UK DEFENCE CLUB

MAKING A DIFFERENCE

End of Year Review 2016

UKDC
IS MANAGED
BY **THOMAS MILLER**

Above & Beyond

On Cover
Giving you the confidence that your exposure to legal costs is protected.

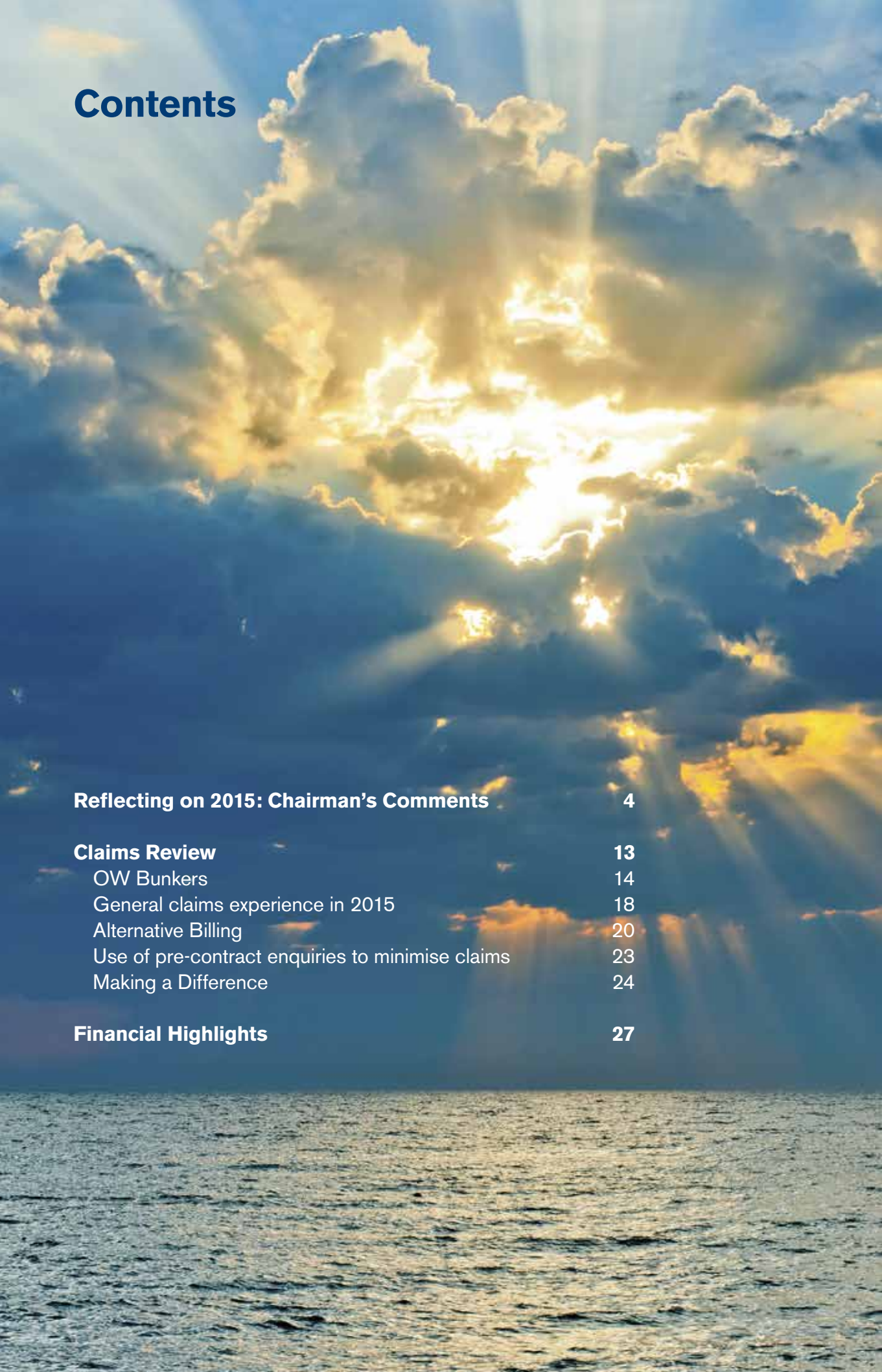
On Finances
Because we focus solely on defence our finances are dedicated to providing insurance for legal costs, not other liability claims.

On Service
We provide wide-ranging advice and assistance to Members, all delivered by one of the most experienced teams in the industry.

In Support
We support our Members in relation both to their cases and on wider industry issues.

The Competition
The UK Defence Club is the largest insurer of its kind, providing unrivalled cover to shipowners and operators.

Contents



Reflecting on 2015: Chairman's Comments

INTRODUCTION

This is my second year as Chairman of your Club. It has undoubtedly been a challenging period for certain shipping sectors and these challenges show no real signs of a rapid abatement. It is to be hoped that scrapping and lay-ups may have some impact on freight rates, allowing markets to recover and providing breathing space for owners and operators to look ahead with some confidence.

In terms of your Club, it too has faced challenges. As a mutual I think it is important that your Chairman, your Board and the Managers can be judged on how the year has developed so that you can have confidence in the direction that the Club is taking. Confidence also that we continue to focus on ensuring that your interests are at all times fully and properly protected in maritime forums world-wide.

In a change from the norm I set out below four key areas which I consider to be the most important in the year just gone.

1. THE REGULATORY ENVIRONMENT - SOLVENCY II

Whether we like it or not regulatory compliance is a key part of any business. As Members you should have the confidence that the Club is regulated to a high standard and meets the requirements set by a particular regulator. The Club is a UK based company and is regulated by the Prudential Regulatory Authority and Financial Conduct Authority.

I am sure that you have heard the words Solvency II used on many occasions over the past few years. Under Solvency II a lot of emphasis is placed on capital and the Club's reserves very comfortably exceed minimum capital requirements. It is however much more than that. In short it is a comprehensive programme of regulatory requirements for insurers covering corporate governance, supervisory reporting, public disclosure as well as solvency and reserving requirements.

