

2nd UPDATE: Swiss Court Lifts Ban On Nespresso Rival Denner

By John Revill of DOW JONES NEWSWIRES

(Adds background, Nestle exec comments, other rival comments)

ZURICH -(Dow Jones)- Swiss food giant Nestle SA (NESN.VX) was dealt a blow by a Swiss Court Friday in its battle to retain control of the lucrative coffee capsule market.

The court withdrew a preliminary ban on a rival coffee capsule to Nestle's (NESN.VX) Nespresso single serve coffee brand, in a move that is likely to open the market to other competitors.

The Commercial Court in St Gallen withdrew an injunction against Swiss retailer Denner, which is owned by Swiss cooperative Migros, and its manufacturing partner Alice Allison, that prevented the company from selling its own version of the Nespresso capsules.

The injunction, imposed on Jan. 11, ordered that production, sale and advertising, of Denner's capsules, which first went on sale on Dec. 15, be halted.

Denner said it would now restart production of the capsules, which it sells under the NexPod brand name, with the capsules returning to the shelves in the next three weeks.

While the court's decision is not a final ruling on the case and Nestle has pledged to continue its legal battle, the move is nonetheless a potential indication of how similar cases Nestle has brought against other single-serve coffee makers including Sara Lee Corp. (SLE) of the U.S. could go. The St Gallen ruling only affects Denner, but will create a precedent for other cases in Switzerland and act as an example for foreign courts, according to Prof Marc Amstutz at the law faculty of University of Fribourg in Switzerland.

Patents, which last for 20 years in Swiss law, have long been used as a way for companies to protect the investment they make when they develop a new product, Amstutz said.

Denner spokeswoman Nicole Schoewel told Dow Jones Newsires: "We are so happy. This decision is not just for us, but it is for the whole market."

The court upheld its previous ruling that Denner withdraw its "Denner What Else?" marketing, which Nestle had claimed was too similar to its own advertisements featuring Hollywood actor George Clooney.

"It's Nestle's opinion that we have no right to sell a coffee capsule which fits in a Nespresso machine, and our capsules are not different enough from theirs," Schoewel said.

“It cannot be that Nespresso controls the market and tries to keep other sellers of coffee capsules out of the market.”

Nespresso spokesman Julian Liew said, “This ruling does not predetermine any future decisions by the court in this matter. We believe in the strength of our legal arguments and we will continue with the legal action to protect our intellectual property rights.”

But Friday's decision is not Nestle's first setback as it fights to protect its leading position in the fast-growing market. A Zurich court ruled earlier this year that Denner's pods did not infringe Nestle patents, as they were not identical to Nespresso ones.

While the Zurich case referred to the patents, the St Gallen one was concerned with the shape of the capsules.

Meanwhile Nestle is also taking legal action against the privately-held Ethical Coffee Company in France as well as Sara Lee Corp (SLE) in France and the Netherlands, which have their own capsules which are compatible with Nespresso machines.

The reason for Nestle's aggressive stance is clear.

Since it was launched in 1986, Nespresso has become the fastest growing of Nestle's so-called billionaire brands, which each have sales of more than CHF1 billion. In 2010 Nespresso sales rose 22.5% to more than CHF3.2 billion (\$3.44 billion).

Nestle does not break down profitability by brand, but Nespresso's profit margin is estimated to be at least 30%, which compares favorably with the 20% industry standard for soluble coffee.

Coffee capsules represent only 8% of the global coffee market by volume, based on market researchers AC Nielsen figures, but 25% by value.

Nespresso is the market leader, with about 1.5% of the coffee market, and is looking for growth.

“We can continue to grow, certainly in double digits,” Nespresso CEO Richard Girardot told Dow Jones Newswires. “We are on the same growth trend so far this year as we were in 2010.”

Sara Lee spokesman Joost den Haan said the company was monitoring the Denner case but is confident its capsules, which are sold under the Douwe Egberts brand, comply with all applicable legal and regulatory requirements.

The Ethical Coffee Company, which has already launched its competing capsules in France, is planning to launch them in Switzerland and Germany later this year.

Led by former Nestle executive Jean-Paul Gaillard, who was CEO between 1989 and 1997, the privately-held company is taking a more belligerent stance against Nestle's dominance.

Gaillard said he was not surprised by the St Gallen decision, which he said marked the beginning of the end of Nestle's control of the coffee capsule market.

“This battle is like a wasp taking on an elephant and winning. If this was a war, Nestle would have lost.”

“Nestle will appeal, but they will lose. It is simply an attempt to make a patent last forever.”

Gaillard said most of the 1,700 patents held by Nespresso are a smokescreen and is convinced he has found legal ways around them.

“In real life facts, there are only six patents on the capsule, and only three or four of them are relevant. Many of the patents are there to confuse competitors.

“You cannot patent hot water, but you can patent a way to make it hot,” Gaillard said. ““We found a different way to Nespresso to get the same result.”

“Our capsules work in Nestle's machines, are cheaper but have better tasting coffee. That is why Nestle hates us and is trying to stop us through funny means,” Gaillard said.

He accused Nestle of acting like Microsoft, which was fined EUR497 million by the European Commission in 2004 for abusing its dominant market position to stifle competition.

“Nespresso is behaving like Microsoft in the old days. They are using dirty tricks to prevent fair competition.”

That is a claim rejected by Nespresso's Girardot who said, “It is our duty to our employees and shareholders to defend the company and what it has innovated over many years.

“We are not using the law to keep competitors out. It is like if somebody came into your house and then started taking food from the fridge or using your bathtub.”

Ultimately, analysts believe Nestle is bound to lose some of its market share to new entrants, but will likely retain its top spot and grow in line with the market.

“They were the first mover,” said Switzerland-based food analyst and consultant James Amoroso. “They have got the best product and the best infrastructure, with the Internet operation, the Nespresso club and the boutiques.

“They offer a complete service, an integrated concept, when the others are offering only capsules. Unless they sit on their hands, which I doubt, they will stay ahead.”

Legal action, meanwhile, is likely to continue against interlopers. Petraea Heynike, Nestle board member with responsibility for Nespresso, told Dow Jones last month, “We spend a lot of time on innovation and R&D. We patent it and we will defend it. If other companies come, we will defend it.”

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