

**STOPPING ANOTHER PHANTOM MENACE:
USING THE COMMERCE CLAUSE TO FORCE STATES
TO POLICE ONLINE AUCTION SHILL BIDDING
OR FACE CONGRESSIONAL MANDATES***

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INTRODUCTION

Rampant fraud¹ (mostly by sellers) is being committed on eBay, the most successful online auction house and marketplace. Online auction fraud is growing like a festering cancer because much of the fraud goes undetected, unreported, or unprosecuted. Moreover, even when credible evidence of fraud becomes available to eBay or the law enforcement community, little (if any) action is taken to remedy the problem. Therefore, to establish the Internet as a truly viable and stable commercial community, minimum guidelines and regula-

* The information contained in this Comment is meant to be current through Spring 2003. Due to the quickly changing online marketplace and business models (especially online auctions), I suggest any subsequent research into this topic be thoroughly vetted.

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¹ Fraud is "[a] knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment." BLACK'S LAW DICTIONARY 670 (7th ed. 1999).

tions must be established to instill broad consumer confidence in highly successful businesses like eBay.²

The most efficient and effective enforcement regime may be state regulation for some Internet commerce; however, such state regulation, if not framed within the proper scope, may run afoul of the dormant Commerce Clause.³ Therefore, this paper will emphasize

² See Michael Cooper, *Beanie Baby Scams and Identity Thefts*, N.Y. TIMES, Sept. 22, 1999, at G19 ("The world's flea markets, souks and bazaars have always been magnets for the criminally minded, from mountebanks and snake-oil salesmen to plain old-fashioned pickpockets."). Thus, it is no surprise that Internet commerce "has drawn its share of crooks." *Id.*

³ See generally *Or. Waste Sys. v. Dep't of Envtl. Quality*, 511 U.S. 93, 99 (1994) (sustaining a Commerce Clause challenge to a surcharge applied only to out-of-state solid waste bound for Oregon); *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 88 (1987) (discussing the Court's history of invalidating statutes containing inconsistent regulations under the Commerce Clause); *Maine v. Taylor*, 477 U.S. 131 (1986) (upholding a Maine statute banning baitfish importation, because its local benefit outweighed Commerce Clause concerns); *Northeast Bancorp v. Bd. of Governors*, 472 U.S. 159, 174 (1985) (asserting that Congress may overrule the Commerce Clause by authorizing state statutes); *S.-Cent. Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82, 91 (1984) (striking down a statute requiring primary in-state manufacture of timber prior to exportation under the Commerce Clause); *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941, 960 (1982) (holding that reciprocity requirement imposed before water can be transferred out of state violated the Commerce Clause); *New Eng. Power Co. v. New Hampshire*, 455 U.S. 331, 341 (1982) (stating that the burdens New Hampshire placed on the interstate sale of hydroelectric power ran afoul of the Commerce Clause); *Kassel v. Consol. Freightways Corp.*, 450 U.S. 662, 678 (1981) (finding that an Iowa ban on 65-foot double trailer trucks impermissibly burdened interstate commerce); *Pike v. Bruce Church, Inc.* 397 U.S. 137, 142 (1970) (summarizing the general rule for weighing Commerce Clause challenges); *Bibb v. Navajo Freight Lines*, 359 U.S. 520, 530 (1959) (finding that Illinois mudguard laws were so extreme as to violate the Commerce Clause, despite safety interests); *Prudential Ins. v. Benjamin*, 328 U.S. 408 (1946) (stating that a Congressional law authorizing a tax on foreign insurance companies was not in violation of the Commerce Clause); *S. Pac. Co. v. Arizona*, 325 U.S. 761, 767 (1945) (declaring statutory penalties on out-of-state railroad companies to be unconstitutional under the Commerce Clause); *W. Union Tel. Co. v. Commercial Milling Co.*, 218 U.S. 406, 412 (1910) (holding that a telegraph statute merely reflected the duties of a public service corporation, thereby making it permissible under the Commerce Clause); *N.Y. State Dairy Foods, Inc. v. Northeast Dairy Compact Comm'n*, 198 F.3d 1 (1st Cir. 1999) (affirming summary judgement in favor of the commission because a statute barred only one kind of payment, failing to harm commerce); *ACLU v. Johnson* 194 F.3d 1149, 1161 (10th Cir. 1999) (discussing the relationship between the internet and interstate commerce as defined by the Commerce Clause); *Zeran v. Am. Online*, 129 F.3d 327 (4th Cir. 1997), *cert. denied*, 524 U.S. 937 (1998) (acknowledging the strong relationship between state statute and liability for those involved in Internet commerce); *Hendrickson v. eBay, Inc.*, 165 F. Supp. 2d 1082, 1089 (C.D. Cal. 2001) (exploring secondary liability of Internet providers for engaging in illegal commerce); *Blumenthal v. Drudge*, 992 F. Supp. 44 (D.D.C. 1998) (finding in favor of an Internet provider sued over a defamatory statement posted on Matt Drudge's personal website); *Am. Libraries Ass'n v. Pataki*, 969 F. Supp. 160 (S.D.N.Y. 1997) (asserting that the Internet was analogous to highways and railroads as an aspect of interstate commerce); *Gentry v. eBay, Inc.* 121 Cal. Rptr. 2d 703, 715 (Cal. Ct. App. 2002) (involving a sports memorabilia statute and the contention that an Internet merchant was in violation thereof for failing to comply with California requirements).

the need for regulatory oversight and law enforcement, either on the state or federal level (or both).

Cyber-fraud is a serious problem because it hinders online consumer confidence, and nowhere is the need for consumer confidence more important than within the online auction community.⁴ In that community, one major player, eBay,⁵ controlling 85% of the market,⁶ has arisen to serve as the standard for both the online auction community and Internet commerce (unlike Amazon, eBay *consistently* turns a profit).⁷ However, eBay is neither a model corporate citizen nor is it concerned with establishing consumer protections that may result in lower profits.

I. LAW ENFORCEMENT, RESOURCES, AND JURISDICTION

Internet auction fraud will remain a scourge until intrastate, interstate, and international agreements encourage law enforcement communities to aggressively crack down on all types of e-commerce fraud. Most legal entities consider the Internet to be "borderless,"⁸ therefore, determining jurisdiction over many auction fraud cases

⁴ Most Internet fraud involves online auctions and, overall, Internet fraud accounted for over \$4,300,000 in consumer losses from January-October 2001. National Consumers League Internet Fraud Watch, *2001 Internet Fraud Statistics*, at <http://www.fraud.org/internet/2001stats10mnt.htm> (last visited Apr. 12, 2003). This number is probably grossly understated because many consumers either do not know of or do not report fraud incidents. See Evan I. Schwartz, *At Online Auctions, Good, and Raw, Deals*, N.Y. TIMES, Mar. 5, 1998, at G9.

⁵ <http://www.ebay.com> (last visited Apr. 12, 2003). Additionally, for an explanation of the difference between auction types (English, Dutch, reverse, and sealed-bid), see Sally McGrane, *The Bidding Can Be More than Price*, N.Y. TIMES, Sept. 20, 2000, at H46.

⁶ Jon Swartz, *Fighting Back*, USA TODAY, Sept. 19, 2002, at 3B. See also Lisa Guernsey, *The Powers Behind the Auctions*, N.Y. TIMES, Aug. 20, 2000, § 3, at 1 (reporting that, at the time, eBay controlled 90% of the online auction market, based on gross sales). Additionally, because of eBay's market superiority/monopoly regarding online auctions, I use it as the example of what is wrong with the system. Smaller players such as Amazon and Yahoo must follow suit, adopting similar low-cost/low security measures to remain competitive.

⁷ In January 2003, eBay reported record revenues of \$413.9 million (with a resulting \$87.0 million net income) for its most recent quarter. Press Release, eBay Inc., eBay Inc. Announces Fourth Quarter and Year End 2002 Financial Results (Jan. 16, 2003), at <http://www.shareholder.com/ebay/news/20030116-99663.htm> (last visited Apr. 12, 2003). Additionally, during the last quarter of 2002, eBay hosted a record 195 million listings, confirmed registered users totaling 61.7 million and of those registered users, 27.7 million bid, bought, or listed goods on eBay over the trailing twelve months.

⁸ See *Global Naps, Inc. v. New Eng. Tel. & Tel. Co.*, 226 F. Supp. 2d 279, 283 n.7 (D. Mass. 2002); *Verizon Online Serv., Inc. v. Ralsky*, 203 F. Supp. 2d 601, 613 (E.D. Va. 2002). But see *Cybersell, Inc. v. Cybersell, Inc.*, 130 F.3d 414, 415 (9th Cir. 1997) (rejecting the argument that cyberspace is without borders).

can be “a nightmare,”⁹ especially for those cases of fraud involving relatively small amounts of money.¹⁰ Furthermore, local and federal law enforcement agencies are reluctant to spend thousands of budget dollars on investigating and prosecuting fraud valued at a few hundred, or even a few thousand dollars.¹¹ Many of the Internet auction fraud cases that are reported to various state and federal agencies “are not pursued vigorously because the investigative costs far outweigh the victims’ financial losses.”¹²

The fraud problem is exacerbated because eBay’s goal, according to their lawyers, is to have limited oversight.¹³ As a result of this purposefully limited oversight by eBay, governmental regulators, and law enforcement, fraud is rampant¹⁴ and either goes virtually unchecked or is under-policed on many levels, including: shill bidding,¹⁵ non-

⁹ See *Millennium Enter., Inc. v. Millennium Music, LP*, 33 F. Supp. 2d 907, 923 (D. Or. 1999).

¹⁰ Melissa Kossler, *Fraud a Problem as Online Commerce Grows*, COLUMBUS DISPATCH, May 20, 2002, at 4E.

¹¹ *Id.* Additionally, to illustrate the limited prosecution of online auction fraud, a Westlaw search of state and federal cases concerning Internet/online auction/eBay fraud merely turns up six adjudicated cases with some relevance to the combined search terms: *United States v. Gajdik*, 292 F.3d 555 (7th Cir. 2002); *United States v. Nickens*, Nos. 00-cr-00121 and 00-cr-00351, 38 Fed. Appx. 721, 2002 WL 993571 (3rd Cir. Apr. 12, 2002) (unpublished); *United States v. Blanchett*, No. 01-3285, 2002 WL 511745 (10th Cir. Apr. 5, 2002) (unpublished); *Hendrickson v. eBay, Inc.*, 165 F. Supp. 2d 1082 (C.D. Cal. 2001); *In re 2TheMart.com, Inc. Sec. Lit.*, 114 F. Supp. 2d 955 (C.D. Cal. 2000); *Lim v. The TV Corp. Int’l.*, 99 Cal. App. 4th 684 (Cal. Ct. App. 2002).

¹² Jennifer Lee, *Web’s Bloom Creates Garden for More Sophisticated Scammers*, CHI. TRIB., Mar. 11, 2002, § 4, at 8.

¹³ Glenn R. Simpson, *eBay Coin Auctions Produce Allegations of “Shill” Bidding*, WALL ST. J., June 12, 2000, at A3 (reporting that too much oversight into transactions may make eBay liable for ones that go bad).

¹⁴ See Saul Hansell & Judith H. Dobrzynski, *eBay Cancels Art Sale and Suspends Seller*, N.Y. TIMES, May 11, 2000, at A1 (reporting that based on eBay’s own estimates, approximately 200,000 eBay auctions, during 2000, involved fraud). See also Amitai Etzioni, *E-Communities Build New Ties, but Ties that Bind*, N.Y. TIMES, Feb. 10, 2000, at G7 (stating that eBay’s spokesman claims fewer than one percent of their auctions involve fraud, but this number probably only represents users complaining of non-payment or non-delivery of goods, rather than users who have overpaid as a result of shill-bidding).

