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UNIT 7
BUSINESS REGULATION
CASE STUDY:
STANDARD OIL

by
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Chapter 1
The Industrial Revolution

The word 'revolution' implies a dramatic change, and is usually used to describe a political event like our rejection of England's rule. The term also can also be used to describe an economic upheaval. In an 'industrial revolution' there is a dramatic change from a society in which most people live on farms to one where most people live in towns or cities. For example, when George Washington was president the vast majority of Americans (some 90%) made their living by tilling the soil, and some two hundred years later, fewer than 3% were farmers.

Sometime between the year 1800 and 2000, the U.S. experienced an industrial revolution that caused numerous changes in the ways people thought, earned their living, dressed, traveled, related to one another, and spent their free time. It is difficult to point to the exact years in which these changes took place. Most historians, however, would agree that the smaller changes occurred slowly during the 1790's, picked up during the years before the Civil War, and gathered speed after the War. By 1920 the U.S. had completed its change from a nation of farmers to an industrialized society.

Advantages of Having an Industrial Revolution

It is easy to see the advantages an industrial revolution can bring. Imagine not having electricity, running water, or a car. Imagine walking 10 miles to a one-room school, wearing clothes that were made at home, and having a fireplace your only source of heat. These were just a few hardships faced by our pre-industrial, colonial ancestors. Today, countries that have not gone through an industrial revolution typically have an infant death rate approaching 20%, a life expectancy under 50 years of age, a diet that can't insure good health, and a per person income of less than the amount of money an American high school student and his/her date might spend on their senior prom. People who live in non-industrial countries such as Bangladesh and Haiti, Nigeria or Algeria typically can't read or write, have at least one child die before the age of five, never see a doctor, and seldom get enough to eat. People who live in the most industrial nations have far different lives that often include homes with central heating, cars with air conditioning, one or more computers, several TV's, and a dishwasher. Even may of the poorest Americans eat meat several times a week and have access to minimum health care, electricity and indoor plumbing. Such are the great advantages of living in a country that has been through an industrial revolution.

What is Necessary to Have an Industrial Revolution?

Industrial revolutions don't just happen. To have an industrial revolution a country must have at least seven different things:

% of World's Industrial Production		
Country	**1870**	**1914**
US	23.3	35
Germany	13.2	15.7
UK	31.8	14
France	10.3	6.4
Russia	3.7	5.3

Natural resources such as fertile soil, coal, and iron ore;
Basic inventions such as the telegram and electric generators;
A transportation system, called an infrastructure, that includes roads and railroads; A large working force;
A surplus of money to invest;
Men or women of talent, ambition, and energy, with administrative abilities;
A favorable government policy.

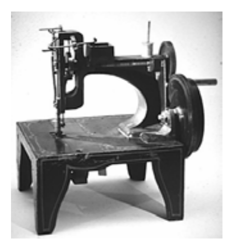
Raw Materials, Inventions and Workers in the US

England was the first country to industrialize, but others in Europe -- namely France and Germany — soon followed. Across the Atlantic Ocean, the United States was also beginning to stir. Always rich in natural resources, the former English colonies were blessed with a huge supply of fertile land. Dense forests throughout the country provided wood for building and heating. In the Northeast many swift rivers provided the power to turn water wheels. Huge deposits of coal were discovered in the Allegheny Mountains around the time of the Civil War. The mighty Mesabi Mountain Range in Minnesota was a source of the ore needed to make iron and steel. Rich deposits of copper were found in the West. Reserves of crude oil were discovered In Pennsylvania and Ohio, and when these ran out they were found in Oklahoma and Texas. The United States was truly a land of plenty.

Known for the cotton gin, Eli Whitney's application of the principle of inter-changeable parts was equally important

Although the technological basis for our industrial revolution was created in England, it was not long before Americans added to the world's list of important inventions. Eli Whitney brought the famous cotton gin into existence in 1791 and revolutionized the South's plantation system. Twenty years later he showed the world how to make rifles by creating *interchangeable parts.* He made each of the different parts of the rifle, the stocks, triggers, rifle barrels, etc. exactly the same. A trained worker could pick any part from a series of piles and assemble them into a working gun.

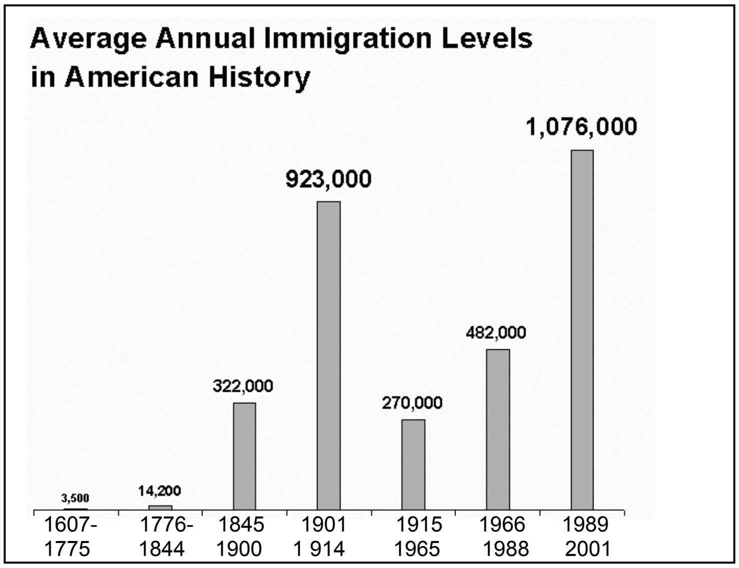
Another famous inventor, James Watts, brought us the steam engine which was first used in factories in England. Robert Fuller, an American, revolutionized water transportation by attaching a steam engine to paddle wheels and was able to send ships 'steaming' up America's rivers. Not long afterwards, Watts's basic invention was mounted on wheels giving birth to the first American railroad. The Baltimore and Ohio, started in 1828 about the same time that the British began building their own railroad. Many minor inventions were needed to make the railroad safe and efficient — the cowcatcher (inventor unknown) and George Westinghouse's air break among them. Railroad mileage in the U.S. expanded quickly in the 1840's and reached 30,000 miles by 1860.



Many other American inventors contributed to the industrialization of the US as well as Western Europe. Elias Howe invented the sewing machine in 1846 and Isaac Singer perfected it. An African-American by the name of Jan Mezinger made one that could sew the sole to the top of a shoe. Samuel Morse's creation of the code that bears his name was responsible for the telegraph; and a man named Colt revolutionized warfare by designing a pistol with a spinning cylinder capable of firing six bullets in a matter of seconds. In 1839 Charles Goodyear turned springy rubber into hardened surfaces by a process called vulcanization. In the 1850's an American, William Kelly, invented a process (identical to one credited to the Englishman, Harry Bessemer) for turning molten iron into steel by blowing air through it. By 1860, the U.S. Patent Office had granted 36,000 applications, and by 1890, the number was an astounding 440,000.

An American named Cyrus McCormick invented the reaper to harvest wheat, oats, barley, and other grains. Other inventions by Americans that helped shape our modern world include the electric light bulb, the phonograph, and motion pictures by the great Thomas Edison; the telephone by Alexander Graham Bell; and the airplane by the Wright brothers. Of equal significance was Henry Ford's method of the moving assembly line. He made his Model T car so inexpensive that the average American workingman could afford to buy one.

The working force for America's Industrial Revolution came from two sources. First, such inventions as the mechanical reaper made it possible for hundreds of thousands of people to leave their farms and move to the city. In cities they found jobs in the new factories and offices built during this industrial age. Women found work as typists, salespersons, and clerks, as well as in the then more traditional fields of teaching and nursing. By 1900 there were a total of 5 million women working outside of their homes, 17% of the work force. Their pay was barely half the amount paid to men. Over 1.7 million children under sixteen years of age had also entered the workforce by 1900 and were paid even less than women were. [1]



Meanwhile, millions of immigrants left England, Germany, Italy, Poland, Romania, Russia, Greece, and dozens of other countries and came to the United States where they hoped to find jobs created by the Industrial Revolution.

The Infrastructure and Capital

The famous "East meets West" photo taken at Promontory Summit, Utah, May, 10, 1869

The infrastructure that included, first and foremost, a system of transportation was also developed during the industrial revolution. By the time of the Civil War there were already 30,000 miles of railroads spanning America. This was just a start. A full 200,000 miles of railroads were built between 1865-1910. Steel rails covered the country, connecting East to West, North to South, and all regions in between. Certain captains of industry like Cornelius Vanderbilt and James J. Hill played leading roles in this feat. The most notable accomplishment was completing the transcontinental railroad in 1869 with the pounding in of the famous golden spike into the ground where the eastward and westward bound track met. The Chinese laborers, who were mostly responsible for the work on the Western terminal of that railroad, performed heroically. They were often lowered down mountains in straw baskets to plant dynamite charges and sometimes killed in the blasts. In the winter they slept huddled under snow tunnels which frequently collapsed. Harassed or ignored by white workers, they nevertheless out-worked and out-produced their better-paid European counterparts. Millions of dollars and over 400,000,000 acres of land

1 The Federation for American Immigration Reform, Issue Brief ,Washington, DC, 2001

were granted to the corporations that built these railroads, and the roads, built in haste, had to be reinforced and replaced to make travel safe. The railroads, of course, made further industrialization possible because they connected buyers with producers and factories with the sources of their raw materials.

And then of course there was money! Nothing of great importance happens without it. The American industrial revolution was financed by two sources. First, profits from previous commerce, such as New England's famous 'China trade' of the 1840's and later from the profits made by industrialists like Andrew Carnegie and John D. Rockefeller. Second, investors from foreign countries, particularly England, played a major role in financing our industrial revolution by investing over 500,000,000 dollars before the Civil War. Outsiders were attracted by the possibilities of earning great amounts of money. A stable society and the rule of law, in addition to an ever-expanding economy, gave investors a reasonable chance of making large profits.

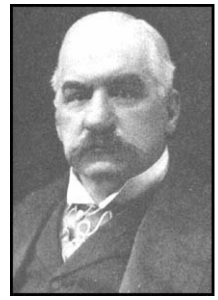
Entrepreneurs

The Industrial Revolution in the U.S. may never have occurred without the contributions of a relatively small group of energetic men who devoted their intelligence, daring, energy, and administrative abilities to the purpose of making money by creating huge industrial empires. Though it is impossible to name them all, a few thumbnail sketches of such business tycoons is possible.

Cornelius Vanderbilt (1794-1877), with a $100 loan from his father, Vanderbilt began his business career by opening a local ferry service. He repaid his dad tenfold within a year. Known for his confession "I have been insane on the subject of making money all my life," Vanderbilt started in earnest by running sailboats along the Hudson River before moving up to the paddlewheel steamer. His bold business practices soon put Robert Fulton out of business and allowed him to capture the Hudson River trade halfway up to Albany. Unable to expand his license, Vanderbilt switched to the profitable coastal trade between New York and New England. In the 1850's he ran ships to Nicaragua to make money on the gold rush. Despite his unrivaled wealth, Vanderbilt switched to railroading as he approached the age of 70, gained control of the New York Central, extended its reach to Chicago, and built Grand Central Station.

Andrew Carnegie (1835-1919), Carnegie's family left their native Scotland when Andrew was 13. He soon went to work in a cotton mill, taught himself to read, and continued to educate himself all of his life. He held a number of different jobs before learning the Morse code and finding work as private secretary to Tom Scott, director of the Pennsylvania Railroad's western division. After making several shrewd investments with Scott's help, Carnegie entered the iron and steel-making business at the age of 26. He started his own company four years later. By introducing new technology, paying careful attention to cost cutting, making careful purchases, hiring capable assistants, and employing vigorous salesmanship, Carnegie expanded his holdings to control one-fourth of the U.S. steel-making capacity. He sold his company for a personal profit of $250,000,000 (over $3.5 billion in year 2000 dollars) to JP Morgan who combined it with other companies to form US Steel, valued at $1.4 billion. Believing it was wrong for a person to die rich, Carnegie devoted the rest of his life and much of his fortune to making charitable contributions.

