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The rise of online penny auctions

The first online penny auction site appeared in 2005 and since then grew significantly in numbers although several of them have also closed in the interim period (e.g., *Rapid Bargain*, *Swoopo*, *Bid Boogie*). Penny auctions are also known as bidding fee auctions that bears close similarities to the ‘*dollar auctions*’ that according to Shubik¹ existed as early as in 1971. As the entry in *Wikipedia*² notes:

“A bidding fee auction, also called a penny auction, is a type of all-pay auction in which all participants must pay a non-refundable fee to place each small incremental bid. The auction ends after a period of time, typically ten to twenty seconds, without new bids; the last participant to have placed a bid wins the item and also pays the final bid price, which may be significantly lower than the retail price of the item. The auctioneer makes money in two ways: the fees for each bid and the payment for the winning bid, totalling typically significantly more than the value of the item. Such auctions are typically held over the Internet, rather than in person”

Online penny auctions have become a popular way for prospective bidders to buy a wide range of goods (typically electronic items) at heavily discounted (and therefore bargain) prices. There are dozens of penny auction operators (such as *MadBid*, *Funbid*, etc.). The chance to buy such bargain goods means that penny auctions are attractive to individuals that want to buy such goods but who may not necessarily be able to afford them at their usual retail price. Online penny auctions are often viewed as similar to other online auction sites (such as *eBay*). However, they differ in two main ways.

Firstly, while traditional market places typically allow bidders to place their bids for free with the site deriving their incomes from the commission paid by sellers, those who wish to participate in online penny auctions need to purchase in advance the bids/points bundle (*Madbid.co.uk* class them bids; *FunBid* calls them points) typically at the cost of 60-120 pence per bid depending on individual package (although some sites such as *WellBid* cost as little as a few pence). Those purchased bids/points are then used in the auction and each incremental bid increases the price of the goods by one penny only.

Secondly, traditional online auctions run for a limited period of time, duration of which is set at the commencement of the auction and is not dependent on the bids themselves whereas each bid in penny auctions also restarts the timer to enable others to increase their offers. The auction only concludes when the countdown finally reaches 'zero'. The person with the highest bid 'wins' the merchandise and in order to receive the goods the bidder is required only to pay the final amount plus any shipping cost that may also be due. Other bidders' options – who have not won despite already spending some money – depend on the auction's format. If the site offers a 'buy-now' feature, bidders may use the value of their lost bids towards the cost of purchasing the product at the displayed retail price.¹ The retail prices tend to be inflated at the start of the auction although the actual price in those auctions tends to drop with each bid made. Those who do not wish to purchase at such a price or those who participated in auctions with no 'buy-now' feature do not have any other avenue and the funds that were spent on purchasing the bids are lost.

Are penny auctions a form of gambling?

It has previously argued by Cobb³ that penny auctions are a novel form of "*entertainment shopping*", and by Griffiths⁴ that penny auctions are "*gambling in all but name*". It has also been asserted that there is no formal definition of gambling, but there are a number of common elements that occur in the majority of gambling instances that distinguish 'true' gambling from mere risk-taking⁵. These include: (i) the re-allocation of wealth (i.e., the exchange of money [or something of financial value] usually without the introduction of productive work on either side, (ii) winners gain at the sole expense of losers, (iii) the exchange is determined by a future event, which at the time of staking money (or something of financial value) the outcome is unknown, (iv) the result is determined (partly) by chance, and (v) losses incurred can be avoided by simply not taking part in the activity in the first place.

The UK legal delimitation of gambling is contained in s.3 of the Gambling Act 2005 that provides that gambling includes "gaming", "betting" or "participating in lottery". Gaming is defined by s.6 of the 2005 Act as "*playing a game of a chance for a prize*" while betting involves the process of placing or accepting a bet on anything other than financial services (s.10(1) Gambling Act 2005) that remains uncertain to at least one party of the transaction at the time of the bet (s.9(2)a and s.9(3)b Gambling Act 2005). Penny

auctions have been compared to a form of betting because the participants bet that their last bid will not be outbid by another players, to lotteries because although penny auctions do not depend on random events⁶ their outcomes are still determined largely by chance, as well as to slot machines because “*like a slot machine, the bidder deposits a small fee to play, aspiring to a big payoff (obtaining the item well below its value)*”⁷.

