

Procurement Guidelines Statement UK Transmission

April 2008 version 7.0

PROCUREMENT GUIDELINES STATEMENT Modification

Modification Reference Number	Date of Implementation	Notes
Housekeeping Part B Section 1	April 2008	Clarification of National Grid NTS GT Licence conditions relevant to Procurement Guidelines and System Management Services

PROCUREMENT GUIDELINES STATEMENT

Document Revision History

Version/ Revision Number	Date of Issue	Notes
V1.0	2 nd October 2002	First Version
V2.0	1 st April 2003	Incorporated annual revisions, including updates to information provision and contact names and addresses.
V3.0	1 st April 2004	Incorporated annual revisions, including updates to contact names and addresses. Also, minor textual clarifications.
V4.0	1 st April 2005	Modified to incorporate Mod 0710 and housekeeping changes.
V5.0	19 th July 2005	Housekeeping changes
V6.0	1 st April 2006	Housekeeping changes (National Grid rebrand)
V7.0	1 st April 2008	Annual review as required by National Grid GT Licence Special Condition C5.3 Housekeeping changes.

CONTENTS

	Page
PART A: INTRODUCTION	4
1. Purpose of Document	4
2. National Grid NTS Performance	5
3. Change Process	5
PART B: GENERAL PRINCIPLES	6
1. System Management Services	6
1.1 Trading Systems	6
1.2 Other System Management Services	7
2. Procurement Principles	7
3. Tool Usage	8
PART C: SYSTEM MANAGEMENT SERVICES REQUIRED	10
1. Types of System Management Services	10
2. Description of System Management Services	10
2.1 Use of Services	10
2.2 Procurement & Trading Arrangements	10
PART D: PROCUREMENT MECHANISMS	12
1. Procurement Process	12
1.1 Physical Service Provision	12
1.2 Other Service Provision	13
2. Credit Risk	13
3. Information Release	14
3.1 Tender Processes	14
3.2 Procurement Guidelines Report	15
3.3 Other Procurement Processes	15
4. Procurement Communication Media	15
5. Procurement Summary	16
PART E: INFORMATION PROVISION	18
1. General Provisions	18
2. Information Provision Contacts	18
3. Information Provision Detail	18
4. Disclaimer	18

PART A: INTRODUCTION

1. Purpose of Document

This document sets out the Procurement Guidelines (“the Guidelines”) which National Grid Gas is required to establish in accordance with Special Condition C5 (the Special Condition) of the National Grid NTS Gas Transporter (GT) Licence (the Licence). The purpose of the Guidelines is to set out the kinds of System Management services/tools which might have a role in respect of gas, energy and/or capacity management associated with National Grid NTS’s National Transmission System, that National Grid NTS might be interested in buying and selling in pursuance of its System Management role.

The Guidelines cannot cover every possible situation that National Grid NTS is likely to encounter, but rather, represents a generic statement of the procurement principles it expects to follow and an appreciation of the sorts of tools it might wish to develop and utilise from time to time.

The Guidelines make reference to a number of definitions contained in the Uniform Network Code (UNC). In the event that any of the relevant provisions in the UNC are amended it may become necessary to modify the Guidelines in order that they remain consistent with the UNC.

In any event, where statutory obligations or the provisions of the UNC are considered inconsistent with any part of these Guidelines, then the relevant statutory obligation and/or UNC provision will take precedence.

Unless defined in the Guidelines, terms used herein shall have the same meanings given to them in the National Grid NTS GT Licence or, the UNC as the case may be.

The latest version of this document is available electronically from the National Grid website.

Alternatively a copy may be requested from:

Ritchard Hewitt
Gas Code Development Manager
National Grid
Warwick
CV34 6DA
Tel. 01926 655861
E-mail: ritchard.hewitt@uk.ngrid.com

Previous versions of the Procurement Guidelines will be held for reference purposes by the above contact.

2. National Grid NTS Performance

In relation to responding to the SO incentive schemes and performing functions described in this document, National Grid NTS will seek at all times to follow the guidelines contained within and shall seek to act in good faith and in a reasonable and prudent manner in its dealings save to the extent that:

- there is any standard of performance already provided for by any statute, regulation or Licence condition to which National Grid NTS is subject; or
- the continued exercise of the discretions or functions described herein could cause National Grid NTS, in its reasonable opinion, to come into conflict with any provision of statute, the Licence or other regulation.