John Pierpont (JP) Morgan (1837-1913) For some 30 years, J.P. Morgan played a leading role in his father's investment firm before taking full control in 1890. He quickly became the world's most influential banker. He lent money to Thomas Edison, bought out Andrew Carnegie to form the world's first billion-dollar corporation, financed dozens of railroad mergers, and controlled numerous banks, mines, and insurance companies. In the 1890's he lent money to the U.S. government at a considerable personal profit in order to maintain the gold standard. He used his own money to support the stock market in 1907 and by doing so insured the value of his vast holdings. His money helped big businesses monopolize entire industries by buying out smaller companies. Morgan, however, always claimed that trust and integrity and not wealth and power were the basis for his success.



Favorable Government Policy

Finally, we come to the role of government in the American Industrial Revolution. Beginning with Alexander Hamilton's proposals for a Federal Bank, protective tariff, and support for the Whig Party's push for internal improvements, the US Government played an important part in encouraging industrial development. During the canal and railroad building frenzy of the 1820's through the 1850's, state governments did their best to encourage the development of an infrastructure. But the real assistance for industrial growth came after the Civil War when the North triumphed and was able to impose its economic priorities on the rest of the country. High protective tariffs were passed to shield American businesses from foreign competition. An open immigration policy guaranteed a plentiful supply of workers willing to labor for long hours at low wages. A sound money policy kept the currency from inflating and convinced creditors they would not be repaid with dollars of equal value. Striking workers were harassed and frequently arrested by state, local, and national governments dedicated to keeping an obedient work force. Millions of dollars and acres of land were granted to corporations to encourage them to lay more railroad track than were laid in the rest of the world.

QuickTime™ and a
Photo - JPEG decompressor
are needed to see this picture.

Cartoon reflecting widespread belief that industrialization only helped the very rich.

Perhaps the most important government policy regarding businesses was to leave them alone and unregulated. That way businessmen did not have to worry about government interfering with their activities and they had the freedom (within limits) to make money in any way they could. This policy was based on a belief in "laissez-faire" and "survival of the fittest," two theories that will be explained in another chapter.

Industrialization Continues

While your great grandparents were young they probably listened to old vinyl 78 rpm records which played for barely 4 minutes at a time. Automatic changers allowed them to listen for longer periods to albums and classical recordings. Later your grandparents danced to the latest tunes on the smaller 45's or listened to 33 rpm long playing recordings of classical music. Then, around the time your parents were your age, the cassette player came along, followed by the boom box. Now your generation listens to music on Ipods, 'burns' their own CD's, and shares their favorite tunes while talking to their friends on picture phones. Does anyone think that the technological revolution is over?

Student Activities:

1. Answer each of the following as fully as you can:

a. What is an 'industrial revolution'?
b. Give 3 examples of life in countries that have not industrialized.
c. Name 5 things needed to have an industrial revolution.
d. Give 3 examples of each of the 5 things needed to have an industrial revolution.
e. What is meant by the term 'infrastructure'?
f. Give evidence that industrialization still continues

2. During the process of industrializing, the life of workers displaced by machines would suffer and wages may not keep up with production. What could you say to workers who are not enjoying the benefits of industrialization.

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Chapter 2
Rockefeller's Millions

I had no ambition to make a fortune. Mere money-making has never been my goal; I had an ambition to build. — *John D. Rockefeller*

A little over one-hundred years ago most Americans lived in small villages or worked on the family farm. They depended mainly on themselves for their food, and they did not spend more than a few hundred dollars a year. Even workers did not labor in large factories but practiced some kind of skilled trade in small shops catering mainly to people who lived in the same town or county. Generally, they knew the people who purchased the things they made, and they took pride in what they produced.

Today the face of America is quite different from what it was so many years back. Few of the products we eat, wear, or use are made anywhere near our homes. We are dependent on businesses and workers in other states and even other countries to supply us with the necessities of life. We no longer live in small villages, and few of us are farmers. Even our local drug stores and food markets are part of national chains that are dependent on loans from large banks and on a huge network of roads and rails to get their products to us. While we undoubtedly enjoy better food and more of life's luxuries than our forefathers, we may occasionally bemoan the fact that impersonal corporations rather than local workers supply these to us. Life has become much more complicated; we feel ourselves far too dependent on people whom we don't know, and we miss the many personal contacts that have tied us to the people who supply our needs.

This incredibly complicated series of changes, which has altered not only our lives but the lives of many of the people throughout the world, began in earnest sometime shortly before the Civil War. During the 1840's, Americans began to tie their nation together in a huge network of railroads. These railroads made it possible for businesses to produce for a national rather than a local or regional market. It also made it possible for the great efficiencies of mass production to bring us cheaper goods from all corners of the country. As businessmen began to produce for national markets, they were able to expand in size to the point that fewer and fewer companies were needed to produce the necessities of life. Even our definition of what goods were necessary to live changed very radically. For instance, where at one time people were content to light up their homes with candlelight, they later became dependent on whale oil, and then the kerosene lantern, and finally the electric light bulb. Each of these improvements was made possible by a huge network of changes in the methods of producing power, refining oil into kerosene, and manufacturing such products as copper wire, tungsten filaments, and glass bulbs.

The use of kerosene as a means of lighting our homes was only one of the many thousands of small changes that accompanied the Industrial Revolution in the United States. Yet, this single example had important effects on the methods of doing business and the rules of fair competition. It gave rise to a powerful monopoly, organized and controlled by John D. Rockefeller. In studying the rise of Rockefeller's monopoly in the refining and transportation of oil, we will come to better understand the process of organizing businesses for national markets that was taking place throughout the United States and the Western world. We will learn not only how businessmen succeeded in providing for the needs of America, but also how they were able to destroy those who competed with them in meeting these needs.

And, finally, we will begin to understand some of the difficult problems we face today — how to enable energetic and talented men like John D. Rockefeller to harness the forces of nature so that they serve us and not exploit us. This unit traces the career of one man in one industry. By shedding light on the techniques he employed, we will be helped to understand how a whole generation of equally talented industrial giants changed the face of the nation and came to accumulate great wealth and power in the process.

The Early Days of the Oil Industry

In the 1840's whalers from New England roamed the seas in search of the creature of the deep who provided the oil that lit lamps in millions of homes. The discovery by a Canadian geologist that an equally efficient illuminate could light these lamps by distilling kerosene from oil ended the importance of the whaling industry. The search for whales was replaced by a search for oil. This substance had often been seen leaking from the surfaces of the earth in the western parts of Pennsylvania. There, in 1859, 'Colonel Edwin Drake sank the first oil well some sixty feet into the ground. Drake was able to extract, store, and finally sell some $500 worth of this substance every day, an amount that represented an average man's yearly salary. The boom in this part of the country was not interrupted by the guns that fired at Fort Sumter or the bloody Civil War that followed. Hundreds of men made their pilgrimage to the western parts of Pennsylvania. Forty-niners who had failed to find their fortune in California some ten years earlier came to try their luck. Men experienced in drilling for salt sought to make far more money in oil. Young farm boys left their homes with a team of oxen and a wagon to haul the 'black gold' to railroads some twenty miles from the fields. All were looking for the miracle of instant wealth and were lured on by tales of easy riches.

As money was sunk into oil, quick fortunes were made. Farmers charged thousands of dollars for the privilege of sinking wells on their land. Claims were jumped. Empty holes were filled with oil and sold as good wells. Men drilled at an angle in order to draw oil from the underground pools beneath their neighbor's property. Teamsters charged hundreds of dollars to haul heavy barrels of oil to the railroads and then tore up pipelines designed to circumvent having to pay these bills. Armed guards were hired to protect private property.

The price of oil rose and fell. A 42-gallon barrel of oil once sold for $20. Two years later, the same barrel sold for $12.00 and six months later for 10 cents. When prices fell, hundreds of prospectors were forced out of business. When prices recovered, quick fortunes were made.

John D. Rockefeller

John D. Rockefeller in the Oil Business

John D. Rockefeller wisely avoided the oil rush of the early 1860's. He also avoided serving in the Civil War. Born in 1839, Rockefeller quit school and began to work at age 17. His mother was a religious woman who attended church regularly and insisted her children do the same. His father, a jovial bigamist, lived by his wits, disappearing for months in a row, engaging in a number of businesses, including selling patented medicine cures for cancer. The father sharpened his son's wits by lending him money at 10% interest, and took a delight in cheating both him and his brother William. John learned bookkeeping in high school and never attended college because his father was engaged to another woman and could not afford to educate his son. Although he had hoped to become a minister, John enthusiastically entered the business world. As a $25.00 a month bookkeeper, Rockefeller began the practice of donating one tenth of his salary to the church, saving most of the rest, and teaching Sunday school. Over his lifetime he had given away

$530 million dollars (many billions by today's standards), and though he was once the richest man in the US, he died with an estate worth less than $27 million.

In the year that Colonel Drake drilled his first oil well, John D. Rockefeller and a partner set up a business buying and selling farm products. During the Civil War, they made a small fortune selling flour to the Union army. By 1863, Rockefeller was ready to go into a new business. After careful investigation, he decided to start refining oil. With crude or unrefined oil selling for 40 cents a barrel in Pennsylvania and kerosene selling for 40 cents a gallon, Rockefeller thought that he could make a fortune by processing or refining the oil. He would thus avoid the wildcat speculation in the oil fields and seek to make money in the more predictable business of distilling oil into kerosene.

Rockefeller was also determined that his business would not be a shoestring operation. He planned to build an efficient and modern plant equipped with the best machinery money could buy. Furthermore, Rockefeller planned to cut expenses in every way possible. Rather than pay a plumbing contractor to build his plant, Rockefeller hired his own plumbers. Rather than buy oil barrels at high prices, Rockefeller hired workmen to make his own. Rather than buy the wood needed to make the barrels, Rockefeller bought an entire forest. When he learned that it cost him too much money to haul the green wood for barrels to his shop, Rockefeller had kilns built in the woods and brought in the cured and (therefore) lighter lumber. Rockefeller himself arrived at his shop at 6.30 in the morning to supervise his workers and often lent a hand in order to speed production. He took great pains to see that there was no waste. No detail was too small to escape his sharp eyes. Savings of only a few cents per barrel would eventually be translated into millions of dollars in profits.

Rockefeller wanted to know:

« Last month you reported on hand, 1119 bungs. 1o,ooo were sent you beginning this month. You have used 9,527 this month. You report 1092 on hand. What has become of the other 500?»*

*Small cork used to close a barrel

Rockefeller's care and shrewdness soon paid dividends. In 1865 he was able to buy out one of his partners for $72,000. Together with his brother William and with Mr. Andrews and Mr. Flagler five years later, Rockefeller formed a corporation. This corporation, Standard Oil, was worth one million dollars at the time of its founding, and evolved into Eastern Seaboard Standard Oil (Esso) and is now known as Exxon.

This huge organization earned over $790 million profits by 1906 and made the name Rockefeller synonymous with wealth and power. Indeed the family has prospered over several generations with grandson Nelson having been governor of New York for sixteen years and Vice-President for two, and Nelson's son Jay, governor of and later senator from West Virginia. Another grandson, Winthrop, became governor of Arkansas, and yet another, David, president of the Chase Manhattan, the Nation’s third largest bank. A granddaughter served on the governing board of the Rockefeller Foundation which dispenses about $400 million a year in charitable contributions. In addition to the foundation, the more noteworthy contributions of the Rockefeller family included the University of Chicago, Spellman College, the restoration of Williamsburg, Virginia and numerous medical schools. Eighty percent of the Rockefeller wealth went to advance medical research and to build medical facilities over the entire world.

Among the more important family holdings was Rockefeller Center in New York City, which was later sold to Japanese investors.

Descendants of Standard Oil in 1986			
Original Name	Now called	Value (in 1986)	Size* (in 1986)
Eastern Seaboard Standard Oil (ESSO)		70 bil	# 2 US
Standard Oil Company of New York (Socoy-Mobil)✺	*	45	# 5 US
Standard Oil company of California (Calso)		24	# 10 US
American Oil Company (Amoco)		18	# 13 US
Standard Oil Company of Ohio (SOhio)		?	?
Atlantic Refinery (now with Richfield Arco)	Arco	?	?

