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AR 676 Rulemaking General Rate Revisions HB 3179

Staff Electric & Gas O&M Concept v2

Phase 2; Track 1

Purpose

This document provides Staff's concept v2 proposal related to the treatment of electric and gas utility operations and maintenance (O&M) costs under the multi-year rate plan framework.

Introduction

Staff continues to find that most O&M can function well within the MRP through Staff's primary approach: establish a reasonable forward-looking revenue requirement at the beginning of the plan, apply the MRP index to the revenue cap during the term, and expect utilities to manage ordinary differences among individual O&M costs within that budget. Comments on Staff's Electric and Gas O&M concept v1 generally supported that basic structure, while identifying areas where Staff could be clearer about the role of the test year, normalization, predictable mid-cycle changes, index design, deferrals, and other alternative tools. Staff's concept v2 refines Staff's proposal and strives to add clarity to the core components of the primary approach and use of alternative tools.

Summary of Staff's Concept v2

Component	Staff's Proposed Approach
Going-in rates	Retain a forward-looking test year supported by historical actuals, reasonable forecasts, and known changes. Fully litigated, cost-of-service based.
Normalization	Allow representative amounts for recurring, uneven costs where supported by sufficient evidence; include in the indexed budget.
Mid-cycle step adjustments	Allow narrowly defined, prospective adjustments for known future cost changes established and approved with the initial MRP.
Annual indexing	Apply the standard MRP index to the aggregate indexed revenue requirement; no category-specific O&M escalators.
Reopeners	Reserve for broader circumstances warranting reconsideration of the approved plan; avoid routine category-specific O&M adjustments.
Z-factor	Address qualifying unforeseen, material, exogenous events arising during the MRP, subject to established criteria.

Component	Staff's Proposed Approach
Deferrals and balancing accounts	Narrow existing mechanisms where practical; evaluate continued or new use based on their function and interaction with the MRP.
Customer programs	Generally include within the MRP; consider limited exclusions where program characteristics or immature budget frameworks warrant transitional treatment.
Pass-through costs	Apply the primary approach unless specific cost characteristics justify Commission-authorized alternative treatment.
Alternative treatment	Require a demonstrated material impact and evidence that the cost cannot reasonably be managed within the aggregate indexed allowance.

Going-in Rates

Key learnings: Staff heard that the approach to establishing going-in rates (i.e., Year 1 revenue requirement) is a significant and impactful framework choice in a multi-year plan because each annual index adjustment builds from that starting point. Misalignment(s) in Year 1 will compound over the full term of the plan as each subsequent index-based adjustment builds from that initial baseline. A reasonable starting point therefore depends on both a forward-looking view of the rate year and a disciplined use of historical actuals to test whether forecasts, budgets, and proposed changes are supportable.

Staff proposal: Staff maintains its proposal to continue using a forward-looking test year to establish a baseline for most Year 1 costs in the MRP. In other words, the MRP should begin with a reasonable representation of the costs expected when rates take effect, supported by historical actuals, known changes, reasonable forecasts, and appropriate escalations. Staff believes historical actuals should provide a meaningful evidentiary anchor, while allowing for utilities to demonstrate why forecasted changes are reasonable. While a historical test year with known and measurable adjustments can limit forecast risk and provide strong discipline against embedding uncertain cost growth in a five-year MRP; Staff continues to favor the forward-looking test year because it can also reflect well supported changes in operating conditions (e.g., staffing, workload, service) that may not be sufficiently certain to qualify as "known and measurable". Including reasonable forecasted costs support a more representative starting point for the cap, strengthening the expectation that utilities manage within it, and reducing pressure for corrective adjustments that could shift risk back to customers during the MRP. Further Oregon stakeholders are already familiar with the process and evaluation of a forward-looking test year, while years two through five of the MRP will function more akin to an escalated historical test year. Ultimately, the rate case process allows for scrutinization of forecasts, budgets, escalation assumptions, staffing levels, and other test-year inputs against actual experience. A forward-looking test year does

not translate to acceptance of unsupported utility budgets. As with our current practice, establishing going-in rates would be part of a fully litigated process based on a cost-of-service analysis and proposal filed by the utility.

Normalization

Key learnings: Normalization was identified as a useful approach to establishing a reasonable baseline for going in rates where a recurring O&M cost is real and expected to continue, but the amount in any single test year is not representative because the cost occurs unevenly over time. Examples raised include ordinary storm response or established cyclical maintenance. A normalized amount may be developed from multiple years of actual experience, an established cycle, or another supported method, and then included in going-in rates. Normalization of costs can create management incentive risk and reward where the utility benefits if it manages costs below the normalized level and loses if costs exceed it. Evaluating these earnings variances should be performed consistently and symmetrically.

