



BUCKEYE POLICY BRIEF

BREWING FREEDOM

ENSURING THE FREEDOM TO CONTRACT FOR OHIO'S CRAFT BREWERS

BY GREG R. LAWSON
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Introduction

Ohio has a burgeoning craft beer industry with total barrels brewed growing by more than 18 percent between 2020 and 2022.¹ Unfortunately, an antiquated state law threatens to stunt their continued growth. Enacted in 1974, Ohio's alcohol franchise law is a relic from an era dominated by large "macro-breweries" that used their market power to compel small wholesale distributors into one-sided distribution agreements. The 1974 statute does not allow any manufacturers or distributors to "cancel or fail to renew a franchise or substantially change a sales area or territory without the prior consent of the other party for other than *just cause* and without at least sixty days' written notice to the other party setting forth the reasons for such cancellation, failure to renew, or substantial change."² The law's "just cause" requirement has been used for 50 years to effectively prevent breweries of any size or market-share from seeking new distributors or wholesaler agreements with better terms. That anti-competitive approach uses the force of law to reinforce a "three-tier system" for alcohol—comprised of manufacturers, distributors, and retailers—that gives Ohio's distributors oversized negotiating power and advantage at the brewers' expense.

But alcohol and beer markets have changed since the 1970s. Recent federal agency research has shown that alcohol franchise laws like Ohio's have inhibited growth in craft breweries across the country,³ and has raised concerns about the anti-competitive effect of alcohol's three-tier system altogether.⁴ In Ohio, the "just cause" requirements for terminating distributor agreements act as a statutory backstop to contracts that short-circuits normal service contracts by specifically limiting the permitted reasons for non-renewal.

¹ Ohio Craft Brewers Association, **2022 Economic and Fiscal Impact of Ohio's Craft Brewing Industry**, OhioCraftBeer.org (Last visited on December 15, 2023).

² **Ohio Revised Code 1333.85 (1994)** (emphasis added).

³ Jacob Burgdorf, **Franchise Termination Laws, Craft Brewery Entry and Growth**, Economic Analysis Group of the Antitrust Division of the U.S. Department of Justice, November 2021.

⁴ U.S. Department of Treasury, **Competition in the Markets for Beer, Wine, and Spirits**, Home.Treasury.Gov, February 2022.

The market imbalances that once justified that backstop during the Nixon and Ford administrations have been displaced. It is time for state policymakers to reassess the three-tier system and the franchise law's true costs and benefits in today's alcohol market and, at the very least, consider exempting small brewers from the law's outmoded "just cause" termination requirements that effectively create an "auto-renewal" policy for distributors.

FREE CRAFT BREWERS FROM OHIO'S ALCOHOL FRANCHISE LAW



Background

Prior to the 18th Amendment outlawing alcohol in America, brewers typically sold beer directly to retailers.⁵ In fact, brewers commonly held ownership stakes in bars and taverns. The 18th Amendment prohibited these practices until the 21st Amendment ended the Prohibition era and gave states broad powers to regulate the manufacture, distribution, and sale of alcohol within their borders. Most states, including Ohio, developed and now regulate alcohol's three-tier system of manufacturers, wholesale distributors, and retailers.⁶ Wholesale distribution requires significant capital investment to pay for the infrastructure needed to move alcohol from brewery to local bar and, by the 1970s, distributors argued that their logistics investments were jeopardized by large brewers that could force low-ball contracts by threatening to terminate agreements or find new distributors arbitrarily and without sufficient notice.⁷ That argument prevailed, and Ohio's 1974 alcohol franchise law was enacted to address the distributors' concern.⁸

⁵ Barry Kurtz and Bryan H. Clements, "**Beer Distribution Law as Compared to Traditional Franchise Law**," *Franchise Law Journal*, Volume 33 Issue (Winter 2014) p. 397-409.

⁶ *Ibid.*

⁷ Nick Evans, **Ohio craft brewers want carve out from 50 year old law locking them into distribution agreements**, Ohio Capital Journal, June 6, 2023

⁸ *Ibid.*

The law’s “just cause” and “successorship” provisions⁹ make it difficult for alcohol manufacturers to terminate or decline to renew a franchise agreement with a distributor by limiting the acceptable “just causes” to events like bankruptcy and the revocation or suspension of required permits.¹⁰

But alcohol’s three-tiered system has changed since then. Small brewers have proliferated across the country¹¹ and cut into the macro-brewers’ market-share, while the number of beer wholesalers has declined nationally from approximately 4,500 in 1980 to 3,000 in 2020.¹² That consolidation has increased the distributors’ market power and leveled the playing field with large brewers, which weakens the rationale for backstopping contracts in the distributors’ favor. And as the market has shifted over 50 years, so has the balance of negotiating power. Alcohol distributors now flex disproportionate strength against smaller craft brewers because those small brewers, although never an original concern in 1974, cannot seek better terms or sign new wholesale contracts under state law, even though macro-brewer Anheuser-Busch still controls nearly 50 percent of all beer sold in America.¹³

