

UKDC
UK DEFENCE CLUB
125 YEARS NEW

GOING FORWARD

End of year review 2013

UKDC
IS MANAGED
BY **THOMAS
MILLER**

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OVERVIEW

3,707

Total Number of Ships Entered

19.96 | 52.6

End of Year Reserves (£ million)

Total Funds (£ million)
For the year ended 20th February, 2013

In 2013 the Association will celebrate its 125th anniversary, a significant milestone for any organisation. It will be an opportunity to celebrate the Association's heritage and in particular, through the cases that it has supported over the years, its contribution to the industry and the development of maritime and contractual law.

The year will also be about looking to the future and how to address some of the current concerns about cost control and the effectiveness of maritime arbitration for modern shipping disputes. During the year the Managers will be seeking the views of the Membership on these issues and also hope to be able to engage the wider industry in the debate.

CHAIRMAN'S STATEMENT



This year the Association celebrates its 125th Anniversary. Over the last 125 years the Association has been involved in many cases that have shaped the maritime legal landscape.

This past year has been no different and the Association has been involved in a number of cases both in the UK and elsewhere which have assisted Members in resolving their disputes.

The market collapse of 2008 continues to affect Members, however when the Association can assist Members to recover significant amounts from third parties the value of the cover cannot be under estimated.

One of these involved the case of the KYLA which concerned a constructive total loss and whether a Member was entitled to terminate a contract on the grounds of frustration. This case has attracted considerable attention, with the English High Court ultimately overturning an arbitration award in the Member's favour. Steps are being taken to appeal that decision. Other notable cases have involved a number of newbuilding cases where Members have been successful in recovering pre-delivery instalments under shipbuilding contracts. The amounts recovered have been significant and highlight not only the benefit of the Association's cover but also the value of having effective refund guarantees in place to support such advance payments.

The LMAA continues to be the forum of choice for the majority of Members in their contractual agreements. Whether this is simply a historical choice rather than one given active consideration is moot however having such an experienced arbitral body available provides much comfort when things do not go as planned. The LMAA is not, however, without detractors some of whom point to it having been established as an industry led cost effective means of dispute resolution. A question commonly raised is whether it continues to remain true to those core values? From this Association's point of view there appear too many cases where the costs of the process are entirely out of proportion to the value or complexity of the claim itself. Costs inevitably increase when a firm hand is not guiding the process to an appropriate conclusion.

Other jurisdictions are attempting to gain a greater foothold in the area of maritime arbitration and have largely replicated the LMAA model. One must be careful however, not simply to replicate an existing system and considerable effort needs to be spent on making sure any system moves forward with the times and learns lessons from the past.

This Association has been a staunch supporter of arbitration as a means of resolving disputes efficiently and cost effectively. If however, arbitration is simply becoming a quasi judicial process, then one does have to question its relevance in this modern era.

Members continue to face a difficult operating environment with low freight rates and high bunker costs continuing to exert much commercial pressure. Your Board is acutely aware of this and has endeavoured, over the last few years, to ensure that any premium increases that are necessary reflect that operating environment, but at the same time ensure that the Association is properly reserved. The Association's financial position remains strong with free reserves in the order of £19.96 million. That approach is set to continue although it is quite clear that the costs of litigation are now considerable and we must be cognisant of this fact when looking to the future.

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I am pleased to report that the Association had a pleasing growth during the year with the Association's owned tonnage exceeding 114 million gt.

I am pleased to report that the Association has experienced sustained growth during the year with owned tonnage exceeding 114 million gt and over 3,700 ships (owned and chartered) being entered. This can be compared to 106 million grt and 3,300 ships in 2011/12. A number of new Members joined the Association at this renewal, in addition to existing Members consolidating their entries with us.

I would like to thank my fellow Directors for their tireless work throughout the year in all aspects of the Association's affairs. The work that is involved is at times unenviable however they discharge their duties with great commitment and endeavour.

I would also like to thank the Managers who have displayed their customary support to the Board and to the Membership.

Finally, on behalf of the Board I would like to express my thanks to you as Members for your continued Membership now and in the future. The Association is 125 Years New this year and it is very much down to you, as Members, that we have been able to reach, and now reflect on, this very significant milestone.

M.G. Pateras

Chairman

The United Kingdom Freight, Demurrage & Defence Association Ltd.

June, 2013

The Association's financial position remains strong with free reserves in the order of £19.96 million.