[2]

Rockefeller in 1870

In 1870, the millions which Rockefeller would earn were still far in the future. Then, in Cleveland, he faced a difficult situation. Although his refinery was the largest and most modern in the country, he was faced with cutthroat competition and his success certainly was not a foregone conclusion. The industry had the ability to refine three times as much oil as was demanded. The presence of so much more supply than demand threatened to bring prices down to the point that no refinery could make money. All this competition, Rockefeller believed, was wasteful, inefficient and foolish. He thought that it could not continue without destroying the industry so he set out to see that it would not continue.

The next chapter carefully explains the situation Rockefeller faced in Cleveland and presents a simulation which puts you in the competition for profits. Afterwards, you will study Rockefeller's career and the rules that were developed to prevent others from controlling single industries as oil.

Suggested Student Exercises:

1. Briefly list the extent of the Rockefeller family's wealth and power.

2. Does it make sense for one person to acquire so much wealth and power? Which of the following answers comes closest to representing your view on the subject. Support your answer.

a. Yes, everyone is entitled to what he or she can earn.
b. No, money and power should be more evenly distributed in a just society.
c. It depends entirely on how the money is made and how the power is used.

✺ Mobil and Exxon reunited through a merger in 19999
2 Fortune, April 27, 1987, p. 390.

Chapter 3
John D. Rockefeller in Cleveland

John D. Rockefeller and his partners started the Standard Oil Company in Cleveland, Ohio in 1870. It was the biggest and most modern oil refinery in the United States at the time and much bigger than any of the other 25 other oil refineries in Cleveland. Standard Oil refined about 1500 barrels of crude oil into kerosene every day, about 12% of the city's 10,000-12,000 barrel a day business, and about 4% of the U.S.'s refining business.

Just two years later, John D. Rockefeller and his partners owned the only oil refinery in Cleveland. All the other 25 refineries were either sold to Standard Oil or went out of business. This chapter tells the story of how Rockefeller gained control of the oil business in Cleveland and asks you to evaluate his business deals.

The South Improvement Company

At first, Rockefeller and his partners concentrated on refining oil in Cleveland. Then they came up with a plan to combine the city's largest refineries under the control of one company — theirs. They formed a new corporation, the South Improvement Company, by combining 13 different refineries and issuing 2,000 shares of stock. Along with his partners, Rockefeller bought 900 shares of this stock, giving Standard Oil the controlling interest of the South Improvement Company.

The South Improvement Company directors knew that there were three railroads running from Cleveland to New York City — the Erie, the Central, and the Pennsylvania. They also knew that these railroads were hurting themselves by competing with one another to carry oil to New York. Under Rockefeller's leadership the SIC [South Improvement Company] made the railroads an interesting offer. It guaranteed the railroads regular business, an end to the competition between them, and a supply of railroad cars and loading facilities. In exchange, the railroads would give the SIC special low prices and secret information on the plans of the other refineries. The following is a summary of the deal:

1. The official rate per barrel of oil shipped from Cleveland to New York City would be $2.56.

2. The Erie, Central, and Pennsylvania Railroads however would pay the SIC a rebate (refund) of $1.06 under the official rate for every barrel of oil they shipped.

3. In addition, the three railroads would pay SIC a drawback (someone else's' rebate) of $1.06 for every barrel of oil shipped by refiners not part of the SIC deal.

4. The three railroads would also supply SIC with detailed information on the customers, destinations, prices, and delivery dates of oil shipped to Standard and Rockefeller's competitors.

5. The SIC would divide all of its shipments among the three railroads by giving 45% to the Pennsylvania and 27 1/2% to both the Central and the Erie Railroads. The SIC also promised to give the railroads a regular amount of business each month.

6. The SIC promised to provide loading platforms for the oil, as well as insurance, railroad tank cars, and barrels as needed.

7. The terms of this deal (see box on right) would remain secret.

There is no doubt that both the railroads and Rockefeller thought they had made a good deal.

Rockefeller Uses the South Improvement Company Deal

With a copy of his deal with the railroads in hand, Rockefeller and his partners paid calls to the refineries that were not included. They told them that they could continue to compete with Rockefeller if they wished, but that Rockefeller has a special arrangement with the railroads that effectively shut them out. Then, Rockefeller and his partners offered to buy refineries for about 45% of what their owners thought they were worth. They said they would not pay more than the value of the company to Standard Oil, and that they would pay with Standard stock or with cash. In some cases the deal was sweetened by an agreement to allow the seller to continue to manage his former company but only on the condition he not tell anyone, not even his wife, that he had sold his company.

I, -- -, do solemnly promise upon my honor and faith as a gentleman that I will keep secret all transactions which I may have with the corporation known as the South Improvement Company; that should I fail to complete any bargains with the said company, all the preliminary conversations shall be kept strictly private; and finally that I will not disclose the price for which I dispose of any products or any other facts which may in any way bring to light the internal workings or organization of the company. All this I do freely promise.

In less than a year, all of the independent refineries in the Cleveland area had either sold out to Rockefeller or gone out of business. Many believed they had no choice but to accept Rockefeller's terms. This is how Mr. Alexander, one of the owners, explained why he and his partner sold out to Rockefeller:

> *There was pressure brought to bear on almost all citizens of Cleveland in the oil business. We were told that unless we sold out to the South Improvement Company we would be crushed out. My partner, Mr. Hewitt, said that's what Rockefeller's men said to him. We sold our company at a loss because we had no choice. They told us they had a contract with the railroad which they could use to crush us. When I heard of the deal they had, I decided to withdraw from the business rather than fight that monopoly with no chance of winning. They offered us only about 45 per cent of the value we placed on our refinery. We figured it was worth about $150,000, but we sold it to Mr. Rockefeller in the name of Standard Oil for $65,000.*[3]

Rockefeller Justifies Taking Rebates

Rockefeller thought there was nothing wrong with what he did. In the following statement he justifies getting rebates. Notice what he does not mention:

> *Because the Standard Oil Company was located in Cleveland, Ohio, it could use any of three railroads. I took advantage of that situation and made the best possible deal for Standard. Other companies tried to do the same thing. Standard Oil was always able to offer the railroad many cost reducing savings. It offered to provide loading platforms, and freight in large carloads and trainloads. It provided regular business which allowed the railroads to use its own hauling capacities to its best advantage and not have to wait until the refinery was ready. Standard carried*

3 Ida Tarbell, The Standard Oil Company, quoted in Earl Latham, ed., John D. Rockefeller: Robber Baron or Industrial Statesman, D.C. Heath and Co., Boston, 1949, p. 18

its own insurance and saved the railroads from paying for losses caused by theft or fire. For these many services the Standard Oil Company received some special favors. But even so, the railroads made much more money in their dealings with Standard Oil than by the smaller and irregular traffic from other companies that might have paid the higher rate.

It must be remembered that the railroads were all eager to enlarge their freight traffic. They were competing with the rates offered by the boats on lake and canal and by the pipelines. They were desperately anxiously to successfully meet this competition. We provided means for loading and unloading cars, agreed to furnish a regular fixed number of carloads each day, the final result being to reduce the cost of transportation for both the railroads and ourselves. All this was following in the natural laws of trade. [4]

Suggested Student Exercises:

1. Describe the deal the South Improvement Company made with the railroads and the advantages offered Standard Oil as well as the railroads.

2. Do you regard this deal as simply a shrewd business practice, or do you think it bordered on taking property by using threats based on an unfair advantage?

3. What do you think would happen to the world economy if all businesses would be allowed to use tactics similar to those used by Rockefeller?

4quoted in Earl Latham, ed., op. cit., p. 55

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Chapter 4
The Theory of Laissez-Faire

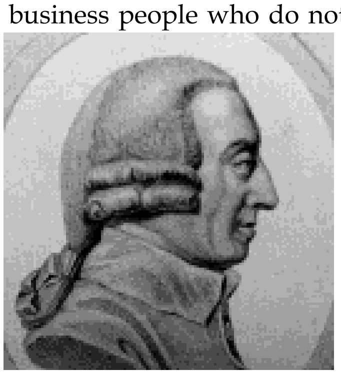
It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. — Adam Smith

Why do some men succeed in business and others fail? Why are some people rich and others poor? Why does one company develop new products, make huge profits, and remain successful while others fail? Why does one athlete become a superstar and another never makes the team? One possible answer to all these questions is that the successful are often better equipped to survive than those who fail. People who get ahead in life are usually those with both ability and the willingness to work hard. Those who fail either don't have what it takes or just don't work hard enough to get to the top.

Some people believe that life is a jungle, that the rules of the game are to compete as hard as you can, take care of yourself and not to worry about others. If you lose, you have nobody to blame but yourself.

Adam Smith and the Invisible Hand

If you agree with the ideas in this introduction, then you probably agree with the philosophy of 'laissez-faire' and the social theory of 'survival of the fittest.' Such ideas are also guiding principles of the business people who do not want the government to interfere with their actions. It is the philosophy of those who are against 'big government,' and who believe that too many rules in the business world prevent healthy, keen competition and stop progress. These are not the sentiments of people who believe in the golden rule.



Adam Smith

The words 'laissez-faire' are an abbreviation of a phrase which originally read, '*laissez-faire passer le monde de lui meme;*' 'don't interfere, the world will take care of itself.' This advice was first directed at the French government well over 200 years ago. At that time there were laws dealing with nearly every aspect of business: tanners were told when they could slaughter their cattle; weavers were told how many strands of thread must be woven into each inch of cloth. Those who broke these rules could be prevented from staying in business; and if they continued to break them, they could have a finger, hand, or even an arm amputated.

Not surprisingly, the businessmen of France felt they would be much better off if left alone and free of these ridiculous rules. Philosophers who agreed, began to write essays that advocated 'laissez-faire,' but, it was a Scotchman who made the idea of laissez-faire famous. In his book, *The Wealth of Nations,* Adam Smith argued that all restrictions on business should be removed. His book appeared in England the same year the American colonists took up arms against the country that imposed unfair trade restrictions on them.

One of the most important ideas in Adam Smith's book, was the concept of the 'invisible hand.' Smith believed that this invisible hand would always guide the selfish acts of individuals to help the country:

> *[B]y working for his own private gain, the businessman must produce as much as he can, and for the lowest price. In order to sell his goods he charges very little. This will help society as a whole, even though that was not his purpose. The invisible hand thus directs selfish acts for the good of the community.*

He urged trust in the invisible hand and not in the government:

> *[E]very person is a much better judge of what is good for him than any President, Governor or Congressman. When the government starts telling people what they should do with their money, they are telling people how to mind their own business. This will make a bigger mess than that which they tried to correct.*

Survival of the Fittest

The philosophy of laissez-faire was given unexpected support from a famous English scientist, Charles Darwin. Darwin's book, *The Origins of the Species*, appeared in 1859. It made quite a stir because it argued that mankind had descended from the apes by a process known as evolution. Darwin claimed evolution worked because more animals in any species are born than can possibly survive. Only those whose particular features allow them to adapt to their environments live long enough to produce offspring which inherit the characteristics that made their parents more fit. The giraffe, for instance, developed his long neck because short-necked giraffes could not reach the leaves from the top of trees. The 'fittest' giraffes, therefore, were those with long necks, and their long-necked children, too, would be more likely to live and reproduce. According to some scientists the same process produced human intelligence. The less capable or 'unfit' cavemen died; those who could use their intelligence lived and produced more children.