¹⁵ A shill is “[a] person who poses as an innocent bystander at a confidence game but actually serves as a decoy for the perpetrators of the scheme.” BLACK’S LAW DICTIONARY 1382 (7th ed. 1999). For shill bidding, the shill bids and competes with other potential buyers (while the shill has no intention of buying), to ensure the selling price is higher than the owner might otherwise receive in a “fair” auction. Interestingly, most cities have rigid laws regulating auction conduct; however, rural towns may not, allowing for some country auctions to allow shill bidding. Edward R. Lipinski, *Using Auctions to Your Advantage*, N.Y. TIMES, May 4, 1997, § 13, at 17D.

delivery or non-payment¹⁶ for goods, and in the user-feedback system.¹⁷

A. *Shill Bidding and Other Online Auction Fraud*

eBay has been in business for approximately eight years, however during that time, eBay has established only minimal, reactive controls to seriously deter users who “shill bid” on their own goods.¹⁸ Shill bidding is accomplished by (a) a single user with many e-mail accounts who uses those accounts to register to bid under numerous identities, or (b) a consortium of users who agree on a plan to bid-up/feel-out the maximum price that legitimate and honest users are willing to pay.¹⁹ Criminally-minded users have little incentive not to shill bid, as the cost for winning your own auction is merely the commission rate on the money you never have to pay to yourself.²⁰ Furthermore, a very small percentage of these infractions are probably discovered or reported to law enforcement authorities, while eBay *may* merely suspend (for thirty days) first-time shill bidders and *might* impose an indefinite suspension for subsequent acts.²¹ Nothing prevents suspended users from re-registering with a new e-mail address and user name.²²

Other types of online fraud, such as the purported sale of fake or nonexistent goods, or goods that are never delivered, are probably more easily regulated by the free market than shill bidding. Poten-

¹⁶ See Lisa Guernsey, *A New Caveat for eBay Users: Seller Beware*, N.Y. TIMES, Aug. 3, 2000, at G1 (reporting that credit card fraud is a major problem for online auction sellers).

¹⁷ The user-feedback system allows buyers and sellers to rate their experience; thus, giving future buyers and sellers prospective information regarding trustworthiness. *But see* John Schwartz, *eBay Suspends Coin Seller Over Delivery Concerns*, N.Y. TIMES, Apr. 18, 2001, at C4 (reporting that a seller whose eBay account was suspended for non-delivery of gold and silver coins and bullion quickly returned to the online auction world by purchasing another user's feedback file, “including the screen name and thousands of glowing testimonials from satisfied buyers”).

¹⁸ Judith H. Dobrzynski, *In Online Auction World, Hoaxes Aren't Easy to See*, N.Y. TIMES, June 2, 2000, at A1 (reporting that eBay's rules do not prevent users from using more than one screen-name, nor do the site's policies prevent “friends from bidding on each other's offerings, pushing up the price, as long as the bidding is *sincere*”) (emphasis added).

¹⁹ eBay Policies, at <http://pages.ebay.com/help/policies/hub.html> ([click] “Rules for Sellers”) (last visited Apr. 21, 2003):

What is shill bidding? Shill bidding is the deliberate placing of bids to artificially raise the price of an item and is not allowed. To avoid the appearance of being involved in this activity, family members, friends, and individuals living together, working together or sharing a computer should not bid on each other's items.

²⁰ See Dobrzynski, *supra* note 18.

²¹ *Id.*

²² Even the more restricted policy for sellers can be circumvented by merely using new credit card and bank accounts.

tially fake or non-existent goods can be paid for by using a secure payment (e.g., PayPal²³) or escrow system tied to a confirmed and valid credit card.

Using Paypal, buyers pay the sellers when the auction ends through an account that protects their credit card information, and Paypal, unlike eBay, vigorously investigates payment fraud and irregularities.²⁴ With an escrow account, sellers would only ship goods after notification by the certified escrow service regarding the service's receipt of buyers' payment.

The difficulty with regulating and preventing shill bidding derives from the fact that no unique personal identification system exists (or is trusted, for privacy reasons, by consumers).²⁵ For example, a single user who signs up for America Online (AOL) is allowed to have seven unique screen names.²⁶ It can easily be seen how a group, or a single user who has signed up with more than one Internet Service Provider (e.g., AOL, Verizon, Comcast, etc.), could manipulate the prices of goods by using a combination of screen names.²⁷ Once the manipulation begins, traditional pricing models based on supply, demand, and scarcity break down.²⁸

Recent user authentication procedures (and their shortcomings) are discussed more fully below.

²³ <http://www.paypal.com> (last visited Apr. 12, 2003).

²⁴ See Brad Stone, *Busting the Web Bandits*, NEWSWEEK, July 16, 2001, at 55.

²⁵ eBay could make user verification mandatory, for a minimal cost per user, however verification may scare off a considerable percentage of users. See *Ebay to Offer Free Insurance and ID System*, N.Y. TIMES, Jan. 16, 1999, at C16 (reporting that Equifax, the largest national consumer-credit reporting service, started a user-verification program in March 1999 where users register their Social Security number, driver's license information and date of birth for a five dollar fee and once authenticated, eBay gives authenticated users a special on-screen icon).

²⁶ <http://free.aol.com/tryaolfree/cdt.adp?139331> (last visited Apr. 12, 2003) (offering "7 E-mail addresses").

²⁷ See Brian Krebs, *Trio Nabbed in E-Bay Bidding Fraud Scheme—Update*, NEWSBYTES NEWS NETWORK, Mar. 9, 2001, available at 2001 WL 2816342 (reporting that Ken Walton and his shill bidding ring obtained their identities by signing up for free e-mail addresses that required little or no verifiable contact information and then shill bid on over 500 auctions over a year and a half).

²⁸ See Amy Harmon & Leslie Kaufman, *Online Auctions: Let's Make a Deal Without the Haggle*, N.Y. TIMES, Apr. 13, 1999, at A1 ("Economists say the blossoming of online bidding is no surprise. Auctions are *theoretically* a very efficient form of commerce, the perfect nexus of the supply-and-demand curves.") (emphasis added).

B. Framing the Problem—Aggregate Harm to Consumers and the Market

Most fraud-related eBay transactions are relatively small in value (probably from tens of dollars up to a few thousand dollars).²⁹ Nonetheless, because of the epidemic level of these small scams, the aggregate yearly consumer loss from Internet scams, where eBay represents a majority, is estimated at \$500 million.³⁰ In any event, because eBay and the law enforcement communities insist on viewing the fraud problem as involving isolated individual instances—mostly small in value and geographically diverse—they can justifiably ignore the issue as hard-to-fix complaints of petty thievery. This view of the problem is severely short-sighted because it fails to see the aggregate cost and harm to consumers and the economy.

eBay employs some fraud-protection measures to identify and prevent criminal activities; however, most of these safeguards were only implemented as a reactionary response to prior complaints alleging that eBay is just as much a fraud facilitator as it is an online auction house. If eBay does not implement new user regulations that are binding on all current and prospective users, requiring identity verification akin to credit checks, fraud (and the resulting economic losses) will reach epidemic levels.

eBay's "let 'the market' determine our level of consumer protection" attitude is understandable from an economic standpoint, however, the law enforcement community's (both local and federal) *laissez-faire* response is disturbing. The growing epidemic of online auction and Internet-related fraud should be treated like the drug war, and the law enforcement community must be given the appropriate tools to attach the auction fraud scourge on both the state and federal levels. For this reason, to attack the growing online fraud problem without violating our views of properly functioning federalism, Congress must thoroughly investigate whether or not to police the problem solely from a national level, or devise a system consisting of aggressive intra- and inter-state online auction regulation and enforcement similar to the concept behind the current war on drugs.

The state and federal law enforcement communities do not knowingly allow thousands of street dealers to sell small amounts of marijuana, cocaine, ecstasy, or heroin because our society's mores insist

²⁹ The current median loss is estimated at approximately \$500. *Lee, supra* note 12, § 4, at 8. And, for the initially successful scofflaws, instances of fraud can quickly accelerate into thousands of dollars per item.

³⁰ Chris Farnsworth & Chris Knap, *Net Fraud is Tangled Web for Victims and Police*, ORANGE COUNTY REC., Mar. 26, 2002, at 1D (discussing the difficulties in catching online criminals).

on reductions of the aggregate criminal, economic, and social ills created by wide-spread drug use. Thus, in the drug war law enforcement targets the street dealers, the local buyers and, eventually, the organizational kingpins. Similarly, the federal government should help states and localities to crack down on online auction fraud at its different organizational levels (eBay's fraud policies, simple scammers, and the well-organized racketeers) or give the individual states the ability to take aggressive action. If either the local or national government takes swift and effective action now, it may be able to eradicate most of the online auction fraud while it is being facilitated under a single regime (eBay) that may be relatively easy to analyze and reform.³¹

eBay's lax self-regulation leads to higher prices paid by consumers and, subsequently, bloated earnings based on revenues³² inflated by the fraudulent activities of many eBay users.³³ In its defense, eBay's self-regulation proponents argue that if the site is required to comply with all the laws regulating brick-and-mortar companies, eBay may be badly hurt or destroyed.³⁴ But it's hard to accept such an argument from a company with a market capitalization of over

³¹ Similarly, if the record companies had not shut down Napster, they might have stemmed the tide of piracy by negotiating a reasonable payment structure for file sharing of copyrighted music. Nonetheless, because of the record industry's shortsightedness, they continue to lose revenue as Gnutella-based file sharing programs have spread illicit copying exponentially.

³² See Press Release, *supra* note 7. In January 2003, eBay reported record revenues of \$413.9 million (with a resulting \$87.0 million net income) for its most recent quarter. Additionally, during the last quarter of 2002, eBay hosted a record 195 million listings, confirmed registered users totaling 61.7 million, and of those registered users, 27.7 million bid, bought or listed goods on eBay over the trailing twelve months. Furthermore, eBay's revenue is determined by getting a set percentage of each completed sale, plus a listing fee (regardless of whether the item ultimately sells). See *id.*

³³ One of the most egregious and embarrassing cases for eBay involved a Sacramento lawyer, Kenneth A. Walton, whose shill bidding ring resulted in a purported (but ultimately fake) Richard Diebenkorn painting that was bid-up from \$0.25 to \$135,805. Speculation on the painting's authenticity was prompted by Walton bidding \$4,500 on his own offering during the auction's second day. Furthermore, Walton is known to have used at least five user-names while buying and selling on eBay. Dobrzynski, *supra* note 18, at A1. See also John Schwartz & Judith Dobrzynski, *3 Men Are Charged With Fraud In 1,100 Art Auctions on eBay*, N.Y. TIMES, Mar. 9, 2001, at A1 (reporting that Walton and his accomplices were charged with placing approximately 1,100 shill bids between October 1998 and May 2000, using screen-names such as "big-fat-mamba-jambas").

³⁴ See Michael Liedtke, *Fray over eBay*, DESERET NEWS, June 28, 2000, at C1.

\$24,100,000,000³⁵ and holding an 85% market share in an industry representing possibly 87% of all online crime.³⁶

While hard figures are not available for the percentage of buyers and sellers defrauded (due to undetected shills or non-reporting victims),³⁷ evidence gathered by various groups indicates that many users question the validity and "value" being derived from this relatively new online market.³⁸ Despite increasing evidence of fraud and the possible penalties for shill-bidding schemes, including punishment under federal money laundering, mail, and wire fraud laws (with each infraction carrying a maximum penalty of five years in jail and \$1,000,000 in fines),³⁹ apparently auction fraud has not waned. Therefore, cracking down on Internet fraud may require novel and ingenious methods of attack, including coordination among various federal and state agencies.⁴⁰ In anticipation of the need to enforce trans-jurisdiction problems involving Internet fraud, in 1998 the Federal Trade Commission set up SafeBid, providing training and case referrals to local, state and federal agencies tracking Internet auction fraud.⁴¹ This action, by itself, lends some support for state regulation of Internet auctions; but more vigilant action is needed, including a hard look at whether current notions of the dormant Commerce Clause⁴² (precluding regulation of some Internet commerce) violates federalism's basic presumptions.

³⁵ Yahoo Finance Stock Quotes, at <http://finance.yahoo.com/q?s=EBAY&d=t> (last visited Apr. 12, 2003).

³⁶ Nick Wingfield, *EBay Auction Fraud Detected With New Software*, INTERNET WIRE, Feb. 12, 2001, available at 2001 WL 17534645 (reporting estimates by eMarketer Inc., a provider of Internet statistics).

³⁷ Schwartz, *supra* note 17 (reporting that in 2000, 10,800 of 25,000 total complaints to the Federal Trade Commission regarding Internet fraud concerned auctions). However, eBay claims it receives approximately 27 fraud complaints per one million auctions. *Internet Auctioneer Facing Fraud Inquiry*, N.Y. TIMES, Jan. 26, 1999, at C26.

³⁸ Internet Fraud Complaint Center, *Internet Auction Fraud Report* (May 2001), at <http://www.ifccfbi.gov/strategy/AuctionFraudReport.pdf> (last visited Apr. 12, 2003).

