

WORK PROGRAM PRIORITIZATION

1.0 OVERVIEW

The investment prioritization process is part of the overall company planning process. (see Exhibit A, Tab 14, Schedule 1). The prioritization process converts Hydro One Distribution business values (consistent with the strategic goals set out in Exhibit A, Tab 3, Schedule 1) and key performance indicators in Table 1 into investment criteria and guidelines that are used for managing risk and facilitating trade-offs between investments. At the core of the process is a multi-criteria analysis, which is used to help decision-makers understand and quantify business risks and uncertainties so that objective decisions can be made respecting priorities.

Capital and OM&A investments are prioritized on an annual basis. The investments included in the process have been developed in response to asset, customer and business needs. The process incorporates risk tolerances consistent with corporate direction and also considers resource constraints.

The output of the prioritization process is an investment plan proposal. While this proposal is prepared at a specific time of the year, the resulting plan is modified as new risks or opportunities emerge, conditions change, and/or priorities shift throughout the year. A redirection process, described in Section 2.5 of this Exhibit, enables the incorporation of such modifications.

The investment plan proposal is composed of a list of prioritized program/project investments, both capital and OM&A. Program/project descriptions for 2008 capital investments in excess of \$1 million are provided in Exhibit D2, Tab 2, Schedule 3.

1 **2.0 INVESTMENT PRIORITIZATION PROCESS**

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3 The current investment prioritization process was implemented in 2001, in response to
4 utility best practice and to address factors such as aging infrastructure, customer demand
5 for higher reliability, changing regulations, funding pressures, etc. Since 2001, the
6 process has seen continuous improvements using the experience gained in each
7 subsequent year. For example, the prioritization methodology has been expanded over
8 the years to cover a broader scope of program areas. Also, program execution issues
9 such as outage availability, effective work bundling, etc. have been more fully included
10 in the development of the proposed expenditures, which has resulted in investment
11 proposals that are more accurate from an implementation perspective.

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13 The prioritization process uses the business values to rank proposed investment levels in
14 accordance to the benefits they provide, and facilitates the preparation of an investment
15 plan proposal. This annual process consists of the following steps:

- 16
17 • Define business values
18 • Develop multiple levels of investments to meet business values while mitigating
19 identified risks
20 • Determine the cost and benefits for each level
21 • Prioritize the levels across all areas
22 • Assess the results and build the investment plan

23
24 These steps are described in the remainder of this exhibit.
25

2.1 Business Values

The Business Values (BVs) are designed to enable the achievement of the strategic goals set out in Exhibit A, Tab 3, Schedule 1. They form the basis of the criteria used to develop investments, manage risk and facilitate trade-offs between investments.

BVs are defined by key success factors and measured by a set of key performance indicators (KPIs). The BVs and associated key success factors represent the objectives that are to be factored into the decision making, while the KPIs represent how the impact on the BVs is to be measured. The table below shows the BVs and KPIs used in 2007 to establish the 2008 investment plan proposal.

**Table 1
 Business Values, Key Success Factors and Key Performance Indicators**

| Business Value (BV) | Key Success Factor | Measure / Key Performance Indicator (KPI) |
|----------------------------|---|---|
| Safety and Environment | Keep our People, Service Providers and the Public Safe; Limit Impact on the Environment | <ul style="list-style-type: none"> • Deficiencies in Health and Safety Managed System • Public Safety • Environmental Impact |
| Customer | Improve Overall Customer Satisfaction | <ul style="list-style-type: none"> • Customer Satisfaction Survey |
| Reliability | Ensure Reliable Delivery of Electricity | <ul style="list-style-type: none"> • SAIDI • SAIFI |
| Financial | Meet Hydro One's Profitability Target | <ul style="list-style-type: none"> • Net Income • Net Present Value |
| Efficiency & Effectiveness | Increase Hydro One Competitiveness | <ul style="list-style-type: none"> • Work Program Accomplishment • Unit Cost Reduction • Competent and Skilled Staff |
| Reputation | Strengthen Hydro One's Reputation | <ul style="list-style-type: none"> • Public Profile • Shareholder Confidence |
| Regulatory Relationship | Meet All Compliance Standards | <ul style="list-style-type: none"> • Regulator's Confidence • Distribution System Code Requirements • Legal Violations |

1 The KPIs form the basis of the multi-criteria analysis used to prioritize investments by
2 measuring the impact on BVs if the associated investment is not made. For each impact
3 level, there is a likelihood of the impact occurring. The process incorporates a five-point
4 scale to determine the impact ratings for each KPI: Minor, Moderate, Major, Severe and
5 Worst Case.