Charles Darwin never intended to apply his theory of evolution by 'natural selection' to human society. Others, philosophers rather than scientists, however, could not resist the temptation and were quick to adapt the theory of natural selection and survival of the fittest to explain social interactions. These men were called Social Darwinists, and their philosophy was called Social Darwinism. Charles Sumner, who became America's leading philosopher of Social Darwinism argued:

> *Competition, therefore, is a law of nature. Nature is entirely neutral. She gives her rewards to the fittest. Men get from nature just what they deserve; what they have and enjoy is always a result of what they can and do. This is the system of nature. If we do not like it and try to change it, there is only one way we can do it. We can take from the better and give to the worse. We can give the rewards to those who have failed in life. This might lessen the inequalities. But, it shall favor the survival of the less fit, and shall be accomplished by destroying liberty, and this would be foolish.* [5]

American businessmen quite naturally were attracted to the philosophy of laissez-faire and survival of the fittest. They saw their own success in business as a result of the laws of nature. Businesses destroyed in competition and men unable to support their families were considered as unfit for survival as the short-necked giraffe or the clawless tiger. Helping losers instead of rewarding winners, according

5 Quoted in The College of the University of Chicago Social Sciences 1 Staff ed., The People Shall Judge, Vol II , University of Chicago Press, Chicago, 1949, p. 85.

to social Darwinists, would only encourage the lazy and perpetuate the traits that did not equip people for survival. Thus government help, no matter how well intended, would only weaken society. Using the philosophy of 'laissez-faire' and 'survival of the fittest,' John D. Rockefeller told his Sunday school class that Standard Oil was:

> *merely an example of survival of the fittest. The American beauty rose can be produced in the beauty which brings joy to those who see it by sacrificing the early buds which grow around it. This is not an evil tendency in business. It is merely the working out of the law of nature and the law of God.*[6]

A Contrary View

One of the early critics of the philosophy of Social Darwinism was Henry Damerest Lloyd, author of *Wealth Against Commonwealth.* Writing in 1894, Lloyd claimed that:

> "*There is no hope for any of us, but the weakest must go first," is the golden rule of business. There is no other field of human associations in which any such rule of action is allowed. The man who should apply it his family or his citizenship this ''survival of the fittest" theory as it is practically professed and operated in business would be a monster and would be speedily made extinct, as we do with monsters. To divide the supply of food between himself and his children according to their relative powers of calculation, to follow his conception of his own self-interest in any matter which the self-interest of all has taken charge of…would be a short road to the penitentiary or the gallows. In trade men have not yet risen to the level of the family life of the animals. The true law of business is that all must pursue the interest of all. In the law, the highest product of civilization, this has long been a commonplace. The safety of the people is the supreme law.* [7]

Laissez-Faire and Survival of the Fittest on Trial

The ideas preached by Adam Smith, Charles Sumner, and John Rockefeller could be backed with some important statistics. During the great age of laissez-faire, between 1860-1915, production in the United States increased 1200%. In this period, America moved from a second rate industrial power, behind England and France, to the world's leading economic giant. By 1915, America produced over one-third of the world's steel and built almost one half of its railroads. During this period, fortunes were made in oil, steel, meatpacking, shoe making and hundreds of other industries. Businessmen who had started with hardly a penny, rose to command industrial empires richer than many countries. Poor peddlers became millionaires; hard working immigrants made fortunes; workers rose to become bosses; and the sons of peasant farmers became the fathers of successful lawyers, doctors, salesmen and accountants. Although the government of the United States aided businessmen with protective tariffs, hard money policies, subsidized railroad construction, an open immigration policy, and some financial encouragement, it did not restrict industry with burdensome regulations.

Success, however, was not uniform. While some millionaires spent fortunes in wild displays of their wealth, millions went to bed hungry every night. Millions were killed or maimed in industrial accidents. Farmers were driven off their lands, immigrants were unable to get jobs, residents of cities could not educate their children, and youngsters aged 10 and 11 were forced to work for a few cents per

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6Quoted in Richard Hofstadter, Social Darwinism in American Thought, Beacon Press, Boston, 1955, p. 43.
7 Quoted in The College of the University of Chicago Social Sciences 1 Staff ed., op. cit., p. 72.

hour. Forests were stripped, waters polluted, and natural resources were wasted and depleted; politicians were bribed, workers were underpaid, and the standard of living for the average man hardly improved.

Those who did not profit from laissez-faire, the so called 'unfit,' as well as socially conscious members of the middle class, clergymen, teachers, lawyers, and even many businessmen, did not agree with this philosophy. They eventually exerted enough pressure to introduce government regulations and welfare legislation. This unit puts the philosophy of laissez-faire and the survival of the fittest on trial in the person of John D. Rockefeller and the Standard Oil Corporation.

Suggested Student Exercises:

1. The theories of laissez-faire and survival of the fittest are really aspects of the same philosophy. Explain each and how the two are related.

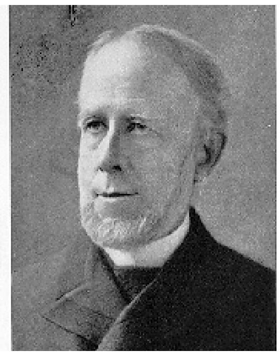
2. Do the philosophies of laissez-faire and survival of the fittest explain why John D. Rockefeller succeeded in Cleveland, and was his success good for the oil industry and the American consumer?

3. Which of the following statements best illustrates your view of the philosophies of laissez-faire and survival of the fittest:

a. While they might seem harsh, in the long run these philosophies led to a more developed and prosperous society. Following these ideas will continue to lead to further prosperity while helping the less fit will not.
b. Maybe this philosophy worked well during the late 19th and early 20th century, but it is not the way to move into the 21 st century.
c. These philosophies, though they may contain a grain of truth, are based on and encourage selfish, anti-social behavior which primarily helps those who are in a position to take advantage of others.

Chapter 5
Empire 's Challenge to Standard

Tom Scott



Joseph Potts

In the richly furnished office two men carefully examined a few sheaths of paper — the dark oak paneling in the background gave an indication of the power wielded by the man who stood at the desk. His tall frame, shrewd face, and flashing eyes, marked Tom Scott as a leader of men who controlled the nation's largest corporate enterprise, the mighty Pennsylvania rail-road. His companion, shorter, less ample in frame, with a prominent nose and a white beard, was also a man whose ambition and ability had brought him great wealth and respect. He was Joseph Potts, president of' an independent subsidiary of the Pennsylvania Railroad, the Empire Transport Company.

Both men realized that they were about to embark on a fatal step and that the contract they were so busy examining was bound to bring upon them the wrath of none other than John D. Rockefeller. Before finally committing themselves, both hesitated — as if to measure the strength and resolve of the other — and then each signed the papers set before them.

Tom Scott and Joseph Potts had come together that cold January morning in 1877 to sign a contract which in effect would put the Empire Transportation Company in the business of refining oil. Tom Scott had agreed to act as Potts's partner and pledged the resources of his giant railroad to support him in his challenge to John D. Rockefeller's control of the oil industry.

What brought these two men to take this dangerous step, and what happened to their plan to wrest control of the oil refining business from Rockefeller's grasp is the subject of this chapter. The reader will learn how Rockefeller met this challenge to his control over the oil industry and will decide if Rockefeller's actions in his last major battle for dominance were justified.

Allies Against Rockefeller

After his conquest of the Cleveland refineries, Rockefeller continued to expand Standard Oil's operations. In the years 1872-73, Standard began buying refineries in New York, and during the following two years, its operation expanded to Philadelphia, the Oil Regions, and the Pittsburgh area. One by one, Rockefeller and his agents were secretly buying out independent refineries. Hardly a month passed without at least one more refinery quietly joining the Rockefeller bandwagon.

For similar reasons two different men viewed these events with great alarm. As president of the powerful Pennsylvania Railroad, Tom Scott had done business with Rockefeller and had even been accused of initiating the South Improvement Company scheme which enabled Standard to buy out the refineries in Cleveland. Now Tom Scott worried that Standard would soon be the nation's only oil refinery and would be in a position to dictate freight rates for oil to the railroads.

During the years since the Civil War Joseph Potts of the Empire Transportation Company had built a very successful business hauling oil between refineries and the railroads, storing it, and moving other commodities such as grain. By 1876 Potts was operating 5,000 railroad cars (including some 1,500 oil tankers) 520 miles of pipelines, and several hundred thousand barrels of storage space. His fees from these facilities amounted to $11 million each year, and he paid dividends totaling $400,000 from stock worth $4,000,000. Despite his success, Potts shared Scott's concern that Rockefeller would use the monopoly he was gaining in the oil industry to put him out of business.

The Three Divisions of the Oil Industry

When asked by a Congressional Committee some years later for his reasons forming an alliance with Scott against Rockefeller, Potts explained:

> *We reached the conclusion that there were three great divisions in the petroleum business — the production of oil, the carriage of it, and the preparation of it for the market. If any one party controlled absolutely any one of these divisions, they practically would have a very fair show of controlling the others.* [8]

While Scott and Potts opposed Rockefeller's gaining control over the oil refineries, Rockefeller was determined not to allow the Pennsylvania Railroad to get involved in the refining end of the business. To this end, Rockefeller had the support of both the Erie Railroad and the New York Central, neither of whom wanted their powerful rival, the Pennsylvania, to be refining oil. Thus the dispute pitting Rockefeller against Scott and Potts involved the Erie and the Central as well as Standard Oil.

Shortly after completing an agreement with Tom Scott, Potts began diverting his tank cars from the territory served by Rockefeller to new oil fields along the Pennsylvania's railroad tracks and acquiring oil refineries. Rockefeller became aware of the shortage, and immediately ordered his own tank cars be taken off the Pennsylvania's lines. In the spring of 1877, he told Mr. Scott's assistant that Standard Oil would no longer send any of its freight over the Pennsylvania unless the Empire gave up its refineries. When Empire refused to surrender its refineries, Rockefeller canceled his future contracts with Tom Scott and paid him a personal visit. Rockefeller notified Scott that if he wanted Standard Oil as a customer he must stop trying to get into the business of refining oil. In effect, Rockefeller told Scott to choose between him and Potts. Scott expected this threat and refused to be intimidated. Rockefeller promptly closed his refinery in Pittsburgh and other areas served only by the Pennsylvania Railroad. At the same time, he placed an order for some 600 new tank cars. His ally, New York Central president Corneluis Vanderbilt, agreed to lend him the money.

The Scramble for Oil, Customers, and Refineries

Having taken these precautions, Rockefeller started invading Empire's sources of crude oil. Rockefeller sent agents into the oil fields with orders to buy up all the oil on the market. Then Rockefeller suddenly slashed prices of kerosene in the areas where Empire was doing business. This cut in the price of kerosene was likely to cause Empire to lose her customers and was a tactic Rockefeller frequently used when threatened with competition.

8Quoted in Allan Nevins, Study in Power, John D. Rockefeller, Charles Scribner's Sons, New York, 1953, p. 232.

Tom Scott soon came to Potts's rescue. He slashed rates for Empire and finally transported Potts' oil for no charge at all. Meanwhile, Potts instructed his agents to increase their price for crude oil. "Never mind what you pay for the oil." Potts instructed, "just get it." At the same time Potts reduced the prices he charged for refined petroleum and began to look for more refineries to buy while feverishly continuing to build new ones.

Scott then started working actively to attract more passengers to his railroad. He cut prices for his passenger service to woo customers who had used the Erie and the Central, but this strategy did not work. Both of the railroads allied to Rockefeller also reduced their fares and Scott was unable to cut into their trade.

The Railroad Strike of 1877

In the midst of this desperate competition, Tom Scott faced trouble from another source. All of the major railroads had laid off men and cut salaries by 20 per cent in order to reduce their expenses. Soon the strategy backfired. Driven to take desperate measures, the workers on the Pennsylvania took to the streets, and on July 20, 1877, raided the Pennsylvania's machine shops in Pittsburgh, seized axes, hammers and crowbars, and set to work destroying stations, freight cars, and railroad tracks. Scott demanded help from the governor of Pennsylvania who promptly sent in the state militia. Numbering in the thousands, the angry mob refused to retreat. The militia opened fire and killed twenty demonstrators. This drove the crowd into a frenzy. They attacked the troopers who ran for cover. Emboldened by their success the rioters set about raiding the city's gun shops, and now armed, proceeded to attack the militia and to set fire to hundreds of railroad cars loaded with coal and oil. When firemen came to the scene they were met by a hail of bullets. Scott then appealed to President Rutherford Hayes to send in Federal troops. When they arrived the next day, the crowd's fury had finally been spent. However, the damage was extensive. Over 2,500 freight cars (including oil tankers) were destroyed along with 120 locomotives and twenty-seven buildings. The losses to the Pennsylvania Railroad exceeded 3 million dollars.

In addition to the riot damage the Pennsylvania suffered losses of some three and one half million dollars in lost and reduced revenues as a result of the competition with Rockefeller. The Pennsylvania was therefore unable to pay dividends in 1877, was forced to take out loans at high rates of interest, and saw the price of its stock collapse in the New York Exchange. Despite Potts's strenuous objections, Scott sadly concluded it was time to call a halt to his competition with Standard Oil, and he telegraphed his surrender to Rockefeller.

