

UNRIVALLED EXPERIENCE

End of Year Review 2015

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.

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CHAIRMAN'S STATEMENT

By announcing a 0% general increase for the 2015/16 policy year, combined with the introduction of a continuity credit scheme, the Board evidenced very clearly that the finances of the Association are strong and that continuing to support the Membership is paramount.

CHAIRMAN'S STATEMENT



M.F. Lykiardopulo
Chairman

When I took over as Chairman of the Association in the middle of 2014 I had a number of aspirations. First and foremost I wanted the Association to continue to build on its solid financial footing which my predecessor had put in place. I also wanted to ensure that the Association continues to provide cost effective legal costs insurance to its Members who increasingly face difficult and litigious trading conditions.

Fundamental to any insurance business is financial security and stability and I am pleased to say that the Association is very well positioned in this regard. Free reserves have grown to £28.4m. Membership has also grown. I am pleased to report that total entered tonnage now stands in excess of 167 million GT, following a net 5% growth in owned tonnage during the year. This reflects the continued confidence that Members place in the Association's cover particularly in these uncertain times.

I also believe that by announcing a 0% General Increase for the 2015/16 policy year, combined with the introduction of a continuity credit scheme, the Board evidenced very clearly that the finances of the Association are strong and that continuing to support the Membership is paramount. As a mutual your Board recognises that the Association's primary focus should be on its Members. Financial security is crucial. However, at the same time it should also be recognised that there must come a point that the Association's reserves, barring some sort of unforeseen catastrophe or another, are sufficient in the vast majority of cases to meet its liabilities. We are not a commercial underwriter. We are a mutual and as a mutual the Board of Directors has a duty to you as Members to regularly review its capital requirements.

Your Board is very cognisant of difficulties which the current market conditions place on Members, particularly in the dry sector. Those circumstances place great pressure on the operating environment. The demise of OW Bunkers however, highlights very clearly that claims can manifest themselves in different ways, at different times and can seriously impact upon the activities of our Members.

Your Association is currently involved in a significant number of OW Bunkers related disputes. The desire to avoid double payments to physical suppliers and OW administrators is paramount. Various actions have been commenced in the UK, the United States and elsewhere in order to challenge various claimants. Your Board has already committed considerable support to expedite certain claims in order to obtain much needed clarity. Over the years the Association has taken the lead in many cases which have benefited Members generally and this is another such situation. We hope any decisions that are ultimately reached by the tribunals and courts involved will have much wider application than just the individual cases and Members concerned. It cannot be right that Members should be exposed to a double payment situation and we are determined to assist Members, as far as we can, who may be exposed to such situations.

Free Reserves

£28.4m

Growth in owned tonnage

5%

An icon consisting of two shopping bags, one light blue and one dark blue, positioned to the left of the 5% text.

CHAIRMAN'S STATEMENT

Legal costs are far from insignificant and I challenge any Member to fund the costs of a five-day arbitration hearing without having cause for concern as to the cost, irrespective of the financial value of the claims involved.

Another area in which the Association is endeavouring to take a lead is in respect of legal fees. The Managers' Value for Money programme was introduced a few years ago with the aim of increasing the focus on how costs were being incurred and the likely outcome in any given case. We are determined to continue to move this forward. Hourly rates have been with us for many years and I doubt anyone really believes that hourly billing promotes the timely and cost effective resolution of cases. I think we must all strive to achieve much greater certainty and value from our legal service and other suppliers. Your Board and the Managers are actively seeking to agree, where appropriate, new billing type arrangements such as fixed fees, caps and collars and the like in order to provide much greater certainty to the outcome of a case.

The value of Defence cover is increasingly important to Members, irrespective of trade or jurisdiction particularly in the present market environment. Legal costs are far from insignificant and I challenge any Member to fund the costs of a five-day arbitration hearing without having cause for concern as to the cost, irrespective of the financial value of the claims involved.

Regulation plays an increasing and important part of the Association's day to day affairs, as it should. For a number of years now your Board and the Managers have been working hard to ensure that Solvency II capital and other requirements, which come into force in January, 2016, are met. That work continues alongside the day to day activities of the Association.

