

# End of Year Review 2011

For the year ended 20th February, 2011



**Total Number of Ships Entered**

3,493

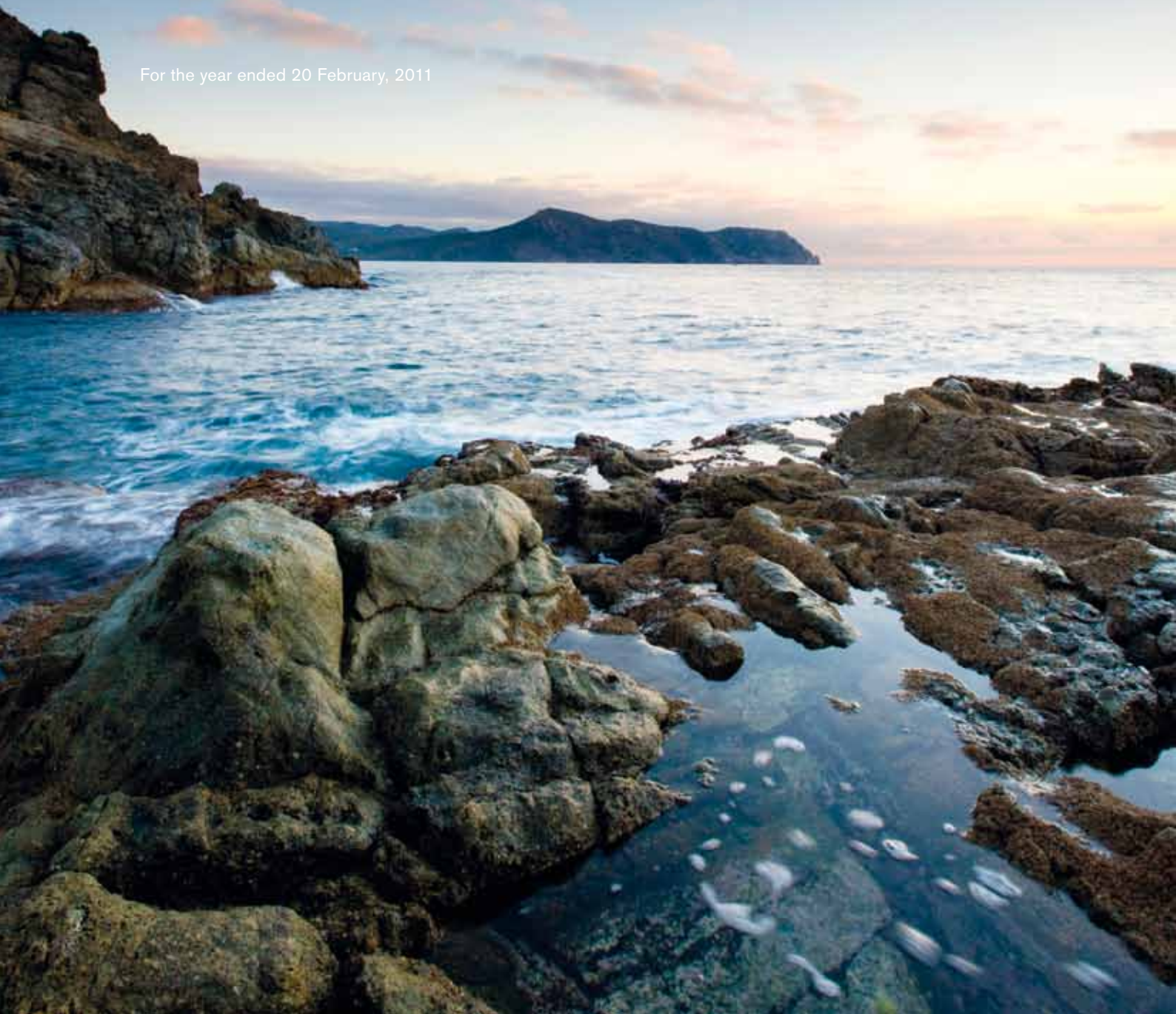
**Total Funds**

£51.6 million

**End of Year Reserves**

£21.7 million

For the year ended 20 February, 2011



# Chairman's Statement



“Reflecting on my third year as Chairman of the Association I am led to the inevitable conclusion that this period has been one of the most volatile for shipping markets that I can remember.”