£19.96M



CLAIMS REVIEW

As far as 2012 is concerned, it is fair to say that by comparison with the preceding years this was a more favourable claims period for the Association.

As we approached the beginning of the 2012 policy year there was some uncertainty as to what the coming year might bring in terms of claims.

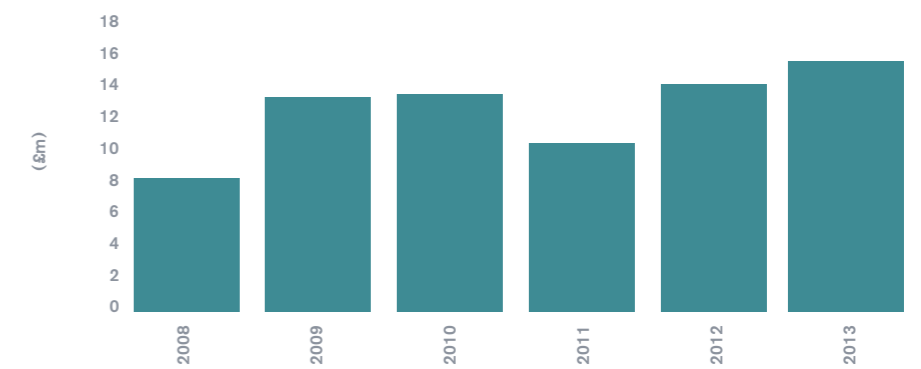
The years immediately following the financial crash of 2008 brought a significant increase in the Association's claims both in terms of number and value and that had extended through to 2011. Because of its strong financial position the Association had been well placed to withstand this period of increased claims without the significant increases in premium required by some of its competitors however we were very much looking forward to a period of less intensive claims activity.

Claims development

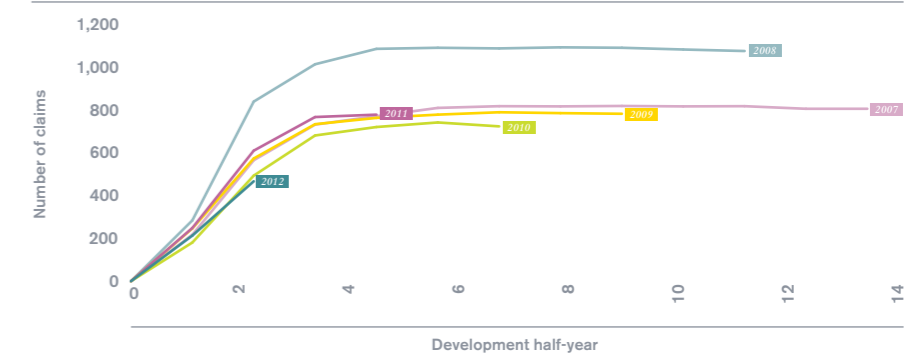
As far as 2012 is concerned, it is fair to say that by comparison with the preceding years this was a more favourable claims period for the Association. The number of claims reduced to a level almost 25% lower than the average of the previous five years at the same stage of development. Unfortunately however the average cost per claim remains in line with previous years. In the last six years the ultimate average cost per claim has moved from just over £10,000 in 2006 to an all time high of £18,000 in 2008 to an estimated £16,000 in 2012.

One other factor which distinguishes 2012 from the prior years is that there was a larger proportion of claims falling in the \$50,000-200,000 band. This brings 2012 more in line with the years predating 2008. Many of these claims could be described as the more traditional types of disputes concerning, for example, bunker quality, speed and performance and final hire statements. In a number of cases the amounts in dispute were relatively modest however, given the prevailing economic climate, it is entirely understandable that Members were keen to take steps to protect their position and the Association is here to support them in this whenever possible.

Net claims incurred 2008-2013



File number development – Claims with positive transaction amounts



- Key
- 2012
- 2011
- 2010
- 2009
- 2008
- 2007

Through their Value For Money programme, and ongoing work with Preferred Legal Partners, the Managers continue to do their utmost to control the costs of handling and litigating claims.

Control of costs

As a legal costs insurer it is clear that controlling the cost of litigation is of crucial importance to the Association. In July, 2012 a Circular was issued to the Membership on the "Effective Management of Claims and Control of Costs" which highlighted the importance of the accurate estimating of costs. In recent years the Board has seen a number of costly cases where lawyers have significantly underestimated the costs to be incurred in resolving the dispute. Whilst estimating is not an exact science, the accurate estimating of costs is crucial and the Circular highlighted that if it becomes apparent that an estimate is likely to be exceeded then the service provider must raise this with the Managers at the earliest opportunity. Furthermore, in the case of an inadequate or inappropriate estimate the service provider will be expected to honour the estimate previously given unless there are mitigating circumstances.

