

Unsafe Bid—The Online Caveat Emptor

An Argument for an International Convention Covering Internet Auction Fraud

By Julia Engel

As technology advances, it is often a challenge for law to keep pace with the new developments.¹ This has been the case for the online auction market, which, due to a lack of effective regulation, fails to protect its users from fraud. In addition, current protective measures in place only address issues on a national level, while ignoring the Internet's global reach, which highlights the need for an international approach. Hence, there is a need for an international convention that works towards the unification of laws across borders.

Internet auctions are the world's largest and fastest growing channel of commerce.² The top 18 auction websites have more than 130 million listings.³ Each day more than six million new listings are posted on eBay, the most popular auction website.⁴ The process of participating in an online auction is very straightforward. Sellers and buyers register with the auction site and pay transaction fees in addition to an initial participation fee. Online auctions begin with a seller posting items and continue with subsequent bids from prospective buyers. After a prescribed period of time has passed, the highest bidder on the website wins and the seller and buyer usually agree through email about the terms of payment and delivery. Traditionally, the seller sends the merchandise to the buyer after having received payment. Online auction sites, such as eBay, however, are removed from responsibility in the transaction since they neither take physical possession of goods nor supervise terms of payment and delivery.⁵

The loose oversight of this process allows for various types of fraud to emerge. The seller can post fake or illegally obtained goods. A seller can also, upon receipt of payment, deliver a good of lesser quality or not deliver at all. The buyer can use stolen credit cards, bounced checks or other techniques to receive the goods without proper payment.⁶ Additionally, the buyer or seller could commit additional fraud through the use of fake online escrow services. Traditional escrow services prevent fraud by acting as a secure third party, which holds the money for the seller until the buyer inspects and confirms the quality of the item. However, buyers and sellers can exploit this intermediate process and disappear with the money or merchandise through the use of a fraudulent escrow service.⁷ As proof of the severity of the issue, Internet auction fraud is always in the top of Internet Crime Complaints.⁸

The online auction industry is not ignorant to the negative impact of fraud on its business through possible

decreases in user participation.⁹ Accordingly, there are a number of self-regulation solutions against fraud. eBay is probably the best example of a company creating proactive initiatives to protect users. The company has been implementing various "Trust and Safety Programs," the first being a feedback system, where users could rate each other.¹⁰ Further, eBay enacted the Verified Rights Owner Program that allows retailers to notify it if counterfeit or unlawful merchandise is sold on the auction website, in which case eBay will remove the listing.¹¹ Due to increasing concerns, eBay made its Selling Practices Policy stricter and announced the eBay Buyer Protection Program, which reimburses the full purchase price to the buyer in the event of fraud.¹² However, only users who purchase via the U.S. website are eligible for this protection. In addition to various exclusions, eBay also reserves the right to refuse the reimbursement service at its discretion.¹³ Essentially, all of those approaches are based on voluntary participation and on an *ex post facto* approach,¹⁴ where victims of fraud are helped, but fraud is not prevented. Most importantly, the existing procedures and protections fail to address the international nature of online auction fraud. eBay currently operates in 22 countries in Asia, Europe and North America. It has hundreds of millions of registered users globally, out of which 90 million participate actively, and its total worth of goods sold amounted to approximately \$60 billion.¹⁵

Although other smaller market players do not have the resources and capabilities to implement similar programs, there are some solutions and other initiatives to prevent fraud that can be used. For example, an online Trustmark seal on a user's account symbolizes that the user is reputable or that his or her identity has been confirmed.¹⁶ In addition, some companies outsource automated fraud detection software, which scans their databases for fraud patterns and compares them to reported fraud schemes. Unfortunately, however, many users are unaware about Trustmark seals and automated software often fails to catch new and creative fraudulent activities.¹⁷ Therefore, the self-regulation undertakings of all players in the industry fall short of what is necessary both domestically and internationally.

However, since there is no legal framework in place that covers online auction fraud, many victims refrain from taking legal action.¹⁸ Online auction houses cannot be sued because they are allowed legal abdication from responsibility.¹⁹ In addition, Internet auction websites

are not classified as auction houses, but as "Interactive Service Providers" (ISPs).²⁰ Under the Communications Decency Act,²¹ ISPs are protected from certain liability for material originating from third parties' postings on their service sites.²² Fraud victims are limited to litigating the other party to the transaction, yet this legal expense may cost more than the loss incurred in the sale. Furthermore, lawmakers embrace a policy akin to *caveat emptor*,²³ which has been in place for years and therefore is seen as sufficient. Accordingly, laws that are designed for other jurisprudential landscapes²⁴ are being used to address Internet auction fraud.²⁵ In most cases, the Uniform Commercial Code or mail and wire fraud laws are applied.²⁶ Yet it is not possible to sue for breach of contract over a sale on auction websites.²⁷ Since there is no law governing Internet trade fraud, fraud victims do not have legally valid recourse.