³⁹ Judith H. Dobrzynski, *F.B.I. Opens Investigation of EBay Bids*, N.Y. TIMES, June 7, 2000, at C1.

⁴⁰ Steve Lohr, *Policing the Internet: Anyone but Government*, N.Y. TIMES, Feb. 20, 2000, § 4, at 3 (discussing the Internet's vulnerability to cyber-vandals).

⁴¹ Jim Carlton & Pui-Wing Tam, *Controversial eBay Sale Highlights Growing Problem of Fraud Online*, WALL ST. J. EUR., May 15, 2000, at 31 (discussing instances of online fraud, including the sale of a forged Diebenkorn painting).

⁴² See *Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 287 (1997) ("The negative or dormant implication of the Commerce Clause prohibits state taxation, or regulation, that discriminates against or unduly burdens interstate commerce and thereby imped[es] free private trade in the national marketplace.") (citations and internal quotations omitted).

II. CONSTITUTIONAL RECIPES FOR PROTECTING BIDDERS: THE DORMANT COMMERCE CLAUSE

To prevent shill bidding and other online auction fraud, Congress could either continue to regulate the online auction business under its Commerce Clause powers,⁴³ or Congress could grant the individual states the power to regulate and enforce certain aspects of the online auction process. With a cooperative intra-state regulatory scheme in place, Congress (through the Federal Trade Commission and Federal Bureau of Investigation) would maintain oversight over measures implemented to reduce fraud. Thus, Congress would only have to intervene and pass more restrictive online auction laws (preempting the states' initiatives) if certain states failed to adopt mandated minimum protections for consumers. Congressional consent for these new state laws may be necessary because without it, due to the interstate nature of the Internet and Internet commerce, the dormant Commerce Clause doctrine might invalidate any unilaterally imposed state regulation.⁴⁴

The dormant Commerce Clause is a judicially-created doctrine prohibiting states from maintaining laws that overly burden interstate commerce.⁴⁵ Despite the fact that Congress has not expressly regulated an area of interstate commerce, states may not impose laws that facially discriminate against such commerce under the dormant Commerce Clause rationale. Nor may states impose laws that excessively burden interstate commerce, despite not being deemed facially discriminatory or protectionist.⁴⁶ Furthermore, the dormant Com-

⁴³ U.S. CONST. art. 1, § 8, cl. 3. ("The Congress shall have Power To regulate Commerce with foreign Nations, and among the several States").

⁴⁴ See cases cited *supra* notes 3, 42 and accompanying text.

⁴⁵ See Jack L. Goldsmith & Alan O. Sykes, *The Internet and the Dormant Commerce Clause*, 110 YALE L.J. 785 (2001). Nonetheless, the Commerce Clause does not invalidate *all* state restrictions on commerce. *Kassel v. Consol. Freightways Corp.*, 450 U.S. 662, 669 (1981) (quoting *S. Pac. Co. v. Arizona*, 325 U.S. 761, 767 (1945) ("[I]n the absence of conflicting legislation by Congress, there is a residuum of power in the state to make laws governing matters of local concern which nevertheless in some measure affect interstate commerce or even, to some extent, regulate it.")).

⁴⁶ See, e.g., *Or. Waste Sys. v. Dep't of Env'tl. Quality*, 511 U.S. 93, 99 (1994); *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 88 (1987); *Maine v. Taylor*, 477 U.S. 131 (1986); *Kassel v. Consol. Freightways Corp.*, 450 U.S. 662 (1981); *Pike v. Bruce Church, Inc.* 397 U.S. 137, 142 (1970); *Bibb v. Navajo Freight Lines*, 359 U.S. 520, 530 (1959); *Prudential Ins. v. Benjamin*, 320 U.S. 408 (1946); *S. Pac. Co. v. Arizona*, 325 U.S. 761, 767 (1945); *N.Y. State Dairy Foods, Inc. v. Northeast Dairy Compact Comm'n*, 198 F.3d 1 (1st Cir. 1999); *ACLU v. Johnson*, 194 F.3d 1149, 1161 (10th Cir. 1999); *Am. Libraries Ass'n v. Pataki*, 969 F. Supp. 160 (S.D.N.Y. 1997).

merce Clause helps to prevent impediments to the free flow of national commerce.⁴⁷

To understand the complexity of the problem and numerous avenues for greater oversight (and better consumer protections), some aspects of the eBay business model must be explained. Therefore, the following section gives a more detailed overview of eBay's business and policies. A critique of why these policies are ineffective to prevent fraud will follow, including specific instances of fraud and how it could be prevented if eBay took proactive measures that do more than pay lip-service to the idea of aggressively combating fraud.

III. EBAY'S BUSINESS

A. *eBay Defined*

eBay bills itself as "The World's Online Marketplace," and emphasizes on its user agreement page that although eBay is "commonly referred to as an online auction" site, eBay is not a traditional auctioneer.⁴⁸ Nevertheless, on its initial page, eBay promotes auctions.⁴⁹ By definition, an auctioneer is a person "legally authorized to sell goods or lands of other persons at public auction for a commission or fee."⁵⁰ And an auction is the "sale of property to the highest bidder."⁵¹ Technically, eBay may not fit under the traditional auction definition, but word-usage changes as the nature of activities change, including the medium.⁵²

Thus, for all intents and purposes, eBay is running auctions. eBay set up the protocols and conduits allowing sellers to list their wares on its site, as well as the search engine and automated, graduated bidding system to be used by potential buyers.⁵³ All of the essential information and mechanisms for facilitating both the buying and sell-

⁴⁷ See Abigail B. Pancoast, *A Test Case For Re-Evaluation of the Dormant Commerce Clause: The Maine Rx Program*, 4 U. PA. J. CONST. L. 184, 191-92 (2001).

⁴⁸ User Agreement, eBay, Inc. (Apr. 19, 2002), at <http://pages.ebay.com/help/community/png-user.html> ("eBay is a Venue.") (last visited Apr. 12, 2003).

⁴⁹ <http://www.ebay.com> (last visited Apr. 12, 2003).

⁵⁰ BLACK'S LAW DICTIONARY, *supra* note 1, at 126.

⁵¹ *Id.* at 125.

⁵² When television came on the air, it was still *broadcasting*, despite the transmission of pictures rather than just voice. Prior to the development of television, broadcasting was merely the transmission of voice, through some type of amplified speaker apparatus.

⁵³ See Lisa Guernsey, *Night of the Living Bid: Four Tales From an Hour of Ebay*, N.Y. TIMES, Sept. 22, 1999, at G7. During the initial bidding process, users enter their maximum bid price. eBay's servers then act as a proxy bidder, entering new amounts for your bid as needed, up to the maximum price you are willing to pay.

ing of offered goods can only be accomplished through the eBay system. And, despite the fact that the seller and buyer have to finalize the sale outside eBay's purview, eBay is guaranteed its commission through an automated charge to the seller's credit card based on the auction-winning price.⁵⁴ Therefore, despite the lack of paddle-waiving, number-calling, and gavel-pounding, eBay is running modern, new-economy auctions.

eBay handles approximately 85% of all online auctions.⁵⁵ During the fourth-quarter of 2002, eBay handled \$4,600,000,000 (yes, that's billion) in sales.⁵⁶ Net profit for the quarter was \$87,000,000 on revenues of \$413,000,000.⁵⁷ In 2001, the company claimed that among its 422 million items listed, there were an estimated 42,000 *confirmed* fraud cases.⁵⁸ Additionally, eBay's spokesperson, Kevin Pursglove, is consistently quoted as saying that *confirmed* fraud occurs in less than one-tenth of one percent of all eBay transactions.⁵⁹ However, this statistic is misleading because it is merely based on eBay's internal measurement of insurance claims filed with the company.⁶⁰ Nevertheless, available statistics support the conclusion that, while there are approximately nine million items available for sale each day,⁶¹ approximately 900 fraudulent offers are posted each day.⁶²

Seventy-five percent of reported fraud claims involve allegations that the seller has failed to deliver a paid-for product.⁶³ However, this statistic may be misleading because a more prevalent and sinister type of fraud, usually unknown to its victims, may be occurring in the background and thus going unreported: phantom bidding and shill bidding.⁶⁴ Both phantom and shill bidding are criminal actions un-

⁵⁴ For a description of eBay's revenue-generating fees, see *infra* notes 84-91 and accompanying text.

⁵⁵ Swartz, *supra* note 6.

⁵⁶ Press Release, *supra* note 7.

⁵⁷ *Id.*

⁵⁸ Swartz, *supra* note 6.

⁵⁹ Jerry Adler, *The eBay Way of Life*, NEWSWEEK, June 17, 2002, at 50. See also Bob Sullivan, *Auction fraud on the rise, some say*, MSNBC, July, 29, 2002, at <http://www.msnbc.com/news/784132.asp> (last visited Apr. 12, 2003).

⁶⁰ Mike Brunker, *eBay's Tough Talk on Fraud Doesn't Withstand Scrutiny*, MSNBC, Oct. 9, 2002, available at <http://www.msnbc.com/news/809148.asp> (last visited Apr. 12, 2003) ("No Hint Law Enforcement Notified").

⁶¹ See Nancy Salem, *Do You eBay?*, ALBUQUERQUE TRIB., August 12, 2002, at 6.

⁶² William Porter, *The Wide World of eBay*, DENVER POST, July 25, 2002, at F1.

⁶³ *Id.*

⁶⁴ See Brunker, *supra* note 60 (describing that "phantom bidding" is when a seller manipulates his own auction by using additional screen names to bid on his own goods, thereby fraudulently raising the final price of the sold goods). "Shill bidding" has the same effect as phantom

der state and federal law, and constitute violations of civil law as well.⁶⁵

eBay's business model is designed to generate revenues from maintaining a popular marketplace where high volume is the goal—in terms of number of goods sold and (hopefully) high prices from competitive bidding. Thus, eBay's primary revenues are derived from a combination of listing fees and commissions earned that are based on an item's final selling price.

B. User Registration

Sellers must register (via credit or debit card) with eBay prior to initially listing items for sale.⁶⁶ This automation guarantees that eBay receives its listing fee as soon as an item is registered and, in a successful auction, eBay charges its commission when the specific auction's bidding window closes (assuming at least one person bids over any reserve price).

Buyers are not required to register with eBay as long as they provide a traceable e-mail address (i.e., not ones freely available like @hotmail.com or @yahoo.com).⁶⁷ If a bidder has a traceable e-mail address (eBay probably infers), they are probably less likely to fail to consummate a transaction resulting from a winning bid. And, if the bidder fails to pay, the bidder might be tracked down from the given e-mail address or associated Internet Service Provider. However, a bidder who uses an anonymous Hotmail-type account, and therefore must verify her identity with a credit card, is an easier to locate potential breaching party. Nevertheless, other than buyers who fail to pay, there is probably infrequent buyer-related fraud because prudent

bidding, however, instead of one user manipulating the system, a conspiracy between/among users manipulates the auction to maximize the final selling price. *See id.*

⁶⁵ *See Stormy Weathers, Inc. v. FDIC*, 834 F. Supp. 519, 523 (D.N.H. 1993) (indicating that the seller may not participate in the bidding process, directly or indirectly, unless the seller expressly announces that he is reserving such privilege; and the seller is not allowed to secretly bid for the purpose of enhancing the final selling price). *See also* U.C.C. § 2-328(4) (1992), available at <http://www.law.cornell.edu/ucc/2/2-328.html> (last visited Apr. 12, 2003) (including comments indicating that there is a common-law prohibition against undisclosed seller participation in auction bidding); <http://www.maineantiquedigest.com/articles/ethi0700.htm> (last visited Apr. 12, 2003) ("What the Law Says About Sellers Bidding at Auction").

⁶⁶ *See* Seller Guide, eBay, Inc., at <http://pages.ebay.com/sell/guide.html> ([click] "Set up an account") (last visited Apr. 12, 2003).

⁶⁷ eBay Education, eBay, Inc., at <http://pages.ebay.com/education/options/index.html#buy> ("How to Buy on eBay") (last visited, Apr. 12, 2003); Buyer Guide, eBay, Inc., at <http://pages.ebay.com/help/buyerguide/index.html> (last visited Apr. 12, 2003).

sellers wait to ship goods until payment is received and the funds are authenticated.