Through their Value For Money programme, and ongoing work with Preferred Legal Partners, the Managers continue to do their utmost to control the costs of handling and litigating claims. This includes requesting lawyers to consider alternative fee arrangements to the usual approach of hourly billing and the use of an independent cost draftsman where appropriate. Historically, this has been limited to assessing the costs incurred by an opponent. However, going forward the Managers envisage using a costs draftsman to review cost estimates and also the fees incurred on certain cases with a view to encouraging a much greater focus on the cost effectiveness of steps being taken.

Significant cases in 2012

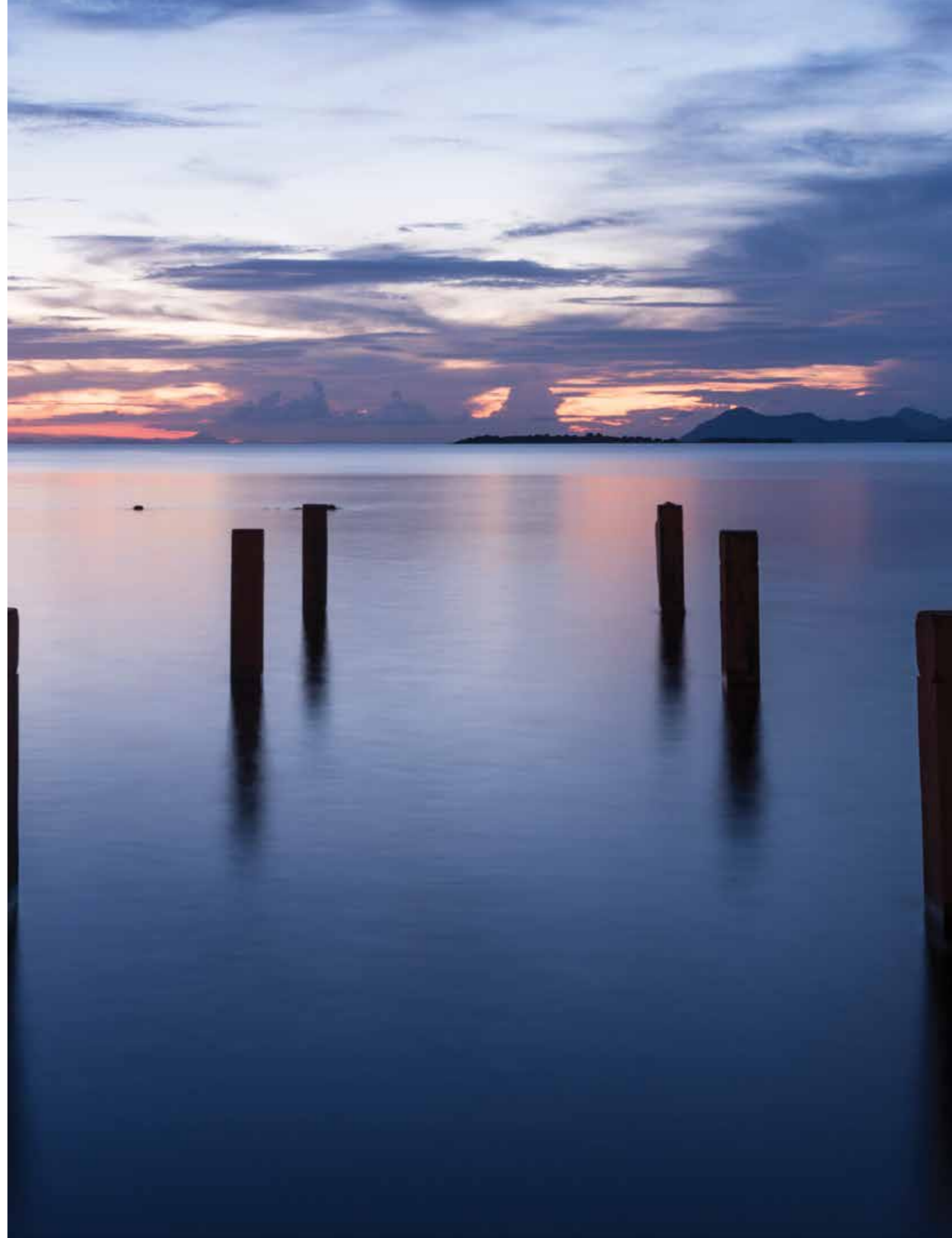
In 2012, the Association gave support to over 90% of cases being litigated and also made significant cost recoveries totalling \$2.2 million where Members had been successful in progressing their claims. The majority of cases were subject to London arbitration proceedings. The Association's most high profile case in 2012 was that of the KYLA. The dispute arose from a collision that occurred in Brazil in 2009. The damage caused to the KYLA led the Member to declare the ship a constructive total loss ("CTL") and to terminate its time charter with Bunge. Bunge disputed that the ship was a CTL and challenged the Member's termination of the charter. The Member brought a claim in London arbitration proceedings for a declaration that the charter was frustrated as a consequence of the collision and Bunge counter-claimed for damages of approximately \$9.4 million.