Solvency II came into force in Europe on 1st January, 2016. A considerable amount of work has been undertaken over the past few years in order for the Club to meet its requirements. I am pleased to report that those requirements were met in good time. The key now is to ensure that that compliance is maintained going forward.

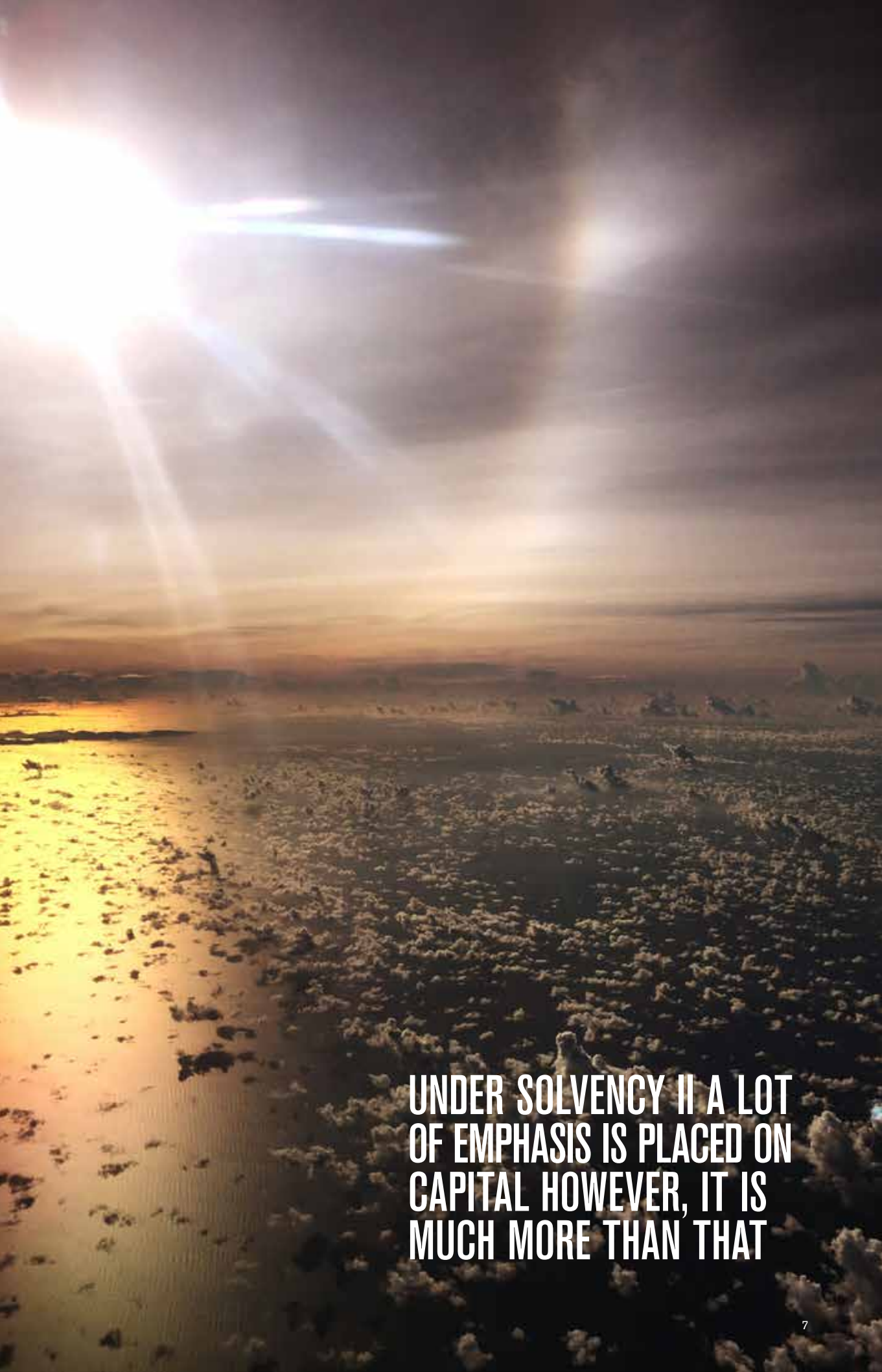
2. LEADING THE WAY - OW BUNKERS

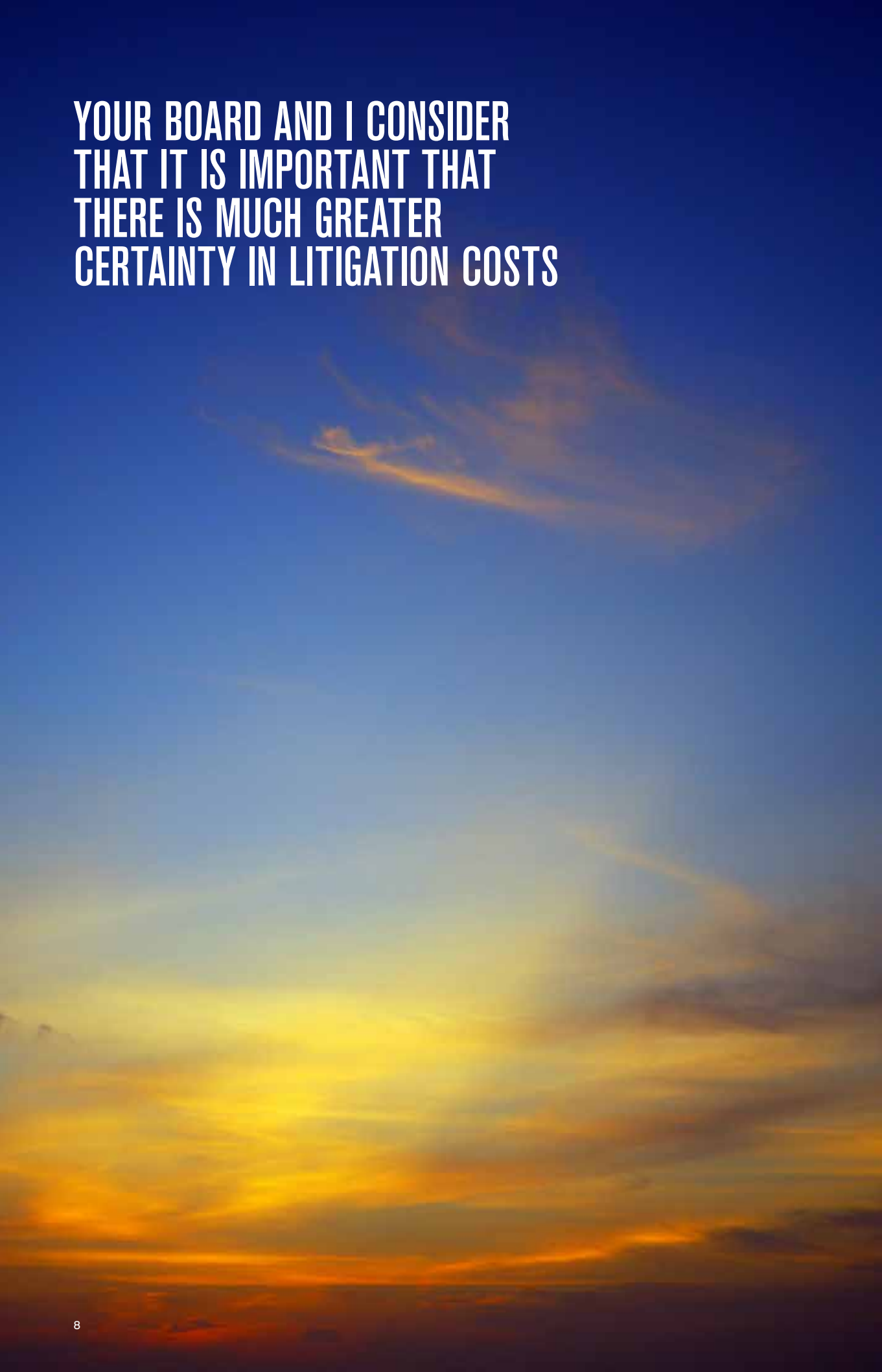
I have always considered the Club to be the standard bearer for the industry when it comes to Defence cover. That has been proven over the years when one considers the number of high profile judgments involving the Club, which shaped and continue to shape the law particularly in the UK. Your Club has been involved in cases such as the RAINY SKY which concerned a refund guarantee under a shipbuilding contract and was the first shipping case to be considered by the UK Supreme Court. That case emphasised the need for commercial contracts to be read with "business common sense".

The GOLDEN VICTORY, a case before the House of Lords (the pre-cursor to the Supreme Court), dealt with the issue of damages and the extent to which a subsequent event might have on the calculation of damages.

In 2015 your Board supported the case of the RES COGITANS. This case arose from the collapse of OW Bunkers and concerns the obligation under an English law bunker contract of an owner to pay a counter-party supplier that did not have title to the bunkers. The amount in dispute has been dwarfed many times over by the legal costs. The issue at stake for Members and non-Members alike was very significant. Your Board considered that this was a case where judicial clarity had to be obtained regardless of the economics of the case, so it was supported to the highest level. Regardless of the outcome, I think that this clarity has been achieved and would not have been achieved were it not for the support of the Club.

The legal issues in the RES COGITANS have received considerable exposure and I do not intend to deal with these here. Going forward, I suspect that many owners and operators will be reviewing their contracts to limit the potential pitfalls. The Club will continue to assist Members and has already issued a Soundings offering some initial guidance.


UNDER SOLVENCY II A LOT
OF EMPHASIS IS PLACED ON
CAPITAL HOWEVER, IT IS
MUCH MORE THAN THAT


YOUR BOARD AND I CONSIDER
