Circuit Court for Montgomery County
Case No. 486771V

UNREPORTED*

IN THE APPELLATE COURT

OF MARYLAND

No. 1025

September Term, 2023

FRANK LEO ZARRELLI

v.

HISCOX INSURANCE COMPANY, INC.

Zic,
Kehoe, S.,
Getty, Joseph M.
(Senior Judge, Specially Assigned),

JJ.

Opinion by Kehoe, J.

Filed: August 2, 2024

* This is an unreported opinion. This opinion may not be cited as precedent within the rule of stare decisis. It may be cited for persuasive value only if the citation conforms to Maryland Rule 1-104(a)(2)(B)

This matter is an appeal of a grant of summary judgment by the Circuit Court for Montgomery County in favor of the Appellee, Hiscox Insurance Company, Inc. ("Hiscox") against the Appellant, Frank Leo Zarrelli ("Mr. Zarrelli"). Mr. Zarrelli sued Hiscox for breach of an insurance contract for failing to defend or indemnify him in a suit in which he had been named as a defendant. This case raises the question as to whether an insurer has an obligation to indemnify an insured when the claim against the insured misconstrues the nature of the insured's business. For the reasons outlined in this opinion, we affirm the judgment of the trial court.

Factual Background

Mr. Zarrelli worked as a professional accounting control specialist, who provided internet technology security design and consulting services. Raju Chavan ("Mr. Chavan") set up Cross Industry Solutions, Inc. ("CIS") to provide internet technology management support and consulting services to paying customers. In 2016, Mr. Zarrelli began to work for CIS to develop an internet-based inventory control platform to secure a contract with the Washington Suburban Sanitary Commission ("WSSC"). To this end, Mr. Zarrelli met with WSSC information technology officers on several occasions to discuss the services that CIS could provide. From these meetings, Mr. Zarrelli and Mr. Chavan were able to understand how best to structure WSSC's inventory control. In early 2018, CIS made a successful bid for WSSC's management support services contract.

On February 8, 2019, Mr. Zarrelli and Mr. Chavan met with representatives of WSSC and a representative of DS Pipe & Steel Supply, LLC ("DS Pipe") regarding the

supply of copper tubing for WSSC's inventory. CIS assured WSSC that it could assist in communicating with subcontractors and suppliers like DS Pipe.

On October 4, 2019, Mr. Chavan, on behalf of CIS, entered into an agreement with DS Pipe to supply copper tubing to WSSC. DS Pipe fabricated and delivered the tubing to a WSSC facility in Hyattsville, Maryland. This order went unpaid, and, on May 28, 2020, DS Pipe filed suit against CIS, Mr. Chavan and Mr. Zarrelli in the Circuit Court for Montgomery County ("DS Pipe Complaint"). The DS Pipe Complaint alleged only one count against Mr. Zarrelli: breach of statutory and common law trust.[1] DS Pipe's allegations against Mr. Zarrelli were based on its information and belief that Mr. Zarrelli was the chief financial officer of CIS. The allegations against Mr. Zarrelli were further based on DS Pipe's information and belief that CIS held money in trust for the benefit of DS Pipe. The purchase orders by Mr. Chavan were allegedly for a WSSC project at 4101 Lloyd Street, Hyattsville.[2]

[1] The DS Pipe Complaint consisted of the following Counts:
Count I - breach of contract against CIS;
Count II - quasi contract against CIS;
Count III - breach of statutory and common law trust against Mr. Chavan and Mr. Zarrelli;
Count IV - breach of the prompt pay statute against CIS; and
Count V - fraud in the inducement against Mr. Chavan.

[2] It appears from the purchase order that 4101 Lloyd Street is a WSSC facility. Other than a naked allegation that the tubing was supplied for a construction contract, the DS Pipe Complaint does not explain how it came to understand that the tubing was intended for a construction contract.

At all relevant times, CIS maintained a professional liability insurance policy (the "Policy") with Hiscox, which covered CIS, Mr. Chavan and Mr. Zarrelli. The Policy provided that Hiscox would pay any damages or claim expenses for wrongful acts in failing to provide professional services. Professional Services under Endorsement 1 to the Policy was defined as Technology Services, which were further defined as:

> 1. application service provider (ASP) services;
> 2. data processing, analysis, and database design services;
> 3. IT Project Management services;
> 4. internet service provider (ISP) services;
> 5. internet hosting services;
> 6. network security design and consulting services;
> 7. software installation, customization, and support;
> 8. software programming and development;
> 9. systems/hardware/network installation, maintenance, and support;
> 10. systems/network advice, design, and integration;
> 11. technology products training;
> 12. value-added resale of hardware; and
> 13. website design.[3]

The Policy defined Wrongful Acts as:[4]

> Wrongful Act means any actual or alleged breach of duty, negligent act, error, omission or Personal injury committed by You in the performance of Your Professional Services.

