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## When the Highest Bidder Loses: Fraud and Internet Auctions

Dallas, Shane\*

### Abstract

The growth of Internet auctions has resulted in many benefits, but it has also caused a few problems, particularly in the area of fraud. Government consumer protection agencies are often called upon to render assistance when difficulties arise; however, they are generally limited in the remedies they can seek. Despite these limitations, government agencies still have an important role to play in minimizing Internet fraud – namely in the area of education and in the fostering of greater cooperation not only within a country but also between nations.

**Key words:** Internet auction, fraud, responses to problem, national and international cooperation

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\* Dallas, Shane, MPA(Executive), Investigator, Australian Competition and Consumer Commission.

## I. Introduction

It was inevitable that the technological age would not only herald new industries, but also introduce new methods for completing traditional forms of business. One of the changes has been online shopping – the ability to browse, compare, decide and buy all from the comfort of a computer screen. The facility to reach large audiences for a minimum of cost is a large incentive for established business to sell their products through this new medium.

Furthermore, these same benefits have attracted a new brand of seller and buyer – who instead of relying on the old technique of hauling their used goods to second-hand markets or placing advertisements in the newspaper, can now benefit from the ease and efficiency that the Internet can bring. All of these factors have combined to ensure that a facilitation service known as Internet Auction Sites (IAS) has become a prevalent presence on the World Wide Web.

The first IAS was formed in 1995 under the name AuctionWeb, but has since changed its name to eBay. It is now the world's largest IAS, with more than 114 million registered members and has 25 million items for sale at any one time.<sup>1</sup> The number of IAS has increased dramatically, and though it is difficult to estimate, the number must be in the thousands. However, none have reached the scale or market penetration of eBay.

## II. Auction Fraud

Buying an item when you are unable to physically hold the product and meet the seller lends itself to problems. The usual trust and communication that occurs as part of a normal transaction is absent, and it leaves both buyer and seller more vulnerable to deception. The most common complaints about Internet auctions are when the purchaser

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<sup>1</sup> eBay (2006c).

fails to receive any goods, or that the goods are significantly different from what was advertised. Other complaints include disputes over the cost of postage, late delivery of goods, and the failure to disclose a term of sale. Such practices as “bid siphoning” and “second chance offers” also lure buyers into error, where prospective purchasers are coaxed to purchase the item off the IAS and thus lose all forms of protection offered by the site.<sup>2</sup>

Sellers can also fall victim to fraud, and this normally involves payments not being delivered to the seller through ID fraud or a false third party clearing house (known as an escrow service).<sup>3</sup> Another common type of fraud targeting sellers is the check overpayment scam. This occurs when the buyer sends a check to the seller for a higher amount than the agreed price. Very shortly afterwards, the buyer admits to a mistake and then requests the seller return the difference by wire transfer (such as Western Union and MoneyGram), but a few days later the check is discovered as a fraud and the seller loses both the product plus the amount of money wired back to the fraudulent buyer.<sup>4</sup> However, this paper will focus on the problem of Internet auctions from a buyer’s perspective, which is a much more common phenomena.

### **III. Problems Getting Worse?**

Discussing the scale of the problem is difficult, mainly because research indicates that almost 17% of people who experience problems do no attempt to resolve them, and only 1.9% of buyers who have experienced a problem contacted a government consumer enforcement agency<sup>5</sup> Of those that are reported, they do form a significant number of complaints received by government agencies. For example, complaints about Internet auctions accounted for 12% of all fraud complaints received by the USA’s Fair Trade

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<sup>2</sup> FTC (2006d) p10.

<sup>3</sup> OFT (2006).

<sup>4</sup> FTC (2006b) p12.

<sup>5</sup> Moustakas (2006) p11.

Commission (FTC).<sup>6</sup>

These figures are borne out by the FTC's 2005 statistics, where, when isolating the high portion of identity fraud (accounts for 37% of all complaints) Internet auctions are the source of the highest number of theft, totaling 18.7%.<sup>7</sup> By comparison, the Internet Crime Complaint Center (IC3) states that 62.7% of all complaints it receives are related to Internet Auction fraud.<sup>8</sup> Anecdotal information from different government agencies also confirms that Internet auction fraud is a regular source of complaints.