C. Seller Authentication (a fertile culture for epidemic fraud)

Despite its seller-authentication system, eBay claims that user authentication on the Internet is difficult and eBay "cannot and does not confirm each user's purported identity."⁶⁸ It is exactly this discrepancy, between the seller and buyer authentication methods, that facilitates all kinds of Internet fraud, including shill bidding.⁶⁹ However, if each buyer had to link their bank account and credit card information to his screen name, overall fraud would probably decrease because of the relative ease of finding and prosecuting offenders. Single-user shill bidding would also be relatively easy to detect because most users probably have few credit card/bank account combinations that can be used without duplication.⁷⁰ Nevertheless, shill-bidding rings (multiple users acting in concert) would still be relatively difficult to detect without some kind of software to analyze the combinations of various buyer-user names repeatedly bidding on a specific seller's goods.⁷¹

D. Verifying User-Provided Information

Technologically, eBay recently signed a security/fraud-prevention agreement with VeriSign, to run limited background information checks (scheduled to begin in mid- to late-2002) on all *new* eBay sell-

⁶⁸ User Agreement, *supra* note 48 ("Safe Trading").

⁶⁹ See "Frequently Asked Questions about Shill Bidding," at <http://pages.ebay.com/help/basics/f-shilling.html> ("Shill bidding is the deliberate placing of bids to artificially drive up the price of an item. This is also known as 'bid padding' and is not allowed.") (last visited Apr. 12, 2003). See also "Shill Bidding: What It Is and Why It's Not Permitted on eBay," at <http://pages.ebay.com/help/community/shillbidding.html> (last visited Apr. 12, 2003); "Member Violations: Questionable Bidding: Seller Bidding on their Own Auctions," at <http://pages.ebay.com/help/rulesandsafety/43010001.html> (last visited Apr. 12, 2003); "Member Violations: Questionable Bidding: Bidder Always Bids with Same Bidders," at <http://pages.ebay.com/help/rulesandsafety/43010003.html> (last visited Apr. 12, 2003); "Member Violations: Questionable Bidding: Bidder Always Bids on Same Seller," at <http://pages.ebay.com/help/rulesandsafety/43010002.html> (last visited Apr. 12, 2003).

⁷⁰ Furthermore, unlike users who fail to pay for or send goods following a completed auction, shill bidders, especially continually successful ones, have every incentive to give valid information for at least one of their online personas to build trust and reputation for future swindles.

⁷¹ eBay currently only sporadically employs proprietary software, like "Shill Hunter" (a service whose workings eBay's management, for security reasons, refuses to describe), to identify shills as they happen. See Schwartz & Dobrzynski, *supra* note 33.

ers.⁷² Under this agreement, VeriSign will mine databases of phone numbers, addresses and credit reports to verify that addresses and phone numbers provided by new sellers are legitimate.⁷³ With this information, eBay claims the system will filter out a significant amount of phony contact information, including those sellers who are trying to conduct eBay-related business from hotels, motels, prisons, etc.⁷⁴

Despite the ambitiousness of this new identity identification plan, it has two major flaws. First, VeriSign's system won't actually confirm that the sellers actually live at the addresses provided, but merely that the addresses aren't suspicious (known hotel, motel or prison addresses).⁷⁵ Second, the VeriSign registration will only affect newcomers, not eBay's current legion of users.⁷⁶

eBay has not yet chosen to institute a more rigorous and thorough real-time VeriSign-proposed program that can provide background checks that include verification tools based on monthly mortgage payments, credit card limits, and financial account balances.⁷⁷ eBay claims that privacy concerns for its users caused the company to hesitate to institute these additional checks.⁷⁸ However, the company anticipates using this second tier of verification for prospective high-price transactions.⁷⁹

⁷² David Colker, *eBay to Digitally Verify New Sellers*, L.A. TIMES, May 9, 2002, at C3; *VeriSign Signs Pact With eBay to Fight Fraud on Auction Site*, WALL ST. J., May 8, 2002, at A9.

⁷³ L.A. Lorek, *Internet Cops Fight Online Auction Fraud*, SAN ANTONIO EXPRESS-NEWS, July, 7, 2002, at 1K.

⁷⁴ *VeriSign Signs Pact with eBay to Fight Fraud on Auction Site*, *supra* note 72.

⁷⁵ *Id.*

⁷⁶ See Colker, *supra* note 72 ("Only new sellers will be affected.").

⁷⁷ *VeriSign Sign's Pact with eBay to Fight Fraud on Auction Site*, *supra* note 72.

⁷⁸ *Id.* See also *Trans Union Corp. v. FTC*, 245 F.3d 809, 812 (D.C. Cir. 2001) (discussing that the Fair Credit Reporting Act of 1970 ("FCRA"), 15 U.S.C. §§ 1681, 1681a-1681u, imposes "various obligations to protect the privacy and accuracy of credit information" held by consumer reporting agencies); *Baker v. Am. Express Travel Related Serv. Co.*, No. Civ. A. 02-26-JBC, 2002 WL 1205065, at *2 (W.D. Ky., May 28, 2002) (finding that the Fair Credit Reporting Act ("FCRA"), 15 U.S.C. §§ 1681 *et seq.*, "prohibits disclosure of an individual's credit report except under certain, enumerated 'permissible' circumstances"). And, these "permissible" circumstances, under §1681(b), include procedures that are "fair and equitable to the consumer, with regard to the confidentiality, accuracy, relevancy, and proper utilization of such information." Thus, if eBay decides to implement more stringent background checks, any information it (or its agent) gathers may become subject to the FCRA. Nonetheless, if eBay does not plan to disclose any of that information, except to a legitimate law enforcement probe, the argument that these more stringent checks will violate consumer privacy rights is not persuasive. Furthermore, if eBay requires the additional information as a condition to using its site, the user may choose to provide the information or use a different marketplace.

⁷⁹ Greg Wiles, *eBay, VeriSign Enter Agreement for Verifying Sellers*, BLOOMBERG NEWS, May 8, 2002.

Economics (i.e. the cost of the additional checks) is influencing eBay's decision, but the separate layers of protection adopted for relatively lower priced goods versus expensive ones creates second-class citizen status for most of eBay's buyers (who buy relatively low-priced goods). Thus, the majority of eBay's users may face the prospect of being swindled out of hundreds if not thousands of dollars because of minor privacy concerns.⁸⁰ This is a justifiable marginal additional cost for eBay to aggregate enough information to red-flag questionable user-practices that may deter criminal activity or help build civil or criminal cases against fraudulent parties.

At a minimum, the new less-stringent verification tools should be implemented against all new and existing users (buyers and sellers alike). Such an update would be extremely easy to implement—the next time a user decided to sign-in or transact on eBay, they would be prompted to read and agree-to a new user policy regarding fraud protection. This alert would be just as binding and effective as any new user agreement update that eBay requests that members assent to through non-passive click-wrap agreements.⁸¹

For buyers, a universal update in registration requirements will serve as an active tool against, and a deterrent to, deadbeat bidding (buyers not paying after winning an auction) and shills. If all buyers are prospectively required to provide credit card information, billing addresses, and phone numbers, this information could be easily verified and used to cross-reference against other registered users (to filter out potential shills), users who have previously violated eBay policies, or those who are known to have failed to consummate a completed transaction.

Not surprisingly, many of eBay's additional fraud protection tools are unreported, to prevent criminals from developing methods and

⁸⁰ I do not mean to discount even minor infringements of personal privacy, however, we must look at privacy on a sliding scale, balancing our own personal privacy with the needs of society and economic security.

⁸¹ See, e.g., *Specht v. Netscape Communications Corp.*, 306 F.3d 17 (2d Cir. 2002); Martin H. Samson, *Click-Wrap Agreement Held Enforceable*, available at <http://www.phillipsnizer.com/artnew27.htm>. (last visited Apr. 12, 2003). Samson defines click-wrap agreements as a situation where

[a] party posts terms on its website pursuant to which it offers to sell goods or services. To buy these goods, the purchaser is required to indicate his assent to be bound by the terms of the offer by his conduct, typically the act of clicking on a button stating "I agree." Once the purchaser indicates his assent to be bound, the contract is formed on the posted terms, and the sale is consummated. No paper record is created nor is the signature of the purchaser required.

schemes to bypass the security measures.⁸² eBay periodically notes that it uses a program called “Shill Hunter” to detect suspicious, coordinated buying and selling activities.⁸³

E. Fee Structure

Currently, to merely list an item on eBay, it costs a minimum of \$0.30-\$3.00, a graduated fee schedule depending on either the starting (no reserve) or reserve price.⁸⁴ There are additional fees charged for listing enhancements (i.e., utilizing **bold** type, including a thumbnail picture, or being a “featured item”).⁸⁵ Fees can also become substantial if an item is listed at one of eBay’s specialty stores or services, such as vehicles sold through eBay Motors or real estate transactions. Listing fees are non-refundable.⁸⁶

eBay earns commissions based on an item’s final sale price.⁸⁷ If the auction is successful, the seller is immediately charged a commission based on the “closing bid.”⁸⁸ The commission is calculated on a graduated scale depending on the closing bid.⁸⁹ Additionally, now that eBay owns PayPal, transactions completed by sellers accepting payment by credit card will be assessed an additional 2.2% or 2.9%

⁸² See Nick Wingfield, *Elusive Figures: An eBay Merchant Disappears, Failing to Deliver the Goods*, WALL ST. J., Feb. 22, 2002, at A1 (“eBay says it has an arsenal of fraud prevention weapons, many of which it won’t disclose.”).

⁸³ Jim Carlton & Ken Bensinger, *Phony Bids Put eBay on Defensive*, WALL ST. J., May 24, 2000, at B1.

⁸⁴ See “Fees Overview,” at <http://pages.ebay.com/help/sell/fees.html> ([click] “Insertion Fees”) (last visited Apr. 12, 2003).

⁸⁵ *Id.* ([click] “Final Value Fees”).

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Id.* The graduated fees are calculated by using the following chart from eBay’s web page:

Closing Value	Final Value Fee
\$0 - \$25	5.25% of the closing value
\$25 - \$1,000	5.25% of the initial \$25 (\$1.31), plus 2.75% of the remaining closing value balance (\$25.01 to \$1,000)
Over \$1,000	5.25% of the initial \$25 (\$1.31), plus 2.75% of the initial \$25 - \$1000 (\$26.81), plus 1.50% of the remaining closing value balance (\$1000.01 - closing value)

plus \$0.30 for the privilege/protection of using PayPal.⁹⁰ Other types of payment transfers utilizing PayPal are free.⁹¹

F. Feedback Forum

In addition to requiring sellers to register and provide financial information,⁹² eBay also encourages users to rely on its Feedback Forum to determine the credibility of respective buyers and sellers.⁹³ eBay's management touts the review of users' feedback as the best defense against fraud or other problems arising during a transaction.⁹⁴ Proven limitations of the soundness of eBay's Feedback Forum and its credibility are described below.

Thus, the combination of the lack of a reliable self-policing feedback system, dependence on Power Sellers,⁹⁵ and a flawed user-identity-authentication only makes eBay more attractive to the criminally-minded while posing an ever-expanding menu of types of fraud that need policing.

G. Current Initiatives to Combat Fraud

To combat fraud, eBay employs both traditional human investigators and technological tools. The in-house fraud investigation team consists of merely 20 fraud investigators.⁹⁶ This limited number of

⁹⁰ *Id.* ([click] "PayPal fees").

⁹¹ *Id.*

⁹² See discussion *supra* notes 66-83 and accompanying text.

⁹³ See "Feedback Forum," at <http://pages.ebay.com/services/forum/feedback.html> (describing how the Feedback Forum operates) (last visited Apr. 12, 2003).

⁹⁴ Nick Wingfield, *Are You Satisfied? eBay's Battle Against Fraud Rests Primarily on a Simple Concept: Customer Feedback*, WALL ST. J., Sept. 16, 2002, at R7.

⁹⁵ Power Sellers are defined by eBay as:

the pillars of our community . . . committed to upholding and embracing the "core community values" that are the very foundation of eBay. They are exemplary members who are held to the highest standards of professionalism, having achieved and maintained a 98% positive feedback rating and an excellent sales performance record.

<http://pages.ebay.com/services/buyandsell/powersellers.html> (last visited Apr. 12, 2003).