Staff proposal: Staff remains open to normalizing certain costs as part of going-in rates. To clarify when Staff believes it may be appropriate to consider normalization for going-in rates, Staff proposes three criteria. First, the underlying activity must be recurring rather than speculative or unique in nature. Second, there must be enough evidence to establish a representative level or cycle. Third, normalization should be symmetrical: unusually high and unusually low years, temporary costs, and known roll-offs should be reflected as appropriate. Staff notes that it intends to push for a fair consideration of risk allocation between ratepayers and shareholders as it evaluates normalization options. In any given year, the normalized amount will likely come in either higher or lower than actual costs, equitable risk allocation means that ratepayers may over-pay in low-cost years, while the utility may under-collect in high-cost years. Importantly, however, the normalized amount should be expected to sum to prudent costs equaling recovery over the MRP cycle. Once set, the normalized amount is part of the indexed budget; it is not reconciled annually to actual spending.

Some stakeholders have expressed concerns about the impact of normalization on results of operations. Given that actual costs will deviate from normalized revenue by design of the normalization, the utilities earnings will be impacted. Staff notes that deferrals currently pose a similar or more difficult problem where costs incurred and revenues recovered do not match up in the same timeframe. Staff believes that similar adjustments can be made to the Results of Operations (ROO) as those made to the ROO currently for deferrals. However, Staff would again push for consistent treatment and risk allocation. Ratepayers should not be harmed when a utilities earnings are lower than authorized due to an event, if they do not also benefit when a utilities earnings are higher than authorized due to the absence of those same costs materializing.

Mid-cycle Step Adjustments

Key learnings: A step adjustment is distinct from normalization. Normalization establishes a representative starting level for a recurring but uneven cost. A step adjustment recognizes a known change in level that begins later in the plan. Neither is intended to provide dollar-for-dollar recovery of actual O&M. Based on discussions, known, future costs/changes could be investigated as part of the going-in rates process and vetted for a future streamlined step adjustment (into base rates). This approach was considered in comparison to "ignoring" a known future material cost when the MRP is being established and initiating a new mid-cycle proceeding or more narrowly scoped alternative tool later. To this end, a prospective step can be useful where a discrete cost is reasonably known at the outset but begins or materially changes later in the plan. Considerations should also be made with the use of this approach relative to temporary start-up costs for duration and phase-out, so a short-lived expense does not become a permanent part of rates.

Staff proposal: Staff believes that the instances of known future costs material enough to warrant a mid-cycle adjustment will be relatively rare and circumstance specific. However, Staff proposes to include consideration of narrow, pre-established mid-cycle step adjustments where the timing and nature of a future cost change are known but the costs do not belong in the Year 1 revenue requirement and could not be reasonably absorbed in the overall MRP budget. Eligibility, timing, methodology duration, offsets, and any phase-outs should be established in the initial utility MRP record where need, materiality, and scope will be evaluated. The later implementation filing should confirm that the approved trigger occurred and apply the approved adjustment. The step should function as a narrowly applied prospective design feature of the MRP, not a general means of updating O&M to actual costs.

The mid-cycle step adjustment effectively introduces a degree of forecasted costs to the index-based revenue cap. To this end, Staff reiterates its expectation that this would be an infrequent and narrowly applied alternative tool. Staff continues to evaluate how to best establish guardrails around its use to distinguish it from mid-cycle O&M additions that would enter in with associated capital through the SCFM. Staff is also considering how to best balance timely integration of a known future cost with budget discipline and formulaic adjustments over the MRP term.

Annual Indexing

Key learnings: O&M costs do not move uniformly, and no single index will precisely track the cost pressures facing every category over an MRP. Labor is one illustrative example where contracted wage growth was said to diverge from general inflation. However, this isolated divergence may be reasonably managed just as other O&M costs may move more slowly, decline, or respond to management choices. To this end, more tailored indices or cost-specific adjustments can improve the fit for a particular

expense, but each additional adjustment or tailored escalator reduces the degree to which the utility is responsible for managing cost differences and offsets across the overall budget.

Staff proposal: Staff does not propose category-specific O&M escalators. The MRP index is intended to establish the annual change in the utility's overall indexed revenue requirement, not to forecast each input independently. A labor-specific escalator would isolate one source of divergence while leaving offsetting movements elsewhere in the O&M budget untreated; extending that approach across categories would materially reduce the budget-management function of the MRP.

