AGREED VALUE OR MARKET VALUE?

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There is a lot of controversy nowadays on this question in France, the practical meaning of which is as follows : when a ship has a substantially lower value on the market than the value upon which the parties have agreed in the insurance contract, or if her value is much higher, which value must be applied?

In this paper I argue that it is the contractually agreed value which must prevail, for two reasons : **(I)** the first being a matter of law, and **(II)** the second being a matter of economics.

I. The conflict between two principles as a matter of law.

A. The dilemma

Judges and arbitrators are like Ulysses steering his way between Scylla and Charybdis: whatever course they adopt, they will always be blamed. If they decide to apply the agreed value, they will be blamed for ignoring the principle that it is only the real loss which must be indemnified and that nobody is entitled to benefit from unjust enrichment (the assured by receiving more than the actual value of the vessel or yacht if it were sold on the open market, or the insurer by paying less than the real price if the agreed value is high). If on the contrary they decide it is the market value, they will be blamed for failing to apply the express stipulations in the contract which clearly specify the value of the insured asset, and upon which the premium is calculated accordingly.

How can they overcome or resolve this dilemma? This paper will deal with the solutions and reasons potentially available to judges and arbitrators. In particular, what is the value of replacement or rebuilding ("*reconstruction*" in French), a new criterion which has appeared in French law? Does this apply only to real estate activities on land, or can this be extended to offshore and marine activities? Can the insurance policy provide for an indemnity which is higher than the actual market value and are such provisions valid?

How should "wear and tear" or the age of the ship be dealt with when the policy contains a clause in which the value is agreed? Should a distinction be made between agreed value clauses and refurbishment or replacement clauses ("*valeur à neuf*" in French – ie. replacement with new)?

B. Clauses and interpretation by case law

Many insurance policies contain a clause which states a specific amount as being the insured value, or specifies that the indemnity will be for "value as new" ("*valeur à neuf*" as we say in French). The amount specified is a kind of maximum indemnity on which the parties agree, or it can be the cost of building a new ship of the same value if the ship is lost. In short, it is possible for the parties to define the insured value in the insurance contract. This does not conflict with the French rule that the indemnity must not exceed the market value of the property when it is damaged.

Several insurers and brokers market their services by advertising that "*the agreed amount will be reimbursed to you in full*". However this kind of publicity can have a boomerang effect in the event of a dispute with the assured. In French law there is a rule laid down by an article in the Insurance Code which provides that when an insured item is lost, the insurer must indemnify the assured at the sale value of that item.

The problem then is : which "value" to be taken into consideration - the market value, or the agreed value?

C. Is this provision of the Insurance Code mandatory?

There are two possible interpretations :

1. Either : this rule as laid down by the Insurance Code is mandatory and the parties therefore cannot derogate from it by agreement.

2. Or : this rule is not mandatory and the parties can agree to a so-called "value as new" clause ("*valeur à neuf*" in French) or to a specific figure.

The second interpretation was preferred in a judgment rendered by the Cour de Cassation on 13th September 2007 :

> "*the principle of compensation laid down by article L 121-1 of the Insurance Code does not prevent the application of a contractual clause which provides for payment of an indemnity calculated on the reconstruction value ; this value, which relates to the cost of making good the asset destroyed, cannot amount to an enrichment of the assured even if the actual value of the property before the casualty is less than the cost of rebuilding it*".

This is what Professor Kullmann considers to be a valid insurance for the risk of the value of the asset being reduced through normal wear and tear after the date when insurance contract was taken out. In this respect Professor Kullmann concludes that "*parties who take out insurance for value as new (reconstruction or replacement) by paying a higher premium in order to be free from the adverse consequences of wear and tear are both validly covered and happily reassured*".

The clause for "value as new" provided by the insurance policy is therefore indisputably valid and compatible with the principle of compensation.

This remedy is not conditional upon rebuilding the asset (in shipping matters, the lost vessel is often at the bottom of the sea). This solution had been applied to yachts in several judgments (for example by the Montpellier Court of Appeal on 20th October 2011) and many similar decisions have also been rendered in real estate matters.

D. Is this solution of derogation limited to real estate, excluding ships?

There were two conflicting points of view :

- for the insurers, derogation from the rule laid down by the Insurance Code can only apply to buildings, not to ships, as only buildings can be reconstructed ;

- for the assured, it applies to all kinds of assets as our case law does not expressly make a specific distinction.

The clause for "value as new" means that the indemnity must be equivalent to the price of a new vessel to replace the vessel which has been lost. In a recent case the insurer argued that the rule laid down by article L.121-1 of the Insurance Code applied only to buildings and not to ships[1]. For the assured, I replied that according to this argument the same legal provision and the same principle would produce two completely different and conflicting results.

