Annual Report 2006

Our choice is clear... and clean.

Hydro Québec

Hydro-Québec generates, transmits and distributes electricity, mainly using renewable energy sources, in particular hydroelectricity. It supports the development of wind energy through purchases from independent power producers. It also conducts research and development in energy-related fields such as energy efficiency. The company, whose sole shareholder is the Québec government, comprises four divisions:

Hydro-Québec Production generates power for the Québec market. When appropriate, it sells its surpluses on markets outside Québec, where it is also active in arbitraging and purchase/resale transactions.

Hydro-Québec TransÉnergie operates the most extensive transmission system in North America for the benefit of customers inside and outside Québec.

Hydro-Québec Distribution provides Quebecers with a reliable supply of electricity. To meet needs beyond the annual heritage pool which Hydro-Québec Production is obliged to supply at a fixed price, it mainly uses a tendering process. It also works to encourage its customers to make efficient use of electricity.

Hydro-Québec Équipement and Société d'énergie de la Baie James, a subsidiary of Hydro-Québec, are the prime contractors in construction projects for Hydro-Québec Production and Hydro-Québec TransÉnergie.

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On the cover
Toulnustouc hydroelectric development

Our choice is clear... and clean.

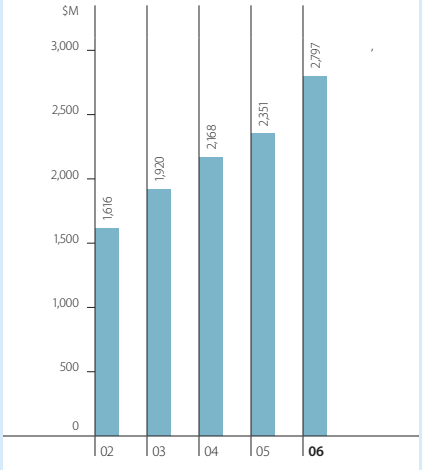
Hydro-Québec relies on its hydroelectric generating fleet to produce billions of kilowatthours a year without depleting water resources. We are continuing to develop hydropower potential in Québec — not only to meet today's growing demand, but to ensure a clean source of power for future generations. Our commitment to sustainability is also expressed through energy efficiency programs, wind power purchases and technical innovation … not to mention the smaller, everyday gestures that are an integral part of working at Hydro-Québec.

Hydro-Québec at a Glance

	2006	2005
Operations and Dividends ($M)		
Revenue	**11,161**	10,888
Operating income	**5,009**	4,538
Income from continuing operations	**2,797**	2,351
Income (loss) from discontinued operations	**944**	(99)
Net income	**3,741**	2,252
Dividends declared	**2,342**	1,126
Balance Sheets ($M)		
Total assets	**63,248**	60,432
Assets held for sale	**42**	2,311
Long-term debt, including current portion	**35,491**	34,427
Liabilities related to assets held for sale	**8**	1,385
Shareholder's equity	**18,840**	17,376
Cash Flows ($M)		
Operating activities	**4,006**	4,401
Investing activities	**(4,276)**	(3,650)
Financing activities	**183**	(856)
Cash flows from discontinued operations	**52**	101
Cash and cash equivalents	**57**	92
Ratios (%)		
Return on equity	**20.7**	13.4
Average cost of debt	**7.9**	7.6
Profit margin from continuing operations	**25.1**	21.6
Capitalization	**36.1**	34.2
Self-financing	**86.5**	58.6

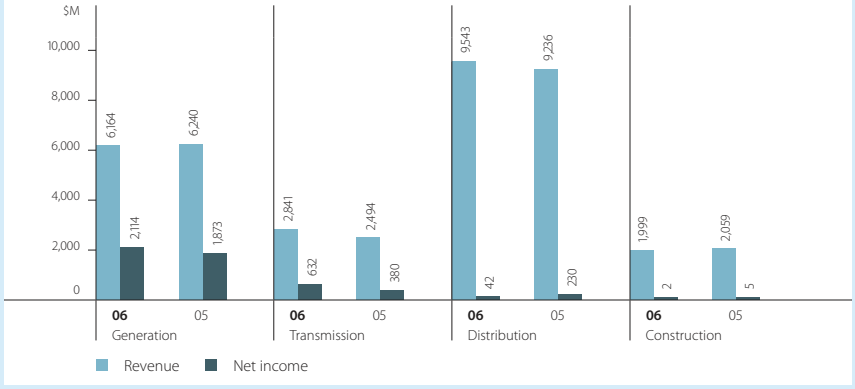
Note: Certain comparative figures have been reclassified to reflect the presentation adopted for 2006.

Income from Continuing Operations

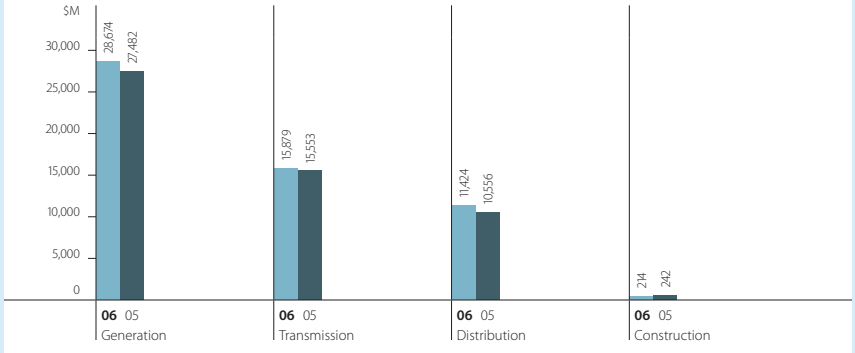


Income from continuing operations totaled $2.8 billion, up $446 million from 2005. This increase is mainly attributable to the recognition of a foreign exchange gain on debts and swaps denominated in U.S. dollars.

Revenue and Net Income by Segment



Total Assets by Segment



Note: Certain comparative figures have been reclassified to reflect the presentation adopted for 2006.

	2006	2005	2004	2003	2002
Customers and Sales					
Total customer accounts in Québec	**3,815,126**	3,752,510	3,701,275	3,644,463	3,596,542
Electricity sales in Québec (TWh)	**167.3**	169.2	165.9	167.1	158.6
Electricity sales outside Québec (TWh)	**14.5**	15.3	14.4	15.8	54.2
Number of Employees[a]					
Permanent as at December 31	**19,116**	19,009	18,835	18,317	18,025
Temporary (year's average)	**3,799**	3,577	3,567	3,596	3,632
Facilities					
Number of hydroelectric generating stations	**55**	54	53	52	51
Total installed capacity (MW)[b]	**35,315**	34,571	33,892	33,616	32,661
Peak power demand in Québec (MW)[c]	**36,251**	33,636	34,956	36,268	34,989
Lines (overhead and underground)					
Transmission (km)	**32,826**	32,544	32,487	32,434	32,314
Distribution (km)[d]	**108,883**	108,344	107,423	106,568	105,871
Number of transmission substations	**508**	505	506	506	505
Power Generation and Purchases					
Renewables (GWh)	**182,423**	183,399	175,704	180,556	183,304
All generating sources (GWh)	**194,280**	192,862	188,269	191,841	191,491
Proportion of renewables (%)	**94**	95	93	94	96

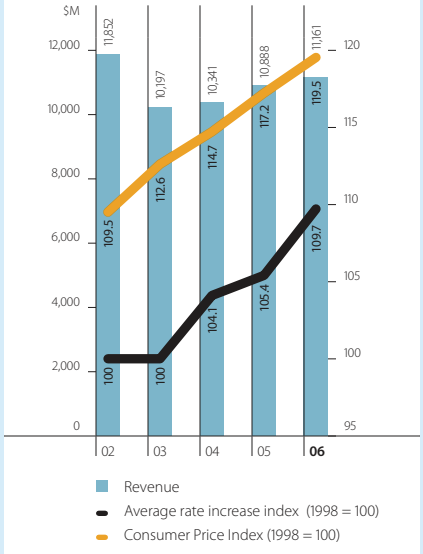
a) Excludes employees of subsidiaries and joint ventures.

b) Hydro-Québec also has access to almost all the output from Churchill Falls generating station (5,428 MW) and purchases all the output from six privately owned wind farms with a total installed capacity of 320 MW. In addition, 1,206 MW are available under agreements with other independent suppliers.

c) Total power demand at the annual domestic peak for the winter beginning in December, including interruptible power.

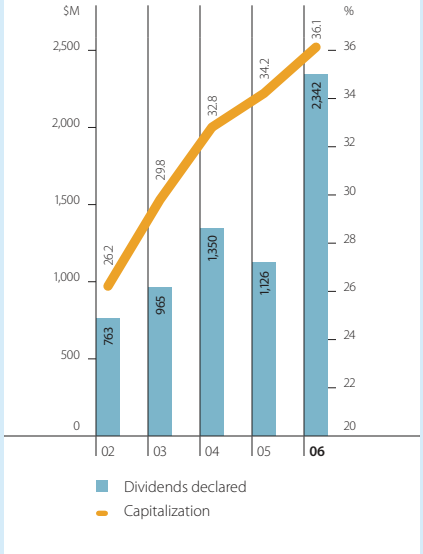
d) These figures include off-grid systems but exclude private systems, lines under construction and 44-kV lines (transmission).

Revenue, Average Rate Increase Index and Consumer Price Index



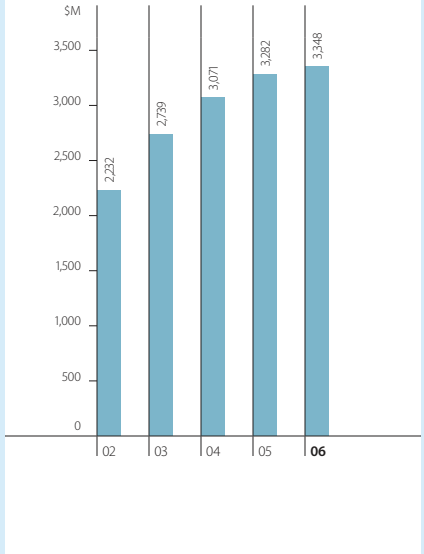
Revenue totaled $11.2 billion, up 2.5% over 2005. This increase was mainly the result of the recognition of a foreign exchange gain on debts and swaps denominated in U.S. dollars. Revenue from sales in Québec rose $281 million; revenue from sales on markets outside Québec decreased by $315 million.

Dividends Declared and Capitalization



Dividends of $2,342 million were declared. This tenth consecutive payment, the largest to date, will bring the total paid to our shareholder since 1998 to over $8.7 billion.

Investments in Property, Plant and Equipment and Intangible Assets



Cash from operations stood at $4.0 billion. Combined with the proceeds of the sale of our foreign holdings (more than $2 billion), these funds made it possible to finance a substantial portion of our capital program ($3.3 billion) and pay the dividends declared for 2005 ($1,126 million).

Note: Certain comparative figures have been reclassified to reflect the presentation adopted for 2006.

Strong performance

Hydro-Québec continued to improve its financial performance in 2006 — testimony to its careful management and its employees' commitment. The results achieved, which are the outcome of both the company's core operations and our decision to sell off foreign assets, will allow us to pay our shareholder record dividends.

Throughout the year, the Board of Directors worked to ensure that Hydro-Québec met the challenges of its growth and the economic role it plays in Québec. Among other activities, it approved the *Strategic Plan 2006–2010* and closely monitored the company's financial position, risk management, infrastructure investments and technological development, as well as the sale of its foreign assets. It also focused on issues related to succession, training, and employee motivation and compensation.

The Board took note of the requirements of the *Act respecting the governance of state-owned enterprises and amending various legislative provisions*, which the Québec government adopted in December. Most of its current practices are already in line with the new law, for example, the separation of the positions of Chairman of the Board and President and Chief Executive Officer, the functions of the Audit, Human Resources, and Environment and Corporate Governance committees, and the stipulations of the *Code of Ethics and Rules of Professional Conduct for Directors, Executives and Controllers of Hydro-Québec*.

Hydro-Québec's Board of Directors is made up of experienced people from a variety of backgrounds who advise and support the company in choosing and applying its strategic objectives. They all demonstrate exemplary motivation and dedication, and I thank them for their invaluable input. Sadly, in 2006 we lost one of our long-time members, Yvon Lamontagne, Chair of the Audit Committee, who passed away in March. I would like to express my gratitude to Michel Noël de Tilly and Régis Labeaume, who left the Board during the year. Two new members, Anik Brochu and Hélène F. Fortin, will contribute their expertise and competence to benefit the company.

Michael L. Turcotte
Chairman of the Board

> "The Board carefully monitored the efforts made by Corporate Management and all our employees to keep Hydro-Québec on a prosperous footing."
>
> **Michael L. Turcotte**

Results that speak for themselves

In 2006, net income reached a new record, rising to $3.74 billion. Income from continuing operations amounted to $2.80 billion, up 19% from $2.35 billion in 2005. The sale of almost all of our foreign assets yielded a further $944 million in income from discontinued operations. As a result, we will be able to pay dividends of $2.34 billion — our largest ever — to our shareholder, the Québec government.

Sustainability at the heart of our activities

By making sustainability an integral part of all our activities, Hydro-Québec contributes to improving the collective well-being through its values, its policies and its day-to-day practices. In September, we testified to this commitment before a parliamentary commission and explained how the three main development thrusts that underlie our *Strategic Plan 2006 – 2010* will guide our actions in the coming years. Essentially, we are relying on energy efficiency, technological innovation and the complementary development of hydroelectricity and wind power to meet the needs of today and pave the way for tomorrow.

Continued development of hydroelectric potential

In 2006, the 480-MW Eastmain-1 powerhouse was commissioned several months ahead of schedule, and construction proceeded on Péribonka, Mercier, Chute-Allard and Rapides-des-Cœurs generating stations. In addition, the provincial and federal authorities have given us the green light for the Eastmain-1-A/Sarcelle/Rupert project. Officially launched on January 11, 2007, this "project of the decade," which will add 893 MW to our generating fleet, will provide us with annual output of 8.5 TWh at a highly competitive cost.