Rockefeller Triumphs

Once in the driver's seat, Rockefeller negotiated a tough bargain. First, he insisted that Potts sell all of his pipelines, storage facilities, and refining capacities to Standard. Without further help from Scott, Potts had no choice and sold these valuable investments for $2,500,000. In that deal Potts's Philadelphia refinery, which was valued at only $500,000, netted Rockefeller a profit of $1.4 million over the next four years. Potts was also forced to sell all of his 1,500 tanker cars to Scott for $900,000. Standard then lent the money to buy the tankers to the Pennsylvania Railroad in exchange for an agreement to make 90% of them available to Rockefeller whenever he needed them. Standard Oil also renewed

The band of men who had built it up to such a healthy success were not giving it up because they had lost faith in it, or because they believed there were larger opportunities for them in some other business; they were giving it up because they were compelled to, and probably men never went out of business in this country with a deeper feeling of injustice than that of the officials of the Empire Transportation Company on October 17, 1877, when they sent out the telegrams which put their great creation into liquidation.
Ida Tarbell, History of the Standard Oil Company, The Internet. p. 194

some of the important elements of the South Improvement Company deal. Rockefeller promised the railroads regular business, with a 45 per cent share to go to Pennsylvania. In exchange he was given a handsome rebate on all of his freight charges, with an extra 10 percent to come from the Pennsylvania.[*]

When all of the complicated aspects of this arrangement are added together, it is difficult to disagree with the opinion reached by one student of Rockefeller's career: Standard could ship oil by rail so cheaply that it put the remaining independent refineries at a hopeless disadvantage. Indeed, Empire's challenge to Rockefeller's supremacy in the field of refining and transporting his oil was almost the last threat to Rockefeller's control over the oil business. Throughout the 1880's, Standard Oil and its subsidiaries refined 90% of the country's oil, and a protective tariff prohibited any serious competition from overseas.[9] The only organization in a position to challenge Standard Oil's monopoly was the Federal government.

Suggested Student Exercises:

1. How did the possibility of Rockefeller gaining complete control over the refining of oil threaten the Pennsylvania Railroad and the Empire Transportation Company?

2. Describe how both the Potts and Scott combination and Standard Oil competed against each other by listing at least four different actions that each took.

3. Do you think that either party was within its rights by using the techniques they employed in competing with the other?

4. What does this episode tell us about Rockefeller and the means he used to gain and retain dominance in the oil industry?

* After complaining for years about his being ruined by Rockefeller's unfair business tactics, Joseph Potts accepted a job as active director of a Standard Oil pipeline subsidiary in the early 1880s'

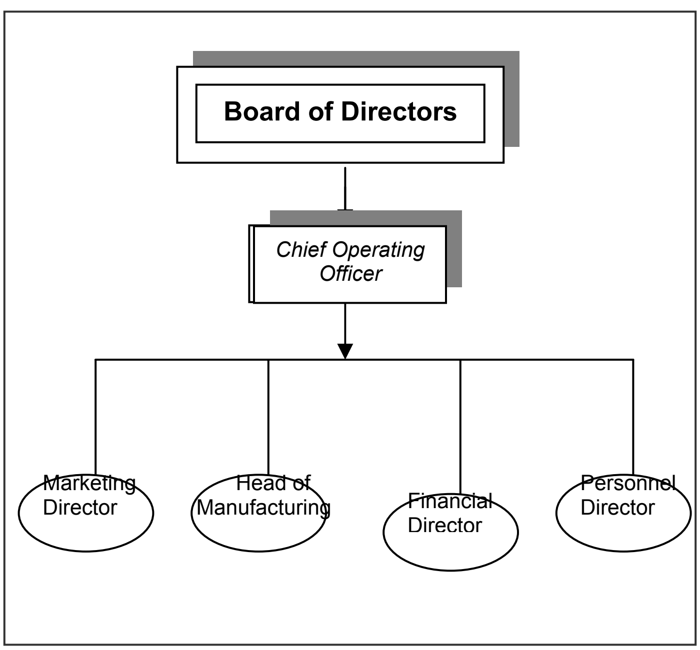
9 Albert Z. Carr, John D. Rockefeller's Secret Weapon, McGraw-Hill Book Co., 1962, p. 4.

Chapter 6
Business 0rganizations

In the days when most goods were made by hand, the craftsman needed only to hang his shingle over the door of his shop to organize his business. He did not need to worry about forming a partnership, a corporation, a trust, a holding company, or a conglomerate. But as businesses increasingly were organized to sell on national rather than local markets, a need for more complicated forms of organization arose. Today, these organizational structures permit corporations to buy and sell oil in all parts of the world, operate a huge fleet of super tankers, and employ more people, own more property, spend more money and generate more wealth than most governments in the world. These activities would be impossible under the forms of business organization that were used by the local blacksmith or candle maker. This chapter will acquaint readers with the new forms of business organization that developed during our Industrial Revolution and the uses that were made of them.

From Individual Proprietorship and Partnership to Corporation

Not too long ago a young woman entered a grocery store, asked for the rest room, and was mistakenly directed toward the door leading to an elevator shaft. She broke both legs after falling ten feet to the basement. The store's owner was sued for over $100,000 and since his insurance did not cover him, he had to sell his store, house and automobile in order to pay the claim. This story helps explain why fewer and fewer business people are satisfied to remain as individual owners or partners in a businesses that can hold them personally liable for debts the business incurs. Two other disadvantages of simple ownership or partnership are its limited life should the principal or a partner die and its difficulty in raising money. Forming a corporation avoids these problems and has become a preferred form of business organization.



A corporation is a business owned by its stockholders. The stockholders manage the corporation by electing a board of directors to supervise the president and other officers. In addition to the vote, a share of stock in the corporation entitles the stockholder, to a share, (called dividends) of the corporation's profits. When one stockholder dies, his/her heirs inherit the stock so that the corporation continues without disruption. The Hudson Bay Company, for the debts incurred by the corporation, a very important consideration for investors wishing to buy stock.

example, was incorporated in 1670 and is still in existence. The other distinct advantage of the corporation is the protection it offers its owners. No stockholder can be held liable for

One reason owners of a corporation are not liable for their debts is that corporations according to the U.S. Supreme Court are "artificial being(s), invisible, intangible, and existing only in contemplation of law." Therefore, corporations can sue and be sued, borrow and lend money, and have the right to due process under the law. Most business in this country is performed by corporations. Corporations have become both a convenient and an accepted way of raising large sums of money and executing complicated business dealings. In short, a corporation can be defined as a firm usually established for the purpose of doing business; owned by its stockholders, and a legal entity before the law.

Abuses of Corporate 0rganization: Watered Stock

One of the least respectable businessmen of the period after the Civil War was a shrewd manipulator of stocks and securities named Daniel Drew. Drew got his start in business as a boy driving cattle to New York City from his home in up state New York. Just before weighing his livestock for market, young Drew allowed them to lick salt tablets and gave them large quantities of water to satisfy their thirst and add to their weight. Thus the term 'watered stock' has been used to describe the huge amounts of water sold as beef. After Daniel Drew entered the corporate business world he found even more devious ways of watering stock. In 1867 Cornelius Vanderbilt tried buying stock in the Erie Railroad which was then controlled by Drew, Jay Gould, and Jim Fiske. The trio printed up some 23 million dollars worth of watered stock in a single year and Vanderbilt bought it. This stock, like the watered beef, represented no real value and only diluted the value of shares owned by others. Nevertheless, watering stock was a common way for corporations to raise money for a few insiders and thus cheat stockholders. In 1901, for example, the great banker J.P. Morgan bought out Andrew Carnegie and several other huge steel companies for $700 million. He promptly issued and sold $1.4 billion worth of stock — half of it, because it represented no real value, was said to be water.

The Pool

While the purpose of forming corporations was to reduce liabilities and to perpetuate the life of a firm, other business organizations were formed for somewhat less legitimate reasons. The continual pressure of many firms bidding for an increasingly small market often forced competitors to reduce prices below their costs. Such was the condition of the salt industry described by J. E. Shaw in 1876s:

> *Salt has depreciated in value, dropped steadily down, until today it has no market price on the Saginaw River, and is quoted at only $1.27 in Chicago, and $1.00 in Toledo. That the experience of '75 will be that of each succeeding year, unless something is done to check the general demoralization, cannot be gainsaid. The oldest manufacturers of the Syracuse, Kanawha, and Ohio districts, tell us that their experience, dating back forty years in some cases, has always been this: "0rganized we have prospered. Unorganized we have not."* .[10]

Shaw's resolution to his problem was to form a pool, which was a kind of gentleman's agreement, with other salt manufacturers to limit competition. Members of a pool might agree either to keep its prices high no matter what the competition and limit the amount produced, or to divide the market along some geographic lines. In all these cases the purpose was to maintain an artificially high price. The South Improvement Company scheme developed by Rockefeller and his partners is another example of the

10Quoted in William Z. Ripley, ed., Trusts, Pools and Corporations, Ginn and Company, Boston, 1916). p. 6.

pool, and the agreement among Oil Producing and Exporting Countries (OPEC) is a modern example on an international scale.

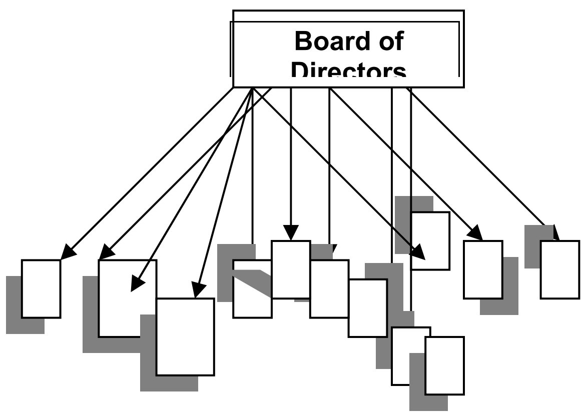
The problem with forming a pool was that its members often did not live by their agreements. In one frequently cited example, railroads that were agreeing on fixed rates found that one member of the pool asked his home office to cut the rates the pool was setting while the meetings were still in progress. Because pools were not legal agreements that could be enforced under law they often failed to accomplish their objectives. Therefore, other means of organization were devised.

The Trust

Samuel Dodd, the ingenious lawyer working for Standard Oil, devised a way to escape from state laws that prohibited one firm from owning the stock of another. Here he suggests the advantage of forming a trust:

…[Y]ou could have a common name, a common office, and a common executive committee. If the directors of one of the companies and their successors shall be made trustees of all such stock, you thus procure a practical unification of all the companies. [11]

Under Dodd's leader-ship thirty-nine different companies refining and transporting oil secretly formed a single super corporation called a trust.



One Board of directors controls 12 Corporations that once competed

The stockholders in each of the corporations were told to surrender the voting rights of their stocks to the Board of Trustees. This Board was then permitted to make decisions for all the corporations in the trust and thus was able to eliminate waste, overlapping operations, and price competition. With the formation of this trust in 1882, a total of 700,000 shares of certificates worth $70,000,000 were issued to a total of forty-one people. This single organization refined 80% of the nation's oil and controlled 90% of its pipelines. This ingenious device was widely imitated by the formation of trusts in whiskey, beef, sugar, farm machinery, and steel.

After Congress passed the Sherman Anti-Trust Act in 1890, Standard Oil was forced to reorganize its subsidiary corporations. Seizing upon the laws in New Jersey that permitted single corporations to own and operate firms doing business in other states, Standard Oil formed a holding company. The parent corporation, Standard Oil of New Jersey, was given the controlling stock in its empire of thirty-nine other oil refineries and pipeline operators. In this way the trustees, who had once commanded the Oil Trust, were able to maintain their control through the holding company.

11. Quoted in Bernard Bailyn et. al. The Great Republic: A History of the American People, D.C. Heath and Company, Lexington, Ma., 1973, p. 838.