1. Argument based on conflicting results

(a) In matters of building construction the principle of compensation would not prevent the insurance policy from providing for a clause whereby the assured is entitled to obtain an indemnity which is equal to the value of reconstructing the building which has been destroyed, even if this cost is greater than its market value before the damage.

(b) But the same principle and the same statutory provision would produce a different result when applied to a pleasure yacht, because according to the insurer, the clause for the agreed value only reverses the burden of proof as regards the value of the insured asset at the time of the casualty. Therefore the insurer could adduce evidence that the market value of the yacht was less than the agreed value.

2. Argument based on case law

Our case law does not and cannot draw a distinction depending on whether the asset insured is a building or a pleasure boat. The principle of compensation laid down by article L.121-1 of the Insurance Code is of general application. In providing that "*the indemnity payable by the insurer to the assured cannot exceed the amount of the value of the insured asset at the time of the casualty*" this article makes no distinction as to whether the asset insured is movable or immovable, a building or a ship, or any other tangible or intangible asset.

The assured did not allege that the insurers must indemnify them strictly at the value agreed regardless of the yacht's market value. Upon relying on the actual terms of the policy, the assured alleged that the insurance indemnity must correspond to the value as new, in other words, to the price of purchasing a new vessel to replace the insured asset, within the limits of the agreed value.

Most of the decisions which derogate from the rule called the "principle of compensation" relate to buildings, but some of these relate to ships or to industrial equipment, as I explain below in greater detail.

In various decisions it has been held that the assured was entitled to an indemnity calculated on the value of reconstruction (decisions of 13th September 2007 and 26th March 2015), or on the agreed value (decision of 24th February 2004 where the

insurer failed to adduce evidence that the value of the yacht which sank was lower). On the basis of these three decisions, the insurers purported to draw a distinction between the type of asset insured. The assured objected, arguing that although the details may vary depending on the terms of the policy, they must not lead to different remedies depending on the type of object insured.

The decision of 13th September 2007 stated that the insurance indemnity "*which relates to the cost of making good the asset destroyed, cannot amount to an enrichment of the assured even if the actual value of the property before the casualty is less than the cost of rebuilding it*". The same remedy necessarily emerges not only from the decision of 26th March 2015 in a real estate matter but also from that of 24th February 2004 in the case of a pleasure boat.

One could say the same of the decision of 26th March 2015 which held that "*the clause in issue providing for an indemnity for value as new within the limits of a particular maximum must be applied*". It goes without saying, therefore, that if the policy provides for an indemnity for value as new, or of rebuilding, or of replacement, this will always be within the limits of the ceiling fixed by the policy.

The decision of 24th February 2004 in the case of a pleasure boat specifically dealt with a clause for an agreed value and declared that since a figure was "*stipulated in the policy, it had the effect of reversing the burden of proof as to the value of the object insured at the time of the casualty, and since the insurer had failed to produce any evidence that on the date it was destroyed the value of the sailing yacht was less than the agreed value, having thus drawn the proper consequences of the stipulation in the clause for the agreed value, [the Court of Appeal] rightly held, without disregarding the principle of compensation laid down by article L 121-1 of the Insurance Code, (…) that CGU Courtage were bound to pay Mr X an indemnity equal to the value agreed*".

3. Argument based on the expectations of the parties

A second common uniform principle also emerges from these decisions : the principle of compensation does not limit the indemnity to the market value at the time of loss. The indemnity may be equal to the cost of rebuilding or of making good the asset destroyed. The decision of 26th March 2015 states that compensation for the cost of rebuilding can be capped at a limit fixed by the policy, although this is obvious. The decision of 24th February 2004 specifically dealt with the agreed value clause and laid down the scope of this value : it is quite simply the presumed value of the object insured, which can only be rebutted if the insurer proves that the value of the object insured is in fact less. The agreed value clause therefore has the effect of an agreement as to the burden of proof.

The remedy whereby the assured can receive compensation for “value as new”, or “the cost of rebuilding”, or “replacement value” or for the “agreed value”, any of which may be greater than the market value, is not in any way restricted to insurance for buildings. This remedy has been allowed without hesitation for insuring chattels, such as machinery and industrial equipment (Cass. 1st Civ. 19th February 1969, no. 67-12279, Bull. Civ. I, no. 76 : where the dispute was only about the condition for actual replacement under the policy). Many insurance policies for movable assets, and in particular for equipment, provide for compensation on the basis of new or replacement value. It could therefore be argued that the intentions and expectations of the assured would be thwarted if such clauses were to be interpreted in a manner which enabled the insurer to restrict the compensation to the market value.

The only peculiarity of this principle of compensation in the case of buildings is laid down by article L. 121-17 of the Insurance Code whereby the assured is obliged, subject to certain reservations, to use the funds paid by way of compensation for damage caused to a building, to actually repair the damage to that building. This provision is considered a derogation from the principle of compensation (as also article L. 121-16) and therefore has no application outside this specific domain. This particular rule does not seem to apply to ships or other movable assets.

