

Summary of responses to the last resort levy claims true-up process consultation

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On 23 June 2022 we issued a consultation seeking views on the recovery of wholesale costs under the Supplier of Last Resort (SoLR) levy (“the levy”), as well as a number of other areas in relation to the levy claim true-up process.

The consultation closed on 4 August 2022, and we received nine responses from suppliers, consumer groups and network operators. The key themes contained in the responses we received are outlined in this document. Please note that these are the views of stakeholders and **do not necessarily represent the views of Ofgem**

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1. Introduction

Context

- 1.1. The unprecedented rise in gas and electricity prices over the past year has put energy markets under severe strain. Wholesale market volatility means that energy suppliers have faced increased challenges in managing the risks involved in buying energy for their customers. This contributed to a large volume of supplier failures towards the end of 2021, requiring us to intervene and appoint a new supplier for customers whose energy supplier had failed (referred to as a 'Supplier of Last Resort' (SoLR)).
- 1.2. In carrying out this role, SoLRs incur additional costs which they may not be able to recover through normal cost recovery routes¹. The Last Resort Supply Payment (LRSP) process (known as the 'SoLR levy' or 'the levy') is the "backstop" industry arrangement that enables a supplier to seek to recover the additional and otherwise unrecoverable costs that they reasonably incur when acting as a SoLR. This includes the reasonable costs incurred in purchasing the gas or electricity needed to supply these customers at short notice².
- 1.3. In normal circumstances, and under the competitive process we follow to appoint a SoLR, the SoLRs may be expected to waive some or all of their right to make claims on the levy. Our preference is for a SoLR to absorb the costs of acting as a SoLR, or if they do choose to make a claim, to minimise the costs, as ultimately these costs fall to all consumers.
- 1.4. Recent market conditions have resulted in appointed SoLRs seeking to make claims on the levy for the additional and otherwise unrecoverable costs they have faced in supplying the customers of the large number of suppliers that failed in late 2021. As with the normal claim process, we would still expect suppliers to make all reasonable efforts to avoid these costs, or absorb them where possible. We acknowledge the

¹ In assessing whether a claim is reasonable, we need to consider whether the SoLR could have recovered the costs through other means. It would not be appropriate for us to allow the SoLR to claim for costs it could have recovered through the administration process or customer charges, for example.

² In purchasing any additional gas or electricity to supply newly acquired customers the SoLR is required to do so as economically as possible under the circumstances.

higher costs suppliers have faced under recent market conditions, but we are also very conscious of the challenges faced by customers at this time. We expect suppliers to consider the ultimate impact on consumers' bills should they choose to make claims on the levy.

Measures we introduced

1.5. During winter 2021/22 we introduced a number of changes to the levy process which were designed to ensure that the SoLR process continues to protect consumers in the current market conditions. The changes included:

- The temporary introduction of a faster, multiple-claims levy process³, and
- Modifications of licences to allow for third-party financing of SoLR levies⁴

1.6. The multiple-claim levy process is intended to reduce the time taken for suppliers to submit claims and for us to make decisions, by allowing SoLRs to submit two claims per failed supplier: an initial claim for immediate costs faced in serving SoLR customers (typically wholesale commodity costs) followed later by a true-up. The true-up process is intended to reconcile costs submitted by suppliers with the initial claims and determines what final payments should be made to them.

1.7. In line with our faster, multiple claims process, by December 2021 we had consented to SoLRs making initial levy claims totalling £1.83 billion. We set out that we would give further due consideration to a number of issues and consult with stakeholders before assessing final claims and any true-up.

What we consulted on

1.8. On 23 June 2022 we issued a consultation⁵ (the "Consultation Document") on our minded-to positions on the fair approach to reflecting the costs suppliers faced in providing energy to customers after being appointed as a Supplier of Last Resort (SoLR) between September 2021 and December 2021. The Consultation Document set out options for the recovery of wholesale energy costs under the SoLR levy, and

³ [Decision letter on supplier of last resort levy claims | Ofgem](#)

⁴ <https://www.ofgem.gov.uk/publications/decision-third-party-finance>

⁵ <https://www.ofgem.gov.uk/publications/last-resort-levy-claims-true-process-consultation>

put forward our 'minded-to' position on our preferred option. The Consultation Document also set out proposals and clarifications on the approach we intend to take in other areas in relation to the levy claim true-up process. The areas we consulted on are set out below:

Wholesale costs: we set out our analysis and minded-to position that claims for wholesale costs should be limited to the cost of energy delivered by the end of March 2022, or within six months of being appointed, whichever is later.

