

## License to Profit: An Analysis of Entry Regulations in the Legal and Real Estate Professions

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# **LICENSE TO PROFIT: AN ANALYSIS OF ENTRY REGULATIONS IN THE LEGAL AND REAL ESTATE PROFESSIONS**

EVGENY S. VOROTNIKOV<sup>1</sup>

## 1. INTRODUCTION

What do fortune tellers, florists, barbers, real estate agents, lawyers and nuclear engineers have in common? All these professionals must obtain licenses in order to perform their work legally in the United States. The generally stated goal and main justification for this particular entry regulation is to ensure quality of goods or services provided to the public by eliminating dishonest practitioners and charlatans from the market. A reasonable person would agree that it is necessary to control proficiency of nuclear engineers because their mistakes could result in disasters leading to tremendous negative consequences for the population and the environment. Also, the reasonable person would agree that fortune tellers', florists' or barbers' mistakes, in a worst case scenario, could ruin a customer's mood and potentially cause some insignificant money loss. After comparing basic potential consequences of nuclear engineers', fortune tellers', florists' and barbers' mistakes, the reasonable person would probably wonder whether licensing requirements should be similar for these professions. An expert researcher would inquire further and would be interested in studying whether licensure, in fact, improves the quality of services or restricts competition in the professions and increases practitioners' incomes.

The goal of this work is, first, to choose two professions, one where a professional's mistake could cause significant and irreversible damages, and another where that is not entirely the case. The second step is to study the development of entry regulations in each of these professions. The final step is to investigate whether these regulations are justifiable, and whether the ultimate beneficiary of those is the professional himself, or the customer. The legal profession was chosen for its impact on society.

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Lawyers' mistakes may cause damages that have high cost in monetary terms and irreversible impacts in terms of broken lives. The real estate profession was selected because mistakes of these professionals are not as immaterial as is the case with florists, fortune tellers and barbers, yet at the same time not as costly or irreversible as it is the case with lawyers.

The subsequent section reviews the history of entry regulations development and their current state in both professions. Section 3 explains the real estate agents' and lawyers' work specifics. Section 4 contains the main contribution and studies whether mandatory licensing is justified in each of the professions. It further explores the consequences of the strict entry regulations. The final section concludes.

## 2. HISTORY

### 2.1 Development of Entry Regulations in the Legal Profession

The development of entry regulations in the legal profession began with local courts during the colonial period.<sup>2</sup> Apprenticeships were a common entry requirement and could last as long as 11 years.<sup>3</sup> The requirements were raised and tightened over the years with some states requiring college education in addition to apprenticeships.<sup>4</sup> Nonetheless, even in these states the control was weak.<sup>5</sup> Despite the low entry barriers, each state policed the compliance of practitioners with them.<sup>6</sup> During the Jacksonian era, entry requirements into the profession were eased or abolished in several states and territories.<sup>7</sup> A number of states nevertheless administered some type of bar examination.<sup>8</sup>

Entry barriers came back after the Civil War.<sup>9</sup> This rise coincided with the establishment or strengthening of local and state bar associations as well as the creation of the American Bar Association (ABA) in 1878.<sup>10</sup> "Concern for improving the competence of those entering the profession was a major reason for creating the American Bar Association.... The Association remains vitally and actively interested in improving the legal profession

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2. Randall T. Shepard, *On Licensing Lawyers: Why Uniformity is Good and Nationalization is Bad*, 60 N.Y.U. ANN. SURV. AM. L. 453, 454 (2004) (discussing the early history of the American legal practice requirements).

3. *Id.*

4. Daniel R. Hansen, *Do We Need the Bar Examination? A Critical Evaluation of the Justifications for the Bar Examination and Proposed Alternatives*, 45 CASE W. RES. L. REV. 1191, 1194 (1995) (discussing the early history of the American legal practice requirements).

5. *Id.* at 1193–1194.

6. Shepard, *supra* note 2, at 454.

7. RICHARD L. ABEL, AM. LAWYERS 40 (1989).

8. Shepard, *supra* note 2, at 454.

9. ABEL *supra* note 7, at 41.

10. History of the Am. Bar Ass'n, [http://www.americanbar.org/utility/about\\_the\\_aba/history.html](http://www.americanbar.org/utility/about_the_aba/history.html); <http://www.abanet.org/about/history.html>.

through legal education.”<sup>11</sup> In 1879, fifteen of the thirty-eight states required formal education and seven required three years of apprenticeship to practice law.<sup>12</sup> Between 1889 and 1914, most states adopted some form of written examination.<sup>13</sup> Furthermore, “apprenticeship virtually vanished as a mode of entry.”<sup>14</sup> The stricter regulations did not deter people from entering the profession, and the number of law students increased by more than four times during that time period.<sup>15</sup>

