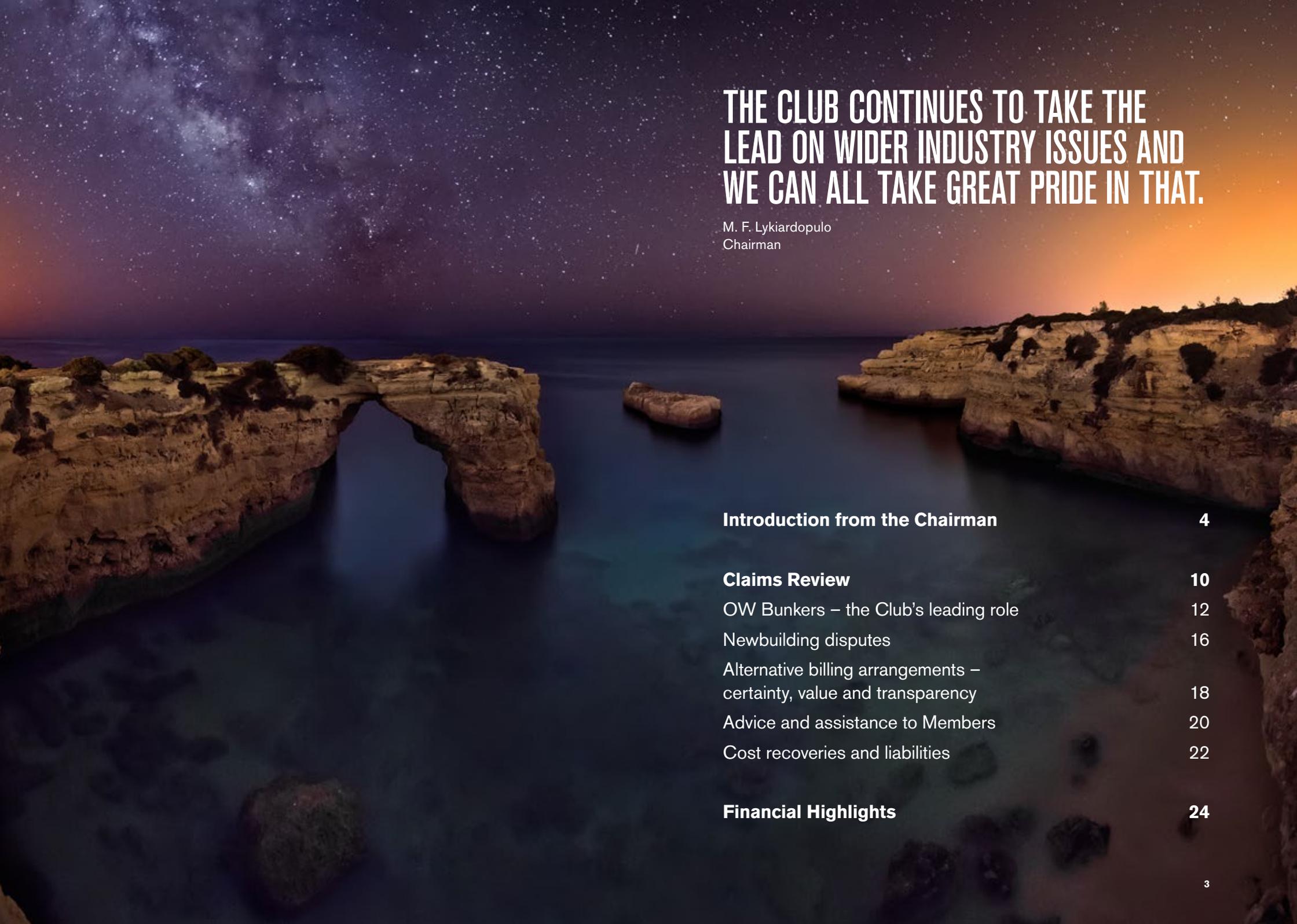


Leading the way

End of Year Review 2017

£1.5m

**FOR THE SECOND YEAR
RUNNING, £1.5m WAS
RETURNED TO MEMBERS
VIA CONTINUITY CREDITS.**



THE CLUB CONTINUES TO TAKE THE LEAD ON WIDER INDUSTRY ISSUES AND WE CAN ALL TAKE GREAT PRIDE IN THAT.

