

# **A Penny for Your Auction:**

## **The Intersection of Purchasing and Gaming**

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A new iPad for \$2.45? A \$50.00 Visa gift card for \$3.67? Who wouldn't want to take advantage of deals like that? Is it really possible to provide customers with the chance to get new-in-box merchandise for pennies – or even fractions of pennies – on the dollar? Using so-called “penny auctions,” the answer is “Yes,” and those who provide the platform for penny auctions have the potential to see enormous success.

### *I. Penny Auction Overview*

Penny auctions, sometimes also referred to as “bidding fee auctions” or “entertainment shopping” are not like traditional online auctions, such as those hosted by eBay. Rather than the bidder with the highest bid winning an auction for his or her bid amount after a set period of time, penny auction bidders hope to become the last bidder in an auction when a countdown timer reaches zero. That sounds easy enough – simply wait until the auction is seconds from completing, and then place the bid. If only it were that simple. In most penny auctions, each bid adds more time to the countdown timer. So, if a bid is placed in the last five seconds of an auction, twenty or thirty more seconds may be added to the auction. As such, a penny auction is theoretically never-ending – bidders could continue to bid on the item, and therefore continue to add pennies and time to the auction, until they simply run out of money or pass out from sleep deprivation.

A key distinction between traditional online auctions and penny auctions is the manner in which bids are acquired. Most penny auction sites sell “bid packs” to users. Users are typically required to purchase bids in order to participate.<sup>1</sup> Each time a bid is placed, not only does the auction's countdown timer increase, but the cost of the retail item (which the winning bidder will

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<sup>1</sup> There are numerous penny auction models, and not all penny auctions utilize the same business model. For example, there are hybrid models wherein bids may be obtained in ways other than by purchasing the bids.

pay in order to receive the prize) increases by one penny in value. Also, to encourage continued participation, many penny auction sites offer auctions where the prize is...more bids! By now, it is likely clear that penny auctions can be quite lucrative for the auction site operator. There may be hundreds of bidders spending hundreds of dollars on bids for the chance to win a retail item at a substantial discount. Of course, even with the substantial discount, there is virtually no way for the auction site to lose if there are enough people bidding. For example, a user may be willing to spend \$100 on bids for the chance to win a camera (liberally) valued at \$600. Now multiply that \$100 bid limit times 100 users, all vying for the same prize, and it is easy to see how profitable a penny auction site can be. It may also be easy to recognize that this business model has some inherent legal risks for the site operator.

The most obvious issue is just one of economics and the psychology of online shoppers seeking out “too good to be true” deals. It shouldn’t be difficult for a responsible bidder to keep track of money spent on bids; however, one of the largest complaints from users is that they spent much more money trying to obtain a product at a reduced rate than if they had bought the product from other sources.<sup>2</sup> Unlike a traditional auction, once penny auction bids are purchased, they are typically non-refundable. In an effort to placate losing bidders, many penny auction sites will allow bidders to apply the value of their bids to the retail purchase price of an item and still purchase it after the auction ends, as a form of consolation prize.<sup>3</sup> Given the potential for losing bidders to become frustrated with process, penny auctions have generated substantial consumer complaints, resulting in governmental authorities confronting this unique intersection of purchasing and gaming – often for the first time.

In addition to the lawsuits mentioned below, numerous consumer watchdogs and consumer protection agencies have issued warnings and statements regarding penny auctions, with the Better Business Bureau placing penny auctions on its “Top Ten Scams of 2011” list.<sup>4</sup> In

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<sup>2</sup> This type of complaint also ignores the entertainment aspect that penny auctions provide. Just like a traditional auction, win or lose, the bidders are participating in a multi-user, social entertainment experience.

<sup>3</sup> As explained below, penny auction operators offer this “Buy Now” service not only to give losing bidders some amount of reward for their efforts, but also in an effort to comply with gambling laws.