The year just gone is one in which we have all faced many challenges. I would like to think that the Association understands some of those challenges and has responded in an appropriate way. As a Board we always strive to support Members when disputes arise and to find ways to resolve cases as is appropriate. Some cases appear intractable, many involve charterparty chains with differing views and opinions depending on the parties involved. Our goal, and that of the Managers, is to find solutions where solutions exist. If cases have to litigate, and many have to, I like to think that your Association is one which will stand by you, where we can, irrespective of the level of costs which may be incurred. The Association's strong financial position allows us to do this.

I am very honoured to chair this Association and I am grateful to my fellow Directors for their tireless contribution to the Association's affairs. The Managers also deserve much credit and my sincere thanks to them for all their activities ensuring that this Association is, in my mind, second to none.

M.F. Lykiardopulo

Chairman

The United Kingdom Freight,
Demurrage & Defence Association Ltd.
May, 2015

Ships covered

3,700



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

Current tonnage entered



167m GT



CLAIMS REVIEW

The Association has a long track record of being involved in high profile cases, notwithstanding the significant costs that are likely to be incurred.

CLAIMS REVIEW

Claims arising from the collapse of OW Bunkers undoubtedly dominated the claims landscape in 2014.

2014 Claims - OW Bunkers

2014 was an interesting year for the Association as far as claims were concerned. Until the last quarter of the year it appeared that claims would be at a similar level to those in the previous year. However a number of high profile insolvencies, most significantly the OW Bunkers group of companies, changed that.

Claims arising from the collapse of OW Bunkers undoubtedly dominated the claims landscape in 2014. At the time of writing, the Association is assisting Members in relation to stems supplied to over 160 ships. OW related claims represented 9% of all cases opened in the 2014 policy year and 30% of notified claim amounts. The situation has been made more complex by the fact that whilst some entities within the OW group have entered into formal insolvency or bankruptcy proceedings, other companies remain afloat, albeit without significant funds. ING Bank BV has sought to enforce claims against many Members as an assignee of OW's claims. Notwithstanding this, many Members continue to face claims from physical suppliers who have not been paid by OW.

The Association's Members are content to pay those amounts that are due but, of course, they do not want to pay twice. The Association is supporting Members in seeking to identify the correct party to pay and in defending litigation in various jurisdictions, most notably in London and in the United States. Some of those cases potentially have wider implications beyond the individual disputes concerned and it is hoped that they may give guidance to other Members who have similar contractual arrangements.

The Association's experience and expertise allows it to handle disputes like those arising from the collapse of OW Bunkers in a coordinated and proactive way. This is not only to the benefit of the Association's own Members but also the wider industry. The Association has a long track record of being involved in high profile cases, notwithstanding the significant costs that are likely to be incurred. The financial strength of the Association ensures that it is able to do this.

Significant case outcomes

As in previous years the Association has supported many Members in relation to a wide range of disputes.

A Member benefitted from the Association's support in a number of disputes with a Chinese shipyard for the construction of 10 chemical carriers. In one case the Member cancelled a contract when the yard failed to deliver the ship by the "drop dead" date. The Member successfully recovered nearly \$20 million plus interest and a contribution to costs of approximately \$600,000 in respect of pre-instalments previously paid to the yard, following publication of a London arbitration award.

The Association also supported a Member in its pursuit of a claim for approximately \$1.3 million for the consequence of improper remedial work to a ship's main engine. ICC arbitration was brought against the engine maintenance technicians, which ultimately settled in the Member's favour by means of commercial benefits including waiver of fees and extended engine warranties.

Claims related to OW Bunkers

9%

of all opened cases in 2014

30%

of notified claims amounts

160+

open files



CLAIMS REVIEW

The proactive management of disputes and the value of the legal costs insurance provided by the Association is evidenced by its involvement in high profile, high value litigation.

A charterer made a series of short payments of hire due to an owner Member. The Member withdrew the ship and sought a worldwide freezing injunction of the charterer's assets. This action prompted subsequent negotiations which led to a commercial settlement.