The Licence imposes on National Grid NTS an obligation to operate the system in an efficient, economic and co-ordinated manner. Ofgem has indicated that it would expect the obligation to be satisfied where National Grid NTS is responding to the commercial incentives in its SO incentive schemes. However Ofgem has indicated that the behaviour of National Grid NTS should be appropriately constrained by the economic, efficient and coordinated obligation, for example, when its commercial incentives are no longer considered to be effective - such as when revenues relating to one or more incentive schemes are, or are expected to be, either greater than the incentive cap or lower than the incentive collar.

3. Change Process

The Guidelines have been developed by National Grid NTS and the form of the Guidelines has been approved by the Authority. It may only be modified in accordance with the processes set out in Special Condition C5 of the GT Licence. National Grid NTS will monitor the operation and application of the Guidelines and it is the intention of National Grid NTS that it will meet with Users on a periodic basis to review the operation of the Guidelines and, where appropriate, to consider modifications to the Guidelines.

The Guidelines make reference to a number of provisions contained in the UNC. In the event that any of the relevant provisions in the UNC are modified it may become necessary for National Grid NTS to seek an amendment to the Guidelines in order that it remains consistent with the UNC. Prior to any such amendment the UNC shall take precedence over the Guidelines.

For the avoidance of doubt, these Guidelines do not form part of the UNC.

PART B: GENERAL PRINCIPLES

1. System Management Services

The services that National Grid NTS needs to procure in order to operate the National Transmission System constitute System Management Services.

Within National Grid's GT Licence (Special Condition C5) in respect of the NTS, System Management Services is defined as "*services in relation to the balancing of gas inputs to and gas offtakes from the NTS and includes balancing trades and balancing trade derivatives and constraint management services*". Furthermore, constraint management services is defined within the National Grid GT Licence (Standard Special Condition A5) as "*services in relation to the management of capacity rights*".

National Grid NTS also has an incentive structure contained within its GT Licence (Special Condition C8B) ("the SO Incentives") whereby it is incentivised to balance the NTS in an economic and efficient manner.

Such System Management Services may be provided from a variety of sources. For example National Grid NTS may access existing mechanisms or markets. This might be for example, via a Trading system or alternatively, it may be sourced through other contractual frameworks.

1.1 Trading Systems

Trading systems are defined as electronic trading mechanisms. National Grid NTS may have access to any trading system that may assist in the provision of services to support the National Grid NTS System Management role.

This could include access to markets and mechanisms operated by third parties as well as access to mechanisms that might be operated by National Grid NTS (e.g. UK Link Capacity system).

Such markets/mechanisms will enable the provision of services to National Grid NTS. For example, the on the day commodity market (OCM) operated by APX Gas Ltd is one such trading system.

National Grid NTS also envisages that, at least until any third party operated market is considered an acceptable alternative, it will provide a mechanism where Users are able to buy or sell capacity with National Grid NTS close to gas flow. This will provide National Grid NTS with a potential capacity management tool. Such a mechanism is currently provided by the UK Link Capacity System.

Such trading systems can be regarded as providing tools that can be used either close to or well in advance of the time of gas flow.

Where National Grid NTS transacts on Trading Systems provided by third

parties it will transact on exactly the same basis as other participants, including any provisions applicable in respect of credit arrangements and information release.

1.2 Other System Management Services

These services may be physically or financially based services or contracts.

These services may include:

- Forwards, futures and options contracts in respect of both gas (NBP or locational) and/or capacity and other derivatives
- storage or other gas facility based services
- supply/demand side management contracts.

Physically based services will be focused on enabling National Grid NTS to buy a right to physically adjust gas flows at points on or at either extremity of the system with the counterparty having an obligation to deliver such change. It is likely that such services will primarily be of interest to National Grid NTS in its System Management role and that few, if any, other industry players will have such requirements.

These services may be distinguished from financially based services where service provision is only likely to impact physical flows via indirect effects, if any. For example re-purchase of buy-back capacity or purchase/disposal of gas at the NBP.

2. Procurement Principles

When procuring System Management Services, National Grid NTS will apply the following principles:

- Without prejudice to the factors below and after having taken relevant price and operational differences into account, National Grid NTS shall contract for System Management Services in a manner that is consistent with the Competition Act and the statutory obligations of National Grid NTS.
- National Grid NTS will be influenced by the terms in its GT Licence relating to the SO incentive schemes and the economic, efficient and co-ordinated operation obligation.
- In contracting for the provision of System Management Services National Grid NTS will endeavour to purchase from the most economic and efficient sources available to National Grid NTS having regard to the attributes of such service and delivery, which may include assessed liquidity of the market, reliability, quality, quantity, location, lead time, deliverability, and diversity of such services at that time available.

