

# house rules

*phantom bids, shill bids, secret signals—*  
a lot more can happen in  
an auction salesroom

**By Thomas & Charles Danziger**

The two of us are such shameless technological Luddites that until recently we thought that eBay was a honeymoon destination in the Caribbean. By contrast, our client Bowne had developed an Internet technology so complicated that he probably didn't understand it himself, and made a tremendous fortune in the process.

Bowne now lived in palatial splendor in Florida, and often jetted to New York on his new Gulfstream. During one such visit, he asked us to accompany him to an evening auction. Although he was an avid bidder in online auctions, he had never attended a live sale, and we thought it would be helpful to guide him through the minuet of the evening. As it turned out, the education, in large part, was ours.

The auctioneer introduced the first lot by announcing, "I can open at \$100,000." He raced through some early bids, but stopped a bit before the low estimate published in the auction catalogue. The room remained silent. After a few moments, he softly said, "Passed," in an impeccable Oxbridge accent, and moved on to the next lot. "Bad luck that no one made just one more bid," clucked Bowne.

We quietly noted that, appearances notwithstanding, it was likely that no one in the room had actually bid for the lot in

question. Instead, the auctioneer had probably pretended to take bids until he reached the increment just below the reserve price agreed upon by the consignor and the auction house. These fake bids, sometimes known in the trade as "chandelier bids," are technically bids on behalf of the consignor, we explained.

"What makes you think the auctioneer was taking chandelier bids?" our client asked. We replied that as he was going through the bids, the auctioneer had not used the phrase "I have a bid for"—words he is allowed to say only if there is an actual offer.

Looking doubtful, Bowne asked for a quick primer on what an auctioneer can and cannot do in the salesroom. We quietly explained that chandelier bidding is a permitted practice designed to create enthusiasm in order to achieve the highest price for the seller. New York City law, however, requires that the auctioneer may only make chandelier bids up to the amount of the reserve price and that an announcement to that effect be made prior to the auction.

"So it's different from inducing bidders to purchase at excessive prices?" inquired Bowne.

"Yes," we replied. "That would constitute what is called 'shill bidding' or 'puffing,' and it's illegal."

"Just like the recent eBay controversy," he responded.

To our surprise, Bowne was familiar with the first U.S. criminal case involving online shill bidding, in which three individuals were indicted for fraud involving a fake Richard Diebenkorn painting. The government alleged that this illegal ring employed multiple fake user names to drive up the bidding on the picture.

As a result of fraudulent bids made during the online auction in 2000, the price of the "Diebenkorn" went to \$135,805 before eBay cancelled the sale. Two men eventually pleaded guilty to wire and mail fraud involving that and other online auctions, and until recently, the third individual was a fugitive from justice.

Changing the topic, Bowne asked, "Do most lots in New York auctions carry a reserve?" We said it depended on the auction house and the particular sale, but generally speaking, reserves are the norm at the major auction houses. In New York City, the law requires auction houses to identify lots that carry a reserve, which they typically do in the sale catalogue. The reserve amount can remain confidential, but may not exceed the low estimate assigned to the work.

Bowne appeared to be focusing intently on the auctioneer. "How much discretion does he have in running the auction?" he asked. "Quite a bit," we said. The auctioneer's conduct—and related matters, such as the licensing of auction houses and auctioneers—are governed by specific statutory restrictions that vary from state to state. There are few federal laws regarding auctions, and state and local authorities periodically review an auction house's records to check for violations.

In addition, the Uniform Commercial Code (UCC) as enacted in each state sets general requirements regarding the sale of goods, and these requirements are applicable to auctions and other commercial transactions. Still, the auctioneer has wide latitude regarding such matters as the order in which bids are accepted, whether to close or reopen the bidding and whether a bid was made in a timely manner.

"Does that include discretion over the increments of the bids?" asked Bowne. We noted that an auctioneer may, in theory, raise the bids in any increment he wishes, but as a practical matter, bidding increments are often published in the auction catalogue and the auction house usually adheres to them. As a rough rule of thumb, bidding often proceeds in increments not exceeding 10 percent of the prior bid. Auction houses generally prefer to keep these standard increments because they do not want to appear to be treating some clients differently from others.