THAT IT IS IMPORTANT THAT
THERE IS MUCH GREATER
CERTAINTY IN LITIGATION COSTS

3. REWARDING THE MEMBERSHIP - CONTINUITY CREDITS

At the beginning of the year your Board introduced a scheme of continuity credits which Members entered with the Club in excess of 1 year could benefit from reduced premiums. That scheme was well received by Members, particularly at a time of falling freight revenues.

In terms of the growth of the Club, over the last 5 years Membership has grown from 3,493 ships to 3,935 ships. This represents entered tonnage in excess of 172 million grt. This is pleasing to see and suggests that the value of the Club's cover, and the support and assistance provided by the Managers, is appreciated by its Members in these uncertain times.

4. LEGAL FEES AND ALTERNATIVE FEE ARRANGEMENTS

Legal fees make up the greatest proportion of the Club's annual expenditure. The vast majority of these fees are incurred in the UK with London arbitration being the forum in which many Members' disputes are resolved. Historically, legal and other fees have generally been charged on the basis of an hourly rate. This has usually been justified on the basis that it is difficult to gauge with any certainty how litigation will progress. Much may depend on the arguments raised by each party, the consequent evidence that is required to support or refute the arguments put forward and the general conduct of the parties. Over the years I have seen repeated cases where estimates of costs were exceeded. This can result in costs becoming disproportionate to the amount at stake so that by the end of a case the overall economics become questionable.

Your Board and I consider that it is important that there is much greater certainty in litigation costs. No litigation is free from uncertainty however, it must be preferable that all parties involved in the litigation bear a proportion of risk. It is for this reason that we are requesting that each law firm that is instructed on behalf of Members considers alternative billing arrangements. Fixed fees, success fees and caps and collars should become second nature when it comes to litigation costs. They should not be mere after thoughts. The size of the Club's Membership affords it a bargaining power which can be used to bring about change in an effective way. It is however important that we all support this endeavour so that we can move away from the era of hourly rates.