In assessing the reliability of the service National Grid NTS will

consider, for example, the historical performance of the provider and an assessment of the prospective effectiveness of the procured service.

Where there is, or is likely to be in the future, sufficient competition in the provision of a System Management Service National Grid NTS would normally seek to procure that service via an appropriate competitive process (identified in Table 1) or market mechanism, as described in Part D of this document. In such instances National Grid NTS shall provide a statement indicating the processes and terms under which contracts will be awarded. Copies of these statements are available from the Information Provision Contact listed in Part E of this document.

- If National Grid NTS considers that there is insufficient competition in the provision of a System Management Service, or where National Grid NTS considers it to be more economic or efficient to do so, National Grid NTS may contract for such provision on a negotiated bilateral basis. National Grid NTS may wish to stimulate development of secondary markets by the use of bilateral contracts.
- If System Management Services of high value are required over a relatively long term, National Grid NTS will ordinarily advertise that requirement to market participants.

3. Tool Usage

The consideration of National Grid NTS whether to undertake actions within or outside of the trading systems will be based on an assessment of the level and cost of services expected to be available within such trading systems.

Contracts will be entered into to complement or substitute for trading system use when

- National Grid NTS anticipates there is insufficient service availability via the trading systems to meet requirements, or
- if National Grid NTS considers that such contracts will lead to a reduction in overall cost or a more favourable National Grid NTS and/or community risk profile, or
- to provide operational characteristics that are not available through the trading systems.

When considering what actions will be undertaken National Grid NTS will consider the use of all available System Management Services including forwards and options agreements.

When National Grid NTS considers it likely to lead to economic and efficient outcomes, it may elect to trade on any other market or mechanism available

to other market participants, or procure and trade any contract affording value arising from storage, gas, capacity, any related derivative or supply/demand management service, having regard to Special Condition C5 of its GT Licence.

PART C: SYSTEM MANAGEMENT SERVICES REQUIRED

1. Types of System Management Services

National Grid NTS is interested in procuring System Management Services to enable it to fulfil its statutory, regulatory and Licence obligations. Such procurement may include procurement in respect of satisfying requirements in respect of :

- Shrinkage
- Operating margins (System reserve)
- Entry and Exit Capacity Management
- Gas Balancing
- System Operation.

2. Description of System Management Services

2.1 Use of Services

National Grid NTS is encouraged to utilise a broad range of tools for system management purposes, taking account of Licence obligations, under a series of incentive schemes.

National Grid NTS's Licence obligation to operate an economic and efficient system implies it should be able to consider and deploy a range of tools including, but not limited to, any energy or capacity contracts forward/options and other related derivative products called both inside and outside of the OCM and UK Link capacity management mechanism or any other trading system that it might use.

National Grid NTS is prohibited from purchasing or otherwise trading energy/capacity except pursuant to the procurement or use of services in respect of facilitating balancing management and constraint management (as defined in Special Condition C4).

2.2 Procurement & Trading Arrangements

Reasons why National Grid NTS may buy or sell gas or capacity option/forward contracts or indeed any other tools that are developed subsequent to the approval of this document include:

- To manage the risk and exposure of the community and National Grid NTS to system management costs through the use of risk management tools and strategies.
- To provide additional and complementary contractual arrangements to meet requirements to maintain a safe and secure system using procured tools rather than undue dependence on tools secured close to the time of gas flow or administratively based approaches (where

appropriate). The services described above may fulfil this requirement providing either operational and/or financial risk mitigation for both the System Operator and system users.

- To reduce the total cost of system management of the transmission system compared with sole reliance upon prompt mechanisms. For example, if OCM and UK Link capacity management utilisation is anticipated it may be more economic to purchase or sell a volume of energy/capacity forward or on an option basis such that a reduced cost or more acceptable risk profile might be anticipated.
- To better manage the financial risks/rewards associated with system management.
- To enable commercial optimisation across different system management instruments in order to yield a lower total cost or improved risk/reward position.
- To access or develop greater liquidity in commodity markets and to promote new sources of flexibility.

PART D: PROCUREMENT MECHANISMS

1. Procurement Process

1.1 Physical Service Provision

Where National Grid NTS is involved in procuring physical services and sufficient competition exists, National Grid NTS will normally seek to contract for services via some form of market mechanism. In other circumstances, bilateral contracts may be entered into with the service providers. In all circumstances National Grid NTS will be mindful of its Licence obligations when entering into these agreements.