Financing costs: we set out our expectations in relation to the evidence that we will require to demonstrate that the financing costs claimed provide value-for-money and are reflective of the true cost faced.

Traditional PPM Credit Balances: we set out our position on how levy claims for traditional Prepayment Meter (PPM) credit balances should be treated and sought stakeholder views on the proposed proxy for quantifying the value of a traditional PPM credit balance.

Audit Requirements: we set out our expectation that SoLRs should have all claims independently audited and signed-off by internal (or, where relevant, external) auditors. We also set out Agreed Upon Procedures that internal audits will be required to meet.

Temporary mitigation measures: to reduce the risk of overpayment and lessen the short-term impact of levy claims on energy bills, we proposed ending the temporary process as early as possible after winter 2022/23.

Related publications

Consultation to which this response document refers:

<https://www.ofgem.gov.uk/publications/last-resort-levy-claims-true-process-consultation>

Open letter on introducing a faster, multiple-stage process for making Last Resort Supply Payment (LRSP) claims:

<https://www.ofgem.gov.uk/publications/letter-suppliers-supplier-last-resort-levy-claims>

Letter confirming temporary changes proposed in the above:

<https://www.ofgem.gov.uk/publications/decision-letter-supplier-last-resort-levy-claims>

Revised guidance on the Supplier of Last Resort process (2016):

<https://www.ofgem.gov.uk/publications/supplier-last-resort-revised-guidance-2016>

2. Consultation Respondents

2.1. We received a total of nine responses to the consultation, including three confidential responses. We received seven responses from suppliers, all of whom we expect to submit true-up claims. The remaining two responses were from a consumer group and a network company. Not all responses included a response to every question, so for some questions there are fewer than nine responses.

2.2. The stakeholders who provided non-confidential responses (or the stakeholder provided a non-confidential redacted version of an otherwise confidential response) are listed in Table 1, below. Responses that were not marked as confidential have been published on our website⁶.

Table 1 - non-confidential responses received

Organisation	Type
Citizens Advice	Consumer Group
Centrica	Supplier
SP Energy Networks	Network Operator
Utilita	Supplier
E.ON	Supplier
EDF	Supplier

⁶ <https://www.ofgem.gov.uk/publications/last-resort-levy-claims-true-process-consultation>

3. Responses to questions on wholesale cost claims

Minded-To Position 1 (Option 2): all SoLRs appointed in the period from September – December 2021 should be able to recover additional and unrecoverable wholesale costs incurred relating to energy delivered up until 31 March 2022 or until the end of their 6-month SoLR direction, whichever is later (option 2).

Question 1: Do stakeholders agree with our minded-to position 1 (option 2)?

3.0. We received eight responses to this question with four being broadly supportive of the minded-to position, and four stating that they disagreed with the proposed approach.

3.1. For reference, the four options considered in our Consultation are summarised in Table 2, below. Our minded-to position, as put forward in the Consultation, was to implement Option 2.

Table 2 - Options considered in our Consultation

Option 1	Limit recovery to the cost of energy delivered within six months of being appointed. ⁷
Option 2	Limit recovery to the cost of energy delivered by the end of March 2022, or within six months of being appointed, whichever is later.
Option 3	Limit recovery to the cost of energy procured within six months of being appointed and which will be delivered by the end of September 2022.
Option 4	Limit recovery to the cost of energy that will be delivered by the end of September 2022.

Impact on consumers

3.2. One response, from a consumer group, stated that Options 3 and 4 would not be in the best interests of consumers, as significantly extending the period of supply for which

⁷ This would limit recovery to energy delivered during the 6-month SoLR direction, which for some suppliers ends before the Summer 22 price cap adjustment. This would be consistent with the approach to our assessment of final claims that we took in our assessment of initial claims.

claims can be made beyond the 6-month period specified in the SoLR direction would mean customers bearing normal risks that should fall to suppliers.