The role of wind power

Following Hydro-Québec Distribution's signing of contracts with independent power producers in 2005 for the supply of 990 MW of wind power, we began upgrading the transmission system in order to integrate this new generating option and maximize its contribution. We were consequently able to bring Baie-des-Sables wind farm onto the grid, and it delivered its first megawatthours in November.

Increasingly popular programs

Our energy efficiency programs are attracting a growing number of customers. The favorable response by all customer categories to our heightened efforts in this area gave rise to total energy savings of 643 GWh in 2006, enabling us to surpass our objective for the second year in a row. We have therefore decided to raise our energy conservation target from 4.1 to 4.7 TWh by 2010, and to 8 TWh by 2015. Every kilowatthour saved represents a gain both for the environment and for our customers.

Major investments in transmission

Hydro-Québec's transmission system is constantly evolving, as demonstrated by the $882 million we devoted to rolling out advanced technologies, connecting generating stations such as Eastmain-1, Péribonka and Bécancour (TransCanada Energy), and ensuring the long-term operability of our facilities. Our efforts are bearing fruit, as was corroborated by an audit conducted in 2006 by the North American Electric Reliability Council which cited our grid for excellence in a dozen different areas, confirming that our system had achieved a remarkable level of reliability.

Sound labor relations

We signed a new collective agreement with the union representing specialists and professionals at Hydro-Québec, and updated the salary clauses of six other agreements. The result is that the work activities of all our unionized employees are now covered by labor agreements in due form. This step forward guarantees a stable work climate, which will be a major factor in achieving our long-term objectives.

Numerous jobsites

Hydro-Québec Équipement and Société d'énergie de la Baie James managed a portfolio of 166 generating station construction, refurbishment and refitting studies and projects. And that number does not include the nearly 1,000 transmission-related projects carried out by Hydro-Québec Équipement. The two entities' volume of activity totaled $1,999 million. As a result of the efficient management of these projects, several facilities were commissioned ahead of schedule.

Improved performance through technological innovation

The performance of our facilities depends on developing and integrating new technologies. Under mandates assigned to it by the Generator, the Transmission Provider and the Distributor, our research institute worked on over a hundred innovation projects in 2006.

The people behind our success

The sizable increase in our generating fleet in 2006 enabled us to expand our margin of operating flexibility. Thanks to the outstanding performance made possible by the hard work of the people with energy who make up the company, Hydro-Québec is very profitable and stands out as one of the flagships of the Québec economy.

We would like to thank the members of the Board of Directors for giving us the benefit of their invaluable experience and knowledge.

Thierry Vandal
President and Chief Executive Officer

> "Sustainable development guides our long-term strategies and our daily operations."
>
> **Thierry Vandal**

Eastmain-1 powerhouse, inaugurated in December, adds 480 MW to our generating capacity. These megawatts, available at all times, enhance the security of our electricity supply. Bringing this project to fruition is one component in the continuing development of Québec's hydropower potential.

Hydro-Québec Production

A longstanding commitment to hydroelectricity

In 2006, as always, Hydro-Québec Production was able to count on the skill and motivation of all its employees and partners in carrying out a large number of hydroelectric generating projects. One of the year's highlights was the commissioning of Eastmain-1 powerhouse months ahead of schedule, at a cost of $2.3 billion. Also noteworthy were the public hearings on the Eastmain-1-A/Sarcelle/Rupert project, which called for sustained efforts from everyone who took part in them. Thanks to the work of these people, and of the hundreds who labored on the preliminary studies, the provincial Review Committee and the federal Review Panel recommended that the competent authorities approve this major undertaking.

In addition, in order to extend the service life of certain generating stations and increase their efficiency, we carried out refurbishment work worth a total of $441 million. Our periodic maintenance programs were also integral to achieving our output objectives. During the year, we managed our energy reserves rigorously, so we could make optimal use of them while fulfilling our contractual commitments. As for our financial results, we posted revenue of $6.2 billion, and our investments totaled $1.6 billion.

"Our employees' commitment and know-how are the key to our success."

Richard Cacchione
President, Hydro-Québec Production

OUR MISSION

Hydro-Québec Production generates electricity to supply the domestic market and sells its excess output on wholesale markets outside Québec. It also provides Hydro-Québec Distribution with wind power balancing services designed to offset fluctuations in wind output and thereby facilitate the integration of this energy source into the Hydro-Québec grid.

OUR FACILITIES

Our generating fleet comprises 54 hydroelectric generating stations, 1 nuclear generating station, 4 other thermal generating stations and 1 wind farm. It has an installed capacity of 35 GW and represents assets worth $25 billion. We also have 26 large reservoirs, with a storage capacity of 175 TWh, and more than 570 dams and control structures.

OUR ACTIVITIES

We supply Hydro-Québec Distribution with a heritage pool of up to 165 TWh of electricity per year, at an average price of 2.79¢/kWh. Above this volume, we compete freely in selling our output inside and outside Québec, in response to calls for tenders or on short-term markets.

2006 IN FIGURES

Revenue	$6.2 billion
Net income	$2.1 billion
Customers (% of revenue from electricity sales)	
Hydro-Québec Distribution	80%
Other	20%
Sales volume	
Hydro-Québec Distribution	165.1 TWh
Other	14.5 TWh
Property, plant and equipment as at December 31 (including work in progress)	$27.7 billion

Putting our energy to work

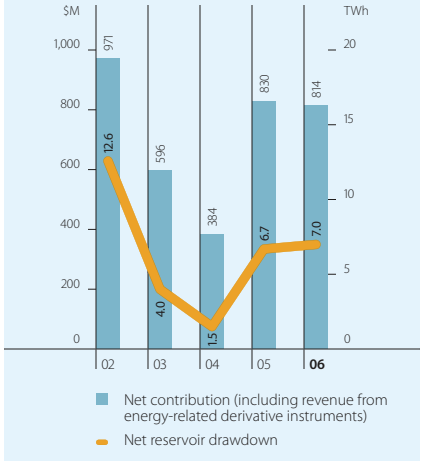
In addition to supplying the domestic heritage pool required by law, we continued to sell our excess output and conduct energy trading operations on markets outside Québec. The flexibility of our fleet of hydroelectric generating stations allows us to import electricity when prices on external markets are low and export it when prices are higher.

In 2006, exports accounted for only 3.9% of our sales volume, but generated 27% of net income.

- In 2006, we recorded net income of $2,114 million, up from $1,873 million in 2005. This $241-million increase is mainly due to a $234-million foreign exchange gain.
- Electricity sales outside Québec generated $1,149 million for 14.5 TWh, compared with $1,464 million for 15.3 TWh in 2005. Net electricity exports and the related financial transactions generated $814 million for a net reservoir drawdown of 7.0 TWh and unit income of 11.6¢/kWh — similar to the contribution in 2005 ($830 million for 6.7 TWh). The decline in sales is mainly attributable to a decrease in the volume of purchase/resale transactions in 2006.
- Electricity sales to Hydro-Québec Distribution totaled 165.1 TWh, versus 165.9 TWh in 2005.
- As at December 31, 2006, our energy reserves corresponded to 114.3 TWh, compared with 105.3 TWh at the end of the previous year. Because runoff was below the historic mean in the first three quarters, we had to limit net electricity exports and manage our reserves carefully. With the commissioning of the Eastmain-1 development in the second half and higher-than-average runoff in the fourth quarter, we were able to build up our reserves and increase the volume of exports by year end.
- We manage our reservoirs in such a way as to maintain a sufficient energy reserve at all times to offset a potential runoff deficit equivalent to 64 TWh over two consecutive years and 98 TWh over four consecutive years. To comply with the industry's current reliability criteria, we also keep a capacity reserve approximately 10% higher than our contract commitments.
- To support the agreements signed by Hydro-Québec Distribution with independent producers for the purchase of 990 MW of wind power, we offer the Distributor a wind power balancing service that continuously guarantees capacity equal to 35% of the contractual capacity of the wind farms operated commercially by those producers. Deliveries of wind power began in November 2006, following the startup of the 109.5-MW Baie-des-Sables facility. The seven other wind farms planned in the Gaspé region will gradually come on stream between now and 2012.

The average cost of a kilowatthour in 2006 was 1.9¢, which corresponds to the sum of the Generator's production and supply costs divided by the net sales volume.

Net Electricity Exports



We use water to generate 97% of our output.

Developing our hydroelectric potential

Work to develop Québec's hydroelectric potential proceeded at a steady pace in 2006. At year end, we had projects worth $2.3 billion under construction, for a capacity of 575 MW and annual output of 3.4 TWh. All our projects comply with the criteria we have set for development: they must be profitable, environmentally acceptable and favorably received by local communities.

We are continuing to develop Québec's hydroelectric potential in order to meet demand growth with clean, renewable energy.

- At James Bay, the commissioning of Eastmain-1 powerhouse several months ahead of schedule added 480 MW to our installed capacity and 2.7 TWh to our annual output. This $2.3-billion development further optimizes the La Grande complex.
- Construction moved ahead at Mercier generating station in the Outaouais region. The 51-MW facility, slated for commissioning in 2007, will add 0.3 TWh in annual output at a cost of $176 million.
- On the Péribonka River, in the Saguenay–Lac-Saint-Jean region, we are investing $1.4 billion to build a 385-MW generating station that will produce 2.2 TWh a year. We completed a critical stage in October when we finished pouring a plastic-concrete cutoff wall beneath the future dam. This wall, which is 312 m long and up to 115 m deep, will prevent reservoir water from seeping under the dam. Once it was in place, we were able to begin construction on the dam itself. Reservoir impoundment is scheduled for this coming fall, followed by commissioning of the three generating units in 2007 and early 2008.
- Work proceeded on the Chute-Allard and Rapides-des-Cœurs developments on the Saint-Maurice River. After these two generating stations come on stream in late 2008, they will supply a combined capacity of 139 MW and annual output of 0.9 TWh, in return for a capital outlay of approximately $0.7 billion.
- The environmental impact assessment of the Romaine hydropower complex in the Mingan region is due to be tabled in the second half of 2007. As currently planned, this complex will comprise four generating stations with a total installed capacity of 1,550 MW and annual output of 7.7 TWh.

Eastmain-1 powerhouse, in the James Bay region.

- The Québec government gave its approval for the Eastmain-1-A/Sarcelle/Rupert project on November 24; the federal authorities issued the approval of the Governor in Council on December 14. At a planned cost of $5.0 billion, this project is Québec's largest hydroelectric development of the decade. Two powerhouses will be constructed, and the Rupert River will be partially diverted to Eastmain 1 reservoir and then on to the three existing generating stations on the lower Grande Rivière, whose output will be increased by the new inflows. When completed, the project will add 893 MW to our fleet and 8.5 TWh in annual output. The diversion and powerhouses will go into operation in stages from the end of 2009 to winter 2012.
- Following work carried out by the supplier, Unit No. 1 at Sainte-Marguerite-3 generating station on the North Shore can now operate at its full 440-MW capacity.
- We are considering the construction of a 1,500-MW complex on the Petit Mécatina River, about 300 km east of the Romaine River. In 2006, we began studies and conducted surveys to determine the development's configuration and cost.

Long-term operability of our generating assets

In 2006, we invested $441 million in rehabilitating and refurbishing our facilities to ensure their long-term operability and, in some cases, to increase their generating capacity. Optimizing our assets depends on in-depth knowledge of the condition of our fleet and its upgrade potential. Our employees' expertise and commitment are therefore crucial to achieving our goals.

We operate assets valued at $25 billion.

- Work currently in progress at Outardes-3 and Outardes-4 will yield additional peak capacity of 334 MW by winter 2008 – 2009.
- At Beauharnois, rehabilitation continued with a view to adding approximately 200 GWh in annual output after the scheduled completion of the work in 2016.
- Work also proceeded on phase II of the La Tuque refurbishment, begun in 2005.
- Refurbishing at Rivière-des-Prairies, Rapide-2, Rapide-7 and Rapides-des-Quinze will ensure their reliability and long-term operability.
- Rehabilitation progressed at Coteau-1, Coteau-3 and Île-Juillet dams, and got under way at Melville dam in the Shawinigan complex.
- Rehabilitation also continued at Mercier dam, along with alterations in preparation for the addition of the generating station of the same name, which is currently being built.

The Premier of Québec, Jean Charest, with the Grand Chief of the Grand Council of the Crees, Matthew Mukash, at the launch of the Eastmain-1-A/Sarcelle/Rupert project.

Péribonka generating station, under construction in the Saguenay–Lac-Saint-Jean region.

- Following a public hearing held on August 16 and November 7, the Canadian Nuclear Safety Commission (CNSC) announced on December 22 that it would renew the operating licence of Gentilly-2 generating station until the end of 2010. A public hearing was also held before the CNSC on November 7 and 8 concerning the environmental impact assessment of the project to modify the radioactive waste storage facilities and refurbish the plant. A favorable decision on the assessment was issued on December 22. We expect to complete the alterations to the storage facilities in 2007, once we receive the necessary approvals. Studies on refurbishing the plant continue, and we plan to make a decision on this aspect of the project by 2008.
- The ongoing program to increase security at our facilities, launched in 2005, is scheduled for completion in 2007.

Improving generation through innovation

To meet our technological innovation needs, we assigned our research institute a portfolio of 17 projects worth a total of nearly $18 million in 2006.

- The MIDA diagnostic tool, which rates generators on the basis of their degree of wear, is in the final stage of development. Innovations now at the industrialization stage include a Scompi robot specially designed for welding and grinding hydraulic turbine blades.
- In the fall, during a scheduled shutdown of Gentilly-2 generating station, we successfully measured the residual tension in the guide tube springs in the plant's reactivity mechanisms. This feat — a first for CANDU reactors — was made possible by a tool developed in cooperation with a team of researchers and technicians at the institute.
- Two new projects got off the ground in 2006. The first involves modeling the mechanization of the dismantling of reactor feed pipes at Gentilly-2 in order to facilitate and speed up refurbishment and increase worker safety. The second centres on robot inspection of lintels, sills and embedded parts of hydraulic control structure gates to better diagnose the condition of parts before repair work begins.

Refurbishment at Rapide-7 generating station, in the Abitibi-Témiscamingue region.

Francis turbine at Beauharnois generating station, in the Montérégie region, where modernization is under way.