In forming a holding company in 1899, Standard Oil once again pioneered in adopting a new form of business organization to insure maximum profits and efficiency at the expense of price competition. Other businesses followed this example, and in some instances controlled scores of corporations in the same line of trade. When the Standard Oil Company was ordered dissolved in 1911 and broken into thirty-three competing companies, not much changed in the way of price competition. Many of the men who sat on the board of directors of one of the Standard companies, also directed several of the others. This practice, known as interlocking directorships, again became common practice in many other industries. Furthermore, Standard Oil was able to maintain the old pooling arrangement made possible by the Trust. Each separate corporation, Sohio, Esso, Mobile, and Chevron, for example, maintained their geographic divisions, confining their operations to Ohio, New Jersey, New York and California respectively.

The Supreme Court ordered the executives of the Standard holding company not to plan business operations together. But the Court could not prohibit the many social gatherings attended by men who had worked together for many years, nor could it prevent the continuation of business arrangements that these old friends had found mutually beneficial. Thus their community of interests prevented a quick return to direct competition between rival oil firms. Similar communities of interest reduced real competition between the corporations that dominated such diverse industries as farm machinery, whiskey, shoe machinery, and sugar refining.

Why Monopolize?

Why did businessmen form ever-larger organizations? Why did corporations form pools; pools turn into trusts, and trusts into holding companies? Why did giant companies devour one another in a kind of corporate cannibalism with each meal creating a larger and larger industrial organization? For the cynic the answer might be quite simple -- to destroy competition, and to obtain monopoly.

Monopolists (from the Greek word 'mono' meaning single) can set their own prices because no competitor can force them to charge less. But there are other reasons for increasing the size of a business. Corporations today sell and buy in a national if not an international market. At the height of his career, Andrew Carnegie could boast that his steel mills took:

> *…two pounds of ironstone mined upon Lake Superior and transported [them] nine hundred miles to Pittsburgh; one pound and one-half of coal, mined and manufactured into coke, and transported to Pittsburgh; one half-pound of lime, mixed and transported to Pittsburgh – and these four pounds of materials manufactured into one pound of steel, for which he charged the consumer one cent.* [12]

This magnificent feat of production and organization could only be accomplished by a multi-million-dollar firm and Carnegie's companies eventually served the basis for the first billion-dollar corporation. To give another example, Henry Ford was able to reduce the price of his touring car from $2,800 to $360 over a ten-year period. But he could do this only because he increased the number of cars he sold each year, from 6,400 in 1907-08 to 730,000 in 1916-17. Because Ford was able to engage in what economists call the economies of large-scale production, he reduced the time spent building the chassis of his car from roughly twelve and one-half to one and one-half hours in just one year. Had they not controlled giant organizations, neither Carnegie nor Ford could have produced goods so cheaply or

12Quoted in Charles and Mary Beard, The Rise of American Civilization, The MacMillan Company, New York, 1930, p. 175.

passed the savings on to the public. Thus bigness serves both the business tycoons and the consumer. But questions arise when does bigness destroy competition at the expense of the consumer rather than creating savings from which consumers will benefit.

Suggested Student Exercises:

1. What are the three major differences between a partnership and a corporation?

2. Explain how trusts, pools, holding companies, and communities of interest work to reduce competition and to introduce 'economies of scale.'

3. Give examples of how Standard Oil participated in four of the above forms of business organization.

Chapter 7
Robber Baron or Industrial Statesman

Many years ago the term 'robber baron' was applied to German lords who forcibly collected money from every ship passing by their castles on the Rhine River. The same term was later used to describe the captains of industry in America who were said to hold up commerce by controlling the rivers of trade. As one of the most powerful and wealthy businessmen, whose kerosene was used in practically every American home, Rockefeller often invited comparison to those German robber barons. However, a large number of people would disagree with this unfavorable portrait of the oil magnate. Rather than curse him as a pirate who drank deeply from the rivers of trade, admirers portrayed him as a great businessman who eliminated wasteful competition and provided the world with an excellent product at a reasonable price — someone they would rather call an 'industrial statesman.'

Robber baron or industrial statesman? This chapter presents two views of John D. Rockefeller and the Standard Oil Company. The reader is asked to decide which label fits him best.

George Rice on Railroad Rates

For twenty years George Rice attempted to remain in the refining business despite what he claimed was a determined effort by Rockefeller to wipe him out. In 1899, Rice was called to testify before the United States Industrial Commission. Sections of that testimony — much of it corroborated in independent investigations — are quoted below:

> *I am a citizen of the United States, born in Vermont, and have been refining oil for some 20 years. My business had been shut down for three years now, due to the methods that the Standard Oil Trust used to jack up my freight rates. I have been driven from pillar to post, from one railroad line to another, in a vain attempt to get fair railroad rates with the Standard Oil Trust, which I have been utterly unable to do. Consequently, I had to shut down with my business absolutely ruined and my refinery idle. I have done my best to stay in business, and have hoped that I would be saved by the fair and proper execution of the law, which, as yet has not come. But, I am still living in hopes, though I may die in despair.*
>
> *With their unlawfully acquired monopoly, Standard Oil Trust could cut customer's prices temporarily and sell to them below their costs. This they could easily do, and thus effectively wipe out all competition. Standard Oil's prices were generally so high that I could sell my goods at 2 to 3 cents a gallon below their prices and make a nice profit. But, I could not match their price cutting on my customers' goods, because unlike them, I had no other areas to make profits while losing money for the purpose of driving out competition. But, do not just accept my word. Allow me to read to you from a Federal court's decision, Judge Baxter presiding*
>
> *"It appears that the Standard Oil Company and George Rice were competitors in the business of refining oil in the neighborhood of Macksburg, Ohio, and each equally dependent on the same railroad. It further appears that Standard wished to 'crush' Rice and his business. Under the threat of building a pipeline to carry its oil, Standard was able to force the railroad to charge Rice 35 cents a barrel and Standard only 10 cents. In addition, the railroad had to pay Standard a drawback of 25 cents a barrel for every barrel shipped by Rice."*

Furthermore, Rockefeller made threats to my agents who were buying my oil. For instance, he told merchants in Nashville, if they continued buying oil other than Standard's, he would enter into competition on all articles sold in their grocery stores. In New Orleans, Standard offered to pay one merchant a total of $48,000 not to handle my oil. [13]

Rockefeller on Rockefeller

During several decades, when various employees of Standard Oil were hauled before the bar of public opinion, Rockefeller turned out to be the most persuasive witness in his own cause. In the excerpts quoted below, Rockefeller gives his explanation for his success in the oil business. [•]

Q. To what advantage, or favors, or methods of management do you ascribe chiefly the success of the Standard Oil Company?

A. I ascribe the success of the Standard to its consistent policy to make the volume of its business large through the merits and cheapness of its products. It has spared no expense in finding securing and using the best and cheapest methods of manufacture. It has sought for the best superintendents and workmen and paid the best wages. It has not hesitated to sacrifice old machinery and old plants for new and better ones. It has placed its manufacturers at the points where they could supply markets at the least expense. It has not only sought markets for its principal products, but for all possible by-products, sparing no expense in introducing them to the public. It has not hesitated to invest millions of dollars in methods of cheapening the gathering and distributions of oils by pipelines, special cars, tank steamers, and tank wagons. It has erected tank stations at every important railroad station to cheapen the storage and delivery of its products. It has spared no expense in forcing its products into the markets of the world among people civilized and uncivilized. . . .

Our first combination was a partnership and afterwards a corporation in Ohio. That was sufficient for a local refining business. But dependent solely upon local business we should have failed years ago. We were forced to extend our markets and to seek for export trade. This latter made the seaboard cities a necessary place of business, and we soon discovered that the manufacturing for export could be more economically carried on at the seaboard .

We soon discovered as the business grew that the primary method of transporting oil in barrels could not last. The package often cost more than the contents, and the forests of the country were not sufficient to supply the necessary material. Hence we devoted attention to other methods of transportation, adopted the pipeline system, and found capital for pipeline construction equal to the necessities of business. To operate pipelines required licenses from the states in which they were located. To perfect the pipeline system of transportation required in the neighborhood of fifty millions of capital invested. This could not be built or maintained without industrial combination. The entire oil business is dependent upon this pipeline system. Without it every one would shut down and every foreign market would be closed to us. The pipeline system required other improvements, such as tank cars upon railways, and finally the tank steamer. Capital had to be

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13 Quoted in Thomas Manning E. David Cronon and Howard Lamar, The Standard Oil Co., Holt, Rhinehart, and Winston, New York, 1960, pp. 24-25 (edited)

• Rockefeller could also be very forgetful on the witness stand. In one case in 1908, it took him a full minute to remember he was in the oil business.

furnished for them and corporations created to win and operate them. Every step taken was necessary in the business if it was to be properly developed, and only through such successive steps and by such an industrial combination in America today enabled to utilize the bounty which its land pours forth, and to furnish the world with best and cheapest light ever known [14]

Rockefeller as Industrial Statesman

The most thorough study of John D. Rockefeller's career was made by the noted historian, Alan Nevins. In his generally favorable biography, Nevins excused what he considered to be occasional questionable practices by Rockefeller because he had to "use the weapons and instruments of his time," and concluded that his motives were to "impose a more rational and efficient pattern" on the oil industry. Nevins believed Rockefeller was "an organizing genius" who "looms up as one of the most impressive figures of the century" and that those who objected to the methods he used were not engaged in "a struggle against" wrongdoing, but "a struggle against destiny."

> *It is plain that the place Rockefeller holds in American history is that of a great innovator. His vision brought order to an industry bloated, lawless, and chaotic. Pursuing his vision, he devised a scheme of industrial organization which was magnificent in its symmetry and strength, world-wide in its scope, possessed of a striking novelty.*
>
> *Rockefeller was a realist.. . . . Partly by intuition, partly by hard thought, he understood the real nature of economic forces, and the real motives operative in American industry. He and the other leaders of the "heroic age" in American business development thus constituted the guiding elite, in a modern sense, of our industrial society. Many of the forces and elements in that society were irrational and wasteful. Rockefeller wished to impose a more rational and efficient pattern, answering to his own intuitions and conclusions. Behind this desire he placed an intellectual keenness, a skill in organization, and a dynamic personal force which were not surpassed, and possibly not equaled, by those of any other industrial captain in history. It is true that some of his methods were open to criticism; but then it must be remembered that he had to use the weapons and implements of his time.*
>
> *We have said that his place in the history of business was that of a great innovator; and that is also his place in the history of philanthropy. This man who remolded one industry and offered a design for remaking others crowned his activities by the colossal grant of some $550,000,000 to various objects. But the unexampled scale of his gifts is not their most striking feature. What made his donations arresting and memorable was in larger part the skill with which he planned and organized them. He devoutly believed that God had made him a trustee for these hundreds of millions, not to be kept but to be given wisely and carefully.* [15]

Rockefeller as Robber Baron

The author of a book on the business captains of the 19th century was so convinced that Rockefeller and other successful monopolists of the time were dishonest and grasping exploiters that he entitled his work, *The Robber Barons*. Matthew Josephson found that Rockefeller's "margin of profit" was consistently controlled by the monopoly and amounted to "grotesques figures." Rockefeller's control over industry,

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14 Quoted in Thomas Manning E. David Cronon and Howard Lamar op. cit., pp. 25-26 (edited)
15 Allan Nevins, John D. Rockefeller, Volume II, quoted in Earl Latham, ed., John D. Rockefeller: Robber Baron or Industrial Statesman , DC. Heath, Lexington, Mass., 1949, pp. 78-82 (edited)

Josephson suggested, was not the result of superior efficiency, but "of the secret aid of the railroads and the espionage of their freight agents." And the so-called benefits to the consumer, he argued, were but "accidental by-products" of an organization that was clearly "out for the dollar."

