflicts of interest in commercial leasing transactions was a significant component of the original scope of work (see Appendix A: Scope of Work). However, approximately two months into

the research component of the Scope of Work, the Research Director determined that something much more robust would be required to assess Consumer Sentiment. Accordingly, what was envisioned at the outset, in designing this research project, and articulated in Section II of the Scope of Work, was largely replaced with two new components: The review and analysis of the 2013 Watkins Research study, detailed above in Paragraph a of this Subsection V.D, above, and designing and administering a survey of practices experienced by current tenant-only agents and brokers when they were employed by full-service CRES firms (see Appendix B: Conflicts of Interest Survey Instrument, in this particular), the results of which are detailed in Appendix C: Conflicts of Interest Survey Results.

**a. Conflicts Scenarios Tested in the Conflicts of Interest Survey Instrument**

Among other things, the Conflicts of interest survey instrument (Appendix B), posed the following question:

Q7.Regardless of whether you represented Tenants only, Landlords only or represented one or the other depending upon the circumstances and/or the Landlord, please check each of the following situations in which you were involved where a potential conflict of interest regarding a Tenant represented by your full-service CRES firm was ignored or resolved in favor of the Landlord:

- a. The Tenant Agent's commission on the transaction was manipulated or threatened as an inducement to steer tenants to a particular Landlord or building.
- b. The Landlord Agent or Broker actively induced the Tenant Agent or Broker employed by the same firm to complete transactions involving the Landlord's building(s), including but not limited to any of the following inducements:
  - i. Being advised or advising that the Landlord Agent or Broker would receive remuneration over-and-above the normal compensation for completed transactions in which the firm was also the Landlord's Broker.
  - ii. Being advised or advising that upcoming or future performance evaluations would be impacted positively, including but not limited to increases in salary, benefits, and/or future promotions
  - iii. Being advised that the Landlord had promised the firm new or additional work, including but not limited to representing additional properties, if the building was tenanted quickly, and

that Tenant Agents would be rewarded if such additional work for the same Landlord materialized as a result

- c. Being asked, requested or directed to intentionally withhold from a Tenant information about the financial condition of the ownership entity holding title to the property, which information might make the property less attractive to a prospective Tenant
- d. Being denied access to information gathered and analyzed by the firm about the CMBS market, including properties owned by the Landlord, through services such as Trepp©'s TreppWatch© service, which information could be viewed by the Tenant as helpful or critical to the Tenant's ability to make a better-informed decision in its Premises search.
- e. Other:

**b. Highlights from Appendix C: Conflicts of Interest Survey Results**

- i. Two-thirds (66.7%) of agents previously employed by full-service CRES firms were asked to work for Developer/Property Owner clients of the firm despite being primarily engaged as Tenant Agents with that firm, or were asked to work with tenants despite being primarily Listing Brokers or agents. Having Tenant Agents periodically working as agents for Developer/Property Owner clients of the full-service CRES firm, and vice-versa, would conceivably increase the likelihood that a client confidence would be shared with an adversarial party at a later time, because the Tenant Agent in such scenarios would be privy to Developer/Property Owner confidential information, and might also feel compelled to share with the Developer/Property Owner clients of the full-service CRES firm during periods where the Tenant Agent is acting on behalf of such clients.<sup>90</sup>
- ii. Almost 3/5's (58.3%) of Respondents reported receiving no guidance from their full-service CRES employers regarding how to identify and avoid conflicts of interest in the representation of their clients.<sup>91</sup>
- iii. Despite the responses summarized in subparagraphs a. and b., respectively, above, 44% of those Respondents ranked as "Well," "Extremely Well" or "Excellent" the job performed by their previous employer, full-service CRES firm did in handling conflicts of interest, with 39% ranking the previous employer's handling of conflicts as "Poor" or "Extremely Poor," and 19% not providing any response to this question.<sup>92</sup>

## **VII. Recommendations for Better Disclosures Regarding and Avoidance of Conflicts of Interest in Commercial Leasing Transactions**

### **A. Up-front Disclosure of Potential Conflicts of Interest**

Transactions involving commercial properties, whether such properties are in development or are being sold or refinanced, are inherently complex. In the financing context, it is increasing likely that one or more CRES firms have been involved in representing not only the Developer or property owner but also one or more equity investors and one or more lenders. In the context of commercial leasing, the interests of Developers, Property Owners, Equity Investors, and Lenders are aligned, in that the ongoing viability and profitability of any commercial property depends on the strength and resiliency of its rent roll. As such, there is a potential for conflicts of interest not only in the dual-agency scenario, where the Listing Broker and Tenant Agent are both employed by the same, full-service, CRES firm, but also in situations where the Tenant Agent is employed by the same, full-service CRES firm has represented any of the equity investors and/or lenders retaining interests in subject property in which the prospective tenant may be seeking to secure premises.

### **B. Waivers of Conflicts of Interest**

Waivers cannot ever be fully effective unless they are based on fully informed consent. However, assuming clients presented with a dual agency or “conflicted agency” situation are fully informed about the nature of the conflict and the manner in which that conflict may negatively impact that client’s representation, then the agent should secure from the client a detailed, written waiver before the representation commences or at the point at which the conflict presents itself (e.g. the Tenant Agent, as part of a targeted search on behalf of a client, determines that one of the buildings offering Premises that meet the Tenant’s threshold requirements has financing placed by the Tenant Agent’s CRES firm, presenting a potential conflict of interest should the tenant decide to proceed with pursuing a transaction in that commercial property).

### **C. Conflicts of Interest that May Never Be Waived**

### **D. Current Industry Practice**

As detailed throughout this report, there is no uniform industry practice or even acknowledged Best Practices within the CRES sector regarding the disclosure and avoidance of conflicts of interest. Short of an absolute ban on dual representation, which is the only way to prevent conflict of interest arising out of dual-representation situations, the CRES sector should consider adopting or encouraging the adoption of uniform standards for handling conflicts of interest.

### **E. Tenant Understanding Of Multi-Party Representation**

This should be a standard requirement in all tenant representation for full-service CRES firms, subject to the recommendations in the section.

