

Losses Due to Pandemic: Insurability, Scope and Limits

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Abstract

The world is not what it was at the beginning of the year 2020. A pandemic has substantially changed the way business is carried out in almost all walks of life. A lockdown to contain this pandemic roughly between March and May 2020 hit several businesses hard dragging them to loss of income and other such problems. In the light of this situation, this paper seeks to discuss the possibility of force majeure risk insurance. For this, this paper would first define what a force majeure is taking cue from various interpretations of the same. Further, this paper shall discuss the scope of liability insurance in general and business interruption liability insurance in particular. This paper shall discuss whether force majeure risks, especially ones that happened due to COVID-19, could be covered under such business interruption liability insurance. While discussing the same, this paper shall find whether such insurance policy is possible to be issued in India.

Keywords: Force majeure, liability insurance, COVID-19, business interruption insurance.

INTRODUCTION

COVID-19 was a completely unexpected change to our lifestyles. Owing to this pandemic, the Union of India announced a country wide lockdown across the nation on March 25, 2020, which phased out from April 21, 2020 [1]. During this lockdown, the MSMEs were hit hard and almost one-third of them went out of business [2]. A progressive and long-sighted insurance coverage could have possibly saved them at least from the catastrophe of having to shut shop. The author felt that there is a need for study of such insurance coverage especially in light of the present pandemic situation.

This paper begins by discussing the various definitions of force majeure and comparing it with the common law concept of frustration of contract. In this section of the paper, the author tries to draw a distinction between the common law and civil law understanding of force majeure and then try to understand whether it can co-exist with the doctrine of frustration. Following this, the paper discusses the meaning and scope of liability insurance generally and business interruption insurance in particular. Following that, the paper moves on to discuss whether such insurance can be made applicable to the loss faced by businesses during the current pandemic or similar situations where there is no significant loss to property. Further, the possibility of application of the said insurance policy to India is discussed. This paper finally tries to find if Indian insurance policies are sufficient to make good the losses that were incurred due to COVID-19.

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FORCE MAJEURE AND FRUSTRATION OF CONTRACT

Force majeure is a doctrine established under French law and hence alien to the common law system which itself developed from Roman law [3, 4]. Force majeure is thought to have developed parallel to the common law concept of frustration [5]. Both of them have developed a certain parallelism, but force majeure is narrower in providing relief than its common law counterpart [5, 6]. In this section, we shall discuss the various

definitions of force majeure, the possibility of parties agreeing to their own definition of force majeure and conclude with the difference between the common law concept of frustration and force majeure.

Force Majeure

Force Majeure under Civil Law

As stated already, force majeure is a concept that originated under the Roman law, which is a precursor to the existing civil law system. Under the French law, there are three conditions that need to be fulfilled for one to prove force majeure – (i) the externality of the event or the fact that the parties had nothing to do with the happening of the event; (ii) Unpredictability of the event; and (iii) Irresistibility or the fact that the parties could have done nothing that could have stopped the event from happening [3]. It is to be noted that *force majeure* and *casus fortuitus* are distinct concepts in French law and are applicable differently [3]. On the other hand, German law does not differentiate between the two concepts and holds that *pacta sunt servanda* can be breached only when it is unreasonable to do otherwise [7]. Like the common law principle of adjustment of contract, German law encourages adjustment of the legal obligation of parties first [7]. Several civil law countries follow the principles laid down in the French law [8].

Force majeure under common law

Though a borrowed concept, force majeure clauses exist in common law jurisdictions also and they are usually governed by the law relating to contingent contracts in each of these countries [9]. Common law jurisdictions have generally interpreted force majeure to be wider than *vis major* or Act of God [9]. In simpler terms, common law courts have interpreted force majeure to include things that are caused even by humans. The only catch is that such event should not have occurred because of, or be capable of control by the parties to the contract. Force majeure cannot include events that can be easily foreseen at the time of drafting the contract [10]. The intention behind these clauses is usually to relieve the defaulting party of liability that arose due to events over which they had no control [11].

UNIDROIT Principles

Article 7.1.7 of the UNIDROIT Principles defines force majeure thus –

“Non-performance by a party is excused if that party proves that the non-performance was due to an impediment beyond its control and that it could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.”

This Article, according to the UNIDROIT commentary, covers the grounds of frustration and force majeure but is identical to neither [12]. Again, a plain reading of the Article would give us the same three parameters that we saw hereinabove:

- (i) Irresistible
- (ii) Unexpected
- (iii) Unavoidable

Therefore, we may safely conclude that irrespective of the jurisdiction under which we are dealing, the common characteristics of force majeure are that these events are unforeseen, beyond the control of contracting parties and could not have been avoided by the parties.