3.3. Two respondents noted that Option 1 could result in detriment to consumers, as suppliers would face financial impacts they had not accounted for, leading to a potential loss of trust in the SoLR process among suppliers. This could mean suppliers are less likely to act as SoLRs in future and put in less competitive bids, which would ultimately lead to greater costs.

SoLR appointments

3.4. A number of respondents, who otherwise broadly supported the position, expressed concern about perceived differences between our minded-to position and the SoLR appointment process. One respondent stated that the decisions we make at this stage should reflect reasonable assumptions suppliers had at the time of appointment, while another stated that no costs should be agreed to during the SoLR appointment process which are subsequently not honoured in the levy claim.

Challenges to our minded-to position

3.5. Of the four respondents who disagreed with the position, three stated that they believed that Option 4 was the most appropriate. One of these respondents stated that Option 4 provided the best balance between existing and future customers, while also having regard to suppliers being able to finance activities.

3.6. One respondent challenged our assessment that Option 2 represents a fairer option for consumers. They stated that the additional costs we estimated for Option 4 represent real costs that suppliers have incurred for supplying SoLR customers, and if those costs are not recovered through the SoLR process then they will form part of the costs submitted to Ofgem as part of its proposal to allow suppliers to recover unexpected SVT costs. They stated that the SoLR process is a much fairer mechanism, for both consumers and suppliers, in the recovery of unexpected wholesale costs. They further noted that utilising the SoLR Levy to recover costs provides an opportunity for suppliers to use third party financing, which can benefit consumers by lowering the overall financing costs and spreading costs over a long duration, easing the financial burden for customers in the short-term.

3.7. One respondent stated that they believe our argument for focusing on the period of energy delivery, rather than the period when the cost exposure takes place, is flawed. They

expressed concern that our proposed approach overlooks what they see as prudent action by the SoLR to hedge in line with existing customers and the price cap. They agreed that suppliers should be treating SoLR customers in line with existing customers as quickly as possible, but considered this should not mean that suppliers are exposed to additional costs within the SoLR direction period in respect of energy delivered outside of that direction period.

3.8. A further respondent stated that our minded-to position is discriminatory. They considered that Option 2 favours suppliers who were appointed as SoLRs earlier and are, therefore, able to recover a greater proportion of 'catch-up' hedging costs. They also stated that Option 2 would use the LRSP process to reduce costs to customers by disallowing costs incurred by prudent suppliers who hedge according to Ofgem's methodology, against expectations, and after these costs have been incurred.

3.9. Another respondent who disagreed with the position also highlighted the impact on suppliers who have appropriately hedged in line with the price cap. They stated that they do not understand the logic of what they consider to be penalising suppliers who have prudently hedged, and would welcome further clarity from us on how we derived our assessment of prudent hedging behaviour.

4. Responses to questions on financing costs

Minded-To Position 2: SoLR to submit claims for financing costs reflective of their actual costs, but we will require SoLRs to further demonstrate, and provide evidence, that their financing cost claim delivers value for money to customers (and was the best possible rate they could have achieved given their individual circumstances).

Question 2: Do stakeholders agree with our minded-to position 2?

4.1. We received seven responses to this question. Of those, four were largely supportive of the proposals, while two expressed general support but suggested some changes. One respondent stated that they disagreed with the proposed approach.

Demonstrating value-for-money

4.2. Among the respondents who broadly supported the proposals, all considered it appropriate that SoLRs should be required to demonstrate that their claim delivers value-for-money for consumers. One respondent welcomed our recognition that financing costs will vary based on the individual characteristics of the supplier, such as the size of the organisation, the perceived risk level of the organisation and whether they are part of a group. For those reasons, they supported our proposal not to publish benchmark financing cost rates.

4.3. One respondent agreed with the first part of the proposal, i.e. that SoLRs should be able to submit claims for financing costs which are reflective of their actual costs, but disagreed that SoLRs should be required to demonstrate, with evidence, that their financing cost claim delivers value for money to customers and was the best possible rate they could have achieved.