### **F. Tenant Acceptance Of Multi-Party Representation**

This Should Also Be a Standard requirement in all tenant representation for full-service CRES firms, subject to the recommendations in the section.

## **VIII. Next Steps**

### **A. Further Study**

1. CREUA could serve as the clearinghouse for critical commentary on this report, including but not limited to the following:
  - a. Receiving conflict of interest policies, disclosure and waiver forms, and compliance procedures from full-service CRES firms, with a view toward creating a Best Practices approach to internal conflict of interest avoidance and compliance policies.
  - b. Collecting from law firms serving and in-house counsels with full-service CRES firms, to supplement and update the legal research and analysis presented in this report.
  - c. Working with interested CRES sector firms that want to serve a peer-review function to improve the research and analysis contained in this report, which could then be supplemented and updated accordingly.
2. Primary research into practices among full-service CRES firms and, in particular, their tenant clients, including but not limited to:
  - a. Further inquiry into the incidence and intensity of actual conflicts of interest in the CRES Sector (See specifically, in this regard, Appendix B: Conflicts of Interest survey instrument and Appendix C: Conflicts of Interest survey results, respectively).
  - b. Collection, review and analysis, and assessment of conflicts-of-interest policies, procedures, and compliance measures among full-service CRES firms to establish Best Practices that could be emulated by all full-service firms.
  - c. Primary research into the client group's (i.e. tenants') depth of understanding about what conflicts of interest occur in commercial leasing transactions, how they arise, and the potential, adverse consequences for tenants when such

conflicts are resolved against their best interests and in favor of the landlord, which might be undertaken as a joint effort between CREUA and Watkins Research.

### **B. Better and More-Centralized Organization of the CRES Sector**

There is a plethora of examples in the United States of how industry self-regulation can be very effective in protecting consumers and also improving the efficiency of markets. As already mentioned, the National Association of Realtors provides much of the regulatory and compliance framework for its members, who are then also licensed in the states in which they do business. The National Association of Securities Dealers (NASD) is another such example. Through the creation of a national trade association devoted exclusively to the CRES sector, and in which CRES firms, individual agents and Associate Brokers, public officials involved in the regulation of CRES providers in their jurisdictions, and—of course—tenants, including but not limited to corporate real estate executives, would all be invited and encouraged to participate actively and substantively, the CRES sector could create its own framework for establishing uniform rules of conduct and the enforcement of those rules. CREUA could act as the convener of CRES firms, both full-service and tenant-only, to assist in the process of having the CRES sector deliberate the pros and cons of creating a centralized organizing body.

### **C. Development of a Model Code of Conduct for CRES Firms, and Their Associate Brokers and Agents**

Short of creating a national CRES organization to which all firms would belong and contribute, and which would—among other things—develop the regulatory framework for addressing conflicts of interest in commercial leasing transactions—the CRES sector could organize an effort to draft model legislation to be provided to state legislatures and interest groups, including consumer advocacy organizations, seeking to provide uniformity and consistency in the manner in which commercial real estate services are provided throughout the country (assuming eventual, widespread adoption of such model code). CREUA could play a pivotal role in receiving critical input from various CRES firms in shaping a Model Code and assisting in its promoting it to state regulatory agencies and legislative committees.

**NOT IN THE SOW:** The Scope of Work described in this proposal is comprehensive in its own right; however, it does not contemplate undertaking any primary research. For example, the examination of “Consumer Sentiment” described in Section II, above, seeks only to establish very basic parameters, based on informal, non-empirical information-gathering from various stakeholders in commercial leasing transactions, about the relationships of these stakeholders to each other and to commercial leasing transactions. Establishing an empirical understanding of how existing and prospective consumers of commercial brokerage services, from a tenant’s perspective, will require a separate scope of work and a separate study cost. However, the outcome from this study is expected to inform the commercial real estate industry about whether such follow-up primary research is indicated and, if it is, what shape such research might take to optimize its effectiveness.

# Center for Real Estate and Urban Analysis

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## ENDNOTES

<sup>1</sup> As shown in the table at the beginning of Appendix D: Profiles of the Largest Full-Service and Tenant-Only CRES Firms, in 2013 the five largest, full-service CRES firms were involved in 150,461 commercial property transactions generating over half-a-billion dollars in commercial property transaction revenues (\$553.3 million in the aggregate). The five largest, full-service CRES firms also generated over \$16 billion in aggregate, total revenues in 2013. As demonstrated by the table, below, excerpted from Appendix D to the report, there is a substantial disparity between the size and scale of the five largest, full-service CRES firms and the five largest full-service CRES firms operating in the U.S. in 2013. See Notes 76, 77, and 78 regarding this information. Also see **Section VI. The Commercial Real Estate Services Sector in the United States** of the report.

In the span of six years, three large, tenant-only CRES firms—Julian Studley, The Staubach Companies, and Newmark Real Estate Company, Inc.—have been acquired by much larger, global, full-service CRES firms. Studley, Inc., originally founded as Julian J. Studley in 1954, was the U.S.’s oldest tenant-only CRES firm. See Subsection **III. B. The Role of the CRES Sector in Commercial Real Estate Transactions**, paragraph 2. **The Consolidation Trend in the CRES Sector and the Assimilation of Tenant-Only CRES Firms into Full-Service CRES Firms**

<sup>3</sup> Much has been made over the decades about the manner in which the parties, specifically commercial real estate brokers and their agents, are compensated. It is true that landlord’s actually commit to pay commissions on completed leasing transactions, including the commission for a “cooperating broker”—meaning the tenant’s broker—assuring that both the listing broker responsible for placing tenants in the landlord’s building, and the agent representing the tenant, will be compensated for each completed leasing transaction (i.e. a fully and duly executed lease agreement). Paying someone who is purportedly representing the best interests of an inherently adverse party seemingly violates the Golden Rule: She who has the gold makes the rules. However, this skewed perspective is counterintuitive to the realities of these transactions. First and foremost, the landlord is paying the leasing commission out of the revenue stream represented by the lease agreement such that, in reality, the tenant is paying the commission for both its agent and the landlord’s listing broker. Furthermore, while courts, in other contexts, have looked to who is paying an adverse party as one indicia for determining whether a conflict of interest has occurred, the legal definition of the duties an agent owes to its principal are much more substantive than who pays whom. However, by creating a bright-line separation between its business and the business and interests of landlords, tenant brokerage effectively preempts the source of the payment of the commission from tainting the tenant’s representation.