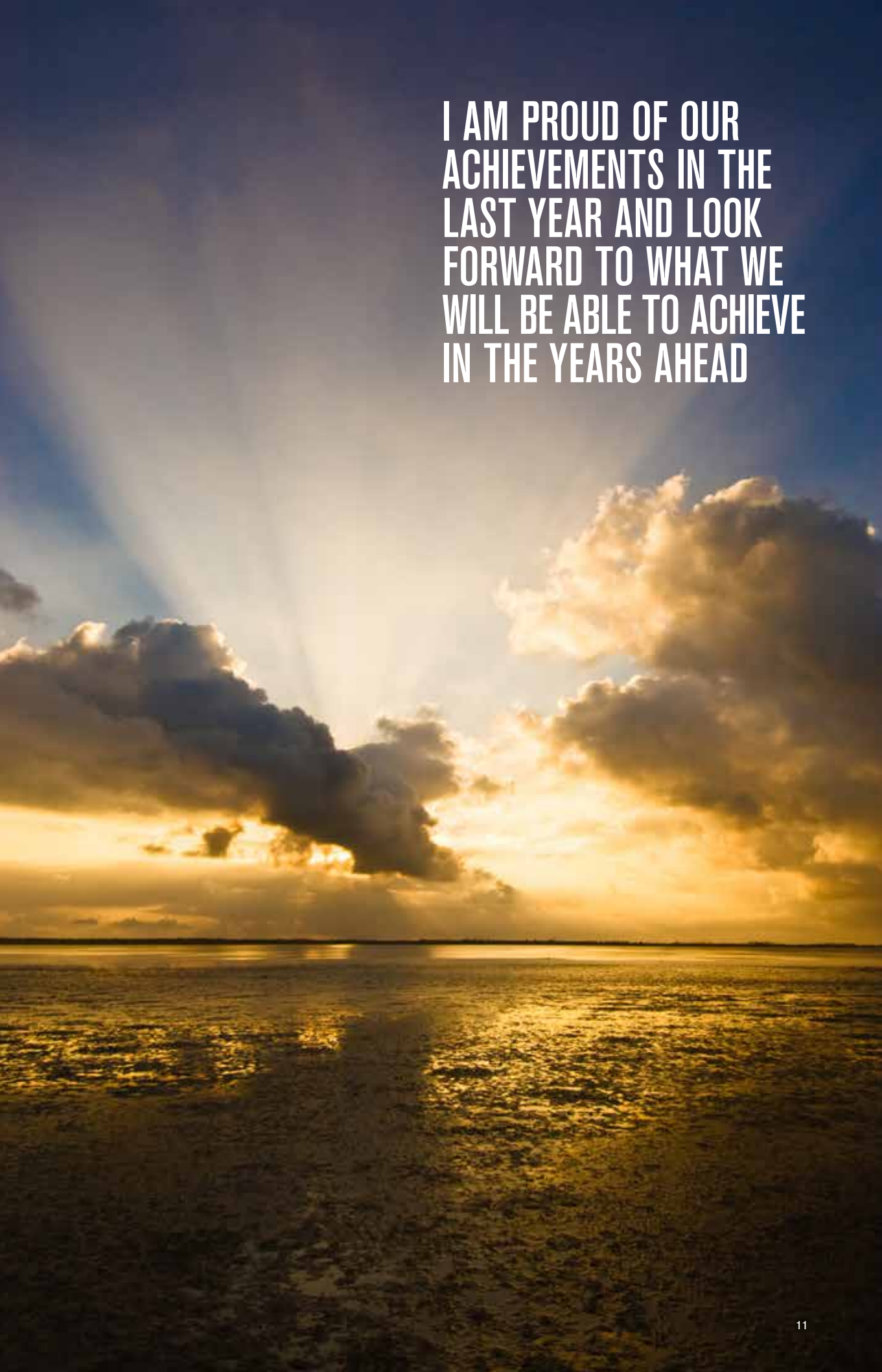
CONCLUSION

In my view, these four key areas highlight how the Club differentiates itself from its competitors and emphasises the work that is undertaken for the benefit of its Members and the industry at large.

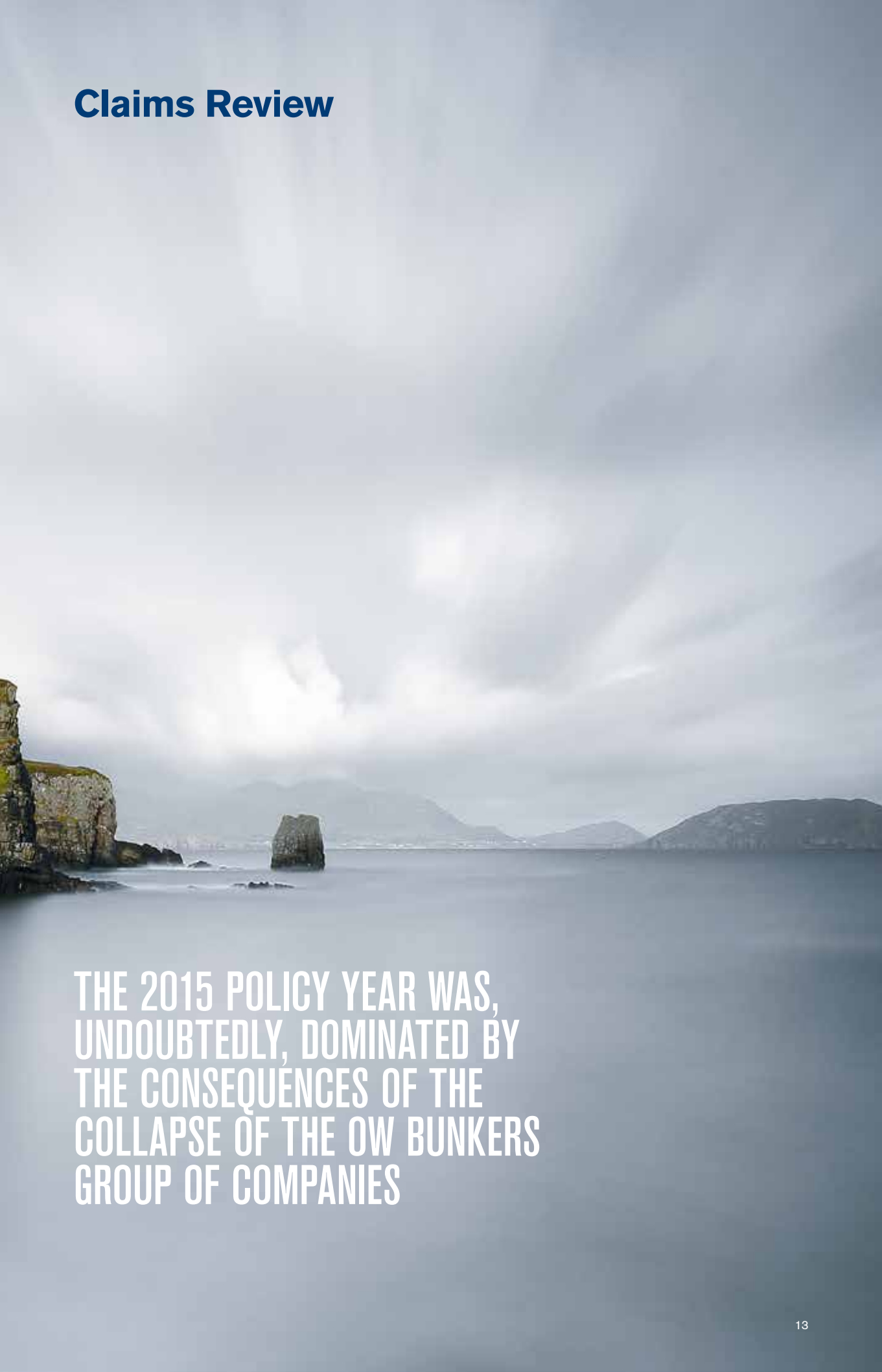
I am proud of our achievements in the last year and look forward to what we will be able to achieve in the year ahead. I would like to thank all my fellow Directors for their time and commitment to the Club's affairs. I would also like to thank the Managers for their efforts in carrying out the day to day activities which you as Members see first hand.