4.4. This respondent expressed concern that this would have the effect of imposing a test that was not in place as part of the original SoLR bid process, and which SoLRs would not be able to meet retrospectively. They further stated that it would be challenging for a supplier to carry out a full assessment, at the time their capital or financing was raised, given the short timescales involved in the SoLR bid process. This respondent also commented that some suppliers may have limited financing options available, for example if they are part of a group, and would not be able to explore other financing options. They also considered that our approach appears to mandate suppliers to consider third party

financing, which they did not feel was appropriate for Ofgem to do. For these reasons, the respondent did not agree that it would be possible for a company director to attest to the fact that the company fully considered the commercial options available to it and had chosen the option that represents the best value for money for consumers.

Conversely, another supplier welcomed the references made to intra-group loans in our Consultation Document, and agreed with our proposal that in such cases suppliers should demonstrate the steps taken to ensure that the rate applied to such an intra-group loan is fair. They also highlighted that appropriate evidence in such cases would likely include the relative risk inherent in the supplier's activities within the parent group, as this would be a key factor in determining the rate applied to the supplier for the purposes of financing a SoLR event.

Rate of finance

4.5. One respondent disagreed with the proposed approach, noting that in other matters (for example, the price cap methodology), Ofgem uses the financing costs of an 'efficient supplier' in order to determine what represents 'reasonable costs'. They stated that unless a different cost was agreed at the time the SoLR was appointed, the same approach should be taken to determining reasonable costs for SoLR Levy claims.

Submitting evidence

4.6. One respondent stressed the need for a standardised approach for suppliers to provide evidence of their financing costs. They suggested that Ofgem should provide a template letter that company directors can sign and submit with their claim. They also sought further clarity on the methodology suppliers should follow when calculating their working capital costs. This respondent also expressed concern that working capital rates they believe were agreed during the bid process may not be honoured during the true-up process. They stated that, in their view, if Ofgem does not think the working capital aspect of a bid is appropriate, this must be raised as part of the bidding process, not during the true-up process. They noted that failing to honour rates agreed on at the bidding stage could undermine confidence in the SoLR process.

4.7. Regarding the period of costs for which claims may be made, a respondent who was otherwise broadly in favour of the proposals commented on the Agreed Upon Procedures (AUP) set out in chapter 4 of the consultation (Audit Requirements). This is addressed in chapter six.

Methodology for assessing claims

4.8. In terms of how Ofgem assesses claims, one response, from a consumer group, stated that Ofgem should consult upon the methodology that we will use to assess claims for financing costs. They further noted that it was not clear from the consultation under what circumstances Ofgem would disallow a claim for costs.

5. Responses to questions on traditional PPM credit balances

Minded-To Position 3: In principle, subject to all the circumstances of the case, Ofgem considers it reasonable for SoLRs to seek to make a case to recover traditional PPM credit balances from the levy, where these are otherwise unrecoverable.

Question 3: Do stakeholders agree with our minded-to position 3?

Minded-To Position 4: Average credit balances from suppliers' existing smart meter PPM customers are a suitable proxy for a typical PPM customer's credit balance. Question 4: Do stakeholders agree with our minded-to position 4?

Question 4: Do stakeholders agree with our minded-to position 4?

Question 3

5.1. We received seven responses to this question, all of which expressed broad support for our minded-to position. It was noted by multiple respondents that traditional PPM credit balances represent an unrecoverable cost to the gaining supplier as a direct result of acting as the SoLR.

5.2. One supplier noted that our analysis in the Consultation Document did not include smart PPM credit balances where those meters have not been successfully switched to credit mode before transferring to the appointed SoLR. The supplier suggested that Ofgem should also allow SoLRs to make a claim for these unrecoverable smart PPM credit balances where they occur, noting that the data should be readily available if the smart meter is communicating which would limit the need for any claim to be based on an estimation.

Question 4

5.3. We received six responses to our minded-to position on the methodology for estimating traditional PPM customer credit balances. The majority of responses were broadly supportive of our proposed approach for estimating traditional PPM credit balances. Only one respondent disagreed with our minded-to position and suggested an alternative approach that should be taken.