The proliferation of lawyers in the United States spurred further tightening of entry regulations into this profession.<sup>16</sup> Initially, pre-legal education requirements were increased.<sup>17</sup> In 1896, only 7 out of 76 law schools required a high school diploma, but by 1903 this proportion increased to 51 out of 104 schools.<sup>18</sup> Further increases in entry regulations appeared in 1908 when law schools started to require two years of college education (seven law schools in 1908).<sup>19</sup> The ABA supported this requirement in 1918, and it spread rapidly among law schools.<sup>20</sup> By 1927 only 66 schools of 166 did not enforce this prerequisite.<sup>21</sup> The college education requirement was effective in deterring people from law schools. The enrollment almost halved at the University of Wisconsin Law School and Cornell University after the requirement adoption, and it more than halved at the University of Minnesota and Yale.<sup>22</sup> According to the Review of Legal education, by 1948 practically all states adopted the two years of pre-legal education prerequisite.<sup>23</sup> Even though the state bar associations played an important role in tightening entry restrictions, Abel sees the ABA as a main lobbyist for the new entry requirements.<sup>24</sup>

In 1948, the first Law School Admission Test (LSAT) was administered by the Law School Admission Council (LSAC), founded a year earlier.<sup>25</sup> The LSAC designed the LSAT to measure the strength of

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11. 2010–2011 ABA Standards for Approval of Law Schools [http://www.americanbar.org/content/dam/aba/migrated/legaled/standards/2010-2011\\_standards/2010-2011abastandards\\_pdf\\_files/preamble.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/migrated/legaled/standards/2010-2011_standards/2010-2011abastandards_pdf_files/preamble.authcheckdam.pdf).

12. ABEL, *supra* note 7, at 41.

13. Elizabeth Chambliss, *Professional Responsibility: Lawyers, A Case Study*, 69 FORDHAM L. REV. 817, 833 (2000).

14. ABEL, *supra* note 7, at 41.

15. *Id.*

16. *Id.* at 43.

17. *Id.* at 48.

18. *Id.*

19. *Id.*

20. ABEL, *supra* note 7, at 48.

21. *Id.*

22. *Id.* at 49.

23. ABEL, *supra* note 7, at 46–47.

24. *Id.*

25. Lynda M. Reese & Ruth Anne Cotter, *A Compendium of LSAT and LSAC-Sponsored Item Types 1948–1994: Law School Admission Council Research Report 94-01*, at 1, LSAC

candidates' skills in the areas that are important for success in law school.<sup>26</sup> The LSAT also helped to assist law schools with their search for candidates.<sup>27</sup> The LSAT was a full-day test that initially consisted of ten sections.<sup>28</sup> Over the years, it has changed several times with the current form being valid since 1991.<sup>29</sup> Today, it is a half-day, six-section test, administered by LSAC four times a year, and all ABA-approved law schools require students to sit for this test.<sup>30</sup>

In 1952, the U.S. Department of Education acknowledged the ABA as the national agency for law school accreditation.<sup>31</sup> However, prior to that, the ABA already established its minimum standards for the first time and started to evaluate law schools in 1921–1922.<sup>32</sup> Presently, there are three types of law schools in the United States: ABA-accredited,<sup>33</sup> state-accredited, and non-accredited.<sup>34</sup> The ABA explains the need for accreditation by stating that “[I]aw schools that are ABA-approved provide a legal education that meets a minimum set of standards promulgated by the [ABA].”<sup>35</sup> Since 1921, the enrollment in non-ABA-approved schools has been constantly declining.<sup>36</sup> In 1927, 67 percent of the students were enrolled in unapproved schools.<sup>37</sup> This number fell to nine percent in 1964 and to one percent by 1982,<sup>38</sup> and there were few students that graduated from state-accredited and non-accredited schools during the 1997–2008 period.<sup>39</sup> The number of non-ABA-approved institutions declined as well.<sup>40</sup> Researchers and academics have been concerned with many requirements that law schools must meet in order to qualify for accreditation. The ABA

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RESEARCH REPORT SERIES (Apr. 1994), <http://www.lsac.org/LSACResources/Research/RR/RR-94-01.pdf>.

26. LSAC—About the LSAT, <http://www.lsac.org/JD/LSAT/about-the-LSAT.asp> (last visited Apr. 12, 2011).

27. *Id.*

28. Reese & Cotter *supra* note 25, at 1.

29. *Id.* at 7.

30. LSAC—About the LSAT, *supra* note 6.

31. 2010–2011 ABA Standards for Approval of Law Schools.

32. ABEL *supra* note 7, at 54.

33. Currently, there are 200 ABA-accredited law schools, and these schools must go through the accreditation process every seven years.

34. *Comprehensive Guide to Bar Admission Requirements 2010*, at 10, Nat'l Conference of Bar Examiners, NCBEX.ORG, available at <http://www.ncbex.org/comprehensive-guide-to-bar-admissions/>.

35. *Frequently Asked Questions, Approval of Law Schools: What is ABA approval of law schools?*, Am. Bar Assn., ABANET.ORG, available at <http://www.abanet.org/legaled/resources/faq.html>.

36. ABEL *supra* note 7, at 277–79 (Table 21).

37. *Id.*

38. *Id.*

39. Bar Admission Statistics 1997–2009, Nat'l Conference of Bar Examiners, NCBEX.ORG, available at <http://www.ncbex.org/bar-admissions/stats/>.