It must be noted that Power Sellers, because selling on eBay is probably their *primary* method of income, have a great incentive to take whatever actions are necessary to pad their bottom-line. Additionally, these types of sellers are also more likely to have multiple (if not scores of) email addresses available to them (or their workers/helpers, if applicable) to serve as shills/purported potential buyers. Thus, to make sure an item reaps a lucrative profit, an eBay business can use its staff to monitor the current price and, using its multiple email addresses, bump up the price toward the end of the auction. Profit building can also be accomplished through bid-sniping software that is programmed to manipulate an auction within the last minutes (or seconds).

⁹⁶ Wingfield, *supra* note 82.

human resources seems woefully inadequate, despite eBay's technological tools, for a business listing millions of auctions per day. These investigators are known to only contact law enforcement if there is significant evidence of wrongdoing.⁹⁷ However, as this paper will show, not even clear and convincing evidence of user-wrongdoing will probably lead to much more than a warning or short suspension of a user's privileges.⁹⁸

IV. REMEDIAL MEASURES

A. *Initial Remedial Measures Needed*

Effective new fraud protection measures will require the aggregation and analysis of sensitive personal identifying information from eBay's users. Thus, the government (federal, state or both) and eBay, working together, need to adopt an effective but reasonable (and adaptable) regime that balances individual privacy with collective security. Critics of government regulation will attack a regulatory regime as unnecessarily paternalistic and economically inefficient; however, our capitalistic democracy has indicated broad support for the government's role in protecting against harms of this type. Furthermore, the most efficient system would not be an autocratic government mandate, but a partnership with eBay in creating appropriate protocols.

From a social policy perspective, it is with strong public support that the government aggressively regulates economic crimes and inefficiencies, especially monopolistic business acts, tax scofflaws, and securities fraud. Our society does not condone criminal acts purely based on economic theories that a capitalist economy is most efficient when providers and consumers act based solely on economic incentives. Moreover, as the current capital markets scandal indicates, most market participants and consumers demand that their government root out crimes creating a fraud on the market.

⁹⁷ *Id.*

⁹⁸ See Michael Brunker, *Cautionary tales of two auctions*, MSNBC, Oct. 10, 2002, at <http://www.msnbc.com/news/818257.asp> (last visited Apr. 17, 2003) (discussing investigative findings that phantom bids by revenue-generating "power sellers" merely draw warnings, not suspensions, from eBay and that the auction site also failed to shut down an alleged stamp-forgery ring, run by a power seller, despite conclusive evidence of its existence); Brunker, *supra* note 60 (MSNBC findings that wrongdoing goes unpunished, despite conclusive evidence of fraud).

B. If Remedial Measures Fail

If eBay fails to get serious about policing online auction fraud, the federal government should take aggressive action to: (1) financially sanction the company for knowingly condoning fraud, *and* (2) force both the implementation and strict regulation of new, aggressive consumer protection measures. Since eBay seems to only care about its financial bottom-line,⁹⁹ the company may only be persuaded to provide effective, proactive consumer protections when its profits are reduced by the combination of government-imposed fines and forced regulation. Private causes of action (including class-action lawsuits) would probably be just as effective, but it would take years for them to work through the state and federal courts. Furthermore, eBay has found no legal, moral, or economic incentive to institute fraud-reduction policies and penalties that may push lucrative business partners (so-called "Power Sellers") away, merely because they swindle buyers once in a while.¹⁰⁰ Therefore, either eBay's stockholders, users, or the government needs to provide appropriate disincentives to eBay, emphasizing to the company that condoning rampant fraud is not part of an acceptable business model.

V. REGULATION?

A. Regulation Alternatives

There are three alternatives for addressing the shill bidding problem regarding online auctions: (1) Congress could directly regulate online auctions, invoking its Commerce Clause powers; (2) auction sites could be allowed to continue to self-regulate; or (3) Congress could give states the authority and jurisdiction to regulate end-user auction activity by having the states update and modify existing consumer protection laws. As discussed above, self-regulation has not worked because of online auctioneers' economic disincentive to do so until they see fraud as deterring large numbers of users from coming to their site.

The third proposal, allowing states to regulate in their traditional consumer protection role, may trigger the dormant Commerce Clause, requiring Congressional consent because Internet transac-

⁹⁹ Bruner, *supra* note 60.

¹⁰⁰ Bruner, *supra* note 98.

tions are predominantly interstate.¹⁰¹ Notwithstanding initial Congressional consent, Congress could provide guidelines to the states regarding appropriate minimal protections, remedies, and punishments for fraudulent users as well as for online auction sites whose protection measures (or lack thereof) facilitated the fraudulent activity.¹⁰²

B. *Self-Regulation is Not the Answer*

Self-regulation has failed miserably, despite claims of a very low percentage of fraud in relation to total number of auctions.¹⁰³ Self-regulation overlooks the fact that alleged fraud statistics are probably not accurate in light of all of the non-detected criminal activity and that the so-called low percentage of fraud constitutes thousands, if not tens (or hundreds) of thousands of fraudulent activities per year.¹⁰⁴ Much of this criminal activity, likely unknown to the defrauded user(s), could be easily prevented by creating systems that deter criminals while having a minimal annoyance-factor to law-abiding users. Regrettably, by characterizing fraud rates with a low percentage rather than an estimated aggregate number, auction sites instill honest users with a false sense of security while protecting their revenues. As long as the majority of shill bidding goes undetected and can be characterized as “insignificant” by online auction sites, those sites can boast impressive revenues based in part on bloated commissions paid by defrauded buyers. Online auctioneers have an incentive to let crime remain unchecked, thus, the most effective method to stop online auction fraud may be to attach liability not

¹⁰¹ *Prudential Ins. v. Benjamin*, 328 U.S. 408 (1946) (stating that Congress can allow states to regulate activities that would otherwise be subject to federal preemption because, unlike the Equal Protection Clause, the Commerce Clause is not an absolute federal power).

¹⁰² Unilateral state action, without Congressional guidance, would surely bring constitutional scrutiny and analysis under the three-part balancing test developed in *Kassel v. Consolidated Freightways Corp.*, 450 U.S. 662 (1981). The *Kassel* test weighs and balances the following factors: (i) the rationality of the state law; (ii) the balance between burdens on interstate commerce and the local benefits sought by the state legislature; and (iii) the notion that protectionist laws are unconstitutional regardless of reasons. *Id.*

¹⁰³ See Press Release, *supra* note 7 (regarding eBay's internal estimates of online auction fraud).

¹⁰⁴ Hansell & Dobrzynski, *supra* note 14 (reporting that based on eBay's own estimates, approximately 200,000 eBay auctions, during 2000, involved fraud). See also Etzioni, *supra* note 14 (indicating that eBay's spokesman claims fewer than one percent of their auctions involve fraud, but this number probably only represents users complaining of non-payment or non-delivery of goods, rather than users who have overpaid as a result of shill-bidding).

only to the perpetrators, but also the entity capable of significantly reducing crime, the online auctioneer.¹⁰⁵

VI. IS THE LAW ON EBAY'S SIDE?

To be fair, while it can be argued that eBay knows there is a considerable amount of shady activity being facilitated by their marketplace, a number of judicial opinions have supported theories that the company may not be liable for *some* types of fraudulent acts perpetrated by users. In *Gentry v. eBay, Inc.*,¹⁰⁶ the California Court of Appeals found that eBay was immune from liability for posting information by third parties that resulted in fraudulent sales of sports memorabilia because the sales were conducted by third parties.¹⁰⁷ Under 47 U.S.C. Section 230, as incorporated into the Communications Decency and Telecommunications Act, there is "federal immunity to any cause of action that would make interactive service providers liable for information originating with a third-party user of the service."¹⁰⁸ Thus, eBay has been "exempted from liability over an item's authenticity, value and origin."¹⁰⁹

Additionally, there is some case law, relying on questionable logic, holding that eBay may be considered a passive Internet Service Provider (ISP) under the Digital Millennium Copyright Act (DMCA),¹¹⁰ thereby making eBay immune to tort liability resulting from fraudulent user activity.¹¹¹ If this ruling were extended by analogy to eBay's argument that it is not participating in the auctions (under the traditional notions of an auctioneer), the harm to the auction marketplace and consumers will be compounded. Auction sites, because of the nature and focus of their business (including control over user participation and content), should not be afforded tort liability protections given to "true" ISPs like America Online (AOL), the Micro-

¹⁰⁵ James M. Snyder, Note, *Online Auction Fraud: Are the Auction Houses Doing All They Should or Could to Stop Online Fraud?*, 52 FED. COMM. L.J. 453, 465 (2000) (discussing that self-regulation of a fledgling technology industry has failed miserably before, including the 900-number industry and the resulting strict federal regulations).

¹⁰⁶ 121 Cal. Rptr. 2d 703, 715 (Cal. Ct. App. 2002).

¹⁰⁷ *Id.* See also *eBay Doesn't Sell Merchandise, Can't Be Liable For Fraudulent Sales*, E-BUSINESS L. BULL., August 2002, at 1.

¹⁰⁸ *Id.*

¹⁰⁹ Mary Anne Ostrom, *Some Deal on eBay Are a Little Too "Hot": Online Auctions Becoming a Conduit for Stolen Items*, MILWAUKEE J. SENTINEL, June 30, 2002, at 21A.

¹¹⁰ 17 U.S.C. § 512 (2003).

¹¹¹ *Hendrickson v. eBay*, 165 F. Supp. 2d 1082, 1089 (2001) (explaining that "passive" ISPs may have safe harbor protections for copyright infringements by "active" users).

soft Network (MSN), or AT&T.¹¹² Online auction houses probably fail to meet the policy standards for exempting ISPs despite current court rulings that fail to understand what constitutes a passive ISP.¹¹³

A. Resources and Remediation

Direct, uniform Congressional regulations might work to curb online auction fraud, but, the federal court system is already over-worked and different states may want to offer an array of consumer protections above and beyond whatever watered-down regulation emerges after debate and compromise within Congress. Instead of allowing such a Congressional bill to be the ceiling for national Internet consumer protections, allowing the states to regulate under minimal Congressional guidelines would merely establish the floor or foundation that could be built upon to strengthen consumer confidence.

B. The Dormant Commerce Clause

In the leading Internet case dealing with the dormant Commerce Clause, *American Libraries Association v. Pataki*, the district court may have misinterpreted dormant Commerce Clause precedents in deciding that Internet commerce may not be regulated by individual state laws.¹¹⁴ The *American Libraries* court found that the burden of state laws on interstate commerce greatly outweigh the regulatory benefit to the state.¹¹⁵ Additionally, the court argued that indiscriminate and uncoordinated state regulation would only frustrate Internet growth.¹¹⁶ Subsequently, the Tenth Circuit, in *American Civil Liberties Union v. Johnson*, invalidated a New Mexico law regulating Internet

¹¹² See *Zeran v. America Online*, 129 F.3d 327 (4th Cir. 1997), *cert. denied*, 524 U.S. 937 (1998); *Blumenthal v. Drudge*, 992 F. Supp. 44 (D.D.C. 1998) (exempting ISPs from liability based on users' published statements).

¹¹³ Mary M. Calkins, Notes & Comments, *My Reputation Always Had More Fun Than Me: The Failure of eBay's Feedback Model to Effectively Prevent Online Auction Fraud*, 7 RICH. J.L. & TECH. 33 (2001) (explaining that the DMCA limits liability for ISPs because they provide a significant societal benefit of inexpensive, user-friendly Internet access; however, online auction houses do not provide such an essential service).

¹¹⁴ *Am. Libraries Ass'n v. Pataki*, 969 F. Supp. 160 (S.D.N.Y. 1997).

¹¹⁵ *Id.* at 169 ("[T]he Internet is one of those areas of commerce that must be marked off as a national preserve to protect users from inconsistent legislation that, taken to its most extreme, could paralyze development of the Internet altogether.").

