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Nestlé Sues Sara Lee in Coffee War

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Swiss food giant Nestlé SA has sued Sara Lee Corp. in France, claiming coffee capsules sold by the U.S. company violate patents on Nespresso, Nestlé's popular at-home coffee maker.

Earlier this spring, Sara Lee developed coffee capsules that work in Nespresso machines and began selling them in France at a 10% discount to those sold by Nestlé. The move was a threat



Nespresso coffee machines are displayed at the Nestlé shareholders' meeting in Lausanne, Switzerland in April.

to the Nespresso brand, whose highly profitable business model is based on shoppers returning again and again to buy its pricey capsules.

Sara Lee claims to have found a gap in the 1,700 patents that Nestlé says protect the Nespresso machines. Nestlé responded Tuesday with a suit in France against the American company.

A spokesman for Nestlé, the world's biggest food manufacturer, declined to provide further details Tuesday

but said "we will always take appropriate steps to defend our intellectual property rights when these have been infringed."

A Sara Lee spokesman said the company is confident the capsules don't infringe on Nespresso patents and will continue to roll out distribution of the coffee pods across France.

Nestlé's response is aimed at defending one of its biggest and most profitable brands. On the strength of its machines' cool design, the high quality of its coffee and a splashy ad campaign featuring George Clooney, Nespresso has posted annual growth of about 30% for much of the last decade. Its business model rests on the fact that Nespresso machines take only its own capsules. Last year, Nestlé sold 5.5 billion of the small, colorful coffee pods, which come in a variety of blends. With 2009 sales of 2.8 billion Swiss francs, Nespresso is one of Nestlé's biggest brands. Nespresso's biggest market is France.

Sara Lee's Senseo machine overtook Nespresso as the biggest-selling home coffee system several years ago, but Nespresso users tend to spend more on the capsules, prompting Sara Lee to find a way to court its rival's premium customers.

In the first quarter, Nespresso sales grew by 20%. About a month after the launch of the Sara Lee capsules, Nestlé management said it hadn't seen any negative impact on the sale of Nespresso capsules in France. Sara Lee has sold about 12 million Nespresso capsules so far and has reached about 80% of the distribution channels it targeted at the start of the roll out.

Most of Nestlé's sales are generated in Europe where the system of machines and colored pods have successfully tapped into the growing popularity of cafe culture, inspired by Italian style. Consumers in the U.S. and Latin America are also taking up the trend and analysts expect the product to continue to grow at double-digit rates for years to come.

"The market is far from mature, even in markets such as France and Switzerland," said Switzerland-based consultant James Amoroso. "In fact, this market has only started to develop," he said, estimating that the penetration rate in Switzerland is hovering at about 20% and that the figure in France is even lower. France, Switzerland and Spain are so far considered to be among the most attractive markets.

Due to Nestlé's patent policy, competition was non-existent until recently as competitors struggled to find ways to circumvent Nestlé's product protection. Companies such as Sara Lee, Mars Inc. and Kraft Foods launched their own coffee system with different capsules that don't work with Nespresso machines. There are several dozen coffee-system producers world-wide.

Sara Lee and former Nespresso chief Jean-Paul Gaillard, who founded Switzerland-based Ethical Coffee Co, found "holes in the wall" and earlier this year launched their own products in France, one of the world's most attractive markets for coffee systems.

Ethical Coffee's Mr. Gaillard said that sales of his product, which is produced in France, are "proceeding well" and that Nestlé hasn't filed a lawsuit against his firm. "We have already orders for about five billion capsules," Mr. Gaillard said, adding that the company will broaden its geographic scope next year.

Mr. Gaillard claims his product is more environmentally friendly and less expensive than Nespresso; Ethical Coffee and Sara Lee are both targeting costumers who have so far shied away from Nestlé's relatively pricy products. "The main difference to Nestlé is that our distribution system is cheaper and that we can thus invest most of our money in the coffee itself," Mr. Gaillard said. Ethical Coffee sells its pods at a 25% discount to some of Nestlé's products.

Ethical Coffee sells its product solely to large hyper markets in France such as Carrefour SA, keeping its cost base under control. By contrast, Nestlé owns Nespresso shops in expensive city-center locations.

—Goran Mijuk contributed to this article

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