One option for fraud victims is to contact trade organizations, which have for years tried to monitor online auctions and provide legal advice. For example, consumer groups like the National Fraud Information Center,²⁸ the National Consumers League,²⁹ and the Better Business Bureau Online³⁰ track auction fraud developments and present tips to avoid common schemes. In addition, for-profit online dispute resolution (ODR) enterprises that specialize in Internet issues have emerged.³¹ Governmental organizations go even a step further and try to track down defrauders. The Department of Justice created the Internet Fraud Initiative to prosecute Internet fraud.³² The Internet Crime Complaint Center, a special partnership among various legal entities, offers cyber-crime victims the possibility to report Internet crimes and alert the authorities.³³ It releases annual reports with data about the complaints received. The FBI also works closely with the Internet Crime Complaint Center to stop defrauders.³⁴ As a result, the first federal prison sentence resulting from Internet auction fraud occurred in 1999, when Robert J. Guest exploited people on eBay by never delivering bid-upon goods.³⁵ The government sued him and he was found guilty of mail fraud.³⁶

However, the most notable organization to deal with the issue has been the Federal Trade Commission (FTC). The FTC fiercely tries to fight Internet auction fraud through education training and law enforcement.³⁷ For educational purposes, the FTC published a guide for buyers and sellers about Internet auctions. The organization also created OnGuard Online, a free training program designed to assist individuals against auction fraud.³⁸ Moreover, the FTC Consumer Sentinel fraud database collects consumer complaints and disseminates them to law enforcement organizations.³⁹ The FTC even sues defrauders directly. Its first case dates back to 1998, when Craig Lee Hare⁴⁰ was sued for violating the FTC Act and the Mail or Telephone order Merchandise Rule,⁴¹ because he accepted payment and never delivered goods. He was found guilty of wire fraud.⁴² Yet all of those efforts are not

proactive or preventive, since they respond to fraud after it has already been committed.

There is a real need for an international solution, as there are large inconsistencies in the decisions of online auction fraud cases, depending on in which country the trial is held. While the United States believes in economic self-regulation, the European Union wants to protect the consumer through stricter state-imposed regulations.⁴³ The contradictory decisions reached in lawsuits brought against eBay in the United States and Europe exemplify this conflicting ideology.⁴⁴ In the 2004 case *Tiffany & Co. v. eBay Inc.*⁴⁵ the jewelry company claimed that eBay should be held liable for trademark infringement through the sale of counterfeit goods on its website. The company wanted the auction site to police listings preemptively and not solely rely on notifications received from Tiffany & Co. Yet eBay was acquitted of all charges, including for contributory liability in its duty to prevent fraud.⁴⁶ Contrary to this, in 2006 in France, the case *Moët Hennessy Louis Vuitton v. eBay Inc.*⁴⁷ was a notable defeat for eBay. Moët Hennessy Louis Vuitton (LVMH) claimed that the Internet auction site was liable for both the sale of counterfeit goods advertised as LVMH products and the illegal sale of its originals.⁴⁸ Further, it was claimed that eBay did not establish enough mechanisms to prevent fraud.⁴⁹ The court's decision ordered eBay to pay LVMH 38.6 million Euros in damages.⁵⁰ These starkly different decisions reached in different countries serve as evidence for the growing need for international unification on auction regulations.

As the current efforts are not effective enough and ignore the international aspects of Internet auction transactions, buyers and sellers worldwide would benefit from an international convention.⁵¹ An effective agency for instituting this convention would be the United Nations Commission on International Trade Law (UNCITRAL), which establishes conventions in order to unify trade law through legal obligations.⁵² It should propose a Convention for Internet Fraud Prevention, with the purpose of setting uniform online auction fraud regulations. These new regulations must then be implemented in the existing auction websites and serve as the standard for new entrants. Each website should be required to educate its users about the danger of fraud. Furthermore, each company has to establish mandatory fraud prevention efforts which include identity and credit verification for sellers and buyers, a free in-house escrow system or a partner escrow system, and the possibility to purchase insurance in case of fraud. As an added layer of security, only one username per party should be allowed and the online auction house would be required to keep records of its users' histories. Fraud detection software has to become mandatory. Online auction houses also have to invest into research for new ideas to fight Internet auction fraud, for example, by using social network analyses to locate groups of potential fraudsters.⁵³ Finally, online auction

houses must accept further responsibility and be held financially liable if they do not fulfill their due diligence to educate customers and prevent fraud. "Unless and until the online auction sites are held financially responsible for fraud on their sites, they have no real incentive to clean up fraud beyond the minimum necessary to ensure a customer base using their sites' services."⁵⁴ This way the UNCITRAL convention will finally establish a global solution to assure users' protection from Internet auction fraud.

