

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

In re

KENNETH SZOSTEK, SR.,
DEBORAH LYNN SZOSTEK,

Debtors.

Chapter 7

Case No. 99-23910

BAYOFF ENTERPRISES, INC.,

Plaintiff,

v.

Adversary No. 99-2206

KENNETH SZOSTEK, SR.,

Defendant.

MEMORANDUM DECISION

The plaintiff filed this adversary proceeding against the debtor Kenneth Szostek, Sr., asking that a debt be excepted from the debtor's discharge under 11 U.S.C. § 523(a).¹ In the portion pertinent to this decision, the complaint alleged that Mr. Szostek violated the Uniform Trade Secrets Act, § 134.90, Wis. Stats., in connection with his employment by the plaintiff.

After a trial before this court, the parties filed briefs on the applicability of the law to the facts

¹The complaint alleged that the defendant's actions resulted in a nondischargeable debt under § 523(a)(6), for willful and malicious injury. However, the allegations more properly support a § 523(a)(4) claim for embezzlement of a trade secret. *See In re Harland*, 235 B.R. 769 (Bankr. E. D. Pa. 1999). Cases excepting from discharge under § 523(a)(6) conduct intended for the personal gain of the debtor but not intended to harm the plaintiff, as alleged in the trade secret portion of this case, generally predate *Kawaauhau v. Geiger*, 523 U.S. 57, 118 S.Ct. 974 (1998).

presented, as well as the appropriate remedies. This court has jurisdiction under 28 U.S.C. § 1334(b), and this is a core proceeding under 28 U.S.C. § 157(b)(2)(I). The following opinion constitutes the court's findings of fact and conclusions of law pursuant to Fed. R. Bankr. P. 7052.

For the reasons stated herein, the plaintiff lacks standing to prosecute a cause of action with respect to the pizza dough recipe used by Little Caesars, and the plaintiff has not proved it is entitled to relief with respect to other matters complained of. Consequently, judgment will be entered in favor of the debtor on this issue.

PROCEDURAL BACKGROUND

On November 22, 1995, Bayoff Enterprises filed a lawsuit against its former employee, Kenneth Szostek, in Milwaukee County Circuit Court alleging, among other things, breach of fiduciary duty, breach of duty of employee loyalty and violation of the Wisconsin Trade Secrets Act, § 134.90, Wis. Stats. After a trial on the complaint, the Honorable Christopher Foley dismissed the non-compete, breach of contract and trade secret claims, but found that Mr. Szostek had violated his fiduciary duty of employee loyalty to Bayoff Enterprises. On November 10, 1998, Bayoff Enterprises moved for reconsideration or, in the alternative, for a new trial based on newly discovered evidence on its trade secret violation claim. Judge Foley granted Bayoff Enterprises' motion for a new trial on the trade secret issue.

After Mr. Szostek and his wife filed a chapter 7 bankruptcy petition on April 20, 1999, Bayoff Enterprises filed this adversary proceeding alleging that the cause of action for breach of fiduciary duty was excepted from his discharge and that Mr. Szostek violated the Wisconsin Trade Secrets Act, § 134.90, Wis. Stats.

The automatic stay was modified to allow Judge Foley to decide damages on the issues he had already heard. The plaintiff was awarded compensatory damages of \$26,556.94 on the violation of fiduciary duty claim, punitive damages of \$10,000, plus costs, for a total of \$40,727.80. Judgment was entered by the state court on September 29, 1999. On the plaintiff's summary judgment motion in this action, this court previously determined that the findings by Judge Foley clearly showed that Mr. Szostek engaged in conduct that resulted in a deliberate and intentional injury to Bayoff Enterprises, and the judgment debt was nondischargeable under 11 U.S.C. § 523(a)(6) (Court Minutes, October 12, 1999).

Because Judge Foley had previously granted Bayoff Enterprises' motion for new trial on the alleged violation of the Uniform Trade Secrets Act, and the evidence was different in some respects from that presented to Judge Foley, the trade secret matter was heard by this court and is the subject of this opinion.