Russian statutory bans on the import of foodstuff from the US in December, 2009 provoked a claim for damages for wrongful termination of a charter by the Association's owner Member against its charterer. The case proceeded to a hearing at which the London arbitration tribunal awarded the Member its claim in full. The Member was awarded damages in excess of \$850,000, based on the freight that would have been earned had a full cargo been loaded. Costs were ultimately settled by the charterer making a payment of \$230,000.

Cost recoveries and liabilities

In excess of 95% of cases receive support to some extent or another. Many of those cases are resolved at an early stage following the intervention of the Managers. Others may be settled following the commencement of legal proceedings, whether by mediation or amicable negotiation. Relatively few cases proceed to arbitration or court hearings however, where they do, the costs incurred (and potential cost liabilities) can be very significant.

During the year, the Association's Members made cost recoveries in excess of \$1.4 million in 11 cases which had been supported by the Association. During the same period, Members also benefitted from the Association's payment of cost liabilities incurred in relation to unsuccessful cases, totalling approximately \$205,000.


Advice and assistance to Members

The proactive management of disputes and the value of the legal costs insurance provided by the Association is evidenced by its involvement in high profile, high value litigation. What is perhaps less visible is the day to day advice and assistance provided by the Managers to Members. The relationships that have developed with Members, over many years, have afforded the Managers the opportunity to understand Members' businesses and this, combined with the Managers' experience and expertise, enables a swift and considered response when new issues emerge. These may be statutory, regulatory or case driven. Queries arising from international sanctions regimes dominated the enquiries received in 2014 however other key areas also featured.

Cost recoveries

\$1.4m 

Cases supported

95% 

CLAIMS REVIEW

Chinese guarantees

For performance guarantees in China, amendments have been made to the regulations governing the approval of and registration with the relevant authorities. Amendments have also been made by the Chinese State Administration for Foreign Exchange to its guarantee regulations, including the removal of the need for prior "SAFE" approval for guarantees to be considered lawful. Legal capacity and authority to bind a Chinese corporate guarantor continue to be factors that Members are advised to consider.

Unsafe ports

The number of enquiries and disputes in respect of unsafe ports and unsafe berths has increased in recent years. Between 2005 and 2009 there was an annual average of 22 such enquiries and disputes arose, but between 2010 and 2014, that average rose to more than 70 per year.

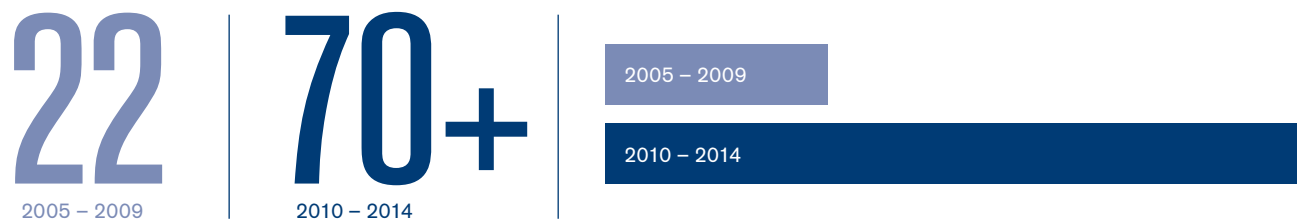
In one recent case an owner Member maintained a claim for unpaid hire following an incident in which the ship's propeller was damaged whilst navigating in ice. The Member claimed that the charterer was in breach of its safe port warranty under the charterparty and sought recovery of the costs of the temporary and permanent repairs. Support was given to the Member, which eventually resulted in a significant recovery from the charterer, including a contribution to interest and costs.

Ebola

The Managers have continued to provide timely advice and assistance to Members faced with the ramifications of ships ordered to countries affected by Ebola. Such advice has proactively focused on the validity of charterers' employment orders. For example, in the context of time charterparties, most charterers are under a duty only to order a ship to ports that are prospectively safe, absent which owners can require the nomination of alternative port. Given the evolving nature of the risk and the World Health Organisation's advice that infection can be avoided by taking adequate precautions, it has not been clear that an Ebola infected port would be considered to be legally unsafe.

Advice provided by the Managers also examined obligations to pay hire and issues of laytime and demurrage under voyage charters. Additional practical assistance has included advice upon Members' ships being quarantined or barred from subsequent port entries, and suitable charter clauses covering the eventualities arising from the Ebola outbreak.