<sup>4</sup> See BBB Names Top Ten Scams of 2011, available at: <http://www.bbb.org/us/article/bbb-names-top-ten-scams-of-2011-31711>. The following links are just a small sample of the cautionary advice that government and other agencies have issued regarding penny auctions: Press Release, Federal Trade Commission, Online Penny Auctions (September 2011), available at: <http://www.consumer.ftc.gov/articles/0037-online-penny-auctions>;

an effort to educate consumers and prevent future lawsuits and investigations, some penny auctions, such as industry powerhouse QuiBids, offer extensive FAQs and white papers regarding bidding strategy and how to succeed at winning an auction.<sup>5</sup> Despite these good faith efforts to educate consumers and prevent them from over-spending on bids, complaints are still rampant, as evidenced by the large amount of cautionary advice which may be found online.

While the penny auction business model has existed for several years, the lawsuits that this business model has generated are still in their infancy, and it is too early to tell just how courts will handle the legal issues that penny auctions implicate. Unfortunately, the few cases that have been brought demonstrate that judicial uniformity is still a long way away.

For example, QuiBids has faced numerous lawsuits from consumers, yet most have been dismissed due to confidential settlements or other reasons not related to the merits of the claims.<sup>6</sup> While each case brought unique claims, they were generally divided into two types of claims. First, there are consumer protection claims, such as unfair and deceptive trade practices, fraud, and false advertising. Second, and most germane to this article, are the claims that penny

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ConsumerReports.org, “With penny auctions, you can spend a bundle but still leave empty-handed”, (March 2012), available at: <http://www.consumerreports.org/cro/2011/12/with-penny-auctions-you-can-spend-a-bundle-but-still-leave-empty-handed/index.htm>; Press Release, Washington State Office of the Attorney General, Attack of the “bidbots” (Jan. 10, 2013), available at: <http://www.atg.wa.gov/pressrelease.aspx?id=30859#.UZPs2cr4aLV>; AND Better Business Bureau of Eastern Massachusetts, Maine, Rhode Island and Vermont, Educational Consumer Tips: Penny Auctions, available at: <http://www.bbb.org/boston/industry-tips/read/tip/penny-auctions-136>; Press Release, North Carolina Department of Justice, Information About Zeekler/Zeek Rewards (Aug. 22, 2012), available at: <http://www.ncdoj.gov/getdoc/5db7b91a-27a2-4f0c-b73b-8018efd613e7/Information-about-Zeekler-Zeek-Rewards.aspx>; North Carolina Attorney General Roy Cooper, “Penny Auctions Can Cost You Plenty”, (Sept. 7, 2012), available at: <http://www.ncdoj.gov/News-and-Alerts/Consumer-Columns/Penny-auctions-can-cost-you-plenty.aspx>; OnlineScamWebsites.com, “So How Do Penny Auction Websites Really Work? – Penny Auction Scams Exposed!”, available at: <http://onlinescamwebsites.com/how-do-penny-auctions-work/>; and The RedTape Chronicles on NBCNews.com, “An iPad for \$2.82, or illegal gambling?”, (Feb. 18, 2011), available at: <http://redtape.nbcnews.com/news/2011/02/18/6345481-an-ipad-for-282-or-illegal-gambling?lite>.

<sup>5</sup> See QuiBids 101, available at: <http://www.quibids.com/en/quibids101/>; How to Bid on bidcactus, available at: <http://www.bidcactus.com/help/info>.