M. F. Lykiardopulo
Chairman

The United Kingdom Freight,
Demurrage & Defence Club Ltd.
July, 2016


I AM PROUD OF OUR ACHIEVEMENTS IN THE LAST YEAR AND LOOK FORWARD TO WHAT WE WILL BE ABLE TO ACHIEVE IN THE YEARS AHEAD

Claims Review



THE 2015 POLICY YEAR WAS, UNDOUBTEDLY, DOMINATED BY THE CONSEQUENCES OF THE COLLAPSE OF THE OW BUNKERS GROUP OF COMPANIES

OW BUNKERS

The 2015 policy year was, undoubtedly, dominated by the consequences of the collapse of the OW Bunkers Group of companies in November, 2014. The Club has been involved in some 240 disputes and has instructed lawyers in over 20 jurisdictions worldwide. The most notable of those are London (120 cases) and the United States (37 cases) with lawyers also being instructed in Germany, Singapore, Greece, Malta and Dubai.

RES COGITANS & a "licence to consume"

The RES COGITANS is the most widely publicised of those disputes and saw the Club supporting the Member through the initial arbitration and subsequent appeals all the way to the Supreme Court of England and Wales. Notwithstanding the cost of that litigation, the support of the Club means that all Members, and the wider maritime industry, now have clarity and certainty in their dealings with bunker suppliers, at least under English law. Throughout its history the Club has been involved in a number of influential judgments that have shaped the legal landscape and the RES COGITANS is another such case.

The Supreme Court has decided that the relevant bunker supply contract was not a sale of goods within the English Sale of Goods Act 1979. The court has held that the contract was instead a licence to consume outside of the statute which did not require OW to transfer, or be able to transfer, property in the fuel.

This interpretation has come as a surprise to many within the industry. The average bunker contract is similar in nature to a sale contract and most buyers of bunkers have believed that they were entering into a contract for the purchase of goods. The Supreme Court recognised that the contract was 'closely analogous to a sale.' Nevertheless, it held that the relevant contract should be seen as a 'sui generis' transaction, that is, a unique contract which is not a contract of sale.

The immediate consequence of this is that under English Law a Member will be obliged to pay OW, even if OW had not paid the physical supplier. Whilst the conclusion reached by the Supreme Court may not have been the obvious one, in supporting the RES COGITANS the Club has obtained clarity and certainty for its

The collapse of the OW Bunkers Group has seen the Club involved in

240
Disputes

20
Jurisdictions worldwide

Members as well as for the wider industry.

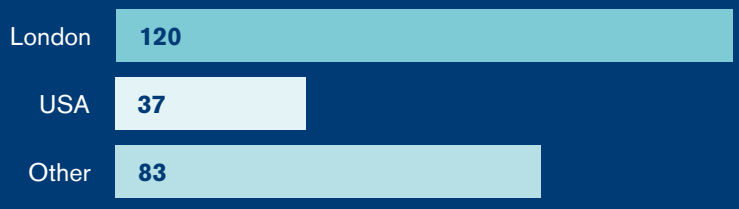
Members forced to provide security

The Managers have assisted Members in resisting unreasonable and wide demands for security from OW and physical suppliers. Nonetheless, Members of the Club have been forced to issue security in relation to almost 80 cases, totalling some $46.26m.

In 25 of those cases, Members have had to issue security which answers to claims by both OW and physical suppliers. This clearly demonstrates the risk of Members having to pay twice for stems in circumstances solely caused by OW's own financial mis-management.

By way of example, a Member's ship was arrested in Australia, without prior notice, by OW/ING. The claim related to a stem delivered to the ship when it was under time charter and had been sub-chartered to another company which had contracted with OW. OW/ING insisted upon security which was to be answerable to an award or judgment against both the owner and the sub-charterer. An urgent application was made to the local court which also highlighted the refusal of security offered by the Member's P&I club. The local judge accepted the Member's urgent weekend interlocutory application and allowed the ship to sail, subject to the issuance of security responding to Australian law.

