

PREDATORY PRICE CUTTING IN THE STANDARD OIL (NJ) CASE, 1911¹

Standard Oil Case is a landmark and a legend. SO was portrayed as the archetype of a economic predator. The aura of this case and these events captured the public mind and led to specific provisions in the Clayton (1914) and Robinson-Patman (1936) Acts that proscribed predatory price discrimination. In spite of the fact that many economists and courts have worried that R-P may protect competitors more than competition, the specter of SO lurks in the background.

However, the theory of predatory price cutting is suspect at best, and the evidence is fleeting. The question is, When would price cutting ever be better than merger or purchase of assets?

Some points:

- 1) Predatory pricing might be ok if you already have a monopoly and are simply trying to protect it by keeping other firms out, but to build a monopoly from scratch by predation is not likely to be a profitable venture. The problem is that to drive other firms out and then raise price so as to enjoy the fruits of victory puts losses first and possible profits second. Discounting works strongly against the predator.
 - 2) As an alternative, why not just merge. This allows for immediate enjoyment of profits. True, merger requires paying off the competition. Possibly these competitors will require a share of the profits, but still it is more profitable than trying to kill them off by price cutting.
 - 3) The same line of argument follows when the alleged predator has gained some large share of the market. Instead of trying to kill off the remaining rivals, buying them out seems the more lucrative alternative.
 - 4) Assume that costs are the same for the monopoly wannabee as for the firms that make up the competitive market at the inception of the alleged price cutting. Otherwise the question is not interesting. If all firms have equal costs and the incipient monopolist attempts to cut price to impose losses on rivals, it must necessarily increase output and increase it in a costly fashion by moving up the rising portion of its cost curve. Hence, it will be incurring more losses than its rivals.
 - 5) Moreover, price cutting will not reasonably drive firms from the industry on a permanent basis. Manufacturing facilities idled because price is below average variable cost do not disappear in the mist. Workers and managers with knowledge of the business do not loose this knowledge because they are laid off. Even if the predator is able to quiet the production of rivals for the short term, when the monopolist attempts to raise price so as to enjoy the fruits of its victory it will likely find the jackals that it thought expelled returning to the feast.
 - 6) It does not make sense to monopolize at every stage of the vertical chain of production. Hence, if SO had a monopoly in refining, predatory pricing in marketing or in crude would have been a waste.
 - 7) Price differentials are not necessarily a sign of predatory pricing. They can be merely responses to relatively levels of competition in segmented markets.
- The evidence is lacking that SO ever engaged in predatory pricing in the refining segment of the oil business, where it is acknowledged to have had a monopoly. Generally the record shows that it bought out its rivals at prices that ranged from modest to handsome. Instances of price cutting

¹ "Predatory Price Cutting: The Standard Oil (N.J.) Case," John McGee, *Journal of Law & Economics*, October 1958, (1), 137-169.

are more often attributed to the rivals than SO. The evidence suggests that SO was itself a victim of *frontrunning*, where rivals bought out at one point would start new enterprises only to be bought out again.

The following are excerpts from McGee's paper:

Perhaps the most famous of all of the monopolizing techniques that Standard is supposed to have used is local price cutting. Given the bad reputé in which monopoly has long been officially held in this country, and the prominence of predatory pricing in Standard Oil, it is not surprising that the practice received special attention in the law. Monopoly was not new in 1911, but a predatory giant may have seemed novel. The vision of a giant firm that used a brutally scientific, and completely effective, technique for acquiring and maintaining monopoly must have aroused uncommon concern. Standard was invincible. Anything economists could say about the transience of monopoly must have seemed hopelessly unrealistic in view of the vigor and success with which Standard was said to have prevented entry. p 137

In any case, by 1914, in the Clayton Act, predatory price discrimination was included among a select group of business practices the character or effect of which called for explicit statutory prohibition. The Robinson-Patman amendment of 1936 lengthened the list, but certainly did not weaken the hostility toward local price cutting. Indeed, its legislative history and subsequent interpretation reveal a continuing dread of the device. p138

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In general, monopolization will not pay if there is no special qualification for entry, or no relatively long gestation period for the facilities that must be committed for successful entry. p. 143

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The voluminous Record in the Standard Oil of NJ dissolution suit furnishes a test of these propositions².

The Record shows that Standard established a refining monopoly³. Collusion among 100 to 200 different sellers was unstable. Standard achieved its monopoly position through merger and acquisition⁴. Although the Government alleged that Standard employed other techniques as well, it concluded that:

² The Transcript of Record consists of over 11,000 printed pages of exhibits and testimony; Appellants' briefs and oral argument covers more than 900 pages; Appellee's briefs and arguments almost 1300 pages. The full record is thus more than 13,500 pages long. Unless otherwise noted, volume references are to the Transcript of Record.

³ In 1879, Standard and those concerns "in harmony" with it, apparently refined from 90 to 95 per cent of the US output. See Vol. 6, at 3303. It is not clear just what these data mean, MR. Archbold testified that in 1870 Standard did about 10 per cent of the refining business in the United States; and that for 1888 Standard's share was probably 75 per cent. Id., at 3246-68. I think that much work remains to be done to determine how Standard's market position really changed over time. See, e.g. Vol. 2, at 783-784.

In any case, Standard's position in crude oil production was relatively small; it did very little retailing and did not perform all of its own wholesaling; several major railroads and the pipeline systems of Pure, Tidewater, Texas Co., Gulf, and others competed in the transportation of crude oil Its strongest position was evidently in refining.

⁴Q. Had you difficulty before you entered into relations with the Standard Oil Company to make money out of the business? A. The competition was always very sharp, and there was always some one that was willing to sell goods for less than they cost, and that made the market price for everything; we got up an association, and took in all the refiners until some of them went back on us, and that would break up the association; we tried that two or three times." Vol. 6, at 3303.

Unquestionably the principal means used by the defendants to monopolize and restrain trade and commerce in petroleum has been the combination of previously independent concerns...⁵

...Standard acquired 123 refineries (many of which also did a marketing business), 11 lubricating oil works, 24 pipeline concerns, and 64 exclusively marketing concerns; a total number of 223.

Neither did these acquisitions all occur at an early date, about half of them, in number, occurred since 1879, and many important ones between 1890 and 1902...⁶

Of the refineries it acquired, Standard dismantled at least 75, and ultimately produced a greatly increased volume in only 20 separate installations⁷.

See also Mr. Rockefeller's interesting testimony on the difficulty of effecting stable conspiracies. Vol. 16, especially at 3074-75.

⁵Brief for the United States, Vol. 1, at 169.

⁶Reply Brief for the United States, at 62. See Appendix C, Sheets 1-11.

⁷Id., at 63-64.