September 25, 2026

# AR 676 Rulemaking General Rate Revisions HB 3179

## Staff Electric Distribution Concept v1

*Phase 2; Track 1*

### Purpose

This document provides Staff's initial concept proposal for treatment of electric distribution capital under the multi-year rate plan (MRP) framework. While informed by the AR 676 engagement and record to date (synthesis included in Attachment 1), this initial concept is intended to provide a straw proposal from which additional feedback and considerations can be directed. For additional context about the goals and purpose of Track 1, see Staff's Track 1 O&M concept.

### Introduction

Track 1 aims to clarify how specific costs and scenarios function within the MRP framework. For electric distribution capital, Staff understands most investment to be planned, recurring, and programmatic. To this end, Staff finds that a straightforward application of the primary approach (below) would manage electric distribution costs effectively within the MRP. In general, going-in rates would be informed by needs identified in distribution system planning (DSP) and account for a reasonable level of costs where normal changes in project mix, timing, and capital spending can be managed without the need for alternative tools.

Staff recognizes that circumstances may arise during the MRP where a utility might propose a mid-cycle adjustment for unpredictable costs. Utilities raised the example of storm-related investment where a representative level of recurring costs can be reflected in going-in rates, but an extraordinary event may create costs that could not reasonably have been accommodated through an indexed baseline.

Large, lumpy investments with net long-term benefits may also be identified in planning that occur mid-cycle in MRPs, such as major grid modernization and flexibility investments. These planned costs may also be proposed by utilities as insufficiently captured by going in rates and adjustments.

Staff also notes the need for additional discussion to identify how DSP should be used to inform going in rates as well as changes needed to the DSP timing and substance to accomplish that.  Below is a summary of the insights and observations surfaced in

discussing how electric distribution capital costs will function within the MRP framework. Staff also notes topics that arose and will be discussed further in other Track 1 cost categories.

## Electric Distribution Capital Staff Concept v1 Summary Table

| COST CHARACTERISTIC | CAPITAL EXAMPLES[1] | FRAMEWORK PATHWAY(S)[2] |
|---|---|---|
| **Recurring & predictable** | • Routine plant additions, programmatic replacement and grid maintenance (e.g., poles, conductors, transformers, meters, services)<br>• Customer and load growth (e.g., reliability)<br>• Modernization and other customer benefits | **PRIMARY APPROACH** |
| **Recurring & volatile** | • Major storm restoration capital | |
| **Future & predictable** | • Known material project entering service mid-cycle<br>• Material portfolio of related investments with a common driver | ***If justified:***<br>• **SCFM subject to structured criteria and limitations.** |
| **Future & volatile** | • Emergent system need identified during the term<br>• Mandate arriving mid-term with limited lead time | ***If justified:***<br>• **SCFM subject to structured criteria and limitations or deferral (exceptional).** |
| **Unforeseen material event** | • Catastrophic, non-routine event<br>• Qualifying events based on established criteria and case-by-case review | ***If justified:***<br>• **Z-factor subject to materiality and sharing.[3]** |

[1] Examples were raised during Track 1 engagement and do not automatically qualify for alternative treatment.

[2] Alternative pathways may be proposed by a utility where justified, subject to review and applicable criteria.

[3] Approved recovery reflects the net incremental revenue requirement, including updated depreciation, retirements, and applicable offsets.

## Alternative Approaches

Staff will develop specific concepts related to annual adjustments and the exceptions process within Phase 2, Track 2 of this proceeding. That said, as we have begun to explore costs and alternatives to the primary cost treatment approach in Track 1, stakeholders have contributed insights on considerations and criteria that may inform the framework's flexibility and use of alternative approaches. The sections below describe some of what Staff has learned on these topics.

