

To: All warehouse companies

Cc: All members, London agents & other interested parties

Ref: 14/298 : A290 : W142

Date: 8 October 2014

Subject: **PROPOSED IMPLEMENTATION OF THE LINKED LOAD-IN / LOAD-OUT RULE – CONSULTATION WITH WAREHOUSES PURSUANT TO WAREHOUSE AGREEMENT**

Summary

1. The LME is pleased to note today's decision by the English Court of Appeal (the "Court of Appeal"), which will allow the LME to proceed with its stated programme of reform of its physical warehousing network.
2. Further to the Court of Appeal's decision, and pursuant to the warehouse agreement, the LME is today launching a two week consultation with LME listed warehouses pursuant to the warehouse agreement regarding the LME's intention to implement a linked load-in / load-out rule. This is set out in the attachment to this Notice "LME Policy Regarding the Approval of Warehouses, Revised 1 February 2015" (the "LILO Rule"), which the LME proposes will apply to LME listed warehouses in accordance with the timetable outlined below.
3. Capitalised terms not defined in this notice have the meaning given to them in the LILO Rule.

Background to the LILO Rule

4. On 1 July 2013, the LME announced (in Notice 13/208 : A201 : W076) a consultation in respect of queues at LME listed warehouses (the "2013 Consultation"). In particular, the 2013 Consultation proposed the introduction of a linked load-in / load-out rule (the "Proposal"). The 2013 Consultation was an extensive three month market-wide consultation with market participants, including the LME listed warehouses. It involved the LME:
 - (a) discussing the Proposal with various sub-committees of the LME;
 - (b) receiving written responses from market participants on the Proposal;
 - (c) discussing the Proposal at a press conference and other industry fora;
 - (d) conducting meetings with over 70 market participants worldwide; and



- (e) considering all of the feedback and responses provided by the aforementioned interaction.
5. On 7 November 2013, the LME announced in Notice 13/326 : A312 : W125 (the “Decision Notice”) the outcome of the 2013 Consultation, including the adoption of the Proposal as originally proposed, with one modification¹ and certain clarificatory drafting changes (the “2013 LILO Rule”), together with a set of other measures. On 7 November 2013 the LME also published a comprehensive report on the 2013 Consultation (the “2013 Consultation Report”).
 6. On 27 March 2014, the English High Court of Justice (the “High Court”) announced its decision to quash the adoption of the 2013 LILO Rule (the “High Court Judgment”). Accordingly – as set out in Notice 14/106 : A103 : 046 (the “JR Notice”), this has not been introduced.
 7. The JR Notice contemplated that the 2013 LILO Rule, or a modified version thereof, could still be implemented at some point in the future and that, were the LME to later implement the 2013 LILO Rule or a modified version, the LME may, subject to any comments received in the future, implement such a rule with a Preliminary Calculation Period commencing on 1 July 2013.
 8. On 8 October 2014, the Court of Appeal allowed the LME’s appeal against the High Court Judgment (the “Court of Appeal Judgment”). The Court of Appeal unanimously found in favour of the LME on all grounds. In handing down the Court of Appeal Judgment, the Court of Appeal overturned the High Court’s decision to quash the LME’s implementation of the 2013 LILO Rule. The Court of Appeal has denied Rusal leave to appeal to the Supreme Court and has also denied Rusal’s request to stay the Court of Appeal’s setting aside of the High Court’s decision to quash the adoption of the 2013 LILO Rule.
 9. Given that the LILO Rule is substantially the same as the 2013 LILO Rule (save for some minor clarifications and date adjustments), the LME does not have a regulatory or public law obligation to re-consult with the market – that obligation was discharged by the 2013 Consultation. However, under clause 9.11.4 of the warehouse agreement, the LME is obliged to consult with warehouse companies for a “reasonable period” prior to the introduction of any proposed change would have the effect of materially increasing the obligations of any warehouse (which would include the LILO Rule). The LME believes that a two week consultation period on the LILO Rule is reasonable given that:
 - (a) it supplements the extensive three month consultation already held with market participants, including LME listed warehouses, during the 2013 Consultation on the 2013 LILO Rule; and
 - (b) the LILO Rule is substantially the same as the 2013 LILO Rule (save for some minor clarifications and date adjustments).

¹ An altered queue threshold.



10. The LME intends to implement the LILO Rule because it believes that it represents the most effective measure to address the issues referred to above, and because it is considered superior to other measures which have been considered by the LME, including those referred to in section 6.5.2 of the 2013 Consultation Report.

Current State of Queues

11. Based on publicly available commentary, the LME understands that market conditions have changed since the 2013 Consultation – with, in particular, a greater demand for metals (especially aluminium) from industry. However, the LME also understands that an element of primary production continues to flow into storage – and, in the absence of regulation by the LME, it is to be expected that a significant element of such production would have continued to be loaded into Affected Warehouses.
12. In particular, the LME believes that the behavioural change exhibited by Affected Warehouses since 1 July 2013 would not have come about had those warehouses not anticipated the introduction of some form of rule-making by the LME.
13. Furthermore, while queues at some warehouses have decreased significantly or disappeared entirely, the queues at Metro Detroit and Pacorini Vlissingen continue to entail long waiting times for the availability of metal, and the shrinkage of these queues cannot be guaranteed in the absence of the LILO Rule or other measures, given a market environment where at least some amount of metal production continues to flow to storage. As a result, the LME believes that the current market conditions and persistence of significant queues still warrants the adoption of the LILO Rule to address the queues.
14. For more information on the current state of queues and market conditions, please see paragraphs 9-18 in Notice 14/276 : A268 : W136 (the “September Update Notice”).