**Reflecting on my third year as Chairman of the Association I am led to the inevitable conclusion that this period has been one of the most volatile for shipping markets that I can remember. The pendulum has well and truly swung from a period of exceptionally high freight rates to rates barely covering operating costs. The ramifications of this period are still being felt today and we only have to look at companies that have entered creditor protection schemes to see the effects first hand.**

However, the one thing you can say about shipping is that it is made up of individuals who are not only resilient but also resourceful. Shipping companies do not stand still but evolve and adapt to changing circumstances. Newbuilding orders that were prevalent in 2008 and 2009 have in many cases been renegotiated. Although it is said that these deliveries are contributing to current low freight rates the fact that orders continue to be placed suggests that there is confidence in the medium to longer term. Scrapping of older tonnage will of course assist in easing any oversupply. Some sectors have managed to rebound better than others although these sectors were probably the most affected by the fall in freight rates. The containership sector is one which has been assisted by the tentative steps being seen in world growth.

One area of concern to the industry is the issue of piracy. Crew safety has always been of paramount importance to ship operators and, although operators are taking steps they consider appropriate to protect crew, ship and cargo, further steps undoubtedly have to be taken at a national level to protect shipping from this scourge.

Turning to the Association, it is a mutual provider of legal costs insurance to the maritime industry. It is unique in that it is independent and not part of a P&I cover. I am often asked why this is a preferable approach. My short answer is that it means that the Association, and its Board, is very much focused on its core business, which is assisting Members with their claims. Considerable time is taken at each Board meeting in the consideration of cases. The Board brings immense expertise to this process and is very much aware of and alive to the issues that Members face on a day to day basis.

Over the last few years the Association has seen a significant increase in claims, however, this is precisely why the Association's cover is so important. Not only does it enable Members to take steps to protect their financial position, it also alleviates the heavy burden of legal costs that are incurred in any litigation.

This year the Board has considered a wide variety of cases. These are covered in more detail in the claims report later in this review, however, one significant case referred to is the RAINY SKY, which was a claim by a Member under a refund guarantee. With the support of the Association this case is proceeding to the Supreme Court of the United Kingdom, previously the House of Lords. It is a case which has provoked considerable controversy and legal analysis as to whether a refund guarantee should respond to the insolvency of a shipyard. The question I pose is what is the point of a refund guarantee if it does not respond to such a situation? The English judicial system is one that is renowned for viewing matters in a commercial way and it is hoped that the Supreme Court will consider the wider issues and the implications of such a decision on the industry generally.

## Chairman's Statement (continued)



Vase presented to Alain Bernard on his retirement from the Board. The vase was commissioned to depict some of Alain's own artwork.

The Association was also involved in one of the leading piracy related cases, the SALDANHA. In this case the High Court held, rightly in my view, that a ship under an un-amended NYPE form should remain on-hire during a piracy incident. This provided much needed clarity to shipowners and operators.

LMAA arbitration for Members has also featured heavily during the year. There has been criticism of the LMAA in some quarters, both in terms of its make-up and the speed with which arbitrations are conducted. However, one case involving the Association showcases how the system should operate. The case involved a long term charter and whether or not the ship was able to be delivered. The case started life in late June, 2010. By September, 2010 it had been arbitrated and an award rendered in the Member's favour. The costs incurred in this case were significant, however, the issues involved were of paramount importance to the Member given the long term nature of the charter. The Board had no hesitation in assisting the Member.

The above provides a mere snapshot of cases in which the Association has been involved, however, as can be seen many of these are important industry cases and are of considerable importance in assisting Members in their business activities.

As an Association focused on its core activities your Board has always been mindful of the Association's financial position. The more solid the foundations the more the Association is able to respond to Member needs and cushion the impact of ever increasing legal fees. I am therefore pleased to report that notwithstanding this volatile period the Association's financial position remains strong.

Free reserves for the year end are £21.7 million, which can be compared to reserves of £19.0 million in 2009/10. This financial position meant that the Association was able to levy a general increase of 2.5% for the year ahead, significantly better than a number of competitors. One must also not forget that the Association does not impose mandatory deductibles or individual claim limits. These should be recognised as clear differentiators between the Association and its competitors.