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7 BVs, success factors and KPIs are reviewed yearly to ensure that they remain aligned
8 with Hydro One's strategic goals. The review follows the strategy phase of the overall
9 planning process (see Exhibit A, Tab 14, Schedule 1). Following the review, strategic
10 goals, BVs, success factors and KPIs are formally issued to contributors to the investment
11 prioritization process.

12 13 **2.2 Multiple Investment Levels**

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15 Customer, asset and business needs, risks and objectives guide ongoing planning
16 activities. Investment proposals are developed to address these needs, risks and
17 objectives, which are then input into the prioritization process. However, the scope and
18 level of most investments – and the accomplishments those investments deliver – will
19 vary depending on the level of risk mitigated. Therefore, besides prioritizing investments
20 that address different needs, risks and objectives, there is also a need to prioritize
21 different levels of accomplishments within an investment area.

22
23 Increasing levels of accomplishment representing decreasing levels of risk to the BVs are
24 established for each area. For example, increasing investment funding so that 7,000
25 substandard wood poles are replaced in a year compared to a level of funding which
26 results in replacement of 4,000 substandard wood poles results in a lowering of risks
27 related to reliability and safety. In other cases, reduced accomplishment levels can create
28 longer term sustainability issues, resulting in higher long term costs. There are also
29 minimum levels of accomplishment which are necessary to avoid unacceptable risk to the

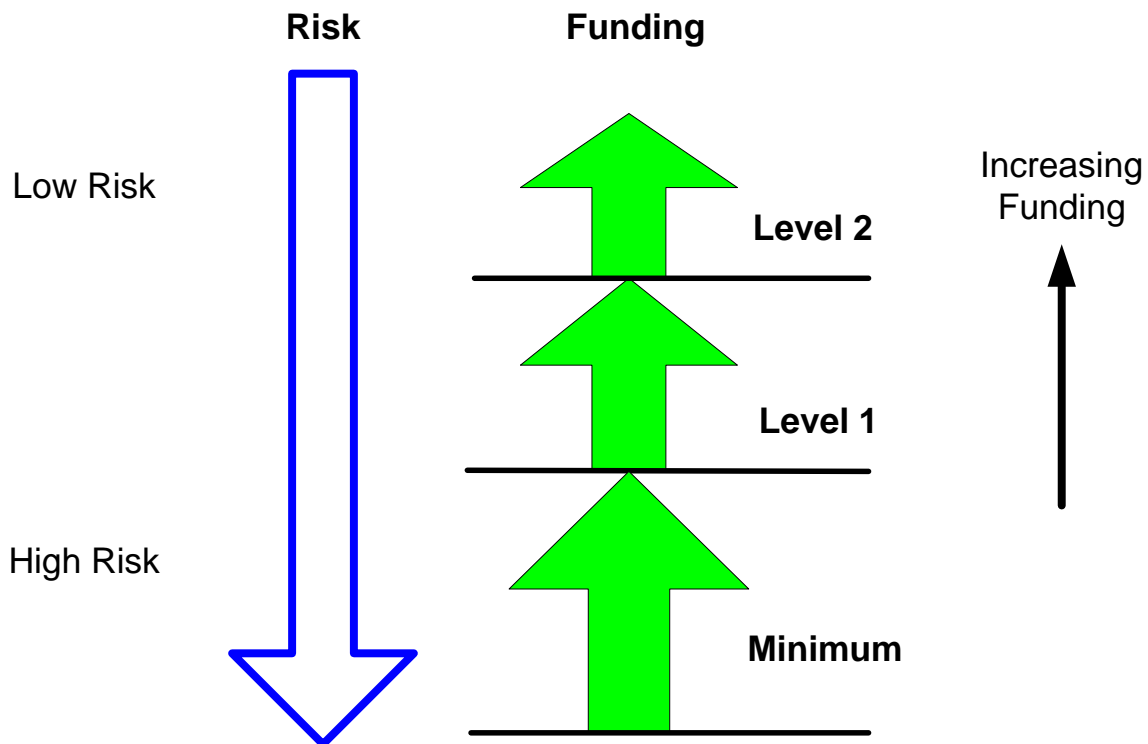
1 BVs. For example, if accomplishments fall below a certain level for a particular
2 program, meeting applicable safety, regulatory or legal requirements may be at risk. In
3 the example above, the prioritization process could identify that replacing less than 4,000
4 poles per year would represent an unacceptable reliability and safety risk. Another
5 example would be accomplishments necessary to meet the minimum requirements
6 prescribed by the Distribution System Code.