40. ABEL *supra* note 7, at 277–79 (Table 21).

has been sued on these grounds.<sup>41</sup> Massachusetts School of Law filed an antitrust claim against the ABA alleging that “the ABA inflated faculty salaries, reduced teaching loads, increased the cost of legal education, and prevented disadvantaged persons from obtaining a legal education . . . ABA operat[ed] like a typical cartel, increasing price and decreasing output.”<sup>42</sup> The US Department of Justice further accused the ABA: “[t]he ABA’s process for accrediting law schools had been misused to inflate faculty salaries and benefits.”<sup>43</sup>

The ABA accreditation affects law schools’ ranking and recognition, which makes the task of finding employment easier for graduates of those institutions. In many states only students from the ABA-accredited institutions are permitted to sit for the bar exam.<sup>44</sup> Additionally, it is more complicated for graduates from state-accredited and non-accredited schools to practice outside of the state they obtained their degrees.<sup>45</sup> The majority of the states waive bar exam requirements only for graduates from the ABA-accredited law schools.<sup>46</sup> This process, referred to as Admission on Motion, allows lawyers to practice in new states without retaking the bar exam once they have a certain amount of work experience.<sup>47</sup>

The next wave of tightening entry regulations started in 1972 when the National Conference of Bar Examiners (NCBE), an affiliate of the ABA, developed and administered the Multistate Bar Examination (MBE) for the first time.<sup>48</sup> With the exception of Louisiana, Washington, and Puerto Rico, 53 jurisdictions currently have the MBE as part of their respective bar exams.<sup>49</sup> The MBE is a six-hour exam that is administered twice a year. The goal of the MBE is to “determin[e] competence to practice.”<sup>50</sup>

In 1980, NCBE introduced the Multistate Professional Responsibility Examination (MPRE).<sup>51</sup> Since then, 52 U.S. jurisdictions have adopted this

41. Mike Magan, *ABA Law School Accreditation Standards Anti-Competitive, DOJ Charges*, THE INDIANA LAWYER (July 12, 1995); Andy Portinga, *ABA Accreditation of Law Schools: An Antitrust Analysis*, 29 U. MICH. J. L. REFORM 635, 636 (1995).

42. Portinga, *supra* note 41, at 636; *Massachusetts Sch. of Law v. American Bar Ass’n*, No. 93-6206, at 1–2 (E.D. Pa. 1993).

43. Magan, *supra* note 41.

44. *Comprehensive Guide to Bar Admission Requirements*, *supra* note 34, at 10.

45. See Mark Dykstra, *Why Can’t Johnny Sit for the Idaho Bar? The Unfair Effect of ABA Accreditation Standards on State Bar Admission Requirements*, 3 SAN DIEGO JUSTICE J. 285, 287–90 (1995) (providing further discussion of disadvantages that students from non-ABA approved schools face).

46. *Comprehensive Guide to Bar Admission Requirements*, *supra* note 34, at 25–28.

47. *Id.* at 25.

48. Nat’l Conference of Bar Examiners, *Bar Admission Statistics 2009*, at 30, NCBEX.ORG, available at <http://www.ncbex.org/bar-admissions/stats/>.

49. *Id.* at 30.

50. Multistate Bar Examination (MBE), Nat’l Conference of Bar Examiners, NCBEX.ORG, available at <http://www.ncbex.org/multistate-tests/mbel/>.

51. Although the MPRE was the first national legal ethics exam, “a survey of bar examiners

exam<sup>52</sup> as a prerequisite or co-requisite to taking the Bar examination.<sup>53</sup> The MPRE is a two-hour exam that is administered three times a year.<sup>54</sup> The goal of the exam is “to measure the examinee’s knowledge and understanding of established standards related to a lawyer’s professional conduct.”<sup>55</sup>

Additionally, NCBE introduced the Multistate Essay Examination (MEE) in 1988 and the Multistate Performance Test (MPT) in 1997.<sup>56</sup> Currently, 23 and 34 jurisdictions, respectively, use them as a part of the bar exam.<sup>57</sup> In most of the jurisdictions, the MEE consists of six 30-minute essay questions.<sup>58</sup> The MPT is a three-hour exam that consists of two skills questions.<sup>59</sup> Both of the exams are conducted twice a year with the goal to “determin[e] competence to practice.”<sup>60</sup>

Some states, in addition to all of the aforementioned exams and test, require new lawyers to attend basic skills and professionalism orientations.<sup>61</sup> Most of the states also require lawyers to attend eight to fifteen hours of continuing legal education classes a year to maintain their licenses in active status.<sup>62</sup> These classes include one to three hours of ethics education per year for the purpose of maintaining lawyers’ proficiency and ethics level after their initial admission to the bar.<sup>63</sup>

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in 1949 showed that legal ethics was tested on the bar in 35 of the 49 jurisdictions—more frequently than such subjects as trusts, sales, taxation and administrative law.” Paul Hayden, *Symposium: The Legal Profession: Looking Backward: Putting Ethics to the (National Standardized) Test: Tracing the Origins of the MPRE*, 71 *FORDHAM L. REV.* 1299, 1326 (2003).