Track 2 will determine the methodology and calibration of the I-factor and X-factor. For Track 1 purposes, Staff's policy direction is that the index should be evaluated at the level of the indexed cost base. Evidence about the composition and drivers of O&M can appropriately inform index design without creating category-specific recovery.

Reopener

Key learnings: An MRP necessarily creates greater exposure to changes that cannot be fully anticipated when the plan is established. A reopener can provide an important safeguard when circumstances materially depart from the assumptions underlying the approved plan. Staff recognizes that the design of the reopener is significant to maintaining the integrity of the MRP. Frequent or cost-specific reopeners would increase administrative burden during the plan and reduce the utilities responsibility to manage cost pressures, efficiencies, and offsets within the overall budget.

Staff proposal: Staff does not conceive a reopener as a routine pathway for an individual O&M category that materially exceeds the established revenue path. Track 2 will address whether and how a reopener functions as a broader safeguard, but for O&M it should not be used to simply realign costs that should be reasonably managed within the established baseline or as a substitute to other alternative tools like the mid-cycle step adjustment, inclusion with associated capital in the SCFM, or event-based Z-factor.

Z-factor

Key learnings: Staff recognizes MRPs need a backstop for genuinely unforeseen, exogenous, and material events. The Z-factor is intended for discrete events rather than cost categories. Volatility, limited control, or growth above the index can be relevant facts, but they are not independently sufficient. Recurring volatility presents somewhat of a different problem: insurance, for example, may be heavily influenced by external markets but is still an expected operating cost with some utility choices around coverage, retention, procurement, and risk management.

Staff proposal: Staff proposes that the Z-factor address discrete, material, exogenous events that arise after the plan is established and are outside reasonable utility control. As articulated in other Track 1 Staff concepts clarifying the policy approach to the Z-factor, the key is the event-based trigger and not whether a particular cost category is generally volatile. A qualifying event should be sufficiently distinct from ordinary business risk, not reasonably reflected in going-in rates or the index, and material under criteria developed in Track 2. Treatment should also account for cost decreases, offsets, and other benefits associated with the event. Returning to the excess liability insurance example, Staff does not propose a standing insurance balancing account or automatic true-up but clarifies that a discrete event that materially changes insurance cost could be evaluated under the Z-factor or other applicable framework if it meets the established criteria.

Deferrals, Balancing Accounts, and Costs Outside the Cap

Key learnings: Staff recognizes that under the current framework, deferrals and balancing accounts can provide less procedurally intensive, symmetrical treatment for difficult to forecast costs which can be reconciled to actual amounts. The concern is that continued reliance on deferrals and single-issue ratemaking can undermine the MRP's incentive structure by insulating individual costs from the revenue cap. Deferrals may allow unfavorable cost variances to be addressed separately without necessarily accounting for efficiencies or favorable variances elsewhere. In terms of the role of existing and new deferrals as we move to the MRP framework, we must consider the function the mechanism serves, how it would interact with the broader framework, and whether it could be reasonably addressed without the alternative treatment.

Staff proposal: Staff proposes (consistent with Staff expectations communicated in AR 677) that existing deferrals and balancing accounts should be narrowed and limited to the extent practical. Remaining or new deferrals in the MRP framework should be evaluated for their continuing function in a manner that supports the MRP and the Commission's stated goals and outcomes. Any policy decision to exclude a cost from the cap should be explicit rather than inferred from the existence of deferred accounting.

Customer Programs and Transitional/Initial Exclusions

Key learnings: Several discussions raised the issue that policy-driven and participation-driven customer programs can create a different incentive problem than ordinary O&M. Where spending rises because more eligible customers participate, a fixed budget can place the utility's cost-containment incentive in tension with the program's intended outcome. However, that does not make every customer program unsuitable for an MRP; other important considerations include the program's cost driver, maturity (e.g., extent to which costs can be reasonably forecast), budget structure and cycle, and the degree of utility control. Demand response illustrates the point. In principle, demand response belongs within an integrated MRP because it can substitute for generation or distribution investment and should be considered alongside those

alternatives. The present challenge is establishing a durable going-in budget and performance framework that does not discourage participation or efficient deployment.

Staff proposal: Staff continues to propose a foundation of all programs being included within the framework, with the allowance of limited exclusions considered where current program design, statutory requirements, participation-driven funding, or the absence of a sufficiently developed budget framework makes an indexed going-in amount impractical for the first MRPs. Staff expects exclusions to be identified by Commission order and revisited as planning and budget frameworks mature.