We added that it is not uncommon for customers to try to "split the bid," meaning to bid less than what the auctioneer calls for. But the auctioneer need not accept the bid.

"So as a legal matter," our client asked, "does title to the property pass to the bidder when the auctioneer accepts his bid during the sale?" The answer was no. When the auctioneer accepts the highest bid, a purchase contract is formed with the winning bidder, but the bidder acquires legal title to the work only upon payment to the auction house.

"But there's no sale contract if the highest bid is below the reserve, correct?" asked our smart companion.

"Right," we said.

Next Bowne asked what kind of prearranged secret bidding signals are used. We explained that beyond the usual winks and nods, the techniques used by bidders who wish to remain anonymous are practically endless. For instance, we know of one collector who signalled his first bid by raising his hand and thereafter bid by raising one eyebrow. He indicated that he was finished bidding by remaining expressionless. Others prefer to use open or closed catalogues as signals, or to put on or remove their eyeglasses.

We cautioned our client that such signals can be risky, especially because in the heat of the moment, a bidder may forget them. In one case, a bidder's prearranged signal consisted of putting his pen in his mouth to start bidding and removing the pen to indicate the end. The problem was that chewing on his pen was the fellow's nervous tic, and he inadvertently continued bidding past the point at which he had wanted to stop.

Though telephone bidding might be a safer way to remain anonymous, this method has two distinct disadvantages. First, the auctioneer customarily takes "order bids" (those made in advance of the sale) and bids from the room before he takes telephone bids. Additionally, by not being present, the phone bidder may have difficulty sensing the general mood and the enthusiasm (or lack thereof) for a particular lot. The result might be either a losing bid or a winning one on a lot for which there was no other interest—and which might otherwise have been purchased more cheaply in an after-sale transaction. We advise serious collectors to make certain they are in the auction room, even if they have someone else bid for them.

"May bidders agree not to bid against each other on a lot in order to keep prices down?" Bowne asked. We said that this type of conduct, known as "chill bidding" or "pool bidding," is a likely violation of U.S. antitrust laws. In the classic cases in this area, buyers agree to refrain from competing with one another in the salesroom, thereby permitting one member of the ring to acquire a work at a lower price. Afterwards, they hold a private "knockout" auction, where they bid among themselves for the work.

"But that doesn't mean it's necessarily illegal for bidders simply to pool their assets and split profits on a later resale, so long as they don't intend to depress prices," Bowne observed correctly. He was catching on rather quickly, we thought. "I've seen online bidders engage in 'sniping,'" he continued, using a term that was new to us. Bowne explained that sniping occurs when a buyer submits a winning bid (often time-released by a computer) in the last few seconds before an online auction closes in order to prevent others from reacting to the bid.

Sniping is less likely to occur at live auctions, we told him, because in the event of a last-second bid, the auctioneer would customarily go back and call for more bids before dropping the gavel. "Remember that it is the auctioneer's obligation to try to get the seller the highest possible price," we said.

"How about 'bid shielding'? That used to happen frequently in online auctions." Bowne observed that this term refers to the collusion between two bidders to discourage others from competing for the lot. The high bidder typically bids an amount greatly above that of his partner (the under-bidder), then withdraws his bid at the last minute, permitting his partner to take the lot.

We pointed out that bid shielding, like sniping, is probably not such a problem in a live auction, since the auctioneer would typically start the bidding afresh if a winning bid is withdrawn. Moreover, under the UCC, the retraction of a bid does not revive any previous bid, so the under-bidder would not automatically win the lot. Although this UCC regulation would apply to both online and live auctions, in practice bid shielding is more prevalent (and successful for the perpetrators) online.

By the end of the evening, we had received a primer in online auctions, and Bowne had learned something about live sales. As we filed out of the salesroom, we raised one final point: that once the auctioneer's hammer comes down and the piece is sold, the sale is generally final and the work is not returnable, even if the bidder suffers a near-fatal case of "buyer's remorse."

"I know," Bowne replied in a perfect deadpan, as he stepped into his waiting limousine. "I'm from Miami. Not Mars."