Case distribution



The approach of physical suppliers

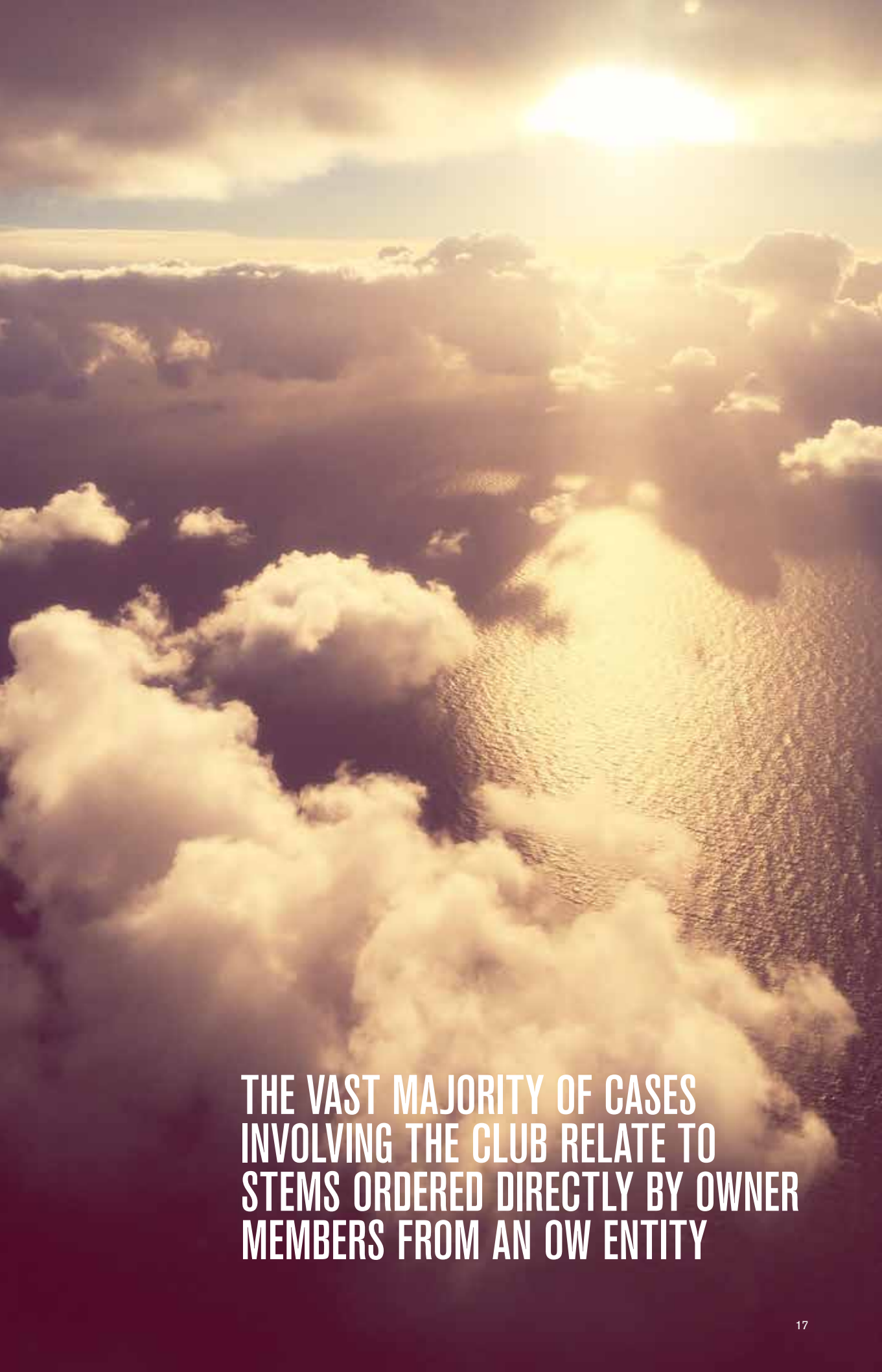
The vast majority of cases involving the Club relate to stems ordered directly by owner Members from an OW entity. In some cases bunkers were ordered by a charterer but in most of these cases the charterer has effectively taken over the conduct of the claims and has been dealing directly with its OW counterparty and the relevant physical supplier.

The approach adopted by physical suppliers has been varied but there was an increase in demands being addressed to Members following the Court of Appeal decision in the RES COGITANS. Following the Supreme Court judgement a number of Members are taking the opportunity to reach an amicable settlement of their disputes.

Physical suppliers' terms and conditions vary widely. Typically, they are subject to local law or seek to incorporate the laws of other jurisdictions as a means to retain the most "bunker-supplier-friendly" interpretation.

In some jurisdictions physical suppliers may be able to present claims even if there are competing demands from OW. However, the Managers have seen cases in which local courts have refused physical suppliers' claims on the basis that they had effectively agreed to take the risk of default by OW.

Physical suppliers based in the United States have taken an aggressive approach to the obtaining of security and pursuit of litigation in the hope of persuading the US courts that they have a right to be paid. The majority of the litigation is concentrated in the Southern District of New York where there are a number of pending interpleader actions. Whilst the outcome of those cases is awaited, the presiding judge has expressed a preliminary view that the situation where a shipowner or operator is exposed to the risk of double payment should be avoided.



THE VAST MAJORITY OF CASES INVOLVING THE CLUB RELATE TO STEMS ORDERED DIRECTLY BY OWNER MEMBERS FROM AN OW ENTITY

GENERAL CLAIMS EXPERIENCE IN 2015

The 2015 policy year saw a higher number of notified claims than was the case in 2014 however the average cost of claims was lower.

2015 was impacted by claims relating to the collapse of OW Bunkers however there was also a higher than expected number of attritional claims. The majority of those related to either low value charterparty disputes or general enquiries, in particular in relation to international sanctions.