FACTS

At all times relevant to this adversary proceeding, the plaintiff, Bayoff Enterprises, Inc., did business as Little Caesars Pizza in southeastern Wisconsin. The defendant, Kenneth Szostek, was employed by Bayoff Enterprises in various capacities: as Training Supervisor from August to November of 1989, as Area Director from November 1989 to December 1991, and as Director of Operations from December 1991 through April 1994. He left Bayoff Enterprises on April 5, 1994. While employed by Bayoff Enterprises, Mr. Szostek reported directly to the company's president, Tom Bayoff. As Director of Operations, Mr. Szostek was responsible for the total

operation of the more than 30 Little Caesars.² These responsibilities included customer satisfaction, employee staffing and development, security, and overall profitability of all stores.

After leaving Bayoff Enterprises in 1994, Mr. Szostek worked for a different pizza chain, Sbarro's, as an area director. After his employment with Sbarro's ended, Mr. Szostek and Nick Valavanis, Jr., a former franchise representative of Little Caesars who also worked at Sbarro's, went into business together. The two became shareholders of Pastabilities, Inc., which owned and operated Spaghetti Jack's, a fast-food Italian restaurant. They opened a Spaghetti Jack's franchise in Pewaukee, Wisconsin, in August 1997.

While previously employed with Little Caesars' corporate headquarters, or possibly when he was employed by Little Caesars Pizza in Omaha, Nebraska, Mr. Szostek learned the Little Caesars' pizza dough recipe. Little Caesars provided their franchises with packaged, preweighed mixes to be used to make its fresh pizza crusts. The "preweighs" were distributed to the franchises by Blue Line Foods, a full service distributor fully owned by Little Caesars. The preweigh ingredients were not disclosed to employees, and very few people in the corporation were privy to the recipe.³

Mr. Szostek claimed that he did not use the Little Caesars' dough recipe while at Spaghetti Jack's. Although the Spaghetti Jack's franchises used frozen crust pizza, he sought permission to use a fresh crust in his location. Mr. Szostek stated that he developed the pizza

²Bayoff Enterprises operated Little Caesars Pizza restaurants in Wisconsin and Texas. In 1993, Little Caesars Corporation took over management of the Texas restaurants.

³All exhibits containing the preweigh recipe and cost calculations have been sealed and will be destroyed by the office of the bankruptcy clerk after all orders in this adversary proceeding are final and non-appealable.

dough recipe by trial and error, making adjustments to amounts of yeast, water and oil used. He admitted that he had Mr. Valavanis obtain an uncooked dough ball from a Little Caesars' store, but only to taste test the cheese and sauce. The Spaghetti Jack's chain of restaurants had pizza sales of approximately 2% of total sales. At Mr. Szostek's restaurant, however, pizza sales increased to at least 18% of sales after the frozen crust was replaced with the fresh pizza crust.

Mr. Valavanis testified that Spaghetti Jack's used the Little Caesars' recipe to make the pizza crust it served to its customers. The parties had discussed using a recipe obtained when they both worked at Sbarro's, a different pizza restaurant, but it proved to be too labor intensive. Mr. Valavanis disputed Mr. Szostek's claim that they tested various recipes. Instead, Mr. Szostek varied the Little Caesars' recipe only out of necessity. They used vegetable oil instead of olive oil because it was less expensive. Also, they could only purchase 25 pound bags of high gluten flour because the 27 pound bags that Little Caesars used were unavailable, and calculations for large batches had to be modified. The court is persuaded that Mr. Szostek used the confidential Little Caesars' recipe without significant change in preparing the pizza dough for Spaghetti Jack's.

Mr. Szostek also had access to confidential Little Caesars' franchisee manuals during his employment with Bayoff Enterprises. The complaint states that he removed several of these manuals, along with the food cost calculations he developed, from Bayoff Enterprises. The manuals were provided to employees for training purposes only. Mr. Valavanis testified that, while living with the Szosteks, he personally viewed the Little Caesars' manuals in a closet in Mr. Szostek's residence in late 1997 and several times thereafter. Although Mr. Szostek denied

taking any manuals, the court is satisfied that he did. However, he never used them after he took them.