Given that the current efforts by the U.S. government and the self-regulation of the industry prove ineffective in globally protecting users from Internet auction fraud, an international convention is required. This convention will provide a unified basis to prevent fraud through imperative consumer education, mandatory fraud prevention, research efforts and financial liability of auction websites. The law needs to keep pace with new technologies and their widening reach, or else its outdated structure will do more harm than good.

Endnotes

1. CHRIS REED, *INTERNET LAW: TEXT AND MATERIALS 1* (Cambridge University Press, 2nd ed., 2004) ("The Cyberspace fallacy states that the Internet is a new jurisdiction, in which none of the existing rules and regulations apply.").
2. Todd E. Lerner, *Playing the Blame Game, Online: Who Is Liable When Counterfeit Goods Are Sold Through Online Auction Houses*, 22 *PACE INT'L L. REV.*, 241 (Winter 2010).
3. Power Sellers Unite, Auction Site Count, <http://www.powerseller-sunite.com/auctionsitewatch.php> (last visited February 24, 2011).
4. MARSHA COLLIER, *EBAY FOR DUMMIES 313* (Wiley Publishing Inc., 5th ed. 2006).
5. DIANE ROWALD, *INFORMATION TECHNOLOGY 427* (Psychology Press, 3rd ed., 2005).
6. Internet Auction, OnGuard Online, <http://www.ogoleng.org/topics/internet-auctions.aspx>. Those are just the major examples of fraud. In other cases, the buyer can engage in bid shielding, where he or she uses fake high bids to scare off other bidders and then retracts them to buy the good at a lower price. In the "buy and switch" fraud, the buyer receives a good and then sends a fake back for a refund from the seller. The seller can also engage in bid shilling, which involves fake bids to raise the price higher. Furthermore, the seller can add fake fees for shipping and raise the price.
7. Federal Trade Commission, *Internet Auction Fraud Targeted by Law Enforcers*, <http://www.ftc.gov/opa/2003/04/bidderbeware.shtm>.
8. Annual Reports, Internet Crime Complaint Center, <http://www.ic3.gov/media/annualreports.aspx>. The Internet Crime Complaint Center reported that the total dollar loss from only reported complaints from Internet auction fraud in 2009 amounted to about \$58 million. The total dollar loss from all referred cases amounted to \$559.7 million. Internet auction fraud accounted for about 10.3% of referred cases. This calculation does not include cases the Internet Crime Complaint received directly. Furthermore, those are complaints received only by one organization in the United States. It is not possible to say how high the loss really is worldwide.
9. James M. Snyder, *Online Auction Fraud: Are the Auction Houses Doing All They Should or Could to Stop Online Fraud*, 52 *FED. COMM. L.J.*, 459 (2000).
10. eBay, Feedback Forum, <http://pages.ebay.com/services/forum/feedback.html>.
11. eBay, eBay Buyer Protection, <http://pages.ebay.com/help/policies/buyer-protection.html>.
12. eBay, eBay Buyer Protection, <http://pages.ebay.com/coverage/index.html>.
13. See eBay, *supra* note 10.
14. BLACK'S LAW DICTIONARY 620 (8th ed. 2004). An ex post facto approach means literally "after the fact." This is a retroactive approach, which leads to activity once the crime has happened.
15. eBay, Who We Are, <http://www.ebayinc.com/page/who>.
16. Computer Crime Research Center, *E-Commerce and Internet Auction Fraud: The E-Bay Community Model*, <http://www.crime-research.org/articles/Wahab1/3>.