<sup>6</sup> See e.g., *Brock et al., v. QuiBids LLC et al.*, No. 8:12-CV-01216 (C.D. Cal. July 26, 2012) (class action alleging QuiBids' website contains false and misleading advertisements); *Hertzog et al. v. QuiBids LLC et al.*, No. 5:12-CV-00786 (W.D. Ok. July 6, 2012) (the plaintiff is currently seeking to amend its complaint); *Brock et al., v. QuiBids LLC et al.*, No. 30-2012-00578561-CU-MT-CXC (Orange County Super. Court June 20, 2012) (state case in which the plaintiffs contend that QuiBids falsely advertises and engages in unfair business practices); *United States et al. v. QuiBids LLC et al.*, No. 2:11-CV-01299 (W.D. Wash. Aug. 5, 2011) (claims brought against QuiBids for RICO violations and illegal gambling); *Bryant et al. v. QuiBids, LLC et al.*, No. 1:11-CV-01013 (N.D. Ill. Feb. 11, 2011), *transferred*, No. 5:12-CV-00134 (W.D. Ok. Feb. 6, 2012) (the plaintiff alleged that QuiBids penny auctions are fraudulent and subterfuge for Internet gambling); and *Locke et al., v. QuiBids, LLC*, No. 5:10-CV-01277 (W.D. Ok. Nov. 30, 2010) (alleging fraud against QuiBids for failing to disclose material facts about bidding).

auctions facilitate illegal gambling. QuiBids is not alone in facing these types of claims. Other penny auction sites, including BidCactus, Swoopo, UpBids, and BidSauce have been sued under similar theories.

## *II. Prize, Chance, Consideration*

What is the primary argument that penny auctions facilitate gambling? According to those opposed to penny auctions, it is because the auctions contain the three elements typically associated with gambling: prize, chance, and consideration. Also, penny auction opponents allege that bids constitute “bets” or “wagers,” which are also key elements in various federal and state gambling prohibitions. These arguments have yielded inconsistent results in the courts.

In order to avoid the “prize/chance/consideration” trifecta, and thus remove the activity from the realm of “gambling,” gaming companies often try to remove one of those elements; typically “chance” or “consideration.” For example, if it is entirely free to play a game of chance that offers an opportunity to win a prize, then the consideration element has been removed. Of course, that would also make for very low profitability.<sup>7</sup> Instead, many sites, including QuiBids and BidCactus, argue that bidding on a penny auction is not an exercise in chance; rather, it is a skill-based activity.<sup>8</sup>

BidCactus recently failed in its attempt to dismiss a federal case in Connecticut using the “skill, not chance” argument. In *Mendelsohn v BidCactus*, the court denied BidCactus’s Motion to Dismiss, thereby allowing the case to continue.<sup>9</sup> The plaintiff in that case argued that BidCactus engages in gambling since, in the auctions, there is consideration, chance, and the opportunity for a prize. Since the case had progressed only to the motion to dismiss stage, the court was required to take the allegations in the Complaint as true;<sup>10</sup> however, the court did state that the plaintiff may be able to demonstrate that BidCactus is engaged in gambling “by showing

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<sup>7</sup> There may, in fact, be ways to profitably run a penny auction site with the “consideration” element removed, but those issues are beyond the scope of this article.

<sup>8</sup> Some states, including Florida, prohibit wagering on games of chance *or* skill, so the chance/skill distinction is largely irrelevant in Florida and jurisdictions with similar laws.

<sup>9</sup> 2012 WL 1059702 (D. Conn. 2012).

<sup>10</sup> This is a procedural requirement imposed by the applicable court rules, however the truth of the allegations will be tested in later proceedings – or at trial.

that chance predominates over a consumer's use of bidding skills.”<sup>11</sup> Rather than proceed with the litigation, BidCactus settled with the plaintiff and agreed to a Final Consent Judgment whereby BidCactus agreed to post a disclosure on the registration page(s) of its website. The disclosure points to resources regarding how the auctions work, and it also provides a chart which “shows how many bidders, on average, there were for specific categories of auctions, and the average number of bids placed by the winning bidders.” The stated purpose of the chart is “to show [bidders] the level of competition that exists for each type of auction shown.”<sup>12</sup> Unfortunately, since the gambling allegations were never litigated on their merits, it is impossible to state with certainty how the court would have ruled on those issues. However, the court's language in refusing to dismiss the case suggests that the court was leaning toward ruling against BidCactus on the gambling allegations. That is likely why BidCactus agreed to the judgment against it – because in doing so, it ended the case without risking a final determination that gambling was occurring on the site.