<sup>4</sup> “CFO Perspective on Corporate Real Estate,” CFO Research Services, in cooperation with United Systems Integrators Corporation, September 2003,

Corporate real estate (CRE) is one of the largest items on the balance sheet, but one that often receives scant attention from the CFO. After all, this asset is typically managed by the company’s various operating units or by a separate real estate function. And unlike the supply chain or sales operations, its ability to change quickly and influence a company’s strategic goals is not always immediately apparent (an exception being retailers, who have long been aware of CRE’s importance).

Yet for most companies, CRE—which we define as the real estate a company uses to operate its business, excluding property held as a speculative investment—is a vast expense, trailing only salaries and the procurement of direct materials. Indeed, our survey of senior finance executives at large companies indicates that for 66 percent of companies, CRE is among the top four expenses (see Figure 1). Typically, CRE comprises 5-10 percent of a company’s expenses.

Real estate is also an essential component of a company’s ability to achieve its strategic plans. For retailers and consumer banks, sales depend on the many properties that house their stores and bank branches. For other companies, such as manufacturers or high tech firms, real estate can be the limiting factor for growth plans or a burden when companies switch from a focus on rapid growth to maintaining profitability, as many are doing today.

<sup>5</sup> Julian J. Studley is considered to be the first tenant-only brokerage firm in the U.S., and was founded by its namesake in New York City in 1954. When it was acquired in 2012 by Savills, LLC, a global, full-service CRES firm, Studley, Inc. had 25 offices in the U.S. and 400 commissioned brokers and 175 support staff.

<sup>6</sup> “CFO Perspective on Corporate Real Estate,” CFO Research Services, in cooperation with United Systems Integrators Corporation, September 2003, pg. 4

### A changing view of real estate

CFOs are taking a fresh look at CRE. Under pressure to improve financial performance, many have concluded that real estate warrants significant personal attention. “I’m involved in every real estate decision,” says Mark White, CFO of SAP Americas. “Because of the impact on the P&L, my real estate person brings every deal to me [to review].” As we will show in the next chapter, finance executives expect their role in CRE decisions to grow over the coming two years.

But despite its importance—both as a source of cost savings and an enabler of

strategy—CRE is not well managed at many companies. Real estate plans are not integrated with corporate strategy, CRE management is often fragmented and uncoordinated, and CFOs feel they lack adequate information about this asset.

<sup>7</sup> For purposes of this report, the term “Tenant Agent” refers to a CRES agent or associate broker who is ostensibly representing the interests of a tenant that is the client of a full-service CRES firm. An agent or associate broker who is employed by a CRES firm that represents tenants exclusively, sometimes referred to in this report as a “Tenant-Only CRES firm,” is referred to in this report as a “Tenant Broker,” to distinguish these participants in the commercial leasing transaction from Tenant Agents.

<sup>8</sup> Looking at conflicts of interest in the legal profession, by analogy, the American Bar Association, which is the author of Model Code of Professional Conduct for attorneys, recognizes that there are some conflicts that are so adversarial, that disclosure alone is not sufficient to protect a client and, therefore, the conflict cannot be waived regardless of the level of disclosure provided.

<sup>9</sup> Such as in the case of passage by the California Legislature of California Senate Bill 1171. See Note 25, below.

<sup>10</sup> More than half of all real estate agents in the U.S. (estimated at approximately 2 million) are members of the National Association of Realtors (1,063,950 as of June 30, 2014), according to the N.A.R. membership statistics and information compiled by Association of Real Estate License Law Officials (ARELLO). N.A.R. “Field Guide to Quick Real Estate Statistics” <http://www.realtor.org/field-guides/field-guide-to-quick-real-estate-statistics>

<sup>11</sup> Substantial portions of Section III. Understanding Commercial Real Estate Transactions, Including Leasing, and the Role of the Commercial Real Estate Services (CRES) Sector in These Transactions of the Report are based on Professor Smirniotopoulos’s prior and on-going academic work in his transactional real estate law courses, currently offered in the George Washington School of Business MBA program, and on his research and writing of **Real Estate Law: Fundamentals for The Development Process**, a real estate law textbook for graduate real estate programs and MBA programs offering concentrations in real estate development and finance, scheduled to be published by Routledge in the summer of 2015. Professor Smirniotopoulos owns the copyright to all such portions of Section III that are based on his academic research and writing in this regard, and may not be reproduced, in whole or in part, without his advance, written consent, except where published or disseminated in the context of and as an integral part of this Report in its entirety.

<sup>12</sup> As noted in Appendix D: Profiles of the Largest Full-Service and Tenant-Only CRES Firms, the five, largest full-service CRES firms—CBRE Group, JLL, Cushman & Wakefield, Colliers International, and Newmark Grubb Knight Frank (NGKF)—do not report the same information or in the same way. Some are privately owned while others are wholly owned subsidiaries of non-U.S. companies. Accordingly, the 150,461 “commercial properties transactions” number includes 42,100 commercial leasing and sales transactions. However, because the 2013 Annual Report for BGC Partners, Inc., the parent company of NGKF, doesn’t provide data on commercial leasing transaction volume or aggregate value, the 150,461 in 2013 commercial property transactions is arguably under-reported here, and not over-reported. Finally, in deference to Julian J. Studley’s pioneering work as the country’s first tenant-only CRES firm, which tenant-focus continued after internal ownership changes and re-branding of the firm in 2003 as simply Studley, Inc., the post-merger firm Savills Studley is included among the largest tenant-only CRES firms in Appendix D. However, it is entirely possible, if not more-likely than not, that Savills Studley operates in very much the same ways as the other, five largest, full-service CRES firms for which summary information is provided in Appendix D. Accordingly, the 150,461 commercial property transactions may be further under-stated by the 3,467 leasing transactions reported by Savills-Studley for 2013.