52. Maryland, Puerto Rico, Washington, and Wisconsin are the jurisdictions that do not require the MPRE and incorporate local ethics rules in their respective bar examinations.

53. Failing the MPRE exam postpones taking the Bar by six months which introduces additional opportunity cost.

54. Multistate Professional Responsibility Examination (MPRE), NAT’L CONFERENCE OF BAR EXAMINERS, available at <http://www.ncbex.org/multistate-tests/mpre/>.

55. *Description of the MPRE*, NAT’L CONFERENCE OF BAR EXAMINERS, <http://www.ncbex.org/multistate-tests/mpre/mpre-faqs/description0/>. See also Evgeny S. Vorotnikov, *The Adverse Consequences of Entry Regulation in the Legal Profession*, at 8 (under review 2010, on file with author) (analyzing the MPRE requirement as one entry barrier to the legal profession).

56. *Bar Examination and Admission Statistics, 2009 Statistics*, NAT’L CONFERENCE OF BAR EXAMINERS, 38–40, <http://www.ncbex.org/bar-admissions/stats/>.

57. *Id.* at 38–40.

58. *Multistate Essay Examination (MEE)*, NAT’L CONFERENCE OF BAR EXAMINERS, <http://www.ncbex.org/multistate-tests/mee/>.

59. *Multistate Performance Test (MPT)*, NAT’L CONFERENCE OF BAR EXAMINERS, <http://www.ncbex.org/multistate-tests/mpt/>.

60. *Multistate Essay Examination (MEE)*, *supra* note 58; *Id.*

61. Benjamin H. Barton, *The ABA, the Rules, and Professionalism: The Mechanics of Self-Defeat and a Call for a Return to the Ethical, Moral, and Practical Approach of the Canons*, 83 *N. C. L. REV.* 411, 480 n. 18 (2005).

62. *Comprehensive Guide to Bar Admission Requirements 2010*, NAT’L CONFERENCE OF BAR EXAMINERS, at 43–44, <http://www.ncbex.org/comprehensive-guide-to-bar-admissions/>.

63. *Id.*

Based on the historical facts, it is evident that occupational licensure in the legal profession has been developing throughout the years introducing entry barriers that have grown and tightened over these years.

## *2.2 Development of Entry Regulations in Real Estate Agent Profession*

The development of occupational licensure in the real estate agent profession began in 1870's and 1890's when American cities in their search for new revenue sources started to tax the agents.<sup>64</sup> Initially, these license laws were non-regulatory, and everyone who could afford to pay necessary fees was able to receive a real estate agent license.<sup>65</sup> Local real estate boards supported the existence of these fees, argued for the need to raise them, and for the introduction of a bond requirement. Local boards saw fees and a bond requirement as a way of cleaning the market from curbstoners. However, evidence showed that license fees were not effective in eliminating curbstoners from the market.<sup>66</sup> This situation led state real estate associations to propose a regulatory license law bill in California in 1907, which was rejected.<sup>67</sup>

In the same year, Edward Judd proposed the formation of National Association of Real Estate Exchanges that was subsequently founded in 1908,<sup>68</sup> aiming "to unite the real estate men of America for the purpose of effectively exerting a combined influence upon matters affecting real estate interests."<sup>69</sup> Later, in 1916, the name of the organization was changed to The National Association of Real Estate Boards and, in 1972, to the National Association of Realtors (NAR).<sup>70</sup> Currently, the NAR is a well-known donor to political campaigns with the biggest Political Action Committee<sup>71</sup> and "lobbies members of Congress and the administration on virtually every issue facing business."<sup>72</sup>

While state real estate boards played an important role in professionalization of real estate agents, the NAR remained as the primary engine. In formulating its code of ethics, the NAR followed the example of the professions of medicine, law, and engineering.<sup>73</sup> The code was proposed by the NAR at Winnipeg in 1913, and it covered the duty of real estate

64. PEARL JANET DAVIES, *REAL ESTATE IN AMERICAN HISTORY* 104 (1958).

65. *Id.* at 105.

66. *Id.*

67. *Id.* at 106.

68. *Field Guide to the History of the National Association of Realtors*, NAT'L ASS'N OF REALTORS, <http://www.realtor.org/library/library/fg002>.

69. *Id.*

70. *Id.*

71. *Id.*

72. NAT'L ASS'N OF REALTORS, CENTER FOR RESPONSIVE POLITICS, <http://www.opensecrets.org/orgs/summary.php?id=D000000062&cycle=2010>.

