

## Owner of small coffee shop takes on java titan Starbucks

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**By Edward Iwata, USA TODAY**

After coffeehouse owner Penny Stafford sued Starbucks in September, she says she was stunned by hostile and anonymous telephone calls and e-mails. Drop your lawsuit, she was warned. How dare you attack Starbucks?

"It's as if I had insulted apple pie and America," says Stafford, owner of the Belvi Coffee and Tea Exchange in Bellevue, Wash.

In the closely watched federal lawsuit in Seattle that alleges nationwide antitrust violations, Stafford's attorneys portray Starbucks ([SBUX](#)) as a predatory monopoly crushing her and other small coffee sellers.

The lawsuit charges that Starbucks illegally maintains its monopoly by barring other coffeehouses from prime downtown high-rises in Seattle and Bellevue through exclusive leases with property owners.

Starbucks also drove Stafford and other coffeehouses out of business by buying coffee sellers and flooding neighborhoods with new Starbucks stores that even cannibalized the sales of existing Starbucks shops, the lawsuit alleges.

"This is wrong, period," Stafford says. "I'm not willing to leave the specialty coffee business because of Starbucks shutting me or anyone else down."

Starbucks spokeswoman Sanja Gould says, "Starbucks denies that we have done anything improper, and we intend to rightfully defend ourselves. As Starbucks has grown, so has the industry, all of which benefits coffee consumers and the competitors of Starbucks."

In a court filing, attorney Thomas Boeder of the Perkins Coie law firm writes: "Starbucks is committed to conducting business in a respectful, ethical and responsible manner in the communities it serves."

While it's early, antitrust experts say the lawsuit could clarify a murky area of the law by defining what a monopoly might be — and what business conduct by a monopoly might be illegal.

The Starbucks case comes amid what Boston attorneys Thane Scott and Veronica Abreu call "antitrust's second golden age." Attorneys are heatedly debating what monopoly practices are predatory. Regulators are weighing whether antitrust law should be upgraded in the new global economy, just as the law was shaped in the early 20th-century industrial economy. And antitrust civil lawsuits are on the rise, reports *Competition Law 360*, a legal publication.

The lawsuit also increases the controversy around fast-growing Starbucks, the target of a vocal backlash in recent years from neighborhood and anti-globalization activists and some consumers.

Stafford's lawsuit seeks class-action status. So far, dozens of coffee sellers in Washington, California, Illinois and other states report similar problems with the coffee behemoth, says Stafford's attorney, Steve Berman of Hagens Berman Sobol Shapiro in Seattle. If a federal judge finds that Starbucks is a monopoly that violates the antitrust Sherman Act, his ruling would apply to all Starbucks in the USA, Berman says.

## **Legal debate**

A monopoly itself isn't illegal. But a monopoly cannot willfully acquire or maintain power through predatory acts, such as blocking rivals from a market. Nor can it limit consumers' choices, courts have ruled.

That's why lawyers are eyeing the Starbucks suit, plus a recently argued Supreme Court case in which Ross-Simmons Hardware Lumber accused Weyerhaeuser of pricing rivals out of the market. The cases raise a long-running legal question: What practices by a monopoly are predatory and anti-competitive?

Attorneys say there's no single legal test. Judges offer conflicting guidance, from the Supreme Court's landmark 1911 Standard Oil ruling to a lower court's settlement approval in the vast Microsoft case in 2001.

In antitrust cases such as Starbucks, plaintiffs face long odds, says Stephen Calkins, a Wayne State University law professor and former Federal Trade Commission general counsel. They must show that a firm is a monopoly, then prove that it abuses its power.

Courts typically require plaintiffs to show that a business has more than 40% market share before it might be deemed a monopoly, says Dionne Lomax, a partner at Vinson & Elkins and a former Justice Department attorney.

Already, Starbucks and Belvi are trying to define market share. Belvi Coffee says Starbucks monopolizes 73% of the market for gourmet coffee and espresso drinks in coffeehouses, while Starbucks says it represents "7% of all coffee consumption in the U.S."

If the lawsuit is not dismissed, the ensuing debate in court could raise other crucial antitrust issues:

- Market definition.** How should a monopoly and its "market" be defined? By range or type of products sold? By business region? Or, as alleged in the Starbucks lawsuit, by access to leased high-rise space — a narrow, hard-to-prove definition, says law professor Andrew Chinat the University of North Carolina.