Refurbishment at La Tuque, in the Mauricie region.

We count on state-of-the-art technologies to make our transmission grid more reliable. With this in mind, we are continuing to convert our facilities and systems to digital technologies in order to improve performance, service quality and efficiency.

Hydro-Québec TransÉnergie

A focus on continued improvement

In 2006, we increased the capacity of our transmission system and brought 1,246 MW in new output onto the grid. We also carried out extensive equipment refurbishment and introduced more efficient technologies. Altogether, our capital investments totaled $882 million.

Major efforts went into maintaining and improving the quality of our assets with a view to maximizing system reliability. In a report issued in June, the North American Electric Reliability Council recognized that our grid is remarkably reliable and remains stable during major events.

To see our projects through, we rely on diversified expertise that keeps pace with the latest technological advances. That is why we offer our employees training inspired by industry best practices and constantly improve our work methods to make them ever more efficient.

"It takes sustained effort to maintain transmission system reliability. Day after day, our people work to make it happen."

Isabelle Courville
President, Hydro-Québec TransÉnergie

OUR MISSION

Hydro-Québec TransÉnergie operates the most extensive transmission system in North America. It manages power flows throughout Québec and markets system capacity, while maintaining the necessary standard of reliability.

OUR FACILITIES

Our system comprises 32,826 km of lines and 508 substations, as well as numerous interconnections with the systems in Ontario, New Brunswick and the U.S. Northeast.

OUR ACTIVITIES

In compliance with North American regulatory provisions, we offer non-discriminatory access to our system to all customers on the wholesale market in northeastern North America.

2006 IN FIGURES

Revenue	$2.8 billion
Net income	$632 million
Customers (% of revenue)	
Hydro-Québec Distribution (transmission services)	93%
North American wholesalers (transmission services)	5%
Other	2%
Property, plant and equipment as at December 31 (including work in progress)	$15.0 billion
Regulatory regime	Cost-based

An expanding system

We invested $405 million in developing the transmission system in 2006. This included bringing the output of Baie-des-Sables wind farm, Eastmain-1 and Bécancour (TransCanada Energy) generating stations and the Bowater Canadian Forest Products plant onto the grid. We also continued to expand capacity at several substations and broke ground on two new satellite substations, which are substations connected to the main grid through source substations. In addition, we launched a project for a new interconnection with Ontario.

Our system is growing yearly to meet increased demand.

- Connecting Baie-des-Sables wind farm, in the Gaspé region, called for a capital investment of $11 million. Work is proceeding to adapt the region's transmission facilities, including Gaspé, Percé and Rivière-au-Renard substations, to prepare for the upcoming connection of L'Anse-à-Valleau wind farm.
- The connection of Eastmain-1 powerhouse, in the James Bay region, was completed with the construction of the substation of the same name and a 59-km, 315-kV line, as well as the addition of a 735/315-kV section to Nemiscau substation, at a total cost of $157 million.
- We connected the TransCanada Energy cogeneration plant to Bécancour substation, at a cost of $44 million. We also connected Vignan substation to the Bowater Canadian Forest Products cogeneration facility, which produces electricity from biomass; this was a $2-million project.
- With a view to connecting the future Péribonka generating station, in the Saguenay–Lac-Saint-Jean region, we began building a 128-km, 161-kV line, plus Simard and Péribonka substations. This project will cost an estimated $185 million.
- In the Upper Mauricie region, work got under way to connect the future Chute-Allard and Rapides-des-Cœurs generating stations to Rapide-Blanc substation. This $105-million project calls for construction of a switchyard at each of these two new powerhouses and a 61-km, 230-kV line, as well as an upgrade of Des Hêtres substation.
- In November, we brought the Cree community of Waskaganish, in the James Bay region, onto the grid. This effort entailed building a satellite substation and a 208-km, 69-kV line, at a cost of $74 million.
- To meet growth in native load, we increased transformer capacity at 11 satellite substations, at a cost of $87 million. In addition, in the Québec City region, we invested $15 million to build a new Donnacona substation next to the old one, which no longer satisfied demand in this fast-growing city.
- To expand energy interchanges with Ontario, we launched an approximately $684-million project to develop a 1,250-MW interconnection in the Outaouais region. We plan to build a 315/230-kV converter station for this interconnection and a 113-km, 315-kV line, which is subject to Régie de l'énergie approval. The substation is scheduled to be commissioned in 2009 and the line in 2010.
- Studies on integrating the output of other planned wind farms are in progress. They focus on developing forecasting models, stochastic simulation and wind farm modeling.

Eastmain-1 powerhouse is connected to the grid by a 315-kV line and substation.

A 69-kV substation has been built to serve the Cree community of Waskaganish.

Reliability that is recognized continent-wide

Our rapidly changing transmission grid calls for redoubled vigilance to avoid compromising overall power system reliability. The same need for reliability has prompted us to invest in major undertakings to ensure long-term operability. This included $477 million in 2006 to maintain and upgrade our facilities, integrate state-of-the-art technologies, and comply with the legal and regulatory requirements of operating a transmission system.

NERC awarded us top marks in 12 different areas in recognition of the reliability of our transmission system.

- Following audits performed all over North America to determine power system reliability, the North American Electric Reliability Council (NERC) rated Hydro-Québec TransÉnergie's performance as excellent in 12 different areas, including operator training and special protection systems. The division drew up an action plan in response to certain recommendations concerning training.
- The average number of hours of service interruption per customer held steady at 0.54 — bettering our target of 0.60 hours per year.
- The quality of our grid enabled us to handle the 2006 – 2007 winter peak load of 36,251 MW, which occurred on February 5, 2007, at 5:30 p.m.
- A $22-million refurbishment of Jonquière substation in the Lac-Saint-Jean area is under way.
- To increase system security, we continued work at Lévis substation to install 735-kV line de-icing equipment slated for commissioning in 2007, and related work on a number of lines in the Québec City region — in all, a $191-million project.
- The multiterminal direct-current (MTDC) system began operating in hybrid (unipolar-bipolar) mode. This system is used to carry the electricity produced at James Bay to the United States. The new operating mode, making its industry debut here, means that the system will keep running even if there is a converter outage at one of the terminals.
- The PONCTEQ system — the product of over four years of collaboration with our research institute — performs spot checks to detect circuit breaker faults. At Jacques-Cartier substation, we installed the system on two 765-kV circuit breakers that operate shunt reactors used to improve system stability.

Refurbishment at Jonquière substation, in the Lac-Saint-Jean area.

Converter valve room at Radisson substation, in the James Bay region. The substation is part of the MTDC system, which constitutes one of the world's most powerful direct-current links.

On the leading edge of technology

Advanced technologies play an increasingly vital role in transmission grids. In keeping with our technology evolution plan, we therefore continued the process of integrating digital technologies, in particular tools for improved facility monitoring and contingency management, into our system.

- Installation of a new system management tool — the SCADA GEN-4 supervisory control and data acquisition system — continued in Québec City, Montréal and Saint-Jérôme.
- We are now using a control mechanism that allows us to lower voltage on the transmission system at peak periods without affecting service quality. This offers our dispatchers an additional 250 MW or so of operating flexibility to manage the winter peak.
- For de-icing operations on transmission lines, we employ various tools developed by our research institute. For example, the System Control Centre uses the STRADEG de-icing software to produce and help deploy optimized de-icing scenarios in case of ice storms.
- We took advantage of the reconstruction of Frégeau substation, in the Mauricie region, to equip the facility with latest-generation protection and data acquisition systems. Ultimately, remote parameterizing, diagnostic and maintenance functions will all be performed at this substation, making it a model for system management.

Closely monitored activities

In Québec, transmission is regulated by the Régie de l'énergie, which sets the rates on the basis of cost of service. The Régie also approves Hydro-Québec TransÉnergie's capital investments and terms of service.

In 2006, the Régie approved $588 million in transmission system investments.

- In April 2006, the Régie authorized an annual increase of $170 million in our transmission revenue for the native load, retroactive to January 1, 2005. This increase takes into account the cost of the transmission infrastructure required to meet the growth in domestic demand.
- The Régie approved capital projects designed to bring the future Péribonka, Chute-Allard and Rapides-des-Cœurs generating stations onto the grid. It also approved the capital budgets of nearly all of our projects for 2006 costing less than $25 million each. These investments totaled $588 million altogether.
- During the year, we applied to the Régie for permission to connect the Cree community of Wemindji and carry out major work at Hauterive substation.
- In December 2006, the Régie approved the total budget of $512 million that we had submitted for projects in 2007 costing less than $25 million each.

A 161-kV line will connect Péribonka generating station to the grid.

Transformer capacity has been increased at La Prairie substation, in the Montérégie region.

- In February 2007, the Régie handed down a preliminary decision on our 2006 application to modify our conditions of service for 2007. It set the revenue needed for the provision of transmission services at $2,675 million, which results in an annual increase of $57 million, retroactive to January 1, 2007, for native load transmission revenue. This increase, like the one authorized 11 months earlier, was made necessary by the higher cost of the infrastructure needed to meet demand growth in Québec.
- Across North America, transmission regulation is heavily influenced by the U.S. *Energy Policy Act*, which sets out mandatory reliability standards and financial sanctions in case of non-compliance. In 2006, Québec's transmission system, which is asynchronous with neighboring systems, was recognized administratively as a full interconnection. The province will consequently be able to develop its own reliability standards, as needed, which will apply in addition to the relevant North American standards. Through the Régie de l'énergie, it will also be able to ensure that all users of the Québec system fully abide by the standards in effect in the province.

Innovating to improve transmission service

Hydro-Québec TransÉnergie devotes over $16 million a year to developing and adapting technological innovations to improve the performance of its system. These projects are carried out jointly with Hydro-Québec's research institute.

- We are currently testing a technology for wireless field data transmission at Hertel substation. The goal of the pilot project is to improve data transmission and make it more secure, and reduce wiring costs inside facilities.
- To optimize maintenance operations, we are developing a new diagnostic method for high-voltage circuit breakers. We are also working on a device to detect cracked insulators, which will be used to locate faults on live insulators.
- We established a new method for measuring dynamic resistance in SF_6-insulated high-voltage circuit breaker contacts. This method will be incorporated into our maintenance practices and applied throughout the system.
- We renewed our support for the Université du Québec à Chicoutimi industrial chair on atmospheric icing of power system equipment (CIGELE) for another five years.

Frégeau substation is becoming a model for system management.

Our energy efficiency programs offer an array of measures and tools designed to help all our customers make better use of electricity. These highly successful programs gave rise to 643 GWh in energy savings in 2006.

Our mission: customer satisfaction

To live up to customer expectations, Hydro-Québec Distribution strives to ensure the security of Québec's electricity supply, to maintain a reliable power distribution system, and to provide a wide range of services and energy efficiency programs, all at the lowest possible cost.

In 2006, we upheld our commitment to renewable energy, especially wind power. We invested in modernizing our facilities to improve system performance and service continuity. Concerned, as ever, with improving our efficiency, we also continued to upgrade our information systems.

In addition, we intensified our efforts in the field of energy efficiency, which led to increased participation by all our customer categories in the programs we offer under the ENERGY WISE banner. This enabled us to surpass our energy conservation objective for the second year in a row, prompting us to raise our target for 2010 from 4.1 to 4.7 TWh.

"All our employees work to achieve the same goal: to give our customers what they need."

André Boulanger
President, Hydro-Québec Distribution

OUR MISSION

Hydro-Québec Distribution ensures a secure power supply and a reliable distribution system for Quebecers. It provides customers with quality products and services tailored to their needs, and a variety of energy efficiency programs that encourage them to make enlightened choices and use electricity wisely.

OUR FACILITIES

We operate 108,883 km of lines, a call centre set up in nine locations, a customer relations centre that offers on-line services, and five distribution control centres.

OUR ACTIVITIES

To serve the domestic market, we rely primarily on the heritage pool of 165 TWh which Hydro-Québec Production is required to supply; beyond that volume, we purchase electricity on the open market. At all times, we ensure efficient operation of the distribution system.

2006 IN FIGURES

Revenue	$9.5 billion
Net income	$42 million
Customers (% of revenue)	
Residential customers	51%
Commercial and business customers	20%
Large-power customers	29%
Property, plant and equipment as at December 31 (including work in progress)	$8.1 billion
Regulatory regime	Cost-based

Security of supply

Our electricity supply strategy is based on signing short-term and long-term agreements, and developing a diversified energy portfolio. Renewables, particularly hydroelectricity and wind power, are the preeminent choices. We have various means at our disposal to manage occasional fluctuations in demand, including a framework agreement with Hydro-Québec Production and peak management options that are mutually beneficial for us and our customers.

The flexibility of our supply portfolio means we can provide reliable electricity service at the lowest cost.

- During the year, the Régie de l'énergie, which regulates power distribution in Québec, approved three measures intended to reduce peak demand:
  - The interruptible electricity option for large-power customers (5 MW or more) was renewed. At times when the system is heavily solicited, Hydro-Québec Distribution can ask customers signed up for this option to reduce their power demand.
  - An interruptible electricity option was introduced for medium-power customers (between 100 kW and 5 MW in billing demand).
  - A new option allows medium- and large-power customers to make use of backup generators.
- The Régie also approved the introduction of a net metering option for residential and commercial customers equipped to generate up to 50 kW of their own electricity. Under this option, customer-generators are credited for any surpluses they feed into the grid, and see a corresponding reduction in their electricity bills. Only renewable sources, including biogas and forest biomass, are eligible.
- Deliveries of forest biomass power generated by Bowater Canadian Forest Products began in April.
- We have been able to count on output from the 507-MW TransCanada Energy cogeneration plant in Bécancour since September.
- In November, we took delivery of the initial output from Baie-des-Sables wind farm, the first of eight such facilities scheduled to go into operation in the Gaspé region between now and the end of 2012, following a call for tenders issued in 2003.
- Under the Québec regulatory framework, the Régie de l'énergie sets distribution rates based on cost of service. In February 2006, it approved a 5.3% across-the-board rate adjustment that came into effect on April 1, 2006. In February 2007, further to our 2007–2008 rate application filed in August, the Régie authorized a 1.9% across-the-board adjustment, effective April 1, 2007.