73. DAVIES, *supra* note 64, at 101.



professionals towards their clients and peers.<sup>74</sup> Davies emphasized that the choice that real estate agents faced at that time was to “[either] develop themselves as a service group, with professional attitudes and qualification, or to accept a role as middlemen-speculators when occasion offered, brokers between times.”<sup>75</sup> Real estate agents chose the former way for their development, and by 1915, a standardized code was approved or adopted by 35 local real estate boards.<sup>76</sup>

At the Winnipeg conference in 1913, the NAR also proposed to adopt regulatory license laws in every state.<sup>77</sup> After the Winnipeg conference, there was a second attempt for a regulatory law in California, but it was vetoed.<sup>78</sup> The third attempt was more successful, with licensing regulations enacted and operated, but it was vetoed as unconstitutional several months thereafter.<sup>79</sup> Finally, in 1919, entry regulations were established in California permanently. The same year Michigan also established entry regulations. Not every real estate agent supported the establishment of regulatory license laws. Some real estate professionals saw licensing as a threat for the profession, and others claimed that licensing would be inefficient in excluding charlatans.<sup>80</sup> Although there was a controversy among professionals, in 1922, the United States Supreme Court held that real estate licensing laws were constitutional.<sup>81</sup> By 1930, 24 states adopted occupational licensure regulations,<sup>82</sup> and by 1958 all states except New Hampshire and Rhode Island adopted these regulations.<sup>83</sup> Currently, all states have some form of real estate licensing regulations.

One of the entry regulations consisted of a mandatory educational test that every new real estate agent had to pass in order to demonstrate his knowledge of real estate business. One of the places where agents could obtain knowledge was educational courses that, for the first time, were introduced by the West Side YMCA of New York in 1904.<sup>84</sup> In 1905, the University of Pennsylvania and the New York University School of Commerce offered similar courses. By 1913, real estate courses were available throughout the country.<sup>85</sup> In 1913, the NAR became engaged in promoting education and, in 1915, decided to develop a standard course that all universities would use. However, this initiative was not met without

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74. *Id.* at 98–99.

75. *Id.* at 99.

76. *Id.* at 101.

77. *Id.* at 90.

78. *Id.* at 106.

79. DAVIES, *supra* note 64, at 106.

80. *Id.* at 108.

81. *Id.* at 164.

82. *Id.*

83. *Id.* at 104.

84. *Id.* at 121.

85. DAVIES, *supra* note 64, at 121.

opposition.<sup>86</sup> Only later, in 1923, a standard two-year course used by universities was developed. In 1926, the University of Michigan started to grant Masters Degrees in real estate business administration.<sup>87</sup>

After 1958, when almost all states adopted occupational licensure regulations, the states started to raise educational and experience standards for this profession.<sup>88</sup> In 1978, the NAR Committee on Education and License Law developed guidelines for the state real estate commissions, where it proposed establishing continuing education requirement as a way to increase the quality of service provided by the agents.<sup>89</sup> By 1999, all states except New Jersey adopted continuing education requirements,<sup>90</sup> and the real estate agents had to take continuing education classes every year, or every other year, in order to renew their licenses.

Currently, candidates must complete state approved classes, a licensing exam, and pay all necessary fees in order to obtain a real estate salesperson's license. In 2010, the course requirements varied from 18 hours in Rhode Island to 210 hours in Texas.<sup>91</sup> Colorado, North Carolina, and Oregon do not have salesperson's licenses and require all candidates to obtain a real estate broker's license, which generally is more complicated to do.<sup>92</sup> In the rest of the states, in order to get a broker's license, candidates must attend 15 (in Alaska) to 630 additional hours of classes (in Texas) and have up to five years (in Delaware) of work experience as salespersons.<sup>93</sup> Additionally, some states require real estate brokers to have surety bonds.

As evident from the historical overview, the licensing regulations in the real estate profession have developed in the direction of raising those standards, just as it has happened in the legal profession over the past two centuries.

### 3. PROFESSIONAL SPECIFICS

#### 3.1 Real Estate Agents

In order to be able to evaluate the possible damages from real estate agents' mistakes and the need for strict entry regulations in this profession, it is necessary to understand the kind of services agents usually provide to

86. *Id.* at 123.

87. *Id.* at 154.

88. *The History of the Real Estate License Act*, [http://www.trec.state.tx.us/formslawscontracts/rules\\_codes/rela.asp](http://www.trec.state.tx.us/formslawscontracts/rules_codes/rela.asp) (demonstrating how licensing requirements were tightened over time in Texas).

89. Benjamin Powell & Evgeny Vorotnikov, *Real Estate Continuing Education: Rent Seeking or Improvement in Service Quality?*, E. ECON. J., at 1–2 (forthcoming 2011).

90. *Id.* at 2.

91. DIGEST OF REAL ESTATE LICENSE LAWS AND CURRENT ISSUES, 207–08 (2010).

92. *Id.*

93. *Id.*

their customers. The job of a real estate agent is to facilitate the sale or purchase of a property.<sup>94</sup> When selling a property, agents guide sellers through the process, preparing the necessary paperwork, arranging the title search and insurance through a title service company, marketing the property either by using Multiple Listing Service or by other means, and showing the property to prospective buyers.<sup>95</sup> Additionally, agents provide clients with information about the property location and the estimates for comparables in the area.<sup>96</sup> This provision of information differs from an appraisal service, which real estate agents do not always provide because in most states this activity requires holding an appraiser license.<sup>97</sup> Agents also help negotiate the price and oftentimes associate themselves with loan officers who help take care of the financing issues for the potential buyer.<sup>98</sup> At the closing stage, real estate agents ensure that all legally mandated inspections take place, and that the parties meet all terms of the contract.<sup>99</sup> After performing these duties, the agent must arrange a closing day, where buyers, sellers and their brokers meet, and an attorney reviews the contract and closes the deal.<sup>100</sup>

Overall, the real estate agents' responsibility is to ensure that buyers and sellers meet each other, and to coordinate the work of other professionals involved in closing a deal. Therefore, the cost of potential damages caused by real estate agents could be significant, but not too high, because most risks in a typical real estate transaction are carried by other specialists. Moreover, most of the possible damages caused by realtors could be estimated in monetary terms.