17. See Computer Crime Research Center *supra* note 14; See also Rachel Konrad, *eBay touts anti-fraud software's might*, CNET News <http://news.cnet.com/2100-1017-932874.html>. eBay's created its own software called Fraud automated detection engine (FADE).
18. Miriam R. Albert, *E-buyer Beware: Why online auction fraud should be regulated*, 39 *AM. BUS. L.J.*; 575-576 (Summer 2002).
19. See HOSSEIN BIDGOLI, *THE INTERNET ENCYCLOPEDIA 332* (John Wiley and Sons, 2004). See also Ebay, *Your User Agreement*, <http://pages.ebay.com/help/policies/user-agreement.html>. "You will not hold eBay responsible for other users' content, actions or inactions, items they list or their destruction of allegedly fake items. You acknowledge that we are not a traditional auctioneer. We are not involved in the actual transaction between buyers and sellers. We do not transfer legal ownership of items from the seller to the buyer. California Commercial Code § 2401(2) and Uniform Commercial Code § 2-401(2) applies to the transfer of ownership between the buyer and the seller, unless the buyer and the seller agree otherwise. We have no control over and do not guarantee the quality, safety or legality of items advertised, the truth or accuracy of users' content or listings, the ability of sellers to sell items, the ability of buyers to pay for items, or that a buyer or seller will actually complete a transaction or return an item."
20. There have been laws passed for the protection of the service providers, but not their users. Digital Millennium Copyright Act (DMCA), 7 U.S.C. §§ 512, 1201-1205, 1301-1332; 28 U.S.C. § 4001 (1998). Passed in 1998, the DMCA exempts Internet Service Providers from both indirect and direct liability for copyright issues arising because of their platform. Copyright Directive 2001/29/EC Arts. 47(2), 55 & 95. Since the equivalent of the European Union's Copyright Directive of 2001 did not address this issue, the separate Electronic Commerce Directive was created. The United Nations Convention on Contracts for the International Sale of Goods evaluates the formation of international contracts, the responsibilities of the parties involved and the remedies in case of breach of contract. UNCITRAL Model Law on Economic Commerce, A/51/162 (June 12, 1996). The United Nations Commission on International Trade Law Model Law on E-commerce has been more concentrated on advancing electronic commerce by making electronic contracts and signatures binding than to codify law in order to regulate e-commerce.
21. Communications Decency Act, 47 U.S.C. § 230 (1996). This Section does not, however, include protection against liability for federal criminal acts and intellectual property infringements.
22. *Gentry v. eBay, Inc.*, 99 Cal.App.4th 816 (2002). In 2002, the Internet auction house was not found liable for the sale of fake sports memorabilia to the plaintiff. The reasoning behind this decision lay in the belief that eBay was not a traditional auction house, but rather an "interactive service provider." Under the Communications Decency Act, see *supra* note 21, interactive service providers were not liable for material originating from third parties' postings on their service site. See *Randall Stoner v. Ebay Inc., et al.*, 2000 WL 1705637, Civ. No. 305666 (Sup. Ct. Ca., 2000). The same ruling was used for the decision in *Randall Stoner v. eBay Inc.* two years prior. The Internet auction site was not held liable for the posting of