Use of Existing Markets/Mechanisms

Wherever an existing market or mechanism is available National Grid NTS will consider the use of such tools if appropriate. However National Grid NTS appreciates that where it requires physical services it is probable that National Grid NTS requirements are likely to be different from most other players and hence it may be the only player. As the sole purchaser, National Grid NTS may need to conduct a competitive procurement process.

Competitive Procurement Mechanisms

This will normally be a tender based process for the selection and award of service contracts. National Grid NTS might seek expressions of interest or consultation with potential service providers ahead of invoking formal tendering processes. The procurement process will normally include:

- a statement of service requirements;
- the issuing of invitation to tender documentation, which will endeavour to provide sufficient information to allow the provision of a service offer to be made, including standard contract terms and conditions;
- arrangements for governance of the process;
- a statement of principles and criteria that National Grid NTS will consider when evaluating the awarding of contracts.

Bilateral Contracts

Where National Grid NTS considers there is insufficient competition to generate an efficient tender outcome (taking into account locational factors where necessary, or because of special technical requirements of the desired service, or where some form of monopoly exists, or in view of the unique characteristics of certain individual providers) it may be appropriate to consider bilateral arrangements.

Where National Grid NTS considers there to be limited competition, National Grid NTS may:

- Contact those service providers believed to be capable of providing the required service or who have expressed an interest in providing the service in order to establish whether they wish to enter into a contract for the service in question; and
- Offer non-discriminatory terms for the acquisition of the service.

However, if there is insufficient time to identify and contact other providers, National Grid NTS reserves the right to contract as appropriate to meet system security requirements.

The use of bilateral contracts may be more efficient or economic or beneficial to long term service or market development. This may, for example, be due to special operational requirements of the desired service or where it may stimulate liquidity or interest in shippers offering services in the longer term.

National Grid NTS will engage with counterparties on a bilateral basis consistent with the Competition Act and its obligation to operate in an economic, efficient and coordinated manner.

Market Development

National Grid NTS will endeavour to play its part in developing markets, liquidity and standardised services and contracts where these are consistent with its obligations. This may involve attempts to stimulate the market through the development of bilateral contracts, as might be expected in emergent markets.

1.2 Other Service Provision

In many areas National Grid NTS will be transacting for services that essentially involve the purchase of a commodity, for example gas at the NBP, System Entry Capacity or storage capacity.

These are markets in which National Grid NTS is not expected to be dominant and National Grid NTS expects to trade in these markets in a similar way to other market players. National Grid NTS will therefore transact on exchanges, or via brokers or via any other means that other players use to buy or sell the commodity.

2. Credit Risk

National Grid NTS will evolve credit risk management strategies that may differ in respect of whether National Grid NTS faces full exposure, or whether it shares the exposure with Users.

Where National Grid NTS has, or is expected to face, full exposure then the credit risk policy will be a matter entirely for National Grid NTS.

Where National Grid NTS has a shared exposure, National Grid NTS will have a policy that is known to Users. From time to time National Grid NTS will seek views from the community as to the effectiveness and/or appropriateness of the policy. Such views will then inform the policy to be applied.

3. Information Release

3.1 Tender Processes

National Grid NTS would normally anticipate issuing information about tender processes in respect of services of a physical nature.

Additionally National Grid NTS has UNC obligations in respect of its activities in respect of procurement of services via Capacity Management Agreements.

This requirement extends to the provision of information in respect of a Contract Type (either Forwards or Options), Period, and ASEP combination for each tender process.

Data will be supplied in respect of contracts entered into as follows:

For Forward Contracts

ASEP	Period	Weighted Average Price	Aggregate Quantity Accepted

For Option Contracts

ASEP	Period	Weighted Average Option Price	Weighted Average Exercise Price	Aggregate Quantity Offered	No. of days on which option exercised

As a general principle where National Grid NTS is involved in competitive tender process, it would expect to publish information in a timely manner about the outcome of the tender process.

3.2 Procurement Guidelines Report

Additionally, National Grid NTS will provide an annual report during April detailing procurement outcomes in the previous year, as required under paragraph 4 of Special Condition C5 of National Grid NTS's Gas Transporter licence.

3.3 Other Procurement Processes

National Grid NTS believes that, as a general principle, it should have discretion as to whether it publishes information about the results of its procurement processes.