The Policy contained the following exclusion to coverage:

> This Policy does not apply to and We shall have no obligation to pay any Damages, Claim Expenses or Supplemental Payments for any Claim:…
>
> …based upon or arising out of any actual or alleged liability of others that You assume under any contract or agreement unless such liability would have attached in the absence of such contract or agreement.

[3] A number of the individual terms for Technology Services are further defined in Endorsement 1 to the Policy.

[4] Under the terms of the Policy, "You" refers to the insured, and "We" refers to the insurer.

On July 10, 2020, Mr. Chavan notified Hiscox of the DS Pipe Complaint. On August 17, 2020, Cheyayn Davidson, Esquire ("Ms. Davidson") sent an email to Mr. Chavan to outline the reasons why Hiscox declined coverage of DS Pipe's claim. On February 25, 2021, Ms. Davidson sent an additional letter to Mr. Chavan, apparently in response to another inquiry, to explain further Hiscox's reasons for declining coverage.

Mr. Zarrelli maintained private counsel in the DS Pipe suit, in which he ultimately reached a settlement agreement. On August 12, 2021, Mr. Zarrelli sued Hiscox for breach of contract in the Circuit Court for Montgomery County. Hiscox filed a timely response. The case was disposed of when the Circuit Court granted Hiscox's Motion for Summary Judgment. In granting the Motion for Summary Judgment, the circuit court stated:[5]

> I am going to find that the exclusion does apply and for purposes of appeal, I want to make it clear for the Appellate Court what my reasoning is. My reasoning is that it's a very close call on the first issue as to whether or not this breach of duty is a wrongful act. I think Mr. Zarrelli's affidavit is admissible. It is useful. I do find it's a close call, but I do find that I have to. There is a potential that that is a wrongful act as that term is defined. The failure of him to hold the money in trust as required by [Md. Code Ann., Real Prop. §] 9-201. As to the exclusion though, I think Hiscox prevails on that because that's the purpose of that exclusion, to prevent this from becoming a performance bond that this underlying suit no matter what label they put on it, was a collection action because they had not been paid. So for that reason, I'm going to grant the motion for summary judgment and I tried to make it clear so that for purposes of appeal, you have a record of saying here's what the judge found and did not find, okay? But I did not consider the Keener [sic] affidavit. I just don't find that helpful at all. I did consider Zarrelli's affidavit on issue number one…

[5] Hiscox attached an affidavit from Chris Keehner, the president and owner of DS Pipe, to its Motion for Summary Judgment. Mr. Zarrelli attached his affidavit to his Opposition to the Motion for Summary Judgment.

Question Presented

Having noted a timely appeal, Mr. Zarrelli has raised one question, which we rephrase as follows:[6]

> Did the circuit court err by entering summary judgment in favor of the Appellee by applying the "contractual liability exclusion" set forth in the Policy?

Standard of Review

In *Maryland Casualty Company v. Blackstone International, Ltd.*, the Supreme Court of Maryland summarized the standard for appellate review of a motion for summary judgment:

> We review a grant of summary judgment as a matter of law. The standard for appellate review of a trial court's grant or denial of a summary judgment motion is whether the trial court was legally correct. Thus, we conduct an independent review of the record to determine whether a genuine dispute of material fact exists and whether the moving party is entitled to judgment as a matter of law. We review the record in the light most favorable to the non-moving party and construe any reasonable inferences which may be drawn from the facts against the movant.

442 Md. 685, 694 (2015) (cleaned up).

[6] In his brief, Mr. Zarrelli framed the question as follows:

> Whether the circuit court erred by entering summary judgment in favor of Hiscox upon application of the "contractual liability exclusion" in the Policy to the undisputed evidence that DS Pipe had sued Zarrelli in the DS Pipe Action solely on the grounds of Zarrelli's alleged breach of duty in performing "IT Project Management Services" (as that phrase is used in the Policy) even though DS Pipe's allegations against Zarrelli were groundless and even though the "gravamen" of the DS Pipe Action was to recover damages for breach of a contract between DS Pipe and Cross Industry for the sale/purchase of pipe inventory and not for breach of a contract for Cross Industry to provide "IT Project Management Services" to DS Pipe?

