Blacklisted*

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A firm can refuse to sell to a consumer for any reason or no reason at all. The paper investigates the link between a firm's incentives to blacklist a customer and market structure. The paper shows that private incentives to blacklist differ from socially optimal ones. The former trades off forfeited profits from "false positives" against incurred losses from "false negatives," while the latter also takes consumer surplus into account. Competition may reduce social losses from blacklisting profitable customers by mistake, yet extensive data sharing creates an impediment. Competition is especially important when decisions to blacklist are made by platforms, which is a novel concern for antitrust enforcement.

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Extended Abstract

On March 29, 2018, hundreds of American consumers suddenly discovered that Amazon chose not to do business with them any longer. Their accounts were permanently deactivated. "There was a problem," was the only response they received when they tried to log in.

In the United States, firms have right to terminate business relationships with any customer. Most terms of service explicitly state that relationships can be terminated for any reason or no reason at all. A hundred years ago, the U.S. Supreme Court held that the antitrust law "does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal."[1] Indeed, in competitive markets, a private decision to terminate business relationships—to blacklist a customer—may not cause significant harm. If a firm blacklists a profitable customer, its competitor will be ready and willing to step in. When markets get concentrated, a blacklisted customer will be left with fewer alternatives. When the growth of Amazon (or Walmart, or any other big firm) forces all mom and pop competitors out, customers blacklisted by the giants will have nowhere to turn.

But why do firms blacklist customers, to begin with? Typically, whether or not a given customer is profitable is uncertain. A firm has to rely on public and private information to decide whether or not to trade. In practice, firms rely on probabilistic loss prevention algorithms that assess the profitability of a potential customer. As any decision in a stochastic environment, the firm's decision to blacklist leads both to "false positives" and to "false negatives." By blacklisting a profitable customer ("false positive"), the firm forfeits profits it could have received. When it trades with an unprofitable customer ("false negative"), the firm suffer from associated losses. The firm's blacklisting policy implemented by its loss prevention algorithm seeks to balance these costs.

The first goal of the paper is to determine whether and to what extent the firm's optimal blacklisting policy differs from what would be socially optimal. The paper shows that the firm will blacklist more good (profitable) customers than it is socially optimal because it does not internalize the full social costs of blacklisting. Only in a knife-edge case when the firm captures the full social

[1] *United States v. Colgate & Co.*, 250 U.S. 300 (1919)

surplus from trade, its blacklisting policy will achieve the socially optimal balance between "false positives" and "false negatives." In other cases, the firm's optimal blacklisting policy will be excessively aggressive.

The second goal of the paper is to assess the overall impact of blacklisting on profitable customers. When markets are competitive, an erroneously blacklisted customer has a readily available recourse: the firm's competitors. If decisions to blacklist are mostly driven by private information, the aggregate probability of being erroneously blacklisted by all firms will be vanishingly small, even taking into account the fact that competition makes individual decisions to blacklist more aggressive (since markups and, therefore, firms' profits are typically lower in less concentrated markets). If the market has fewer competitors, the chance of being erroneously blacklisted by all firms increases, especially when firms in their decisions to blacklist rely more on public signals or share data on blacklisted customers with each other.

The third and final goal of the paper is to analyze the incentives to blacklist when firms that make these decisions are platforms. A recent Supreme Court decision *Ohio v. American Express* called for a more lenient antitrust enforcement when platforms are involved.[2] This paper shows that—at least with respect to blacklisting—antitrust authorities should be less lenient in the enforcement actions against platforms, not more. To see that, consider the trade-off between "false negatives" and "false positives" for the case of platforms. Even though it is still true that platforms do not fully internalize the forfeited social welfare associated with "false positives," there is a countervailing effect in place. If a platform erroneously blacklists a profitable customer, the customer will switch to the platform's competitor. That switch will increase the value of the competing platform in the eyes of all other customers, which will put the blacklisting platform at a disadvantage. Taking this effect into account, competing platforms in equilibrium will blacklist fewer profitable customers. Importantly, the magnitude of this effect varies non-linearly with respect to the number of competing platforms. When the number of competing platforms is large (a somewhat atypical case), the marginal impact of blacklisted customers on the attractiveness of each individual competitor is small. It achieves its maximum strength when the number of competing platforms is small, which is typically the case for competing platforms. However, in the case of a

[2] *Ohio v. American Express Co.*, 585 U.S.____ (2018)

single monopoly platform, this effect vanishes completely. Therefore, transactions that may create a dominant (or monopoly) platform cause an additional concern for antitrust agencies. The current antitrust law provides no available remedies for victims of erroneous ("false positive") blacklisting: lack of competition leaves such customers with no available alternatives.