In the past year I am also pleased to report that the Association has seen continued growth in its Membership. Owned entered ships increased to 2,434 from 2,381 in 2009/10, with the total number (including chartered entries), increasing to 3,493. This is one of the clearest indicators as to the value of the Association's cover.

In previous reports I have mentioned the actions that your Board has been taking in respect of regulation, in particular in preparation for the implementation of Solvency II. The steps continue unabated in order that the Association is able to meet these new EU requirements when they are planned to come in to force in January, 2013.

Throughout my period as Chairman I have been greatly assisted by the dedication of your Board in all the activities of the Association. They are all so committed to the continued success of the Association. It has been a huge pleasure to be Chairman of a Board such as this. There has been some change to the Board with Alain Bernard standing down after 25 years as a Director, and

as Chairman in the period 1996 - 1999. Alain represented Olympic Shipping & Management SA. and his contribution to the Association was unquestionable. Alain's sense of humour and relaxed demeanour hide a keen commercial mind, and Alain was probably the only Director with considerable artistic talent...



Bob Crawford also stood down from the Board during the year. It is safe to say that Bob's tenure as a Board Director over a period of 34 years, three of which were as Chairman (from 1987 - 1990), will remain unparalleled in the annals of the Association. Bob was senior partner with Ince & Co before joining the Vlasov Group. Bob's legal mind and analysis of complex legal and factual issues was something that the Board greatly valued and from which Members benefited. It was entirely fitting that the Association was able to hold a function for him, in conjunction with the UK War Risks Association, at Trinity House on 14th April, 2010.

As ever, I and the Board have been ably assisted by the work undertaken by the Managers. In conjunction with your Board they continue to strive to make the Association what it is today. I am grateful for all their assistance over the past three years.

My sincere thanks to you as Members as well. We have all seen a lot in the past three years and although the business environment has changed, the fundamentals of the Association remain a constant. In this regard I extend my best wishes to my successor, Mr Michael Pateras. The years ahead will undoubtedly be filled with challenges, however, I am confident that the Association will meet these without difficulty and continue to grow and be a cornerstone of Members' operations for many, many years ahead.

**Panos Laskaridis**

Chairman  
The United Kingdom Freight  
Demurrage and Defence  
Association Limited  
May, 2011



# Claims Review

**Following the collapse of the shipping market at the end of 2008, which resulted in a record number of claims being reported to the Association, it is encouraging that the shipping markets have stabilised to some extent in 2010, although some sectors of the market have fared better than others. This stabilisation has resulted in a reduction in the number of new claims being reported to the Association this past year, with claim numbers more in line with those seen in the policy years prior to the market collapse.**

However, the consequences of the upsurge in claims in the last few years are still being felt, with those claims not settled being pursued through to arbitration or court proceedings. Arbitration awards or court judgments obtained then have to be enforced and significant costs are still being expended.

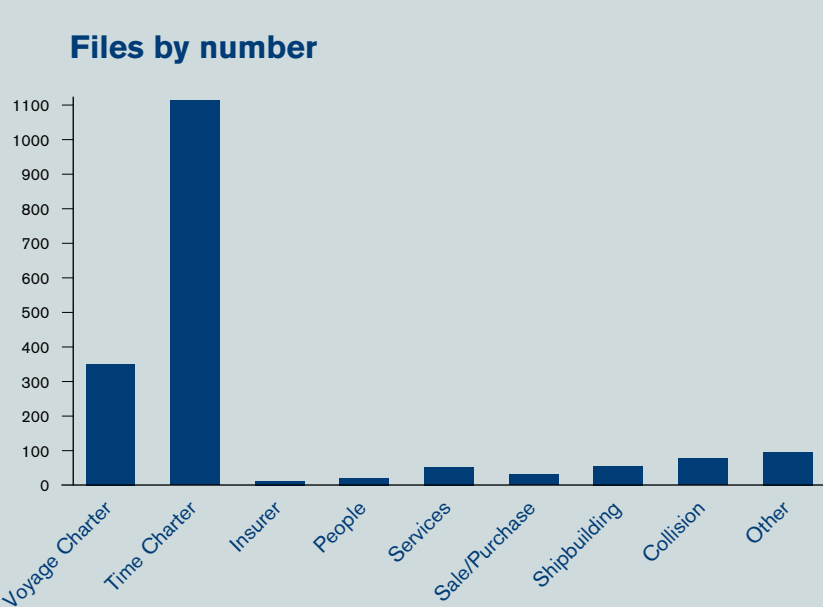
There remains general uncertainty and concern as to what the future holds for the shipping markets. A number of charterers who suffered significant financial pressure from the shipping downturn remain vulnerable. Only time will tell as to the overall impact, but judging from recent experience, it is likely to be some years before the full financial consequences are known.