### *Going-in rates and planning*

Staff proposes to establish going-in rates through a forward-looking test year approach, informed by the utility's DSP to identify a reasonable distribution capital "budget" based on expected system needs, investment priorities, alternatives, and anticipated capital requirements. Under this approach, going-in rates would include distribution capital investment expected to be placed in service by the rate effective date, growth-related capital expected to come online over the test-year, and consideration of recurring but volatile capital. Staff believes incorporating both normal test year capital and a reasonable level of anticipated capital investment for recurring, less plannable capital investment (such as storm recovery) can provide a representative baseline for distribution rate base and helps ensure that ordinary variability in project mix, timing, or annual spending can be managed within the MRP's indexed revenue cap. Staff will work with stakeholders to better clarify what is included in going-in rates and identify parameters for normalization-based approach for recurring and volatile capital needs (i.e., storm restoration).

Staff believes that a dedicated conversation on how DSP needs to inform going rates is needed.

Once going-in rates are established, ordinary distribution investment beyond the test year remains subject to the MRP's revenue-cap discipline. Actual spending may not necessarily match the amount, timing or project mix anticipated at the start of the MRP term, but these differences are expected. Accordingly, a forecast-to-actual capital variance would not, by itself, justify supplemental recovery. The primary framework is designed around the assumption of predictable, planned, fungible distribution capital planning approaches and should preserve both the utility's flexibility to prioritize projects with other costs and its incentive to manage investment efficiently. Similarly, the fact that an individual project is large or that a particular input has increased faster than inflation, does not necessarily establish that the indexed MRP cannot reasonably accommodate

the utilities overall distribution capital needs over the five-year term. Prudent spending will not be considered for costs in isolation but consider the overall ability of the utility to adjust its capital plans and priorities to accommodate a new or different investment. If a future distribution investment is large and lumpy, and the long-term benefits can be shown to justify the near-term costs, the utility may seek to use the SCFM subject to meeting established criteria. The alternative would be a capital recovery approach similar to "normalization", that assumes a portion of this lumpy investment is in service in going-in rates. However, this approach would challenge traditional capital cost recovery principles (e.g., used and useful), expose customers to risks of over recovery, or complicate the application of an earnings test.

> *Storm-restoration example:* Utilities raised major storm restoration as an example where even with an appropriate average normalized into going-in rates, catastrophic unforeseen events could create exceptional costs beyond the level that normalization is intended to accommodate. For such an event, qualifying restoration costs could be considered through the Z-factor. Any supplemental recovery would need to account for amounts already supported through the going-in rates and applicable offsets to ensure customers fund only the incremental costs attributed to the extraordinary event.

### *SCFM vs. Z-Factor vs. Reopener*

Discussions with stakeholders on electric distribution highlighted ambiguities between the SCFM, Z-factor, and a Reopener and of the need for criteria that enables the right use of these alternative tools. Staff recognizes the importance of establishing clear distinctions to govern each tool's unique application in the framework and will use Tracks 1 and 2 to discuss and develop criteria defining when and which tool may be appropriate.

Conversations around distribution capital in the Track 1 process have helped Staff refine the difference between the SCFM and Z-factor and inform how we build our criteria around those. Key takeaways factored into Staff's concept include:

- Most distribution is plannable and fungible.
- Planned, discrete mid-cycle additions that are material *at the project level* are difficult to incorporate into going-in rates.
- The SCFM is generally project driven and can be used to manage planned capital.
    - Limits and guardrails are needed to limit reliance on the SCFM for qualified distribution.

- The Z-factor is generally event driven and can be used to address truly unforeseen capital costs that qualify. For distribution, this would generally be limited to restoration.
- Reopeners are not for capital. This tool is specific to correcting an underlying mechanism or assumption in the MRP without a full exit, such as adjusting an index factor.

### *SCFM*

Given the above findings, Staff see SCFM filings as appropriate for specific projects, that can be planned for but are large, lumpy, fall mid-cycle in an MRP, and without supplemental recovery would result in material underearning. Staff expects a narrow set of investments in this category and proposes to set criteria that allow distribution capital SCFM recovery for discrete, material and where the near-term costs have been justified by long-term customer benefits in planning. Staff agrees with the idea that utilities seeking additional distribution capital in the SCFM should demonstrate that timing and reprioritization of other distribution investments could not reasonable accommodate the investment. A materiality threshold may accomplish this, but Staff will retain this expectation in its SCFM design. Staff will continue to work with stakeholders to determine the appropriate eligibility criteria for qualified projects.