<sup>13</sup> See Note xiii, above.

<sup>14</sup> See Appendix D: Profiles of the Largest Full-Service and Tenant-Only CRES Firms

<sup>15</sup> Contrast this list with that of a tenant-only commercial brokerage firm, for which this is the **only** task undertaken, although there are tenant-only or “occupier-specific” services offered by tenant-only CRES firms but **not** included in this listing.

<sup>16</sup> Drummer, Randy, “Largest Publicly Traded CRE Services Firms Finish 2011 With Strong Revenues, Earnings,” CoStar News, February 15, 2012, <http://www.costar.com/News/Article/Largest-Publicly-Traded-CRE-Services-Firms-Finish-2011-With-Strong-Revenues-Earnings/135622>

<sup>17</sup> Because information regarding either the number of offices or the number of employees with Newmark & Company Real Estate, Inc.

(“Newmark”), at the time of Newmark’s 2006 merger with the U.K.’s Knight Frank could be found, the overall impact of the three acquisitions mentioned in this paragraph, in terms of total number of offices and total number of employees absorbed by larger, full-service, CRES firms is not reported here.

<sup>18</sup> On October 14, 2011, BGC acquired all of the outstanding shares of Newmark & Company Real Estate, Inc. (“Newmark”), plus a controlling interest in its affiliated companies. On April 13, 2012, BGC acquired substantially all of the assets of Grubb & Ellis Company and its direct and indirect subsidiaries that are debtors (collectively “Grubb & Ellis”). Newmark, Grubb & Ellis, and certain independently owned partner offices of the two operate as “Newmark Grubb Knight Frank” in the Americas, and are associated with London-based Knight Frank. BGC’s discussion of financial results for “Newmark Grubb Knight Frank” or “Real Estate Services” reflect only those businesses owned by BGC and do not include the results for these independently-owned partner offices or for Knight Frank. BGC Partners, Inc. 2012 Annual Report, Footnote 5, Letter to Shareholders from BGC Partners, Inc.’s Howard W. Lutnick, Chairman and Chief Executive Officer, and Shaun D. Lynn, President.

<sup>19</sup> American Law Institute, Restatement of the Law of Agency, Second (1958), pg. 6, hereinafter referred to elsewhere in this Report as “the **Second Restatement**.” The common law of agency is decided as a matter of state law, based on legal precedent in each state on the subject. However, those state courts that have adopted a federal common definition of what constitutes “agency” generally follow the Restatement.” Steinberg v. Mikkelsen, 901 F. Supp. 1433, 1436 (E.D.Wisc. 1995).

<sup>20</sup> See subparagraph **I.c.**, **Apparent Authority**

<sup>21</sup> Garner, Bryan A, Editor, **Black’s Law Dictionary, Third Pocket Edition**, Thomson West Publishing, St. Paul, MN (2006), pg. 289, hereinafter referred to in this Report as “Black’s Law Dictionary.”

<sup>22</sup> Black’s Law Dictionary, pg 289.

<sup>23</sup> Regarding licensure and other requirements for agents, associate brokers, and brokers engaged in commercial real estate transactions, including but not limited to leasing, see, e.g., **Texas Real Estate License Act**, Texas Occupational Code §1101.002. (2003), <http://www.statutes.legis.state.tx.us/Docs/OC/htm/OC.1101.htm>, and **Registrations of Certain Professions and Occupants**, Massachusetts General Laws XVI 112 § 87PP, <https://malegislature.gov/Laws/GeneralLaws/PartI/TitleXVI/Chapter12/Section87PP>.

<sup>24</sup> “Commercial real estate laws have favored landlords for decades. In short, they allowed for commercial real estate brokers to represent both a tenant and a landlord in the same transaction, without any requirement that they notify the parties of their role as a dual agent. By contrast, laws strictly requiring disclosure of this “dual agent” practice have been in place in residential real estate laws for years.”

Jason Hughes, president and CEO, Hughes Marino, August 24, 2014, <http://www.hughesmarino.com/hughes-marino-blog/sb-1171-represents-major-victory-for-tenants-in-commercial-real-estate/>

<sup>25</sup> <http://openstates.org/ca/bills/20132014/SB1171/>

<sup>26</sup> California Senate Bill No. 1171. [http://leginfo.ca.gov/faces/billNavClient.xhtml?bill\\_id=201320140SB1171](http://leginfo.ca.gov/faces/billNavClient.xhtml?bill_id=201320140SB1171)

<sup>27</sup> Text from one of the twenty letters of support submitted to the California Senate, urging passage of S.B. 1171

*I have practiced in the commercial/industrial real estate industry for over thirty years. I have been growing very concerned over the increasing incidence of one real estate brokerage representing both sides of a real estate transaction. This practice raises a decided conflict of interest which clashes with the fiduciary duties owed by real estate agents and brokers to their principals. I would support any bill Senator Hueso would introduce that would require commercial real estate agents and brokers to make full disclosure of the conflict of interest that arises when a brokerage firm is representing both sides of a real estate deal. In addition, I urge Senator Hueso to include in any such bill the requirement that in the event of such a conflict the brokerage firm must put in place a security wall that would prevent agents and brokers from disclosing to the other side confidential information which if disclosed would adversely impact their principal.*

*Examples of the types of problems I have personally observed in a dual representation situation include an agent negotiating with a co-worker agent disclosing how much landlord would be willing to accept less than what is being asked for a leased property.*

*Another example is a [sic] agent representing a party to a commercial/industrial sale disclosing to the other side how much the seller would accept below the listing price.*

*I would also recommend that in any bill the Senator introduces there be a provision prohibiting any licensed real estate agent or broker from including in any listing agreement a waiver of any conflict of interest requirements imposed by law.*

*It is time to close this ethics loophole which only exists for commercial/industrial real estate agents and brokers. I appreciate Senator Hueso's consideration of this much needed legislation.*

<sup>28</sup> [http://www.leginfo.ca.gov/pub/13-14/bill/sen/sb\\_1151-1200/sb\\_1171\\_cfa\\_20140731\\_093509\\_sen\\_floor.html](http://www.leginfo.ca.gov/pub/13-14/bill/sen/sb_1151-1200/sb_1171_cfa_20140731_093509_sen_floor.html)

<sup>29</sup> In its Legislative Program 2013-2014, published September 19, 2014, the California Association of Realtors also stated, opposition to S.B. 1171, that “C.A.R. opposed this measure because it **unnecessarily complicates commercial transactions** [emphasis added].”

