HD NEWSMAKER-LME warehousing throws up roadblock for Charles Li

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SYDNEY/HONG KONG, March 31 (Reuters) - Earlier this month, the chief executive of Hong Kong Exchanges and Clearing , Charles Li, was eager to talk about anything but the years-long warehousing crisis at the London Metal Exchange.

At a lunch with reporters, Li brushed aside questions about forthcoming rules that should once and for all break through the logjams in the LME's vast storage network, which end users including brewer MillerCoors alleged had artificially choked supply and inflated prices.

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With the seal of approval from British regulators, after months of consultation, Li told Reuters he was "done" with the issue and intended to focus on the lucrative opportunities offered by China's internationalisation of commodities trade.

Not quite yet it seems.

A British court last week upended the plan, saying the rule-making process was "unfair and unlawful" because the LME had presented only one viable option: reduce queues by limiting how much can be brought in and out each day.

It was a blow for Li, who has taken a leading role in fixing a problem that has been a thorn in the side of the exchange and efforts to wring profits from the $2.2 billion LME takeover.

Michael Lion, Chairman and Director of Sims Metal Management Asia in Hong Kong, said he did not think Li's reputation would suffer personal damage from the set back.

"The question marks around him are will the underlying conditions (in China) enable him to complete the vision that will make the acquisition... as viable as they hoped?"

Nonetheless, Li faces a renewed drive to fix a problem that has divided the industry and delayed his plans to overhaul the 137-year old exchange, which has so far dragged on HKEx profits.

The Hong Kong exchange has said it was disappointed with the ruling and declined to comment on questions about whether it could hit its LME growth plans.

Last month, the exchange reported a lower-than-expected 11 percent rise in annual earnings, as almost HK$800 million ($103 million) in operating expenses from the LME offset a recovery in stock trading volumes last year.

Some of those costs came from the LME building its own clearing house, LME Clear, which should begin contributing fees when it launches in September this year. The Hong Kong exchange pledged not to raise fees until at least the start of 2015.

"CHARLES SOLUTION"

Li, a past executive at JP Morgan Chase and Merrill Lynch's China operations who has worked for several law firms in New York was blooded in commodities as a young man, working in the offshore oil fields of the North China sea prior to college.

Now well connected to China's elite, Li, 52, is regarded as by some in the industry as a "visionary" who will get the job done. He had had his eye on the LME since early 2010, just three months into his new job as CEO of HKEx and well ahead of the starting gun for the LME sale that was wrapped up in 2012.

"He certainly wears his heart on his sleeve as far as what his ambitions are," said Lion, adding Li was refreshingly not afraid of controversy.

Indeed, one of Li's first acts after HKEx's purchase was to pledge an overhaul of the LME's warehousing network, promising in October 2012 to aim "a bazooka" at the problem.

In last week's High Court ruling, the judge published previously undisclosed emails between LME executives that revealed the extent of Li's involvement in the process.

In an email in March last year, Matt Chamberlain, who was hired by Hong Kong to run the consultation and implement the changes, described the plan to link delivery rates to inflows into warehouses with big queues as the "Charles solution".

In the email, Chamberlain gave LME management two options: keep the status quo or push ahead with "Charles' plan".

Warehouses registered by the LME at ports around the world are supposed to allow companies that need metal to take delivery of supplies against the exchange's futures contracts.

But in recent years, banks and traders bought warehouses, stockpiled mostly aluminium in their depots and delivered it out at the minimum pace thus driving up the costs for metal used to make industrial products from soft-drink cans to aircraft.

Wait times that had initially prompted a few grumbles in earlier years got even longer as the new warehouse owners concentrated metal into facilities at single locations.

Facing intense regulatory and political scrutiny and embroiled in class-action lawsuits, the LME announced last November sweeping reforms to force storage facilities with long queues to deliver metal out at a significantly faster rate.

In the plan that was supposed to come into force on April 1, the pace of deliveries would be linked to the inflows of metal.

CORE STRATEGY

The warehousing issue has been diverting attention away from Li's core strategy: to capitalise on growing global yuan trade by developing commodity benchmarks, before turning to the broader and more lucrative currencies and fixed income markets.

The exchange is expected, as soon as next month, to announce new products including a yuan denominated copper contract.

"There are some in London who think it's not going to happen or it's not going to work. But they have to try, and they are trying," an executive at an LME ringdealer said.

Li's connections could also help pave the way for the LME's prized aim of opening up warehouses in China.

The LME suffered a setback last October, when a Chinese government source said that Beijing will retain a ban on overseas commodity exchanges setting up warehouses, dashing hopes that the launch of Shanghai's Free Trade Zone could mean a thaw in the authorities' position.

Chinese trading house Maike has been building warehouses in the zone and the company is seen as a likely contender to become the next new Chinese LME member.

A key obstacle has been resistance from local exchanges reluctant to see fresh competition on their home turf.

But Li's plans to co-list commodity contracts on the HKEx are seen as a peace offering to China's commodities exchanges and a step towards his goal of gaining warehouses in China.

The clock was ticking, but it was too early to come to a judgment yet, said the LME ringdealer executive, noting that Li's LME initiatives would take time.

"He's going to have to show a return on the high price tag which won't be easy." ($1 = 7.7573 Hong Kong Dollars) (Additional reporting by Susan Thomas and Veronica Brown in London; Editing by Jonathan Leff and Ed Davies)

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