



How Sherman's Hammer Shattered Standard Oil: A Case Study

By: Krish Dhingra, published with Pooja Yadav

Abstract

On July 2, 1890, the United States instituted the Sherman Antitrust Act (SAA), and on May 18, 1911, the U.S. Supreme Court ruled to dissolve Standard Oil trusts in violation of this act. The SAA was the United States' attempt to show the general public their stance on monopolies, of which Standard Oil was the most well-known. Over time, the Supreme Court would find Standard Oil in violation of the SAA for several different transgressions. These were known as the three periods of conspiracy, where John Davison Rockefeller and associates would create loopholes in the SAA that the U.S. government would take them to court over several times. The first of these periods was from 1870 to 1882, with the second from 1882 to 1899, and the third from 1899 to the time of the filing of the bill that inevitably led to the dissolving of the trust. In this paper, I will evaluate the decisions made by Rockefeller and others along with the developments that occurred during these conspiracy periods and will use a model to evaluate the efficacy of their judgement.

Introduction

The Sherman Antitrust Act, passed in 1890, was a landmark federal statute in the United States that aimed to promote economic fairness and competitiveness. It prohibited certain business activities that federal government regulators deemed to be anti-competitive, and required the federal government to investigate and pursue trusts, companies, and organizations suspected of being in violation. The act's passage marked a significant shift in the U.S. government's approach to business regulation, setting the stage for future antitrust litigation and the development of antitrust law.

One of the most notable cases involving the SAA was the breakup of Standard Oil in 1911. This case, often referred to as the Supreme Court vs. Standard Oil, provides a detailed look into the operations of Standard Oil and the strategies employed by its leadership, particularly John D. Rockefeller, to dominate the oil industry. This paper examines the strategies used by Standard Oil, the application of the SAA, and the outcomes of the case, using various models from economic and business research to evaluate the effectiveness and impact of these strategies.

The Sherman Antitrust Act: An Overview

The Sherman Antitrust Act was a groundbreaking piece of legislation aimed at curbing monopolistic practices and promoting fair competition. Key provisions of the act included:

1. **Prohibition of Monopolistic Practices:** The act banned any attempt to monopolize any part of trade or commerce in the United States. This included dictating, controlling, and manipulating prices within a particular market.
2. **Penalties for Violations:** Individuals found guilty of violating the act could face up to 10 years in prison and fines of up to \$1 million. Corporations could be fined up to \$100 million, with fines potentially exceeding \$100 million to double the profits gained from illegal activities.
3. **Promoting Economic Fairness:** The act aimed to ensure that no single company could dominate a market to the detriment of competitors and consumers, thereby promoting economic fairness and competitiveness.

The act earned the nickname "Sherman's Hammer" for its ability to break up large monopolistic companies into smaller entities. Some of the most significant applications of this act were in the breakups of Standard Oil and American Tobacco in 1911, where American Tobacco's gaping hole in the market allowed companies such as R.J. Reynolds and Liggett & Myers to take its place.

Standard Oil and John D. Rockefeller

Standard Oil, founded by John D. Rockefeller, was a prime example of a "natural monopoly"—a monopoly in an industry that is expensive and difficult to enter, thus discouraging potential competitors. The company's dominance in the oil industry was achieved through a combination of aggressive business tactics, strategic acquisitions, and innovative practices.

The Supreme Court vs. Standard Oil

The case against Standard Oil was brought before the Supreme Court with three main defendants accused of conspiracy to monopolize: John D. Rockefeller, William Rockefeller, and Henry M. Flagler. The court case detailed how the Rockefellers and their associates organized the Standard Oil Company of Ohio in 1870, transferring the business of their prior partnerships to this corporation.

Standard Oil's strategies included gaining control of nearly every oil refinery in Cleveland, controlling approximately 90% of all oil refineries and related businesses, and using this control to fix prices and monopolize the petroleum industry. The company also engaged in practices such as obtaining rebates and preferences from railroad companies, monopolizing pipelines, and using unfair methods to suppress competition.

Strategies Employed by Standard Oil

Standard Oil's business model relied heavily on vertical integration and monopsony. Some identifiable key strategies that were used included:

1. **Vertical Integration:** Standard Oil controlled every aspect of the petroleum industry, from production and refining to transportation and sales. This allowed the company to reduce costs and increase efficiency.