M. F. Lykiardopulo
Chairman

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Introduction from the Chairman



INTRODUCTION

Being the Chairman of the UK Defence Club for the past three years has been both an honour and a privilege. Another successful renewal has seen entered ship numbers increasing to 3,938, totalling 187.7m grt. I believe this is evidence in itself of the confidence that our Members place in the Club and the cover that it provides.

The Club is somewhat unique in the industry. As a standalone organisation providing legal costs insurance to the international maritime community, we are focused purely on your legal disputes and finding effective ways to resolve those disputes. This is our Club's reason for being. We offer wider cover than any other provider and do so at competitive rates. This is made possible by our size and the economies of scale which that brings, as well as the direction given by an experienced Board made up of senior industry participants.

INDUSTRY LEADERSHIP

The Club continues to take the lead on wider industry issues and I believe we can all take great pride in that. The Club's support for the Member in the RES COGITANS is a case in point. Although ultimately unsuccessful before the Supreme Court, this was a case which your Board felt very strongly deserved support given the impact on the industry in general.

The issues involved affected many operators internationally and some will have long standing consequences. The turmoil caused by the collapse of OW Bunkers continues to resonate today. In this regard the Club is supporting a test case before the courts in the United States to provide much needed clarity as to the proper party entitled to bunker payments in that jurisdiction.

FINANCES

For the current policy year your Board again announced a 0% general increase. This is the third year in a row that no increase has been sought. Free reserves have grown to £29.2m even after continuity credits are taken into account, which were introduced three years ago. Such credits, depending on the Club's financial position in any given year, utilise the Club's free reserves to reward continued Membership.



Net surplus for the year 2016/7

£0.78m*

**WHICH INCREASED FREE
RESERVES TO £29.2m.**

* All figures as at 20th February, 2017

LOOKING TO THE FUTURE

Future claims trends are always difficult to predict. The recent slight upturn in the dry freight markets is a welcome relief for many. Were it perhaps to give rise to an increase in sale and purchase and new building activity, that could potentially have an impact on future claims, were the markets to shift significantly one way or the other. One cannot predict the future, but history has taught us that such claims can be difficult and expensive to resolve, if and when they arise.

As I have mentioned in previous years, the Club is endeavouring to bring about changes in the provision of legal and other services by the greater use of alternative fee arrangements. Certainty of costs is an important component in determining whether a case should be progressed. The appropriateness of caps, collars and success fees should all become routine questions for legal advisors to consider. The hourly rate may not become a thing of the past but it should not be the only way that the costs of litigation to the client are determined. All service providers have a part to play in ensuring the proportionality of costs.

The Club will do its part; however, we do need Members and all industry participants to assist in this goal. At the end of the day, it is the industry which pays for the legal costs either through insurers such as ourselves or directly.

If we collectively aim for greater certainty, I firmly believe that the outcomes of litigation will be enhanced directly, both through results and reduced costs.

REGULATORY ENVIRONMENT

Your Board spends considerable time assessing the Club's future capital and other regulatory requirements. The Club, of course, continues to meet its solvency requirements under Solvency II.

The outcome of the referendum in the UK in June, 2016 was something of a surprise to many and may well have an impact in terms of the structure of the Club depending of course on how Brexit negotiations between the UK and the EU proceed. Some adjustment may be required to the Club's current structure to ensure that European passporting rights are maintained in the years ahead. We will, of course, keep Members closely advised of the changes that may be necessary.

BOARD AND MANAGERS

Over the past year we have welcomed a number of new Directors to the Club's Board. This ensures that your Board remains reflective of the Club's Membership both geographically and in terms of ship type.

This is my last annual statement as Chairman as my tenure completes in June, 2017. I have been greatly assisted during my tenure as Chairman by the dedication that your Directors have shown to the affairs of this Club. That assistance has eased the burden upon me considerably.