From both a structural and psychological perspective, almost all online penny auctions could be argued to be a form of ‘gambling’ as they share many commonalities in terms of structural characteristics (and arguably include the five elements listed above). In relation to the similarities between penny auctions and gambling, Griffiths⁴ noted the following:

- *In penny auctions, winning is essentially chance-determined:* There may be limitations on the number of text messages operators allow per month and some auction sites limits the number of wins that any given participant may accrue but theoretically a person can bid again and again (on either a single product or multiple products) with no certainty that they will ever win the product. In short, a person could make 10 bids for an item on their mobile phone at £1.50 a bid and end up with nothing. Whether a bidder wins the auction or not, it does not seem to depend on any discernable skill and is more like a chance-based gaming. If there is no demonstrable skill in participating and is essentially a chance activity, it is (in essence) a form of gambling.
- *Penny auction websites utilise the ‘availability bias’:* The availability bias occurs when a person evaluating the probability of a chance event makes the judgement in terms of the ease with which relevant instances come to mind⁸. For instance, lottery winners are highly publicised. This perpetuates the idea that wins are regular and commonplace. Penny auction websites prominently display the winners of each item and the final (usually very low price) at which the product was sold for. This is a way of emphasising winning and minimising the act of losing. Similarly, some penny auction websites have a *‘Meet the winners’* webpage highlighting people that have won very expensive items (like a car) for incredibly low amounts of money. These instances are very rare but by publicising them it makes them appear a more common occurrence.

- *Multiple staking for no reward is commonplace in penny auctions:* It is clear from looking at almost any of the item bidding histories that many people make multiple bids without ever winning the product. Here, peoples' multiple bids are similar to putting down multiple stakes when there is a high jackpot prize to be won (e.g., buying lots of lottery tickets during a 'rollover' week). In almost all penny auctions, all the bidders bar one on each auction fail to win the product (i.e., the 'prize').

- *Penny auction websites provide tips for winning:* As with many Internet gambling websites (especially online poker websites), some penny auction website operators feature webpage sections providing tips on winning for its clientele (e.g., "*What can I do to improve my chances of winning?*").

- *Penny auction websites have responsible gambling-like policies:* Instead of 'responsible gambling' policies, the more ethically and responsibly minded penny auction websites have 'responsible bidding' policies. For instance, *FastBidding.co.uk* has a helpful FAQ section and provides a link on their 'Responsible Bidding' page which gives the following advice:
 - Take regular breaks between buying activities.
 - Decide a monthly budget in advance as your own personal limit. Do not increase the maximum limit that you have decided for yourself later on.
 - Before you start participating in a product purchase, decide the number of bids you are willing to place or determine a price at which you will not raise the bid further.
 - Never participate under the influence of alcohol or medication, or if you are in a depressive mood.
 - Bid only when you are fully rested and concentrated.
 - Remember you are not guaranteed to win so study and learn first

The present authors argue that this list looks as though the penny auction operators has read the responsible gambling guidelines at an online gambling website and simply replaced the words 'gamble' and 'gambling' with the words 'bid' and 'buying'. This view is

shared by others, such as the US Federal Trade Commission⁹ who note in the consumer advice on their website that:

“Penny auctions might be a fun way to try to get big ticket items at reduced prices. But in many ways, a penny auction is more like a lottery than a traditional online auction. In a penny auction, you have to pay to bid. Before you know it, you could spend far more than you intended, with no guarantee that you'll get anything in return. Winning the auction doesn't mean you've won the auction item: It means you've won the right to buy the item at the final price. For example, your \$50 winning bid for a camera might seem like a bargain, but if you placed 200 bids that cost \$1 each, your cost will actually be \$250 – plus shipping and handling, and possibly a transaction fee. If you lose an auction, chances are you've lost your money. If you placed 199 bids on that camera, for example, you'd be out \$199. Some penny auction sites have a 'Buy-It-Now' feature that lets losing bidders buy the item at retail price and apply the amount they spent on bids as a discount. So, you might not lose your investment in the bids you purchased, but you wouldn't save any money off the retail price, either”.