<http://www.car.org/governmentaffairs/stategovernmentaffairs/legprogram>, page 9. It should be noted, in this regard, that **California Business and Professions Code Section 10176(d)** imposes upon commercial real estate brokers a duty to disclose a dual agency relationship; S.B. 1171 merely codified the requirement and method for securing the client’s written consent to such dual agency, consistent with the manner in which dual agency is required to be disclosed to residential clients of brokers and agents.

<sup>30</sup> [http://www.leginfo.ca.gov/pub/13-14/bill/sen/sb\\_1151-1200/sb\\_1171\\_cfa\\_20140731\\_093509\\_sen\\_floor.html](http://www.leginfo.ca.gov/pub/13-14/bill/sen/sb_1151-1200/sb_1171_cfa_20140731_093509_sen_floor.html)

<sup>31</sup> DeMott, Deborah A., “Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and Their Consequences,” *Arizona Law Review* (2006), 48:925, at pg. 925:

Writing in 1908, the American philosopher Josiah Royce characterized loyalty as the ethical principle that unifies and animates all other virtues. Royce defined loyalty as “[t]he willing and practical and thoroughgoing devotion of a person to a cause.” Loyalty in his account necessarily requires submission of other desires to the object of loyalty, which then guides an actor’s conduct.

<sup>32</sup> DeMott, Deborah A., “Disloyal Agents,” *Alabama Law Review*, Vol. 58:5:1049 (2007), pg. 1049.

<sup>33</sup> DeMott, “Disloyal Agents,” at 1052.

<sup>34</sup> DeMott, “Disloyal Agents,” at 1052-1053.

<sup>35</sup> Risk Management & License Law Forum, May 15, 2013, “Fiduciary Duties” (hereinafter the “NAR Statement on Fiduciary Duties of Agents”, <http://www.realtor.org/sites/default/files/handouts-and-brochures/2014/nar-fiduciary-duty-032213.pdf>).

A real estate broker who becomes an agent of a seller or buyer, either intentionally through the execution of a written agreement, or unintentionally by a course of conduct, will be deemed to be a fiduciary. Fiduciary duties are the highest duties known to the law. Classic examples of fiduciaries are trustees, executors, and guardians. As a fiduciary, a real estate broker will be held under the law to owe certain specific duties to his principal, in addition to any duties or obligations set forth in a listing agreement or other contract of employment. These specific fiduciary duties include:

- Loyalty
- Confidentiality
- Disclosure
- Obedience
- Reasonable care and diligence
- Accounting

<sup>36</sup> NAR Statement on Fiduciary Duties of Agents

<sup>37</sup> NAR Statement on Fiduciary Duties of Agents

<sup>38</sup> NAR Statement on Fiduciary Duties of Agents

<sup>39</sup> The ABA Model Rules of Professional Conduct were adopted by the ABA House of Delegates in 1983. They serve as models for the ethics rules of most states. Before the adoption of the Model Rules, the ABA model was the 1969 Model Code of Professional Responsibility. Preceding the Model Code were the 1908 Canons of Professional Ethics (last amended in 1963).

[http://www.americanbar.org/groups/professional\\_responsibility/publications/model\\_rules\\_of\\_professional\\_conduct.html](http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct.html)

<sup>40</sup> ABA Rules of Professional.

<sup>41</sup> Comment [28], Rule 1.7 Conflict of Interest: Current Clients, North Carolina State Bar.

<sup>42</sup> Illinois State Bar Association, ISBA Advisory Opinion 91-11, November 22, 1991. <http://www.isba.org/sites/default/files/ethicsopinions/91-11.pdf>

<sup>43</sup> Mishkin, Frederic S. “Policy Remedies for Conflicts Of Interest in the Financial System,” Graduate School of Business, Columbia University, July 2003, pg. 1. This paper is hereinafter referred to as “Mishkin’s Policy Remedies”).

<sup>44</sup> See, also, regarding how the financial markets handle asymmetrical information, White, Eugene N. “Can the Market Control Conflicts of Interest in the Financial Industry?” Department of Economics, Rutgers University, May 24, 2004, p. 2:

*Economic theory typically treats financial institutions as though each type of institution solved one kind of informational asymmetry, however institution that have learned how to manage one information asymmetry often possess skills that may be used to handle others. Banks have long-term customer relationships, which they use to obtain information about firms’ resources, cash flows, and other characteristics and reveal more confidential information. Financial institutions gain cost advantages because they can exploit cross-sectional information across customers, becoming low cost producers of information for complementary financial services.*

*Such synergies or economies of scope provide producers and customers substantial benefits, but they also create potential costs in the form of conflict of interests.*

*For the financial industry, conflicts of interest may be defined as arising when a financial service provider, or an agent within such a service provider, has multiple interests which create incentives to act in such a way as to misuse or conceal information needed for the effective functioning of financial markets.*

*The combination of financial services in one intermediary creates conflicts of interest that may be exploited. If firm or individuals within the firm can exploit conflicts interest, they do so because they can benefit from the information asymmetries vis-à-vis customers. This behavior will obstruct the efficient allocation of funds to their most productive uses. But behavior that exploits a conflict of interest will, once recognized, reduce the reputation of an institution. Consequently, the existence of a conflict does not imply it will be exploited if the institution places a high value on its reputation. The implication is that public policy remedies may not be required to control the exploitation of conflicts. When they are necessary, government intervention to reduce conflicts needs to be balanced against any reduction in the economies of scope.*

<sup>45</sup> Mishkin’s Policy Remedies, pg. 2.

<sup>46</sup> Mishkin’s Policy Remedies, pgs. 7-8.

<sup>47</sup> Mishkin’s Policy Remedies, pg. 8.

<sup>48</sup> Mishkin’s Policy Remedies, pg. 9.

