



# **Procurement Guidelines for Distribution**

Version 5.0 March 2009

**PROCUREMENT GUIDELINES PRINCIPLES STATEMENT**  
**Modification History**

<b>Modification Reference Number</b>	<b>Date of Implementation</b>	<b>Notes</b>
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# **PROCUREMENT GUIDELINES STATEMENT**

## **Document Revision History**

<b>Version/ Revision Number</b>	<b>Date of Issue</b>	<b>Notes</b>
V1.0	1 May 2005	First Version
V2.0	March 2006	The words "and exit" added in Part C 1.
V3.0	March 2007	Table 1 – Uniform included in Network Code Changes to NGN address in PART E 2.
V4.0	March 2008	Document updated to note new Interruption Regime.
V5.0	March 2009	Updated Contact Details in PART E 2 to reflect NGN internal structure

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**PART A**

# **PART A: INTRODUCTION**

## **1. Purpose of Document**

This document sets out the Procurement Guidelines (“the Guidelines”) which Northern Gas Networks is required to establish in accordance with Standard Special Condition D5 (the Special Condition) of its Gas Transporters (GT) Licence (the Licence). The purpose of the Guidelines is to set out the kinds of Constraint Management services/tools which might have a role in respect of gas, energy and/or capacity management associated with Northern Gas Networks pipe-line System, which Northern Gas Networks may be interested in buying and selling in pursuance of its Constraint Management role.

The Guidelines cannot cover every possible situation that Northern Gas Networks is likely to encounter, but rather represent 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.

For the avoidance of doubt the Guidelines refer to the DN’s system balancing role and do not include energy balancing activities.

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

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

Unless defined in the Guidelines, terms used herein shall have the same meanings given to them in its GT Licence or Network Code as the case may be. The latest version of this document is available electronically from the Northern Gas Networks website at [www.northerngas.co.uk](http://www.northerngas.co.uk) . Alternatively a copy can be requested from Alex Wiseman, Regulation Director, Northern Gas Networks, 1100 Century Way, Thorpe Business Park, Colton, Leeds LS15 8ZA.

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

## **2. Northern Gas Networks Performance**

In relation to responding to the DN incentive schemes and performing functions described in this document, Northern Gas Networks 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 Northern Gas Networks is subject; or
- the continued exercise of the discretions or functions described herein could cause Northern Gas Networks, in its reasonable opinion, to come into conflict with any provision of statute, the Licence or other regulation.

The Licence imposes on Northern Gas Networks 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 Northern Gas Networks is responding to the commercial incentives in its SO incentive schemes. However Ofgem has indicated that Northern Gas Networks behaviour should be appropriately constrained by the economic, efficient and coordinated obligation, for example, when its commercial incentives are not biting - 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 Northern Gas Networks 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 the Special Condition. Northern Gas Networks will monitor the operation and application of the Guidelines and it is Northern Gas Networks intention 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 Network Code. In the event that any of the relevant provisions in the Network Code are modified it may become necessary for Northern Gas Networks to seek an amendment to the Guidelines in order that it remains consistent with the Network Code. Prior to any such amendment the Network Code shall take precedence over the Guidelines.

For the avoidance of doubt, the Guidelines do not form part of the Network Code.

## **PART B: GENERAL PRINCIPLES**

### **1. Constraint Management Services**

The services that Northern Gas Networks needs to procure in order to operate its Distribution pipe-line system constitute Constraint Management Services.

Such services may be provided from a variety of sources. For example Northern Gas Networks may access existing mechanisms or markets. This might for example be via a Trading system or alternatively it may be via other contractual frameworks.

#### **1.1 Trading Systems**

Trading systems are defined as electronic trading mechanisms. Northern Gas Networks may have access to any trading system that may assist in the provision of services to support the Northern Gas Networks Constraint 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 Northern Gas Networks.

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

Where Northern Gas Networks 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 Constraint Management Services**

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

These services may include:

- Capacity services at entry or exit from the network
- Storage or other gas facility based services
- Demand side management contracts.

Physically based services will be focused on enabling Northern Gas Networks 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 Northern Gas Networks in its Constraint Management role and that few, if any other industry players will have such requirements.

## 2. Procurement Principles

When procuring Constraint Management Services, Northern Gas Networks will apply the following principles:

- Without prejudice to the factors below and after having taken relevant price and operational differences into account, Northern Gas Networks shall contract for Constraint Management Services in a manner that is consistent with the Competition Act and Northern Gas Networks statutory obligations.
- Northern Gas Networks will be influenced by the terms in the Licence relating to the SO incentive schemes and the economic, efficient and co-ordinated operation obligation.
- In contracting for the provision of Constraint Management Services Northern Gas Networks will endeavour to purchase from the most economic and efficient sources available to Northern Gas Networks having regard to the attributes of such service and deliver.
- In assessing the reliability of the service Northern Gas Networks 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 Constraint Management Service Northern Gas Networks 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 Northern Gas Networks 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 Northern Gas Networks considers that there is insufficient competition in the provision of a Constraint Management Service, or where Northern Gas Networks considers it to be more economic or efficient to do so, Northern Gas Networks may contract for such provision on a negotiated bilateral basis. Northern Gas Networks may wish to stimulate development of secondary markets by the use of bilateral contracts.
- If Constraint Management Services of high value are required over a relatively long term, Northern Gas Networks will ordinarily advertise that requirement to market participants.

## 3. Tool Usage

Northern Gas Networks consideration of 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

- Accessing services prescribed in Network Code, or



- Northern Gas Networks anticipates insufficient service availability via the trading systems to meet system security requirements, or
- if Northern Gas Networks considers that such contracts will lead to a reduction in overall cost or a more favourable Northern Gas Networks 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 Northern Gas Networks will consider the use of all available Constraint Management Services including forwards and options agreements.

