

Procurement Guidelines Statement

UK Transmission

2010 – 2011

PROCUREMENT GUIDELINES STATEMENT

Relevant UNC Modification Proposals

Modification Reference Number	Date of Implementation	Notes
0240 – Promoting Competition in Operating Margins Provision	16 Feb 2009	Revision to Section K - Operating Margins to extend the definition to non-LNG sources

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

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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 Licence (the Licence). The purpose of the Guidelines is to provide information on the System Management services and tools that National Grid NTS may procure pursuant to its System Management role . The Guidelines cannot cover every possible situation that National Grid NTS 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:

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

2. National Grid NTS Performance

In following the guidelines detailed in this document, National Grid NTS 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 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 this obligation to be satisfied where National Grid NTS 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 National Grid NTS to be constrained by the Licence condition.

3. Change Process

The Guidelines have been developed by National Grid NTS 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. National Grid NTS 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 National Grid NTS 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.

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.

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*”. National Grid NTS 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. National Grid NTS 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 National Grid NTS (e.g. 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, 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 National Grid NTS to buy a right to physically adjust gas flows at points on 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 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 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 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 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 either insufficient competition in the provision of a System Management Service or there is a more economic or efficient option, 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

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 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 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
- National Grid NTS considers that such contracts will lead to a reduction in overall cost or a more favourable risk profile for the community and/or National Grid NTS, or
- National Grid NTS considers that the required operational characteristics are not available through the trading systems.

PART C: SYSTEM MANAGEMENT SERVICES REQUIRED

1. Types of System Management Services

National Grid NTS requires System Management Services to enable it to fulfil its statutory, regulatory and Licence obligations 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, UK Link capacity management mechanism or any other trading system.

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

National Grid NTS 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 National Grid NTS 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 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 a forward or option 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.

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 a 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.

1.2 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 for physical services National Grid NTS' requirements are likely to be different from most other players, and hence there may not be an economic market or mechanism available, and therefore National Grid NTS 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. National Grid NTS 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 National Grid NTS will consider when evaluating the awarding of contracts.

1.4 Bilateral Contracts

Where National Grid NTS 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.

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.

In addition to this, where National Grid NTS 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 National Grid NTS to operate in an economic, efficient and coordinated manner.

1.5 Market Development

National Grid NTS 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 National Grid NTS will be transacting for services that 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 therefore National Grid NTS expects to trade in these markets in a similar way to other market participants. National Grid NTS will therefore transact on exchanges, or via brokers or any means available to other parties, 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 anticipates issuing information about tender processes for System Management services to the industry. Additionally, National Grid NTS 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 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 it would expect to publish information in a timely manner about the outcome of the 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 the 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

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, National Grid NTS should be able to use such methods and have similar commercial freedom as any other player regarding its trading position. 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.

The assessment of National Grid NTS 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 National Grid NTS'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.

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

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

Table 1 - SYSTEM MANAGEMENT SERVICES SUMMARY TABLE:

	SERVICES	ANTICIPATED APPLICATION	MEANS OF PROCUREMENT	TIMESCALES
SYSTEM MANAGEMENT SERVICES	Energy (gas)	Energy balancing Capacity management Shrinkage Operating Margins	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	Ongoing
	Capacity	Capacity Management (Energy Balancing)	UK Link capacity system Over The Counter / brokered markets Other exchanges (e.g. Spectron Online) Tenders Bilateral agreements Contracts derived from market tenders	Ongoing
	Supply & Demand-side Management tools	Capacity Management	Bilateral agreements Contracts derived from market tenders	As required
	Other Services	Operating Margins	Tenders Bilateral agreements Standard Contracts	As required
SYSTEM RESERVE	Energy (gas)	N/A	Bilateral agreements Tenders Capacity auctions (where held)	As required
	Operating Margins Gas	N/A	As Energy above	Min Annual
	Supply & Demand-side Management tools (including Interruption Services)	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 without compromising 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 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.