I would personally like to thank all the Directors individually for their efforts over the last three years. My appreciation extends equally to the Managers who diligently deal with Members' enquiries on a daily basis and implement the Board's vision of how the Club shall seek to enhance and improve on what it does in the future.



M. F. Lykiardopulo
Chairman

The United Kingdom Freight,
Demurrage & Defence Club Ltd.
May, 2017

**OVER THE PAST YEAR WE HAVE
WELCOMED A NUMBER OF NEW
DIRECTORS TO THE CLUB'S BOARD.**

Claims Review





Ships covered



3,938

**THE CLUB'S CONTINUED
GROWTH REFLECTS THE
CONFIDENCE OF ITS
MEMBERS IN THE COVER
AND SERVICE IT PROVIDES.**

OW BUNKERS – THE CLUB'S LEADING ROLE

The collapse of the OW Bunkers group of companies in November, 2014 has had a significant impact on the claims landscape since 2014.

As far as the Club is concerned, Members faced claims relating to over 250 stems within numerous jurisdictions including England, United States, Greece, Germany, Malta, France, Denmark, Singapore, UAE, Australia, Belgium and Italy. The focus of those Members was to avoid, or minimise as far as possible, the risk of having to pay twice for the same stem.

The RES COGITANS was a landmark case and the Club's leading role in that case has been well publicised. The Club supported the owner Member from the stage of the initial arbitration through to a hearing before the Supreme Court in London. The Supreme Court found that, under English law, contracts to buy fuel were in fact mere licences to consume that fuel and intermediate bunker suppliers and their financiers were entitled to demand payment in full without needing to pay their own suppliers or to provide good title to the buyers of that fuel.

Whilst the outcome was not in the Member's favour, the judgment did at least provide clarity as to which party was entitled to be paid. This benefitted not only the Club's Members but also the wider industry. The costs incurred in relation to the case (including a cost liability) are in the region of \$3.3 million, many times in excess of the amount that was in dispute. This highlights the Club's commitment to supporting its Members and the leading role it plays in relation to industry issues.

THE RES COGITANS HIGHLIGHTS THE CLUB'S COMMITMENT TO SUPPORTING ITS MEMBERS AND THE LEADING ROLE IT PLAYS IN RELATION TO INDUSTRY ISSUES.



**THE RES COGITANS WAS A LANDMARK
CASE AND THE CLUB'S LEADING ROLE IN
THAT CASE HAS BEEN WELL PUBLICISED.**

OW BUNKERS – THE CLUB'S LEADING ROLE

Courts in other jurisdictions have come to different conclusions and Members continue to face the risk of disruption to their trading patterns, and expensive and time consuming litigation with the risk of contradictory judgments in circumstances entirely of the making of OW Bunkers.

Beyond the RES COGITANS the Club has also supported several Members involved in high profile litigation in the United States and other jurisdictions. In the United States, Members are facing claims from OW Bunkers and multiple physical suppliers, with interpleader proceedings afoot in Texas and New York.

In New York a Member faces claims in relation to fuel supplied to four of its ships. The Member was threatened with the arrest of its ships for directly competing claims from OW Bunkers, its financiers ING and the physical supplier. They asserted competing maritime liens and have attempted to secure summary judgment for claims in the region of \$6 million each. Having secured the parties' claims the Member has sought the guidance of the court as to which party should be paid for the fuel. Following an oral hearing in December, 2016, Judge Caproni issued her judgment on 9th January, 2017. She ruled that under the relevant US statute the physical suppliers did not have a lien because they did not provide fuel to the ships on the order of the ships' owner or authorised representative. The court has found that the physical suppliers served as sub-contractors to OW Bunkers and therefore they fell outside the local statutory definition of a party entitled to maintain a maritime lien.

Judge Caproni expressed some sympathy for physical suppliers but held that the contractual relationship between the parties are clear and must be respected. She noted that the chain of back-to-back supply contracts was intended to avoid multilateral obligations that could embroil ships in litigation between suppliers flowing from the unfortunate reality of OW Bunkers' bankruptcy. However, Judge Caproni stated that:

“The Court's sympathetic view of the Physical Suppliers' situation is not, however, boundless, and it does not extend to rewriting the consistent, and nearly uniform, case law denying subcontractors a maritime lien.”