### *Z-Factor*

Staff proposes Z-factor adjustments will be event driven and limited to discrete, material, *exogenous and unforeseen* O&M and/or capital restoration costs that cannot be managed and may require a different signal related to lag. [1] After further discussion on storm-related costs, Staff envisions Z-factor adjustments operate similarly to the deferral → amortization recovery path used historically, but will apply enhanced guardrails for qualifying eligible costs and distributing risk between the utility and ratepayers (e.g., deadbands and cost sharing). Staff has not identified different criteria for distribution capital than for other O&M costs discussed in Track 1 to date.

[1] Staff notes that exceptionally rare unforeseeable circumstances may arise for which a deferral warrants consideration outside the MRP framework. Given the range of mechanisms available within the MRP. Staff expects the bar for such treatment to be particularly high. Deferrals will not automatically serve as an alternative recovery pathway where a cost does not qualify for treatment under an established MRP mechanism or would otherwise remain subject to the revenue cap.

### *Reopener*

Staff does not see a reopener as a tool to bring in capital investment. Staff views a reopener as a targeted mid-term adjustment used to fix a structural issue in the MRP when the plan remains workable but needs correction to function as intended. A reopener is appropriate when a material change undermines a core assumption or input underlying the indexed revenue cap and that assumption must be recalibrated for the plan to operate properly. For example, if the Commission adopts a new policy standard that requires utilities to treat a category of recurring costs differently than assumed in the original MRP design, a reopener allows that specific parameter to be updated so the plan can continue without broader renegotiation or termination of the framework.

Discussion of distribution capital has surfaced these distinctions between SCFM, Z-factor, and reopener in this concept paper, but Staff will continue to evaluate the best way to define each mechanism and invites feedback on the matter

### *Tiered SCFM Approach*

Staff's goal is to set a high bar for use of the SCFM to balance lag and provide a limited supplement for defined, qualified exceptions. Staff is considering a SCFM design that would limit utilities to two SCFM filings within a 5-year MRP term, inclusive of all qualified capital. Considering utilities' limited opportunities to make an SCFM filing and the finding that electric distribution costs are particularly unlikely to warrant use of an SCFM, Staff is considering the use of tiered SCFM criteria. For example, Tier 1 would apply to less fungible, higher cost, policy driven investment (e.g., transmission, generation, storage, and possibly certain prudent and well justified IT projects with short lives).[2] Tier 2 of the SCFM would cover other qualifying capital, such as distribution investments, but apply higher materiality thresholds, and more stringent standards for justifying the inclusion of the additional capital. Staff expects Tier 2 filings of the SCFM to not exceed one application in a single MRP term and in many iterations would not expect to see any filings at all.

Staff is also interested in exploring ways to represent the reduced regulatory lag offered by the SCFM. One example of this could be sharing of the costs included in the SCFM. Alternatively, a reduced ROE could be applied to capital placed in the SCFM. These features could help balance risks and benefits between customers and the utility when

[2] Staff will continue to discuss the RAAC and potential transitions in capital cost recovery mechanisms under the MRP framework as part of the upcoming Track 1 Electric Transmission and Other Capital Costs segment.

the SCFM is applied. These approaches can also help preserve important cost containment incentives for utilities considering a SCFM filing and may provide valuable customer protections against rate shock. Both Tier 1 and Tier 2 projects would require a demonstration of a capital need that cannot be reasonably absorbed via the index or addressed at the next rebasing. At the time of filing utilities should evidence consideration of alternatives and why management or reprioritization of indexed costs is insufficient. Approved SCFM projects would also be subject to prudence review, updated depreciation, and exclusion of amounts already supported through the revenue cap or another recovery mechanism.