Cost recoveries and liabilities

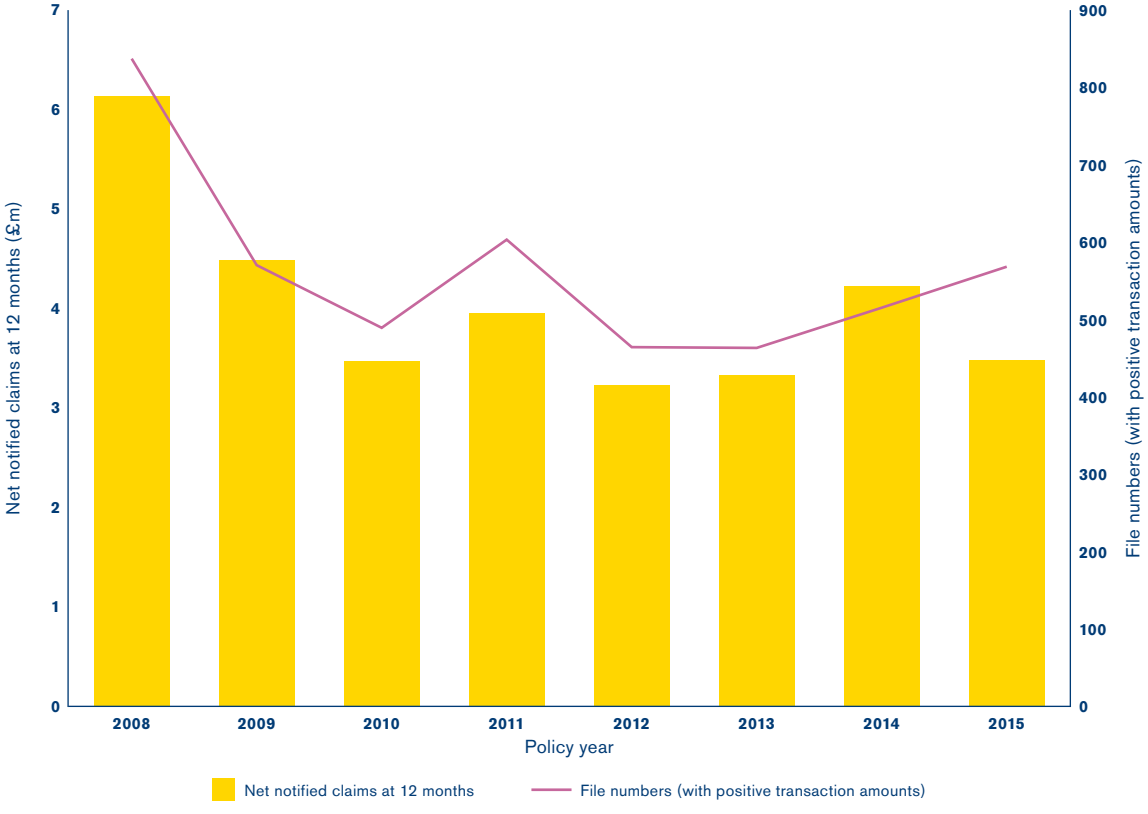
Some two thirds of cases notified to the Club are handled by the Managers without recourse to external advisers. They relate to a wide range of issues from charterparty clauses to debt recovery and trading to Iran.

The vast majority of contentious disputes are resolved amicably whether through negotiation and settlement or mediation. Relatively few proceed to an arbitration award or court judgment, resulting in a cost recovery or liability. Nonetheless, during the course of the year cost recoveries were made by the Club's Members in 14 cases totalling $1.5 million. In three unsuccessful cases Members' cost liabilities totalled $111,400.

THE VAST MAJORITY OF CONTENTIOUS DISPUTES ARE RESOLVED AMICABLY WHETHER THROUGH NEGOTIATION AND SETTLEMENT OR MEDIATION

Financial Year Net Claims Incurred / Combined Ratio

Net Notified Claims / File Numbers at Year End



ALTERNATIVE BILLING – IS THE END IN SIGHT FOR THE HOURLY RATE?

On a number of previous occasions the Board of the Club, and the Managers, have expressed concern about the accuracy of estimates provided by law firms and others. As a legal cost insurer it is essential that the Club is able to predict accurately the likely cost of a case.

Over the course of the last year the Managers have placed increasing importance on the requirement for law firms to provide alternative billing proposals throughout the development of a case. Such arrangements provide more certainty for future fee exposure, deliver more clarity in relation to fees and lead to cost savings as cases mature.

A review of recent cases has shown that:

- the majority of cases continue to be handled in-house by the Managers without the need to instruct external advisers;
- alternative billing arrangements have been agreed in nearly 40% of cases in which UK law firms have been instructed; and
- firms which are more open to offering alternative fee arrangements are instructed more often.

There has been an increased willingness by UK law firms to engage with alternative billing arrangements, both in relation to the initial stages of a case and for cases in which the amounts in dispute are relatively low. Discussions are on-going with several law firms to increase the take-up of such arrangements further and, increasingly, firms are prepared to consider more risk-based fee arrangements.

The Managers are exploring ways in which to widen the scope of the alternative billing programme in order to capture a wider spread of advisers including those outside the UK, such as American law firms. The Managers are also liaising with law firms in other jurisdictions in particular with a view to exploring the availability of contingency fees and damages-based agreements.

THERE HAS BEEN AN INCREASED WILLINGNESS BY UK LAW FIRMS TO ENGAGE WITH ALTERNATIVE BILLING ARRANGEMENTS

MEMBERS WILL BE AWARE OF THE IMPORTANCE OF UNDERTAKING PROPER ENQUIRIES OF THEIR POTENTIAL COUNTERPARTY

USE OF PRE-CONTRACT ENQUIRIES TO MINIMISE CLAIMS

In light of the challenge being faced by shipping markets the Club has continued to support Members who have been affected by counter-party default.

Members will be aware of the importance of undertaking proper enquiries of their intended counterparty prior to entering in to a contract, whether it be a charterparty, MOA, yard contract or supply agreement. The extent of those enquiries may depend on:

- whether the Member has had previous dealing with the other party
- the nature of the trade and
- the type, terms and details of the agreement being entered into.

Where a proposed counterparty is unknown or relatively unknown to the Member, reasonable enquiries should be made in advance with:

- other operators who have had dealings with the other party
- brokers who are knowledgeable of them or
- independent third party advisers.

MAKING A DIFFERENCE

In addition to the general advice and assistance provided to Members on a day to day basis, the Managers are actively involved in supporting Members through the provision of seminars, whether on a bespoke basis for an individual Member or to a wider audience in a particular region.