In considering this motion for summary judgment, we assume the allegations in the DS Pipe Complaint against the Appellee to be true. *Sheets v. Brethren Mut. Ins. Co*., 342 Md. 634, 638-39 (1996). We, therefore, examine whether the trial court was legally correct in finding that the claim was not covered. *Id*.

Discussion

Mr. Zarrelli urges that the DS Pipe suit was covered by the Policy under the potentiality rule. *Litz v. State Farm Fire and Cas. Co*., 346 Md. 217, 226 (1997). The potentiality rule considers whether the allegations of the tort action potentially bring the claim within the policy's coverage. *St. Paul Fire & Marine Ins. Co. v. Pryseski*, 292 Md. 187, 193 (1981).[7] In this context, Mr. Zarrelli contends that when one strips away the veneer of DS Pipe's unfounded assumption that the tubing was ordered for a construction contract, any action on the part of Mr. Zarrelli would necessarily fall under the provision of Technology Services, which are covered by the Policy. As Mr. Zarrelli makes clear in his affidavit, he never did anything that was not tied to WSSC's inventory control needs.

The determination as to whether there is coverage requires a court to look at the language of the contract. *Id*. at 194. *See also Sheets*, 342 Md. at 639. A court needs to examine whether any claims or defenses fall under the requirements of the policy and whether the allegations potentially bring the claim under the policy. *Pryseski*, 292 Md. at

[7] Both *Litz* and *Pryseski* address whether there is a duty to defend, not whether there is coverage for the underlying claim. *Litz*, 346 Md. at 225; *Pryseski*, 292 Md. at 193 The duty to defend is broader than the requirement to indemnify. 346 Md. at 225. This distinction is not necessary for the purpose of the analysis in this case.

194. The first question focuses on the policy and the second question focuses on the claim. *Id*. A duty to defend is triggered when the underlying tort claim "is potentially covered by the policy, no matter how attenuated, frivolous, or illogical that allegation may be." *Sheets*, 342 Md. at 643. A groundless allegation will not relieve the insurer of its duty to defend. *Id*.

In *Sheets*, the Sheetses sold a farm to the Christensens. *Id*. at 637. The Christensens sued the Sheetses for negligent representation that the septic system was in good working order because it turned out that the septic system was inadequate to meet the needs of a family the size of the Christensen family. *Id*. The Court found that the Christensens' alleged causal connection between the Sheetses' misrepresentation and the failure of the septic system was sufficient to trigger the insurer's duty to defend. *Id*. at 645.

In *Pryseski*, Mr. Pryseski, who was an employee of Sun Life, was sued by R.G.[8] for intentional infliction of emotional distress, assault and loss of consortium. 292 Md. at 190-91. St. Paul, as the liability insurer of Sun Life, refused to cover Mr. Pryseski stating that he was not acting within the scope of his employment and his conduct was willful and, therefore, not covered by the policy. *Id*. at 191. The Court remanded the case to determine whether Mr. Pryseski's alleged conduct was an occurrence under the terms of the Policy. *Id*. at 200.

The Court in *Pryseski* set up a two-part test to determine coverage:

[8] The underlying suit in *Pryseski* alleges a sexual assault, and the Plaintiff's name has been redacted for this opinion. 292 Md. at 190.

> In determining whether a liability insurer has a duty to provide its insured with a defense in a tort suit, two types of questions ordinarily must be answered: (1) what is the coverage and what are the defenses under the terms and requirements of the insurance policy? (2) do the allegations in the tort action potentially bring the tort claim within the policy's coverage? The first question focuses upon the language and requirements of the policy, and the second question focuses upon the allegations of the tort suit. At times these two questions involve separate and distinct matters, and at other times they are intertwined, perhaps involving an identical issue.

Id. at 193.

As to the first prong of *Pryseski*, courts will construe an insurance policy according to contract principles. *Blackstone Int'l., Ltd*., 442 Md. at 694. Maryland follows the objective law of contract interpretation. *Id*. (citation omitted). Accordingly, the written language embodying the terms of an agreement will govern the rights and liabilities of the parties. *Id*. at 695 (cleaned up). Words in an insurance policy must be accorded their customary, ordinary, and accepted meaning. *Id*.

The Policy provides that it will indemnify "any actual or alleged breach of duty, … error, omission … committed by [Mr. Zarrelli] in the performance of [Mr. Zarrelli's] Professional Services." As noted, the Endorsement 1 of the Policy defines Professional Services as Technology Services, and it sets forth the attributes of Technology Services.