In addition, the problem is increasing at an almost exponential rate as the popularity of the online shopping rises. According to the USA's Federal Trade Commission (FTC), Internet cross-border fraud complaints have quadrupled in the past three years<sup>9</sup>. However, this must be balanced against eBay's claims claim that only 0.01% of transactions (1 in 10,000) are a confirmed case of fraud.<sup>10</sup>

## IV. Protecting Consumers

Prevention is obviously the best means to avoid any problems and the choice of payment method is a major determinant as to the presence of fraud.<sup>11</sup> Certain payment methods in the purchase of goods are riskier than others, with cash, money orders, checks and direct deposits less likely to offer protection.<sup>12</sup> The least secure payment type is the use of wired money services. This is strongly discouraged by Internet auction sites and government authorities, and eBay even prohibits it as a form of payment, and does not extend any of its buyer protection programs to those who use this method.<sup>13</sup> The US has found that paying by wire transfer is the most common means (54% - excluding Canadian

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<sup>6</sup> FTC (2006d).

<sup>7</sup> FTC (2006e) pp 4, 76.

<sup>8</sup> IC3 (2006) p7.

<sup>9</sup> FTC (2006c) p4.

<sup>10</sup> Wikipedia (2006).

<sup>11</sup> Wahab (2004).

<sup>12</sup> FTC (2006b) pp7-8.

<sup>13</sup> eBay (2006a).

companies) by which fraudsters are able to obtain money in cases of cross-border fraud.<sup>14</sup>

Furthermore, several payment methods have been established to assist in making transactions more secure. An Escrow service is one where a third party holds the money in trust until the purchaser has acknowledged receipt of the goods – a nominal fee is normally charged for this service on the purchaser of the goods. PayPal was acquired by eBay in 2002<sup>15</sup>, and it is purported to provide not only a faster means of payment, but a safer one as well, mainly due to the compensation offered by eBay in the case of fraud or a dispute (see below). Fees for PayPal are normally charged on the seller of the goods.

The cautious shopper is able to utilize the feedback rating systems employed by many IAS that enable a potential buyer to ascertain the reputation of a seller. The higher the number of positive feedbacks received is generally indicative of a safe seller, though, these rating systems can also be manipulated by the unscrupulous. In these cases, a trader may sell many cheaper items of worthless value (normally to friends) and thus receive a higher feedback score, but then not fulfill their obligations when it comes time to offer a higher value product. Within the eBay network, those sellers who have a long-established and secure reputation are awarded the title of 'PowerSeller', thus providing another layer of assurance for the buyer.

## V. Alternative Resolutions

If a product fails to be delivered, or another problem is discovered after the auction has concluded and money paid, then there are numerous resolution avenues that can be pursued. The initial course of action is always to contact the seller in an attempt to explain the problem as some miscommunication or misunderstanding may be the source of the difficulty. If this is unsuccessful due to the failure of the seller to respond, or an unsatisfactory answer, then the next step is to utilize the dispute resolution mechanisms

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<sup>14</sup> FTC (2006c) p10.

<sup>15</sup> Wahab (2004).

established by the auction site. The OECD has commented on the importance of dispute resolution mechanisms for user of an IAS.<sup>16</sup>

As an example, eBay has implemented a comprehensive series of procedures to be followed in the case of a dispute. eBay defines these into various categories, and all are subject to eBay's buyer protection programs<sup>17</sup>, which all require the buyer to attempt to resolve the problem with the seller first, prior to eBay becoming involved as facilitator. However, eBay imposes timelines for parties to lodge a grievance<sup>18</sup>, which may cause a buyer who is not fully conversant with the requirements in lodging a problem to miss the opportunity to use these dispute mechanisms.

Different types of dispute mechanisms are available, depending on the item involved, such as a motor vehicle, business equipment, PayPal purchase or non-PayPal purchase. In addition, eBay has implemented a Standard Purchase Protection Program that covers items up to US\$200 (minus a \$25 processing fee) – though this amount varies from country to country.<sup>19</sup> On PayPal purchases, eBay provide full reimbursement on amounts up to US\$1,000 – but again this does vary in different countries. A further form of protection, though established prior to the arrival of Online auctions, is to lodge a dispute with the credit card provider if a credit card was used in the transaction.