The assessment of National Grid NTS will be guided by considerations such as:

- The extent of competition known or considered likely to exist
- The normal practise within a particular market.

The extent of information release will be designed to encourage, in National Grid NTS's view, the most economic and efficient outcomes.

National Grid NTS believes that it should have similar flexibility and obligations as any other market player in respect to information provision. For example, where the market is largely conducted on the basis of bilateral trades National Grid NTS should be able to use such methods and have similar commercial freedom to any other player in respect of what information about its trading position is released. Similarly where National Grid NTS is transacting on third party Trading Systems, such participation will be on the basis of the same terms that would be available to any other user of that system.

Invoice Support

Sufficient information to establish basis for any charges will either be released to support invoiced amounts or made available to an industry or Ofgem appointed auditor to confirm the validity of the charges.

4. Procurement Communication Media

Wherever practical, and where consistent with economic and efficient operation, National Grid NTS shall communicate any service requirement by contacting those parties that it believes may be interested in providing the service, including any existing or past service providers, and anyone that has expressed a prior interest in providing such services in the future. In addition, notification of tenders will normally be advertised as appropriate.

5. Procurement Summary

This summary Table 1 sets out the System Management Services National Grid NTS expects or intends to procure and the mechanisms by which it expect to procure such services.

Table 1 SYSTEM MANAGEMENT SERVICES SUMMARY TABLE

SERVICES	ANTICIPATED APPLICATION	MEANS OF PROCUREMENT	TIMESCALES
SYSTEM MANAGEMENT SERVICES			
Energy (gas)	<ul style="list-style-type: none"> • Energy balancing • Capacity management • Shrinkage • Operating Margins 	<p>On the day Commodity Market (title, physical and locational)</p> <p>Over The Counter / brokered markets</p> <p>Other exchanges (e.g. ICE, IPE, Spectron Online)</p> <p>Tenders</p> <p>Bilateral agreements</p>	Ongoing
Capacity	<ul style="list-style-type: none"> • Capacity Management • (Energy Balancing) 	<p>UK Link capacity system</p> <p>Over The Counter / brokered markets</p> <p>Other exchanges (e.g. Spectron Online)</p> <p>Tenders</p> <p>Bilateral agreements</p> <p>Contracts derived from market tenders</p>	Ongoing

SERVICES	ANTICIPATED APPLICATION	MEANS OF PROCUREMENT	TIMESCALES
SYSTEM MANAGEMENT SERVICES			
Supply & Demand-side Management tools	<ul style="list-style-type: none"> • Capacity Management 	Bilateral agreements Contracts derived from market tenders	As required
Other Services	<ul style="list-style-type: none"> • Operating Margins 	Tenders Bilateral agreements Standard Contracts	As required
SYSTEM RESERVE			
Storage Services		Bilateral agreements Tenders Storage provider capacity auctions (where held)	As required
Operating Margins Gas		As Energy Above	Min Annual
Supply & Demand-side Management tools (including Interruption Services)	<ul style="list-style-type: none"> • Entry and exit capacity management • Energy balancing 	Bilateral agreements Tenders Standard Contracts	As required

PART E: INFORMATION PROVISION

1. General Provisions

National Grid NTS will normally publish information on the System Management Services that it intends to procure. In doing so National Grid NTS will seek to provide market participants and other interested parties with sufficient information whilst endeavouring not to compromise the commercial position of any contracting party, including National Grid NTS.

2. Information Provision Contacts

All queries regarding the provision of System Management Services National Grid NTS intends to procure should be made, in the first instance, to:

Ritchard Hewitt
Gas Code Development Manager
National Grid
Warwick
CV34 6DA
Tel. 01926 655861
E-mail: ritchard.hewitt@uk.ngrid.com

3. Information Provision Detail

In circumstances where tenders are held National Grid NTS will publish, where appropriate, information on the outcome of these processes via market reports, which are available on the National Grid website:

<http://www.nationalgrid.com/uk/Gas/OperationalInfo/operationaldocuments/ProcurementSystemManagementServicesStatementsReports/>

4. Disclaimer

All information published or otherwise made available to market participants and other interested parties pursuant to these Procurement Guidelines is done so in good faith. However, no warranty or representation is given by National Grid NTS, its officers, employees or agents as to the accuracy or completeness of any such information, nor is any warranty or representation given that there are no matters material to any such information not contained or referred to therein. Accordingly, no liability can be accepted for any error, misstatement or omission in fraudulently.