- Exclusionary conduct.** Are Starbucks' leases with landlords exclusionary vehicles that bar other coffee sellers from the market?

• **"No economic sense" test.** When does a monopoly cross the line from tough, competitive practices to illegal actions that make no economic sense and serve only to wipe out rivals?

"Courts are all over the map" on issues, says Mark Popofsky, a partner at Kaye Scholer and former Justice Department senior counsel on the Microsoft case.

### **Starbucks praised**

Starbucks is widely admired by Wall Street and other businesses as a well-run corporation, a mighty marketing machine and, until recently, a highflying stock.

Since its first store opened in 1971 in Seattle, Starbucks has grown to 12,400 outlets worldwide, 115,000 employees and \$7.8 billion in revenue in fiscal 2006. The chain hopes to expand to 40,000 outlets, cafes and kiosks worldwide.

Starbucks also has been praised for its social and environmental acts, from donating millions of dollars to charities, to promoting "fair trade" export practices with Third World coffee bean producers.

But Stafford's lawsuit symbolizes the distaste that critics have toward Starbucks. Few retail chains have been the target of such a long-brewing backlash from neighborhood activists, anti-globalization protesters, labor organizers and some consumers and small-business owners. Starbucks has been accused of being a corporate bully whose tactics hurt small businesses, erode the character of local communities and exploit the coffee bean economies of Third World countries.

Starbucks' vast size and "aggressive real estate grabs" clearly alienate some people, says Bryant Simon, a Temple University historian and author of *Consuming Starbucks*, to be published in 2008

"By being everywhere, they create markets," Simon says. "But they also narrow the markets and limit opportunities for companies."

The \$11 billion U.S. market for specialty coffee keeps growing, with about 23,000 coffeehouses, reports the Specialty Coffee Association of America trade group. Spokesman Mike Ferguson says sales won't peak "until there's an espresso bar in every neighborhood."

Starbucks dominates with a 73% market share of U.S. coffeehouse sales in 2005, says Mintel, a global consumer research firm in Chicago. The coffee king faces scant competition from Caribou Coffee and Peet's Coffee and Tea, its closest rivals.

But Starbucks commands only 43% of the gourmet coffee market if Dunkin' Donuts (27%), Krispy Kreme (5%) and Tim Hortons (2%) are included, says Mintel.

Marcia Mogelonsky, an industry analyst at Mintel, says coffeehouses with loyal customers and strong business strategies "can co-exist with Starbucks." But, she adds, "There's no denying that Starbucks can easily put a lot of independents out of business."

### **Small coffee sellers**

Owners of small coffeehouses describe Starbucks' impact as "a double-edged sword." They praise it for launching a mass market for specialty coffee and espresso drinks and educating consumers. Starbucks brings consumers to shopping districts, and paves the way for "independent coffeehouses to come in, find a niche and provide higher-quality products," says Joe Mancuso of Caffè D'arte, a Seattle roaster.

Mike Sheldrake, owner of Polly's Gourmet Coffee, says he nearly closed his store in the late 1990s, after two Starbucks opened near him in Long Beach. But Sheldrake retrained his staff, painted his store and added more coffee beans, pastries and other items.

"We understood the battle is never over," says Sheldrake, whose coffeehouse is healthy again with \$1 million in annual sales.

But some coffee sellers still lose customers to Starbucks — especially in areas saturated with Starbucks outlets, according to Stafford's lawsuit and a dozen coffeehouse owners interviewed by USA TODAY.

When coffeehouses find their leases up for renewal, some must close or relocate after Starbucks pays property owners two or three times the fair market rental price, say Stafford and other coffee sellers. Stafford, Mancuso and other small coffee sellers also are troubled by Starbucks' exclusive lease deals with landlords.

"Unfortunately, it happens so much here, it's common knowledge," Mancuso says.

These coffee sellers have lost to Starbucks:

•**Boston Coffee Exchange.** For 25 years, Mort and Bonnie Glovin have run this popular coffee stand in the historic South Station train terminal in Boston.

But the Glovins were stunned when the terminal's property manager, Equity Office Properties, would not renew their lease, which expires Jan. 31. The new tenant? Starbucks, says Mort Glovin.

The Glovins printed T-shirts that read "Don't Throw Us in the Grinder." Two thousand customers signed a petition urging that the coffee stand be allowed to stay. Even Boston Mayor Tom Menino wrote EOP, urging the firm to renew the lease.