<sup>49</sup> Mishkin’s Policy Remedies, pgs. 7-8.

<sup>50</sup> Sarbanes-Oxley Act of 2002, Public Law 107-204 (107<sup>th</sup> Congress). The full text of the Sarbanes-Oxley Act of 2002 may be found at: <http://www.gpo.gov/fdsys/pkg/PLAW-107publ204/html/PLAW-107publ204.htm>

<sup>51</sup> Kass, Benny L., “Dual Agency: A Misunderstood Concept,” Realty Times, November 25, 2013.

<http://realtymtimes.com/consumeradvice/sellersadvice1/item/26724-20131126-dual-agent-a-misunderstood-concept>

<sup>52</sup> Insert full citation to S.B. 1171.

<sup>53</sup> [http://www.leginfo.ca.gov/pub/13-14/bill/sen/sb\\_1151-1200/sb\\_1171\\_cfa\\_20140731\\_093509\\_sen\\_floor.html](http://www.leginfo.ca.gov/pub/13-14/bill/sen/sb_1151-1200/sb_1171_cfa_20140731_093509_sen_floor.html)

<sup>54</sup> According to 2012 Economic Census numbers from the U.S. Department of Labor, 1,926,027 workers were employed in real estate businesses (NAICS 53: Real Estate and Rental and Leasing), out of a total of 349,561,848 workers employed in all industries.

<sup>55</sup> According to the GSA’s September 2014 Lease Inventory, the federal government has 197,676,370 sq. ft. of office space under lease currently, <http://www.gsa.gov/portal/content/101840>

<sup>56</sup> General Services Administration, National Broker Contract Program portal. <http://www.gsa.gov/portal/content/104481>

<sup>57</sup> GSA National Broker Services Contract, Volumes I & II (REDACTED), [http://www.gsa.gov/graphics/pbs/NBC2contract\\_VOL-I\\_REDACTED-Signed\\_21June2010-rs508c.pdf](http://www.gsa.gov/graphics/pbs/NBC2contract_VOL-I_REDACTED-Signed_21June2010-rs508c.pdf)

<sup>58</sup> Office of Inspector General (OIG), United States Postal Service (USPS), “Contracting for Management Services,” Audit Report Number SM-AR-13-001, June 12, 2013, <https://www.uspsoig.gov/sites/default/files/document-library-files/2013/sm-ar-13-001.pdf>

<sup>59</sup> Office of Inspector General (OIG), United States Postal Service (USPS), “Management Alert – Risks Associated With CB Richard Ellis, Inc.,” Report Number SM-MA-14-003, February 12, 2014,, <https://www.uspsoig.gov/sites/default/files/document-library-files/2014/sm-ma-14-003.pdf>

<sup>60</sup> In juxtaposing CBRE’s policies for managing conflicts of interest with the two USPS OIG Reports where such inherent conflicts of interest are specific findings by the Inspector General, it is worth noting that in Management’s responses to the initial findings on conflicts of interest, it does not appear that Management relied on CBRE’s conflicts avoidance policies but, instead, used internal or independent means to make sure USPS was treated fairly. See Office of Inspector General (OIG), United States Postal Service (USPS), “Contracting for Management Services,” Audit Report Number SM-AR-13-001, June 12, 2013, pg. 5:

Management indicated that conflict of interest concerns have been mitigated by using real estate specialists to review estimated property values used for negotiations. In cases where the estimated property value or annual rent exceeds

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\$150,000, the Postal Service obtains third-party appraisals to establish market value. Finally, management stated that the contractor has acted on behalf of both the Postal Service and lessors in negotiating leases only 12 times since the real estate management services contract was awarded. See Appendix C for management's comments in their entirety.

<sup>61</sup> McMillan, John, **Reinventing the Bazaar: A Natural History of Markets**, W. W. Norton & Company, New York, N.Y., 2002, ISBN: 0-393-05021-1 (hereinafter cited as "McMillan, **Reinventing the Bazaar**."

<sup>62</sup> McMillan, **Reinventing the Bazaar**, pg. 135.

<sup>63</sup> McMillan, **Reinventing the Bazaar**, pg. 42.

<sup>64</sup> McMillan, **Reinventing the Bazaar**, pg. 41.

<sup>65</sup> McMillan, **Reinventing the Bazaar**, pg. 44.

<sup>66</sup> "International Property Markets Scorecard Guidebook," pg. 10, Center for International Private Enterprise, 1155 15th Street, NW, Suite 700, Washington, DC 20005, <http://www.cipe.org/>, [http://www.propertymarketscorecard.com/wp-content/uploads/2013/02/Scorecard\\_Methodology\\_Chapter\\_1.pdf](http://www.propertymarketscorecard.com/wp-content/uploads/2013/02/Scorecard_Methodology_Chapter_1.pdf);

<sup>67</sup> McMillan, **Reinventing the Bazaar**, pg. 90.

<sup>68</sup> McMillan, **Reinventing the Bazaar**, pg. 53.

<sup>69</sup> McMillan, **Reinventing the Bazaar**, pg. 54.

<sup>70</sup> McMillan, **Reinventing the Bazaar**, pg. 67.

<sup>71</sup> McMillan, **Reinventing the Bazaar**, pg. 65.

<sup>72</sup> McMillan, **Reinventing the Bazaar**, pg. 66.

<sup>73</sup> Sewell, Martin, "History of the Efficient Market Hypothesis," Research Note RN/11/04, January 20, 2011, University College London (UCL), Department of Computer Science.