Wind power is a key component of our electricity supply strategy.

Hydro-Québec promoted its energy efficiency programs at the Montréal Home Show.

Listening to our customers

In everything we do, we are driven by a desire to enhance customer satisfaction. We are taking various initiatives to improve our efficiency in receiving and processing customer requests, for example. The updating of our information systems continued with the rollout, in January, of the commercial and business customer portion of the Customer Information System (CIS), which groups all the information needed for customer service operations into a single database. We also stepped up our energy efficiency efforts and improved our programs for low-income customers.

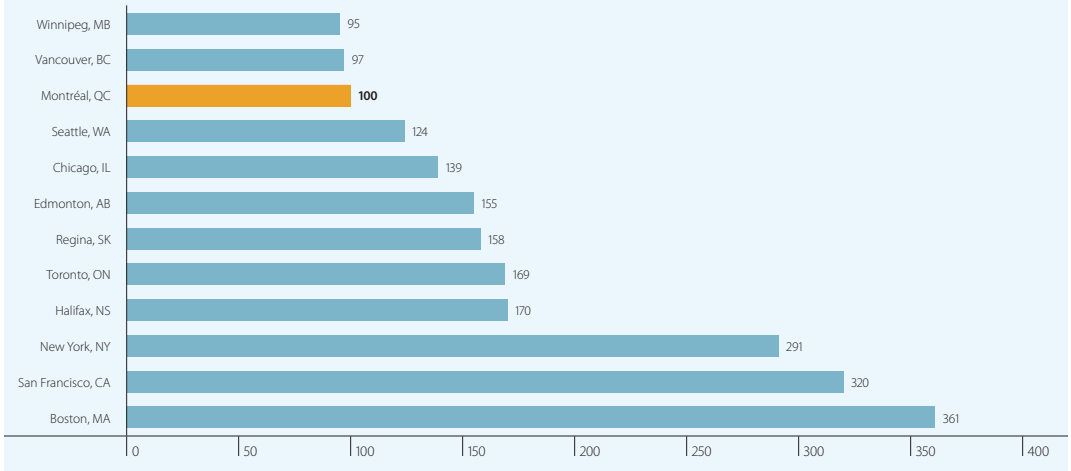
Residential, commercial and business customers

Our customers have responded favorably to our energy efficiency programs.

- The satisfaction index for residential customers held steady at 7.3 out of 10. At year end the index stood at 7.3 for commercial customers and 7.1 for business customers.
- We continued consolidating commercial and business customer files in the CIS and developing the residential segment of this system.
- We boosted our efforts to promote energy efficiency programs for residential and business customers, through our presence at conferences, exhibitions and trade shows throughout the province, running a wide-ranging media campaign on ENERGY STAR® appliances and signing 290 agreements with manufacturers, retailers and other partners in the marketplace.
- To stimulate energy efficiency innovation, we promoted AVENUES (Marketplace Testing for Energy-Efficient Technologies) and IDEAS (Technology Demonstration and Experimentation Initiatives). Under AVENUES, we signed five contracts for the recycling of high-consumption refrigerators and freezers, and issued a call for proposals for solar pool heaters, while new lighting, heating, ventilation and air conditioning technologies were the subject of an IDEAS call for proposals.
- Under our Energy Efficiency Plan, we developed or relaunched three programs to help low-income households manage their electricity consumption better.

  - The Québec Agence de l'efficacité énergétique (AEE) program for low-income households, now known as Éconologis, targets some 7,500 households. Energy efficiency experts visit participants in their own homes, and give them personalized advice and a kit of energy-saving products.

Comparative Index of Electricity Prices at April 1, 2006
Residential Customers[a]



a) Monthly bill (before taxes) for a consumption of 1,000 kWh.

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- Another AEE program, called Novoclimat, provides technical and financial support to builders of social housing in order to reduce energy bills and increase tenants' comfort.

- Hydro-Québec, in cooperation with the Société d'habitation du Québec, also offers an energy renovation program for low-income households. The social component of this program includes various general energy conservation measures for owners of low-rental housing units, such as electronic thermostats, ENERGY STAR washing machines and efficient lighting fixtures in common areas.

- Since 2001, we have offered special payment arrangements to low-income customers who are having trouble paying their electricity bills. In 2006, we entered into 22,475 such arrangements, for arrears of $26.5 million. As well, following discussions with consumer associations at an issue table, we provided financial support to more than 1,600 households experiencing serious difficulty paying their bills.

Large-power customers

Industrial, commercial and institutional customers that have a power demand of 5 MW or more consume 43% of the electricity distributed in Québec. In 2006, they achieved more than one-third of the province's energy savings.

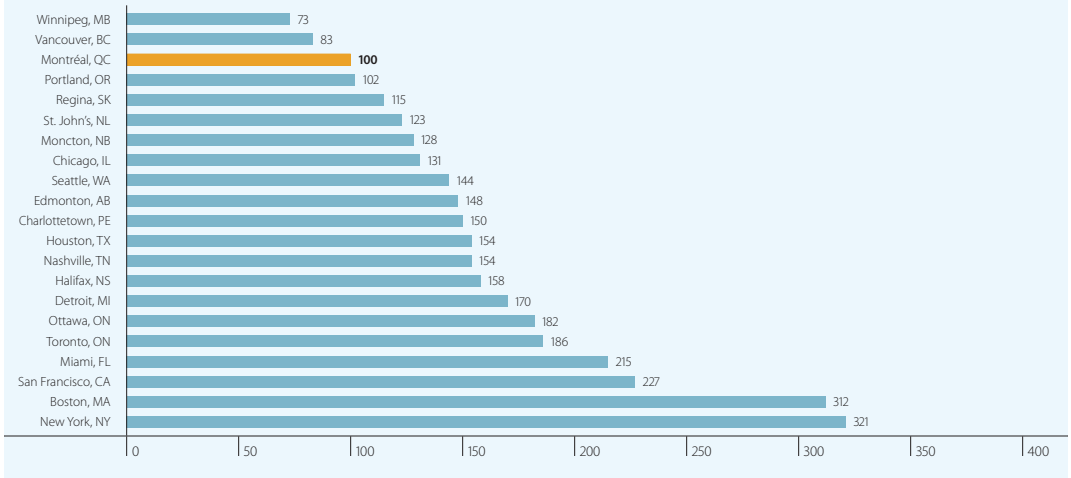
- In 2006, the satisfaction index for large-power customers remained at 9.1 out of 10. The consistently high level of satisfaction in recent years is attributable to frequent, personalized communication with these business partners and the industrial associations they belong to. It can also be credited to the fact that large-power customers deal with commercial representatives assigned specifically to their accounts and that the technical support we offer them is tailored to their changing needs, particularly in terms of power quality.

- Energy efficiency programs designed for this customer category gave rise to a total of 138 projects that will yield 207 GWh in annual energy savings. To date, 68% of large-power customers have participated in one or more of our programs.

- The new Plant Retrofit Program is intended for industrial customers who make substantial investments to reduce their facilities' overall electricity consumption. For example, in 2006, we pledged up to $30 million to Kruger for a project to improve the de-inking process at its Trois-Rivières paper mill. This approximately $200-million project should generate 403 GWh in annual savings.

- The Energy Savers' Circle, which recognizes major customers who are particularly proactive in their energy conservation efforts, welcomed six new members. To qualify, they took steps to cut their plants' electricity consumption by at least 5% or to save at least 50 GWh per year.

Comparative Index of Electricity Prices at April 1, 2006
Large-Power Customers[a]



a) Monthly bill (before taxes) for 50 MW of power at 120 kV and a consumption of 30,600 MWh.

- Several R&D projects carried out in partnership with large-power customers were completed in 2006. For example, Niobec Mine introduced a new technology for drying granular material that uses an induction-heated screw conveyor developed by our research institute. Elsewhere, a technology for monitoring hoist cables during ore extraction has been installed in a mine owned by Agnico-Eagle Mines. This technology represents potential annual energy savings of 1 GWh for all listed deep mines in Québec.
- The Centre de recherche industrielle du Québec has agreed to work with our research institute on an energy efficiency R&D project in the pulp and paper industry.

A reliable distribution system

A reliable power supply and quality service are top priorities for Hydro-Québec Distribution. Every year, we expend considerable efforts to improve service continuity and the information provided to customers in this regard. Our system automation program will reduce the length of service interruptions and the number of customers affected. As well, we submitted a proposal to the Régie de l'énergie to amend the terms of service in effect in order to simplify our practices. Finally, we demonstrated our ability to take fast action during exceptional power failures following thunderstorms or violent winds.

We make every effort to constantly improve service continuity.

- The normalized system average interruption duration index (SAIDI) was 123 minutes per customer. This excludes major weather events, which in 2006 raised the unadjusted index to one of its highest levels in the past decade. It should be noted that the normalization method we have adopted, for compliance with North American practices, is more accurate than the one we used previously.
- We entered data needed for system control into the geographic information system (GIS) for the Eastern and Northern Québec territories and carried out all engineering operations using this system. The GIS will ultimately display the entire distribution system on a continuous map base and provide descriptions of all the equipment in operation.
- We completed more than 46,000 new hookups on schedule.
- Customers received advance notice of scheduled outages, and the work was carried out on time, in 89% of cases.

The IBM Canada plant in Bromont took advantage of our energy efficiency programs to install a state-of-the-art thermal storage system.

Montréal's École Polytechnique has joined our Energy Savers' Circle. The school's energy efficiency coordinator, Michel Rose (right), stands next to André Boulanger, President of Hydro-Québec Distribution.

- The underground distribution grid in downtown Montréal is now remote-controlled by close to a hundred motorized switches with fibre-optic connections to a Distribution Control Centre.
- In June, we began rolling out a remote control system for overhead distribution. By 2010, this system will allow remote intervention on some 1,100 lines, selected on the basis of their potential for improving service continuity.
- To ensure transparency and equity, we submitted a request to the Régie de l'énergie to amend the terms of service applicable to system extensions and alterations, and to the cost of such work.
- Servo control of distribution voltage promises energy savings accruing from more precise voltage management over the entire length of the lines. In 2006, we evaluated the savings potential of this operating mode in conjunction with our research institute, taking into account the typical loads of Québec customers and system operating constraints. The results point to significant benefits both for us and for our customers.

Crews dispatched to the Laurentians worked night and day to get the power back on after violent thunderstorms.

More than 46,000 new hookups were completed on time.

Innovating to improve distribution service and energy efficiency

The innovation projects we carry out with our research institute serve many different purposes, from ensuring the long-term operability of our equipment to enhancing its performance. We also work to develop highly energy-efficient solutions for our own and our customers' facilities.

- The institute has designed a self-contained pneumatic pruner that will considerably speed up tree trimming for vegetation management — an essential activity for system reliability.
- Three projects related to characterizing and limiting the electric and magnetic fields produced by distribution systems were completed. Their results will help us implement an action plan in line with the company's guidelines on pollution and nuisance prevention and control.
- To better quantify the spin-offs of the new energy efficiency technologies, we asked our energy technologies laboratory to develop energy modeling tools for buildings. The laboratory also conducted research on solar buildings as part of its participation in a specialized research network in this area. Network members include close to a dozen universities.

Automation of the overhead system. The control panel at the foot of the pole allows workers to operate the disconnect switch located at line level.

Installation of remote control equipment on the underground distribution grid in Montréal.

The new self-contained pneumatic pruner, used for tree trimming.

Like all of Hydro-Québec's hydroelectric development projects, Eastmain-1 powerhouse was built in cooperation with the local community. This approach allowed us to minimize the project's environmental impacts and maximize its benefits for the region. The Cris and other James Bay residents played an active part.

Concerted action

Our 2006 order book offered us many stimulating challenges. More than ever, our efficiency depends on cooperation among all our teams, whether at work on our jobsites or involved in related operations prior to or during our construction projects.

At James Bay, we commissioned Eastmain-1 powerhouse several months ahead of schedule. In the Saguenay–Lac-Saint-Jean region, we poured a plastic-concrete cutoff wall — the world's deepest wall made of this kind of material, at up to 115 m — beneath the future Péribonka dam. We also launched the Eastmain-1-A/Sarcelle/Rupert project, Québec's largest hydroelectric development of the decade, and carried out rehabilitation, refurbishment and refitting at more than 20 generating facilities.

Also in 2006, we connected Baie-des-Sables wind farm to the grid and continued work to upgrade the Matapédia regional transmission system with a view to integrating the output of all the wind farms planned for the Gaspé region. As well, the past year saw the launch of the project to build Outaouais substation, which will provide a new interconnection with Ontario.

"Our success flows from the expertise and commitment shown by all our teams."

Réal Laporte
President, Hydro-Québec Équipement
President and Chief Executive Officer, Société d'énergie de la Baie James

OUR MISSION

Hydro-Québec Équipement and Société d'énergie de la Baie James carry out engineering and construction work related to generating and transmission facilities for Hydro-Québec Production and Hydro-Québec TransÉnergie. Our projects must be profitable, environmentally acceptable and favorably received by local communities.

OUR ACTIVITIES

Our services cover all project stages and aspects, from planning through to completion: studies of the biophysical and human environment, engineering, construction, management of the work and handover of the facilities to the operator. We are continually seeking new solutions to reduce costs and construction time without sacrificing facility performance in any way. We work actively with partners in the community and in industry.

2006 IN FIGURES

Volume of activity	$2.0 billion
Main customers (% of volume)	
Hydro-Québec Production	63%
Hydro-Québec TransÉnergie	36%
Other	1%

Rising to the challenge

The mandates Hydro-Québec Production assigns us follow tight schedules that involve major financial stakes and are made all the more difficult by seasonal constraints. It's the same race against the clock in the projects we carry out for Hydro-Québec TransÉnergie, since the transmission system must be ready to receive the output from new wind farms and hydropower developments. We therefore take great pride in the year's accomplishments, made possible by our proactive management methods and the team spirit that drives us.

Working with local partners, we were able to maximize the economic spinoffs of the Eastmain-1 project and ensure its profitability.

