Excerpt from Powell, Benjamin and Adam Summers. *Antitrust is Anti-Consumer.* Economic Education Bulletin. Vol. XLII No. 7. July 2002.

The Standard Oil Case (1911) On May 15, 1911, the Supreme Court upheld a lower court's ruling and ordered the Standard Oil Company of New Jersey to be broken up. Judge Hook of the lower court had found:

> A holding company owning the stocks of other concerns whose commercial activities, if free and independent of common control, would naturally bring them into competition with each other, is a form of trust or combination prohibited by Section I of the Sherman Act. The Standard Oil Company of New Jersey is such a holding company.

This lower court ruling, if taken seriously, prohibits all mergers of any companies that might compete with one another from ever forming a single company, regardless of the possible economic benefits for both companies and consumers. The Supreme Cfsourt, when reviewing this decision, instead of finding that all holding companies were illegal *per se*, advocated the use of a "rule of reason." Justice White said that in determining whether a company was guilty of breaking the Sherman Antitrust Act, the Court must consider whether the company possessed

> …the intent to do wrong to the general public and to limit the rights of individuals, thus restraining the free flow of commerce and tending to bring about the ends, such as enhancement of prices, which were considered to be against public policy.

While the "rule of reason" is mentioned in the court's findings, there is little evidence to indicate that it was applied. Instead, the rule of the lower court was essentially upheld because Standard Oil had formed a large holding company. Justice White even said that the allegations against Standard oil were practically "not within the domain of reasonable contention." If we look at Standard Oil's performance, though, we find that it obtained its large market share by relentlessly innovating, creating new products, and lowering costs. It expanded output and lowered prices. Both Standard Oil *and* consumers benefited. The only group that did not benefit were competitors who could not match Standard Oil's ability to serve consumers.

In 1870, when Rockefeller reorganized his company into Standard Oil, he had a 4 percent share of the kerosene market selling it for 26 cents per gallon. By 1880, his market share was 80-85 percent. During this time he searched for ways to use the byproducts from kerosene production that his competitors simply discarded. He used tars for paving, sent naphtha to gas plants, and used gasoline for fuel. He began selling lubricating oil, petroleum jelly, and paraffin for candles. He also discovered innovative ways to cut costs. He hired his own plumbers and cut the cost of labor, pipes, and plumbing materials in half. Coopers charged him $2.50 per barrel, so he made his own and cut costs to 96 cents. He eventually hired chemists and developed 300 byproducts from each barrel of oil. All of this led to significant cuts in cost. Rockefeller's average cost of refining a gallon of kerosene fell from 3 cents a gallon in 1870 to 0.452 cents in 1885. Through most of this time, he held a market share of close to 90 percent. The gains from his innovations led not just to lower costs and larger market shares for him, but also to cost savings and new products for consumers. From 1870 to 1885, refined kerosene dropped from 26 cents a gallon to 8 cents, and by 1897 had fallen to 5.91 cents.

Standard Oil maintained its dominant position, not through any "monopoly power," but through constant innovation and cost cutting that better served the consumer.

Eventually, Standard Oil made some business decisions that did not serve the best interests of the consumers. In the early 1900s, Standard did not invest in the oil boom in Texas, and it delayed in switching production from kerosene to gasoline. When it made these mistakes, its

competitors took advantage. Standard Oil's market share fell from its high of around 90 percent in the 1890s to 68 percent by 1907, and further declined to 64 percent by 1911, when the Supreme Court ordered the company to separate. Standard Oil's market size did not make it immune from competition.

Standard Oil had achieved its market dominance in the oil industry by creating new products and cutting costs, all to the benefit of consumers. Standard Oil, through the *process of competition*, achieved what competition is supposed to: better products and lower costs.

To look only at firm size and industry concentration at a moment in time misses the larger picture. Standard was competing the entire time; it was just doing it better than anyone else. When it did err and made choices that were not in the best interest of consumers, it had no free market "monopoly power" to prevent it from losing market share. Other entrepreneurs exploited the opportunities Standard did not recognize, allowing them to make profits and take away market share. The Supreme Court's decision only came down after this process was well underway. The process of competition was working.