*Back in the 16th century the prominent Italian mathematician, Girolamo Cardano, in Liber de Ludo Aleae (The Book of Games of Chance) (Cardano, c. 1564) wrote: 'The most fundamental principle of all in gambling is simply equal conditions, e.g. of opponents, of bystanders, of money, of situation, of the dice box, and of the die itself. To the extent to which you depart from that equality, if it is in your opponents favour, you are a fool, and if in your own, you are unjust'.*

*In 1828 the Scottish botanist, Robert Brown, noticed that grains of pollen suspended in water had a rapid oscillatory motion when viewed under a microscope (Brown, 1828). Then in 1863 a French stockbroker, Jules Regnault, observed that the longer you hold a security, the more you can win or lose on its price variations: the price deviation is directly proportional to the square root of time (Regnault, 1863). As far back as 1880 the British physicist, Lord Rayleigh, (through his work on sound vibrations) was aware of the notion of a random walk (Rayleigh, 1880). Whilst in 1888 John Venn, the British logician and philosopher, had a clear concept of both a random walk and Brownian motion (Venn, 1888). Even in 1889 efficient markets were clearly mentioned in a book by George Gibson entitled *The Stock Markets of London, Paris and New York*. Gibson wrote that when 'shares become publicly known in an open market, the value which they acquire may be regarded as the judgment of the best intelligence concerning them' (Gibson, 1889). The following year Alfred Marshall wrote *Principles of Economics* (Marshall, 1890).*

*In 1900 a French mathematician, Louis Bachelier, published his PhD thesis, *Theorie de la Spéculation* (Bachelier, 1900). He developed the mathematics and statistics of Brownian motion five years before Einstein (1905). He also deduced that 'The mathematical expectation of the speculator is zero' 65 years before Samuelson (1965) explained efficient markets in terms of a martingale. Bachelier's work was way ahead of his time and was ignored until it was rediscovered by Savage in 1955. Five years later Karl Pearson, a professor and Fellow of the Royal Society, introduced the term random walk in the letters pages of *Nature* (Pearson, 1905). Unaware of Bachelier's work in 1900, Albert Einstein developed the equations for Brownian motion (Einstein, 1905). The following year a Polish scientist, Marian Smoluchowski, described Brownian motion (von Smoluchowski, 1906). Bachelier's arguments can also be found in Andre Barriol's book on financial transactions (Barriol, 1908). In the same year, De Montessus published a book on probability and its applications (de Montessus, 1908), which contains a chapter on finance based on Bachelier's thesis. Meanwhile, Langevin developed the stochastic differential equation of Brownian motion (Langevin, 1908).*

<sup>74</sup> Cochrane, John H., "Eugene Fama: Efficient markets, risk premiums, and the Nobel Prize," Remarks presented at "The Work Behind the Prize" symposium at the University of Chicago, November 4 2013.

*Another part of that contention reflects simple ignorance of the definition of informational "efficiency." Every field of scholarly research develops a technical terminology, often appropriating common words. But people who don't know those definitions can say and write nonsense about the academic work.*

*An informationally-efficient market can suffer economically inefficient runs and crashes -- so long as those crashes are not predictable. An informationally efficient market can have very badly regulated banks. People who say "the crash proves markets are inefficient" or "efficient market finance is junk, you did not foresee the crash" just don't know what the word "efficiency" means. The main prediction of efficient markets is exactly that price movements should be unpredictable! Steady profits without risk would be a clear rejection.*

<sup>75</sup> Fama, Eugene F. "Efficient Capital Markets: A Review of Theory and Empirical Work," *Journal of Finance*, Volume 25, Issue 2, Papers and Proceedings of the Twenty-Eighth Annual Meeting of the American Finance Association New York, N.Y. December, 28-30, 1969 (May, 1970), pg. 383.

<sup>76</sup> McMillan, **Reinventing the Bazaar**, pg. 42.

<sup>77</sup> NAR Statement on Fiduciary Duties of Agents, see, specifically in this regard, Notes 37 and 38, respectively.

<sup>78</sup> As noted in Appendix D: Profiles of the Largest Full-Service and Tenant-Only CRES Firms, the five, largest full-service CRES firms— CBRE Group, JLL, Cushman & Wakefield, Colliers International, and Newmark Grubb Knight Frank (NGKF)—do not report the same information or in the same way. Some are privately owned while others are wholly owned subsidiaries of non-U.S. companies. Accordingly, the 150,461 “commercial properties transactions” number includes 42,100 commercial leasing and sales transactions, without a breakdown between the two. Additionally, the 2013 Annual Report for BGC Partners, Inc., the parent company of NGKF, doesn’t provide data on commercial leasing transaction volume or aggregate value. Accordingly, the 150,461 in 2013 commercial property transactions is arguably misstated but is more likely under-reported here, rather than over-reported, because of the lack of 2013 transactions data on NGKF. Finally, in deference to Julian J. Studley’s pioneering work as the country’s first tenant-only CRES firm, which tenant-focus continued after internal ownership changes and re-branding of the firm in 2003 as simply Studley, Inc., the post-merger firm Savills Studley is included among the largest tenant-only CRES firms in Appendix D. However, it is entirely possible, if not more-likely than not, that Savills Studley operates in very much the same ways as the other, five-largest, full-service CRES firms for which summary information is provided in Appendix D. Accordingly, the 150,461 commercial property transactions would be further under-stated by the 3,467 leasing transactions reported by Savills-Studley for 2013 and credited to the five-largest tenant-only brokerage firms.

<sup>79</sup> See Note xiii, above.

<sup>80</sup> See Appendix D: Profiles of the Largest Full-Service and Tenant-Only CRES Firms

<sup>81</sup> Drummer, Randy, “Largest Publicly Traded CRE Services Firms Finish 2011 With Strong Revenues, Earnings,” CoStar News, February 15, 2012, <http://www.costar.com/News/Article/Largest-Publicly-Traded-CRE-Services-Firms-Finish-2011-With-Strong-Revenues-Earnings/135622>

<sup>82</sup> See Note 19.

<sup>83</sup> Perhaps the resistance from at least some segment of the CRES sector to mandatory disclosure laws is that if a tenant is not aware of the existence of conflicts of interest, the tenant won’t know to look for adverse consequences due to a conflict of interest resolved against the tenant.

<sup>84</sup> For example, the tenant would have to know that its agent showed the tenant the premises in building A, which is owned by the Developer that hired the agent’s CRES firm as its Listing Broker, to the exclusion of premises in other buildings where that same CRES firm is **not** the Listing Broker.