- Eastmain-1 powerhouse went into commercial operation in the summer and has been fully functional since December. In 2006, more than 120 Crees were employed on the site. For the project as a whole, contracts and purchases amounted to $402 million from Cree suppliers and $118 million from other suppliers based in the region.
- To integrate output from Eastmain-1, we built a substation and a 59-km, 315-kV line, and made alterations to Nemiscau substation. Because the powerhouse commissioning date was moved up, we had to follow a revised work timetable.
- The Cree community of Waskaganish is now connected to the system by a substation and a 208-km, 69-kV line. This line is insulated to operate at 120 kV, in anticipation of future needs. To avoid disturbing the region's sensitive soil and facilitate construction, we carried out much of the work in winter and used a new type of tower that can be spaced at intervals of approximately 600 m.
- We brought Baie-des-Sables wind farm onto the grid. This entailed extensive adjustments to the special protection systems and telecommunications facilities.
- Replacement of the four generating units at Outardes-3 is nearly complete. Between 2003 and 2006, this work gradually added 278 MW in total capacity.

The Nemiscau – Waskaganish line runs on a new type of tower.

More than 120 Cree workers were on the job at Eastmain-1 in 2006.

Adding capacity and energy

For Hydro-Québec Production, we are building three major hydroelectric projects, rehabilitating, refurbishing or refitting more than 20 other facilities and conducting the environmental impact assessment for the planned Romaine complex, which will comprise four generating stations with a total installed capacity of 1,550 MW. In all, these operations generated a volume of activity equivalent to $1,254 million in 2006.

- The Péribonka development is in full swing. Construction peaked in 2006 with a workforce of nearly 1,350, over 80% of whom came from the region. Regional spinoffs totaled close to $400 million in 2006 alone, surpassing the $345 million initially anticipated for the project as a whole.
- Construction is almost 45% complete at Chute-Allard and Rapides-des-Cœurs. This project created 823 person-years of employment in 2006, and has generated regional spinoffs of $85 million since it began.
- Work proceeded on the Mercier building site.
- Following the launch of the Eastmain-1-A/Sarcelle/Rupert project on January 11, 2007, we began to enlarge Nemiscau workcamp, build Rupert workcamp and construct a 36-km road between the latter camp and Albanel substation. Work on the permanent hydraulic structures is scheduled to get under way in April.
- At Sainte-Marguerite-3, Unit No. 1 was put back into service in the fall and can now operate at its full 440-MW capacity.
- We finished replacing a second generating unit at Outardes-4. On project completion in 2008, we will have added 56 MW to this plant's capacity.
- Rehabilitation at various other generating stations, including Beauharnois, Rivière-des-Prairies, Rapide-2, Rapide-7 and Rapides-des-Quinze, is proceeding as planned.
- We continued draft-design studies on refurbishing Gentilly-2 nuclear generating station. We also took part in the public hearing held by the Canadian Nuclear Safety Commission with a view to obtaining the necessary approvals to modify the radioactive waste storage facilities and carry out the plant refurbishment.

More than 80% of workers on the Péribonka jobsite in 2006 came from the Saguenay–Lac-Saint-Jean region.

Eastmain-1 powerhouse, commissioned much earlier than scheduled.

Outardes-3 generating station, in the Manicouagan region, is undergoing refurbishment and refitting.

Intensified work on the transmission system

With the commissioning of new generating facilities — hydroelectric, wind and other — the load on the transmission system will be greater than ever. Together with Hydro-Québec TransÉnergie, we are doing our utmost to increase system capacity and reliability, and improve performance. In 2006, our volume of transmission-related activity reached $719 million, up 27% over the preceding year.

We were involved in nearly 600 projects throughout Québec to increase the transmission system's reliability and ensure its long-term operability.

- Upgrading of the Matapédia regional grid in order to connect the wind farms in the Gaspé Peninsula is nearly 65% complete.
- We broke ground on the new Outaouais substation. This 315/230-kV converter substation will provide a 1,250-MW interconnection with Ontario, allowing increased business with that province.
- Work began in the fall to bring the future Péribonka, Chute-Allard and Rapides-des-Cœurs generating stations onto the grid. A 128-km, 161-kV line will connect Péribonka to the new Simard substation, while a 61-km, 230-kV line will connect Chute-Allard and Rapides-des-Cœurs to Rapide-Blanc substation.
- To increase system capacity, we added power transformers at a dozen substations. Eventually, 31 substations will have this equipment.
- We upgraded the load-shedding devices or installed new ones at 16 substations. This means that 24 substations are now equipped with remote-parameterizable load-shedding devices to maintain system stability in case of any major incident.
- At Lévis substation, we completed the building and installations that will house the high-voltage line de-icing equipment, slated for commissioning in winter 2007 – 2008.

A 161-kV line is being built to connect Péribonka and Simard substations.

We adopted an action plan to improve worker safety on our jobsites.

Innovative approaches

Our innovation strategy calls on the skills of all our teams, in areas ranging from engineering and geomatics to environment and project management. It consists in testing the most promising methods and technologies in pilot projects before incorporating them into our practices, so as to minimize risk.

- The presence of a trench of permeable overburden up to 115 m deep in the bed of the Péribonka River at the confluence with the Manouane had long prevented us from developing this site's exceptional hydroelectric potential. However, Hydro-Québec Équipement and its partners have found a way to build a dam on a solid foundation by filling the trench with a plastic-concrete cutoff wall. Designing the wall and installing it in this steep-sided trench posed a sizable challenge — one that the project team carried off brilliantly.
- We recently adopted the CATIA V5 software, making Hydro-Québec the first generator and transmission provider in the world to use 3D design technology to develop its projects. CATIA (Computer Aided Three-dimensional Interactive Application) enables data from different branches of engineering to be integrated in a single design platform and allows many different options to be analyzed in order to optimize projects. In 2006, we entered all the parameters of the planned Romaine-1 generating station in the 3D model we had developed in 2005. We also established a 3D model for a typical underground powerhouse and a standard low-voltage (120/25 kV) transformer substation. Working with consulting engineers, we modeled other planned generating stations (Romaine-2, Romaine-3 and Romaine-4) and 16 transformer substations at different voltages. In addition, Eastmain-1-A and Sarcelle powerhouses are undergoing detailed modeling.
- Since draft-design studies on the Romaine complex revealed a lack of materials suitable for building a conventional dam, we had to examine alternative options, including a bituminous-concrete dam. We are going to employ this method for the first time to build Nemiscau-1 dam, part of the Eastmain-1-A/Sarcelle/Rupert project. If the experience proves conclusive, we could use the same method for certain structures in the planned Romaine complex.
- The *Building Code* now requires the use of reinforced concrete to improve building strength in case of earthquakes. To test the strength of existing facilities and minimize the work needed to upgrade buildings, we have developed a tool that will give us an exact picture of the behavior of a generating station built more than 50 years ago.

Work is proceeding at Rapides-des-Cœurs generating station.

Equipment used to install a cutoff wall at Péribonka dam.

A profitable strategy

Financially speaking, 2006 was a remarkable year on more than one level. We posted record net income of $3.74 billion, largely by carrying out most of our plan to sell off our foreign holdings in order to concentrate on building domestic operations. The sale process took place in six countries over a period of 18 months, and yielded a gain of close to $917 million.

We were able to achieve such a substantial capital gain partly because the timing was favorable for selling regulated energy infrastructure, but mainly as a result of our strategy of sale by entity rather than in one large block. By following this approach, we believe we created the best possible transactional environment in each country where we operated and, in so doing, sold each holding for its full value, with an emphasis on finding high-quality purchasers.

Our shareholder, the Québec government, announced that $500 million of the gain yielded by these sales will be paid into the Generations Fund.

Foreign Holdings Sold in 2006

	Country	Transaction (C$)	Gain (loss) (C$)
Consorcio TransMantaro S.A.	Peru	$84 M	$39 M
Cross-Sound Cable Company, LLC	United States	$182 M	$29 M
Hidroeléctrica Río Lajas S.A.	Costa Rica	$5 M	($0.3 M)
HQI Latin America Ltd. (Fortuna generating station)	Panama	$113 M	$38 M
HQI Transelec Chile S.A.	Chile	$1.8 B	$813 M
MurrayLink HQI Australia Pty Ltd	Australia	$60 M	($2 M)

Hydro-Québec maintains an active international presence through its involvement in such organizations as the World Energy Council, the International Council on Large Electric Systems and the e8.

Determined to help reduce greenhouse gas emissions, Hydro-Québec is currently testing different models of electric vehicles. Our fleet will soon include three Cleanova IIs and two Cleanova IIIs, prototypes built by the Société de Véhicules Électriques and equipped with motors straight out of the lab of TM4.

The strength of technological innovation

We count on the creative force of Hydro-Québec's research institute to meet the technological challenges we face in developing and improving our power system. Innovation projects involve all facets of our business, from electricity generation to consumption. The objective of these projects is to extend the service life, enhance the performance and optimize the maintenance of our facilities, and support our energy efficiency programs.

In 2006, we allocated $98 million to R&D and carried out over a hundred innovation projects. The impact of these projects on the company's net income since 2001 is estimated at $147 million, including $32 million in 2006 alone.

An enormous pool of expertise

Hydro-Québec's research institute has a top-notch team of scientists with complementary expertise in electrical equipment; power system analysis, operation and control; automation and measurement systems; chemistry and materials; mechanical, metallurgical and civil engineering; and energy use. Applying this knowledge to develop specialized technological solutions boosts our divisions' performance, while enhancing the safety of the public and our employees.

Over the years, our researchers have developed robotic tools adapted to hostile and difficult-to-access environments. Examples of such innovations, which take advantage of the institute's broad range of expertise, include the underwater robot Maski, used to inspect control structures and dams; robotic inspection tools used at Gentilly-2 nuclear generating station; RODAV, a steerable robot delivered in 2006 that is used for steam de-icing of transmission facilities; and the manipulator robot currently being developed for work on the underground distribution network.

The challenge of integrating wind power

Hydro-Québec intends to become a world benchmark in bringing wind power onto a major grid. In 2006, it commissioned the institute to oversee a portfolio of innovation projects involving the forecasting and characterization of wind power generation and the simulation of network behavior with wind farms connected.

Partnering for solutions

Our many partners include industrial companies, universities, research centres and associations. By pooling our knowledge and know-how, we can encourage the emergence of new research avenues, while sharing the ensuing risks and value created.

- We continue to participate in research conducted by the Ouranos consortium on regional climatology and climate change adaptation. In 2006, we analyzed mean temperatures in northern Québec and the impact of climate change on water resources.
- In the area of wind power integration, we are developing new short-term (24 hours or less) meteorological forecasting models in conjunction with Environment Canada.

ABB power transformers being assessed in the new testing area at Hydro-Québec's research institute.

Designing a manipulator robot for work on the underground network.

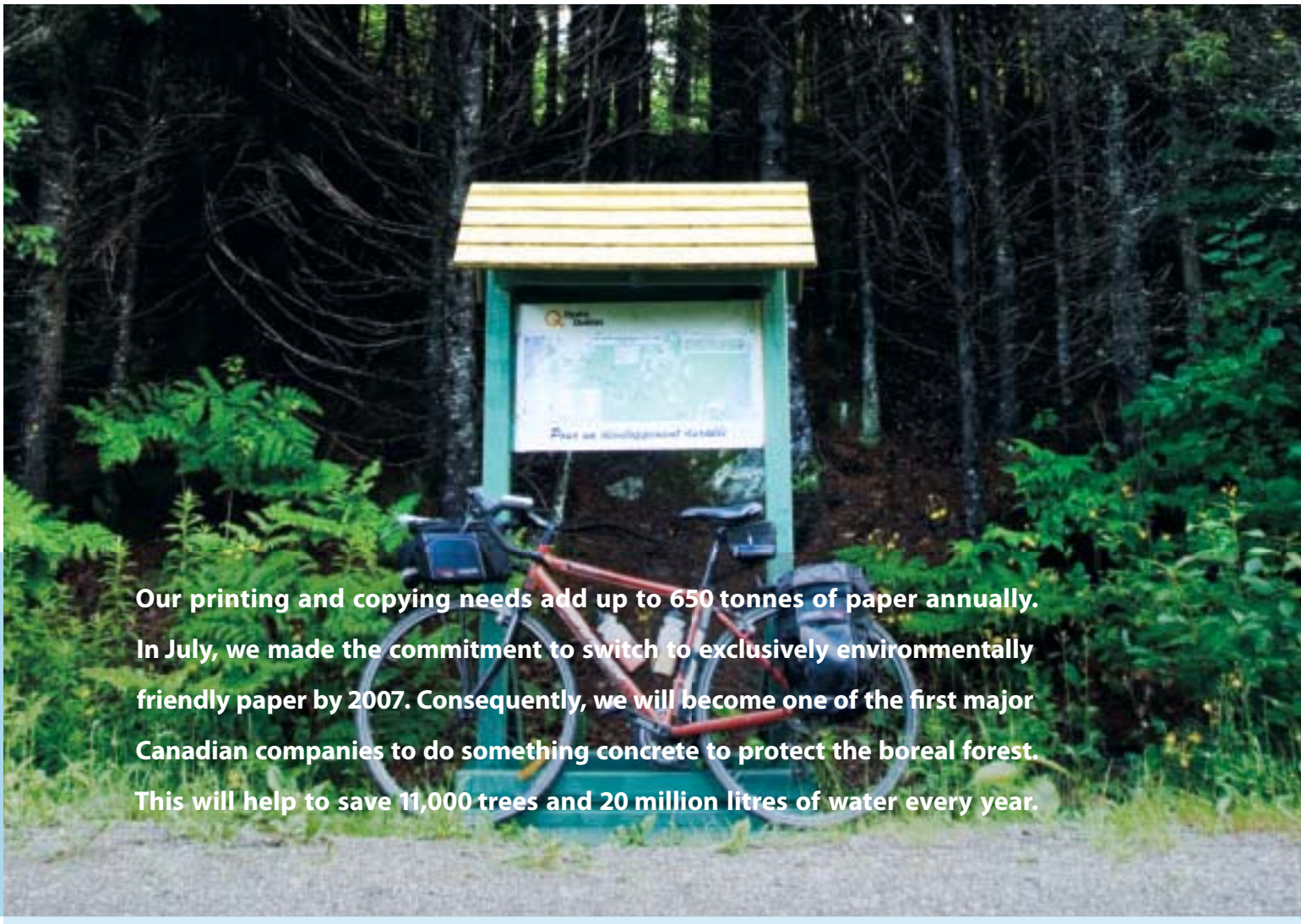
- In cooperation with Forintek Canada, Canada's wood products research institute, we are developing various energy-efficient electrotechnologies under the ÉlectroBois program.
- In 2006, Hydro-Québec contributed $6.1 million to Québec universities for research contracts and 15 research chairs.
- Hydro-Québec, Alcan, the CANMET Energy Technology Centre – Varennes and the Natural Sciences and Engineering Research Council of Canada signed a five-year funding agreement with the Université de Sherbrooke to establish a research chair in energy efficiency. The work of the chair will mainly involve advanced refrigeration technology, heat waste recovery and the reduction of industrial energy intensity.
- We have begun discussions with McGill University to create three research chairs in renewable energies and distributed power generation, the integration of wind power and hydropower into the transmission grid, and precipitation measurement and nowcasting to optimize the performance of run-of-river generating stations in the context of climate change.

