

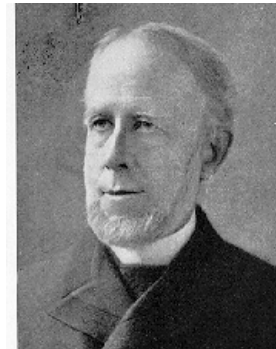
Chapter 5

Empire 's Challenge to Standard



Tom Scott

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 men who controlled the nation’s largest corporate enterprise, the mighty Pennsylvania rail-road.



Joseph Potts

of

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 Cornelius 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.