The physical suppliers have appealed the New York court's decision to the appellate court, the Second Circuit.

OW BUNKERS – THE CLUB'S LEADING ROLE

CONTINUED

A Member also faces competing claims from OW Bunkers and a physical supplier in Texas in relation to fuel supplied to ten ships with a value of approximately \$7 million. Again, OW Bunkers, ING and the physical supplier have asserted competing claims arguing that they are entitled to a statutory maritime lien. The decision of the Texas district court as to which party has a lien is awaited.

The litigation in the United States is complex and has been the subject of extensive discovery, resulting in significant costs being incurred. There is also a residual risk that separate district courts will make inconsistent judgments which ultimately may require cases to proceed to the US Supreme Court.

In the UAE, Members have also faced claims for fuel supplied to their ships pursuant to contracts with OW Bunkers entities although physically supplied by local bunker suppliers. In one case, the Club supported a Member in relation to competing claims for approximately £1.6 million and that case proceeded through the UAE court system on appeal up to the UAE Federal Supreme Court. That court found that the delivery of the bunkers to the Member's ship did not impose a direct liability on the shipowner to pay the physical supplier. The court found that there were two separate contracts between the Member and OW Bunkers on the Member's bespoke terms, and between OW Bunkers and the physical supplier, each of which contained separate payment obligations. With such a supply chain, the Member had no liability to make payment to the physical suppliers directly. The court recognised that the physical supplier delivered fuel to the ship but found that it did so only on the order of OW Bunkers.

The judgment is significant for Members buying bunkers in the UAE under contractual sale and purchase chains as they may have a good defence to direct claims in the UAE from physical suppliers. However, the UAE legal system is a civil law system and therefore the Supreme Court's decision is persuasive but is not binding.

In general terms, the Managers continue to provide practical assistance to Members to protect their position by minimising the risk of double jeopardy in relation to existing claims and to prevent future claims by seeking to address the imbalance in bunker supply contracts.

THERE BEEN SEVERAL DECISIONS FROM US DISTRICT COURTS ADDRESSING THE LIEN RIGHTS OF THE PHYSICAL SUPPLIERS IN CASES INVOLVING OW BUNKERS.

**THE CLUB HAS SEEN AN INCREASING
NUMBER OF NEWBUILDING DISPUTES
IN RELATION TO QUALITY ISSUES.**

NEWBUILDING DISPUTES

Many Members elect to enter their newbuilding contracts with the Club, ensuring that they have the benefit of the Club's cover for any disputes that arise. As one would expect, the number of contracts entered with the Club tends to vary depending on the prevailing shipping markets and newbuilding activity.

Compared to 2008, and the years immediately preceding the financial crisis, the number of newbuilding contracts remains relatively low, as does the number of newbuilding claims overall. What is interesting however is that the Club has seen an increasing number of newbuilding disputes in relation to quality issues. Because they are highly technical in nature, and require significant input from experts, the costs of these disputes are difficult to predict, can accelerate rapidly and are often significant.

By way of example, a Member's ship, the STAR POLARIS, was built by a yard and was delivered into the Member's service. It subsequently suffered a serious engine failure, necessitating a tow to a yard as it required extensive and time consuming repairs. The Member sought recovery of the cost of repairs, towage fees, off-hire and consumption of bunkers caused by the engine failure, and pursued a claim for diminution in the value of the ship. The yard denied liability but it was subsequently held by a London arbitration tribunal that there was a causative breach of the yard's warranty of quality as there were weld spatters in the pipework within the ship's engine at delivery.

The award left open various issues of quantum. An appeal to the High Court was made which centred upon the interpretation of the shipbuilding contract which set out the yard's liabilities in the event of damage arising from defective workmanship. The court preferred the yard's narrow interpretation of the contract and held that although the contract obliged the yard to rectify physical damage or defects, the yard's liability did not extend to the time taken to carry out such repairs or other consequential losses. Therefore the yard excluded liability for the financial losses caused by its poor workmanship including the claim for diminution in value of the ship. However, the yard remains responsible for the physical damage caused to the engine and quantum issues remain live. In several other cases poor welding by a yard has presented a serious risk to buyers of multiple newbuildings.