Mr. Zarrelli argues that the term "duty" set forth in the policy must be read to require indemnification under Count III of the DS Pipe Complaint because that count alludes to the duty of an officer to hold funds in trust and pay suppliers. *See Sheets*, 342 Md. at 638-39. Again, Mr. Zarrelli's contention is that any duty that he owed to WSSC was necessarily

based on his providing it with Technological Services because that is what he was paid to do.

To address this argument, we move to the second prong of *Pryseski* and examine the specific allegations set forth in the DS Pipe Complaint. 295 Md. at 196. The trial court correctly disregarded the Keehner affidavit because the proper consideration of the court is the content of the DS Pipe Complaint not Mr. Keehner's thoughts. The DS Pipe Complaint alleges Mr. Zarrelli was the CFO of CIS. On October 19, 2019, CIS had ordered tubing for a construction project that WSSC had undertaken at 4101 Lloyd Street, Hyattsville. WSSC had paid CIS to cover the cost of the tubing, and Mr. Zarrelli had a duty under Md. Code Ann., Real Prop. § 9-201 to pay DS Pipe from the funds paid by WSSC to CIS.

Accepting all of the allegations as true, the DS Pipe Complaint, in essence, alleges that it had a contract with CIS to supply copper tubing for construction projects undertaken by WSSC. Mr. Zarrelli as a principal of CIS had a duty, per Md. Code Ann., Real Prop. § 9-201 to pay those funds held in trust by CIS to DS Pipe.

Real Prop § 9-201[9] provides, in pertinent part:

> (a) For the purposes of this subtitle, "managing agent" means an employee of a contractor or subcontractor who is responsible for the direction over or control of money held in trust by the contractor or subcontractor under subsection (b) of this section.

[9] Md. Code Ann., Real Prop. § 9-101 contains a definition of a contract as "an agreement of any kind or nature, express or implied, for doing work or furnishing material, or both, for or about a building as may give rise to a lien under this subtitle." This definition by its terms is limited to Title 9, Subtitle 1 of the Real Property Article. However, the context of Subtitle 2 is that it pertains to contracts for the improvement of a building.

> (b) (1) Any money paid under a contract by an owner to a contractor, or by the owner or contractor to a subcontractor for work done or materials furnished, or both, for or about a building by any subcontractor, shall be held in trust by the contractor or subcontractor, as trustee, for those subcontractors who did work or furnished materials, or both, for or about the building, for purposes of paying those subcontractors.
>
> (2) An officer, director, or managing agent of a contractor or subcontractor who has direction over or control of money held in trust by a contractor or subcontractor under paragraph (1) of this subsection is a trustee for the purpose of paying the money to the subcontractors who are entitled to it.

Md. Code Ann., Real Prop. § 9-202 sets the obligations for a principal who holds money in trust pursuant to a contract:

> Any officer, director, or managing agent of any contractor or subcontractor, who knowingly retains or uses the money held in trust under § 9-201 of this subtitle, or any part thereof, for any purpose other than to pay those subcontractors for whom the money is held in trust, shall be personally liable to any person damaged by the action.

DS Pipe's allegations against Mr. Zarrelli relate to a supply contract. The alleged duty is to pay a subcontractor or supplier out of funds that it has received from the property owner. Taking Mr. Zarrelli's argument to its logical conclusion, the tubing was purchased as inventory for WSSC, therefore it necessarily falls under Technology Services. This argument ignores that the basis of the claim is one in contract. According to the DS Pipe Complaint, WSSC paid CIS for the tubing, but CIS never paid DS Pipe. In his Complaint against Hiscox, Mr. Zarrelli concedes that CIS never paid DS Pipe out of funds that WSSC had paid to CIS.

A condition of liability under Md. Code Ann., Real Prop. § 9-201 is that a defendant would have received the funds pursuant to a contract. The DS Pipe Complaint incorporated

all "paragraphs relating to a contract action as if fully set forth" in the count against Mr. Zarrelli. All of the allegations related to the claim under the Real Property Article arose out of a contract and are, therefore, not covered by the Policy.

The second area of liability relates to the alleged common law breach of trust. The DS Pipe Complaint alleges "breach of trust pursuant to Annotated Code of Maryland Real Property Article §9-202 and at common law." A breach of trust at common law never appears to have been argued, and the theory left the trial court somewhat puzzled. In this context, the DS Pipe Complaint was filed on May 28, 2020. At that time the most prominent statement of breach of fiduciary duty was set forth in *Kann v. Kann*, 344 Md. 689 (1997). In *Kann*, Judge Lawrence F. Rodowsky noted:

> Accordingly, we hold that there is no universal or omnibus tort for the redress of breach of fiduciary duty by any and all fiduciaries. This does not mean that there is no claim or cause of action available for breach of fiduciary duty. Our holding means that identifying a breach of fiduciary duty will be the beginning of the analysis, and not its conclusion. Counsel are required to identify the particular fiduciary relationship involved, identify how it was breached, consider the remedies available, and select those remedies appropriate to the client's problem. Whether the cause or causes of action selected carry the right to a jury trial will have to be determined by an historical analysis. Counsel do not have available for use in any and all cases a unisex action, triable to a jury. This Court would not preside over the death of contract by recognizing as a tort a breach of contract that was found to be in bad faith.