The LILO Rule - Minor Clarifications and Timing Adjustments to the 2013 LILO Rule

15. The LME is proposing the LILO Rule in substantially the same form as the 2013 LILO Rule, with certain minor modifications. The LME believes the LILO Rule represents an appropriately-balanced course of action for the market.
16. The full form of the proposed LILO Rule is set out in the attachment to this notice, as part of the revised Policy on the Approval of Warehouses. Attached to this notice is a clean copy of the proposed revised Policy and also a version showing the changes against the version of the Policy currently in force.
17. The key changes to note from the 2013 LILO Rule announced on 7 November 2013 are as follows:
 - (a) minor clarificatory change to make clear that “Decay Factor” is 0.5 and the “Queue Threshold” is 50 days;
 - (b) minor changes indicating which text denotes defined terms in paragraphs 2, 3 and 4 of Section F;



- (c) the Preliminary Calculation Period shall be the period between 1 July 2013 and 31 January 2015, inclusive;
- (d) the First Calculation Period shall be the period between 1 February 2015 and 30 April 2015 inclusive;
- (e) each subsequent Calculation Period shall be the three months immediately following the preceding Calculation Period. By way of example, the Second Calculation Period shall be the period between 1 May 2015 and 31 July 2015, inclusive (being the three months immediately following the First Calculation Period);
- (f) the Preliminary Discharge Period, which will apply in relation to the Preliminary Calculation Period, will be the three month period between 1 March 2015 and 31 May 2015, inclusive;
- (g) the First Discharge Period and subsequent Discharge Periods are set by reference to the adjusted Calculation Periods;
- (h) the definition of Normal Daily Minimum Load Out Rate has been clarified;
- (i) clarificatory drafting changes have been made to paragraph 4 of Section F, including (i) the introduction of the terms “Incremental Load-Out Requirement” and “Cumulative Incremental Load-Out Quantity” in order to simplify interpretation, (ii) replacement of the terms “Total Load-In” and “Total Normal Minimum Load-Out” by “Cumulative Load-In” and “Cumulative Normal Minimum Load-Out” respectively (these were typographical errors from the 2013 LILO Rule), and (iii) general drafting changes. The substance of the Rule has not been altered as a result of these changes;
- (j) minor clarificatory drafting changes have been made to paragraph 5 of Section F, to clarify that the obligation to load out the Incremental Load-Out Requirement is in addition to the load-out obligations in accordance with Section C of the Policy;
- (k) a provision has been added at paragraph 6 of Section F allowing the LME to adjust the Decay Factor and/or Queue Threshold either on a market-wide basis or on a per-warehouse basis in order to enhance the orderly functioning of the market or to prevent abusive behaviour or for any other reason. This power was noted in the Decision Notice dated 7 November 2013, but it is now considered preferable for it to be explicit within the Policy; and
- (l) minor changes have been made to the worked example of the calculation at paragraph 7 of Section F to reflect the changes above.

Timing and steps of implementation

18. Subject to the consultation, the proposed timeline for implementation of the LILO Rule is as follows:



- (a) 8 October 2014 - two week consultation with warehouse companies on the LILO Rule commences;
- (b) Not later than 31 October 2014 - decision announced and market given not less than 90 days' notice ahead of implementation of LILO Rule; and
- (c) 1 February 2015 - LILO Rule implementation date.

Responding to the Consultation

19. The LME seeks the views of warehousing companies in respect of the LILO Rule. Responses to the consultation should be made in writing by email to Georgina Hallett (consultation@lme.com), no later than close of business on **22 October 2014**. Responses made after this date will not be taken into consideration. Alternatively, or in addition, the LME will make itself available during this period for reasonable requests for meetings with warehouse companies in person at the LME or by teleconference.
20. Following due consideration, the LME may either:
- (a) implement the LILO Rule;
 - (b) implement a modified version of the LILO Rule; or
 - (c) not implement the LILO Rule.
21. The LME may need to share responses received with regulatory authorities or its legal or other professional advisers, or as required by law. Apart from this, all responses received will be treated in confidence.

Next Steps

22. As further described in the September Update Notice, and following the announcement of the outcome of this consultation, the LME will publish further information in respect of the other items it has committed to discuss with the market, namely (i) re-assessing the possibility of capping or banning rents in queues, (ii) re-assessing the possibility of capping the level of daily rents and FoTs, (iii) the warehousing logistical review, (iv) the warehouse agreement legal review, and (v) the rules required to support premium futures contracts.
23. In particular, certain of these other items will give rise to a market-wide consultation on further warehouse reforms, including further changes to the Policy on Approval of Warehouses. This may involve further minor changes to the LILO Rule (for example, but without limitation, if defined terms are introduced across the Policy for consistency), but the LME does not envisage (subject to comments received during the consultation with warehouse companies instigated by this Notice) making further substantive amendments to the LILO Rule as a result of the consultation.



Matthew Chamberlain
Head of Business Development

cc: Board directors

User Committee
Physical Market Committee
Warehousing Committee
All metals committees

Attachment –

Proposed Policy on Approval of Warehouses including the LILO Rule (clean copy and blackline against version currently in force)