The Club has also assisted several Members in relation to delivery disputes with yards and issues which have arisen under refund guarantees. In several cases yards have been unable to meet contractual delivery dates for ships under construction and have resisted demands for repayment of pre-paid instalments. The Club has assisted in the recovery of such instalments following excessive delay by yards notwithstanding allegations from yards that Members contributed to such delays. In one case the delay was due to poor workmanship at the yard's sub-contractor's facility which required extensive monitoring and correspondence with the yard, which remained responsible for the quality of the ship's construction. In other cases refund guarantors have refused to repay instalments and have caused yards to commence London arbitration proceedings as a means to delay the triggering of the guarantees as issued. The Club continues to assist Members in holding yards to account for poor build quality and delayed delivery whilst maintaining claims against guarantors to ensure that instalments are repaid appropriately.

ALTERNATIVE BILLING ARRANGEMENTS – CERTAINTY, VALUE AND TRANSPARENCY

A key element of the Club’s service is the advice and assistance that is provided to Members on a daily basis. Over two thirds of all cases are brought to a satisfactory conclusion without the involvement of external legal advisers. In those cases where it becomes necessary to instruct external legal advisers, the Board of the Club has tasked the Managers with ensuring that proper consideration is given to the way in which those legal advisers charge for the work that they do. This is aimed at moving away from billing by the hour towards more considered alternative billing arrangements.

Alternative billing arrangements can take many forms and vary in complexity however they have the benefit of increased certainty of outcome, transparency and value. Of paramount importance is the ability to put in place accurate estimates of future expenditure, avoiding any unpleasant surprises when bills are submitted for payment.

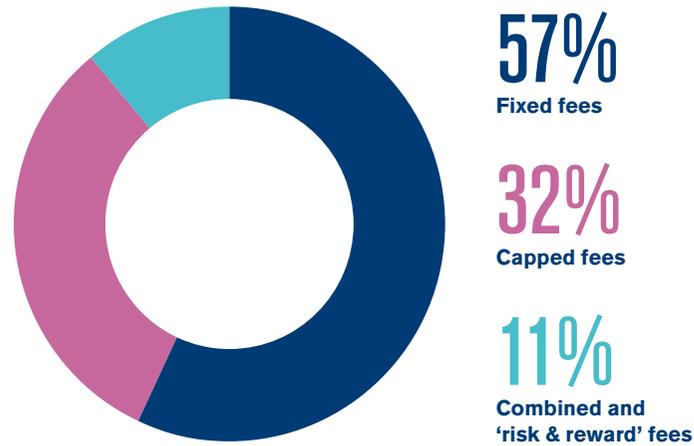
Those law firms working with the Club’s Members are required to give active consideration to alternative billing arrangements both in the early stages and throughout the development of a case. Such billing arrangements are now routinely discussed in over two thirds of cases with law firms usually instructed by the Club.

Those alternative billing arrangements might include capped fees, fixed fees, reduced rates with a success bonus, collar and conditional fee arrangements or combinations thereof. Fixed and capped fees are increasingly common and are often agreed for the performance of a specific task or set of tasks such as the provision of an initial advice, investigations, pleadings, disclosure, or the attendance at meetings or hearings.