Staff acknowledges concerns related to how customer programs, like other costs that are included in the revenue cap, may be considered and/or constrained in the interest of "overall budget management" from utility decision making. To help mitigate unintended outcomes, Staff will endeavor to evaluate the performance of customer programs before and after any changes in cost recovery.

Pass-through and Externally Determined Costs

Key learnings: Discussions raised whether certain statutory, regulatory, and other externally determined costs should receive pass-through treatment outside the indexed revenue cap. For example, circumstances where the utility may have little or no control over the amount of an obligation, where the cost may not grow with inflation, or where the utility largely collects and remits funds determined by another entity.

Staff agrees that these characteristics may warrant consideration, but does not see the pass-through or externally determined nature of a cost as independently establishing a need for treatment outside the cap. The presence of a flat or declining cost within the indexed baseline does not, by itself, establish over-recovery, just as the presence of a cost growing faster than the index does not establish under-recovery. Recovery under the MRP is evaluated against the aggregate revenue allowance rather than the trajectory of individual cost accounts. This remains true where an individual cost does not itself experience inflation. Applying the index to a revenue requirement that includes that cost does not assume that the individual cost will increase at the rate of inflation or provide separate inflation recovery for that cost. Rather, the indexed adjustment applies to the aggregate allowance, within which Staff expects some give and take among costs over the plan term. Costs that remain flat or grow more slowly than the index may create room within the overall allowance for costs experiencing greater pressure, including costs that grow faster than inflation. Those differences are part of the portfolio of cost pressures and savings the utility is expected to manage within the MRP and are an important component of the framework's cost-containment incentive. The fact that a utility cannot control the amount of a particular assessment or remittance remains relevant to understanding the cost, but utility control is only one consideration in determining appropriate treatment. Automatically providing separate recovery whenever an individual cost does not track the index would substantially narrow the costs over which the MRP operates and increase reliance on cost-specific adjustments. In

evaluating the approach to these types of costs, Staff also must consider stakeholder caution against extensive use of alternative pathways which emphasize the potential to erode the MRP's intended benefits of cost containment, rate predictability, strategic cost management, and reduced administrative burden.

Staff also recognizes that certain costs described as pass-throughs may present characteristics that more defensibly warrant different treatment. For example, some charges may need to be collected from a particular customer group, creating cost-allocation considerations that are difficult to accommodate through a systemwide revenue cap. Other costs may vary in a manner that could interfere with an underlying policy objective if constrained within the cap. To reiterate points made earlier in this concept paper, participation-driven customer programs, for example, identified circumstances where costs increase as participation increases and where managing those costs within a fixed allowance could create tension between program growth and other spending needs

Staff proposal: To this end, Staff does not propose a categorical rule for statutory or pass-through costs. The primary approach remains the starting point, including for costs that are externally determined. Alternative treatment should respond to a demonstrated feature of the cost that cannot reasonably be accommodated through going-in rates and management of the aggregate indexed allowance. Like other transitional exclusions, Staff envisions pass-through costs may be managed separately if authorized by Commission order governing the first utility MRPs. Alternatively, Staff may consider pass-through exclusions be identified by utilities prior to their first MRPs as an advice filing. Regardless of the procedural path, Staff's approach is intended to preserve room to address costs with genuinely distinct characteristics while avoiding a broad pass-through category that could place a growing share of O&M outside the MRP's core cost-containment structure.

O&M Cost Examples[1]

Cost driver	Staff Concept v2	Rationale
Routine labor	Primary approach	Contracted wages inform the test year and index-design record, but Staff does not propose a labor-specific annual escalator.
Insurance	Primary approach	Recurring cost with external drivers and management choices. Exceptional event treatment remains available if criteria are met.
Routine IT O&M	Primary approach	Ordinary subscriptions, staffing, licensing, and operations are part of the managed O&M budget.

[1] All alternative treatments will require a proposal, justified and adopted in the MRP.

Cost driver	Staff Concept v2	Rationale
Known major IT implementation / start-up	Going-in adjustment, narrow mid-cycle step, or finite amortization where justified	Treatment should match a known timing/level change and avoid permanently embedding temporary costs.
Recurring storm / cyclical maintenance	Normalization + index where a representative cycle can be established	Uneven timing does not itself justify actual-cost recovery.
Unforeseen major event	Z-factor if criteria are met	Event-based, material, exogenous, outside reasonable control, and not reasonably reflected in the plan.
O&M associated with future capital	Evaluate under going-in rates, growth factor, or a pre-established step; coordinate with SCFM only where necessary	Avoid automatic dollar-for-dollar linkage between capital and O&M; prevent duplicate recovery.
Participation/policy-driven customer programs	Program-specific; limited transitional exclusion where justified	Treatment depends on program design, statutory requirements, participation, and maturity of budget framework.