> *In the field of retail distribution, Rockefeller sought to create a great marketing machine delivering directly from the Standard Oil's tank wagons to stores in towns and villages throughout the United States. Where unexpected stout resistance from competing marketing agencies was met, the Standard Oil would simply apply harsher weapons. To cut off the supplies of the rebel dealer, the secret aid of the railroads and the espionage of their freight agents would be invoked again and again.*
>
> *The documents show that the independent oil dealer's clients were menaced in every way by the Standard Oil marketing agency; it threatened to open competing grocery stores, to sell oats, meat, sugar, coffee at lower prices. "If you do not buy our oil we will start a grocery store and sell goods at cost and put you out of business." By this means, opponents in the country at large were soon "mopped up;" small refiners and small wholesalers who attempted to exploit a given district were routed at the appearance of the familiar red-and-green tank wagons, which were equal to charging drastically reduced rates for oil in one town, and twice as much in an adjacent town where the nuisance of competition no longer existed.*
>
> *They found ways of effecting enormous economies and always their profits mounted to grotesque figures. Though raw materials declined greatly in value, and volume increased, the margin of profit was consistently controlled by the monopoly; for the service of gathering and transporting oil, the price was not lowered in twenty years, despite the superb technology possessed by the Standard Oil.*
>
> *While the policy of the monopoly, as economists have shown, might be for many reasons to avoid maximum price levels such as invited the entrance of competition in the field, it was clearly directed toward keeping the profit margin stable during a rising trend in consumption and falling "curve" in production costs…As often as not it happened that technical improvements were actually long delayed until, after a decade or more, their commercial value was proved beyond a doubt. It was only after rivals, in desperation, contrived the pumping of oil in a two-hundred mile-long pipeline that Rockefeller followed suit. So it was with the development of various by-products, the introduction of tank cars, etc. The end in sight was always increase of ownership, and of course, profits rather than technical progress in the shape of improved workmanship or increased service to the community. These later effects were also obtained. But to a surprising degree they seem accidental by-products of the long-drawn-out struggles for control over the industry.*[16]

Production, Prices and Profits

The following statistics may help you decide if Rockefeller was an industrial statesman or a robber baron. The figures themselves were gathered by the U.S. Government while preparing its case against Rockefeller's giant oil corporation.

16 Mathew Josephson, The Robber Barons quoted in Earl Latham ed., op. cit. p. 39 (edited)

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Standard Oil's Profits — 1883-1906[17]						
Year	$ Invested	$ Profits	Barrels	Profits on investment	Price per gallon	Profit per gallon
1883	72,869,000	11,231,000	16,137,000	15.4%	7.4	5.6
1885	76,762,000	8,382,000	17,578,000	10.9%	8.3	6.3
1887	94,377,000	14,026,000	20,471,000	14.8%	7.1	5.4
1889	101,281,000	14,845,000	27,165,000	14.7%	7.5	5.4
1891	120,771,000	16,331,000	35,997,000	13.5%	7.3	5.3
1893	131,886,000	15,457,000	41,083,000	11.7%	6.1	4.8
1895	143,295,000	24,078,000	40,772,000	16.8%	5.2	3.2
1900	205,480,000	55,501, 000	47,237,000	27.0%	8.5	5.2
1902	231,758,000	64,613,000	50,452,000	27.9%	7.4	4.4
1904	297,489,000	61,570,000	56,204,000	20.7%	8.3	4.4
1906	359,400,000	83,122,000	63,856,000	23.1%	?	?
Totals:	**359,400,000**	**790,000,000**				
1883	72,869,000	11,231,000	16,137,000	15.4%	7.4	5.6

Note the amount of money made by Standard Oil. Does it seem that Standard passed its efficiencies on to the consumer, or that Standard kept the savings in profit? Note also the price of a gallon of oil between 1883-1906. Between 1883-97, prices in general were going down, and between 1893-97, there was a serious depression. Note also that independent refineries claimed that 1/2 cent per gallon was a reasonable profit. Someone might argue that Rockefeller deserved to make these profits as a reward for superior business skills. Read the figures and draw your own conclusions: Rockefeller's private fortune was estimated at $300 million in 1906; in 1913, his fortune was estimated at $900 million – but that was a time when total production in the US (GNP) was about $40 billion. In 1998 it was $7 trillion – almost 200 times more than in 1913

Suggested Student Exercises:

1. Evaluate the evidence presented by Rice and Rockefeller. What light do they shed on the Robber Baron Industrial Statesman debate?

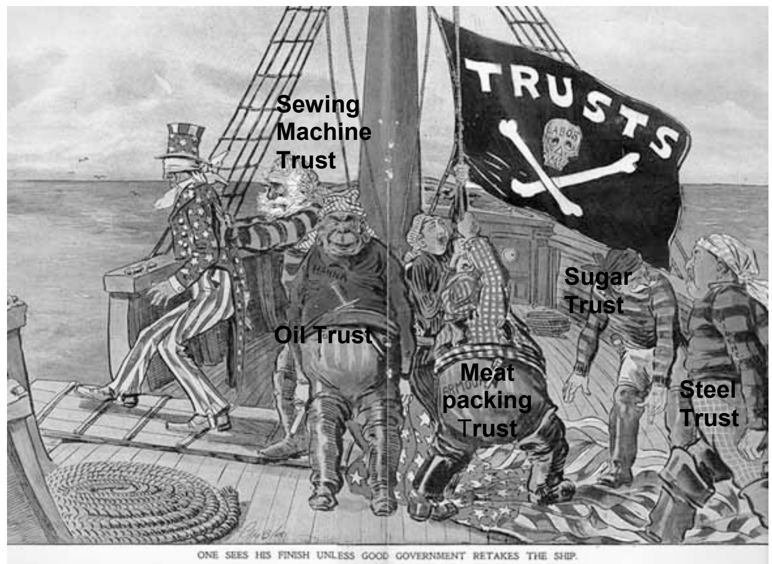
2. After summarizing the main arguments of Nevins and Josephson, explain whether you think the statistics on this page support either historian.

3. Based on all of the information you have on Rockefeller's career, do you think he was a 'Robber Baron' or an 'Industrial Statesman'? Explain.

17Manning et. al. op. cit., pp. 32-34

Chapter 8
The Sherman Anti-Trust Act and Standard Oil

By the mid 1880's Americans had observed a trend toward business consolidation that threatened every major industry. What had happened in oil was also happening in the meat packing business, in copper, steel, whiskey, farm and shoe manufacturing machinery, sugar refining, sewing machines and in other fields far too numerous to list here. The practice of unrestrained competition reflecting the laissez-faire philosophy of Adam Smith and the social Darwinism of William Graham Sumner, was leading to an elimination of competitors. In many instances, the means used to destroy business rivals resembled the law of the jungle more than the practice of civilized men. It seemed to many people that only those firms willing to exploit some special advantages with the railroads or use some other strong-armed tactic were surviving while decent people who practiced ethical principles in their business dealings were quickly driven to the wall and forced into bankruptcy. Gradually a consensus grew among the American people that an end must be put to unrestrained competition and combination. This sentiment produced the Interstate Commerce Act of 1887, which was meant to prohibit particular unfair practices among the nation's railroads. Among the specific methods prohibited by the Act was receiving or providing secret rebates, rate discrimination of any kind between shippers, charging more for short distances than for long, and charging 'unreasonable' rates.



Cartoon expressing popular feeling in 1890's that trusts (the pirates in the picture) are about ready to throw democracy

Three years later, Congress passed the Sherman Anti-Trust Act. It was designed to prohibit unfair competition among large firms. Rather than define specific illegal practices the Sherman Act contained much more general and ambiguous language:

> 1. Every contract, combination in the form of a trust or otherwise, or conspiracy in restraint of trade or commerce, among the several States, or with foreign nations is hereby declared to be illegal.
>
> 2. Every person who shall monopolize, or attempt to monopolize any of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor.

On several points the Sherman Act was not very specific. It left for the Courts to decide what a 'conspiracy in restrain of trade' was; whether manufacturing should be considered part of trade, and what actions would actually constitute an 'attempt to monopolize.' This chapter examines some of the interpretations placed on this important law, and asks the reader whether its provisions were violated by John D. Rockefeller when he consolidated the oil industry.

The Sugar Refinery Case

Whether the Sherman Act would become an effective tool to curb the growth of giant business enterprises remained to be seen. Certainly that would in part determine how vigorously the government prosecuted cases under the Act and how closely the Court would interpret its meaning.

These questions were soon answered in the famous case *U.S. v. E.C. Knight,* 1894. The Supreme Court was asked to decide whether the American Sugar Company's purchase of four refineries in Philadelphia that gave the company control over 98% of the nation's sugar refining capacity represented a conspiracy in restraint of trade. The corporation defended itself in court by arguing that control over manufacture did not constitute a restraint of trade since there was no necessary connection between manufacturing and commerce. With only one dissenting opinion, the Court ruled:

> *The fact that an article is manufactured for export to another state does not of itself make it an article of interstate commerce.*

In fashioning the Knight decision, the Supreme Court in effect vetoed the Sherman Act. The Attorney General at that time was not distressed by the outcome of this case that in effect deprived the national government of the power to "deal with a matter that directly and injuriously affects the entire commerce of country." Commenting on the government's loss in the E.C. Knight case, Attorney General Richard Olney admitted that he had never believed in the Sherman Act:

> *You will observe that the government has been defeated by the Supreme Court on the trust question. I always supposed it would be and have taken the responsibility of not prosecuting under a law which I believed to be no good.* [18]

This combination of a reluctant administration and a pro-business Supreme Court produced only eighteen cases against business under the administration of three Presidents, Harrison, Cleveland and McKinley. The government lost seven of its first eight. Meanwhile, businessmen took advantage of the failure of prosecution under this law and formed combinations at an increasingly rapid rate. Between 1880 and 1902, some 5,000 small businesses were combined into three hundred large combinations. Two-thirds of these combinations were formed between 1898 - 1902., well after the Sherman Act was passed.

In his dissent on the E.C. Knight case, Justice John Marshall Harlan had asked, "what power is competent to protect the people of the United States against [the monopolies] except a national one." After Theodore Roosevelt succeeded William McKinley to the White House in 1901, prosecution of big businesses under the Sherman Act was pursued in earnest. Altogether, Theodore Roosevelt directed forty-four different cases against monopolies. The most famous was the suit against Standard Oil Company instituted in 1906.

U.S. v. Standard Oil

By the time, Standard Oil was brought to court, the Knight decision had been re- versed — manufacturing was no longer considered an "accidental, secondary, remote or merely probably"

18 Quoted in Allan Nevins, Study in Power John Q. Rockefeller Volume II, Charles Scribner's Sons, New York, 1953, p. 362.

relationship to commerce — and the Supreme Court had once again asserted its right to regulate trade in the U.S. But another problem arose which affected the outcome of the decision. The Supreme Court was willing to consider the doctrine of reasonableness as a modification of the wording of the Sherman Act. In effect the Court changed the wording of the Act to read, "every *unreasonable* contract, combination in the form of a trust or otherwise, or conspiracy in restraint of trade or commerce is hereby declared illegal." There was no telling how this new interpretation, if accepted by the Court, might dilute the wording and the intent of the Sherman Act, starting with its application in the Standard Oil case.

Under the direction of its chief prosecutor, Frank B. Kellogg, the government's case soon took shape. The government claimed that the Standard Oil Company had obtained its monopoly "not by superior efficiency, but by unfair and immoral acts — rebate taking, local price-cutting" and so forth, in defiance of *local and federal* laws. What savings the Company could claim in its efficient operations, the government argued, were not passed on to the consumer, but taken by the few men who controlled the Oil industry to make themselves millionaires many times over at the public's expense.

Standard's defense was handled by a team of distinguished lawyers under the supervision of John C. Milburn. They emphasized the extraordinary efficiency of the company, its tremendous constructive achievement in producing an excellent product for a very reasonable price, and meeting the need for kerosene, gasoline, and many different kinds of lubricants. The defense stressed the many innovations in refining and in transporting oil that were developed by Standard, as well as many useful by-products. Its alleged unfair competitive practices were necessary to insure its survival in the business climate of that time. They should be dismissed as ''mere incidents in the conduct of a great business" and due to the "over zealousness of some employees" rather than the intent of the corporation's directors.

The Issues

The suit against Standard Oil was one of the most dramatic tests of strength in the courts of that era because it pitted the U.S. government against the nation's largest corporation and its wealthiest citizen. It was both a test of strength and of philosophies — the strength of private enterprise as opposed to public regulation, and the philosophy of laissez-faire and survival of the fittest, as opposed to the belief in control by the Federal government.

Suggested Student Exercises:

1. State the provisions of the Sherman Act and indicate whether you believe it should

   a. apply to manufacturing and refining, as well as to the actual transportation of goods, and
   b. be modified by the 'rule of reason'.

2. As your teacher directs., prepare a mock trial of Standard Oil for violating the Sherman Act (see next chapter), or discuss whether Rockefeller was guilty under the act.