Safety is a fundamental component of any fixture. It can attract significant liabilities and, although it may seem a simple concept, there can be a plethora of legal difficulties. The $137 million unsafe port claim in relation to the OCEAN VICTORY, which resulted in an English Court of Appeal judgment in 2015, demonstrated the significant legal issues that can arise for an owner or charterer.

During the year, in order to raise awareness of issues related to safety related claims, the Managers hosted four seminars for Members. In Geneva the seminar was a joint venture between the Club and WISTA and in Athens, Cyprus and Singapore the Club's seminars are fast becoming established events in the local maritime calendars.

These seminars provided a contemporary analysis of the physical and political risks facing operators, ships and crews today. They examined several different scenarios, including sanctions, Ebola, piracy, war-related issues and the navigational safety of ports.

An interactive role-play panel format was adopted for the seminars and panel discussions, with speakers from the Managers, international law firms, maritime security companies and major maritime insurance brokers.

In conjunction with the seminars, the Club released a new publication "The Law Relating to Unsafe Ports – from EASTERN CITY to OCEAN VICTORY", which provides a detailed, yet accessible, explanation of the law of unsafe ports.

DURING THE YEAR, IN ORDER TO RAISE AWARENESS OF ISSUES RELATED TO SAFETY RELATED CLAIMS, THE MANAGERS HOSTED FOUR SEMINARS FOR MEMBERS

Financial Highlights

THE 2015 POLICY YEAR SAW THE CLUB INTRODUCE A SCHEME OF CONTINUITY CREDITS AIMED AT REWARDING LONG STANDING MEMBERS BY PROVIDING THEM WITH A DISCOUNT ON PREMIUM

FINANCIAL HIGHLIGHTS

The 2015 policy year saw the Club introduce a scheme of continuity credits aimed at rewarding long standing Members by providing them with a discount on premium. Those Members who had had an entry for one year received a discount of 2.5%; entries of three years received a discount of 5% with those Members having an entry for five years received a discount of 7.5%. In addition a Member entering its full fleet with the Club received a further discount of 1.5%. Across the Membership this resulted in an overall discount on premium of £1.5m. Notwithstanding this the Club produced a net underwriting surplus of £67,000, equating to a combined loss ratio of 99.6%.

The Club continues to reinsure its past and present risks on a quota share basis with the UK Defence Insurance Club (Isle of Man) Ltd ("UKDIA"), Members of the Club also being Members of UKDIA. For the purposes of this report therefore, the financial results of the Club and its quota share reinsurer for the year ended 20th February, 2016 are presented on a combined basis.

PREMIUM INCOME

Premium income for the year totalled £20 million, however after taking into account continuity credits, net premium was £18.4 million. This was only 0.4% lower than 2014/15 mostly helped by the strengthening of the US dollar against Sterling during the year. In US dollar terms premiums were 1% lower before the impact of continuity credits and 8.5% lower after the impact of continuity credits.

Claims arising from the collapse of OW Bunkers had a notable impact on incurred claims however prior policy years' claims generally developed better than, or as, expected. The 2015 policy year experienced higher numbers of low-level attritional claims and net claims incurred for the year, including claims provisions, rose to £14 million, up from £13.1 million in 2014/15.

INVESTMENT PERFORMANCE

Investment performance was helped by the 7% strengthening of the US dollar against Sterling over the course of the year. The total investment return after currency movements equated to 0.5%. Exchange losses include a £360,000 loss on realised premium hedges.

Overall there was a net surplus for the year of £88,000, which increased free reserves from £28.4 million to £28.5 million.

During the year the Club was required to apply a new accounting standard and is now obliged to account for its premium hedges relating to future policy years entered into at the year-end via a separate hedging reserve. Given the strength of the US dollar relative to Sterling the value of this reserve at the year end was an anticipated loss of £743,000, thus reducing the Club's total free reserves and hedging reserves to £27.7m.

Total capital resources for solvency purposes stood at £32.9m.

The combined Clubs' balance sheet remains in robust health with assets of £56.2 million and a ratio of assets to liabilities of 197%.

Net premium income for 2015/16

£18.4m*

* Taking into account £1.5m continuity credits

Returned to Members via Continuity credits

£1.5m

Continuity credits

1 year £	2.5%
3 years £ £ £	5%
5 years £ £ £ £ £	7.5%
Full fleet discount	+1.5%

Free reserves

£28.5m*

*As at 20th February, 2016, before the values of hedging reserves

- 2015/16 - £28.5 million*
- 2014/15 - £28.4 million
- 2013/14 - £24.4 million

Total capital resources

£32.9m*

*All figures as at 20th February, 2016

Combined ratio of

99.6%

Combined Clubs' assets for 2015/16

£56.2m*

*All figures as at 20th February, 2016

- 2015/16 - £56.2 million*
- 2014/15 - £56.5 million
- 2013/14 - £52.2 million

THE COMBINED CLUBS' BALANCE SHEET REMAINS IN ROBUST HEALTH WITH ASSETS OF £56.2 MILLION AND A RATIO OF ASSETS TO LIABILITIES OF 197%

MAKING A DIFFERENCE

End of Year Review 2016

The UK Defence Club
c/o Thomas Miller Defence Ltd,
90 Fenchurch Street, London EC3M 4ST
tel: +44 207 283 4646
email: tmdefence@thomasmiller.com
web: ukdefence.com

Greece
Thomas Miller (Hellas) Limited
tel: +30 210 429 1200
email: hellas1.ukclub@thomasmiller.com

Hong Kong
Thomas Miller (Asia Pacific) Ltd
tel: +852 2832 9301
email: hongkong.ukclub@thomasmiller.com

Singapore
Thomas Miller (South East Asia) Pte Ltd
tel: +65 6323 6577
email: seasia.ukclub@thomasmiller.com

New Jersey
Thomas Miller (Americas) Inc
tel: +1 201 557 7300
email: newjersey.ukclub@thomasmiller.com

Registered Office
90 Fenchurch Street, London EC3M 4ST

Registered in England No. 501877