### The Association's claims experience

Whilst the overall number of claims arising in 2010 is down significantly in comparison to the previous two years, the Association continues to see a number of complex, high value claims which require significant costs expenditure.

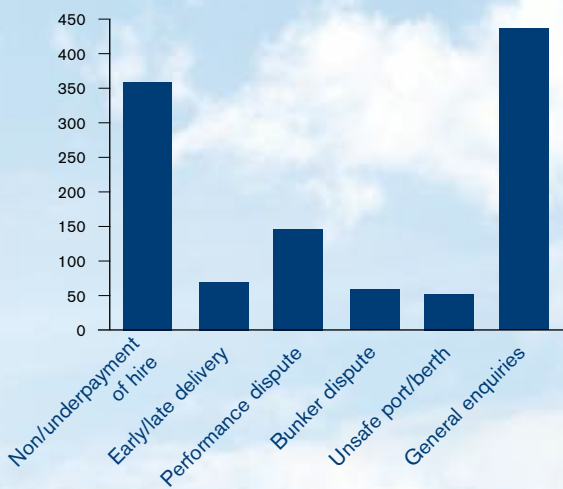
In terms of the types of dispute that arose in the 2010 policy year, the following graph provides a summary of the number of files opened, and the types of dispute involved.

“Whilst the overall number of claims arising in 2010 is down significantly in comparison to the previous two years, the Association continues to see a number of complex, high value claims which require significant costs expenditure.”



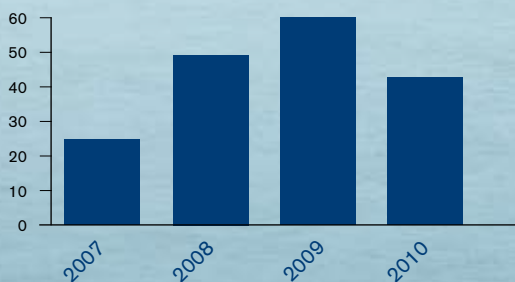
The vast majority of claims the Association is concerned with continue to be time charter disputes, which account for approximately 60% of all new files opened. The following shows the types of time charter dispute that arise, which include the usual hire disputes, early and late redelivery claims, bunker contamination problems and speed and performance claims.

### Time charter disputes



The Association has seen fewer shipbuilding disputes in 2010 than in the last two years, although some undoubtedly will develop in to significant claims. In view of the Association's vast experience in shipbuilding disputes the Managers produced a brochure on shipbuilding contracts highlighting the common issues which are likely to arise. The brochure also reinforces the value of the Association's cover for disputes as they are invariably very costly given the complex issues involved.

### Number of newbuilding disputes



# Claims Review (continued)

## Significant cases

The Association has historically been involved in some of the key cases influencing the shipping industry and this continued in 2010 when it was involved in a number of high profile disputes. In the case of the RAINY SKY there was a dispute between the buyer of a newbuilding and the refund guarantor. Before the ship was delivered the shipyard went into insolvency. The buyer called on the refund guarantee for the return of the pre-delivery instalments. The guarantor bank, the Kookmin bank of Korea, refused to return the pre-delivery instalments paid to the yard on grounds that the guarantee did not respond to insolvency. In the English High Court it was held that the guarantee was an "on demand guarantee" and that it did respond to the yard's insolvency. The bank appealed to the Court of Appeal who held, by a 2:1 majority, that the refund guarantee did not respond to the yard's insolvency. The Member has obtained leave to appeal the decision to the Supreme Court and the hearing will be heard in July this year.