¹¹⁶ *Id.* at 183 (stating that regulation by individual states will force users to "comply with the regulation imposed by the state with the most stringent standard or forego Internet communication").

content that is potentially harmful to minors.¹¹⁷ The court found that the statute: (1) regulated conduct occurring entirely outside the state; (2) was not reasonable; (3) was an undue burden on interstate commerce; and (4) subjected Internet use to inconsistent state laws.¹¹⁸

Nevertheless, the *ACLU* and *American Libraries* rulings may contradict the Supreme Court dormant Commerce Clause precedent established in *Oregon Waste Systems v. Department of Environmental Quality*,¹¹⁹ a ruling built upon the balancing tests established in *Kassel v. Consolidated Freightways Corp.*¹²⁰ and *Pike v. Bruce Church, Inc.*¹²¹ Under the *Oregon Waste* test, the court should first determine whether a statute regulates evenhandedly (and only incidentally affecting interstate commerce) or discriminates against interstate commerce.¹²² Second, if the offending statute regulates evenhandedly, the court analyzes the law's effect on interstate commerce.¹²³ Finally, if the law's effect is an *excessive* burden on interstate commerce, it may be found to violate the dormant Commerce Clause, despite its evenhandedness.¹²⁴

The *Pike* court established a balancing test for situations where a state law is not facially discriminatory, but still results in a burden on interstate commerce. "Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."¹²⁵ Furthermore, state regulations may not "adversely affect interstate commerce by subjecting activities to inconsistent regulations."¹²⁶

¹¹⁷ *ACLU v. Johnson*, 194 F.3d 1149, 1161 (10th Cir. 1999).

¹¹⁸ See Ari Lanin, Note, *Who Controls the Internet? States' Rights and the Reawakening of the Dormant Commerce Clause*, 73 S. CAL. L. REV. 1423, 1440 (2000).

¹¹⁹ 511 U.S. 93, 99 (1994) ("[T]he first step in analyzing any law subject to judicial scrutiny under the negative dormant Commerce Clause is to determine whether it 'regulates evenhandedly with only incidental effects on interstate commerce, or discriminates against interstate commerce.'" (quoting *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979))).

¹²⁰ *Kassel v. Consol. Freightways Corp.*, 450 U.S. 662, 670 (1981) (discussing the need to weigh states' interests and the states' regulations' impact on the Commerce Clause).

¹²¹ 397 U.S. 137, 142 (1970) (stating that "the validity of state statutes affecting interstate commerce" depends on balancing local interests with effects on interstate commerce).

¹²² Discrimination, under the dormant Commerce Clause is "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Oregon Waste*, 511 U.S. at 99.

¹²³ *Id.*

¹²⁴ *Id.* See also Sabra-Anne Kelin, *State Regulation of Unsolicited Commercial E-Mail*, 16 BERKELEY TECH. L.J. 435, 452 (2001).

¹²⁵ *Pike*, 397 U.S. at 142. See also, Jack L. Goldsmith & Alan O. Sykes, *The Internet and the Dormant Commerce Clause*, 110 YALE L.J. 785, 788-89 (2001).

¹²⁶ *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 88 (1987).

These rulings, however, do not require state law uniformity—many interstate conglomerates are subject to the disparities in state laws, including various tort and contract doctrines.¹²⁷ Additionally, Supreme Court dicta suggests that a law might be upheld, despite other states' divergent laws, if the enacting state is able to prove that the regulation is a valid safety enhancement.¹²⁸

Ironically, in *American Libraries*, the court analogized the offending Internet regulations to those for a highway or railroad.¹²⁹ Even though the Supreme Court had previously found that the dormant Commerce Clause does not forestall all state action affecting interstate commerce, including highways used for interstate travel.¹³⁰ Moreover, state regulations enacted to protect citizens' health, safety, or welfare may be upheld unless the state's justifications for the regulation are illusory.¹³¹

Instead of applying the interstate highway or railroad analysis to Internet regulation, it may be more appropriate to analogize burgeoning Internet case law to state regulations of interstate telegraph transmissions from nearly a century ago.¹³² During the nineteenth century, the Supreme Court was inclined to find that telegraph transmission regulation was purely under the aegis of federal regulators.¹³³ However, by 1910, in *Western Union Telegraph Co. v. Commercial Milling Co.*, the Supreme Court upheld a Michigan law imposing obligations on a telegraph company to deliver interstate messages.¹³⁴ As a result of the *Western Union* ruling, states were allowed to impose non-uniform liability limitations, "thereby defeating the 'necessity of one uniform plan of regulation' upon which" earlier telegraph cases based their rulings.¹³⁵ Thus, "the state where a telegraph contract was made had sufficient interest to regulate that contract, even though it

¹²⁷ See Goldsmith & Sykes, *supra* note 125, at 790.

¹²⁸ *Bibb v. Navajo Freight Lines*, 359 U.S. 520, 530 (1959) (noting that an Illinois mudflap law might be valid if the state could prove its safety benefits over other states' mudflap laws). See also *S. Pac. Co. v. Arizona*, 325 U.S. 761, 767 (1945) ("[I]n the absence of conflicting legislation by Congress, there is a residuum of power in the state to make laws governing matters of local concern which nevertheless in some measure affect interstate commerce or even, to some extent, regulate it.").

¹²⁹ *Am. Libraries Ass'n v. Pataki*, 969 F. Supp. 160, 161 (S.D.N.Y. 1997).

¹³⁰ *S.C. Hwy. Dep't v. Barnwell*, 303 U.S. 177 (1938) (finding that use of a state highway is peculiarly of local concern; unlike railroads, highways may be owned and operated by the state).

¹³¹ 450 U.S. 662, 670 (1981) (stating that a mere "incantation of a purpose to promote health or safety does not insulate a state law from Commerce Clause attack").

¹³² See James E. Gaylord, Note, *State Regulatory Jurisdiction and the Internet: Letting the Dormant Commerce Clause Lie*, 52 *VAND. L. REV.* 1095, 1117-21 (1999) (discussing the telegraph cases).

¹³³ *Id.*

¹³⁴ *W. Union Tel. Co. v. Commercial Milling Co.*, 218 U.S. 406, 421 (1910).

¹³⁵ Gaylord, *supra* note 132, at 1121.

might affect conduct in other states.”¹³⁶ By analogy, in Internet auctions, the most likely locale to deem a contract to have been formed, is in the offeror’s state.

Another analogy that may provide appropriate grounds for state regulations to prevent shill bidding and other types of fraud may stem from the similarity between online auction sites and highly sophisticated mail-order catalogs.¹³⁷ Contracts formed under catalog sale agreements¹³⁸ are usually regulated under individual state laws; eBay transactions may be subject to similar laws.¹³⁹ Contractual doctrines regarding offer and acceptance of proposed terms remains a question of state law, regardless of the medium.¹⁴⁰ Similar questions resulting from the rise in telecommunication and transportation technologies have not changed the basic contractual doctrines.¹⁴¹

Furthermore, state regulation of online auctions need not depend on the nature of the Internet itself.¹⁴² Online auctions may create “new legal challenges without any reduction in local stakes.”¹⁴³ If buyers and sellers follow an auction site’s informational protocols, auction transactions involve tangible goods and “knowledge of a physical, geographical shipping destination.” Thus, state regulation might be drafted to only bar transactions emanating or concluding in the regulated state.¹⁴⁴ Moreover, state regulation may be justified because the local interests “are undiminished by the medium shift” from physical, tangible auction houses to images and character strokes representing goods for sale from a bedroom, office, warehouse, etc.¹⁴⁵ Additionally, state legislators exercising their police powers (health, safety, and welfare) have a compelling interest to prevent in-state consumers, whether buyer or seller, from being defrauded. Therefore, absolute preemption for state laws regulating

¹³⁶ *Id.*

¹³⁷ See Lanin, *supra* note 118, at 1453-54 (discussing non-data type Internet transactions).

¹³⁸ See Michael Cooper, *Beanie Baby Scams and Identity Thefts*, N.Y. TIMES, Sept. 22, 1999, at G19 (finding that eBay’s representatives claim that the company “cannot force anyone to follow through on a bid, other than to tell them that their bid represents a legal contract”).

¹³⁹ See Lanin, *supra* note 118, at 1454.

¹⁴⁰ Steven R. Salbu, *Who Should Govern the Internet?: Monitoring and Supporting a New Frontier*, 11 HARV. J.L. & TECH. 429, 448-49 (1998) (discussing activities where state interests are unimpaired by “cybertransition”).

¹⁴¹ *Id.* at 450.

¹⁴² See Lanin, *supra* note 118, at 1454 (discussing Internet transactions that do not involve data shifts).

¹⁴³ Salbu, *supra* note 140, at 448 (discussing activities where state interests are unimpaired by “cybertransition”).

¹⁴⁴ See Lanin, *supra* note 118, at 1454.

¹⁴⁵ Salbu, *supra* note 140, at 448.

Internet commerce, including online auctions, may not be legally sound and, more importantly, may violate our basic notions of federalism.¹⁴⁶

One of the arguments against allowing states to regulate online auction transactions is that such laws may create costs of compliance that are “clearly out of proportion to the benefits of permitting decentralized regulation.”¹⁴⁷ Those disparate costs, however, are alleviated by eBay’s automated nature.¹⁴⁸ Establishing a minimal Congressional mandate from which most states will not deviate will provide some consistency among states.¹⁴⁹ Additionally, user-provided information regarding the state from which the users are transacting reduces the burden on eBay.¹⁵⁰

C. Legitimate State Objective

Even if Congress fails to consent to additional consumer protections against online auction fraud and shill bidding, states should be able to enact anti-shill bidding laws because such laws have a legitimate state objective that cannot be served as well by non-discriminatory means.¹⁵¹ State regulations requiring identity verification to prevent shill-bidding (thus preventing in-state buyers from overpaying for goods) promote an important local concern, while the impact on interstate commerce is minimal—even if the transaction is interstate—because the entire market benefits from reduced fraud.¹⁵² These protectionist mechanisms require relatively simple software programs that are already implemented when a seller first applies to

¹⁴⁶ *Id.* at 476.

¹⁴⁷ Goldsmith & Sykes, *supra* note 125, at 808.

¹⁴⁸ eBay could provide a pop-up screen or hyperlink indicating user rights and obligations regarding selling or buying within a particular jurisdiction.

¹⁴⁹ Due to the nature of the political and law-making processes, it is likely that many states will use the Congressional mandate as both their floor and ceiling for consumer protections. However, some states with aggressive consumer protection laws (e.g., New Jersey and California) may wish to supplement the federal law.

¹⁵⁰ Users are required to provide information regarding their location (i.e., city, town, etc.) and state. However, this system will only work if eBay reprograms its registration page to confirm that users hail from the jurisdiction they list. Currently, buyers only authenticate their identity through an e-mail account that has no jurisdiction-specific information tied to it.

¹⁵¹ *See* *Maine v. Taylor*, 477 U.S. 131 (1986) (finding that facial discrimination may not be per se invalid if legitimate local purpose is not served as well by non-discriminatory means).

¹⁵² Using secure, encrypted authentication programs, eBay can easily verify each seller or buyer’s locale. Therefore, if a problem arises concerning a purported sale, upon verification that a problem exists, eBay can (and should be required to) forward the appropriate information to local authorities to investigate, rather than relying on an already overburdened FBI or postal inspectors.

transact through eBay's online auction house. Furthermore, identity verification requirements are not protectionist (giving rise to per se invalidity)¹⁵³ because identity verification neither gives disparate preference to one online auction house over another or one state over another, nor does it diminish competition.

The Commerce Clause is designed to promote competition and consumer protection; if states enact laws to prevent shill bidding, all online auction houses will be compelled to change their business practices to meet other states' new consumer protection standards. Increased competition will result as consumers are drawn to the online auction sites whose policies decrease the possibility of fraudulent activity. Most importantly, as shill-bidding decreases, consumers will pay lower prices for their goods as true competition reenters the online auction market.

D. Congressional Consent

Any state legislation attempting to regulate online auctions will likely be attacked, regardless of the states' legitimate regulatory interests, as violating the dormant Commerce Clause. Nevertheless, it may be in Congress' best interests, logistically and economically, to explicitly consent to some prescribed state regulation.¹⁵⁴ Such explicit consent to states' regulating how online auctions are conducted between buyers and/or sellers within their states would be immune from attack under the Commerce Clause.¹⁵⁵

Congressional consent to state regulations must be either "expressly stated"¹⁵⁶ or "unmistakably clear."¹⁵⁷ Furthermore, the law or legislative history that a state bases its consent claim upon must show "congressional intent 'to alter the limits of state power otherwise imposed by the Commerce Clause.'"¹⁵⁸

¹⁵³ See *Kassel v. Consol. Freightways Cor.*, 450 U.S. 662 (1981) (holding that protectionist laws are unconstitutional regardless of reasons).

¹⁵⁴ For an explanation of Congressional consent to state regulation, see *New York State Dairy Foods, Inc. v. Northeast Dairy Compact Commission*, 198 F.3d 1 (1999) (holding that commission's pricing regime, with its attendant pooling mechanism and administrative assessments, does not violate the Dormant Commerce Clause since Congress validly consented).

