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ANALYSIS OF THE UK GOVERNMENT'S REJECTION OF ZONAL ELECTRICITY PRICING UNDER REMA AND ITS IMPLICATIONS FOR MARKET DESIGN

Introduction

The UK electricity market is undergoing one of its most significant reform processes in decades under the Review of Electricity Market Arrangements (REMA), initiated in 2022 to ensure the system evolves in line with decarbonisation, affordability, and security of supply objectives. A key debate within REMA has been whether to adopt zonal pricing, a model in which electricity prices vary by region, to better reflect local supply-demand balances and grid constraints. On 10 July 2025, the UK Government officially rejected this option in its REMA Summer Update, opting instead to retain a national pricing model; while pursuing a series of reforms to improve locational signals and market efficiency. This analysis critically examines the rationale behind the decision, explores the core elements of the alternative reform strategy, and assesses the implications for electricity market design in the UK.

Evaluation of the Government's Decision and Alternative Reforms

Zonal pricing introduces regional variations in electricity prices based on network constraints and local demand, which can result in unpredictable revenue streams for generators, especially those with long-lived infrastructure projects such as offshore wind farms and transmission, connected solar farms. According to the REMA Summer Update, stakeholders expressed concern that changing zonal boundaries over time could introduce unacceptable levels of uncertainty into investment decisions, thereby deterring capital inflows into critical renewable and flexible generation assets. In the context of the UK's rapid decarbonisation goals, maintaining a stable and predictable investment environment is essential. By retaining a single national price, the government argues it can preserve revenue certainty for developers and provide a level playing field for participants across the country.

A key concern cited by the UK government was the issue of distributional fairness. Zonal pricing, by design, reflects regional grid constraints and supply-demand imbalances. While this leads to more efficient dispatch, it can also result in significantly higher prices for consumers in certain locations, particularly in congested or supplydeficient zones. The government referred to this outcome as a “postcode lottery,” warning that some regions could face long-term price disadvantages. Such disparities could be politically challenging, particularly at a time when household

energy bills remain a sensitive topic. In rejecting zonal pricing, the government positioned national pricing as a tool for preserving social cohesion and ensuring uniform access to electricity at equitable prices, regardless of geographic location.

Furthermore, the UK government considered the complexity and timescale involved in implementing a zonal pricing system. Transforming the current market structure into a zonal one would require extensive changes to market operations, including new pricing algorithms, settlement systems, and regulatory frameworks. The REMA documentation estimated that the full rollout of zonal pricing could take up to seven years, delaying the delivery of any efficiency gains, while introducing legal, operational, and policy risks. By contrast, the government argues that reforms within the current national framework can be deployed more rapidly, enabling the system to deliver near-term improvements without wholesale structural change.

Instead of zonal pricing, the government proposes a "Reformed National Pricing" approach that aims to strengthen local investment signals and operational efficiency, while maintaining a single national price. Central to this approach is the introduction of a Strategic Spatial Energy Plan (SSEP), to be developed by the Future System Operator (NESO). The SSEP will identify optimal locations for new generation, storage, and demand flexibility based on system needs, grid capabilities, and decarbonisation priorities. This planning process is intended to guide infrastructure investment in a way that addresses geographic imbalances without relying on price signals alone.

Additionally, the government has committed to reforming the Transmission Network Use of System (TNUoS) charges and connection charges—two key levers that already provide some locational signals. These reforms aim to

make charges more predictable, transparent, and consistent with long-term system planning objectives. For example, smoothing year-on-year TNUoS volatility and aligning charges with zones identified in the SSEP could create more coherent siting incentives for new projects. This reform is seen as a middle ground between preserving national price uniformity and enhancing locational efficiency.

Operational reforms also form a major pillar of the reformed pricing strategy. The government plans to lower the threshold for participation in the balancing mechanism, allowing more distributed and flexible assets to contribute to grid balancing. It also intends to introduce unit-based bidding, move towards real-time dispatch and notification systems, and consider shortening the imbalance settlement period from 30 minutes to 15 or even 5 minutes. These changes are designed to improve the responsiveness and accuracy of the market in managing supply and demand fluctuations, particularly as variable renewables become more dominant in the generation mix.

Finally, the strategy includes a series of interventions to reduce constraint costs, currently a major inefficiency in the system. Constraint payments are made to generators when the grid cannot accommodate their output, often because of transmission bottlenecks. These costs, which run into billions of pounds annually, are projected to grow as more renewable capacity comes online. The government proposes tackling this issue through faster grid buildout, greater coordination of local connections, and the inroduction of long-term contracts for flexible demand located behind grid constraints. These tools, while not market-based, are expected to achieve some of the same outcomes that zonal pricing would deliver, particularly in terms of relieving transmission congestion.

Implications for Market Design

1. Signal Accuracy and Investment Efficiency

By rejecting zonal pricing, the UK has chosen a model that places more weight on planned locational signals (via TNUoS and SSEP) rather than real-time market signals. While this avoids the volatility and fairness concerns of zonal pricing, it may deliver weaker price-based incentives for locating new capacity where it is most beneficial for the grid. This could undermine long-term network efficiency and increase system balancing costs unless network and planning reforms are highly effective and well-coordinated.

2. Investor Confidence and Regulatory Stability

The decision reduces regulatory uncertainty for current and prospective investors, particularly ahead of major developments such as the AR7 Contracts for Difference (CfD) auction. Developers now have greater confidence in the revenue environment, which supports investment continuity in offshore wind, solar, and battery storage. However, this comes at the cost of delaying or diluting deeper structural reform.

3. Operational and Cost Efficiency

Without zonal signals, operational improvements must come from reforms to balancing markets, constraint management, and system

forecasting. While the government's proposed changes represent meaningful steps, critics argue they may not match the cost-saving potential of zonal pricing—estimated by some stakeholders at £15 billion by 2040.

4. Equity vs. Efficiency Trade-offs

National pricing avoids regional disparities, which is politically attractive. However, it risks inefficient siting of assets and continued reliance on constraint payments. The long-term challenge will be ensuring that efforts to maintain fairness do not come at the cost of escalating inefficiencies and higher bills for all consumers.

5. Comparative Lag in Market Modernisation

The UK now diverges from several European and North American peers that are implementing zonal or nodal pricing to improve real-time system responsiveness. While the UK's alternative is more evolutionary, it may leave the system less agile in the face of growing electrification, weather variability, and renewable penetration.

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