Finally, Mr. Szostek developed a cost calculation program while employed by Bayoff Enterprises, but denied using it at Spaghetti Jack's. The food cost calculation program he supposedly developed for Spaghetti Jack's, and presented in court, curiously contained information which was irrelevant to Spaghetti Jack's operations. (*See Exhibit 7.*) The Spaghetti Jack's cost calculations included computations for items such as square flour and mix; small, medium and large boards; small, medium and large boxes (Spaghetti Jack's only had pizza in two sizes); crazy cups and lids; four and eight piece bread; and muenster cheese -- all items which Mr. Szostek readily admitted were not used at the Spaghetti Jack's restaurant. Mr. Bayoff testified that Little Ceasars used those terms and items exclusively at its restaurants. Mr. Valavanis also received a Little Caesars' food cost calculation program on computer disc from Mr. Szostek. According to Tom Bayoff, president of Bayoff Enterprises, the program would be useful to a competitor because the franchises' profits depend on the formula used. Mr. Valavanis claimed that they intended to use the Little Caesars' financial materials to aid in their operations of Spaghetti Jack's, but apparently this was never done.

Mr. Szostek left Spaghetti Jack's in May 1998, and the restaurant closed in the fall of 1998.

DISCUSSION

Standing

Bayoff Enterprises seeks a finding that Mr. Szostek misappropriated two separate types of trade secrets: (1) the pizza dough recipe, and (2) the corporate manuals and food cost calculations. As noted above, Mr. Szostek learned the Little Caesars' pizza crust preweigh recipe prior to his employment with Bayoff Enterprises, when he worked at Little Caesars Enterprises, Inc., or possibly when he worked for another Little Caesars' franchise. He disclosed and used the recipe at Spaghetti Jack's after his employment with Bayoff Enterprises was terminated. The manuals and food costs calculations were first used by Mr. Szostek during his employment with Bayoff Enterprises, and they were taken from Bayoff, but they were not used subsequent to his termination.

Bayoff Enterprises argues that it has proper standing to sue since it holds the exclusive license to Little Caesars' trade secrets in southeastern Wisconsin. Bayoff Enterprises pays Little Caesars a royalty, in part for the privilege of using Little Caesars' trade secrets, and it is obligated to keep Little Caesars' trade secrets confidential. Mr. Bayoff testified that Bayoff Enterprises would have been in breach of its obligation to Little Caesars if it had not pursued a claim against Mr. Szostek for misappropriating the trade secrets, as it is contractually obligated to keep Little Caesars' trade secrets safe. Bayoff Enterprises thus claims that the relevant time period to determine standing under § 134.90, Wis. Stats., is not when the alleged violator acquired the trade secret, but when he disclosed or used it. The harm done by Mr. Szotek's disclosure of the trade secret was upon Bayoff Enterprises, a local competitor of Spaghetti Jack's.

Whether a trade secret owner grants an exclusive license has little to do with standing to sue for the secret's improper disclosure or use. See Jay Dratler, Jr., *Exclusive Licenses*, LICENSING INTELL. PROP. § 8.06[5]. Standing to sue instead depends upon whether the complainant has been the victim of improper means to procure the trade secret. Whenever "more than one person is entitled to trade secret protection with respect to the same information, only that one from whom misappropriation occurred is entitled to a remedy." UNIFORM TRADE SECRETS ACT §§ 2, 3, Commissioners' Comments, 14 U.L.A. 433, 451, 457 (1990). Here, there are numerous parties entitled to know and use the dough recipe, including the corporate franchiser and its many franchisees. Bayoff is obligated to protect the recipe in its possession, but this does not mean that it succeeds to the rights of the entity from whom the recipe was misappropriated. Therefore, Bayoff Enterprises lacks standing under the Uniform Trade Secrets Act to prosecute the action against Mr. Szostek with respect to the dough recipe.

Bayoff Enterprises does have standing to bring the action against Mr. Szostek for misappropriation of its manuals and calculations. This information was taken from Bayoff and not another party.

Trade Secret Violation

Trade secret protection arises exclusively under state law. See UNIFORM TRADE SECRETS ACT, 14 U.L.A.. 433-36 (1990). According to the Uniform Trade Secrets Act, which has been enacted by Wisconsin as § 134.90, Wis. Stats., an employee misappropriates a trade secret when the employee knows that knowledge of the trade secret was acquired under conditions giving rise to a duty of secrecy and yet discloses or uses the trade secret without express or implied consent.

The definition of trade secret is found in § 134.90(1)(c), Wis. Stats., and includes information (1) which has independent economic value because it is not generally known to and not readily ascertainable by people who could gain economic value from disclosing or using it, and (2) reasonable efforts are taken to maintain its secrecy. Whether a misappropriation has occurred is determined by examining § 134.90(2):

No person, including the state, may misappropriate or threaten to misappropriate a trade secret by doing any of the following:

(a) Acquiring the trade secret of another by means which the person knows or has reason to know constitute improper means.