Alcohol Franchise Laws Undermine Free-Market Benefits

The state regulatory apparatus governing the manufacture, distribution, and sale of alcohol makes the market for alcohol inherently less than competitive. In a competitive market, wholesale distributors would have to compete for their lucrative service contracts with manufacturers and retailers because manufacturers and retailers would be free to negotiate and contract with wholesalers of their choosing. Parties to those contracts would have to negotiate mutually acceptable terms and protections for their respective interests—perhaps even including prophylactic exit provisions—but without the government’s legal thumb pressed on either side of the scale.

In Ohio, however, the government’s thumb remains firmly on the distributors’ side and the result is a distorted, uncompetitive market advantage. By preventing brewers from easily seeking new distributor contracts, Ohio’s alcohol franchise law undermines a would-be competitive market, negates the market benefits of competition, and limits the freedom of manufacturers to act in their own best business interests. The state law all but ensures that any small brewer inclined to dispute a distributor’s contract terms would find itself in court and at a significant financial disadvantage. And, to highlight the law’s absurd consequences, any craft brewer contesting its distribution contract would still have to rely exclusively on the same distributor to move its beer during the entire course of their litigation. A more rational approach would allow craft brewers to seek new

⁹ See **Ohio Revised Code 1333.84 (2013)**; McDermott Will & Emory, **Ohio Court of Appeals Upholds a Successor Manufacturer’s Termination of a Distribution Franchise**, AlcoholLawAdviser.com, March 3, 2016.

¹⁰ **Ohio Revised Code 1333.85 (1994)**

¹¹ U.S. Department of Treasury, **Competition in the Markets for Beer, Wine, and Spirits**, Home.Treasury.Gov, February 2022.

¹² See, Julie Rhodes, **Together Is Not Always Better: How Consolidation In the Middle Tier Is Impacting The Future of Craft Beer Brands**, Porchdrinking.com, April 23, 2023.

¹³ Jacob Burgdorf, **Trouble Brewing? Brewer and Wholesaler Laws Restrict Craft Breweries**, The Mercatus Center, September 15, 2016.

distribution contracts as needed and allow distributors to sue brewers for breach of contract if necessary and to be redressed by the courts, all without requiring that the two parties at-odds continue doing business together.

Not surprisingly, alcohol franchise laws like Ohio's tend to distort the alcohol market nationwide. A 2021 U.S. Department of Justice report found that although "beer franchise laws were legislated to shield wholesalers from large brewers, the findings...suggest they had the effect of encouraging opportunism by wholesalers and increasing the cost of brewing, thus inhibiting the growth of the craft brewing industry."¹⁴ The Justice Department's findings rejected wholesaler arguments that franchise laws eased market entry for smaller brewers,¹⁵ and instead raised concerns that such laws *stymie* entry into the wholesale market by locking brewers into long-term, auto-renewing contracts that are difficult to amend or escape.¹⁶ Similarly, in its own study of beer franchise laws, the U.S. Department of Treasury observed that "state legislatures might consider if the benefits of the three-tier system outweigh its costs to competition and study markets without a three-tier system."¹⁷ No state has yet abandoned the ubiquitous three-tier alcohol system, but the anti-competitive, market-distorting costs of that system warrant a more critical review and assessment.¹⁸

Conclusion

Ohio's alcohol franchise law is no longer needed to provide statutory protection for wholesale distributors. Market realities have changed, and the law now disproportionately empowers distributors to the detriment of small craft brewers. The time has come for state policymakers to reconsider the oligopolies that the franchise law has fostered and remove the government's statutory thumb from the scales of business and contract negotiations. The statute once intended to protect distributors from other market actors has, like protectionist laws often do, over-corrected. Short of abandoning or making broad changes to its three-tier alcohol distribution system, Ohio could explore exemptions for small craft brewers from the law's onerous provisions in order to restore some equitable balance in negotiating power between those smaller brewers and the large, consolidated wholesalers. Steps should be taken to revive and protect the freedom to contract in Ohio and regain the benefits of free markets and open competition.

¹⁴ Jacob Burgdorf, *Franchise Termination Laws, Craft Brewery Entry and Growth*, Economic Analysis Group of the Antitrust Division of the U.S. Department of Justice, November 2021.

¹⁵ *Ibid.*

¹⁶ *Ibid.*

¹⁷ U.S. Department of Treasury, *Competition in the Markets for Beer, Wine, and Spirits*, Home.Treasury.Gov, February 2022.

About the Author

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