"Little guys like us mean nothing," says Mort Glovin, 72, a former food-service manager.

•**Reality Coffee.** Fifteen years ago, Renee Kappes spent long days selling coffee from a tiny cart in Bellevue. Her hard work paid off. Soon, she owned two thriving Seattle's Best Coffee franchises in Kirkland, Wash., a popular waterfront village.

But after SBC was bought by Starbucks in 2003, Kappes and Starbucks disagreed about the operations and sale of her shops. Kappes says she had a buyer for \$500,000. Starbucks offered her half that price, she says. Kappes rejected the offer, and Starbucks signed new leases with property owners. Before her leases ended, Kappes renamed her business Reality Coffee.

"It's just not right, but Starbucks can get away with it," says Kappes.

•**Deaf Dog Coffee.** Former banker Ron Salisbury moved to Petaluma, north of San Francisco, to start his own coffeehouse in 1994. Deaf Dog Coffee became a hit, and Salisbury opened five local outlets.

Then Starbucks opened six nearby stores and kiosks. Deaf Dog Coffee's \$1 million in annual sales dropped 25%. Salisbury sold new drinks, cut costs and made bumper stickers that read "Friends Don't Let Friends Go To Starbucks."

It wasn't enough. Deaf Dog Coffee was hurt even more by downtown construction and winter flooding. Salisbury, 63, couldn't meet his loan and rent payments, and he recently filed for bankruptcy. "Starbucks has left a lot of bodies in their wake," he says.

### **Stafford's lawsuit**

Penny Stafford, believed to be the first small coffee seller to sue Starbucks on federal antitrust grounds, says she won't cave in. A former commercial real estate agent and mortgage broker, she decided in 2003 to pursue her dream of starting a coffeehouse.

For two years, she hunted for "Class A" retail space in busy high-rises in Seattle and Bellevue. But agents steered her to less desirable sites, according to her lawsuit. When she asked to see better spaces, the agents refused, saying Starbucks had locked up the sites.

"That's when I realized I had a zero chance of getting into one of these locations," Stafford says.

According to the lawsuit, agents told Stafford that Starbucks had signed nationwide exclusive leases with Equity Office Properties and other real estate investment trusts that owned commercial buildings.

Under the leases, the landlords cannot rent to other gourmet coffee sellers, the lawsuit alleges. The agreements also bar landlords from renewing the leases of existing coffee sellers, the lawsuit alleges.

In exchange for exclusivity, Starbucks paid property owners higher-than-market rates, the lawsuit alleges.

Retail tenants typically have "exclusive-use clauses" in their leases that give them the exclusive right to sell products in a building or mall. But Stafford's lawsuit contends that Starbucks' use of exclusive leases is an abuse of monopoly power — which Starbucks denies.

Equity Office Properties spokeswoman Terry Holt declined to comment.

In its court filing, Starbucks acknowledges that some of its leases in downtown Seattle and Bellevue "prohibit the landlord from leasing space in the same building to other retail coffee stores."

Last year, Stafford opened Belvi Coffee in a tiny space in a Bellevue high-rise by leasing the espresso machine of a tenant, Johnika's Deli. But Starbucks retaliated by "poaching" her customers, the lawsuit alleges. Employees from a nearby Starbucks outlet repeatedly offered free coffee samples to Stafford's customers seated outside the deli, says Stafford and her lawsuit.

Four months later, Stafford had to close the outlet.

Her lawsuit alleges that Starbucks, which runs 59 stores within a 2-mile radius of downtown Seattle, creates "Starbucks-only zones" that bar rivals. For instance, Starbucks in 2003 bought Seattle's Best Coffee and Torrefazione Italia for \$72 million, then closed half of SBC's 22 stores and all five Torrefazione stores.

"Starbucks' game plan is to completely dominate a market by forcing out competition," Berman says. "We also believe that this scorched-earth approach is happening in many other major markets across the U.S."

Starbucks denies the allegations. In their filing, Starbucks' attorneys write: "Since its founding, Starbucks has played an integral role in creating an industry for gourmet coffee in Seattle and beyond. ... Starbucks believes there is room for many coffeehouses in the marketplace that meet different customers' needs."

Until the lawsuit is resolved, Stafford is leasing a small spot in a Bellevue office building. So far, she has poured \$130,000 into her coffee business. Despite the risks, she says, "I have to do the right thing."

Meanwhile, another Starbucks has just opened a block away.