The arbitrator considered the position under English law on the question of frustration and concluded that the charterparty was frustrated by virtue of the cost of repair significantly exceeding the value of the ship. He also said,

"The vessel was in commercial terms a constructive total loss or a commercial loss. In commercial terms the vessel was one which was good only for scrapping or disposal on a 'wreck' basis. The obligation in these circumstances to repair the vessel so as to restore her to use was one which no prudent owner would undertake. To hold the Owners to that obligation to repair in so extreme a case would be to hold them to a wholly different bargain of a radically different nature such that they could fairly say:
"Non haec in foedera veni. It was not this that I promised to do"."

The arbitrator also considered the relevance of the effect on the doctrine of frustration of the inclusion of the ship's insured value of \$16 million in the charter. He decided that it was difficult to infer from the clause that the Member had undertaken to repair her up to this level. He said that very clear words would be needed to achieve this.

Bunge however applied to the English High Court for leave to appeal on three grounds, but were granted permission to appeal on one only, which was the effect on the doctrine of frustration of a clause requiring that an owner maintain hull & machinery insurance at a stipulated level. Leave to appeal was granted on this issue on the basis that it was one of general public importance.





The Managers have significant experience in a number of jurisdictions and are always available to assist and advise.

Having heard oral argument, Mr Justice Flaux disagreed with the arbitrator. He held that clause 41 created an assumption of risk and responsibility for the Member to repair hull damage up to the ship's insured value of \$16 million, and as a result, the charterparty had not been frustrated by the incident.

Mr Justice Flaux also refused leave to appeal to the Court of Appeal stating that the case was not one of general public importance, notwithstanding that leave to appeal to the High Court was granted on the basis that it was.

The decision of the High Court has caused considerable concern both to the Member and the Board in relation not only to the decision itself but also the impact this could have on many owners. With the support of the Association, the Member has applied directly to the Court of Appeal for leave to appeal.

The Association has also been involved in a number of other significant cases including two major shipbuilding disputes, the estimated cost of each being in excess of £500,000. Both disputes relate to the relevant yard's failure to deliver the ships in good time and both proceeded to oral arbitration hearings. One was particularly unusual as the yard did not attend the hearing in London to give evidence, but was permitted by the tribunal to do so via video link. This inevitably added to the time required for the hearing, thereby significantly increasing the Member's costs. Whilst it can be appreciated that the arbitrators may have wished to give the yard a "fair hearing", it is hard to imagine a Commercial court judge being quite so sympathetic. On the positive side we are pleased to report that in both cases the Members were successful and made significant recoveries under their refund guarantees.

The concern of the Board and the Managers about the arbitration process is not limited to LMAA arbitrations. The Association also supported a Member in arbitration proceedings, the seat of which was overseas although subject to English law. The Member had received positive advice from leading counsel on the merits and the case proceeded to an oral hearing, incurring significant costs, in particular in relation to the three man tribunal which required payments in advance. Unfortunately, in its award the majority of the arbitration tribunal found against the Member. The Member's solicitors and counsel considered the decision to be both wrong in law and uncommercial with the majority ignoring the law in crucial areas. Regrettably, the prospects of appealing the award within the narrow confines of the prevailing local law were minimal.

The experience in these cases, and others, highlights some of the increasing concerns about the arbitration process and whether, in cases which are particularly complex or where there are significant amounts at stake, arbitration is in fact the appropriate forum to hear any disputes. The Managers would encourage Members to give proper consideration to the law and jurisdiction clauses that they include in their contracts, in particular clauses which provide for overseas arbitrations. The Managers have significant experience in a number of jurisdictions and are always available to assist and advise.