(b) Disclosing or using without express or implied consent a trade secret of another if the person did any of the following:

1. Used improper means to acquire knowledge of the trade secret.

2. At the time of disclosure or use, knew or had reason to know that he or she obtained knowledge of the trade secret through any of the following means:

a. Deriving it from or through a person who utilized improper means to acquire it.

b. Acquiring it under circumstances giving rise to a duty to maintain its secrecy or limit its use.

c. Deriving it from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use.

d. Acquiring it by accident or mistake.

Wis. Stat. § 134.90(2).

Whether information constitutes a trade secret depends on the surrounding circumstances. Factors to consider are the extent to which information is known outside of the business, the extent to which it is known by employees and others involved in the business, the extent of measures taken to guard the secrecy of the information, the value of the information to the party asserting the trade secret and competitors, the amount of effort or money expended by the party in developing the information, and the ease or difficulty with which the information could be properly acquired or duplicated by others. *B.C. Ziegler & Co. v. Ehren*, 141 Wis. 2d 19, 414 N.W.2d 48 (Ct. App. 1987).

Reasonable efforts to maintain secrecy have been held to include advising employees of the existence of a trade secret, limiting access to a trade secret on a "need to know basis," and controlling access to the material. See UNIFORM TRADE SECRETS ACT § 1, Commissioners' Comments, 14 U.L.A. 439 (1990). Accidental release of information (like the uncooked doughball) may not necessarily rise to the level of "culpable carelessness," and thus may not preclude a party from asserting that the information was a trade secret. *B.C. Ziegler & Co.*, 141 Wis. 2d at 32, 414 N.W.2d at 54.

It is highly questionable whether the information taken from Bayoff Enterprises by Mr. Szostek are trade secrets. In *MQS Inspection, Inc. v. Bielecki*, 963 F. Supp. 771 (E.D. Wis. 1995), a corporation's customer lists, bids and pricing formulas, pricing information, and market strategies, all of which former employees allegedly misappropriated, were not "trade secrets" as defined by Wisconsin's Uniform Trade Secrets Act. Also, although security might have been more lax than at Little Caesars, it was held in *Buffets, Inc. v. Klinke*, 73 F.3d 965 (9th Cir. 1996), that employee manuals were not trade secrets. Nevertheless, even if this type of information does reach the level of trade secrets, the plaintiff acknowledges that it suffered and seeks no damages because of their misappropriation because the information was never used. (Plaintiff's brief, p. 4, n. 4). It does, however, seek a permanent injunction with respect to their use.

Injunctive Relief

Bayoff Enterprises requests that this court issue an injunction against Mr. Szostek permanently enjoining him from using the trade secrets of Little Caesars. The parties previously consented to this court entering judgment, and the debtor has subjected himself to the bankruptcy

process. See 28 U.S.C. § 157(c)(2). Section 105 of the Bankruptcy Code provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). Notwithstanding this general authority, equitable powers conferred under § 105 "must and can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207, 108 S.Ct. 963, 968 (1988).

Section 134.90(3) provides for the granting of injunctive relief in appropriate circumstances:

- (a)
 - 1. A court may grant an injunction against a person who violates sub. (2). . . .
 - 2. Except as provided in subd. 3, upon application to the court, the court shall terminate an injunction when a trade secret ceases to exist.
 - 3. The court may continue an injunction for a reasonable period of time to eliminate commercial advantage which the person who violated sub. (2) otherwise would derive from the violation.

- (b) In exceptional circumstances, an injunction granted under par. (a) may condition future use of a trade secret by the person who violated sub. (2) upon payment of a reasonable royalty by that person to the owner of the trade secret for no longer than the period of time for which the court may enjoin or restrain the use of the trade secret under par. (a). Exceptional circumstances include a material and prejudicial change of position, prior to acquiring knowledge or reason to know of a violation of sub. (2), that renders an injunction inequitable.

- (c) In appropriate circumstances, the court may order affirmative acts to protect a trade secret.

Wis. Stats. § 134.90(3).

Assuming the manuals and cost calculations are trade secrets, and this court is not at all persuaded that they are, Bayoff is not entitled to injunctive relief. The information in question dates from 1994. Cost calculations are undoubtedly obsolete, and the franchise manuals probably are, as well. Injunctions concerning trade secrets must be for a reasonable time and