- bootleg recordings and illegal recordings of live performances on its auction site.
23. BLACK'S LAW DICTIONARY 236 (8th ed. 2004). The doctrine of Caveat Emptor in common law means that the buyer buys at his/her/its own risk.
 24. See Albert, *supra* note 18, at 603.
 25. See generally Counterfeit Access Device and Computer Fraud and Abuse Act, P.L. 98-473, 98 Stat. 2190 (1984). The Counterfeit Access Device and Computer Fraud and Abuse Law was the very first piece of legislation to address computer-based abuse. It allowed for prosecution of fraud related to computers. Yet the law became quickly outdated and did not encompass Internet fraud, since the Internet did not become public until 1989. See also National Information Infrastructure Protection Act, 18 U.S.C. § 1030 (1996). The National Information Infrastructure Protection Act (a new version of the Computer Fraud and Abuse Act from 1986) only covered the illegal access of information or transmission of malicious software.
 26. BLACK'S LAW DICTIONARY 687, 1565 (8th ed. 2004). The Uniform Commercial Code governs sales. Mail fraud is a federal offense that involves the usage of the postal system any time during the activity of the fraud. Under 18 U.S.C. §1343 (2010) wire fraud is a federal crime, which involves electronic communications used for fraudulent activity.
 27. GEORGE B. DELTA & JEFFRY H. MATSUURA, LAW OF THE INTERNET 3-16.2 (Aspen Publishers Online, 2002).
 28. National Consumer's League Fraud Center, <http://www.fraud.org>.
 29. National Consumer's League, <http://www.nclnet.org>.
 30. Better Business Bureau Online, <http://www.bbb.org/online>.
 31. E. KATSH, & J. RIFKIN, J., ONLINE DISPUTE RESOLUTION: RESOLVING CONFLICTS IN CYBERSPACE 9 (San Francisco: Jossey-Bass 2001).
 32. United States Department of Justice, Attorney General Statement regarding the Internet Fraud Complaint Center, <http://www.justice.gov/opa/pr/2000/May/254ag.htm>.
 33. Internet Crime Complaint Center, <http://www.ic3.gov/default.aspx>.
 34. Federal Bureau of Investigation, Internet Fraud, http://www.fbi.gov/scams-safety/fraud/internet_fraud.
 35. Federal Trade Commission, *Going, Going, Gone...Law Enforcement Efforts to Combat Internet Auction Fraud*, <http://www.ftc.gov/bcp/reports/int-auction.htm>. It is important to note that no other data about this case could be found other than that was provided by the FTC. Therefore, this citation is incomplete.
 36. See BLACK'S LAW DICTIONARY, *supra* note 26.
 37. Federal Trade Commission, *supra* note 7. The FTC introduced the Operation BidderBeware and Project Safebid, initiatives to advocate its efforts in education, training and law enforcement.
 38. See *OnGuard Online*, *supra* note 6.
 39. Consumer Sentinel Network, *FTC's Consumer Sentinel Network*, <https://www.sentinel.gov>.
 40. FTC v. Hare, Civil No. 98-8194 CIV HURLEY (M.D.Fla. March 30, 1998).
 41. Federal Trade Commission Act, 15 U.S.C.A. § 41-58. (1914). The FTC Act prohibits unfair methods of competition and unfair or deceptive acts or practices. The FTC was established in 1914 to enforce the FTC Act.
 42. See BLACK'S LAW DICTIONARY, *supra* note 26.
 43. Sylvia Mercado Kierkegaard, *E-Contract Formation: U.S. and EU Perspectives*, 3 SHIDLER J. L. COM. & TECH. 12 (Feb. 14, 2007).
 44. JANE K. WINN & BENJAMIN WRIGHT, THE LAW OF ELECTRONIC COMMERCE 5-70 (Aspen Publishers Online, 2001).
 45. Tiffany Inc. v. eBay Inc., 600 F.3d 93 (2nd. Cir. 2010).
 46. eBay was also found innocent in terms of direct infringement, trademark dilution and false advertising on remand.
 47. *Louis Vuitton Malletier v. eBay, Inc.*, Tribunal de Commerce de Paris (Commercial Court of Paris) (June 30, 2008).
 48. *Id.*
 49. *Id.*
 50. *Id.* This amounts to \$61 million. Just two months before, eBay lost a similar case against the handbag company Hermes and was ordered to pay 20,000 Euros. eBay also lost to L'Oreal, *EBay May Be Liable in L'Oreal Trademark Suit*, EU Court Says, Bloomberg News, <http://www.bloomberg.com/news/2011-07-12/ebay-may-be-liable-in-l-oreal-trademark-suit-eu-court-says-1-.html> <http://www.nytimes.com/2011/07/13/business/global/ebay-suffers-setback-on-trademark-infringement.html>.
 51. See BLACK'S LAW DICTIONARY *supra* note 26 at 355 (8th ed. 2004). The reason a convention is better than a treaty, is that it is easier to be instituted and entered by many nations. Vienna Convention on the law of treaties, May 23, 1969. A "treaty" means an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation. An international treaty has to be proposed by a state and needs to be signed by state representatives; the head of state, the head of the government or the minister of Foreign Affairs. The treaty needs to be registered with the secretariat of the United Nations. An open multilateral treaty could be proposed, which however should become universal. There are many requirements for treaty entrance. The treaty has to be entered with free consent and good faith. Furthermore, the treaty is binding, but only to the parties (*pacta sunt servanda*); a fundamental change of circumstances jeopardizes the treaty (*omnia conventio intelligitur rebus sic stantibus*) and it is better to seek maintenance than termination of a treaty (*favor contractus*).
 52. United Nations Commission on International Trade Law (<http://www.uncitral.org/uncitral/en/index.html>). The UNCITRAL is the main legal body for the U.N. in the field of international trade law. It has been reforming the international commercial law for the past 40 years. By creating conventions, model laws and rules, the UNCITRAL tries to modernize and harmonize laws worldwide. Its working Group IV concentrates on electronic commerce. Through an international meeting of representatives from many nations an agreement is created to take actions against a specific issue. The main difference from a treaty lies in the fact that states must deposit instruments of ratification or accession in order to become a party of the convention. The reason is that the pure signature of the convention is not binding.
 53. CHRISTOPHER C. YANG, DANIEL ZENG & MICHAEL CHAU, INTELLIGENCE AND SECURITY INFORMATICS 240 (Springer 2007). Social network analytics study the exchange of information and resources between users in online networks or platforms. It is possible to establish patterns in relationships and interactions.
 54. See Albert, *supra* note 18, at 602.

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