Benefits of Membership

The value of the Association's cover is particularly evident in those large cases where the costs run in to hundreds of thousands of pounds, however fortunately these cases are few and far between. The majority of the Managers' day to day work involves providing support and assistance to Members in terms of the handling of routine claims, general advice and the drafting of charterparty and other contractual clauses. In 2012, the international sanctions regimes continued to be an area of concern to the Membership and the Managers assisted with a significant number of enquiries relating to these.

Following the 2008 financial crisis, the issue of counterparty risk was of crucial importance to Membership, and indeed to the Association, as the default of a number of operators contributed to high levels of claims. The seminars hosted by the Association in 2012 in the key locations of Singapore, Greece and Istanbul focused on counterparty risk and two detailed publications, "Minimising Counterparty Risk" and "Counterparty Risk – Claims for Damages" were produced in support of this.

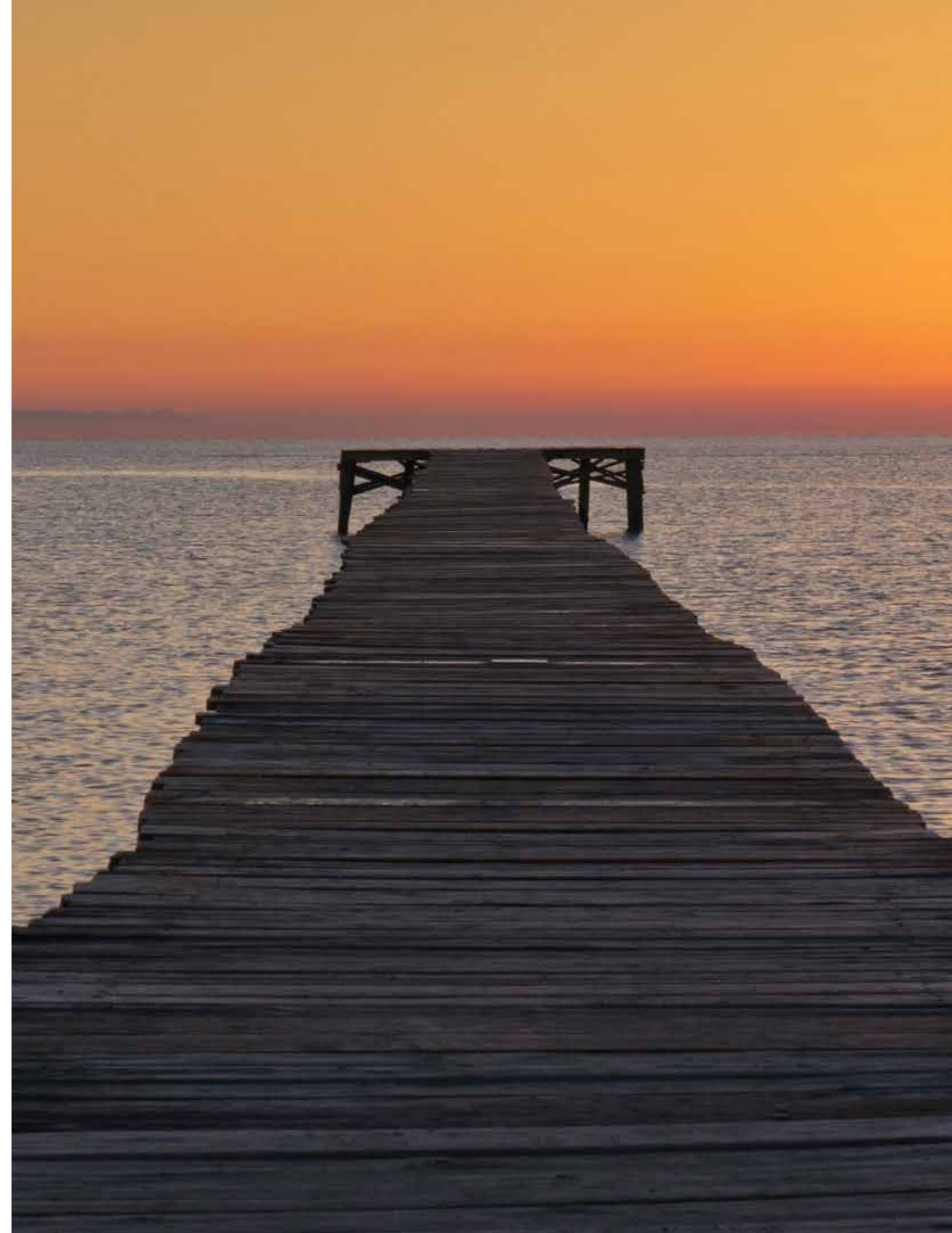
125 Years New

In 2013 the Association will celebrate its 125th anniversary, a significant milestone for any organisation. It will be an opportunity to celebrate the Association's heritage and in particular, through the cases that it has supported over the years, its contribution to the industry and the development of maritime and contractual law. The year will also be about looking to the future, and how to address some of the current concerns about cost control and the effectiveness of maritime arbitration for modern shipping disputes. During the year, the Managers will be seeking the views of the Membership on these issues and also hope to be able to engage the wider industry in the debate.

Daniel Evans
Club Manager

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FINANCIAL HIGHLIGHTS

The UK Defence Club (“UKDC”) reinsures its past and present risks on a quota share basis with the UK Defence Insurance Association (Isle of Man) Ltd (“UKDIA”), Members of UKDC also being Members of UKDIA.

Premium income for the year totalled £17.2m, an increase of 5% compared with 2011/12.

In terms of claims, 2012/13 policy year has so far proved more benign than its recent predecessors, with numbers almost 25% below the average of the previous five years.