### *Revenue Requirement and Depreciation*

Approved and Z-factor capital recovery outside of the index-based revenue cap should account for the full revenue requirement effects of bringing qualifying capital into rates mid-cycle. Staff proposes updating depreciation schedules with each alternative adjustment to recognize accumulated depreciation on existing rate base, depreciation associated with new investment, and applicable retirements and other offsets. When used, alternative tools can reduce regulatory lag and cost risk the utility would otherwise bear under the MRP. The associated revenue requirement should therefore reflect the changes that have occurred over the same period, including the continued depreciation of existing rate base. Doing so provides a more accurate measure of the costs attributable to the mid-cycle adjustment and preserves the cost containment discipline of the MRP framework.

### *Process and Early Eligibility Review*

Given the intent to establish clear applicability criteria, Staff is interested in developing an early procedural review with the opportunity for a preliminary Commission decision on applicability when a utility requests to use an exceptional MRP mechanisms, including SCFM, Z-factor, and Reopener. Establishing a process where a preliminary determination can be made that a proposed mechanism about basic eligibility criteria would mitigate unnecessary time and resources spent on a traditional contested-case review when the criteria for its use is not met.

Given the budget management approach of the MRP framework, Staff recognizes that investments in a given year will be different than forecasted and the utility spending level may be higher or lower than anticipated. Staff does not believe a capital true up mechanism is needed; however, plans to include an annual informational report for in service capital in its MRP process.

Staff expects the procedural design of these processes, including timing, filing requirements, evidentiary standards, and Commission action to be developed in Tracks 2 and 4, but invites stakeholder perspectives across the Phase 2 work.

### Providing Feedback on Staff Concept v1

Staff invites stakeholders to bring their perspectives to the discussion session on September 28 and in written comments due October 9. Staff is particularly interested in feedback on the following areas:

- SCFM initial design considerations
  - Defining "project level materiality"
- Z-factor limited to unforeseen eligible O&M and restoration costs
- Eligibility criteria (incrementality, demonstration of alternatives, materiality, deadbands, sharing, etc.)
- Alignment with the DSP
- Updated depreciation and other associated revenue requirement adjustments for mid-cycle offsets
- Early eligibility review process

### Next Steps

The following dates outline upcoming Phase 2, Track 1 activities related to Electric Distribution. For other upcoming events in Track 1 categories and Tracks 2 and 3, please refer to Staff's final workplan posted on the AR 676 page.

- **September 28:** Discussion session 12:30-1:30pm PT
- **October 9:** Written comment deadline
- **October 30:** Staff Electric Distribution concept v2 issued

Staff appreciates the robust efforts that stakeholders have put into this process thus far and recognizes the significant work ahead. Thank you for your continued engagement in this process.

### Questions

If you have questions about this docket, please contact:

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## **Attachment 1.** AR 676 Phase 2, Track 1, Electric Distribution Discussion Synthesis

### Areas of general alignment

- Most electric distribution capital is planned, recurring, and programmatic.
  - Utilities described portfolios that are budgeted and continually reprioritized as system needs, project readiness, costs, and available alternatives change.
  - Ordinary substitution and reprioritization within the portfolio reflect capital management, and are not by themselves a basis for a mid-cycle rate adjustment.
- Going-in rates are the primary determinant of how distribution capital performs under the MRP.
  - A reasonable and well-supported starting level reduces reliance on alternative tools during the term.
  - Rate case review continues to apply prudence and used-and-useful requirements to the capital reflected in going-in rates.
- Distribution planning should inform the capital level reflected in going-in rates.
  - Participants saw value in the DSP identifying system needs, investment priorities, and alternatives ahead of the rate case.
  - Identification of a project in a planning docket does not itself establish eligibility for recovery.
  - Alignment between DSP timing and MRP filings was raised, including the possibility of an MRP-aligned DSP update.
- Major storm restoration  can be volatile and difficult to capture in going-in rates.
  - Continuing the current practice of normalizing a representative level of recurring storm costs and escalating that level drew general support.
  - An extraordinary event may create costs beyond what going-in rates absorb, which is where alternative treatment was discussed.
- Alternative tools should be limited, bounded, and clearly distinguished from one another.
  - Overlapping eligibility among the SCFM, Z-factor, and reopener was a shared concern across utility and non-utility participants.
  - Duplicate recovery across going-in rates, the index, and any alternative mechanism should be prevented explicitly.