Annual average unsafe port disputes





CLAIMS REVIEW

Capped, fixed or collar fees, success bonuses and risk/reward arrangements can all provide greater levels of certainty.

Maritime lien insurance & charterer's and bunkers supplier's insolvency insurance

The Board of the Association is very aware of the difficulties faced by Members from time to time and in response to the current operating environment two market covers have been created. The first is a maritime lien insurance and the second is designed to respond to charterer's and Bunkers supplier's insolvencies. Both are separate stand-alone policies underwritten primarily in the Lloyds market.

The maritime lien insurance cover will indemnify a Member purchasing a ship for its financial losses arising directly from a maritime lien claim being made against the ship, as a result of debts or disputes that originated prior to the Member taking delivery of the ship and which were beyond the Member's control. The cover does not respond to any maritime lien, encumbrance or cause of action known to the Member on or before the date of delivery or which is discovered during requisite writ searches.

The purpose of the charterer's and bunkers supplier's insolvency insurance is to indemnify Members for financial losses incurred by way of third party claims arising directly from the insolvency of the ship's charterer or bunkers supplier. Such claims would include claims in relation to bunkers on-board. The insurance also covers claims advanced by way of in rem proceedings, or by the exercise of a maritime lien pursuant to which it is alleged by a claimant that it has a right against the Member's ship or the bunkers on-board. It is intended that the cover would respond to any liability to pay the cost of bunkers, port charges, stevedoring costs and any other necessary costs for the completion of a voyage which would properly be the responsibility of the ship's charterer. The cover will also respond to any liability to pay the costs of bunkers in the case of a supplier insolvency event.

Both of the above covers operate as direct covers as between the Member and the market underwriter; premium and associated costs are payable directly by the Member but the Association will handle any claims. Final settlement of the underlying claims will require the market underwriters' approval or an un-appealable judgment or arbitral award.

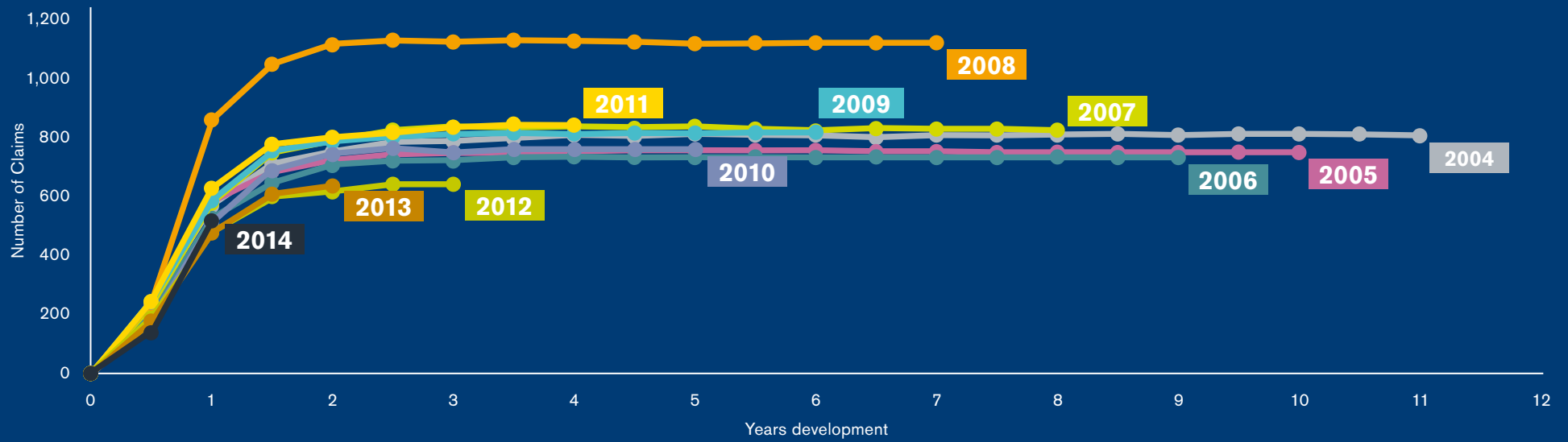
Alternative billing

As a legal cost insurer, certainty of outcome is of paramount importance to the Association and it is an area of focus for both the Board and the Managers. In looking to progress the Managers' Value for Money Programme, there have been discussions with preferred legal partners and others as to alternative fee arrangements that could be put in place, where appropriate, as an alternative to hourly billing.