## VI. Government Response

Despite IAS being responsible for a sizeable number of complaints being lodged with consumer protection agencies throughout the world, the response of such agencies to individual complaints generally falls to the provision of guidance and the collation of date – but why is this so? The reason for this is that lodged complaints usually fall within the jurisdiction of either contract law, or, in the case of non-delivery of goods, outright

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<sup>16</sup> OECD (2006) p58.

<sup>17</sup> eBay (2006a).

<sup>18</sup> eBay (2006a).

<sup>19</sup> eBay (2006b) As an example of different amount, the limit is approximately US\$300 in Australia.

fraud – both of which are normally beyond the ambit of consumer protection agencies whose activities are more focused on misleading, deceptive and untruthful conduct.

According to figures, the largest category of complaints (20%) on Internet fraud relates to goods not being received, whilst misrepresentations accounted for 15%, failure to honor a refund policy are 6%, undisclosed charges of 4%, defective/poor quality 3% and failure to honor a warranty or guarantee 2%<sup>20</sup>. This is worth noting, since actions by consumer protection agencies are more likely to involve misrepresentations, misleading or false statements regarding undisclosed charges – and Internet auction complaints on these areas only account for less than one in five of all complaints made.

Furthermore, even if the alleged conduct does fall within the jurisdiction of government consumer protection agencies, other reasons can explain the apparent non-action. An OECD report in 2006, *Consumer Dispute Resolution and Redress in the Global Marketplace*, identified several reasons. First among these was the difficulty agencies had in achieving monetary redress for consumers – since powers in jurisdictions normally do not extend to such action – and are normally limited to pursuing the imposition of fines and corrective advertising, rather than the ability to obtain refunds.<sup>21</sup> The notable exception is the United States where the FTC can obtain direct court orders for consumer redress. Australia can also achieve direct such redress orders, but only if it receives consent from each party prior to the action commencing. Seven other countries<sup>22</sup> were identified as having the authority to obtain monetary compensation, but this was usually confined to being a representative party to an action.<sup>23</sup>

An additional consideration is whether pursuing cases solely through a consumer protection agency is the most expeditious method. Actions through small claims courts or tribunals are a faster and cheaper option.<sup>24</sup> Government agency litigation can be quite protracted due to the different court processes involved with a higher form of court, and

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<sup>20</sup> FTC (2006c) p13.

<sup>21</sup> OECD (2006) p35.

<sup>22</sup> Canada, Denmark, Finland, Ireland, Mexico, Portugal, Sweden.

<sup>23</sup> OECD (2006) pp36-37.

<sup>24</sup> OECD (2006) pp24-25.

such delays may be unsatisfactory for the aggrieved consumer. Furthermore, consumer protection agencies pursuing blatant fraud cases by smaller operators may find that no financial redress for the affected parties is possible due to the insolvency or bankruptcy of the guilty party. In this instance, the purpose of actions by government agencies are restricted to the punishment of past wrongs and the deterrence of similar conduct in the future, rather than seeking restitution for the adversely affected parties.

The sum of these factors means that consumers who lodge complaints with a government consumer protection agency are usually informed that they should initially raise the dispute with the other party, and if unsuccessful, lodge a complaint with the IAS. Normally these processes need to be followed prior to an agency becoming involved – but even then, it is uncommon for an agency to become involved in individual matters that are contractual or fraudulent. Only if a complaint against a fraudulent seller becomes widespread, will an agency be able to justify the spending on public monies, and be tempted to take action.

### **VIII. Agencies Have a Role**

The inability of government agencies to assist consumers is reflected in the paucity of information offered by established competition and consumer agencies, which is either quite sparse in its availability or cursory in its treatment. However, some agencies, including the UK's Office of Fair Trading, the FTC and the Australian Competition and Consumer Commission (ACCC), have all published guidance. They do provide guidance to users of IAS, both in terms of prevention of problems, and courses of action to follow if difficulties arise.

Though government agencies rarely assist in cases involving Internet auctions, some countries have established different means for dealing with the large number of complaints. These normally involve the collation of complaints and a subsequent analysis of the data, which leads to the identification of trends, and finally, educating participants in the

marketplace on the avoidance of problems. This information is disseminated through reports so that all stakeholders can formulate strategies and implement measures in order to minimize the problem of Internet fraud.

