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Trouble Brewing for Nestlé in Coffee-Pod Market

Swiss food group faces increasing competition to its Nespresso system



A patent battle pitting Nestlé Nespresso coffee pods against an upstart rival has flared again. Above, a Nespresso display at the Swiss company's annual meeting. Photo: FABRICE COFFRINI/AFP/Getty Images

By

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There is fresh legal trouble brewing for Nestlé SA in the market for single-serving coffee pods.

The Swiss food giant about three decades ago created the first coffee-pod system that since has become a \$13.45 billion global business—and one dominated by Nestlé. But after starting to lose patent protection on its Nespresso system in the mid-1990s, Nestlé has battled a bevy of new players, who are chipping away at its global dominance.

Nestlé settled or ended litigation against many other single-serving pod makers after it lost a key patent in 2013, leaving its machines now compatible with more than 200 pods made by competitors. But one small competitor is still fighting.

The Ethical Coffee Co. makes biodegradable capsules it says are better for the environment than Nestlé's aluminum ones. Based in Fribourg, Switzerland, and founded by former Nespresso president Jean-Paul Gaillard, ECC for years has alleged Nestlé modified some of its Nespresso machines to make them incompatible with ECC's coffee capsules. In a twist, though, ECC claims it holds a patent for the technology it alleges Nestlé uses to block its pods.

The eight-year-old company won a big victory last month when Europe's main patent authority threw out a challenge by Nestlé over the patent. ECC is pursuing damages over patent infringement in several venues across Europe and is seeking to block sales of Nestlé's machines.

Nestlé disputes that its machines use the patented technology in the first place and plans to appeal the patent office ruling. "Our machines don't use ECC's technology and therefore we are confident that they do not infringe on ECC's patent," said a spokeswoman. It also defends the environmental impact of its aluminum pods. It says they keep coffee fresh with less extra packaging, that its machines are energy efficient, and its coffee is grown in a sustainable manner.

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The stakes for Nestlé are high. All the Nespresso machines currently being sold in Europe, Nespresso's biggest market, and some of the machines being sold in the U.S. contain the disputed technology.

"The actions, if successful, could lead to a substantial financial loss for Nestlé from both damages paid to ECC and loss of sales in the European Union if Nestlé is barred from selling the machines in their current form," said Robert Waldschmidt, an analyst at investment bank Liberum Capital Ltd.

Nespresso is one of Nestlé's fastest-growing big brands with annual sales of about 5 billion Swiss francs (\$5.03 billion), or about 5.6% of its overall revenue last year. The business carries higher margins than instant coffee and is growing at a faster rate, though sales have slowed from over 20% a few years ago, estimates investment bank Jefferies LLC.

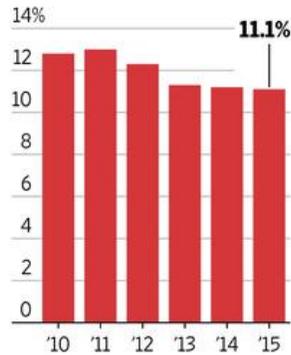
While Nestlé says its push in the U.S. is going well, the Nespresso brand has been losing global market share to competitors. Nespresso controlled 11.1% of the global coffee capsule market in 2015, down from 13% in 2011 according to market researcher Euromonitor International Ltd. Competitors include Jacobs Douwe Egberts, Keurig Green Mountain Inc. GMCR 0.10 % and Starbucks Corp. SBUX 2.08 %

Capsule Wars

Nestlé is fighting to keep its hold of the booming coffee capsule business.

Nespresso has been losing market share in the business it created...

Nespresso's market share by volume



Source: Euromonitor (market share); the company (photos)

...as more rivals pile into the lucrative sector.



Brand	Company	2015 global market share by volume
Nespresso	Nestlé SA	11.1%
Senseo	Jacobs Douwe Egberts	10.0%
Nescafé Dolce Gusto	Nestlé SA	6.5%
Keurig	Keurig Green Mountain	6.0%
Tassimo	Jacobs Douwe Egberts	5.3%
Keurig	Starbucks	3.0%
Keurig	JM Smucker	2.0%

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ECC is a tiny player in the market, but its legal assaults over the years have cast a long shadow. It previously persuaded the European Patent Office to revoke two Nespresso patents. It also won a civil claim before a Paris court accusing Nestlé of engaging in unfair competitive practices. Nestlé is appealing.

In recent months, ECC has stepped up its offensive, filing patent infringement suits against Nestlé in Belgium, Switzerland and Germany. ECC's Mr. Gaillard says he plans more such suits and, including in the U.S. and U.K., estimates total claims could amount to between \$2 billion and \$2.5 billion.

'We don't want to be fighting in the trenches.'

—Patrice Bula, Nestlé vice president

The Nestlé spokeswoman says those damage estimates “are grossly exaggerated in relation to the pending claims in front of the courts, and are unsubstantiated and inconsistent with the realities in the market.”

As competitors piled in, Nestlé has spent heavily on marketing and technology to stay ahead. A key weapon: actor George Clooney, who has appeared in Nespresso ads in Europe for years. Last year, Nestlé brought ads featuring Mr. Clooney to the U.S. In the TV spots, Mr. Clooney tries to help Danny DeVito appreciate fine wine, art and clothes before trying a Nespresso coffee.

Nestlé also has been working hard to innovate. Patrice Bula, a Nestlé vice president in charge of Nespresso, said it is launching new coffee machines with “flair and design,” as well as rolling out a smartphone-controllable machine. It is also pushing new varieties of coffee, including new offerings from Rwanda and Nepal.

“We want to be a class above,” Mr. Bula said. “We don't want to be fighting in the trenches.”

—John Revill in Vevey, Switzerland, contributed to this article.