

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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KRAFT FOODS GLOBAL, INC., :
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 Plaintiff, :
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 -against- : INDEX NO. 10 CIV 09085 (CS)
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 STARBUCKS CORPORATION, :
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 Defendant. :
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DECLARATION OF DAVID C. HYLAND

I, David C. Hyland, hereby depose and state as follows:

1. I am the Senior Director of Tassimo for Kraft Foods Global, Inc. (“Kraft”). My duties and responsibilities generally include developing the annual and long term strategy for marketing, advertising, sales and market research. Prior to becoming Senior Director of Tassimo, I was Director of Gevalia, another coffee brand in Kraft’s product portfolio.

2. Industry analyses demonstrate that the market for single-cup beverage machines, also known as “on demand” beverage systems, represents one of the best opportunities for growth in the coffee market. Attached hereto as Exhibit 1 is a true and correct copy of a Bank of America/Merrill Lynch Report on Green Mountain Coffee Roasters (“Unit sales of single serve coffee makers have increased +38.7% since 2004, faster than overall industry average. Single-cup coffee portion pack sales are currently growing at a double-digit rate as more consumers have adopted the product.” p. 5). Attached hereto as Exhibit 2 is a true and correct copy of a Cannacord/Genuity analysis of Green Mountain Coffee Roasters (“Our thesis remains that single cup brewing is a major consumer trend that will lead to short-term and long-term conversion of

home coffee brewing.” p. 1). Industry-wide sales of such systems in 2010 through September up by 87% versus the same period in 2009 (previously the highest year ever).

3. Single-cup beverage machines use pre-packaged beverage products (such as coffee, tea, or milk products) contained in a cup, pod, filter, bag or other container used to quickly prepare a single-cup beverage (“beverage discs”). As a closed system, the only consumers of particular beverage disc types are the owners of the associated brewers or those who have access to them.

4. Kraft has been in the single-cup brewer market since 2004, and developed, with Bosch, a single-cup beverage machine using proprietary technology belonging to Kraft under the “Tassimo” brand name.

5. The Tassimo system uses beverage discs containing coffee, tea, hot chocolate, or milk, referred to as “T Discs,” to brew a single-cup of coffee, tea, or other beverage on demand.

6. Tassimo is a closed brewing system, meaning that only Tassimo T Discs can be used in the Tassimo brewers (and, conversely, T Discs can only be used in Tassimo brewers). Kraft Foods is the exclusive manufacturer and distributor of Tassimo T Discs.

7. Tassimo brewers are manufactured and sold by Bosch in certain grocery stores and in other retail outlets such as Bed, Bath and Beyond, and sold by Kraft through direct to consumer channels like Tassimo.com.

8. It is important to the success of any single-cup beverage machine that beverage discs containing super-premium coffee be available on the system.

9. In August 2006 and July 2007, Kraft and Starbucks entered into Tassimo Supply and License Agreements (“Tassimo Agreements”), which together gave Kraft the exclusive right to license, market, sell, and distribute T Discs bearing the Starbucks, Seattle’s Best and Tazo

trademarks in specified channels in the United States (that include grocery stores, drug stores, mass merchandisers, and club stores).

10. The Tassimo Agreements preclude Kraft from offering T Discs containing any super-premium coffee other than Starbucks' brand coffee in those channels specified in the agreements. It also precludes Starbucks from marketing, distributing, or selling any other beverage discs in the United States through the specified channels and from granting any license permitting any third party to do so, under the Starbucks, Seattle's Best, or Tazo trademarks. Kraft's exclusive ability to offer Starbucks products in T Discs clearly distinguishes the Tassimo system from other single-cup brewers and gives it a significant competitive advantage over competing single-cup brewers. But the Tassimo system would have no super-premium coffee other than the Starbucks products in the defined channels. Kraft believed this risk was minimized by the Agreements.

11. In 2009, more than 22% of Kraft's revenues from sales of T Discs came from T Discs bearing the Starbucks brands (i.e., Starbucks, Seattle's Best, and TAZO). Through November of 2010, over one quarter of Kraft's 2010 revenues from sales of T Discs came from T Discs bearing the Starbucks brands.

12. Kraft developed comprehensive plans to gain market share in the on-demand segment with the focus culminating in the fourth quarter of 2010. One of the essential components of the plan is expanded retail distribution of the Tassimo brewer.

13. Because of the closed nature of nearly all such systems, success in this market requires early and substantial market penetration in the sale of brewers. *See* Exhibit 1 [BOA report] p. 9 stating "**Increasing the installed brewer base is critical:** . . . long-term sales

opportunity can be estimated by forecasting the potential for total installed brewers and the average rate of [beverage disc] use per brewer.

14. Fourth quarter sales are critical to Kraft's strategy regarding Tassimo. In 2008 and 2009 approximately 60% of all Tassimo brewers sold were sold in the fourth quarter, during the holiday shopping period.

15. Beginning in late 2009 Kraft met with potential retail customers to secure additional distribution points for Tassimo brewers and T Discs for the fourth quarter of 2010. Kraft's ability to offer Starbucks beverages for the Tassimo system was a key point of difference between its Tassimo system and other on demand systems that helped secure new and expanded distribution. Starbucks was aware of these efforts, was aware of Starbucks being a focus of the presentation, and even attended a meeting with SuperValu, Inc. – one of the largest grocery retailers in the United States. At no point did Starbucks ever suggest that Kraft should not use Starbucks as a focus of sales presentations to prospective customers.