2. **Monopsony Power:** By dominating the market, Standard Oil could dictate terms to suppliers and buyers, further consolidating its control over the industry.
3. **Strategic Acquisitions and Partnerships:** The company continuously expanded by acquiring competitors and forming strategic partnerships, effectively eliminating competition.
4. **Rebates and Preferences:** Standard Oil secured favorable terms from railroad companies and other transportation providers, allowing it to undercut competitors and dominate the market.

Legal Challenges and Dissolution

The legal battle against Standard Oil culminated in the Supreme Court's decision in 1911 to dissolve the company. The court found Standard Oil in violation of the Sherman Antitrust Act, specifically citing:

1. **Restraint of Trade and Commerce:** Standard Oil's practices created a monopoly that restrained trade and commerce across state lines.
2. **Unlawful Stock Transfers:** The transfer of stocks to corporations controlled by Standard Oil of New Jersey violated sections 1 and 2 of the SAA, which prohibit combinations in restraint of trade and attempts to monopolize trade.
3. **Unfair Competition:** Standard Oil's methods of competition, including local price-cutting, espionage, and operation of bogus independent companies, were deemed unfair and illegal.

The dissolution of Standard Oil resulted in the creation of several smaller companies, effectively breaking the monopoly and restoring competition in the oil industry.

Evaluation of Strategies Using Economic Models

To evaluate the strategies used by Standard Oil, we can apply several economic and business models, including Blair and Harrison's Buying Power Index (BPI) and variables related to supply, demand, and market information from John H. Brown and Mark Partridge's publishing in 1984.

Blair and Harrison's Buying Power Index (BPI)

The BPI measures the percentage increase in the price of a good if the market transitions from monopsonistic to competitive. This index helps evaluate the value of a monopsony for the individual or entity holding it. Although Standard Oil did not have a complete monopsony, its dominance in the market (80-90%) provided significant monopsonistic power.

Variables to Evaluate

John H. Brown and Mark Partridge identified key factors that can be used to assess Standard Oil's position, which consist of:

1. **Supply of Petrol (S):** Key variables influencing supply include price, cost of production, size of crude oil inventory, and potential cartels among oil producers.
2. **Demand for Petrol (D):** Key variables influencing demand include price, share of petrol exported, business cycle effects, potential cartels among middleman companies, and Standard Oil's dominance.
3. **Market Information (I):** Market information is often random but can be predicted by environmental events and trends.

4. **Transaction Costs (T):** Transaction costs include expenses related to finding trading partners, negotiating prices, and completing transactions.

Analysis

Standard Oil's strategies were highly effective in the short term, allowing the company to dominate the market and generate enormous profits. However, these strategies also led to significant legal challenges and ultimately the company's dissolution. The use of vertical integration and monopsony power allowed Standard Oil to control prices and suppress competition, but these practices were deemed illegal under the Sherman Antitrust Act.

Strategies

Some of the more effective strategies that Standard Oil employed consisted of their acquisitions, which allowed them to have a Standard Oil Co. in 34 states of the country at one point. The Standard Oil Company of New Jersey was able to form partnerships with many of the other Standard Oil Companies as well as Humble Oil, which consisted of over 20,000 square miles of land dedicated to drilling and refining oil. This, although an illegal trust, was an extremely successful business model for a short period of time, and was able to succeed in having a local monopoly and monopsony on oil. Standard Oil of New York found itself in a similar situation, being at the head of a trust after just having acquired Vacuum Oil, another superpower.

Conclusion

The case of Standard Oil provides a compelling study of the interplay between business strategies and regulatory frameworks. While Standard Oil's aggressive tactics and innovative practices allowed it to dominate the oil industry, these same practices ultimately led to its downfall due to violations of the Sherman Antitrust Act. The dissolution of Standard Oil underscored the importance of regulatory oversight in maintaining fair competition and preventing monopolistic practices. Future research can further explore the long-term impacts of the breakup on the oil industry and the effectiveness of antitrust regulations in promoting economic fairness.

Morality

Morality and following the law are essential in business because they uphold fairness, respect for others, and societal norms. They ensure that businesses operate ethically and responsibly, fostering trust among stakeholders and maintaining a stable, lawful environment for operations. Adhering to these principles is fundamental to upholding integrity and contributing positively to the broader community.

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