QuiBids also raised a similar argument – that its auctions involve skill rather than chance – in the *Locke v. QuiBids* case.<sup>13</sup> In that case, the plaintiffs alleged that QuiBids violates, among other things, the unfair trade practices provision of the Oklahoma Consumer Protection Act (“OCPA”). In order to violate the OCPA, the defendant must engage in some “unlawful” conduct, which would then be considered an “unfair trade practice.” The alleged “unlawful” conduct in the *Locke* case was “commercial gambling,” as alleged in the Third Amended Complaint.<sup>14</sup> Thus, by offering gambling, which is unlawful, the *Locke* plaintiffs argued that QuiBids violated the OCPA. The allegations in the *Locke* Complaint regarding gambling are very similar to the allegations which may be brought against the Company either by private citizens via a civil lawsuit or by a government entity pressing criminal gambling charges. Essentially, the argument is that QuiBids is engaged in gambling because it receives “bets” from users in the form of bids. In attempting to dismiss the case, QuiBids argued that its auctions are not illegal lotteries under Oklahoma law because skill dominates over chance when users bid on

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<sup>11</sup> *Mendelsohn, supra*, at p. 4, citing *State v. Parker*, 222 A.2d 582, 584 (Conn. Cir. Ct. 1966).

<sup>12</sup> *Mendelsohn v. BidCactus*, No. 3:11-cv-01500 (D. Conn. 2012), Final Consent Judgment Against BidCactus (Doc. No. 54).

<sup>13</sup> See, n. 6, *supra*

<sup>14</sup> *Locke, supra*, Third Amended Class Action Complaint (Doc. No. 87, Sept. 19, 2012).

the auctions.<sup>15</sup> In May of 2013, the court apparently agreed with portions of QuiBids' argument because it dismissed the OCPA claim that would have required a finding of unlawful conduct based on gambling.<sup>16</sup> Unfortunately, the court did not provide any explanation or analysis – it merely dismissed that specific count in the Complaint while allowing the others to proceed. As such, it cannot be said with any certainty why the claim was dismissed, but QuiBids no doubt views this as a victory, as will others that operate a similar model.

As is apparent from the above, two courts, when faced with virtually the same issues, ruled in seemingly opposite ways. This shows the legal uncertainty with regard to whether penny auctions involve gambling, and is common when courts are first confronted with novel business models.

### *III. Bids As Bets*

In addition to the skill/chance distinction and the prize/chance/consideration analysis, whether or not bidders “bet” or “wager” bids is extremely important, especially in a states which prohibit wagering on both games of chance and contests of skill. While the concept of removing one of the elements from the “prize, chance, consideration” formula may seem simple in theory, analyzing whether or not money is being used to wager or bet is more complicated in practice. *Wagering* on the outcome of a game of skill or chance is prohibited, but *participating* in such a game may not be.

In the *Locke* case, QuiBids made such an argument.<sup>17</sup> In addition to the argument that skill predominates the auctions, QuiBids explained that a user does not “wager” or “bet” on the auctions because the user does not risk *losing* the cost of his bids. Rather, the user knowingly and “unequivocally relinquishes to QuiBids a \$0.60 fee that the user can never get back, even if the user wins the auction in which the bid is placed.”<sup>18</sup> In that regard, the bid is not a bet or

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<sup>15</sup> As repeated throughout this memorandum, such skill/chance distinction, by itself, would likely not negate gambling allegations in Florida.

<sup>16</sup> *Locke, supra*, Order granting in part and denying in part QuiBids' Motion to Dismiss Plaintiffs Third Amended Complaint (Doc. No. 124, May 8, 2013).

<sup>17</sup> Namely; the bet/wager argument.