Potential Changes to Proposed Approach

5.4. Of those responses that were broadly supportive of our position, two suggested changes to Ofgem's proposed methodology in order to improve consistency. These responses both highlighted the risk that the payment behaviours of a smart PPM customer and a traditional PPM customer could differ greatly, and lead to different average levels of credit at any one time, for example due to the greater convenience of topping up a smart PPM.

5.5. To address this risk, it was suggested that Ofgem should compare an individual SoLR's average smart PPM credit levels with either aggregated data from all SoLRs or a market-wide aggregation from all suppliers. Ofgem could then use this benchmark to ensure a level of consistency is applied across claims and investigate any outliers. One respondent suggested that this benchmark could be used to assess claims of any SoLR that does not have a large portfolio of smart PPM customers.

Alternative Methodology

5.6. Only one respondent did not agree with Ofgem's minded-to position, suggesting that differences in average smart PPM customer credit balances could vary significantly across suppliers. This could be a result of different proportions of smart PPMs having been installed to recover debt or the payment behaviours of different suppliers' customer bases. These variances could lead to a SoLR submitting a claim for traditional PPM customer credit balances that is significantly different than a claim that could have been made if an alternative supplier's SoLR bid had been successful.

5.7. The respondent suggested that Ofgem adopt an alternative methodology for calculating traditional PPM customer credit balances that it suggested would be fairer. One suggestion was for Ofgem to issue an RFI to all suppliers with smart PPM customers and use the average of those credit balances. Another suggested methodology was to include average smart PPM customer credit balances within the SoLR RFI and use the average of this data to determine the claimable credit balances for each SoLR event.

6. Responses to questions on audit requirements

Minded-To Position 5: SoLRs should have all claims independently audited and signed-off internal (or, where relevant, external) auditors. We will only request an external, independent audit if we have serious concerns about any part(s) of a SoLR's claim(s).

Question 5: Do stakeholders agree with our minded-to position 5?

6.1. We received seven responses to this question. Of those, six agreed with Ofgem's minded-to position that claims should be subject to an independent internal audit. One disagreed, and suggested an alternative approach.

Level of assurance

6.2. The respondent who disagreed with the proposed position, a consumer group, was of the opinion that an internal audit is not sufficient, given the expected scale of SoLR claims. They stated that the approach taken towards supplier compliance with various schemes administered by Ofgem, where only a certain number of suppliers are selected for audit each year, would be an appropriate and more proportionate approach.

Audit standards and content

6.3. One respondent was of the view that the Standard cited (ISRS 4400) does not appear to be appropriate for the cost categories and activities covered. Another respondent stated that Ofgem should not limit suppliers to using an official internal audit team where another team is appropriately skilled, neither should Ofgem prescribe which standards an auditor should work to. Instead, this respondent stated that it would be more appropriate for Ofgem to require suppliers to set out the approach they work to in undertaking the audit, and why it is sufficient and appropriate, rather than prescribing any one set of standards.

6.4. One respondent requested further guidance from Ofgem on how migration costs should be treated in the audit, while another disagreed with our definition of 'credit balances'.

6.5. Two respondents disagreed with our assessment of financing costs. One of these respondents stated that, in their view, the drafting of the Agreed Upon Procedures would limit costs to only those from the point costs are incurred to the point a claim is made,

rather than from the point costs are incurred to the date the costs are paid back to the supplier from the network companies. They felt that the recovery of financing costs should not be limited to the point a claim is made, and that the AUP should be amended to ensure that this is not the case.

6.6. One respondent considered that should Ofgem require an external audit to be conducted, the treatment of the cost of such an audit needs to be discussed at the time, depending on the outcome.

Practicalities of the audit

6.7. Three respondents shared concerns with regards to timings. Two respondents expressed concerns around their ability to submit their audit at the same time as their true-up claim, and instead suggested that Ofgem allow suppliers to submit a draft audit report with the true-up claim, followed by a final audit report after submission of the final claim. One respondent expressed concern that the publication of Ofgem's decision in September does not leave enough time to assess against any final form requirements internally and leaves no time to conclude an external audit procurement process should it become clear that for whatever reason, the requirements for an internal audit have changed.