¹⁵⁵ *Northeast Bancorp v. Bd. of Governors*, 472 U.S. 159, 174 (1985) ("When Congress so chooses, state actions which it plainly authorizes are invulnerable to constitutional attack under the Commerce Clause.").

¹⁵⁶ *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941, 960 (1982).

¹⁵⁷ *S.-Cent. Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82, 91 (1984).

¹⁵⁸ *New England Power Co. v. New Hampshire*, 455 U.S. 331, 341 (1982) (quoting *United States v. Pub. Utils. Comm'n of Cal.*, 345 U.S. 295, 304 (1953)).

Congressional consent would be the most efficient avenue for all parties involved. Such consent, allowing a sliding scale for online auctions, would not only decrease an ever-growing burden on the federal court system, but also increase the overall resources available to protect the increasingly popular online auction business by transferring the burden to the states. Thus, an explicit statement from Congress indicating that each state may regulate how online auction buyers and sellers may operate as long as the state's regulations meet certain minimum provisions (i.e., the floor). States will have every incentive to protect consumers, from a political and paternalistic standpoint, and, because states want taxes from commerce, they will balance regulations above the floor to have their revenue goals meet their citizens' welfare goals.

VII. FRAUD, FRAUD EVERYWHERE . . . MAKES ONE STOP AND THINK

The following section of this paper details recent, real-world shill bidding scandals and eBay's utter disregard for heightened consumer protections.

A. *How to Commit Fraud and Get Away With It (the eBay Guide)*

During the Fall of 2002, a consortium of reporters from the *Wall Street Journal*, *Newsweek*, and MSNBC completed extensive research investigations into the eBay phenomenon and its pitfalls. Highlighting the prevalence of fraudulent activity, an MSNBC article from Summer 2002 found that:

Clever scammers now regularly ship reams of paper, or even rocks, to buyers. That buys the scam artist a few more days before arousing suspicion, and often a FedEx tracking number is enough to convince a buyer to send the money. Scam artists have also gone to the trouble of creating fake escrow Web sites and fake shipping sites to assuage skeptical buyers. And they also hijack accounts that belong to long-time, credible sellers, and then run their scams on the good name and reputation of that eBay seller.¹⁵⁹

B. *Slow or No Reaction to User Complaints*

Another recent independent investigation by MSNBC uncovered conclusive evidence of egregious shill bidding involving eBay transactions that failed to result in any meaningful penalty to the guilty us-

¹⁵⁹ Sullivan, *supra* note 59.

ers, thereby discrediting eBay's claims that it aggressively fights fraud.¹⁶⁰ Apparently, eBay merely warned the sellers not to do it again.¹⁶¹ Ironically, during Summer 2002, *Newsweek* also produced a series of articles highlighting the benefits and pitfalls of transacting business on eBay.¹⁶² According to one article, "eBay managers are still fanatically attentive to the complaints and desires of their members."¹⁶³ However, many interviewed members of the eBay trading community (including those interviewed for the MSNBC investigation) claim that the company reacts too slowly to address various complaints, including fraud allegations.¹⁶⁴ For example, in January 2002, eBay learned of a security flaw that made every user's account vulnerable to hijacking by Internet bandits who could easily change a user's password as long as the login information was known.¹⁶⁵ Despite the fact that this security flaw was discovered in January (and reported in the mainstream news during April 2002), eBay did not plan to fix the problem until that summer, when eBay was to implement a major, planned security upgrade. In this instance, when major financial repercussions and credit-history damage could have befallen users whose accounts were hijacked (by using the accounts for fraudulent sales and purchases), the government should have forced eBay to either immediately implement a security patch or shut down the site until a reasonable remedy was available. Under no circumstances should an inept and negligent eBay have been allowed to remain silent about the problem, only to have users learn that their online identities were used to perpetrate fraud, with the liability for rebuilding their reputations befallen on the innocent users.

¹⁶⁰ See Brunker, *supra* note 60 ("[E]ven when presented with solid evidence of wrongdoing . . . [eBay] has adopted an especially laissez-faire attitude toward sins by profit-driving 'power sellers.'").

¹⁶¹ *Id.* (discussing that, in light of significant evidence of shill bidding, eBay claimed that it had "taken appropriate action in accordance with [its] site policies;" however, "the 'appropriate action' turned out to be a warning to the seller").

¹⁶² See Jerry Adler, *The eBay Way of Life*, NEWSWEEK, June 17, 2002, at 50; Steven Levy, *How to Play the eBay Game: Snipers, bargains, rip-offs and other tricks of the trade*, NEWSWEEK, June 17, 2002, at 58; Brad Stone, *Meg Gets on the Line; For the CEO, satisfying eBay's tough customers is a full-time job*, NEWSWEEK, June 17, 2002, at 56; Mark Whitaker, *Exploring the irresistible allure of online auctions on eBay*, NEWSWEEK, June 17, 2002, at 6.

¹⁶³ Adler, *supra* note 162, at 53.

¹⁶⁴ Brunker, *supra* note 60.

¹⁶⁵ Brian McWilliams, *Security Flaw Opens eBay Accounts to Hijack*, NEWSBYTES NEWS NETWORK, Apr. 2, 2002, available at 2002 WL 3449930.

1. *Admitted Shill Bidder Still an Active eBay Seller*

At the time of writing this article, more than six weeks after MSNBC published the results of its investigation about a confirmed *and admitted* case of shill bidding (costing the ultimate buyer an additional \$531),¹⁶⁶ both the seller “brsz-2” and shill “nsports” were still listed as legitimate users.¹⁶⁷ EBay user “brsz-2,” a.k.a. Richard Kohl, owner of Broadway Rick’s Strike Zone, *admitted* to the MSNBC reporter that he bid on his own auction using an account set up “for a friend.” Following this acknowledgement, eBay should have: (1) permanently suspended his account; (2) reported Kohl to local and federal law enforcement; and (3) contacted the buyer (and other recent buyers) to inform him of the documented fraud so he could request a refund.¹⁶⁸ Additionally, despite being notified that the seller “brsz-2” and penultimate bidder “nsports” listed identical contact information in their respective user profiles, eBay’s complaint forums, Safe Harbor and the Power Seller Trust and Safety team, responded that there was “not enough evidence to show that a violation [of eBay’s anti-shill bidding policy] had taken place.”¹⁶⁹

More disturbing than eBay’s failure to punish “brsz-2,” is that he is now capable of hiding behind a “private auction” system where eBay allows sellers to list items and “hide the identity of bidders and make it impossible for anyone other than eBay to determine if fraudulent bidding is occurring.”¹⁷⁰ This policy is both highly suspicious and disturbing unless the seller can provide a convincing argument that the sale of certain goods would cause considerable embarrassment or harm to the seller. Therefore, because eBay has no incentive to take any of these reasonable measures, the federal government must act to

¹⁶⁶ Bruner, *supra* note 60.

¹⁶⁷ See “Feedback Summary,” at <http://cgi2.ebay.com/aw-cgi/eBayISAPI.dll?MfcISAPICommand=ViewFeedback&userid=brsz-2> (listing brsz-2’s feedback profile) (last visited Apr. 12, 2003); “Feedback Summary,” at <http://cgi2.ebay.com/aw-cgi/eBayISAPI.dll?MfcISAPICommand=ViewFeedback&userid=nsports> (last visited Apr. 12, 2003) (listing nsports’s feedback profile).

¹⁶⁸ See U.C.C. § 2-328(4) (1992), *supra* note 65 (indicating that if shill bidding occurs, the buyer has the right to avoid the sale or take the goods at the price of the last good-faith bid prior to the completion of the sale); see also Bruner, *supra* note 60 (documenting the process for confirming the fraudulent transaction and describing brsz-2’s reasoning for shill bidding).

¹⁶⁹ Bruner, *supra* note 98.

¹⁷⁰ See *id.* (“I Will Never do it Again”); see also “The Bidder has Refused to Complete the Sale,” at <http://webhelp.ebay.com/cgi-bin/eHNC/showdoc-ebay.tcl?docid=276&queryid=13845861&querystring=private> (last visited Apr. 12, 2003) (describing a private auction, where the bidding participants’ login information remains hidden).

protect consumers from eBay's wanton indifference, either by providing strong federal enforcement or empowering the states to do so.

2. *Stamp Forgery Ring*

In contrast with the Broadway Rick's swindle, MSNBC also found powerful evidence of a collectible stamp altering/forgery scam coupled with a shill bidding conspiracy.¹⁷¹ However, the stamp-scam sellers, "schulyerac" and "chickfrdstk," are no longer listing any goods for sale. Oddly, neither of these accounts seems to be suspended despite eBay being presented with conclusive evidence of before and after examples of altered stamps that demonstrate "with 100 percent certainty" that the stamps presented were altered.¹⁷² The MSNBC article also claims (without providing evidence) that the accounts of "schulyerac" and "chickfrdstk" were suspended in 1999 in response to allegations of shill bidding.¹⁷³ Despite this previous punishment, eBay's spokesperson, Kevin Pursglove, refused to confirm the previous suspension, nor would he comment on the recent allegations regarding stamps being bought, doctored, resold and used to support a shill bidding conspiracy.¹⁷⁴

3. *Feedback Forum Failures*

eBay's refusal to provide information about previously administered sanctions for violations of its user policy, where a user has been justifiably suspended or punished, contradicts the company's rationale for having a Feedback Forum as the primary means for judging the trustworthiness of a transacting party. Instead of eBay's current silence on sanctions inquiries, a more appropriate policy would somehow notify the eBay community about sellers who have been punished for violating eBay's fraud policies. This is exactly the idea behind the Feedback Forum—to warn the eBay community if there are users with whom one should be wary of doing business. An electronic "scarlet letter" might be most appropriate next to the user's screen name (and any subsequent modification to that name). Because the Internet supports efficient, but faceless transactions, shouldn't consumers be entitled to protection by a system akin to an

¹⁷¹ *Id.* ("Teamwork Unmasks Alleged Forgeries").

¹⁷² *Id.*

¹⁷³ *Id.* ("Accounts Reportedly Suspended").

¹⁷⁴ *Id.*

Internet Freedom of Information Act, identifying users for previous fraudulent activities?

4. *Authenticating New Accounts and Manipulating Service Lulls*

Other types of scams involving new sellers to eBay, initially selling large quantities of high-priced goods and requesting payment through wire transfer, should be easy for eBay to discover and regulate.¹⁷⁵ If eBay would merely standardize the method of payment option for any type of electronic transfer of funds (credit, debit, or wire transfers) and confirm that the account would be reachable by United States legal authorities if involved in criminal activity, some problematic auctions would never even get off the ground.

The timing of auctions presents an additional dilemma for honest users and the eBay Fraud Prevention staff. If a seller starts a two-day auction on Friday night, purposely anticipating that eBay has fewer customer service personnel on-site during the weekend, most complaints from users will not be read timely enough to prevent the alleged criminal activity.¹⁷⁶

5. *Monumental Financial Losses, Not Minor Scams*

Instead of considering auction fraud on a case-by-case basis, it may be time for law enforcement leaders to consider financial losses due to auction fraud in global terms, including the daunting costs to the economy and consumer confidence. By late 2001, the median loss from fraudulent online auctions was approximately \$500.¹⁷⁷ Furthermore, nearly 45% of all fraud complaints last year to the FBI stemmed from Internet auctions.¹⁷⁸ The statistics on fraud allegations and prosecutions are depressing and appalling—while the FBI's Internet task force received nearly 50,000 complaints last year, only 93 resulted in an arrest.¹⁷⁹

VIII. THE ECONOMICS OF POLICING INTERNET AUCTION FRAUD

The argument defending limited enforcement is basically the same regardless of the law enforcement agency, “[l]ocal police see most Internet fraud as outside their jurisdiction [and] federal au-

¹⁷⁵ See Sullivan, *supra* note 59 (“High-Crime Categories”).

¹⁷⁶ *Id.* (“Justice In Their Own Hands”).

¹⁷⁷ *Id.*

¹⁷⁸ VeriSign Signs Pact with eBay to Fight Fraud on Auction Site, *supra* note 72.