The Club continues to have a strong balance sheet with assets of £52.6m and a ratio of assets to liabilities of 161%.

For the purposes of this report therefore, the financial results of UKDC and its quota share reinsurer for the financial year ended 20th February 2013 are presented on a combined basis.

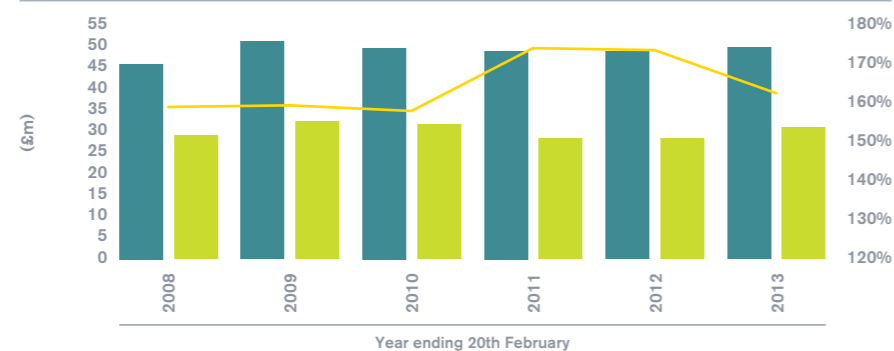
Premium income for the year totalled £17.2m, an increase of 5% compared with 2011/12, assisted by the strengthening of the US dollar against Sterling in the early part of the year. In US dollar terms premiums were up 2% as a result of growth in both owned and chartered entries, total ships entered rising from 3,311 to 3,707.

In terms of claims, 2012/13 policy year has so far proved more benign than its recent predecessors, with numbers almost 25% below the average of the previous five years, though average costs are in line with recent years. Prior policy years' claims, however, deteriorated during the year by £2.6m due to adverse development of 2007, 2008 and 2011 policy years, the Club continuing to support Members on a number of major cases from those years. As a result of the prior years' deterioration net claims incurred for the year, including claims provisions, showed an increase of 10%, to £16.9m, leading to a net underwriting deficit of £3.7m.

There was another strong investment performance in 2012/13, the rally in equity markets and strengthening of the US dollar and Euro against Sterling over the last three months of the year contributing to a total return of £2.2 million, equating to 4.6%. This helped to limit the impact of the increase in claims on the overall result, reducing the net deficit to £1.6m. Though this led to a drop in combined free reserves from £21.5m to £20.0m, the Club continues to have a strong balance sheet with assets of £52.6m and a ratio of assets to liabilities of 161%.

Year ended 20th February	2013 £'000	2012 £'000
Gross premiums written	17,245	16,479
Reinsurance premiums	(383)	(367)
Net claims incurred	(16,900)	(15,325)
Expenses and taxation	(3,697)	(3,634)
Investment return	2,213	2,158
Exchange (losses)/gains	(35)	528
Deficit for the year	(1,557)	(161)
Total funds	52,554	51,434
Claims reserves	(32,597)	(29,920)
Free reserves and capital	19,957	21,514

Total funds & claims reserves



Key

- Total funds
- Claims reserves
- Ratio of total funds to claims reserves





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