### 3.2 Lawyers

The legal system affects nearly every aspect of human lives, and lawyers are the individuals who make the system work through actively participating in its constant development.<sup>101</sup> Lawyers, when performing their duties, act as advisors, advocates, negotiators, evaluators, and on occasion, third-party neutrals.<sup>102</sup> The complexity of the legal system often

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94. *Careers in Real Estate*, NAT'L ASS'N OF REALTORS, <http://www.realtor.org/realtororg.nsf/pages/careers/>.

95. *Why Use a Realtor?*, NAT'L ASS'N OF REALTORS, <http://www.realtor.com/basics/allabout/realtors/why.asp>.

96. *Id.*

97. *Designations & Certifications*, NAT'L ASS'N OF INDEPENDENT FEE APPRAISERS, <http://www.naifa.com/education/designations.cfm>.

98. *Careers in Real Estate*, *supra* note 94; BUREAU OF LABOR STATISTICS, <http://www.bls.gov/oco/ocos120.htm#nature>.

99. *Careers in Real Estate*, *supra* note 94; BUREAU OF LABOR STATISTICS, *supra* note 98.

100. *Careers in Real Estate*, *supra* note 94; BUREAU OF LABOR STATISTICS, *supra* note 98.

101. BUREAU OF LABOR STATISTICS, *supra* note 98.

102. *Preamble, Model Rules of Professional Conduct*, AM. BAR ASS'N, ABANET.ORG, <http://www.abanet.org/cpr/mrpc/preamble.html>.

causes lawyers to specialize in either criminal law or civil law. Moreover, further specialization in each of these areas is also common.<sup>103</sup> Lawyers that specialize in criminal law generally argue their cases in tribunals and work with clients who face criminal convictions.<sup>104</sup> Lawyers that specialize in civil law assist clients with a wide range of matters, including, for instance, litigation, wills, trusts, contracts, mortgages, titles, and leases.<sup>105</sup> No matter what area a lawyer practices in, their mistakes could cause serious damages to their clients. A single mistake in the contract could potentially lead to multimillion dollar losses for a client. On the other hand, in some cases, it may be impossible to reasonably estimate the costs of mistakes in monetary terms and compensate clients accordingly. For instance, what would be an appropriate compensation for the cost of several years wrongfully spent in prison by a client? Moreover, sometimes the damages caused by lawyers' mistakes are irreversible. Is it possible to reverse a wrongful death penalty execution?

#### 4. PRE-LEGAL REQUIREMENTS AND MANDATORY LICENSURE: JUSTIFICATION AND CONSEQUENCES

A reason why the majority of researchers do not generally support occupational licensing regulations is that these regulations are lobbied for by professionals themselves or by affiliated lobby organizations.<sup>106</sup> Hence, instead of protecting customers from incompetent professionals and poor quality of service, these regulations simply reduce competition.<sup>107</sup> Because it becomes more complicated to enter into a profession, the number of professionals in the market remains stable or even decreases.<sup>108</sup> As a result, professionals can charge higher fees for their services, and there remain fewer incentives for them to innovate or compete over quality.<sup>109</sup>

The main justification for the existence of mandatory licensure, which is the most restrictive form of occupational regulation, is that professionals can cause damages that are hard to estimate in monetary terms in order to properly compensate victims, or irreversible damages that are impossible to compensate. In any other case, the population does not need an additional protection by means of occupational licensure regulations because it is already protected from fraud, professional negligence or other types of damages by means of existing laws and a proper court system to enforce those laws.

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103. BUREAU OF LABOR STATISTICS, *supra* note 98.

104. *Id.*

105. *Lawyers, 2010–11 Occupational Outlook Handbook*, BUREAU OF LABOR STATISTICS, <http://www.bls.gov/oco/ocos053.htm>.

106. MILTON FRIEDMAN, *CAPITALISM AND FREEDOM* 138–158 (1962).

107. *Id.*

108. *Id.*

109. Morris Kleiner, *Occupational Licensing*, 14(4) J. OF ECON. PERSP. 189, 192 (2000).

By nature of their profession, real estate agents generally cannot cause irreversible damages, and the presence of the mandatory licensure in this profession could not be justified on this ground. Arguably, the majority of damages that a real estate agent can cause could be estimated in monetary terms. Customers are already protected by existing laws, and all damages would be compensated according to these laws. On the other hand, lawyers could cause irreversible damages. However, Benjamin Barton argued that there is no need to regulate the whole legal market, and only a limited subsection of the market should be regulated because only lawyers that are engaged in criminal defense work could cause irremediable damages.<sup>110</sup> He asserted that other types of lawyers cannot cause inestimable monetary damages, and, as a result, customers have an option to be properly compensated for lawyers' faux pas.<sup>111</sup>