Id. at 713.

On July 14, 2020, in *Plank v. Cherneski*, in holding that there is an independent cause of action for breach of fiduciary duty, Justice Brynja M. Booth further explained Judge Rodowsky's analysis in *Kann*:

> To establish a breach of fiduciary duty as an independent cause of action, a plaintiff must show: "(i) the existence of a fiduciary relationship; (ii) breach of the duty owed by the fiduciary to the beneficiary; and (iii) harm to the beneficiary." *Froelich* [*v. Erickson*], 96 F.Supp.2d [507,] 526 [(D. Md. 2000)] (citing *Lyon v. Campbell*, 120 Md. App. 412, 439 (1998)) (applying Maryland law, under the assumption that Maryland recognizes an independent cause of action). The remedy for a breach is dependent upon the type of fiduciary relationship, and the remedies provided by law, whether by statute, common law, or contract. Under our *Kann* analysis, a court should consider the nature of the fiduciary relationship and possible remedies afforded for a breach, on a case-by-case basis. If a plaintiff describes a fiduciary relationship, identifies a breach, and requests a remedy historically recognized by statute, contract, or common law applicable to the specific type of fiduciary relationship and the specific breach is alleged, a court should permit the count to proceed. The cause of action may be pleaded without limitation as to whether there is another viable cause of action to address the same conduct.

469 Md. 548, 599 (2020). As Justice Booth notes, the frame of reference for action for breach of trust (breach of fiduciary duty) is the relationship that would give rise to the duty. In this case, there is no relationship other than a contractual relationship. Mr. Chavan ordered the tubing, and DS Pipe never got paid for it. Although DS Pipe's prayer for relief asked for "any other equitable relief this court deems just and necessary," there is no discernable relief other than damages for breach of contract. Thus, there is no liability for the breach of a duty that would not exist in the absence of the contract that Mr. Chavan made with DS Pipe.

The Policy provides that there is no coverage for any liability arising out of a contract unless that liability would have existed in the absence of the contract. Every allegation set forth in the DS Pipe Complaint relates to a contractual obligation on the part of CIS. Indeed, in his Complaint, Mr. Zarrelli conceded that Mr. Chavan had entered into

a contract with DS Pipe and that CIS failed to pay DS Pipe out of funds that WSSC had paid to CIS. The duty that is set forth in Md. Code Ann., Real Prop. § 9-201 is a contractual duty, not a tort duty.

Mr. Zarrelli contends that DS Pipe's misunderstanding of the nature of its relationship to WSSC moves the question of coverage to the potentiality argument set forth in *Pryseski*. 292 Md. at 193. Mr. Zarrelli's argument is that since the only relationship that he had with WSSC was to provide Technology Services, the claim by DS Pipe must necessarily be covered by the Policy. This argument ignores the holding in *Sheets*, that the focus in determining coverage rests on the claim made against the insured. 342 Md. at 639. In this case, the DS Pipe Complaint against Mr. Zarrelli arises completely out of a contractual obligation.

Mr. Zarrelli's reliance on *Litz* is misplaced. The underlying claim in *Litz* was a tort action (negligence). 346 Md. at 220. The issue was whether a business pursuits exclusion applied because one of the parties was providing baby-sitting services. The Court found that the exclusion would not apply to one spouse if it was determined that that spouse did not participate in the baby-sitting service. *Id*. at 235. *Litz* involved a tort claim and is inapposite to this case, in which a contract exclusion is asserted.

In conclusion, although the DS Pipe Complaint rested on an apparently erroneous assumption that CIS had provided construction services for WSSC, its allegations against Mr. Zarrelli were based entirely on Mr. Chavan's supply order. This supply order fell

within the contractual liability exclusion of the Policy. Therefore, the trial judge correctly found in favor of Hiscox. Accordingly, we affirm.

JUDGMENT OF THE CIRCUIT COURT FOR MONTGOMERY COUNTY IS AFFIRMED. APPELLANT TO PAY COSTS.