7

8 The approach is illustrated in Figure 1 below.

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Figure 1
Accomplishment Levels versus Risk



1 Accomplishment levels are established and evaluated for a period of five years to allow
2 for, among other things (see section 2.5 below), the long-term management of resources.
3 Short-term constraints, such as scheduling of skilled staff or outages, are also considered
4 when establishing the levels of work that are undertaken.

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6 **2.3 Investment Costs and Benefits**

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8 Total funding requirements to carry out the accomplishments established for each level of
9 investment are determined using current year costs as the basis.

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11 In some cases, there are identified linkages between particular investment areas which are
12 factored in to the plans for those investment areas. For example, additional vegetation
13 management accomplishments should over time reduce the number and extent of trouble
14 calls and damage during storms, thus reducing the future funding required for trouble
15 calls and storm damage. The total net cost is used in the resulting investment plan.

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17 The benefits of each investment are determined by its level of accomplishment and its
18 ability to mitigate risk to the BVs. The KPIs provide a common set of criteria to measure
19 the impact, or consequence, of the investment on the BV. However, risk is the product of
20 the consequence and the probability of occurrence, so this probability also has to be
21 established. The process makes use of five likelihood ratings to establish probabilities:
22 very likely, likely, medium, unlikely and remote. BV risk is identified in a two-dimension
23 table as shown in Table 2. Using this approach, the change in risk for each BV as a result
24 of the investment is established.

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Table 2
Business Value Evaluation Matrix

| | Minor | Moderate | Major | Severe | Worst Case |
|------------------------|-------|------------------------|-------|-----------------------------------|------------|
| Very Likely (>95%) | | | | Unacceptable Risk Zone | |
| Likely (65 to 95%) | | | | | |
| Medium (25 to 65%) | | <i>Decreasing Risk</i> | | | |
| Unlikely (5 to 25%) | | | | | |
| Remote (< 5%) | | | | | |

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2.4 Investment Prioritization

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The needs, objectives, accomplishments, costs, and risk assessment for each level of investment are documented. Asset managers and other stakeholders within Hydro One then review the information. The review ensures the full integration of the numerous investment proposals, and uniformity in the use of the risk assessment model.

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The information provides the necessary cost and risk mitigation data required to conduct the prioritization. All investment levels are prioritized, with the exception of the minimum levels, which are automatically placed in the investment plan proposal. The prioritization methodology then gives priority to investments based on their ability to mitigate significant risk to the BVs.

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A preliminary investment plan proposal is prepared based on the results of the prioritization of capital and OM&A investments. The proposal reflects considerations related to how effectively the investments mitigate risk to the BVs, and overall

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1 affordability of the proposal. The previous year's business plan is used as a reference
2 point.

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4 The preliminary investment plan proposal is assessed by Senior Management, where the
5 residual risk to the business (i.e., the risk to the BVs that remains after the investments
6 are made) is considered before the final investment plan proposal and associated funding
7 requirements are established.

8 9 **2.5 Investment Plan and Redirection**

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11 A five-year planning period is used for the investment plan proposal. A shorter period
12 would not adequately recognize those investments that tend to deliver benefits over
13 longer periods. This is particularly the case for investments that maintain or replace
14 existing assets. The five-year period also allows for the longer term management of
15 resources and allows for redirection of investments between years.

16
17 While the investment plan proposal is the product of extensive planning and analysis, it
18 must at the same time be dynamic and flexible. Redirection may be required for a
19 number of reasons, including changing customer needs, changing asset priorities based
20 on new information, changing external requirements, major events (e.g., extensive
21 storms, equipment failures), and affordability issues. All of these considerations can
22 impact on the subsequent business planning process. This is why the actual plan that is
23 implemented may be modified during the business planning process, and also throughout
24 the year as new risks or opportunities emerge, conditions change, and priorities shift.
25 This redirection of work allows adjustments to be made to the investment plans. For
26 example, distribution line emergency restoration work required to repair damage caused
27 by storms or equipment failures can be significant in any given year, and it is imperative
28 to redirect the required funds and field resources from other investment areas to correct
29 the damage.