The most comprehensive network of Internet fraud collation agencies is in the USA. In addition to the publications and information produced by the FTC, other collaborative government efforts have been established to provide many avenues for aggrieved parties to lodge complaints. A collection of over twenty government, consumer, legal, and industry groups have combined to form the comprehensive site, OnGuard Online ([www.onguardonline.gov](http://www.onguardonline.gov)) which provides an information source for many aspect on Internet related fraud. The site includes complaint lodgment links with participating agencies, information covering every aspect of Internet usage, and interactive games (*Auction Action* and *Online Lineup*) where consumers can test their knowledge of safe Internet auction and shopping practices. Furthermore, the IC3 is a joint initiative of the Federal Bureau of Investigation and the National White Collar Crime Center ([www.ic3.gov](http://www.ic3.gov)) and it receives, investigates and refers all forms of cyber crimes to a myriad of other government agencies. In addition, the FTC has established the Consumer Sentinel (Sentinel) network (detailed below).

Another example of a country where advanced education campaigns have been implemented is in Australia, where only one nationwide service operates, through the Scamwatch website ([www.scamwatch.gov.au](http://www.scamwatch.gov.au)) which the ACCC re-launched in October 2006. Scamwatch deals with many types of illegal schemes that are perpetrated on the unwary consumer, including a section on Internet auctions that provides guidance to consumers on how best not to fall victim to this type of fraud. Furthermore, a database known as Auzshare has been established, a centralized system that permits the ACCC and the different state and territory fair trading offices to share information between jurisdictions and thus identify emerging trends<sup>25</sup> – though it does not deal exclusively with Internet fraud. The Auzshare resource is particularly valuable in instances when

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<sup>25</sup> ACCC (2006a).

conduct is limited to one or two instances in each state that would normally be unnoticed, but when combined into a single database, reveals a more prevalent problem.

There are certainly benefits in having many differing agencies in being able to accept complaints, namely the wider coverage that agencies have in the community by providing consumers with many options for the lodgment of a dispute. However, this is only effective if there is a strong coordination role between the various agencies, otherwise, the dispersal of complaints makes it extremely difficult to identify trends and for agencies to react accordingly. This is the greatest challenge facing a fragmented network of consumer protection agencies – and the coordination shown in the USA and Australia are indicative of the efforts needed in this area to effectively monitor the scale of not just Internet auction fraud, but all types of misleading conduct.

## **IX. Coordination Among Nations**

On a more international level, the FTC has established the Sentinel network, which provides law enforcement agencies in the USA, Canada and Australia with a centralized information system on current cross-border issues, and includes Internet auctions. There are approximately one million complaints logged with Sentinel<sup>26</sup> and it is currently the only major cross-border consumer fraud database in existence.

In conjunction with Sentinel and the FTC, ICPEN (International Consumer Protection Enforcement Network)<sup>27</sup> has instigated the econsumer website ([www.econsumer.gov](http://www.econsumer.gov)) – which a lodgment site for cross border complaints. The website is the recommended means of lodging a complaint if an aggrieved party is complaining about another party who resides in a different country. Though the site does accept complaints, it clearly states that consumers should not expect every complaint to be pursued.<sup>28</sup> ICPEN is also the facilitator of International Sweep Days, normally held in February-March each year,

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<sup>26</sup> FTC (2006a).

<sup>27</sup> ICPEN currently has a membership of 20 countries.

<sup>28</sup> ICPEN (2006).

where staff from consumer protection agencies in 20 countries scour the Internet for fraudulent claims. Previous sweeps included money-making schemes and health claims, but in 2006, the focus was on Internet shopping, though it did not specifically target Internet auctions.<sup>29</sup>

Other cross-border actions include the establishment of the Australasian Consumer Fraud Taskforce (ACFT) in Australia and New Zealand in March 2005. ACFT is comprised of 18 national and state consumer government regulators and departments, such as the ACCC and the New Zealand Commerce Commission. Though its function is to educate consumers on all scams, part of the focus is also on informing people about the potential problems of Internet auctions. The ACFT has joined corporate partners, such as financial institutions and telecommunication groups, in order to best promote the dangers of the more common type of scams. However, Internet auctions were not specifically targeted in the early part of their campaigns, which instead focused on fake overseas lotteries, 'phishing' or 'spoofing', and money transfer or 'Nigerian' fraud scams.

