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A Slippery Slope In Ohio's Rock Salt Market

Law360, New York (December 08, 2011, 3:30 PM ET) -- Creation of duopolistic interdependence by misapplication of a state statute mandating preferential treatment for local producers is an implausible "slippery slope." Erie County v. Morton Salt Inc., N.D. Ohio, No. 3:11-cv-00364-JGC, 9/19/11.

Fifty-four northern Ohio counties filed a state court class action for violations of the Ohio Valentine Act, Ohio's counterpart to the Sherman Act. The counties alleged that the only indigenous miners of rock salt in the state of Ohio, Morton Salt Inc. and Cargill Inc., engaged in a conspiracy to artificially inflate the prices of road salt between 2001 and 2008.

Claims also included alleged violations of the Ohio Deceptive Practices Act and fraud. Defendants removed the action to the United States District Court, Northern District of Ohio, on diversity of citizenship grounds.

Defendants filed a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6) on the ground that the allegations of the complaint did not sufficiently allege a claim of "conspiracy" under the Valentine Act.

In granting the motion, the district court held that the plaintiffs had failed to plead a sufficient factual basis for any of the claims in the second amended class action complaint. Accordingly, the action has been dismissed.

In essence, the court held that, in the words of the Bard, plaintiffs were "hoisted by their own petard." See William Shakespeare, Hamlet (1602). Here, the "petard" was the Ohio Department of Transportation's misapplication of the state's "Buy Ohio" law.

Under the "Buy Ohio" law, state agencies can give a bidding preference to providers of products manufactured or mined in Ohio. The Ohio Department of Administrative Services sets the criteria and procedures for awarding bids under its provisions. There are two requirements of relevance here.

First, the DAS must grant waivers of compliance when the program would result in state agencies "paying an excessive price for the product."

Second, contract awards must be "competitive." If there are two or more qualified bidders offering products produced or mined in Ohio, this is deemed to be "sufficient competition" to prevent an excessive price from being extracted.

The DOT, however, had its own version of the application of the "Buy Ohio" law.

While the DOT was required to seek and obtain a "release and permit" from the DAS to award a contract to a provider of out-of-state rock salt, it failed to do so. Rather, it interposed its own requirements.

The "Buy Ohio" law requires awarding a contract to a provider of Ohio-produced or -mined products where the provider's contract price does not exceed the price offered by a bidder offering out-of-state products by 5 percent.

However, the DOT considered that two bids from in-state producers was sufficient, and would obviate the need to secure out-of-state bids.

On this basis, the only two in-state producers of rock salt in Ohio, namely Morton and Cargill, were deemed to be "sufficient competition". On this basis, the DOT rejected bids from non-Ohio rock salt producers. As a result, either Cargill or Morton would be awarded any rock salt contract put to bid.

By this means, the DOT eliminated competitive bidding by any company other than the two indigenous producers. This created a "duopoly," and, by its interpretation, imposed impermeable barriers to entry by competing out-of-state producers.

Ohio's two underground rock salt mines are both under Lake Erie. One mine is leased to Cargill, and the other to Morton. Each has a 100-year lease. Thus, by the interpretation given the "Buy Ohio" procurement law by the DOT, bids by the two indigenous producers "locked out" all potential competition.

Not surprisingly, and fully consistent with George Stigler's "A Theory of Oligopoly," 72 J.P. Econ. 4 (1964), the market shares of the incumbents were substantially stable, with each company re-winning the same customer year after year with little switchover, and where bidding patterns suggested the use of complementary bids designed to maintain duopolistic interdependence.

In 2009, the Office of the Inspector General of Ohio investigated the industry and came to the conclusion that the marketplace for rock salt was behaving noncompetitively.

The OIG report also noted that the incumbents' profit margins were "unusually high," and markedly higher than in counties to the south where the lock-out provisions were not in operation. Importantly, however, the OIG report also noted that it had "failed to find evidence that [Cargill and Morton] communicated on salt bids."

In granting the motion to dismiss, the Northern District of Ohio went through the litany of analysis of Bell Atlantic Corp. v. Twombly, 550 U.S. 544 (2007), and Ashcroft v. Iqbal, 129 S.Ct. 1937 (2009).

The court held that to find an agreement, the defendants' conduct "must tend to rule out the possibility that the defendants were acting independently." Twombly, supra, at 554. Mere "parallel conduct [with] a bare assertion of conspiracy" is insufficient to raise a claim of anti-competitive conduct from speculative to plausible.

The court noted that the DOT was responsible for the formation and maintenance of the duopolistic market structure for the northern counties. Thus, it is not surprising that abiding by the Stiglerian analysis of "interdependence," it was unnecessary for the duopolists to engage in any level of concerted activity that would trigger liability under the Valentine Act.

The court also noted that this was not a situation where limited but tailored discovery would be helpful. It noted that in the OIG's investigation, subpoenas duces tecum had produced upwards of 300,000 pages of documentary evidence, but no evidence of actionable collusion. Acting like "good duopolists," any such additional contact would have been unnecessary. Such is the workings of a market characterized by interdependence.

Thus, it can be said that the state of Ohio got exactly what it had bargained for, namely a rock salt market that was on an inherently slippery, anti-competitive slope.

The dysfunction of the marketplace that the state of Ohio created for itself guaranteed that Cargill and Morton would be able to earn supra-competitive rents by each sticking to its own territories and maintaining its supremacy with its particular customers. A bidding war would have been inherently contrary to the economic self-interest of each of the duopolists.

As the State of Ohio Department of Transportation created the oligopoly, economic self-interest and rudimentary price theory teach that the state of Ohio was bound to reap exactly what it had sown.

In "cleaning up" the complaint, the court also disposed of the remaining counts alleging deceptive practices and fraud. These counts were dismissed for lack of standing.

In each case, the court held that the state of Ohio, through a misinterpretation of its own internal law, had received exactly what it had bargained for.

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