A contribution to electric-powered ground transportation

TM4, our joint venture with the Groupe Industriel Marcel Dassault, develops electric drivetrains for major vehicle manufacturers. The newest-generation TM4 motor is noteworthy for its energy efficiency, which can exceed 96%. Smaller and lighter than other electric motors, it improves vehicle performance and range. Since September 2005, it has been successfully tested in some 40 utility vehicles used in corporate and government fleets. This technology helps reduce greenhouse gas emissions.

The Niobec Mine, in the Saguenay region, received an Énergia prize for incorporating an induction-heated screw conveyor developed by Hydro-Québec's energy technology laboratory into its operations.

The hydrometeorology team of Hydro-Québec's research institute is active in wind power integration and climate change studies.



Our printing and copying needs add up to 650 tonnes of paper annually. In July, we made the commitment to switch to exclusively environmentally friendly paper by 2007. Consequently, we will become one of the first major Canadian companies to do something concrete to protect the boreal forest. This will help to save 11,000 trees and 20 million litres of water every year.

Enlightened corporate choices for results that benefit everyone

A commitment to green power

Hydro-Québec made a commitment long ago to develop Québec's water resources to satisfy its customers' electricity needs, and this has played a large part in the province's excellent record on greenhouse gas (GHG) emissions. We also rely on complementary energy sources that are clean and renewable, particularly wind power. By contracting to purchase large blocks of wind power from private producers, we support the growth of an energy source whose spinoffs contribute to regional economic development.

Atmospheric Emissions from Hydro-Québec's Power Generation Operations (tonnes)[a]

Gas	2006	2005
Carbon dioxide (CO_2)	**215,243**	369,974
Sulphur dioxide (SO_2)	**979**	2,126
Nitrogen oxides (NO_x)	**5,917**	6,428

a) Our emissions come mainly from thermal generating stations supplying off-grid systems. According to 2003 data, power generation is responsible for only 1.7% of Québec's GHG emissions, compared with 37.4% for transportation and 31.1% for industry.

Sustainable development, the framework in which we operate

Since 1989, Hydro-Québec has embraced the principle of sustainable development as defined in the 1987 Brundtland Commission report: "Development that meets the needs of the present without compromising the ability of future generations to meet their own needs." Our actions are inspired by this principle in all our fields of endeavor, from planning and research to construction and operation. ISO 14001 – certified environmental management systems govern most of our activities; these systems require that we periodically measure our performance so we can keep improving our way of doing things.

Every year, we invest significant amounts in environmental protection. We work with communities to ensure that our projects are well received, and we take the necessary steps to guarantee our employees' and the public's health and safety. In addition, we collaborate with regional, national and international organizations on various projects to promote sustainable development.

- In 2006, Hydro-Québec began to formulate an action plan to support the government's sustainable development strategy as set out in the new *Sustainable Development Act*.
- In late June, Hydro-Québec signed an agreement with Équiterre to construct a green building in downtown Montréal, near our head office. The Maison du développement durable (Sustainable Development House) will be designed to the LEED™ Platinum standard, the highest rating in sustainable construction. The building will house the offices of social and environmental groups.
- Calls for tenders to purchase wind power include specific sustainable development criteria. In addition, many of our contracts with suppliers contain a general clause designed to make suppliers aware of the importance of protecting the environment and to remind them of their obligations in this area.
- To celebrate Environment Month in May, we encouraged our staff to take concrete action to support sustainable development. Nearly 7,300 of our employees made a commitment to adopt environmentally responsible habits like printing on both sides of the paper and using a mug instead of disposable cups at work.

The general coordinator of Équiterre, Sydney Ribaux, and the CEO of Hydro-Québec, Thierry Vandal, signed a contract to construct a green building, the Maison du développement durable, in downtown Montréal.

Contracts are awarded to wind power producers based partly on sustainable development criteria.

A leader in environmental protection

At Hydro-Québec, we act daily to reduce the impacts of our operations on the environment. We also aim to maximize the positive effects of our actions: for example, our environmental studies result in a better understanding of the biophysical and human environment in the regions where we have projects.

- All our projects include mitigation measures to reduce environmental impacts and follow-up programs to assess the effectiveness of these measures. As part of the Eastmain-1 development project, for example, we constructed a weir in the river to maintain forebay water levels similar to those under natural conditions. This helps to maintain bank stability and acceptable water quality, as well as ensuring adequate fish habitat — particularly for lake sturgeon, a favorite species of the Crees.
- In 2006, we conducted a study in collaboration with the Université du Québec à Montréal and McGill University on net GHG emissions at Eastmain 1 reservoir before and after impoundment. As expected, CO_2 emissions were approximately six times greater than those from a natural lake, but they should gradually diminish and return to natural levels in about a decade.
- Since the early 1980s, Hydro-Québec has carried out an extensive research program on the effects of the release of mercury already present in vegetation and soil after reservoir impoundment. This research has shown that it is a temporary phenomenon and mercury levels in reservoirs return to levels equivalent to those in natural lakes after 20 to 30 years. The company also carefully monitors mercury levels in fish in recently impounded reservoirs and helps produce guides to fish consumption to ensure that recreational anglers and subsistence fishermen can safely continue to enjoy the benefits of eating fish. A page put up on our Web site in 2006 on the mercury issue — **www.hydroquebec.com/sustainable-development/documentation/mercure.html** — provides a wealth of information.
- In 2006, the Fondation Hydro-Québec pour l'environnement committed to fund 22 community projects, for a total of over $1 million. For example, it will give $139,300 for revitalizing the Rivière à Mars in the municipality of Saguenay, which was devastated by the major floods in 1996. The funds will be used to create the conditions required for the return of wildlife and plant species whose habitat was destroyed by the flooding.

Weir built in the Eastmain River in the James Bay region.

Revitalization work was carried out on the Rivière à Mars in the Saguenay–Lac-Saint-Jean region.

- The recycling, recovery and reuse of various materials is now company-wide. In 2006, we recycled 871 tonnes of paper and cardboard and 7,801 tonnes of metal. At the end of the year, we also launched a campaign encouraging employees to recycle.
- For several years, we have been decontaminating and recycling insulating oils used in our facilities, thereby reducing our oil purchases. In 2006, our reuse rate was 95%, which is comparable to that in previous years.
- We signed up for BOMA Québec's *Go Green* program to obtain certification for 14 of our buildings, beginning with our head office, which was certified in the fall. In these buildings, we adopted standards of environmental excellence such as the reduction of energy consumption and the recycling and management of construction materials.
- Our *Guide to Ornamental Trees and Shrubs*, a horticultural reference work, has been revised. Copiously illustrated, the 2006 edition describes more than 1,200 species and varieties of plants.
- Hydro-Québec participates in the *allégo* project, an initiative by Montréal's Agence métropolitaine de transport to promote the use of modes of transportation other than single-occupancy vehicles for the daily commute. We provide self-service bicycles for employees' use and offer incentives to take mass transit. According to a survey, more than 60% of our 6,000 employees in downtown Montréal favor this mode of transportation.
- We pay attention to landscape quality both during construction and in operating our facilities. For example, more than 3,000 residential customer connections in 2006 were made to underground systems.

Planting thousands of trees to offset GHG emissions — a commitment made for the 2005 United Nations Conference on Climate Change in Montréal.

Every little bit counts ...

In the Laurentians town of Sainte-Agathe, the absence of overhead lines beautifies the landscape.

A boost to the regional economy

Present throughout Québec, Hydro-Québec is a mainspring of the regional economy. Its construction, rehabilitation, refurbishing and innovation projects generate billions of dollars in spinoffs and support thousands of jobs, as do its ongoing operations. In the area of procurement alone, the numbers speak for themselves.

- Procurement of goods and services within and outside Québec totaled $2,673 million, for an increase of 13% over 2005, and can be broken down as follows: $1,123 million for the purchase of goods, $35 million for rentals, $1,109 million for specialized services and other work and $406 million for professional services.[a]
- In 2006, close to 92% of these goods and services ($2,451 million) were procured from Québec companies.[a]
- For 2006, the number of jobs in Québec linked to our overall procurement of goods and services exceeded 21,000, including 14,000 direct jobs.[a]
- To guarantee security of supply and competitive prices, we are continuing to diversify our sources, particularly for strategic goods.
- We continued to expand our system for evaluating the performance of suppliers of certain goods and services deemed critical by our four divisions, by extending it to markets for circuit breakers, meters, underground switches and generating units. Based on criteria known to suppliers, this system allows structured feedback and will help in future decision making.
- In 2006, our capital spending on various hydroelectric projects generated 4,395 construction jobs for outside suppliers.

a) These data exclude goods and services procured by Société d'énergie de la Baie James.

Employees at our Montréal head office who need to get around for their jobs can use self-service bicycles.

Cable stringing at Péribonka generating station. Materials are procured through our Shared Services Centre.

Hydro-Québec's Contribution to the Québec Economy

	2006	2005
Capital tax ($M)	**261**	330
Municipal and school taxes ($M)	**36**	36
Tax on public services ($M)	**230**	229
Loan guarantee fees ($M)	**158**	155
Percentage of goods and services procured from Québec companies	**92**	92
Direct jobs supported by procurement, including procurement outside Québec (person-years)	**14,000**	12,654
Integrated Enhancement Program grants ($M)[a]	**1.1**	7.8

a) Under the company's Integrated Enhancement Program, communities affected by transmission projects can receive grants equivalent to a certain percentage of the initially authorized value of each project.

Regional Spinoffs of Hydro-Québec Procurement in 2006 ($'000)[a, b]

Administrative region	Procurement of services[c]	Procurement of goods[d]	**Total**
Abitibi-Témiscamingue (08)	15,545	13,628	29,173
Bas-Saint-Laurent (01)[e]	4,930	4,606	9,536
Capitale-Nationale (03)	193,006	41,854	234,860
Centre-du-Québec (17)	85,104	28,699	113,803
Chaudière-Appalaches (12)	41,824	21,763	63,587
Côte-Nord (09)	41,078	10,504	51,582
Estrie (05)	5,013	5,977	10,990
Gaspésie–Îles-de-la-Madeleine (11)[e]	3,429	3,552	6,981
Lanaudière (14)	25,086	21,119	46,205
Laurentides (15)	74,352	26,178	100,530
Laval (13)	136,767	29,306	166,073
Mauricie (04)	119,390	34,138	153,528
Montérégie (16)	92,416	271,206	363,622
Montréal (06)	382,228	455,076	837,304
Nord-du-Québec (10)	8,433	3,260	11,693
Outaouais (07)	5,301	19,584	24,885
Saguenay–Lac-Saint-Jean (02)	196,019	30,406	226,425
Total	**1,429,921**	**1,020,856**	**2,450,777**

a) Amount billed by suppliers located in the administrative region.

b) These data exclude procurement by Société d'énergie de la Baie James.

c) Specialized services, professional services and other work.

d) Purchases and rentals.

e) In the regional county municipality of Matane and the Gaspésie–Îles-de-la-Madeleine region, contracts to independent wind power producers resulting from the first Hydro-Québec Distribution call for tenders for this type of energy generated spinoffs estimated at roughly $215 million in 2006.

Dynamic management of our human resources

Hydro-Québec offers its employees a stimulating work environment, including a wide range of training programs to broaden and improve their skills.

In addition, given the wave of retirements expected in coming years, we are continuing our corporate succession plan, along with our student internship program. We also maintain high occupational health and safety standards.

- In our annual employee survey completed by 12,384 respondents, overall job satisfaction and employee motivation were rated 8.42 out of 10 (compared with 8.38 in 2005) and 6.94 out of 10 (6.77 in 2005), respectively, the highest since 1995.
- At the end of 2006, all programs related to the application of the *Pay Equity Act* had been completed..
- We signed a new collective agreement with the union representing Hydro-Québec's professionals and specialists and agreed on salary clauses for 2007 and 2008 with six other unions. All collective agreements remain in effect until the end of 2008 or 2009, which ensures a stable working climate for the next few years.
- Out of the 2,845 employees eligible for retirement in 2006, 664 left the company, and 64% of our 1,360 new employees are under 35.
- We offered internships to 15 college-level students enrolled in work-study programs in such disciplines as civil engineering and building mechanics. We also welcomed 200 university students.
- The work-related accident frequency was 3.33 per 200,000 hours worked, compared with 3.26 in 2005. In addition, we instituted a new health and safety audit procedure which complements other measures already in place to reduce the number of accidents.
- In 2006, we dedicated 3.9% of the payroll to training programs, and 71% of employees took part in at least one training activity.
- Our project for managing diversity at Hydro-Québec is progressing. Its objective is to promote a culture of openness and enrich Hydro-Québec's workforce by recruiting competent employees from target groups. In 2006, we conducted a survey concerning our openness to diversity and analyzed our human resources policies and procedures as well as our employee recruitment, induction and integration strategies.
- Thanks to our emergency biohazard response plan, we will be able to ensure continuity of service in the event of a pandemic.

Thierry Vandal, CEO, and Benoit Bouchard, head of Hydro-Québec's professionals and specialists union.