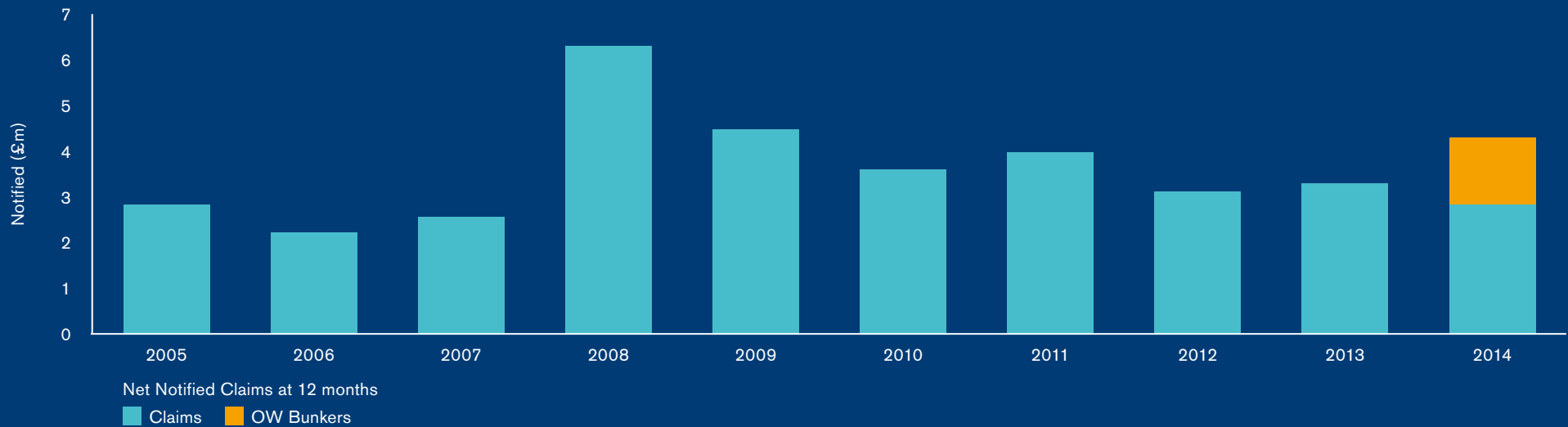
The purpose of these alternative arrangements is to incentivise firms to progress matters efficiently and effectively. Early resolution of suitable cases saves overall costs and is in the interests of both the Membership and the Association. For future and existing cases the Managers will request that firms actively consider and offer alternative billing arrangements on a case by case basis. In some cases, or for certain stages of a case, the most appropriate form of billing may still be a traditional hourly basis. However, the Managers are encouraging a more flexible and innovative approach to billing. Capped, fixed or collar fees, success bonuses and risk/reward arrangements can all provide greater levels of certainty. The Managers are also open to other proposals including, for example, reduced hourly rates upon agreed trigger events or dates, blended rates, and agreed limits on time spent. In all cases the Association's drive is to use its purchasing power to benefit all of the Membership.

In due course it is hoped that this initiative will have a material bearing on how cases are progressed, outcomes and overall costs.

File Number development (Claims with positive transaction amounts)



Claims Development



FINANCIAL HIGHLIGHTS

The Association has produced another strong performance for the financial year to 20th February, 2015 despite some deterioration in the claims environment.

FINANCIAL HIGHLIGHTS

The combined Associations' balance sheet remains in robust health with assets of £56.5 million and a ratio of assets to liabilities of 201%.

The Association has produced another strong performance for the financial year to 20th February, 2015 despite some deterioration in the claims environment. This has resulted in a net underwriting surplus of £1.0m, equating to a combined loss ratio of 94%.