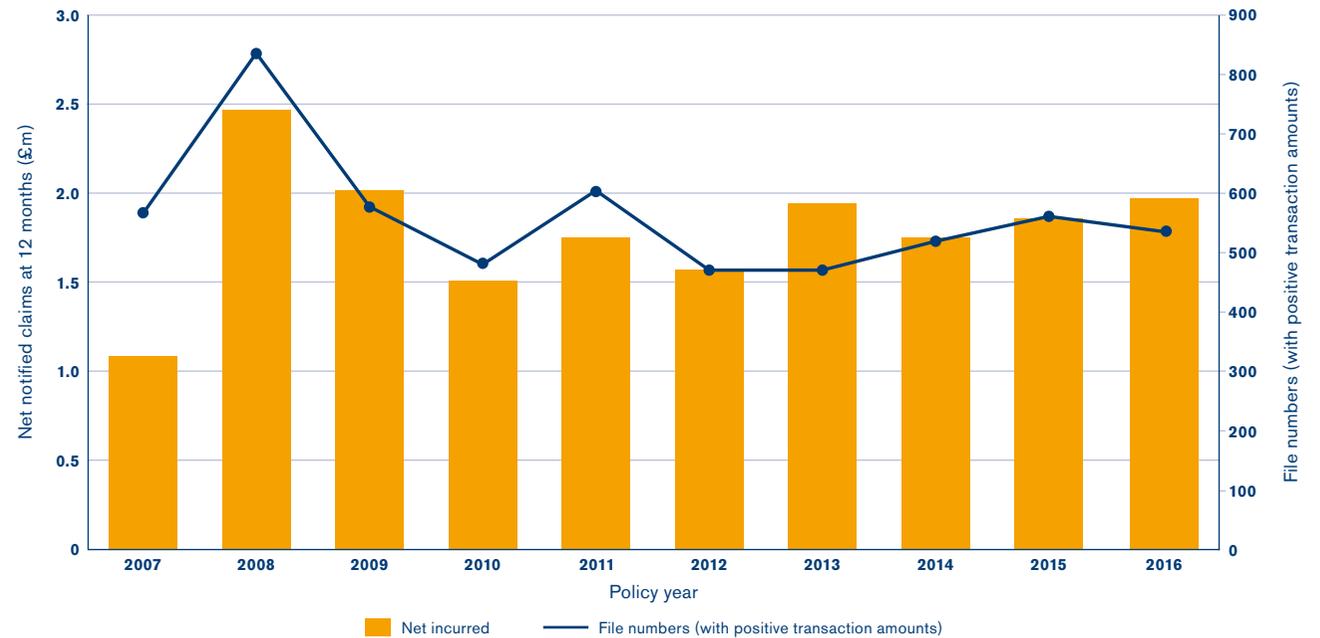
Where alternative billing arrangements include an element of risk sharing it follows that all parties to the litigation, including the lawyers, have an interest and increased focus on the outcome. The Board and the Managers believe that adopting innovative and co-operative approaches in relation to fees increases certainty and transparency and is of benefit to all concerned, in particular the Membership.

ALTERNATIVE BILLING ARRANGEMENTS

Alternative billing arrangements agreed in 2016



NET NOTIFIED CLAIMS / FILE NUMBERS AT 12 MONTHS DEVELOPMENT



**THE CLUB HAS ALSO ASSISTED MEMBERS
WITH DIFFICULT LEGAL AND COMMERCIAL
ISSUES IN RELATION TO BREXIT.**



ADVICE AND ASSISTANCE TO MEMBERS

The Club continues to provide on-going, market leading advice and assistance to Members in relation to specific disputes and areas of industry concern.

During the year the Club has produced Soundings bulletins relating to significant English court decisions on issues such as the enforceability of penalty clauses in commercial contracts, the interpretation of contractual consequential loss provisions and the impact of collateral lies on insured claims. Members have also been advised upon the effect of arrests and delays caused by the actions of a time charterer's sub-contractors as highlighted in the Soundings on the Supreme Court's judgment in the GLOBAL SANTOSH. Extensive assistance has been provided to in relation to the ramifications of the Supreme Court judgment in the RES COGITANS. Korean bankruptcy procedures were highlighted following the financial difficulties of Hanjin and the Club published a detailed analysis of multi-jurisdictional insolvency issues to assist Members in minimising risks in difficult market conditions.

Publications have also focused on arbitration provisions, for example under the London Maritime Arbitrators Association's Intermediate Claims Procedure coupled with a commentary upon the new LMAA 2017 Terms. Advice has also been provided to Members in relation to the Shorter Trials Scheme which is being trialled in the English Royal Courts of Justice, aimed at streamlining procedures for certain commercial disputes. Going forward it will be interesting to see how this scheme might impact on how other forums conduct litigation.

