
Zonal pricing – what is it good for?

Summary

The government is currently considering whether to adopt zonal pricing for wholesale energy markets. While a relatively small number of advocates, including OFGEM, are pushing the policy, it is against fairly widespread opposition from; industry experts, energy suppliers, energy intensive businesses and trade unions.

Zonal pricing's main selling point appears to be that it is a way to lower energy prices. But in reality it can't make power cheaper overall, just cheaper in some areas and more expensive in others - creating a postcode lottery for energy bills. The notion that energy intensive users will relocate their business to areas where more energy is made and prices are lower is a highly theoretical one which fails to take account of real world issues that businesses face, or the time it would take for these price signals to have that affect, or of the uncertainty that would be created in the green energy investor community in the mean time, or of the progress being made in extending our current grid to ensure we can deliver renewable energy to the whole country at all times.

If lowering bills is the aim - we have better, faster and easier system changes available to us, than Zonal Pricing - which we can be sure will work.

The key issues with zonal pricing and the negative consequences

1— *Zonal pricing won't lower prices overall – it will create an energy bill postcode lottery*

- Zonal pricing won't lower bills. Instead, it will spread the costs unevenly across the country. Some areas may have lower bills, but this will be offset by higher bills elsewhere.
- It would create a postcode lottery for energy prices. In most scenarios, less affluent inner-city households will pay more for their energy than more affluent households in the countryside.
- This system would be unfair and is already already unpopular. [Research from Fairer Energy Future](#) found that 70% of people in the UK would prefer national pricing, and that 85% think zonal pricing is inherently unfair. Among older people aged over 65, 90% think it's unfair, with many in this group already being hit by cuts to the Winter Fuel Payment.
- It's possible that the impact on energy affordability for some households would be so severe that the government would need to intervene and provide support to a large number of lower income households in built-up areas.

2— *Assumptions about business behaviour are not grounded in economic reality*

- A key argument for zonal pricing is that energy-intensive businesses will move to areas with a high supply of renewables, and generators will build capacity in areas of high demand. However, there is already clear evidence from businesses and generators that this is not true.
- On demand moving, energy-intensive industries can't just up sticks and move to where there is cheaper renewable energy. UK Steel has warned that steel plants would be unable to move and therefore zonal pricing could leave them with higher electricity costs and ["increase the risks of de-industrialisation"](#).

- On supply moving, price is only one factor that determines where generators build capacity, with other factors such as grid connections, planning regulations and wind resource being much more important determinants.
- Similarly, the tech industry and data centres are often held up as the type of business that could take advantage of zonal pricing, but many of them need to be located near to cities because of latency requirements. This is a point acknowledged by businesses who are in principle supportive of zonal pricing.

3— ***It's roundly criticised by many businesses and is bad for economic growth***

- **Much of the business community has heavily criticised it** – zonal pricing has been widely criticised by many of the industries and businesses that would supposedly benefit from it, including UK Steel, Make UK, RenewableUK, Scottish Renewables, SSE, Scottish Power and the Global Infrastructure Investor Association.
- Those who advocate for zonal pricing argue it's fantastic for business, but the evidence suggests otherwise and seriously undermines the case for the policy.
- **It would damage business investment/investor confidence and therefore economic growth** – investors also argue that zonal would bring price volatility and uncertainty while changes are implemented, which would damage investor confidence and increase the cost of financing. This is financing that is vital to building the renewable energy supply the UK needs to reach its clean power targets.
- Furthermore, a switch to zonal pricing could damage the upcoming Contracts for Difference (CfD) auction round for new renewable projects (AR7). AR7 is a critical moment to ensure the capacity needed for the government's 2030 Clean Power target, with the potential for zonal to damage appetite for new projects, or to push up the strike price, which would undermine the case that renewables lead to cheaper bills.

4— ***The supposed benefits vanish once you account for planned grid upgrades***

- Investing in the necessary upgrades to the grid significantly diminish the supposed financial benefits of moving to zonal pricing.
- Previous benefits modelled by DESNZ were based on outdated network plans. **New research** has shown that when you factor in the network upgrades under the 'Beyond 2030' plans, as well as new commitments to offshore wind through seabed leasing, the benefits are significantly reduced.
- It makes far more sense to focus on improving the grid to deliver Clean Power by 2030 than getting distracted by a complex and unproven solution.

5— ***Zonal pricing would damage energy market competition***

- Large generators or the companies owning demand in a particular zone would be able to exert pricing power and exploit the market.
- It would significantly disadvantage companies with generation and demand spread across the country. These companies would need to trade in several zones at once (rather than one as is now the case) and also need to buy/sell transmission rights across zones to get power to where it's needed.
- This creates a system that favours certain generators, such as those focused in one area or the larger generators, which would ultimately stifle competition and create a barrier to entry. This is bad for customers.

6— Zonal pricing would be a highly complex change with clear risks for questionable rewards

- Zonal pricing would be one of the most complicated reforms that we could make to our energy system. It would be lengthy and difficult to implement, with it being unlikely that it would be finished before 2030, more likely much later, which would create a huge deal of uncertainty for investors and market participants.
- Ofgem has expressed general support for moving to a zonal model, but even they acknowledge that you would need to consider protections for investments and think about how to “even things up between regions and areas within the UK”, which underlines the potential downsides and uncertainties that zonal could bring, including creating a postcode lottery.
- It is basic policymaking best practice that complex policies are only worth pursuing if the benefits are certain and major. Clearly in the case of zonal pricing they are not.

7— We have better, faster, easier options - like ‘breaking the link’

- Ultimately, efforts to move to a zonal system are a distraction. It won’t address the fundamental problem with our energy market, which is the link between the price of gas and the price of all our electricity.
- A far more effective way to reduce energy bills and enable us to benefit from the abundance of low cost green energy in the UK is to break this link by moving from a ‘pay-as-clear’ to a ‘pay-as-bid’ system.