Similarly, but from an economic perspective, Kakhbod¹⁰ asserts that that when engaging in a penny auction, the individual's purpose is the same as when they are gambling. Robinson and colleagues¹¹ claim penny auctions have addictive properties similar to gambling. However, in Great Britain, the Gambling Commission¹² do not view penny auctions as a form of gambling and therefore operators trading in the UK are not required to be in possession of a gambling licence as in their judgement. More specifically, their position on penny auctions is that:

“You can run a penny auction website without a licence from the Gambling Commission. We do not consider such sites amount to the provision of facilities for gambling under the Gambling Act 2005. However, as penny auction sites continue to evolve, we will continue to monitor the way in which they operate to ensure those providing facilities to gamble are properly licensed to do so” (Gambling Commission, 2013).

However, the reasoning behind the Gambling Commission's official statement has yet to be explained and has yet to be tested in any UK judicial proceedings. The present authors submit that penny auctions, in substance, contain all elements that are required in order to satisfy the UK statutory definition of gaming contained in s.6 of the

Gambling Act. They contain an element of chance that is more than *de minimis*, and participants are able to win a prize.

The element of randomness arises from the incomplete set of available information. Participants' knowledge is limited to the retail price of the product, the sale price of similar items on closed auctions, the shipping cost of the product, the cost of their individual bid, the value of the latest bid placed by other bidders, the remaining time on the countdown timer, and the approximate or maximum time which has elapsed from the commencement of the auction. Those that bid on penny auction sites can also assess how many bidders are taking part at any given time but as there are no restriction on bidders joining or leaving the auctions during their durations, this is not a meaningful information as nobody is able to ascertain the value to which others are prepared to bid and whether someone will or will not join in the last minute. This aspect causes any prior plans, prediction or strategies to be meaningless and, as has been pointed out by MacDonald¹³ it introduces even more uncertainty that exists in a traditional game of poker.

Such views tend not to be shared by those that work within the penny auction industry, and who claim that penny auctions are primarily skill-based. The reasoning given for penny auctions being skill-based is because penny auction operators claim there are individuals who win disproportionately more auctions than others because they have developed successful strategies that minimise the element of chance. Such strategies include bidding on less popular items, knowing the times of the day that have the least volume of online traffic in order to maximise the chances, and bidding aggressively as a way of discouraging other bidders participating^{3,14}.^{3,14} However, such strategies are not really genuine skills and that believing they are is more likely to propagate the illusion of control amongst participants rather than increase their chances of success. Even the operators themselves [citing from *QuiBid's* terms and conditions] acknowledge that: "*it is not possible to provide precise odds of winning as each auction is unique*".

However, some scholars such as Lazarus and Levi¹⁵ claim penny auctions are entirely skill-based. They distinguish between internal and external parameters and argue that penny auctions are purely skill-based because any chance element is endogenous of the activity itself and influenced only by the action of other individuals, unlike a game of

poker, where card selection influences the probability of winning. Accordingly they argue that the endogenous elements can be disregarded. Lazarus and Levi also contend that penny auction bidders can always win any auction, as the only thing that bidders have to do is to outbid others. However, this reasoning is flawed in two ways.

Firstly, it can be submitted that their second argument essentially also applies to poker, as a weak hand does not prevent a player with sufficient funds from forcing others into a flop by aggressively raising the bids. But that assumes that the players know the financial abilities of others or that their resources (both financial and in terms of time that can be dedicated to the game) are unlimited – both of which are frequently incorrect. Secondly, although the endogenous versus indigenous distinction was accepted in the United States, no such acceptance was replicated in Great Britain. Crucially, none of these arguments relate to the fact that in auctions with a ‘buy-now’ feature any uncertainty is removed because the bidder can always purchase the desired product at the recommended retail price. Technically this removes any chance element from the auction and it also removes penny auctions from the legal definition of a ‘game of chance’ although it may still satisfy the definition of betting. However, this technical argument gives preference to form over substance as it is highly unlikely that any bidder enters the auction with the intention of actually purchasing the product at the full price in case they are not successful, especially as the retail prices on those sites appear to be inflated and naturally, this justification cannot apply to auctions where no ‘buy-now’ feature is available”.