<sup>85</sup> It is possible that a conflict of interest occurs but that the agent’s failure of one or more duties to the principal (i.e. the tenant) does not result in any adverse consequences for that principal. For example, a tenant’s agent who is provided with information by the tenant but then shares that information with the Listing Broker at the same CRES firm is in breach of the agent’s duties of loyalty to the tenant and to keep confidential all information the agent receives from its principal. However, if the Listing Broker in this instance doesn’t take any action adverse to the tenant as the result of receiving this information, there may be no basis for a legal claim by the tenant against the tenant’s agent. This may not be the case, however, if the aggrieved tenant files a complaint with the licensing organization that issued the agent her real estate license.

<sup>86</sup> Because lease agreements are creatures of the negotiations between the landlord and the tenant, they’re not fungible commodities. As a consequence, it becomes extremely speculative for a tenant to make a claim that goes something like this: “If my agent had shown me the premises in the other buildings for which the CRES firm was not the Listing Broker, I’d be paying \$5 less per-square-foot for the cost of leased premises.” It is impossible to prove how a theoretical negotiation for premises in another building, with another landlord, might have turned out and, consequently, very difficult to that monetary damages were suffered as a direct result of the alleged breach of the agent’s duty to its principal, the tenant.

<sup>87</sup> An informal survey of “Consumer Sentiment” on the subject of conflicts of interest in commercial leasing transactions was a significant component of the original scope of work (see Appendix A: Scope of Work). However, approximately two months into the research component of the Scope of Work, the Research Director determined that something much more robust would require to assess Consumer Sentiment. Accordingly, what was envisioned at the outset, in designing this research project, and articulated in Section II of the Scope of Work, was largely replaced with two new components: The review and analysis of the 2013 Watkins Research study and conducting a survey of practices experienced by current tenant-only agents and brokers when they were employed by full-service CRES firms.

<sup>88</sup> It bears mentioning that, as with any research study of this nature, what was originally envisioned as an appropriate scope or work when the research question was first formulated evolved as the initial research got underway and new information was presented to the Research Director through that process. Consequently, and as is usually the case with this type of exploratory research, the Scope of Work was modified to improve the quality of the research and the findings that might come from that expanded research. As such, the following notations, provided in brackets and bold-faced font below, are provided relative to that original Scope of Work:

I. Literature Review. A survey will be undertaken of current literature, including but not limited to reports, studies, and articles from professional associations, law review articles, and related information and data from authoritative sources and industry experts regarding:

- a. Conflicts of interest in real estate transactions **generally [Almost entirely limited to residential dual-agency.]**
- b. Conflicts of interest in commercial leasing transactions specifically [**None found.**]
- c. Agency Law generally
- d. Legal duties of agents in brokered transactions specifically [**Again, almost entirely limited to residential dual-agency.**]
- e. Cases involving breaches of duties in commercial tenant representation [**None found.**]

II. Review and Analysis of the Legal Relationships among the Parties to a Commercial Real Estate Transaction. The material gathered during the Literature Review described in SOW Component I., above, will be reviewed in the context of the results of the Consumer Sentiment information elicited under SOW Component II., above, to develop a set of Observations in the areas of interest listed below. In the judgment of the Project Team, additional research may be undertaken, as, when, and if needed, to supplement the work product produced in SOW Components I. and II., respectively, in order to develop such Observations:

- a. Conflicts of Interest generally:
  - i. Relationships between Principals and Agents
  - ii. Context for conflicts of interest
  - iii. Duties and responsibilities of the parties
  - iv. What is a “legally actionable” conflict of interest?
  - v. Analogous conflicts of interest outside the real estate context

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b. Impact of the Commission Structure in Real Estate Transactions [While initially thought of as the main point of conflict for Tenant Agents—that the Listing Broker in a dual agency situation might manipulate the Tenant Agent’s commission to get the listing fully tenanted—it became clear that threats against a Tenant Agent’s commission is rarely the mechanism through which dual-agency conflicts of interest manifest themselves. In fact, pressures to get Tenant Agents to favor in-house listings are far more subtle, as demonstrated by the limited-scope survey undertaken as an expansion of the Scope of Work.]

<sup>89</sup> <http://www.watkinsresearchgroup.com/>

<sup>90</sup> Question 4 from the Conflicts of Interest Survey, Appendix B:

*Q4. In any of your prior positions with a full-service CRES firm, were you requested or allowed to represent a Landlord or a Tenant depending upon the circumstances and the Landlord (e.g., even though you were primarily a Tenant rep, you were occasionally asked by the firm or by a Landlord to work on behalf of a specific Landlord or a specific property)?*

- a. Yes
- b. No

<sup>91</sup> Question 5 from the Conflicts of Interest Survey, Appendix B:

*Q5. Regardless of your formal position with a CRES firm, were you provided specific guidance regarding the avoidance of conflicts of interest in the firm’s representation of Landlords and Tenants, respectively?*

- a. Yes.
- b. No.

<sup>92</sup> Question 8 from the Conflicts of Interest Survey, Appendix B:

*Q8. Based on your experience working for Cresa, and your prior experience working for one or more full-service CRES firms (as described in your answers to the above questions), how would you rate how full-service CRES firms generally handle conflicts of interest:*

- a. *Extremely well: Tenants represented by full-service firms have their best interests fully prioritized and respected, and their decision-making process is not influenced in any way by staff representing Landlords.*
- b. *Very Well: Tenants represented by full-service firms have their best interests fully prioritized and respected by the firm, although Tenant Agents and Brokers may occasionally, on their own, steer Tenants to Landlords represented by other staff in the firm because of personal relationships in the firm and not because of any influence exerted by the firm itself on the Tenant Agent or Broker.*
- c. *Well: Tenants receive good representation from their Tenant Agent or Broker, but on rare occasion that agent or broker is encouraged or asked to do things that inure more to the Landlord’s best interests than the Tenant’s.*
- d. *Somewhat Poorly: Tenant agents and brokers are somewhat frequently but episodically asked to compromise the best interests of Tenants in favor of generating completed transactions for Landlords whose properties are also represented by the firm.*
- e. *Extremely Poorly: Tenant agents and brokers are routinely directed by management to compromise the best interests of Tenants in favor of generating an increasing number of completed transactions for Landlords whose properties are also represented by the firm.*