It continues to reinsure its past and present risks on a quota share basis with the UK Defence Insurance Association (Isle of Man) Ltd ("UKDIA"), Members of the Association also being Members of UKDIA. For the purposes of this report therefore, the financial results of the Association and its quota share reinsurer for the year ended 20th February, 2015 are presented on a combined basis.

Premium income for the year totalled £18.5 million, 1% lower than 2013/14 as a result of the strength of Sterling against the US dollar at the start of the year. In US dollar terms premiums were 7% higher, assisted by 5% growth in owned entries.

The 2014 policy year was significantly affected by insolvencies of operators, particularly bunker suppliers, case numbers increasing by 11% and notified amounts by 27% relative to 2013 at the same point. However, prior policy years' claims generally developed

slightly better than or as expected. Net claims incurred for the year, including claims provisions, rose to £13.1 million, up from £10.2 million in 2013/14.

Investment performance was helped by the 8% strengthening of the US dollar against Sterling over the course of the year, though this was partly offset by the Euro weakening by 11% against Sterling over the same period. The total investment return equated to 3.5%, reducing to 3.17% before currency movements, and there were also £1.1 million of operating exchange gains, including hedging.

Overall there was a net surplus for the year of £3.9 million, which increased free reserves from £24.5 million to £28.4 million and total capital resources for solvency purposes from £31.0 million to £34.9 million. The combined Associations' balance sheet remains in robust health with assets of £56.5 million and a ratio of assets to liabilities of 201%.

Year ended 20th February	2015 £'000	2014 £'000
Gross premiums written	18,519	18,762
Reinsurance premiums	(366)	(405)
Net claims incurred	(13,148)	(10,200)
Expenses and taxation	(3,953)	(3,674)
Investment return	1,814	826
Exchange gains / (losses)	1,058	(824)
Surplus for the year	3,924	4,485
Total funds	56,530	52,202
Claims reserves	(28,159)	(27,755)
Free reserves and capital	28,371	24,447

Combined
loss ratio

94%

Net claims incurred

£13.1m

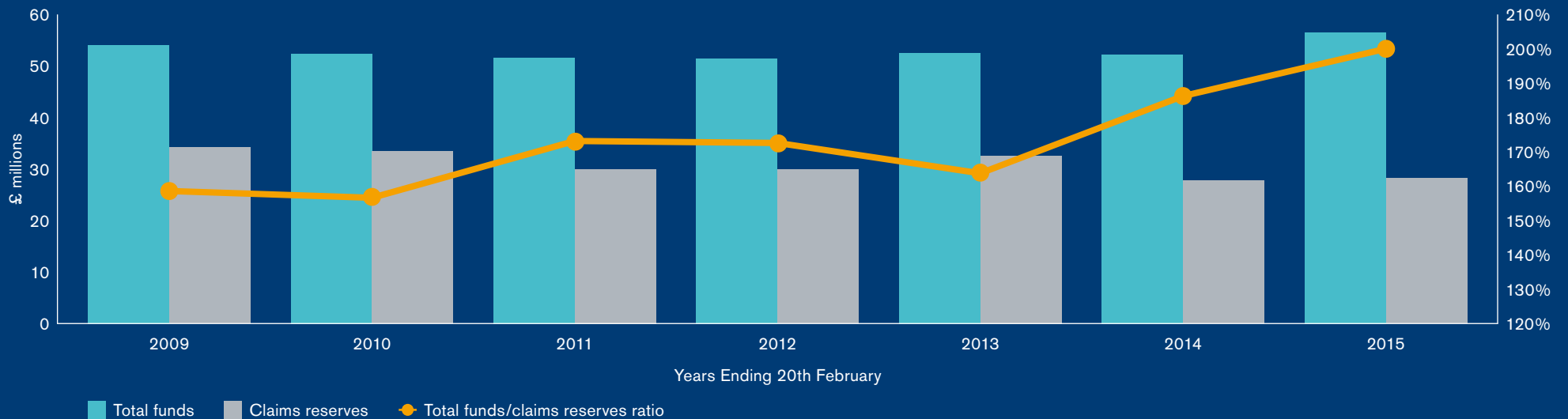
Total funds

£566.5m

Claims reserves

£28.2m

Total funds / claims reserves ratio



Thomas Miller Worldwide office locations



ABOVE & BEYOND

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