SQUIRE PATTON BOGGS

Review of Electricity Market Arrangements (REMA) – Next Steps

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With the government having announced, in December 2024, its intention of completing its REMA policy development by the middle of this year before moving on to implementation of final decision making, the latest REMA Update from the Department for Energy Security and Net Zero (DESNZ) is somewhat underwhelming.

Described by regulatory consultants, Waters Wye Associates, as "the dampest of damp squibs", DESNZ has, as widely predicted, abandoned the government's proposals to introduce a zonal pricing regime, in favour of a continuation of national pricing, with a series of further policy measures to be developed so as to deliver the improvements in locational signals for new build generation and the operational efficiency of Great Britain's transmission and distribution systems that its advocates (including the National Energy System Operator (NESO) and the Office of Gas and Electricity Markets (Ofgem)) argued that zonal pricing would have achieved.

Beyond the bare decision not to move to zonal pricing, there is little in the way of new policy announcements. Instead, the latest update focusses on the processes that will ultimately result in the formulation of decisions to support greater coordination of mechanisms that drive locational choices as to new energy production facilities, and to adjust the current market framework to mitigate other inefficiencies associated with the current national pricing regime.

Spatial Energy Plan

The Strategic Spatial Energy Plan (SSEP) is a coordinated, whole systems approach to planning and anticipatory network investment, currently under development by NESO with the aim of reducing waiting times for grid connections and cutting network constraint costs. It will map potential locations, quantities and types of electricity, as well as hydrogen generation and storage facilities to identify the optimal locations, amounts and types of new projects.

The intention is then to encourage the development of new production facilities in locations identified in the SSEP through a series of "delivery levers", such as reforms to the planning system and the grid connections regime, and improvements to the process of allocating seabed leases for offshore development, most of which are already under development. NESO will be consulting on a draft SSEP, with a view to finalisation in late 2026 and to be updated every three years after that.

On finalisation of the initial SSEP, NESO will go on to develop a Centralised Strategic Network Plan (CSNP) for the development of transmission infrastructure to support the development of the new generating facilities, as well as new large-scale demand from data centres, in optimal locations. A further "delivery lever" will take the form of yet another review of the charges for use of the transmission system (TNUoS) and connection to it, potentially moving away from the "shallow" connection charges favoured by Ofgem in recent years, the aim being to introduce this latest round of TNUoS reform by 2029 "at the very latest".

Improving Operational Efficiency

Leaving aside aligning consenting arrangements with the SSEP, there is little in the update that presages any great reform of the current national pricing arrangements themselves. The suggested reforms to the current balancing and settlement regime and Balancing Mechanism (BM) are tentative, with a NESO consultation process and impact assessment promised later this year. Options under consideration include:

- Reduction in the minimum size of plant that can participate directly in the BM
- Realignment of the deadline for reporting electricity trades under the Balancing and Settlement Code (BSC) with gate closure, reversing BSC modification proposal P342, which extended the submission deadline to the start of the Settlement Period
- "Unit bidding" in the BM, i.e. measures to ensure that BM Bid-Offers reflect the characteristics of individual BM Units and on acceptance are delivered by the relevant BM Unit
- Physical Notifications of planned generation to match traded positions
- Settlement Period duration to be reduced to fifteen, or even five, minutes

Although some of these measures can be expected to lower system balancing and constraint management costs to some extent as a result of improving transparency and reducing the conflicts between operational signals and commercial drivers, NESO will undoubtedly be at pains to ensure that none of them do so at the cost of increasing the challenge of managing a self-dispatch system which, with the UK's increasing reliance on distributed generation and low inertia renewable energy technologies, is already formidable.

DESNZ acknowledges that better alignment between interconnector flows and network constraints could help reduce system operating costs, and in the Common Understanding announced in May, the UK and EU affirmed their intention of exploring parameters for the UK's possible participation in the EU's internal electricity market. In the meantime, NESO will be encouraged to ensure that the existing tools available to it to manage interconnector flows, including system operator to system operator trading and counter trading, are used as effectively as possible.

Next Steps

Work is already underway on addressing the queue for grid connections through implementation of Ofgem's TM04+ package. Changes to the planning process are being developed as the Planning and Infrastructure Bill makes its way through Parliament. The next Contracts for Difference (CfD) allocation round, AR7, is already open for registration. A reformed national pricing delivery plan is promised for later in the year, to set out: "a vision of the future state of operations for the Great Britain electricity market"; a delivery timeline with key activities for implementing "reformed national pricing"; an overview of the legislation required to deliver the reforms; and the government's plans for ensuring locational signals provide clear and consistent signals to project developers and investors.

Publication of final REMA analysis, including a full cost benefit analysis of the different wholesale market reform options, is also promised, though, given that zonal pricing or centralised dispatch, the prime candidates for an alternative to piecemeal reform of the current wholesale arrangements, have already been discounted, it is questionable whether that exercise will do much to progress matters. Instead it appears that DESNZ will be spending most of the rest of the year peering over NESO's and Ofgem's shoulders, "working in partnership with NESO" to deliver the SSEP and a consultation on balancing reform, as well as "supporting" the completion of NESO's Constraints Collaboration project. A consultation on revisions to Capacity Market Rules and a call for evidence on how the market for Corporate Power Purchase Agreements market might be developed are promised, though it is hard to see how either might contribute to the reform of national pricing.

Impact

The big idea in the latest REMA Update, to the extent there is one, is that the inefficiencies inherent in the current national electricity pricing regime can be mitigated by increasing the cost of connection to, and use of, the transmission system by generation which is remote from demand. There is no sign of any proposals from DESNZ to alleviate the adverse impact such measures may have on the owners and operators of existing assets in remote locations, let alone the additional costs that will be faced by prospective developers of new projects, such as offshore windfarms, that rely on energy sources, which show little inclination to relocate themselves in response to transmission system pricing signals.

And it remains to be seen how compatible the operational changes under consideration are with such aspirations as the government may have of reintegrating Great Britain into the European energy market.

On 21st July, Ofgem published an Open Letter in response to the DESNZ update, setting out its initial thoughts on the role of TNUoS in a reformed national pricing framework. TNUoS charges could, it suggests, reflect the anticipated availability of grid capacity in the year in which the new generation is due to commence operation. Greater stability could be achieved by fixing long-term TNUoS charges at the point of investment (potentially over the expected life of the project), or by re-weighting the balance between use of system and connection charges by making the latter "deeper". TNUoS could also be adjusted to incentivise storage projects and new demand, such as data centres, to locate closer to generation thereby reducing the need for future grid upgrades.

For existing assets, with existing TNUoS forecasts already factored into business cases, Ofgem suggests that changes in TNUoS charges could be phased in over an extended period, or that there could be a hybrid regime with differential charging for new and existing assets. Bidders in the current CfD allocation round will doubtless wish to see their projects classified as "existing" assets, so that they can benefit from similar protections. In something of an aside, noting the need to strike a balance between competition and centralised coordination, Ofgem suggests that government might consider incorporating specific targets and limits for specific locations in future CfD and Capacity Market auction rounds so as to help align investment with the SSEP.

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