Customised Force Majeure Clauses

The law of contract does not lay down any specific format or formulation for force majeure clauses. In fact, India being a common law jurisdiction, force majeure is only recognised as part of a contract. It is a special contract and therefore, subject to agreement between the parties. However, such agreement cannot go beyond the interpretation of existing law of contracts. In fact, even the UNIDROIT commentary is of the opinion that the definition under its Article 7.1.7 is rather of a

general character [12]. It further states vis-à-vis international contracts, that they usually contain more precise and elaborate provisions for force majeure that suit their course.

It may be therefore concluded that parties may find it appropriate to customise force majeure clauses to their liking, provided that it is bound within the existing framework of contract law.

Frustration of Contract

Meaning and Scope

The essentials of frustration are that event should have happened without fault of either party and such event should not have been foreseen at the time of entering into the contract [13–15]. It is an implied protection against liability due to unforeseen and uncontrollable events. Common law places impossibility of performance of contract within the concept of frustration of contract. In common law, any contract that is impossible of performance or which subsequently becomes impossible of performance (as in the case of force majeure) is treated void (See generally 9–11). However, frustration is a genus of which impossibility of performance due to unforeseen events is a species [3]. Frustration also includes within its meaning hardship to perform a contract for which common law provides the remedy of alteration of rights and duties of the parties to suit the changed circumstances [9]. Frustration provides a greater protection against liability due to non-performance than does force majeure [5, 6].

Frustration v. Force Majeure

We have seen that frustration is an implied protection and because of that, contracts need not expressly carry any provision to that effect. On the contrary, any event that has been foreseen while drafting the contract and incorporated in the contract therewith would not be covered under the doctrine [6, 9]. We understand that force majeure is a civil law principle and needs to be stated expressly for it to be applicable to a contract. Now, question arises as to whether inclusion of a force majeure clause in a contract would nullify the applicability of the doctrine of frustration.

There is a long discussion that needs to be made to answer this question and such discussions have already been undertaken and successfully published. Such studies of the law conclude that it is practically impossible for someone to draft a force majeure clause that will completely shut out the application of the doctrine of frustration [16].

Be that as it may, what we find during the study of the law relating to frustration of contracts and that of force majeure is that there can be certain liabilities that cannot be escaped even with the tightest of clauses and the greatest of protection of law. Question arises to how a risk in that regard can be escaped. This is where we are forced to turn to the study of the law of insurance in general and liability insurance in particular. Therefore, the next section of this paper shall discuss liability insurance and business interruption insurance along with its nature and scope.

LIABILITY INSURANCE – BUSINESS INTERRUPTION INSURANCE

Liability Insurance

Black's Law Dictionary defines the term liability insurance as a type of insurance that indemnifies one person against a liability that arises out of the injury to the person or property of another [17]. This needs to be differentiated from indemnity insurance, as indemnity insurance is one that indemnifies the insured against loss and not liability arising out of the same or different event [17]. Liability insurance is an umbrella term that covers several insurable subject matters [18].

It includes motor vehicle third-party insurance, accident insurance, tort liability insurance, employee accident insurance among others. In this sections and the one that follows, we shall discuss if this type of insurance can cover liability arising out of business interruption due to a pandemic.

Business Interruption Insurance

Before discussing the details of whether or not a pandemic or a business interruption that happened due to a pandemic can be covered under Business interruption insurance, we shall discuss what is the nature and scope of business interruption insurance.

Nature and Scope

While property insurance indemnifies a person against property loss suffered by them and general liability insurance indemnifies a person against third-party claims for damage to their person or property, business interruption insurance is capable of indemnifying a person against losses even in the absence of any physical damage [19]. Business interruption insurance is capable of replacing the lost income due to non-operability of the insured's business [20]. This type of insurance is available from the early parts of the twentieth century and was expected to have a steady growth even as early as 1932 [20].

Till today, this type of insurance has been used to cover losses arising out of loss of property and person due to natural calamities like the Katrina cyclone and terrorist attacks like 9/11 twin tower attacks [19]. In both of these circumstances, there is a closure of business due to a physical damage to the property along with incidental mental trauma *inter alia*. However, today, we are at a peculiar position where businesses have closed not because someone bombed the place or because some huge natural calamity turned the place head over toe. The problem facing the world today is that businesses closed because of a super-spreader pandemic. There was no physical damage to property but a lot of financial injury to business. The question facing the author is whether such loss can be made good by the existing policies of business interruption insurance. Therefore, the next question that arises is whether business interruption insurance covers only property loss or also other incidental losses.