7. Responses to questions on temporary mitigation measures

Minded-To Position 6: The temporary, multiple-claim, levy process will come to an end as early as possible after winter 2022/23 in order to reduce the risk of overpayment and lessen the short-term impact of levy claims on energy bills.

Question 6: Do stakeholders agree with our minded-to position 6?

7.1. We received nine responses to this question. Five respondents disagreed with Ofgem's minded-to position, two responses were supportive of it, and two responses did not put forward a clear position on when the temporary, multiple-claim process should come to an end.

Impact on consumers

7.2. Two respondents were very strongly in favour of our minded-to position. One response, from a consumer group, stated that reverting to the single-claim process will lessen the short-term impact of levy claims on energy bills, and for that reason we should revert to the previous process as early as possible.

7.3. A further response, from a network, was also strongly in favour of reverting to the previous process 'as soon as reasonably practicable'. They stated that the previous process gave stakeholders ample time to understand and plan for impact of the claims on consumer bills, and also gave Ofgem time to fully scrutinise claims. This respondent also noted that processing claims under the single-claim process involved less complexity and administration.

7.4. However, two respondents disagreed with our assessment that ending the multiple-claim process will reduce risk of overpayment. One stated that there would be no risk of overpayment occurring if the current process is maintained, as long as it is managed properly. Another expressed support for the robust claims process that we have developed, noting that the split claim process provides a high level of scrutiny and rigour for claim assessments, and therefore the risk of overpayment should already be low.

Continued uncertainty in the wholesale market

7.5. Several respondents noted that the current volatility in the wholesale market may continue into 2023, meaning SoLRs will continue to be exposed to additional and unrecoverable costs. They disagreed with our minded-to position to end the split claim process 'as soon as possible after winter 2022/23', as they considered that the multiple claim levy process will continue to provide benefits if volatile market conditions continue.

7.6. One respondent stated that they understood our drive to revert to the single-claim process as early as possible after winter 2022/23, but suggested any move away from the split claim process should be driven by market price reduction, rather than time. This was echoed by another respondent, who acknowledged the administrative effort required from Ofgem to assess multiple claims, but stated that it would be reasonable to revert to the single-claim process only once the wholesale market has returned to a sustainable position.

Retaining the multiple-stage process

7.7. Of the respondents who did not agree with our minded-to position, multiple respondents pointed to the benefits of the multiple-stage process for suppliers, and stated that reverting to the single claim process would make it less attractive for suppliers to volunteer as a SoLR. One respondent suggested that a complete review of SoLR processes should be conducted before any further change to the process is made.

7.8. One respondent stated that they believe the split claim levy process, with its faster cost recovery timeline, is beneficial to suppliers who have less readily accessible capital, such as small suppliers. For this reason, they did not support our minded-to position, stating that the longer recovery time of a singular claim process unfairly favours larger suppliers.

7.9. Two respondents stated that they did not agree with our assessment that ending the multiple-claim process will reduce risk of overpayment. One respondent stated that there would be no risk of overpayment occurring if the current process is maintained, as long as it is managed properly. Another expressed support for the 'robust claims process' that we have developed, noting that the split claim process provides a high level of scrutiny and rigour for claim assessments, and therefore the risk of overpayment should already be low.

Alternative suggestions to our proposal

7.10. Several suggestions were made by respondents for modifying the levy claim process in future. One respondent suggested that suppliers should have the choice of using either process when volunteering to be a SoLR. They recommended that Ofgem incorporates a question asking suppliers which process they would like to follow for their SoLR bid, with reasons. Ofgem could then use this data to identify whether suppliers have a strong preference for single claim process.

7.11. Other suggested changes to the SoLR process included a suggestion to revise the split levy claim to allow SoLRs to make claims at any time, rather than in a single window.

7.12. We also received a suggestion for a modification of the levy process which went beyond the scope of the question. The respondent proposed that Ofgem reduces the time in which suppliers can submit a claim from the current five years, to 2-3 years.