When Northern Gas Networks 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 the Special Condition.

## **PART C: CONSTRAINT MANAGEMENT SERVICES REQUIRED**

### **1. Types of Constraint Management Services**

Northern Gas Networks is interested in procuring Constraint 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:-

- DN Entry Capacity Management
- Storage
- Interruption.

### **2. Description of Constraint Management Services**

#### **2.1 Use of Services**

Northern Gas Networks is encouraged to utilise a broad range of tools for Constraint Management purposes, taking account of Licence obligations, under its incentive schemes.

Northern Gas Networks is prohibited from purchasing or otherwise trading energy/capacity except pursuant to the procurement or use of services in respect of facilitating procurement and constraint management (as defined in Standard Special Condition D4).

#### **2.2 Procurement & Trading Arrangements**

Reasons why Northern Gas Networks may buy or sell gas or procure capacity or indeed any other tools that are developed subsequent to the approval of this document include:

- To manage both the community and Northern Gas Networks exposure to Constraint 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 Constraint Management of the pipe-line system compared with sole reliance upon prompt mechanisms.
- To better manage the financial risks/rewards associated with Constraint Management.
- To enable commercial optimisation across different Constraint Management instruments in order to yield a lower total cost or improved risk/reward position.

## **PART C**

- To access or develop greater liquidity in commodity markets and to promote new sources of flexibility.
- To enable delivery of gas to networks and supply points connected to the Distribution system consistent with the Gas Safety Management Regulations under demand conditions as stipulated by the Licence.

## PART D: PROCUREMENT MECHANISMS

### 1. Procurement Process

#### 1.1 Physical Service Provision

Where Northern Gas Networks is involved in procuring physical services and sufficient competition exists, Northern Gas Networks 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 Northern Gas Networks 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 Northern Gas Networks will consider the use of such tools if appropriate. However Northern Gas Networks appreciates that where it requires physical services it is probable that Northern Gas Networks requirements are likely to be different from most other players and hence it may be the only player. As the sole purchaser, Northern Gas Networks 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. Northern Gas Networks 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 Northern Gas Networks will consider when evaluating the awarding of contracts.

#### Bilateral Contracts

Where Northern Gas Networks 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 Northern Gas Networks considers there to be limited competition, Northern Gas Networks 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, Northern Gas Networks 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.

Northern Gas Networks 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**

Northern Gas Networks 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. The implementation of UNC modification 0090 in April 2008 introduces a market mechanism for NGN to purchase site specific interruption services from Shippers operating within our network area.

### **1.2 Other Service Provision**

In many areas Northern Gas Networks will be transacting for services that essentially involve the purchase of a commodity, for example gas at the NBP.

These are markets in which Northern Gas Networks is not expected to be dominant and Northern Gas Networks expects to trade in these markets in a similar way to other market players. Northern Gas Networks 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**

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

Where Northern Gas Networks has, or is expected to face, full exposure then the credit risk policy will be a matter entirely for Northern Gas Networks.

Where Northern Gas Networks has a shared exposure, Northern Gas Networks will have a policy that is known to Users. From time to time Northern Gas Networks 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**

Northern Gas Networks would normally anticipate issuing information about tender processes in respect of services of a physical nature.

As a general principle where Northern Gas Networks 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**

Northern Gas Networks will provide an annual report during April detailing procurement outcomes in the previous year, as required under paragraph 4 of the Special Condition of its licence.

#### **3.3 Other Procurement Processes**

Northern Gas Networks believes that, as a general principle, it should have discretion as to whether it publishes information about the results of its procurement processes.

Northern Gas Networks assessment 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 Northern Gas Networks view, the most economic and efficient outcomes.

Northern Gas Networks believes 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 Northern Gas Networks 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 Northern Gas Networks 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, Northern Gas Networks 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 Constraint Management Services Northern Gas Networks expects or intends to procure and the mechanisms by which it expects to procure such services.

**Table 1 CONSTRAINT MANAGEMENT SERVICES SUMMARY TABLE**

SERVICES	ANTICIPATED APPLICATION	MEANS OF PROCUREMENT	TIMESCALES
<b>CONSTRAINT MANAGEMENT SERVICES</b>			
<b>Capacity</b>	<ul style="list-style-type: none"> <li>• NTS (Flat) Exit Capacity</li> <li>• NTS (Flexible) Capacity</li> <li>• Storage Services</li> </ul>	Uniform Network Code Arrangements  Tenders  Bilateral agreements	Ongoing
<b>Supply &amp; Demand-side Management tools</b>	<ul style="list-style-type: none"> <li>• Exit capacity management</li> </ul>	Uniform Network Code Arrangements	As required
<b>Interruption Services</b>	<ul style="list-style-type: none"> <li>• DN Interruption</li> </ul>	Tenders	Ongoing



## **PART E: INFORMATION PROVISION**

### **1. General Provisions**

Northern Gas Networks will normally publish information on the Constraint Management Services that it intends to procure. In doing so Northern Gas Networks 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 Northern Gas Networks.

### **2. Information Provision Contacts**

All queries regarding the provision of Constraint Management Services Northern Gas Networks intends to procure should be made, in the first instance, to:

Alex Wiseman  
Regulation Director  
Northern Gas Networks  
Thorpe Business Park  
1100 Century Way  
Colton  
Leeds  
LS15 8ZA

### **3. Information Provision Detail**

In circumstances where tenders are held Northern Gas Networks will publish, where appropriate, information on the outcome of these processes on its website.

### **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 Northern Gas Networks, 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.