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Chapter 9
Standard Oil on Trial

The U.S. government filed suit against Standard Oil Corporation in 1906. It took five years for the courts to give their final ruling in what was one of the most important anti-trust cases in history. The purpose of this chapter is to provide your class with instructions for staging a mock trial of John D. Rockefeller for violating the Sherman Anti-trust Act. In this trial, students will have the opportunity to play the role of John D. Rockefeller himself, a business partner, someone he drove out of business, a famous historian, and a justice on the Supreme Court!

The major question to decide in the trial is whether the Standard Oil Corporation achieved its control over the oil industry through an *unreasonable* restraint of trade. Did it attempt to drive other companies out of business and monopolize the oil industry, or was its monopoly obtained more or less by accident?

Trial Preparation Information	
Prosecution - (Frank Kellogg, attoney)	**Defense** (John C. Milburn, attorney)
Tried to Monopolize	**Monopoly by accident**
Rockefeller obtained his monopoly by getting special rates from the railroads, and using threats, bribes, and other unfair tactics designed to drive his opponents out of business. Rockefeller's dealings with Hewitt, Potts and Rice help prove this point. Their testimony is supported by the famous historian Ida Tarbell.	Rockefeller never did anything that others did not try to do. His monopoly was the result of his superior efficiency and his success resulted from doing what others did. He never tried to drive others out of business. Testimony from Flagler, Scott, and Rockefeller himself will support this argument. It is also supported by the famous historian, Allan Nevins.
Rockefeller might argue that his profits were a result of his superior efficiency. But Ms. Tarbell will show his savings were never passed on to the consumer. Instead Rockefeller made unreasonably high profits at the expense of those who bought his oil and kerosene.	Nevins will also show that Rockefeller made his money only because he was a very efficient producer. His profits were reasonable because he worked hard and was a good businessman. His prices stayed the same for 20 years.
Witnesses	**Witnesses**
Hewitt Formerly a refiner in Cleveland, he will claim that he was forced to sell his company for far less than it was worth because of unfair deals Rockefeller had made with the railroads to get rebates, drawbacks and secret information. It was impossible for him to compete with the South Improvement Co. not because its oil was cheaper, but because it received rebates and other special advantages from the railroads.	**Flagler** Rockefeller's partner will testify that there was nothing illegal about the South Improvement Company deal in Cleveland. Other companies also received rebates, the railroads agreed to the deal, and Rockefeller provided them with loading docks and regular trade. There is nothing wrong with getting rebates and drawbacks. Others have done the same.

Potts Formerly President of Empire Transport Company, Joseph Potts can testify that Rockefeller did his best to prevent him and Tom Scott from going into the business of refining oil. Standard's tactics included telling him to get out of the refining business; lowering prices for refined oil; raising prices for crude; cutting off business with his ally, Scott; reducing railroad rates; and finally forcing him to sell for less than his company was worth. Might hint that Rockefeller was behind the railroad strike and riot that hurt the Pennsylvania Railroad	**Scott** President of Pennsylvania railroad will testify that Joseph Potts used the same tactics against Rockefeller that Rockefeller is accused of using against Potts. by raising the prices he paid for unrefined oil and lowering prices for refined oil. When Potts sold his refineries he got the best deal from Standard that anyone would give him. Will deny that Rockefeller had anything to do with the railroad strike and riot.
Rice Once an independent refiner, he will claim that Rockefeller was able to get railroads to charge him 35 cents a barrel while Rockefeller was only paying 10 cents; that Rockefeller bribed and threatened grocers to buy Standard Oil, and did everything in his power to drive him out of business. Rice will also say he could have competed with Rockefeller except for the railroad rates Standard Oil received.	**Rockefeller** Will claim he was an efficient producer who paid attention to every aspect of the business to save money and that he never did anything but use the tactics of his time, (i.e. he didn't do anything that others did not do). Will say that Rice was a bitter old and unsuccessful businessman who could not be trusted and that if there were any bribes it was due to the overzealous actions of his (Rockefeller's) employees.
Ida Tarbell, historian. Author of a well-known book on Rockefeller, Tarbell knows the story of South Improvement, Potts, and Rice. Believes Rockefeller was a robber baron. Can testify that his actions in these cases were typical of the way he did business, i.e., using railroad rates and price-cutting to gain a monopoly. Can also testify that Rockefeller made huge profits and did not pass any money saved by efficiencies on to consumers. Can say that issue is not whether he gave money to charity but how he got his monopoly.	**Allan Nevins, historian** Author of well-known book on Rockefeller that praised him as an industrial statesman. Can testify that the oil business was very dirty in the early days, Rockefeller gave the railroads good value in the South Improvement case, Potts was out to get Rockefeller, and that Rice could not be trusted to tell the whole truth. Will say that profits were due to Rockefeller's efficiencies and investments, and that he gave much of his money to charity. Can use chart to show he did not raise his prices for 20 years.

General Rules and Procedures

Lawyers

- One lawyer should concentrate on asking questions of friendly witnesses, the other lawyer should do the cross-examination. One lawyer should make the opening and the other the closing statement.
- Have opening statements (200-300 words) prepared in writing before class. It should include:
  why the issue of Standard's guilt or innocence is so important.
  what you are going to prove in general, and

what each witness will say

- Have questions prepared for presenting witnesses and for cross-examination. But first allow witnesses to present their testimony and then ask questions that emphasize parts of their testimony which are most likely to sway the jury.
- Closing statements (300-500 words) should cover:
  why issue of Standard's guilt or innocence is so important
  what was proved in trial with review of what individual witnesses said
  the proposed remedy (for the prosecution): splitting Standard, jailing Rockefeller, etc.)

Witnesses

- Bring written statement containing their testimony to be read in class.
- Be prepared to answer questions lawyers may ask to call attention to points they wish to emphasize.
- Be sufficiently informed about the case so as to be prepared for the unexpected during cross-examination.

Jury

- Students who are not assigned to be lawyers or witnesses are members of the Supreme Court.
- As members of the Court jurors are allowed to ask questions of witnesses and lawyers during the trial.
- Jurors will decide: whether Rockefeller was guilty or innocent and why. Verdict should include specific examples.
- Each juror's decision must be made in writing, be at least 300 words long, and be defended in class. The verdict may also deal with the questions of whether Standard Oil should be split up, and if Rockefeller should go to jail.

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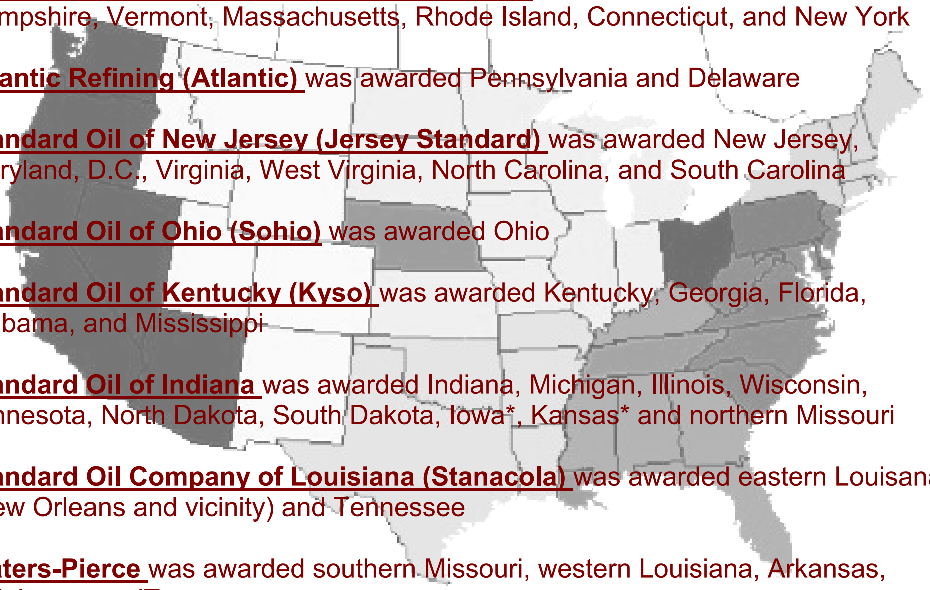
Chapter 10
The Supreme Court Decides

With justice Edward Douglas White writing the landmark opinion, the Supreme Court ruled on May 15, 1911 that Standard Oil and 33 other corporations were engaged in an unreasonable conspiracy to "restrain trade and commerce in petroleum, commonly called 'crude oil', in refined oil, and the other products of petroleum." Chief Justice White had taken great pains to distinguish between a "reasonable" and an "unreasonable" restraint of trade. The latter meant any contract that indicated an attempt to monopolize, fix prices, destroy competition, hold back production, or divide markets.

In its decision, the Supreme Court ordered that Standard Oil of New Jersey be separated into 33 different companies with different sets of directors and officers, and that these do not consult with one another. Holders of stock in the original company were to surrender their stock and be given, in exchange, a percent of stock in each of the 33 companies, equal to the percent they held in Standard Oil. Thus, Rockefeller and his partners, who had owned the majority of Standard of New Jersey's stocks, were to be assigned the majority of stocks in each of the 33 new companies. Rockefeller, who had once held 1/4th of Standard's stock, now was given 1/4th of the stocks in each of the 33. The decree did so little damage to the Standard Oil Empire that the value of its stock increased by some $200,000,000 shortly afterwards. The value of Rockefeller's shares increased from $300 million in 1906 to $900 million in 1913.

The Limits of Competition Following the 1911 Supreme Court Decision



Standard Oil Company of New York (Socony) was awarded Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut, and New York

Atlantic Refining (Atlantic) was awarded Pennsylvania and Delaware

Standard Oil of New Jersey (Jersey Standard) was awarded New Jersey, Maryland, D.C., Virginia, West Virginia, North Carolina, and South Carolina

Standard Oil of Ohio (Sohio) was awarded Ohio

Standard Oil of Kentucky (Kyso) was awarded Kentucky, Georgia, Florida, Alabama, and Mississippi

Standard Oil of Indiana was awarded Indiana, Michigan, Illinois, Wisconsin, Minnesota, North Dakota, South Dakota, Iowa*, Kansas* and northern Missouri

Standard Oil Company of Louisiana (Stanacola) was awarded eastern Louisana (New Orleans and vicinity) and Tennessee

Waters-Pierce was awarded southern Missouri, western Louisiana, Arkansas, Oklahoma, andTexas

Competition in the Oil Industry 1911 -1950

According to one analyst, the long awaited decision regarding Standard Oil did little to increase competition in the industry:

> *. . . {F]or some time it carried little or no increase in competition. The various companies had divided their fields either territorially or functionally. They continued for years to respect the eleven old territorial divisions, though functional lines were less easily maintained. The Standard of Indiana long took pains not to cut into areas held by the Standard of Ohio, and vice versa. The Standard of New York (Mobil), which had been the great exporting agency of the combination, now increased its distributing business in New York State; but it and Standard of New Jersey (ESSO), tried not to trespass on each other's limits. The shares of the thirty-odd companies were so largely owned by the same small group that, in theory at least, the old chieftains could control the directorates and hence the policies…*
>
> *As the years passed, the units of the great Standard flotilla inevitably drifted apart. Stock ownership became widely diffused; old leaders gave way to new. As fields were opened in fresh areas, more capital came in, automobiles were sold in tens of millions, the world market expanded, and the industry became more competitive. The principal companies engaged in refining and marketing began to "integrate backward" and obtain direct control over crude oil; the production and transportation companies combated this by integrating forward to control their own markets. In short, economic developments brought about a breakdown of the old Standard Oil monopoly which laws and courts had been unable to attain. But it should be noted that the competition which resulted has been primarily a service competition, not a price competition. Reduction of charges, all factors considered, has been illusory. Any motorist who finds at his crossroads four service stations of four different companies, selling substantially the same gasoline at precisely the same prices, and battling for trade by variations in washroom facilities, has reason to ponder upon the proper limits of competition.*[19]

Suggested Student Exercises:

1. Summarize the effects of the Supreme Court's decision on competition in the oil industry.

2. Based on everything you know about the Standard Oil case, do you think the Supreme Court made the right decision? Can you think of an alternative?

19Quoted in Thomas Manning, et. al., op. cit., pp. 60-61