E. Unjust enrichment and compensation in full

Another argument often raised by the insurers is that the assured would be unjustly enriched if the insurers have to indemnify him for a value which is higher than the actual market value of the lost ship.

To this the assured replies that there is no unjust enrichment provided a similar yacht of similar value is purchased. The replacement value is simply the purchase price. The principle of compensation in full must take into consideration the replacement value.

But this is another field of discussion.

II. Freedom of the parties to assess the value of a property.

What happens when the market collapses after a crisis? For example the yachts become difficult to sell in the second hand market, even if this is different when the yacht is brand new and has just been built for a specific price.

There are regularly fluctuations in the shipping market. For example, after 11th September 2001 the value of yachts dropped substantially. The price of an asset is sometimes affected by external events which have nothing to do with its real value. In the years 2003 to 2007 prior to the crisis which began at the end of 2008, and at a time when it was said that oil reserves and other petrol products would become rare, and subsequently carriage by tankers, the freights went up, sometimes very high. As a result, everyone wanted to buy new ships.

Now that lots of ships have been built so that supply exceeds demand, and that there appear to be a lot of previously undiscovered oil reserves and substitute products such as shale gas, freights have gone down and sometimes do not even cover the running costs of the ship today. This shows that the value of a ship can vary tremendously depending on external events which have an influence on public opinion but which are completely unrelated to the ship herself.

What is the value of an asset?

After the theory of the “fair price” developed by St Thomas Aquinas there has been some evolution through the philosophers (see the Scholastics) and the economists (Jean-Baptiste Say, L. v. Mises).

Perhaps we can refer to these thinkers to find out the value of an asset. The price of an asset does not come from the nature of that commodity but from the projects allocated to that asset. For example making petrol from oil, which in its raw state at the centre of the earth or under the sea had no value at all for hundreds and hundreds of years …. until Francis Drake and a few others discovered how it could be used as a source of energy. Value, therefore, is always determined by the user, the buyer, and not by the seller. Value, like wealth, is not a material substance such as money. It is a creation of the mind, a consequence of human discovery and invention.

Other examples are containerships, or computers, or cranes, and all kinds of services. Their value is attributed subjectively by the buyer who wants to have them. It is not the seller with his production costs who can do this. He will argue that his production costs are the bottom line which determine the value, because he cannot sell at a loss. But the Austrian school of thought will reply : no, it is competition which brings the costs down because supply must satisfy demand. If you look at the drop in the price of computers or domestic appliances over the last ten years, you will see that not only profits but also production costs can vary drastically. Very often productivity gains are achieved thanks to human ingenuity, sharpened by competition.

Behind this discussion on economics we find a natural principle. Whilst it should make enthusiasts of the so-called "public service" despair, the value of a service is not determined unilaterally by the person who provides it : its value is attributed by the person who receives that service, and forces us to look at that service through the other person's eyes.

This theory of value was developed by Mises and Hayek and all these thinkers of the Austrian School and also, several centuries earlier, by the late Scholastics and especially the School of Salamanca, in particular Francisco de Vitoria, Bartolomé de las Casas, Diego Covarrubias y Leyva (in 1554 he wrote : "*the value of an article does not depend on its essential nature but on the estimation of men, even if that estimation is foolish*"[2]) and also Francisco García who wrote: *"the same book can have a very high value and price for one person and a very low or even no value for another person"* and the same thing applies to all products.

Perhaps it is time for lawyers to refer to economists and philosophers. They might find a solid basis there to acknowledge that the value of a ship can be quantified at a higher figure in an insurance contract than her actual market value, simply because it is only the agreement by the parties to the contract which can determine this value, not the nature of the vessel, nor even the market.

Freedom of contract naturally leads to acceptance of the value chosen by the parties, determined by the assured and agreed by the insurer who calculates the premium payable by reference to the amount insured.

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Footnotes :

[1] The Paris Court of Appeal accepted this argument in a decision rendered on 24th May 2016. We are now before the Cour de Cassation.

[2] The economist Murray Rothbard quotes him.

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Biography :

Patrick Simon (born 1949) was admitted to the Paris Bar in 1973. He is a Doctor of Laws and co-founded the law firm Villeneau Rohart Simon in 1978.

He is a litigator who enjoys the battle of ideas and has extensive experience in charterparty disputes, international arbitration, freedom of trade, pollution cases, admiralty issues, cases against industrial action, strikes and boycotts, numerous ship arrests involving piercing the corporate veil, and major maritime casualties.

He is the author of several books on the philosophy of law, a former President of the French MLA (2007-2012) and a titulary member of the CMI.