

Procurement Guidelines Statement UK Transmission

2013 – 2014

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22 January 2013

Version **12.0**

Deleted: 10 March 2012

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PROCUREMENT GUIDELINES STATEMENT

Relevant UNC Modification Proposals

| Modification Reference Number | Date of Implementation | Notes |
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Deleted: 195AV
 Deleted: 1st April 2009
 Deleted: Introduction of Enduring Exit Capacity Arrangements

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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. |
| V8.0 | 18 th March 2009 | Annual review as required by National Grid GT Licence Special Condition C5.3 Updated table 1 (p15) as a result of the implementation of Modification Proposal 0240 |
| V9.0 | 15 th March 2010 | Annual review as required by National Grid GT Licence Special Condition C5.3 |
| V10.0 | 15 th March 2011 | Annual review as required by National Grid GT Licence Special Condition C5.3 |
| V11.0 | 15 th March 2012 | Annual review as required by National Grid GT Licence Special Condition C5.3 |

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| <u>V12.0</u> | <u>22 January 2013</u> | <u>Annual review as required by National Grid GT Licence Special Condition C5.3</u> |
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PART A: INTRODUCTION

1. Purpose of Document

This document sets out the Procurement Guidelines (“the Guidelines”) which National Grid Transmission (NGT) is required to establish in accordance with Special Condition C5 (the Special Condition) of the NGT Gas Transporter Licence (the Licence). The purpose of the Guidelines is to provide information on the System Management services and tools that NGT may procure pursuant to its System Management role. The Guidelines cannot cover every possible situation that NGT may encounter, but represent a generic statement of the procurement principles and tools that the company will use in respect of gas, energy and/or capacity management.

Unless defined in the Guidelines, terms used herein shall have the same meanings given to them in the Licence or the UNC. 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.

The latest version of this document is available electronically from the National Grid website, alternatively a copy may be requested from:

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

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

2. National Grid Transmission Performance

In following the guidelines detailed in this document, NGT will seek at all times 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 NGT is subject; or
- the continued exercise of the discretions or functions described herein could cause NGT, in its reasonable opinion, to come into conflict with any provision of statute, the Licence or other regulation.

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The Licence imposes on NGT an obligation to operate the system in an efficient, economic and co-ordinated manner. Ofgem has indicated that it would expect this obligation to be satisfied where NGT is responding to the commercial incentives in its SO incentive schemes. However where these commercial incentives are no longer considered to be effective, such as when revenues relating to one or more incentive schemes have, or are expected to have, reached a cap or collar, Ofgem has indicated that it would expect the behaviour of NGT to be constrained by the Licence condition.

3. Change Process

The Guidelines have been developed by NGT and the form of the Guidelines has been approved by the Authority. The Guidelines may only be modified in accordance with the processes set out in Special Condition C5 of the Licence. NGT will monitor the operation and application of the Guidelines and, where appropriate, periodically meet with Users to review the Guidelines and consider modifications.

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 NGT to seek an amendment to the Guidelines in order that it remains consistent with the UNC. Where the provisions of the UNC are inconsistent with any part of the Guidelines, the UNC will take precedence. For the avoidance of doubt, these Guidelines do not form part of the UNC.

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PART B: GENERAL PRINCIPLES

1. System Management Services

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

Special Condition C5 defines System Management Services 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 are defined as “*services in relation to the management of capacity rights*”. NGT also has an incentive structure contained within its 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 via trading systems or contractual frameworks.

1.1 Trading Systems

Trading systems are defined as electronic trading mechanisms. NGT may have access to any trading system that may assist it in the provision of services to support the System Management role. Such services could include access to markets and mechanisms operated by third parties (e.g. the On-the-day Commodity Market operated by APX Gas Ltd.), as well as access to mechanisms that might be operated by NGT. 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 NGT 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, and 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 NGT to buy a right to physically adjust gas flows at points on the system with the counterparty having an obligation to deliver such change.

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

2. Procurement Principles

When procuring System Management Services, NGT will apply the following principles:

- Without prejudice to the factors below, and after having taken relevant price and operational differences into account, NGT shall contract for System Management Services in a manner that is consistent with the Competition Act and the statutory obligations of NGT.
- NGT will be influenced by the terms in its 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, NGT will endeavour to purchase from the most economic and efficient sources available at that time, 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.
- In assessing the reliability of the service NGT 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, NGT would 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 NGT 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 NGT considers that there is either insufficient competition in the provision of a System Management Service or there is a more economic or efficient option, NGT may contract for such provision on a negotiated bilateral basis. NGT 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, NGT will ordinarily advertise that requirement to market participants.

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3. Tool Usage

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

When NGT considers it likely to lead to economic and efficient outcomes it may elect to trade on any 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 the Licence.

The consideration of NGT 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:

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

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PART C: SYSTEM MANAGEMENT SERVICES REQUIRED

1. Types of System Management Services

NGT requires System Management Services to enable it to fulfil its statutory, regulatory and Licence obligations in respect of :

- Shrinkage
- Operating margins
- Entry and Exit Capacity Management
- Gas Balancing
- System Operation

2. Description of System Management Services

2.1 Use of Services

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

NGT'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, UK Link NTS capacity management mechanism or any other trading system.