Since the merits of mandatory licensure are questionable, it is necessary to investigate whether strict pre-licensing regulations in both the legal and the real estate professions benefit customers or practitioners. There are several empirical studies that attempt to answer this question.<sup>112</sup> Carroll & Gaston found that stricter regulations lowered the number of real estate agents per capita and decreased service quality. On the other hand, Johnson & Loucks and Shilling & Sirmans showed that stricter regulations reduced the number of practicing real estate agents, but increased quality of service as measured by the number of complaints filed against the agents.<sup>113</sup> In *Ethics and Lobbying: The Case of Real Estate Brokerage*, Barker argued that the presence of mixed conclusions regarding the effect of entry regulations on quality of service is a consequence of "significant data limitations" prominent in the above studies.<sup>114</sup> Barker showed that stricter entry regulations decreased the number of agents in the market, thereby increasing incomes of the remaining real estate professionals. According to Barker's analysis, an extra year of experience required for a broker's license increased the professional's annual income by \$852. In addition, an extra hour of continuing education resulted in a \$235 addition to the real estate agent's annual income. Lastly, Barker showed that with each additional hour of pre-licensing coursework, annual income increased by \$2.<sup>115</sup>

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110. Benjamin H. Barton, *Why Do We Regulate Lawyers?: An Economic Analysis of the Justifications for Entry and Conduct Regulation*, 33 ARIZ. ST. L.J. 429, 440-41 (2001).

111. *Id.*

112. Sidney Carroll & Robert Gaston, *State Occupational Licensing Provisions and Quality of Service: The Real Estate Business*, 1 RES. IN L. & ECON. 1-13 (1979).

113. Linda Johnson & Christine Loucks, *The Effect of State Licensing Regulations on the Real Estate Brokerage Industry*, 14(4) AM. REAL EST. & URB. ECON. ASS'N J. 567, 580 (1986); James D. Shilling & C. F. Sirmans, *The Effects of Occupational Licensing on Complaints Against Real Estate Agents*, 3(2) J. OF REAL EST. RES. 1, 4-5 (1988).

114. David Barker, *Ethics and Lobbying: The Case of Real Estate Brokerage*, 80(1) J. OF BUS. ETHICS 23, 29 (2008).

115. *Id.* at 23.

Barker also investigated whether the quality of service, as measured by the number of complaints filed, increased when entry regulations became more restrictive. Based on his analysis, Barker did not find any improvement in quality of service after the tightening of entry regulations.<sup>116</sup> Powell & Vorotnikov was the most recent and the first study to estimate the fixed cost of the mandatory continuing education for real estate agent requirements.<sup>117</sup> Using Massachusetts data, they found that the introduction of continuing education, lobbied vigorously by the NAR's affiliate Massachusetts Association of Realtors (MAR), resulted in the ousting of 39-58 percent of agents out of the real estate business.<sup>118</sup> They also found that the average real wage of agents that remained in the market increased by about 11-17 percent as a result of the continuing education requirement.<sup>119</sup> Additionally, Powell & Vorotnikov analyzed the number of complaints to the licensing board or complaints with a guilty verdict and found no evidence of improved service quality. They concluded that these results allowed them to interpret MAR's behavior as a case of "interest group lobbying intended to increase their own incomes rather than a public spirited attempt to improve service quality."<sup>120</sup>

There were a number of empirical studies analyzing the legal profession's licensing requirements in the similar manner as the real estate profession. In their 1981 study, Getz, Seigfried & Calvani considered the bar exam as the only licensing requirement and found no effect of bar examination passage rates on lawyers' incomes.<sup>121</sup> Two decades thereafter, Kleiner used a different approach. He analyzed the effect of licensing on the legal profession through comparing lawyers' incomes with the incomes of individuals in similar but unlicensed professions.<sup>122</sup> Kleiner found that lawyers' incomes were higher by about 10 percent.<sup>123</sup>

Among analysts, there were two plausible explanations for higher lawyers' incomes.<sup>124</sup> One was that stricter regulations forced lawyers to improve the quality of service, which resulted in the demand increase for these services and lawyers incomes.<sup>125</sup> Another view was that the higher entry barriers to the profession weakened competition, which allowed

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116. *Id.* at 16.

117. Benjamin Powell & Evgeny Vorotnikov, *Real Estate Continuing Education: Rent Seeking or Improvement in Service Quality?*, E. ECON. J. (forthcoming 2011).

118. *Id.* at 8.

119. *Id.* at 14.

120. *Id.* at 15.

121. Malcolm Getz, John Seigfried, & Terry Calvani, *Competition at the Bar: The Correlation Between the Bar Examination Pass Rate and the Profitability of Practice*, 67 VA. L. REV. 863, 879 (1981).

122. Kleiner, *supra* note 109, at 194.

123. *Id.* at 196.

124. See generally MORRIS KLEINER, LICENSING OCCUPATIONS: ENSURING QUALITY OR RESTRICTING COMPETITION (W.E. Upjohn Institute for Employment Research 2006).