It is also interesting to note that in the UK, penny auctions might not be considered a form of gambling because penny auctions are not a ‘game’ and the Gambling Act only refers to ‘games of chance’. If the act of participating in penny auctions is not a game, then it does not fall under the UK Gambling Act 2005. However, the Act does not provide any statutory definition of the word “game” neither in s.6 of the Act nor in the interpretative section 353. In the absence of any legal definition, natural and ordinary must be inferred.

Reliance on Black’s Law Dictionary in this context is not helpful as ‘game’ is defined with reference to stakes and wagers or gambling. [Gaming is defined as ‘the act or practice of playing games for stakes or wagers; gambling; the playing at any game of hazard’]. The

British *Oxford Dictionary* is more generic and provides that ‘a game’ means either ‘a form of competitive activity or sport played according to the rules’ or ‘an activity that one engages in for amusement’ or ‘a complete episode of play, ending in a final result’. The first meaning has been specifically excluded by the Gaming Act, and the second alternative is potentially too wide to be useful (e.g., people watch television for entertainment but it is unlikely that anyone would call watching television a ‘game’). Even if this wide meaning is adopted, penny auctions’ participants are likely to bid in order to acquire a good deal on a desired product and any amusement is an additional, but merely incidental benefit. The processes undertaken by bidders also do not give the appearance of an activity that would typically be understood as a game, despite the term being commonly used in published papers when describing penny auctions, but are more akin to a bargain shopping on a bazaar or deal hunting online which may legally justify the Gambling Commission’s interpretation. However, the psychosocial and structural similarities between penny auctions and traditional forms of gambling are sufficiently comparable as to justify its inclusion. If, as it is purported, the Gambling Act truly aims to regulate gambling activities in order to protect vulnerable people from gambling-related harm it is important that all activities, and not only the traditional forms of gaming, that may lead to such harm are encompassed by the regulation. Therefore penny auctions should fall under the gambling regulatory regime and be offered only under a licence unless they modify their practices as to remove all gambling features.

Finally, it should also be noted that there are many non-financial rewards that individuals get while gambling¹⁶. Obviously money (or something of financial value) is a reward. However, gamblers may win in the short run but most will eventually lose in the long run. Another potential reward is activation (‘the thrill of gambling’), and that this could play a role in all gambling situations. It may also play a role in mood modification and regulation. There are also social rewards (e.g. raising of self-esteem, peer praise, social meaning of the activity, rites of passage, etc.). In addition, there are multiple stimuli that can be perceived to be rewarding in gambling settings. For regular gamblers, events such as the pre-race and race sequence at the racetrack, the spinning roulette wheel and the placing of bets can be reinforcing – because they produce excitement, arousal and tension. Therefore, there will be some people that bid on penny auction sites that simply like the activity (in, and of, itself). The money they might lose is the price of entry and winning is a bonus¹⁷.

How are some penny auctions changing?

The preceding section examined whether online penny auctions are a form of gambling. Despite the fact that penny auctions are unlikely (from a legal definition) to be viewed as a ‘game’, it has been argued in a number of papers that penny auctions are a form of gambling^{4,18-20}. However, a few pay-to-bid auction sites have begun to evolve and this section argues that some of them can no longer be classed as gambling by the definitions outlined above. For instance, *MadBid*’s playing philosophy that it educates its customers and now stands for is ‘Win or Buy, Never Lose’. This is because *MadBid* auctions now have a ‘Buy Now’ that provides a ‘No-Lose Guarantee’ (as do other penny auction sites such as *QuiBids* and *BidRivals.com*). More specifically:

- The ‘Buy Now’ feature allows bidders to purchase items they have been bidding on at any time during the auction (i.e. before the closure of an auction whereby the monetary value of already spent bids is offered as a direct discount – unreduced).
- The ‘Earned Discount’ complements the ‘Buy Now’ feature and ensures that the exact value of all unsuccessfully spent bids always gets returned to the bidder in a form of a “shopping voucher” which the bidder can put towards purchasing any product(s) of their own free choice.
- The ‘No-Lose Guarantee’ ensures that a customer loses no money or monies worth

Additionally, *MadBid* have developed from a traditional penny auction model to a model of ‘gamified eCommerce’. Gamification is increasingly being used by commercial companies as a way of enhancing brand loyalty and advocacy via user engagement among its clientele. Typically, commercial organizations add gaming elements to the sales process (for instance, by providing small challenges and rewards such as points and badges). In any game or competition, players have to be motivated by a reward that they feel is worthwhile otherwise they simply wouldn’t engage in the process. There are arguably a number of gamified elements on the *MadBid* auction website. These include:

- The re-setting of the auction timer that makes the auctions more game-like than traditional auctions.