The Club has also assisted Members with difficult legal and commercial issues in relation to Brexit including the impact on shipping contracts, choice of law and jurisdiction clauses, availability of injunctive relief and the impact of Brexit on the enforceability of judgments and arbitration awards.

COST RECOVERIES AND LIABILITIES

During the 2016 policy year cost recoveries totalling \$976,657 were made and cost liabilities of \$96,522 were incurred. This excludes the cost liabilities incurred on the RES COGITANS. The Club has in place a comprehensive reinsurance programme which ensures that the financial impact of larger claims is minimised.

The Club continues to promote alternative dispute resolution as a means to successfully conclude disputes on an amicable and commercially acceptable basis. The Club has recommended the use of mediation in many cases and has also used early neutral evaluation and preliminary issues as a means of narrowing the areas of a dispute to allow a more focused approach on any remaining contentious issues.

The Club has been proactive in seeking commercially acceptable settlements in Members' favour. In one case a Member sought recovery of sums due under three charterparties from the same charterer in relation to early redelivery and bunker consumption. The Club supported the Member to build its case up to, and including, a successful mediation in which the Member recovered approximately 85% of its claim. The Club made a substantial recovery in relation to the costs incurred.

In another case a Member pursued a claim for wrongful refusal by a charterer to take delivery of its ship. With the support of the Club, the Member successfully secured a London arbitration award in its favour of approximately \$850,000. Ultimately a structured settlement agreement was achieved under which the amount awarded plus interest and costs was paid in full.

**THE CLUB CONTINUES TO PROMOTE
ALTERNATIVE DISPUTE RESOLUTION.**



Financial Highlights





Returned to Members
via Continuity Credits

£1.5m*

**EQUIVALENT TO 8% OF
GROSS WRITTEN PREMIUM.**

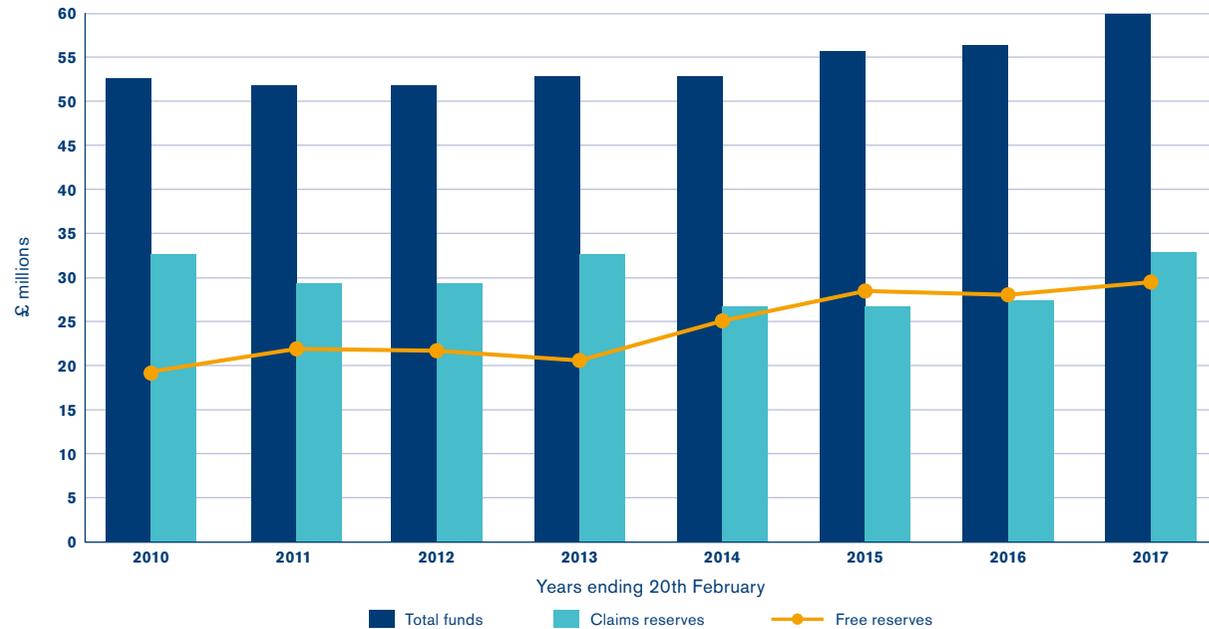
*All figures as at 20th February, 2017

FINANCIAL HIGHLIGHTS

This is the second year whereby the Club has rewarded longstanding Members a reduction in premium under the continuity credit scheme which resulted in a £1.5m reduction in premium to Members that qualify.