16. As a result of Kraft's efforts in the first three quarters of 2010, during the fourth quarter holiday sales, the Tassimo system (brewers and T Discs) is available in significantly more locations than in 2009, and has a significantly increased presence in many of the locations in which they had already been available.

17. In coordination with the increased availability of the Tassimo system, Kraft nearly doubled its fourth quarter promotional investment in Tassimo from 2009, including a 129% increase in in-store spending and more than a 500% increase in television advertising.

18. As a part of the plan, Kraft negotiated with Starbucks to expand the companies' partnership with respect to Tassimo in early 2010. Pursuant to this negotiation, Starbucks

requested information from Kraft relating to every detail of Kraft's on-demand beverage business.

19. Kraft provided Starbucks with highly confidential, detailed information about its on-demand beverage business, including comprehensive marketing plans, sales information, and detailed profit/loss calculations and planning. Much of what was provided was confidential trade secret information that Kraft designated accordingly, including Kraft's strategy for capturing market share in the "on demand" single serve coffee market which included Kraft's intentions regarding the fourth quarter of 2010. In early May 2010, the parties were unable to come to agreement and the negotiations ended.

20. With Starbucks knowledge and participation, Kraft moved forward with the plans to use Kraft's ability to provide Starbucks super-premium coffees as a means to help position Tassimo to take advantage of the 2010 holiday shopping season.

21. In November, Starbucks made public statements that it was terminating its distribution agreements with Kraft that generated substantial commentary by the public-at-large on Tassimo's future. Attached hereto as Exhibit 3 is a true and correct copy of a CNNMoney.com report of November 23 (speculating whether Starbucks leaving Kraft would end Kraft's involvement with Tassimo and Kraft's coffee business altogether). Attached hereto as Exhibit 4 is a true and correct copy of a Fox News article of November 5, 2010 (speculating on Starbucks moving to a Tassimo competitor, Keurig, and whether Kraft would get out of the coffee business).. Attached hereto as Exhibit 5 is a true and correct copy of a December 9, 2010 Comment of Euromonitor International (speculating on Starbucks moving to Keurig). Attached hereto as Exhibit 6 is a true and correct copy of A December 1, 2010 analysis of Kraft foods ("In addition single serve Tassimo has been a struggle and loss of the premium Starbucks retail brand

is difficult to offset” p. 1; “It isn’t clear whether Tassimo can get a fresh start and grow more rapidly to become a factor in the market. Given the early struggle, it will likely take significant funding to emerge as a viable concept in the eyes of U.S. consumers. While the agreement between Kraft and Starbucks that is currently under dispute is different from the contract between Kraft’s Tassimo and Starbucks, one has to wonder how long that relationship continues.” p. 4).

22. This commentary also included social media consumer statements responding to the news reports of Starbucks announcement, the blog commentary, and the analysis. The comments indicate that consumers’ decision to buy the Tassimo system is heavily effected by the uncertainty created by Starbucks’ actions. Attached hereto as Exhibit 7 is a true and correct copy of comments left on the Tassimo Community Board at (<http://innercircle.tassimodirect.com/category/Forums/3>) between November 3-29, 2010 (multiple stated concerns regarding Tassimo’s future and offerings, highlighting added). Attached hereto as Exhibit 8 is a true and correct copy of comments left on the Tassimo Facebook page from November 1-29, 2010 (expressing concerns over the fate of and offering for the Tassimo, highlighting added).

23. Kraft has the ability to bring another super-premium coffee offering for the Tassimo system to the market within six months, but a significant investment is needed to do so.

24. This investment includes securing a replacement super-premium coffee brand, notifying consumers and retailers of the replacement, and a significant marketing campaign to raise the consumer awareness and appreciation for the replacement brand.

25. If Starbucks had exercised its right to terminate the R&G Agreement (and then the Tassimo Agreements) as of March of 2011, by providing notice in September 2010 and

paying the monetary payment, and refraining from attacks Kraft would have been able to suitably replace Starbucks brand offerings by March 1, 2011, and convey to consumers and retailers, with certainty, what would be available on the Tassimo system.

26. By not exercising that option, and instead attempting to impermissibly, unilaterally terminate the R&G Agreement (and the Tassimo Agreements), Starbucks has left Kraft unable to appropriately replace Starbucks brand super-premium coffee offerings in Tassimo.

27. Under the current conditions, Kraft cannot inform its retailers what super-premium offerings will be available for Tassimo after March 1, 2011, because the exclusivity provisions restricting Kraft would still be in effect if the Agreements are still in effect after March 1, 2011.


28. Under the current conditions, Kraft cannot make any commitments to or reach any agreements with providers of alternative super-premium coffees that might be offered in Tassimo in the specified channels to replace the Starbucks coffee brands because the exclusivity provisions restricting Kraft remain in effect and it is uncertain when they will no longer apply.

29. Under the current conditions, Kraft cannot inform consumers wishing to buy a Tassimo system what super-premium coffee offerings will be available, because the exclusivity provisions restricting Kraft would still be in effect if the Agreements are still in effect after March 1, 2011.

30. This declaration is based upon my personal knowledge and/or upon my review of true and correct copies of documents created and/or kept in the normal course of business by Kraft Foods, and I could competently testify to these facts if called as a witness.

I declare under penalty of perjury pursuant to 28 U.S.C. § 1746 that the foregoing information is true and correct.

Dated: December 21, 2010



David C. Hyland