Michael L. Turcotte and Thierry Vandal with United Way/Centraide regional directors. 2006 marked the 30th anniversary of our support for this important charity.

A longstanding commitment to society

Hydro-Québec participates actively in Québec's social and cultural life through donations and sponsorships. In 2006, it contributed $22.8 million — or almost 1% of its income from continuing operations — to activities in various areas, including culture, health and humanitarian aid, education and youth, social and economic affairs, sports, and the environment. This year, which marks the 30th anniversary of our support of United Way/Centraide, we donated over $5.6 million to this organization, half of which came from current and retired employees.

Culture

- Hydro-Québec is a proud partner of such major Québec cultural institutions as the Opéra de Montréal, Théâtre du Nouveau Monde, Grands Ballets Canadiens de Montréal, Montreal Museum of Fine Arts, Musée d'art contemporain de Montréal, and Musée national des beaux-arts du Québec.
- Hydro-Québec sponsors all the symphony orchestras in Québec and continues its association with the Orchestre Métropolitain du Grand Montréal and with musical ensembles such as Les Violons du Roy, Montréal's I Musici chamber orchestra and the Arion Ensemble. Since 1999, the company has also been title sponsor for all of the Orchestre symphonique de Montréal's artistic activities.
- As a loyal sponsor of the dramatic arts, Hydro-Québec funded a number of theatre companies such as Théâtre Denise-Pelletier and Infin**it**heatre in Montréal, the Théâtre du Trident in Québec City, and the Théâtre Les gens d'en bas in the town of Bic.
- A number of major cultural events benefited from our support, such as the Tadoussac song festival, Québec City Summer Festival, the Festival des traditions du monde in Sherbrooke, International FestiBlues Montréal, Montréal FrancoFolies and the Abitibi-Témiscamingue international film festival.
- Québec's museums also benefited from our contributions, particularly the Pointe-à-Callière Montréal Museum of Archeology and History, the Musée Marius-Barbeau in Saint-Joseph-de-Beauce and the Musée de la civilisation in Québec City.

Health and humanitarian aid

- We contributed $2 million to the fundraising campaigns of over 50 hospitals. In the greater Montréal area, these included the Centre hospitalier universitaire Sainte-Justine, Montréal Heart Institute, Hôpital du Sacré-Cœur de Montréal, Cité de la Santé de Laval and Hôpital Charles-Lemoyne. Regional institutions such as the Centre hospitalier Saint-Joseph de La Malbaie, Centre hospitalier universitaire de Sherbrooke and Centre hospitalier régional de Sept-Îles also received financial support from the company.
- Donations were made to over 150 organizations that offer emergency or other types of assistance to people in difficulty, that work with addicts or that work directly with the homeless and disadvantaged, including the Fondation Équilibre Saguenay–Lac-Saint-Jean (mental health advocates), Tel-jeunes (telephone help line for young people), the Québec Breakfast Club and the Fondation Jean Lapointe (support for addicts).

© Kasskara

Kent Nagano, conductor of the Orchestre symphonique de Montréal. Hydro-Québec is the title sponsor of OSM concerts.

© Fondation de l'Hôpital Sainte-Justine

The Centre hospitalier universitaire Sainte-Justine, in Montréal, received financial assistance from Hydro-Québec.

Education and youth

- We gave $2.8 million to Québec universities to support projects in line with their development priorities and to allow them to give scholarships rewarding academic excellence. This amount does not include funding for research chairs ($1.7 million) and research contracts.
- We support the Fondation Ressources-Jeunesse, which helps unemployed youth, and the Québec Skills Competition, as well as the Fondation du maire de Montréal pour la jeunesse, which promotes the development of entrepreneurship among young Quebecers. We also sponsor awards for professional achievement on behalf of the alumni association of the business management school HEC Montréal.
- To get young people interested in science and technology and inspire the next generation of scientists, we supported the project *Les filles et les sciences: un duo électrisant!*, a day's activities encouraging girls 13 to 15 years old to discover science and technology, and *Science, on tourne!*, a contest for college-level students blending humor and science organized by the Fédération des cégeps.

Social and economic affairs

- Hydro-Québec's social and economic involvement is a natural extension of its numerous operations, prompting it to partner with socioeconomic and business groups in various sectors. For example, we support the Italian Chamber of Commerce (Montréal) and similar groups, the Canadian Institute of Mining, Metallurgy and Petroleum, the Association des directeurs municipaux du Québec and the First Nations Socioeconomic Forum.

Sports

- Hydro-Québec partners with the Québec Foundation for Athletic Excellence, which provides financial support for outstanding young athletes. For nearly 25 years, we have supported sports, particularly as a sponsor of the Québec Games.
- For Hydro-Québec, encouraging young people to participate in sports also includes disabled youth, which is why we support the Défi sportif challenge for athletes with disabilities and the Québec Special Olympics.

Environment

- Hydro-Québec sponsored various environmental events and activities in 2006, such as the National Environmental Exhibition, the Centre québécois d'actions sur les changements climatiques, the second business and sustainable development conference organized by the Unisféra International Centre and the "Wind Power ... and Other Green Energies" seminar held by the Association québécoise de la production d'énergie renouvelable.

© Christine Guest, MMFA

The exhibit *Catherine the Great: Art for Empire*, at the Montreal Museum of Fine Arts, was sponsored by Hydro-Québec.

We sponsored high school and college students at the regional finals of the Super Expo-sciences Bell, as a way of encouraging them to consider a career in science or technology.

Working with communities

Hydro-Québec works closely with local authorities, agricultural interests and socioeconomic organizations to ensure that its projects are accepted by local communities and participates actively in the economic and community life of regions where it is present.

- As part of the work done by our liaison committees with municipal representatives, we produced the document "Pannes d'électricité — Planification de la sécurité civile à l'échelle municipale," which will help municipalities draw up a security plan to deal with major blackouts.
- We contributed $10,500 to establish a ferry service for the bicycle path on the Îles de Berthier. We also leased a piece of land for a landing dock and rest area on one of the islands.
- As part of a rehabilitation project for Lumsden dam on Gordon Brook, which flows through the town of Témiscaming, we developed the site so that the dam could be used by cyclists, hikers and snowmobilers to cross from one bank to the other.
- One of our objectives is to inform young people about the advantages of hydropower, a renewable energy source. We presented our workshop entitled *Blue Water = Green Energy* to roughly 8,200 elementary and high school students. We also hosted an interactive game on our Web site called *Are you sustainable?*
- We give awards of academic merit to Aboriginal students. In 2006, we gave a $2,000 scholarship to a university student and offered her a 13-week environmental internship. We also gave $1,000 scholarships to four college students.

International influence

Our activities outside Québec take the form of active participation in national and international organizations, such as the Canadian Hydropower Association, the International Hydropower Association, the World Energy Council, the e8 and the International Council on Large Electric Systems (CIGRE). We also share our expertise with developing nations under international cooperation projects, and we contribute financially to certain projects carried out by the Institut de l'énergie et de l'environnement de la Francophonie.

- In 2006, we participated in a number of international events such as the 4th World Water Forum, which brought together close to 20,000 participants in Mexico City, the 14th session of the United Nations Commission on Sustainable Development in New York City, the 5th Dams and Development Forum organized by the United Nations Environment Program in Nairobi, and the African Ministerial Conference on Hydropower and Sustainable Development held in South Africa.
- From June 18 to 22, Hydro-Québec hosted over 1,500 electrical engineers from around the world in Montréal at the General Meeting of the Power Engineering Society, a division of the Institute of Electrical and Electronics Engineers.

Daniel Richard, President of the Coop Fédérée, and André Boulanger, President of Hydro-Québec Distribution, sign an agreement to help agricultural producers and agri-food firms improve their energy efficiency.

In Haiti, we participated in a reforestation project also involving the construction of weirs to secure water sources supplying the Gaillard power station.

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The Management's Discussion and Analysis should be read in conjunction with the Consolidated Financial Statements of Hydro-Québec and the notes thereto. The financial information and tabular amounts presented herein are expressed in Canadian dollars, unless otherwise indicated. The Consolidated Financial Statements take into account certain accounting practices that are specific to regulated enterprises. These practices are detailed in Note 3 to the Consolidated Financial Statements.

Hydro-Québec would like to point out that this analysis, and especially the Outlook section, contains statements based on estimates and assumptions concerning future results and the course of events. Given the risks and uncertainties inherent in any forward-looking statements, Hydro-Québec's actual future results could differ materially from those anticipated. It should also be noted that certain financial and operating data for previous years have been reclassified to respect the presentation adopted for 2006. Finally, the information contained herein takes into account any significant event that occurred on or before March 16, 2007.

Management's Discussion and Analysis

Overview

Income from continuing operations increased by $446 million (19.0%) to $2,797 million in 2006, compared to $2,351 million in 2005, mainly as a result of the recognition of a foreign exchange gain on debts and swaps denominated in U.S. dollars.

Income from discontinued operations amounted to $944 million in 2006 following the implementation of our plan to sell off our foreign holdings. In particular, the sale of our interest in the Chilean company Transelec generated a gain of $813 million.

Net income rose $1,489 million to reach $3,741 million.

Revenue totaled $11,161 million, up $273 million (2.5%) from 2005, mainly as a result of the recognition of a $234-million foreign exchange gain on debts and swaps denominated in U.S. dollars. Revenue from Québec sales grew by $281 million owing to increased baseload demand and to rate adjustments. Revenue from sales on markets outside Québec was $1,149 million, down $315 million, mainly due to a reduction in the volume of short-term purchase/resale transactions. However, this decline in sales revenue was partially offset by a $238-million decrease in short-term electricity purchases in connection with these purchase/resale transactions.

Return on equity was 20.7%, as against 13.4% in 2005. This indicator reflects the healthy financial performance of our core businesses as well as the income earned from the sale of our foreign holdings in 2006.

Cash from operations amounted to $4.0 billion, down $0.4 billion from 2005. Combined with the over $2 billion in revenue generated by the sale of our foreign holdings, this cash enabled us to finance our $3.3-billion capital program in 2006, in a context of continued investment in major generation and transmission projects, and to pay the dividends of $1,126 million declared for 2005.

Dividends declared were $2,342 million. This tenth consecutive annual payment, the largest to date, will bring the total amount paid to our shareholder since 1998 to more than $8.7 billion.

Consolidated Results

Income from continuing operations amounted to $2,797 million in 2006, as against $2,351 million in 2005, for an increase of $446 million or 19.0%, partly as a result of the recognition of a $234-million foreign exchange gain on debts and swaps denominated in U.S. dollars, in keeping with the hedge accounting treatment adopted. This amount, which represents the realization of a portion of the deferred foreign exchange gain reported on the balance sheet, is presented with other operating revenue. In addition, a $115-million non-recurring expense was recorded in 2005 following the write-off of the Grande-Baleine draft-design studies.

Revenue was up $273 million (2.5%) to total $11,161 million in 2006. Revenue from electricity sales was down $34 million, to stand at $10,551 million. In Québec, it was $9,402 million, an increase of $281 million over 2005. On markets outside Québec, it amounted to $1,149 million, down $315 million. The increase in other revenue is mainly the result of the recognition of a $234-million foreign exchange gain on debts and swaps denominated in U.S. dollars.

Revenue from electricity sales in Québec totaled $9,402 million in 2006, up $281 million (3.1%) over 2005. Sales volume was 1.8 TWh lower than in 2005. Revenue growth was driven by increased baseload demand ($99 million) and rate adjustments ($341 million); these factors were mitigated by the effect of milder temperatures ($201 million).

Revenue from electricity sales outside Québec was $1,149 million in 2006, down $315 million (21.5%) for a 5.8% reduction in volume.

Total expenditure was $6,152 million, compared to $6,350 million in 2005, for a decrease of $198 million (3.1%).

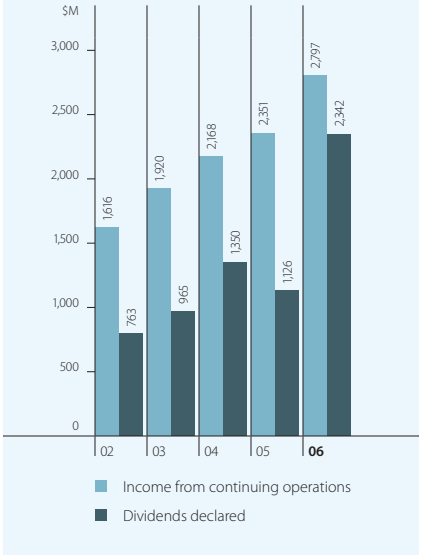
Operating expenses were $2,394 million, or $146 million more than in 2005. Of this amount, $80 million was attributable to the increase in pension costs because of the actuarial effect of the reduction in long-term interest rates on capital markets, and $27 million to additional expenses related to restoration of service following extreme weather events in 2006. Had it not been for these two factors, operating expenses would have risen only 1.9%, which is comparable to the 2006 increase in the inflation rate.

Electricity and fuel purchases decreased by $181 million (12.1%) to stand at $1,315 million, chiefly because of a $238-million reduction in short-term electricity purchases by Hydro-Québec Production.

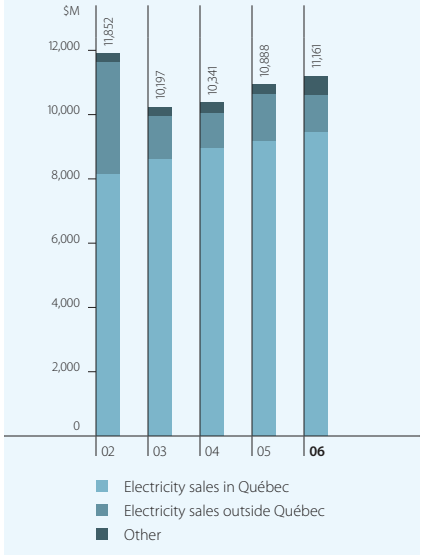
Depreciation and amortization expense totaled $2,007 million in 2006, down $16 million from 2005, mainly because of the write-off of the Grande-Baleine draft-design studies ($115 million) in 2005. Were it not for this factor, depreciation and amortization expense would have been $99 million higher, primarily because of the commissioning of new facilities, including the Toulnustouc development in summer 2005 and Eastmain-1 in the second half of 2006.