In the case of the EAGLE VALENCIA the ship was chartered on an amended Shellvoy 5 form. The ship arrived at the terminal in Nigeria and tendered Notice of Readiness ('NOR'). The ship was ordered to wait at the anchorage as the berth was occupied. The next day the Port Health Authority granted the ship free pratique. The master tendered a further NOR without prejudice to the original NOR. The ship berthed three days later. The owner Member submitted its demurrage claim with supporting documents within 90 days of completion of discharge as required under the charterparty. The supporting documents did not include the second NOR. Well after the expiry of the 90 day period the charterer claimed that laytime had not commenced

until the ship was alongside the berth since free pratique was not obtained within 6 hours of the NOR which in accordance with a term of the charter meant that the NOR was invalid.

The English High Court found in favour of the Member on the grounds that the charterparty provided that a NOR and the commencement of laytime would not be invalid when free pratique is not granted at anchorage but when the ship berthed. The court held that by agreeing this provision the parties must have intended that similar circumstances should apply when the ship was at anchorage. This conclusion meant the judge did not need to consider whether the second NOR was valid or whether the claim was time barred.

On appeal the Court of Appeal overturned the High Court decision and found against the Member. It also held that the claim was time barred because the second NOR was not submitted as a supporting document in time.

The Association also supported the owner Member in the case of the SALDANHA, a much publicised piracy dispute over whether hire was payable under a NYPE charterparty during the period the ship was captured by pirates. The English High Court found in favour of the Member and held that the ship remained on hire throughout. The charterer's application for leave to appeal the decision was refused.

## Advisory services

A key element of the Association's cover is the advisory services it offers to Members. On a daily basis the Managers assist Members with a variety of general enquiries, the drafting of charterparty and other clauses



and in the amicable resolution of disputes before they reach the stage of legal proceedings.

The Association also continues to receive many piracy enquiries, mostly relating to ship routing and convoys, and more recently the use of armed guards on-board ships.

The Association has also received a number of enquiries arising from EU and UN sanctions. The Managers have been able to rely on in-house expertise to respond to most of these enquiries.

During the course of the year regular Soundings bulletins were issued highlighting leading cases and other key issues for the Membership on subjects as diverse as the Deepwater Horizon pollution incident and refund guarantees in shipbuilding contracts.

### Seminars

In 2010, the Managers organised a number of seminars in Piraeus, Hamburg and Singapore covering a range of legal topics, including the differences between London and New York arbitration proceedings, refund guarantees and miscellaneous charterparty issues.

### Management of legal costs

With the complexity of claims increasing it can be expected that significant legal costs will continue to be incurred. In view of this, the Association maintains its commitment to the Managers' Value for Money project. The Managers continue to explore with their legal partners ways to better achieve value for money, including alternative fee arrangements. The Managers

will continue to build on the relationships formed with the existing preferred and approved legal partners and will in due course expand those to other jurisdictions and other suppliers of services such as experts regularly instructed by the Association on behalf of Members.

London arbitration continues to be the most common forum for dispute resolution of shipping cases. Whilst it is preferable to settle cases amicably and short of an arbitration hearing, it is not always achievable. When cases do have to proceed the Managers and the instructed lawyers work closely to try to expedite the proceedings and bring the matter to a conclusion as swiftly as possible. The LMAA are also keen to show that London arbitration is efficient. In a case the Association was concerned with for a Member it did just that when the tribunal dealt with a dispute through to a hearing and published its award all within three months from the commencement of the arbitration.

Mediation has been a common feature for some time in English High Court cases, where the parties are compelled to consider it, with possible costs consequences if the court deems a party's refusal to mediate to be unreasonable. Mediation also appears to be growing in popularity in arbitration disputes. The Association has been involved in a number of successful mediations. The success rate has been very high and over 90% of cases settle at or shortly after the mediation. The Managers will continue to promote mediation in appropriate cases and to look for other opportunities to control costs and resolve disputes in a cost effective way.