125. *Id.* at 78.

practitioners to keep service fees high.<sup>126</sup> Therefore, without studying the effect of regulations on quality of service, it was impossible to conclude whether stricter regulations benefited society or solely the practitioners themselves. In 2005, Pagliero studied the effect of licensing regulation in the legal profession on consumers' welfare and incomes of entry-level attorneys.<sup>127</sup> He found that licensing solely benefitted the legal professionals.<sup>128</sup> Specifically, he showed that the licensing board manipulated bar exam passage rates, which, on average, increased attorneys' annual incomes by \$10,000 (in 2002 USD).<sup>129</sup> However, it is worth noting that in his analysis, Pagliero considered the bar exam as the only licensing requirement, and used the exam score as a proxy for candidates' quality when arriving at his conclusions.<sup>130</sup>

In 2010, Vortnikov conducted a new empirical analysis of the licensing within the legal profession using an array of the prominent regulations to investigate the impact of those on professionals' income and the quality of service provided.<sup>131</sup> The study also used the number of complaints filed against lawyers as a measure of quality, which is one of the most common ways to measure the quality of service as described in the occupational licensing literature.<sup>132</sup> The results demonstrated that service quality fell and the average lawyers' income rose after the tightening of the majority of licensing regulations.<sup>133</sup> Specifically, the study showed that "the combined effect of a one standard deviation decrease in the MPRE and Bar exam passage rates, and a one standard deviation increase in the CLE hour requirement, on average, increased lawyers' incomes by \$7,544 and increased the number of complaints filed by 95 per one million residents."<sup>134</sup> The results of the analysis also illustrated that the introductory education did not affect the incomes, and instead increases the number of complaints in states that have it by 120 per one million state residents.<sup>135</sup> Lastly, the study found that the ethics education had no affect on lawyers' incomes, and a one standard deviation increase in the requirement reduced

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126. *Id.*

127. Mario Pagliero, *What is the Objective of Professional Licensing? Evidence from the US Market for Lawyers* (Sep. 30, 2010) (unpublished 2005, Univ. of Turin, Dept. of Econ. and Finance), available at <http://www.sciencedirect.com>.

128. *Id.* at 1.

129. *Id.*

130. *Id.* at 5 n. 16. See also Evgeny S. Vortnikov, *The Adverse Consequences of Entry Regulation in the Legal Profession*, at 6 n. 11 (under review 2010, on file with author) (arguing that it is not appropriate to use the bar exam score as a proxy for candidates quality).

131. Vortnikov, *supra* note 130.

132. Johnson & Loucks, *supra* note 113; Shilling & Sirmans, *supra* note 113; Morris Kleiner & R. Kudrle, *Does Regulation Affect Economic Outcomes? The Case of Dentistry*, 43 *J. L. & ECON.* 547 (2000); Barker, *supra* note 114; Powell & Vortnikov, *supra* note 89 (using similar approach to measure the quality of service).

133. Vortnikov, *supra* note 130, at 13–14, 16–19.

134. *Id.* at 19.

135. *Id.*

the filed complaints by approximately 11 per one million residents.<sup>136</sup>

The aforementioned studies for both the legal and the real estate professions have revealed that the vast majority of the regulations resulted in either no change in service quality or its deterioration. On the other hand, historical facts demonstrate that the qualification requirements for licensure in the legal and real estate professions have been raised and were tightened over the past decades. Despite the difference in the caliber of costs and types of damages that professional mistakes of those two groups could cause currently, both of these professions endure the most restrictive form of occupational regulation. This spur in licensing laws was not an accident. Both professions have strong lobby groups that have been promoting the establishment of entry regulations, and have been masking the promotion of self-interests with concern about customers. In addition to demonstrating deterioration or lack of change in quality of service for both professions, empirical evidence showed proof that professional incomes in both occupations increased with the introduction of new regulations. Therefore, it is possible to conclude that occupational regulation in the legal and the real estate professions was not designed to protect consumers, and instead, was invented to promote the self-interests of the professionals.

#### 4. CONCLUSION

The laws protecting consumers from fraud and misconduct were designed a long time ago, and have been evolving for decades. A well-functioning court system ensures that these laws are enforced, that the professionals who take advantage of customers or cause them damage are punished, and that victims are properly compensated. Recent research and empirical analysis developments in the area of occupational licensing provide strong evidence that occupational licensing regulations are abused by private interest groups that strive to gain anticompetitive advantages for themselves instead of benefitting the society, thereby interfering with free-market and free competition in the economy. A re-examination of the state of entry regulations in a number of prominent professions is long overdue, the results of which will likely lead to a decision to abolish excessive and ineffective entry regulations for most of the professions. If appropriate measures are not taken, this society may find itself in a situation where children that operate a lemonade stand will be required to acquire a license from the government or some third-party interested organization. Unfortunately, the United States is already in this situation.<sup>137</sup>

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136. *Id.*

137. See, e.g., *Police Shut Down 6-Year-Old's Lemonade Stand*, NEWS4JAX.COM (June 20, 2003), available at <http://www.news4jax.com/print/2283228/detail.html>.