NGT 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

NGT may use any existing or future tools, including the buying or selling of gas and capacity option/forward contracts, to:

- Manage the risk and exposure of the community and NGT to system management costs through the use of risk management tools and strategies;
- Provide additional and complementary contractual arrangements to maintain a safe and secure system whilst avoiding undue dependence on prompt mechanisms. The services described above may fulfil this requirement providing either operational and/or financial risk mitigation for both the System Operator and Users.
- Reduce the total cost of system management of the transmission system and enable commercial optimisation across different system

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management instruments. For example, if it is anticipated before the gas day that capacity management actions are likely, it may be more economic and efficient to use forward or options contracts than waiting until the gas day and using a prompt mechanism.

- Better manage the financial risks/rewards associated with system management.
- To access or develop greater liquidity in commodity markets and to promote new sources of flexibility.

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PART D: PROCUREMENT MECHANISMS

1. Procurement Process

1.1 Physical Service Provision

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

1.2 Use of Existing Markets/Mechanisms

Wherever an existing market or mechanism is available NGT will consider the use of such tools if appropriate. However for physical services NGT's requirements are likely to be different from most other players, and hence there may not be an economic market or mechanism available, and therefore NGT may need to conduct a competitive procurement process.

1.3 Competitive Procurement Mechanisms

This will normally be a tender based process for the selection and award of service contracts. NGT may seek expressions of interest or consult 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 NGT will consider when evaluating the awarding of contracts.

1.4 Bilateral Contracts

Where NGT considers there is insufficient competition to generate an efficient tender outcome (taking into account any locational factors, special technical requirements, unique characteristics of individual providers or where some form of monopoly exists) it may be appropriate to consider bilateral arrangements.

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Where NGT considers there to be limited competition, NGT 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, NGT reserves the right to contract as appropriate to meet system security requirements.

In addition to this, where NGT considers that the use of bilateral contracts may be more efficient and economic, or are anticipated to enhance market development and hence competition in the longer term, bilateral contracts may be used. These contracts will be entered into consistent with the Licence and its obligation on NGT to operate in an economic, efficient and coordinated manner.

1.5 Market Development

NGT will endeavour to develop 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.

1.6 Other Service Provision

In many areas NGT will be transacting for services that involve the purchase of a commodity, for example gas at the NBP or storage capacity. These are markets in which NGT is not expected to be dominant, and therefore NGT expects to trade in these markets in a similar way to other market participants. NGT will therefore transact on exchanges, or via brokers or any means available to other parties, to buy or sell the commodity.

2. Credit Risk

NGT will evolve credit risk management strategies that may differ in respect of whether NGT faces full exposure, or whether it shares the exposure with Users. Where NGT has, or is expected to face, full exposure then the credit risk policy will be a matter entirely for NGT. Where NGT has a shared exposure, NGT will have a policy that is known to Users. From time to time NGT 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.

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3. Information Release

3.1 Tender Processes

NGT anticipates issuing information about tender processes for System Management services to the industry. Additionally, NGT has UNC obligations in respect of procurement of services via Capacity Management Agreements, and this extends to the provision of information in respect of a Contract Type (either forwards or options), Period, and ASEP / NTS Exit Point combination for each competitive tender process.

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

3.2 Procurement Guidelines Report

NGT will provide an annual report during April detailing procurement outcomes in the previous year, as required under paragraph 4 of Special Condition C5 of the Licence.

3.3 Other Procurement Processes

NGT believes that, as a general principle, it should have discretion as to whether it publishes information about the results of procurement processes not covered by sections 3.1 or 3.2 of these Guidelines. For example, where the market is largely conducted on the basis of bilateral trades, NGT should be able to use such methods and have similar commercial freedom as any other player regarding its trading position. Similarly, where NGT 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.

The assessment of NGT as to whether or not to publish the results of its other procurement processes will consider:

- The extent of competition known or considered likely to exist in the market;
- The normal practise of users within the market.

The extent of information release will be designed to encourage, in NGT's view, the most economic and efficient outcome.

3.4 Invoice Support

Notwithstanding the above, sufficient information to establish the basis for any charges and to support invoiced amounts will either be released to the industry or made available to a suitably appointed auditor to confirm the validity of the charges.

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4. Procurement Communication Media

Wherever practical, and where consistent with economic and efficient operation, NGT 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

Table 1 sets out the System Management Services NGT expects or intends to procure and the mechanisms by which it expects to procure them.

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Table 1 - SYSTEM MANAGEMENT SERVICES SUMMARY TABLE:

| SERVICES | MEANS OF PROCUREMENT |
|---|--|
| Gas Balancing | On the day Commodity Market (title, physical and locational) Over The Counter / brokered markets Other exchanges (e.g. ICE, IPE, Spectron Online) Tenders Bilateral agreements |
| Entry and Exit Capacity Management | UK Link system Over The Counter / brokered markets Other exchanges (e.g. Spectron Online) Tenders Bilateral agreements Contracts derived from market tenders |
| Shrinkage | Over The Counter / brokered markets / other exchange Bilateral agreements |
| System Operation | Tenders Bilateral agreements Standard Contracts |
| Operating Margins Gas | Over The Counter / brokered markets Bilateral agreements Tenders |

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PART E: INFORMATION PROVISION

1. General Provisions

NGT will normally publish information on the System Management Services that it intends to procure. In doing so NGT will seek to provide market participants and other interested parties with sufficient information without compromising the commercial position of any contracting party, including NGT.

2. Information Provision Contacts

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

Ritchard Hewitt
 EU and GB 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, NGT will publish 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 NGT, 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.

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