- More occasions for a participant to adjust their bidding strategy on auctions that could last from hours to even days, depending on the popularity the product. Given that there are some bidders that consistently win more than other bidders, suggests there is skill involved. *MadBid* claim that there are various strategy elements that could be defined as skilful including (i) knowing the competition, (ii) knowing at what times are best to bid including specific times of the day or week, seasonal timings, and general event observations (such as World Cup, Super Bowl, etc.). There are also various websites offering tips and advice on how to win penny auctions (e.g., <http://www.wikihow.com/Win-Online-Penny-Auctions>).
- Being on top of competing bidders winning limits, etc.
- The type of bidding style (such as being more aggressive, strategic, and/or reserved sniping).
- The bidding process itself could be fun and exciting for the bidders themselves, along with play features that potentially add to both excitement and strategy (such as ‘Sneak a Peek’ or ‘Auction Peeks’ and playing in ‘Stealth Mode’). More specifically:
 - The ‘Sneak a Peek’ feature enhances the fun element while bidding as it allows bidders to develop their bidding strategy by examining competing bidders’ non-personal information such as when they bid, what they bid on, how they bid, and what they win.
 - The ‘Auction Peek’ feature provides the bidder with the option to get more details of the bidding history on an auction.
 - The ‘Stealth Mode’ provides the bidder with the option to protect their profile from other sneaking bidders who try to find out more about their bidding strategy.

Other penny auction sites have different incentives. For instance *DealDash* and *QuiBids* offer ‘No Jumper’ (‘locked’) auctions that help limit the competition. In ‘No Jumper’ (‘locked’) auctions, bidding is closed to new bidders once the auction reaches a pre-set price. This prevents new bidders from entering auctions that have been running a long time. Companies such as *HappyBidDay* offer 50 free bids on initial sign up as well as a rewards program and regular promotions. Companies like *QuiBids* have a ‘badges’ rewards program. Bidders earn badges for simply participating, winning, and/or losing auctions. Badges can then be used in exchange for free bids.

Some pay-to-bid operators (*MadBid*, *QuiBids*, *BidRivals.com*) have arguably tried to distance themselves from negative publicity surrounding penny auctions (issues such as the use of bots, use by minors, use leading to financial hardship, etc.). They want to be viewed as socially responsible in its actions and want to provide value-for-money for their customers. This is arguably the best way to facilitate and stimulate long-term repeat business as customers will not return to their website if they feel they are not getting their money's worth. In addition to this, some penny auction operators (e.g., *QuiBids*, *MadBid*) have been independently (and voluntarily) audited. For instance, the audit carried out on *MadBid* concluded that the company has appropriately designed control features to ensure (i) bids are only placed by bona fide users that are not related to *MadBid* or its employees, (ii) *MadBid* does not interfere in the bidding process, nor manipulate (no use of shill bidding, no use of bots or bidding by employees) the auction closing price. (iii) it delivers not only products won in auctions, but also products purchased through its 'Buy Now' service, to its customers.

Concluding comment

This brief paper has argued that the overwhelming majority of online penny auctions are engaged in an activity that is gambling in all but name. The law should recognize the substance of such activities and bring them under the gambling legislation to ensure that consumers are adequately protected. Penny auction operators are under positive duty to take active steps to exclude minors from participation, and to highlight that those who still choose to bid are in fact gambling. Operators who do not wish to fall under gambling regulatory regime would have a choice to adapt their processes in order to remove gambling features and indeed some online penny auction sites have already begun to evolve. There are now sites where no money is lost because there is a 'Buy Now' feature (e.g., *QuiBids*, *MadBid* and *BidRivals*), and sites where no new bidders can enter after a certain threshold has been reached therefore, the activity on these particular pay-to-bid sites cannot be considered a form of gambling.

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