### Unresolved issues

- Boundaries among alternative tools.
  - Stakeholders sought clearer definition of when the SCFM, the Z-factor, or a reopener applies, particularly where a single event produces both capital and non-capital costs.
  - Whether capital should be excluded from Z-factor eligibility altogether remains open for comment.
- Materiality and eligibility criteria.
  - No threshold was proposed. Absolute dollar thresholds, revenue-requirement impact, and combined tests were each discussed.
  - Whether eligibility should be tested for an individual investment, in the aggregate across filings in a term, or both.
- Foreseeability of mid-cycle investment.

- How high the bar should be for capital that was foreseeable at filing but not reflected in going-in rates.
- Whether a known project should be identified at going-in, with a narrower review when it enters service.

- Linkage between planning and ratemaking.
  - Utilities expressed caution about connecting planning dockets to cost recovery, particularly for a first MRP.
  - Timing and content of the DSP, and the relationship of other program plans to it, remain to be worked out.
- Revenue requirement effects of mid-cycle recovery.
  - Pooled depreciation practices make project-level matching of additions and retirements difficult and potentially distortive.
  - The level of aggregation at which depreciation, retirements, and offsets can be reflected accurately is unresolved.
- Administrative burden.
  - What annual filings should contain to support transparency and end-of-term review without becoming a rate case in miniature.
  - Whether an early eligibility determination would reduce process or add a proceeding.
  - Cost allocation of material mid-cycle additions was flagged for Track 2.

### Specific topic discussion synthesis

| Issue | Utility input | Non-utility response |
|---|---|---|
| **Storm restoration** | Utilities described normalizing a representative level of recurring storm costs into going-in rates and escalating that level, with an emergency declaration or a materiality threshold raised as possible criteria for extraordinary treatment. | Stakeholders generally supported normalization over an exception process, noting that storms are expected during a five-year term and can be planned for as part of ordinary budget management. |
| **Policy-driven capital** | Wildfire mitigation remains in its existing mechanism and on its own cadence. Few other examples were identified, and materiality rather than the presence of a policy driver was suggested as the better test. | Stakeholders emphasized transparency where a mandate leads to material mid-cycle investment, and questioned how broadly a policy driver could be defined. |
| **Unique, extraordinary projects** | Utilities described single, non-recurring, externally driven projects that can exceed what an index-based adjustment absorbs, and proposed recovery on actual cost and in-service date with used-and-useful review and true-up at rebasing. | Stakeholders cautioned that broad supplemental recovery weakens the budget constraint, and sought criteria separating plannable investment from genuinely unforeseeable events. |
| **Distribution planning** | Utilities saw the DSP as informative for going-in rates but expressed caution about linking planning approval to recovery in a first MRP, and raised aligning DSP timing | Stakeholders supported the planning linkage as the point where operational and non-wires alternatives are surfaced before a capital solution is selected. |

| | | |
|---|---|---|
| | and consolidating related program plan requirements. | |
| **Annual filings and process** | Utilities supported an annual review that confirms what entered service without becoming a mini rate case, and expressed interest in an early determination of eligibility for mid-cycle requests. | Stakeholders sought sufficient information to verify what entered service and to support a meaningful prudence review at the end of the term. |
| **Cost allocation** | Raised where a material mid-cycle addition is driven primarily by a single customer class. | Flagged as a question for Track 2 rather than resolved in Track 1. |