<sup>18</sup> *Locke, supra*, Motion to Dismiss Plaintiffs' Third Amended Complaint and Brief in Support (Doc. No. 91, Nov. 5, 2012).

wager.<sup>19</sup> It is helpful to remember the following language from a Florida’s Supreme Court case, wherein the court held that gambling is “[a]nything which induces men to risk their money or property without any other hope of return than to get for nothing any given amount from another.”<sup>20</sup> When bid fees are relinquished to the penny auction operator and are not part of a pool that another bidder may “get for nothing...from another,” it would seem that the bidding would not be considered betting or wagering, under this analysis. As noted above, however, courts have been inconsistent in providing guidance on this issue, and the lack of substantive rulings in the other recent cases that have addressed the issue makes a prediction on how future cases might be decided, very difficult for operators.

For example, the court in the *Mendelsohn* case suggested that the BidCactus model may involve gambling if chance predominates over skill.<sup>21</sup> However, the court also seemed to reject BidCactus’s argument that bids are “entry fees” as opposed to bets or wagers. The court noted that cases which support the idea that an entry fee is *not* a bet or wager also deal with prizes that are for an “amount certain” or a set price, which is not the case in a penny auction because the final price is unknown until the auction ends.<sup>22</sup>

With that said, there is a recent case that did accept the argument that bids are akin to entry fees and are therefore not bets or wagers. In *Manning v. Creative Headquarters*,<sup>23</sup> a federal court in the Northern District of Illinois stated that; “Because all participants’ entry and bidding fees are certain to be lost to Vesuvius and the other defendants [UpBids.com, Skorelt, BidRivals, and BidSauce], such fees never hang in the balance because at no point do the penny auction participants pay anything to defendants that is in any way dependent on the outcome of

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<sup>19</sup> However, as explained earlier, the *Locke* court did not provide a reason for dismissing the claim that depended on finding commercial gambling, so we cannot state whether or not the court agreed with that argument.

<sup>20</sup> *Creash v. State*, 131 Fla. 111, 114 (1938).

<sup>21</sup> *Mendelsohn, supra*, at p. 4.

<sup>22</sup> *Mendelsohn, supra*, at p. 4, FN3. “BidCactus’s attempt to characterize the cost of bidding as an entry fee is unavailing at this stage, as the court is required to assume the truth of Mendelsohn’s allegations. Furthermore, the cases BidCactus cites in support of this assertion are distinguishable here, as Mendelsohn asserts that the prize to be awarded is the right to buy the merchandise at the price determined by auction, and therefore does not have a set price. *See, e.g., Humphrey v. Viacom*, 2007 WL 1797648, at \*8 (D.N.J. June 20, 2007) (“[E]ntry fees do not constitute bets or wagers where they are paid unconditionally for the privilege of participating in a contest, and the prize for an amount certain that is guaranteed to be won by one of the contestants (but not the entity offering the prize).”).”

<sup>23</sup> *Manning, et al. v. Creative Headquarters, LLC*, No. 1:11-cv-02203 (N.D. Ill. March 31, 2011). This case involved UpBids.com, Skorelt, BidRivals, and BidSauce.

any auction. Defendants do not compete for the merchandise being auctioned. Absolutely nothing is undetermined or contingent about the participants' payment of fees to defendants, and thus, the participants do not "risk" losing their entry or bidding fees."<sup>24</sup> This is precisely the argument that QuiBids made in the *Locke* case, but the court's decision in that case avoided addressing the merits of that argument. Thus, the determination of whether bids are bets, and whether skill predominates over chance in penny auction bidding, are issues that remain unsettled at present.

#### *IV. Conclusion*

Until the relevant legal issues have been adjudicated, entrants into the penny auction market must rely on a patchwork of outdated, traditional gambling cases coupled with a common-sense approach to consumer protection. Even then, each case is unique given the myriad ways that penny auctions can be configured. Review of the configuration by competent legal counsel is essential to mitigate the operator's legal risks. With the steep increase in popularity of the penny auction business model, these legal issues are likely to take center stage in the development of this alternative gaming segment.

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<sup>24</sup> *Manning, supra*, Order Granting Vesuvius Technologies, LLC's Motion to Dismiss (Doc. No. 83, Mar. 30, 2012).