

## UK REVIEW OF ELECTRICITY MARKETS ARRANGEMENTS BUSINESSLDN CONSULTATION RESPONSE

**MAY 2024**

**22. Do you agree with the key design choices we have identified in the consultation and in Appendix 4 for zonal pricing? Please detail any missing design considerations.**

BusinessLDN is a business campaigning group with a mission to make London the best city in the world in which to do business, for the benefit of the whole UK. We convene and mobilise business leaders to tackle the key challenges facing our capital. We have around 170 members from a wide range of sectors, including energy. By 2043 the population of London is expected to reach 9.8 million people, an increase of 800,000 people when compared with 2021.

This projected growth is a reflection of the capital's continued attractiveness as one of the world's leading global cities. Yet, as it grows, the capital's infrastructure continues to come under greater strain. If a growing London is to fulfil its economic potential for the whole of the UK and simultaneously decarbonise to meet the country's next zero targets, the capital will require significant investment in its electricity infrastructure. To achieve this, the regulatory framework must encourage and incentivise network investment and should not negatively impact businesses and consumers relative to other parts of the UK.

Our primary concern within the Review of Electricity Markets Arrangements (REMA) consultation is that the move towards locational marginal pricing (LMP) poses significant risks to **London's competitiveness** because London and the South (Region J, p96 of the Options Assessment) are likely to be impacted by higher electricity prices than other parts of the country. This is a particular challenge for London consumers during a time of cost-of-living pressures and when a quarter of Londoners are living in poverty after housing costs are taken into account. The proposal could also discourage location of energy intensive businesses and investment away from the capital, negatively impacting London's competitiveness.

Figure 24 on page 96 of the LCP Delta Options Assessment suggests that the price differential between London and other regions could be in the region of c.£100 per annum per household based on the price estimates for 2035. This means that London and the South (Region J) would be relatively more expensive in terms of costs of electricity for consumers and businesses than all other regions on a varying scale, and level with Region I (mostly consisting of the West Midlands and parts of the East Midlands). We do, however, note the low confidence attributed to the figures presented by LCP Delta on behalf of the Department.

We are also concerned that the benefits case for a move towards LMP underestimates the cost of capital impact of the proposed reform. It is counter-intuitive that such a major shift from producer to consumer can be achieved with minimal impact on electricity generator investment or on the cost and speed of that investment.

Furthermore, the benefits case depends on a high demand scenario, which appears to assume a much greater increase in demand than is predicted by the National Grid Electricity Systems Operator for 2035 (despite at the same time suggesting that the reform

will itself encourage lower and more flexible demand for electricity). We are sceptical that this higher demand scenario will materialise, given a) continued slow progress in electrifying heat in London, as in other parts of the UK, b) ongoing gains in energy efficiency and retrofitting of homes and c) the advantages of flexibility and the obvious benefits of reduced energy consumption as heat is eventually electrified.

We believe that this complex reform would raise costs in London and the South, relative to other parts of the UK and discourage location of energy intensive businesses and investment away from the capital, negatively impacting London's competitiveness. The reform could also disproportionately disadvantage smaller businesses and SME's over larger businesses that are more able to withstand or offset the hit from the rise in wholesale electricity prices.

Regionalising the price system for wholesale electricity would also likely introduce greater price volatility. This volatility could require intervention from Government to protect vulnerable consumers, at the supplier end of the market. It is unclear whether or not this intervention would extend to some or all small businesses, who could be required to negotiate electricity prices with suppliers on an individual basis. Some may be able to offset high and/or volatile prices through storage or demand side responses or hedging, but others may not, creating all kinds of distortions in the prices paid between different businesses and impacting competition.

The LMP benefits case also doesn't appear to take account of the impact of a highly regulated market and of **local planning considerations**. The market cannot react to price incentives to generate electricity at scale in London and the South because of planning restrictions in densely populated urban areas close to demand. The market will also be heavily constrained by intervention to protect the interests of consumers, and the rights of existing generators, creating substantial uncertainty and market risk for new investors both on the supply and demand side. Faced with regulatory uncertainty, generators will inevitably also face a higher cost of capital to invest. An increased cost of capital for generation would inevitably be passed on to consumers, offsetting any saving from a move to LMP and leaving London prices higher than they are now, rather than lower.

## Summary

A move towards zonal LMP presents many risks at a time when future demand is particularly hard to assess and when major investment in electricity generation and transmission, with high up-front capital costs, is required to meet the challenge of the transition to clean energy. We would prefer to see Government focusing on the following solutions instead:

- Demand reduction via incentives for energy efficient building materials in development as heat is electrified. This is likely to be significantly more cost-effective for consumers than building out new electricity grid infrastructure which will require high upfront costs passed on to consumers through bills.
- Regulatory incentives for grid demand flexibility, to further reduce peak electrical capacity requirements and maximise the storage which any system based on renewables will need.
- A single national market, with investment in transmission capacity, as necessary, to ensure security of supply to all areas at a fair market price.
- A supportive and aligned planning system and grid access and charging regime, alongside the proposed National Grid Strategic Spatial Energy Plan, which will

direct investments to those locations that support low electricity system costs and provide an authoritative evidence base for the key clean energy projects that are needed to deliver our 2035 targets.

- As necessary, conditional grid access for generators and interconnectors to prevent operations which impose high network costs elsewhere.

Once the future shape of the electricity grid is clear as well as the level of demand which can be expected in a renewables-based system, an objective cost/benefit analysis is more likely to reveal whether regionalisation of the wholesale electricity market will deliver a net cost benefit and not negatively impact the competitiveness of London as the UK's hub of economic growth, trade and investment, as we believe would be the case under LMP.

For more information about BusinessLDN or the contents of this submission, please contact:

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