¹⁷⁹ Farnsworth & Knap, *supra* note 30.

thorities see most of it as too small to pursue . . . [while] victims are losing \$500 million per year.”¹⁸⁰ One of the most persistent complaints is that “[g]overnment agencies and police are stuck with old-world budgets, geographical jurisdictions and antiquated laws.”¹⁸¹ Furthermore, it is difficult to determine who is perpetrating various scams when the nature and policies of many Internet companies, like eBay, hinder law enforcement efforts by not verifying information about their active users or taking other reasonable preventive measures against fraud.¹⁸² Thus, a person who wants to execute fraudulent transactions over the Internet is overwhelmingly likely to escape any type of legal penalty by committing a “complex crime below \$100,000” because it is too difficult for the local police and below the federal government’s interest threshold.¹⁸³

The economics of auction fraud support the previously-stated law enforcement community’s reasoning, when viewed from a purely economic standpoint, post-September 11, 2001. Additional law enforcement funding has been earmarked for increased human security, not to address consumer fraud. However, this argument also supports a scenario where the federal government requires the business entity, such as eBay, to bear the brunt of whatever increased costs are involved in making transacting business over the Internet safer. This is not a problem that merely needs more money spent on investigations following perpetrated crimes. Instead, resources need to be devoted to acting proactively to prevent and deter fraud by securely holding reasonable amounts of personal identifiable information, to be used in criminal and civil fraud cases. Such a new system would benefit law enforcement and the court system by providing easily accessible information resources to assist efficient prosecutions involving alleged online commercial fraud.

To address the above concerns and shortfalls, a new, powerful FBI-based Internet crime prevention and enforcement task force must be created; empowered, and sufficiently funded to adequately address these problems.

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² *Id.*

¹⁸³ *Id.*

IX. RECOMMENDATIONS

A. New FBI Taskforce for Internet Security

In addition to any new federal or state laws, to punish eBay for knowingly allowing controllable fraud to continue (especially by guilty Power Sellers and users with sizable complaint files), the federal government, through the Justice Department and a newly-empowered FBI Task Force for Internet Security ("TFIS"), must be prepared to investigate and litigate these allegations against eBay and its fraudulent users. Following a rigorous investigation of eBay's fraud prevention policies, the TFIS should recommend reasonable new anti-fraud safeguards, and announce significant financial sanctions (e.g., \$1,000,000 per month) if eBay cannot meet an initial- (e.g., six months) and long-term timetable for significant fraud-reduction. For the government to propose minimum standards (or, in the alternative, hefty fines) is not a novel idea, as other high-profile businesses maintain government-mandated regulatory programs (e.g., the banking, financial services, and insurance industries).

B. New Procedures

The new fraud reduction services should include consumer protections paralleling the following proposals: (1) the ability to file a fraud complaint with eBay within twenty four hours of discovering the problem; (2) the ability to speak with a live eBay investigator to discuss a fraud complaint within three days of filing said complaint; (3) required suspensions of any user account that has amassed (x)% of negative feedback within a set period of time; (4) automatic freezing of a user's corresponding PayPal account until fraud related issues are resolved (and, possibly, automatic notice to local law enforcement); and (5) requiring substantive information gathered by eBay's internal fraud investigation team to be provided to any complaining user who wishes to file a civil action.¹⁸⁴

Additionally, the Justice Department should require eBay to sign a consent decree that more (a number to be determined as reasonable) customer service personnel will be available daily (including weekends) to address consumer complaints. If eBay's customer service department cannot address the situation within forty eight hours,

¹⁸⁴ A Congressional amendment to the FCRA may be necessary to implement this plan. However, disclosure of sensitive information is a reasonable disclosure once a complaining user has filed a complaint in state or federal court.

an eBay-mandated auction injunction might be reasonable against the accused party.

Other users and potential economic transacting partners should also be warned of those who have knowingly committed fraud. Therefore, upon a finding by the TFIS that an individual or business committed online fraud, mandatory notice should attach to that user's Feedback Profile (an e-commerce Scarlet Letter) and all the credit reporting agencies should be notified. This is a reasonable response to address and deter all e-commerce fraud.

C. Reporting Requirements

Under a new regulatory regime, eBay should also be required to report quarterly (for the next five years) to the TFIS and the Federal Trade Commission ("FTC") that the new fraud-reducing methods are achieving significant reductions—not just for confirmed cases, but for all types of fraud. State and local governments would participate in this new regime by providing information into a centrally located database of reported online auction fraud. Additionally, monthly reports to the TFIS should be required, providing specific details of the allegations, user contact information, and any questionable feedback profile info. eBay could set up an automated database system to aggregate this information as it comes into the customer service department. The TFIS could then work with local law enforcement to share resources and responsibility. A monthly estimate of reported and suspected fraud, in aggregate dollar amounts, should also be required.

Following a TFIS recommendation, the Justice Department (or a corresponding state agency, if so empowered) should be required to file a lawsuit (or, with a promise of financial assistance, encourage local law enforcement to do so) against parties engaged in or facilitating fraud, including eBay itself. While these prosecutions may significantly increase the budget for Justice Department (or state) lawyers and court resources, public policy demands that such widespread fraud be vigorously attacked to protect the economy and consumer confidence. For a persuasive example of how the capital markets react to widespread corporate fraud, one must merely look to the events surrounding the Enron, Worldcom, Tyco, and Adelphia accounting scandals.

These new reporting requirements should not be overwhelming for the TFIS, the Justice Department, or local law enforcement.

Some kind of nominal use-tax could be assessed on eBay¹⁸⁵ transactions (they would figure out how to pass the cost along to consumers anyway) to pay for law enforcement review.¹⁸⁶ Under this new regime, law enforcement could randomly choose who to pressure or prosecute and then notify the local and national news to try to deter others.

If eBay fails to implement these types of measures, or the federal government does not mandate remedies with significant consequences, more users may resort to vigilanteism because no one else is willing to help them.¹⁸⁷ Angry defrauded users may start businesses designed like the A-Team, tracking down and putting pressure on fraudulent sellers.

D. Protecting Privacy

Included in any new governmentally-mandated information sharing system should be tools to protect an eBay user's privacy. This should not be a problem because the truly sensitive information, credit card information and history, would remain on a secure eBay server (or with a trusted outside provider like VeriSign), only available to law enforcement. Moreover, any eBay user can already request the given contact information (address and phone number) for another user it wants to contact, as long as the two parties have engaged in a transaction.¹⁸⁸ The ability for users to contact each other *at verified addresses* (or provide this information to law enforcement) certainly provides greater security than the current system where defrauding parties disappear without any consequences. Therefore, users would not have a very persuasive invasion-of-privacy complaint regarding the new requirements for allowing automatic updates from credit reporting agencies for confirmable residential addresses and phone numbers.

Additionally, the new information verification system could also be used to cross-reference users' backgrounds to make sure they are not participating on eBay as more than one entity. Furthermore, those users who have not been at a confirmed address for a set period

¹⁸⁵ This proposed tax could apply to eBay and other online marketplaces with similar business models.

¹⁸⁶ Unfortunately, someone has to bear the cost of new security measures, and, despite my earlier proposals, I doubt eBay's bean counters are willing to absorb it.

¹⁸⁷ Key the opening theme to "The A-Team" (reformulated as "The E-Team"): "If you have a problem, if [eBay won't] help, and if you can find them, maybe you can hire . . . the [E]-Team."

¹⁸⁸ "Find Members," at <http://cgi3.ebay.com/aw-cgi/eBayISAPI.dll?MemberSearchShow> (last visited Apr. 12, 2003) ("Contact Info").

of time, or have little credit history, might be required to provide some kind of additional information for greater security.

Finally, public policy demands that economics should only play a small part in deciding how vigorously to combat fraud. The only reason that a marketplace like "eBay Motors"¹⁸⁹ is doing so well is that consumers feel like they are provided with adequate security. All eBay users deserve the same relative protections.¹⁹⁰

I do not propose establishing a regulatory regime that would cripple eBay's finances, but it is also not equitable to allow a large set of eBay users to bear the financial cost of being defrauded when there are some relatively simple and inexpensive tools to combat and deter many of the fraudulent activities currently perpetrated. Similar to the current drug war (attacking drug proliferation on both the single-dealer level and its more complex organizational structure), a TFIS-type system and eBay's internal fraud reduction team need to start thinking like criminals so they can react with novel solutions to reduce online auction fraud, which in the aggregate costs U.S. consumers approximately \$500,000,000 per year.

CONCLUSION

As the prevalence and cost of Internet auction fraud rises, public policy demands that the government react to the economic and societal dangers resulting from eBay's failure to devote additional resources to identifying and punishing swindlers. Currently, eBay has every incentive to maintain the status quo of limited fraud prevention tools—every recent fiscal quarter has delivered rising profits and an increased user-base. Therefore, without external intervention by the government or lawsuits filed by consumer advocacy groups (or individuals), eBay will not be incentivized to further reduce fraud.

eBay has an amazing business model and control over the Internet auction market. Furthermore, despite the current dot.com-related economic downturn, eBay will continue to thrive as more merchants look to transact business through its portal. But, as Uncle Ben told Peter Parker in *Spiderman*, "with great power comes great responsibility."¹⁹¹

eBay controls virtually the entire online auction marketplace. However, eBay has abdicated its responsibility to consumers as a service provider, marketplace purveyor, and trade facilitator. Despite

¹⁸⁹ <http://pages.ebay.com/ebaymotors/> (last visited April 14, 2003).

¹⁹⁰ As long as they are not foolish enough to pay for goods with cash or check.

¹⁹¹ *SPIDERMAN* (Columbia Pictures 2002).

troves of legitimate complaints and conclusive evidence of fraud, eBay has failed to employ new human and technological tools to proactively cut down on fraud, timely address users' notification and complaints related to fraudulent activity, and notify users when questionable actions by others threaten the validity of a pending or consummated sale. Apparently, the economic costs of providing more blanket safety to the majority of eBay's users are driving eBay's laissez-faire policies.¹⁹²

Online auctions are an exciting and efficient way to sell and purchase goods, but as this article has detailed, more regulation is needed because the sites' self-regulation has failed miserably and led to a system where the only sure winners are stockholders and criminals, not consumers.

Buying and selling goods over the Internet is only revolutionary because of the ease and speed of the interactivity between buyers and many non-traditional merchants. In reality, eBay is merely providing software for users to run auctions directly from their computers. Thus, there should be no reason why state authorities should be precluded from protecting users from fraud. Since a valid contract is formed upon the closing of the auction by the seller and winning bidder, state contract law should predominate over the more nebulous concept of what constitutes a defrauded auction participant's remedies and whether Internet commerce is purely a state concern versus a federally-governed activity.

Applying the long-established balancing test for determining whether Internet auctions may be regulated by the states, state Internet auction regulation embraces the dormant Commerce Clause jurisprudence because it: (1) regulates evenhandedly with only incidental affects on interstate commerce; (2) while evenhandedly regulating interstate commerce probably does not place an excessive burden on interstate commerce because eBay can easily automate and notify users of their rights and obligations based on sign-up information; and

¹⁹² For an example of how one lucrative market—auto sales—provides economic incentives for eBay to provide consumers with greater confidence and security, see Jeanne Wright, *Your Wheels You Can't Kick Tires Online, but Hassles Can Be Avoided*, L.A. TIMES, June 19, 2002, at G1 (discussing security services (complementary and for a nominal fee) available to consumers purchasing motor vehicles through eBay Motors). See also eBay Motors, at <http://pages.ebay.com/ebaymotors/> (last visited April 14, 2003); eBay Motors Services at <http://pages.ebay.com/ebaymotors/services/overview.html> (last visited Apr. 12, 2003) (listing eBay's free and fee-based buyer assurance services). Every month, more than 7,000,000 users access eBay Motors, with the company expecting sales of \$2,500,000,000 for 2002. Free limited warranty (one month or 1000 miles) protects against powertrain problems. Free purchase insurance, with coverage up to \$20,000 (and \$500 deductible), protects against fraud or material misrepresentation. On-site motor vehicle inspection costs \$99.99.

(3) the states' interests in regulating against shill bidding clearly outweighs the burden on interstate commerce.¹⁹³

Finally, if Internet auction regulation fails to withstand a dormant Commerce Clause challenge, it would be in Congress' best interest to explicitly consent to state regulations because of the growing local problems arising from fraud and the limited resources of the federal government to prevent and prosecute such crimes.

¹⁹³ See *Or. Waste Sys. v. Dep't of Env'tl. Quality*, 511 U.S. 93, 99 (1994) (discussing the criteria for withstanding a dormant Commerce Clause attack).