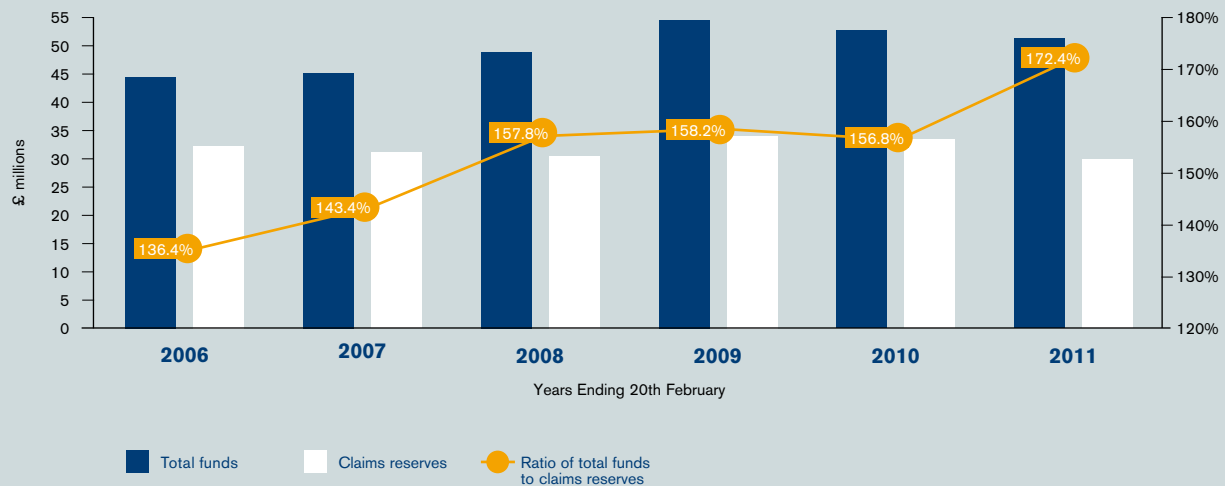


## **Financial Highlights 2011**

**“The Club continues to have a strong balance sheet with assets of £51.6m and a ratio of assets to liabilities of 172%.”**



## Total Funds & Claims Reserves



The UK Defence Club reinsures its past and present risks on a quota share basis with the UK Defence Insurance Association (Isle of Man) Ltd ("UKDIA"). Members of the UK Defence Club are also Members of UKDIA. The table set out below presents the results and reserves of the Club and its quota share reinsurer for the financial year ending 20th February 2011 on a combined basis. The financial highlights for the year are as follows:

- Premium income fell by 4% to £17.7m in 2010/11 due to the US dollar against Sterling compared with the previous year. In US dollar terms premiums increased by 2%.
- Net claims incurred, including the change in provisions, totalled £11.4m, down 23% from 2009/10's £14.7m. The 2010 policy year showed a marked fall in claims numbers compared with the two previous years, which were both affected by the impact of the financial crisis and downturn in shipping markets, and there were also further improvements in prior years' reserves.
- There was a technical operating surplus of £2.2m.
- Investment return totalled £1.2 million, equating to 2.6% and reflecting the Club's relatively conservative approach to investment policy, however, there were net exchange losses of £0.7 million resulting from the hedging of premium income and the weakening of the US dollar and Euro against Sterling during the course of the year.
- The net result for the year was a surplus of £2.7 million, taking free reserves to £21.7m.
- The Club continues to have a strong balance sheet with assets of £51.6m and a ratio of assets to liabilities of 172%.

Year ended 20th February	2011 £'000	2010 £'000
<b>Income and Expenditure Account</b>		
Calls and premiums	17,672	18,344
Reinsurance premiums	(386)	(383)
	<b>17,286</b>	17,961
Net claims incurred	(11,365)	(14,674)
Acquisition costs	(2,132)	(2,102)
Net operating expenses	(1,552)	(1,549)
	<b>(15,049)</b>	(18,325)
Operating surplus/(deficit)	<b>2,237</b>	(364)
Investment return and exchange (losses)/gains	<b>461</b>	(621)
Surplus/(deficit) before taxation	<b>2,698</b>	(985)
Taxation	-	89
Surplus/(deficit) after taxation	<b>2,698</b>	(896)
<b>Reserves and Capital</b>		
Total funds	<b>51,623</b>	52,374
Claims reserves	<b>(29,948)</b>	(33,397)
Free reserves and capital	<b>21,675</b>	18,977
Total funds / claims reserves	<b>172.4%</b>	156.8%

Strength with independence.

**The UK Defence Club**

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