Demonstrating the Need for Alternative Treatment

Throughout this process, many stakeholders have raised questions about how "justification" for alternative treatment might be achieved. Staff would note that this discussion overlaps with concepts evolving from other Phase 2 tracks but offers the following policy perspectives around justification for Track 1 feedback and refinement.

A utility seeking alternative treatment would bear the burden of demonstrating that the cost presents a material impact that cannot reasonably be managed through the primary approach. The showing would identify the cost, its underlying driver, duration, expected impact on earnings and operations, explain what has changed relative to the assumptions reflected in going-in rates, and demonstrate why the impact cannot reasonably be managed within the aggregate indexed allowance. The utility would also need to address rate impacts, available management actions and offsets, and whether the remaining exposure can reasonably be managed until the next rebasing. Where a cost was known or reasonably foreseeable when the MRP was established, the utility would need to explain why it was not adequately addressed in going-in rates.

Staff sees materiality as an important first screen for this analysis and is considering a threshold expressed in basis points of total revenue requirement. Staff would also consider the cumulative impact over the remaining MRP term, particularly where an annual impact persists for multiple years. This avoids measuring materiality based on the percentage change in a narrowly defined cost category and focuses the inquiry on whether the cost creates a meaningful exposure within the MRP as a whole.

Meeting the materiality threshold would allow a cost to be considered for alternative treatment; it would not establish that different treatment is warranted. The utility would still need to make the substantive showing described above. The same annual impact may also warrant different consideration depending on when it arises. A sustained cost pressure early in a five-year MRP creates greater cumulative exposure than the same cost arising shortly before rebasing. As the next opportunity to reset going-in rates approaches, Staff expects a stronger justification for intervening during the MRP. Where that showing is made, the nature of the cost and the reason the primary approach is insufficient will inform the appropriate treatment. Staff does not propose to predetermine that treatment here. The criteria and mechanics for the Z-factor, reopeners, off-ramps, and other MRP tools are being developed through related Phase 2 work, and the least-departure principle will guide how those tools fit together. O&M associated with a qualifying capital addition may also be considered in connection with the SCFM where the costs are directly tied to placing and operating that investment in service, rather than treated as a standalone O&M exception.

Other Issues

Track 1 concepts aim to establish policy direction to inform implementation and procedural details that will be developed in Track 2 and 4. Much like the "justification" issue, Staff flags the following areas of overlap that will continue to be refined:

- Adjustment factor methodology and calibration, including how O&M input-price evidence informs the selected index without creating category-specific escalators;
- Materiality and other eligibility criteria for Z-factors, reopeners, off-ramps, and other alternative mechanisms;
- Procedural and evidentiary requirements for normalization and pre-established mid-cycle step adjustments;
- The role of deferrals and balancing accounts during an MRP, including symmetry, prudence, offsets, and interaction with annual implementation filings;
- The specific list and transition path for costs temporarily or permanently outside the indexed revenue cap;
- Coordination among O&M treatment, the supplemental capital funding mechanism, customer-program frameworks, rebasing, and the earnings sharing mechanism.

Overall, Staff believes the concepts proposed in this document provide a workable foundation for incorporating O&M costs into Oregon's MRP framework while preserving meaningful incentives for cost containment. While certain implementation specifics and adjustment calibrations will continue to be developed in other areas of Phase 2, Staff's Track 1 concepts focus on developing the policies that should inform how to approach such details. As the framework develops, Staff will continue to evaluate alternative mechanisms in the context of the MRP as a whole, including their cumulative effect on utility incentives, customer protections, and administrative efficiency. Staff welcomes

further feedback on the proposed treatment of O&M costs, particularly where specific examples or evidence could inform the criteria for alternative treatment.

Next Steps

The following dates outline upcoming Phase 2, Track 1 activities:

- **October 9:** Electric Distribution comment deadline
- **October 9:** Gas Other cost pre-read[2]
- **October 12:** Electric Transmission & other costs discussion
- **October 16:** Gas Distribution, Transmission & Storage takeaways & concept v1
- **October 19:** Gas Distribution, Transmission & Storage discussion

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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[2] Gas Other Costs is where AR 676 stakeholders will also discuss the Electric and Gas 'taxes' cost category.