The Club has continued to support its Members in respect of claims relating to OW Bunkers, which have been successfully managed through the Club's reinsurance programme. The impact of OW Bunkers has continued to increase claims costs in the 2014 policy year however a strong investment return has assisted the Club in producing a favourable result for the year.

TOTAL FUNDS / CLAIMS RESERVES



Gross premium income for 2016/17

£19.8m

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

£29.2m*

*As at 20th February, 2017, before the values of hedging reserves

2016/17 - £29.2 million*

2015/16 - £28.5 million

2014/15 - £28.4 million

Total capital resources

£33.6m*

*All figures as at 20th February, 2017

Investment return

9%

Combined Clubs' assets for 2016/17

£61m*

*All figures as at 20th February, 2017

2016/17 - £61 million*

2015/16 - £56.2 million

2014/15 - £56.5 million

FINANCIAL HIGHLIGHTS

The Club 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 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, 2017 are presented on a combined basis.

Sterling premium income has remained relatively stable when compared to the previous year, however premium has been helped by a stronger US Dollar relative to Sterling. For the 2016/17 year continuity credits awarded to longstanding Members amounted to £1.5 million, or 8% of gross written premium. The 2016/17 policy year is the second year that the Club has returned premium to its Members by way of continuity credits which, cumulatively, across two years, has amounted to £3 million.

The 2014 policy year remains significantly affected by the OW Bunkers insolvency claims. Following the verdict in the RES COGITANS, the lead case for OW Bunkers claims subject to English law and jurisdiction, this year has seen development beyond the Club’s expectations. This risk has been significantly offset by the Club’s excess of loss reinsurance programme. The Club is committed to this industry-wide issue and continues to support Members in various jurisdictions.

On the whole, a weakened Sterling has had somewhat of an adverse impact on the Club’s claims figures. The 2015 and 2016 policy years have however remained relatively benign in terms of claims with only a small number of larger cases arising in 2016. Prior policy years’ claims, other than 2014, generally developed better than or as expected.

The Club produced a very strong investment return of 9%. Investment performance for the year was aided by a significant strengthening of the US dollar against Sterling following the Brexit vote in June, 2016 however, even absent currency gains, investments have performed well above expectations.

Overall the Club has produced a net surplus for the year of £780,000, which increased free reserves from £28.5 million to £29.2 million. Total capital resources for solvency purposes stood at £33.6 million and the combined Clubs’ balance sheet remains in robust health with assets of £61 million and a ratio of assets to liabilities of 186%.

General increase

0%

REFLECTING THE CLUB'S
CONTINUED FINANCIAL
STRENGTH AND COMMITMENT
TO ITS MEMBERS.

FINANCIAL HIGHLIGHTS

Year ended 20th February	2017	2016
	£'000s	£'000s
Gross written premium	19,790	19,955
Reinsurance premiums	(402)	(400)
Net claims incurred	(16,670)	(13,475)
Expenses and tax	(4,477)	(3,809)
Investment return and expenses	3,000	(921)
Exchange gains/(losses)*	1,047	247
	2,287	1,597
Continuity credits	(1,508)	(1,509)
Surplus for the year	780	88
Total funds	61,011	56,183
Claims reserves	(32,722)	(28,467)
Free reserves and hedging reserve	28,289	27,716
<i>Of which</i>		
Free reserves	29,238	28,459
Hedging reserve	(949)	(743)

* Exchange gains/(losses) includes exchange movements, claims liabilities, investments and hedges.

Leading the way

The UK Defence Club

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