Contingent Business Interruption Insurance

There is a school of thought that says that only when there is loss to property the business interruption insurance coverage is triggered [21]. Recording the reservation that the author has to such interpretation of business interruption policies, this part shall continue on the assumption that business interruption coverage is triggered only by injury to property. In this scenario, we may turn to the Contingent Business Interruption Insurance for coverage, for it provides an absolute coverage over even income losses [22]. Therefore, we may conclude that there are insurance policies that are capable of covering losses that occur even without damage to property or person. For the sake of convenience, both Contingent Business Interruption Insurance and Business Interruption Insurance shall be jointly referred to as Business Interruption Insurance, unless the context requires it to mean otherwise.

APPLICABILITY OF BUSINESS INTERRUPTION INSURANCE TO COVID-19

Business Interruption damages during 9/11 and Hurricane Katrina together amount to around fifty five billion dollars (\$ 55 billion) [23]. However, in both these cases, there was physical damage to property. When it comes to COVID-19, we are left blinded as this situation is unprecedented in modern history. There is no physical damage to any property, but business cannot continue because of governmental health regulations [24]. To understand the situation, let us discuss an illustration and try to apply the current understanding we have to the scenario.

Let us take the example of the tourism industry, which is one of the worst hit industries during the pandemic. The Government of India announced a country-wide lockdown from March 25, 2020 [25]. The government allowed partial reopening of the hospitality industry with strict guidelines from June 08, 2020 [26]. This industry was virtually non-functional for almost a quarter. Even on re-opening, there were several restrictions on the capacity of the same. Also, several States had placed restrictions on opening hotels and other industries even then. The hospitality industry contributed to nearly 7.5% of India's GDP and this was expected to grow up to almost 9.6% by this year [27]. This shows the profits that turned over in this industry. COVID-19 guidelines have negatively impacted the sector by

making it function with less than 50% capacity among other things [28]. Before relaxation of the lockdown, the industry functioned at a zero income mode [29].

In the above illustration, there is no physical damage to property, but there is severe financial injury faced by the hospitality industry for no fault of theirs. The loss that is faced by them is due to a force majeure event in its strict sense [30]. It is argued that such losses can also be covered under business interruption insurance as they are being used as a tool by risk professionals to continue business irrespective of property damage [22]. This type of insurance policy is well established and popular in countries like the United States of America (See generally 16). However, the possibility of such insurance in India is a question that needs to be answered.

POSSIBILITY OF BUSINESS INTERRUPTION INSURANCE IN INDIA

Business Interruption Insurance is usually issued as standalone policies in many jurisdictions. (5, 14, See e.g., 15, 16, 20) However in India, this policy comes under the Fire Insurance (Business Interruption – Special Perils). It protects net profits, working cost, maintenance cost of the business, etc. [31]. According to insurance experts in India, business interruption insurance can be claimed only when there is damage to property [31]. However, the good news is that the feasibility of bringing such claims under business interruption is being discussed now [32]. A structured pool is one of the suggestions put forth by people experienced in the field [32]. One senior insurance executive is quoted as saying that –

“The only way business interruption losses can be taken care of in a pandemic situation is if a pandemic pool is formed because the basic difference in case of catastrophe and a pandemic is in the latter, the entire economy goes for a toss versus terrorism incident or a catastrophic incident where losses come in from a particular place but it is not pan India” (As quoted in 22).

In conclusion, we find that in the present scenario, it is not possible in India to protect businesses from losses in the absence of a loss of person or property as far as business interruption is concerned. There is a dire need for such insurance policies to be brought in as standalone policies in the light of the lessons that this pandemic has taught us.

CONCLUSION

Force majeure and the doctrine of frustration are more or less parallel concepts. However, the latter is more accommodative than the former. In common law jurisdictions, merely because a force majeure clause was incorporated, a contract does not escape the applicability of the doctrine of frustration. However, since there may be still losses that may not be covered under these doctrines, insurance becomes essential. There are two types of business interruption coverage, the general one triggered by loss of property and the contingent business interruption that covers even losses that arise without loss of property. The latter is not available in India, as there is no distinct insurance policy for business interruption here and it needs to be obtained along with fire insurance. Therefore, there is a dire need for a separate policy for pandemic insurance. Perhaps even legislation like the Pandemic Risk Insurance Act, as introduced in the US Congress [33] might do some good in India.

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