Considering the prevalence of cross-border fraud, there is only limited international cooperation in this area amongst government consumer protection agencies throughout the world. Sentinel is considered the paragon in the area, but it is indeed unusual that it has not been replicated to any degree or that other countries have not chosen to become a part of the scheme. Though ICPEN's econsumer website encompasses more nations, is only rudimentary by comparison and even then, it relies on Sentinel to complete the gathering of data.

## X. Conclusion

The rise of Internet auctions has involved not just consumers and IAS, but also government consumer protection agencies, and all three have a role to play in the future attempts to minimize the incidence of Internet auction fraud.

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<sup>29</sup> ACCC (2006b).

Firstly, there will always be a certain amount of responsibility that lies with the consumer – this includes not using wire services, checking on the feedback rating of the seller and being aware of all charges levied on the sale of a good. However, even the most cautious consumer can become a victim of online auction fraud, and as such, even with a comprehensive education campaign, fraud will continue to be a problem.

As the conduit in the transactions, IAS have a significant role to play. The provision of mediation services that are accessible and easy to understand are vital – just is the willingness of the IAS to assist when complaints are brought to its attention. The best mediation service is useless unless it is accompanied by a commitment from the IAS to willingly utilize it. IAS can further enhance their role by identifying trends from the complaints they receive, and liaising with government consumer protection agencies (who have access to further data) so as to most effectively formulate strategies to tackle the issue of Internet auction fraud.

To this end, government consumer protection agencies have an important role to play – for they must initiate campaigns to educate participants in the growing world of Internet auctions as to the potential pitfalls they may face. The continuation of the campaigns should be similar to those in the USA and Australia where they are most comprehensive in their scale and scope.

As previously mentioned, direct discussion with IAS is effective in ensuring that they meet their obligations to provide the safest shopping environment possible. Such self-regulation, in the form of the implementation of sufficient safeguards and resources for users of their system is a cost effective and efficient means of disseminating such messages – and it benefits not only the consumer, but also the IAS and government agencies, who would hopefully see a reduction in complaints they receive.

A further role for government agencies is the collation of data to enable trends to be monitored. However, this must be handled carefully, for even though many agencies encourage consumers to contact them to lodge a complaint, this may give an unnecessarily

high expectation as to the redress the agency will achieve.<sup>30</sup> It is important that agencies effectively manage the expectations of aggrieved consumers. A continuation of public information campaigns must be coupled with a carefully constructed message on the role and limitations of the government in such disputes.

Though the government is restricted in the actions it can take on behalf of consumers, government redress is an essential tool, particularly in cases of cross-border fraud, where the obstacles for an individual are great indeed.<sup>31</sup> This raises the prospect of government agencies targeting their limited resources more on the international sphere of Internet auction fraud, rather than in local instances, whereas private small claims court action and/or intervention by the local police are two options that are not available in cross-border disputes. It is here where consumer protection agencies can perform their greatest service.

However, in order to effectively handle cross-border fraud cases, there needs to be a greater level of international cooperation. In the national arena, different agencies should collaborate in order to effectively identify trends and respond to complaints. This is also true of the global marketplace, where nations need networks to coordinate the usual fragmented nature of international issues in a cohesive and focused manner. This is the certainly the most significant challenge facing all government consumer protection agencies – expanding their work from the local to the global.

As the Internet continues to grow, and as more people utilize it in their daily lives, it is important for all parties not only to keep pace, but to anticipate different methods that the unscrupulous can implement in this technological environment. Though this future task is made easier due to the completed work in this area, it still requires a continual commitment from all parties in order to limit the harm from Internet auction fraud, and to continue to protect all consumers throughout the world.

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<sup>30</sup> OECD (2006) p65.

<sup>31</sup> OECD (2006) p58.

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## 得標者的困境：網路拍賣與詐欺

Dallas, Shane\*

隨著網路拍賣的風行與成長，除帶來各種效益外，亦已導致詐欺等相關問題的產生，或有論者爰要求政府消費者保護部門應適時提供支援與協助解決問題。本文將分析為有效減少網路詐欺，政府部門所能採行的行政措施，並探討政府可扮演之角色，如加強教育或尋求國際間之通力合作等。

**關鍵詞：**網路拍賣、詐欺、爭端解決、國際合作

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\* Dallas, Shane 為澳洲競爭暨消費者委員會視察 (Investigator)。