Taxes were $529 million, down $65 million mainly because of the reduction in the capital tax rate, which went from 0.6% to 0.525% in 2006.

Income from Continuing Operations and Dividends Declared



Revenue



Note: Certain comparative figures have been reclassified to reflect the presentation adopted for 2006.

Regulatory deferrals in 2006 regarding transmission and supply costs led to the recognition of a $340-million regulatory asset and a $262-million regulatory liability, respectively.

In April 2006, the Régie de l'énergie granted, retroactively to January 1, 2005, a $170-million annual increase in the cost of transmission service for the native load in recognition of the cost of the transmission infrastructure required to meet demand growth in Québec. Since the power distribution rates for 2005 and 2006 had already been set by the Régie when this decision was handed down, the increase in transmission cost was recorded as a regulatory asset, in the amount of $340 million.

In accordance with a regulatory practice approved by the Régie de l'énergie, any difference between the actual cost of supply of electricity in excess of the heritage pool and the cost forecasted at the time the rates are set by the Régie is recorded in a separate account. For 2006, the forecasted cost was higher than the actual cost, resulting in the recognition of a $262-million regulatory liability.

Financial expenses rose by $25 million (1.1%), from $2,187 million to $2,212 million. The increase due to higher short-term interest rates on capital markets was partially offset by interest income generated by our investment of the proceeds from the sale of our foreign holdings.

Income from discontinued operations totaled $944 million and reflected the sale of our foreign holdings. The results were as follows: a $39-million gain in the fourth quarter for Consorcio TransMantaro S.A. (Peru); a $38-million gain in the third quarter for HQI Latin America Ltd. (which held our ownership interest in Fortuna generating station in Panama); an $806-million gain in the second quarter from HQI Transelec Chile S.A. (Chile), revalued at $813 million in the third quarter after the release of Transelec's final financial statements as at June 30, 2006; and in the first quarter, a $2-million loss for MurrayLink HQI Australia Pty Ltd (Australia), a $29-million gain for Cross-Sound Cable Company, LLC (which held our ownership interest in the Cross Sound Cable underwater link in the United States), and a $0.3-million loss for Hidroeléctrica Río Lajas S.A. (Costa Rica).

Net income amounted to $3,741 million, an increase of $1,489 million over 2005.

	2006	2005
OPERATIONS AND DIVIDENDS ($M)		
Revenue	**11,161**	10,888
Operating income	**5,009**	4,538
Income from continuing operations	**2,797**	2,351
Income (loss) from discontinued operations	**944**	(99)
Net income	**3,741**	2,252
Dividends declared	**2,342**	1,126
BALANCE SHEETS ($M)		
Total assets	**63,248**	60,432
Property, plant and equipment	**51,813**	50,373
Assets held for sale	**42**	2,311
Long-term debt, including current portion	**35,491**	34,427
Liabilities related to assets held for sale	**8**	1,385
Shareholder's equity	**18,840**	17,376
RATIOS		
Return on equity (%)	**20.7**	13.4
Average cost of debt (%)	**7.9**	7.6
Capitalization (%)	**36.1**	34.2
Self-financing (%)	**86.5**	58.6
Interest coverage	**2.06**	2.00

Note: Certain comparative figures have been reclassified to reflect the presentation adopted for 2006.

Financial Position

Operating activities

Cash from operating activities totaled $4,006 million in 2006, versus $4,401 million in 2005. These funds were used to finance our new investments and pay the dividends declared for 2005.

Investing activities

In 2006, Hydro-Québec invested $3.3 billion in property, plant and equipment and intangible assets, comparable to the amount in 2005. Of this total, $1.9 billion was earmarked for development projects, and $1.4 billion was used to maintain or improve the quality of assets.

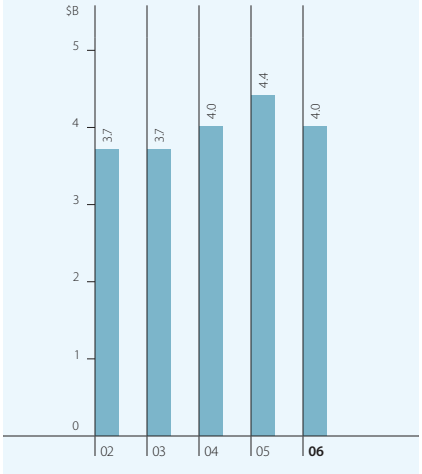
Hydro-Québec Production invested a total of $1,615 million in 2006, versus $1,780 million in 2005. As planned, most of this capital outlay, specifically $1,174 million, was devoted to development projects, while $441 million was allocated to the improvement or ongoing maintenance of existing assets. In 2006, the development projects were as follows: completion of Eastmain-1 powerhouse, which was commissioned in the second half of the year; construction of Mercier generating station and the Péribonka, Chute-Allard and Rapides-des-Cœurs developments; continuation of the approvals process for the Eastmain-1-A/Sarcelle/Rupert project (approval was obtained from the Québec government in November 2006, and approval by the Governor in Council was received from the federal authorities in December 2006); and continuation of the draft-design studies for the Romaine complex. The division also continued the rehabilitation and refitting of several facilities, including Beauharnois, La Tuque, Outardes-3 and Outardes-4 generating stations.

Hydro-Québec TransÉnergie's investments totaled $882 million, almost half of which were aimed at meeting demand growth in Québec, with the remainder allocated to long-term transmission system operability in order to maintain or enhance service quality. This includes the projects to connect Péribonka, Eastmain-1, Chute-Allard and Rapides-des-Cœurs generating stations to the grid.

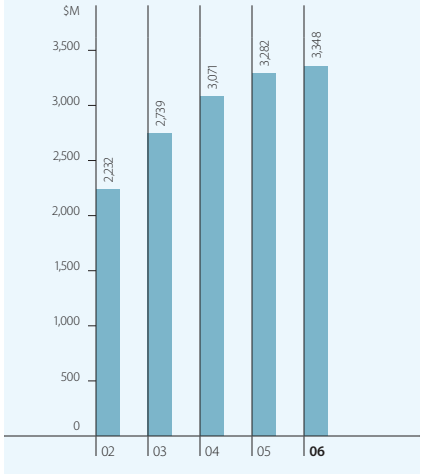
Hydro-Québec Distribution invested $690 million to meet demand growth, ensure long-term operability of the distribution system and enhance service quality. It also invested in other assets, including the Energy Efficiency Plan, which alone required $149 million.

As for Hydro-Québec Équipement and Société d'énergie de la Baie James, they carry out the engineering and construction projects of Hydro-Québec Production and Hydro-Québec TransÉnergie.

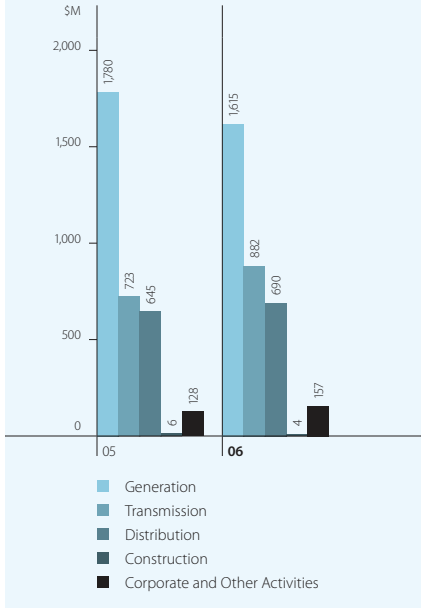
Cash from Operations



Investments in Property, Plant and Equipment and Intangible Assets



Investments in Property, Plant and Equipment and Intangible Assets by Segment



Note: Certain comparative figures have been reclassified to reflect the presentation adopted for 2006.

Financing activities

Net issues of long-term debt in 2006 totaled $1,304 million.

Hydro-Québec's gross borrowings, including receipts and disbursements related to the monetization of swaps and other financings, amounted to $3,955 million, versus $3,080 million in 2005.

Under the borrowing program, four additional tranches of bonds maturing in February 2040 were issued on January 12, January 31, March 29 and April 12, 2006. These operations raised $2,341 million at an average rate of 4.9%. In addition, two financings totaling $1,047 million were carried out through the issue, on October 12, of new bonds maturing in February 2045 and the reopening of this offering on November 8. These new bonds have an average rate of 4.7%. All issues during the year were carried out on the Canadian market.

The over $2 billion in proceeds from the sale of our foreign holdings increased the Corporation's financial resources. These funds were used for such purposes as financing our new investments and redeeming $789 million of debt, most of which would have matured in 2007. In addition, it should be noted that transactions carried out to mitigate counterparty risk led to net cash inflows of $165 million.

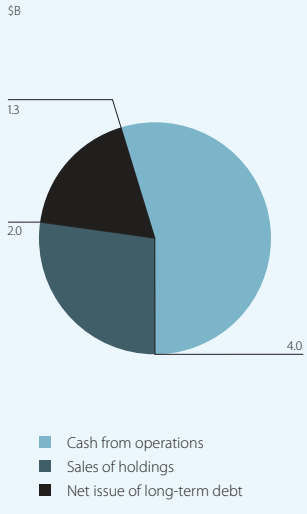
Preauthorized Funding Sources

The Corporation has access to the following preauthorized funding sources:

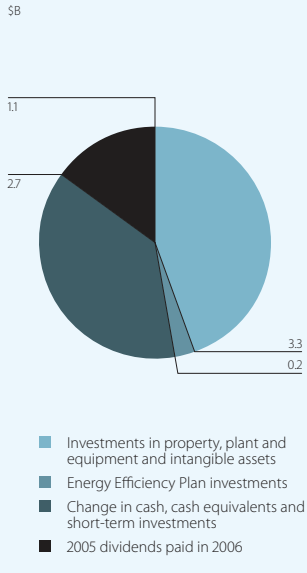
Type of financing	Authorized volume	Market	Outstanding as at December 31, 2006
Credit lines	US$350M or C$350M		–
	C$40M		–
	US$110M		–
Standby credit[a]	US$2,000M		–
Commercial paper[a]	US$2,250M or equivalent in C$	United States or Canada	C$25M
Medium-term notes[a]	US$3,000M or equivalent in other currency	United States	US$520M
	C$16,000M or equivalent in US$	Canada	C$12,336M

a) Guaranteed by the Québec government.

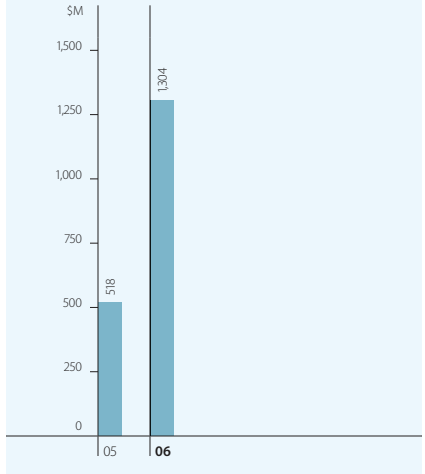
Sources of Funds



Use of Funds



Net Issue of Long-Term Debt



Credit Ratings

Hydro-Québec's credit ratings are presented in the table below:

	2006		2005	
	Commercial paper	Long-term	Commercial paper	Long-term
U.S. agencies				
Moody's	**P-1**	**Aa2 stable**	P-1	A1 positive
Fitch Ratings	**F1+**	**AA- stable**	F1+	AA- stable
Standard & Poor's	**A-1+**	**A+ stable**	A-1+	A+ stable
Canadian agency				
DBRS	**R-1 (middle)**	**A (high) stable**	R-1 (low)	A stable

Dividends and capitalization rate

Since the Corporation's capitalization rate was 38.8% at year end, dividends of $2,342 million were declared for 2006. Payment of the dividends will bring the capitalization rate to 36.1%.

The dividends declared for 2006 will constitute the tenth consecutive payment to our shareholder and will bring the total amount paid since 1998 to more than $8.7 billion.

Segmented Information

As in 2005, Hydro-Québec has four operating segments, namely Generation, Transmission, Distribution and Construction, as well as activities grouped under Corporate and Other Activities. The main change made to the organizational structure in 2006 was the creation of the Technology Group, which comprises the Hydro-Québec research institute, the Telecommunications unit and the subsidiaries Hydro-Québec IndusTech and Hydro-Québec CapiTech. The Group's results are presented under Corporate and Other Activities.

						2006
Segmented financial information ($M)	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Hydro-Québec[a]
Revenue	**6,164**	**2,841**	**9,543**	**1,999**	**1,194**	**11,161**
Income before financial expenses	**3,172**	**1,356**	**449**	**1**	**967**	**5,953**
Total assets	**28,674**	**15,879**	**11,424**	**214**	**7,272**	**63,248**

						2005
Segmented financial information ($M)	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Hydro-Québec[a]
Revenue	6,240	2,494	9,236	2,059	1,089	10,888
Income (loss) before financial expenses	2,923	1,071	614	5	(167)	4,439
Total assets	27,482	15,553	10,556	242	6,831	60,432

a) Includes the intersegment eliminations presented in Note 23 to the consolidated financial statements.

Note: Certain comparative figures have been reclassified to reflect the presentation adopted for 2006.

Segment highlights

Since debt and financial expenses are managed for the Corporation as a whole and allocated among the various operating segments, income before financial expenses is presented below for each segment.

The **Generation** segment recorded income before financial expenses of $3,172 million, versus $2,923 million in 2005. This improvement was mainly the result of the recognition of a foreign exchange gain on debts and swaps denominated in U.S. dollars. It should also be noted that a non-recurring expense was recorded in 2005 following the write-off of the Grande-Baleine draft-design studies.

The **Transmission** segment recorded income before financial expenses of $1,356 million, versus $1,071 million in 2005. This improvement was chiefly due to an adjustment in transmission rates granted by the Régie de l'énergie in April 2006. The adjustment, which is retroactive to 2005, gave rise to an increase in transmission revenue for the native load in recognition of the cost of transmission infrastructure required to meet demand growth in Québec. The growth in income was partially offset by increases in depreciation and amortization expense and in pension costs.

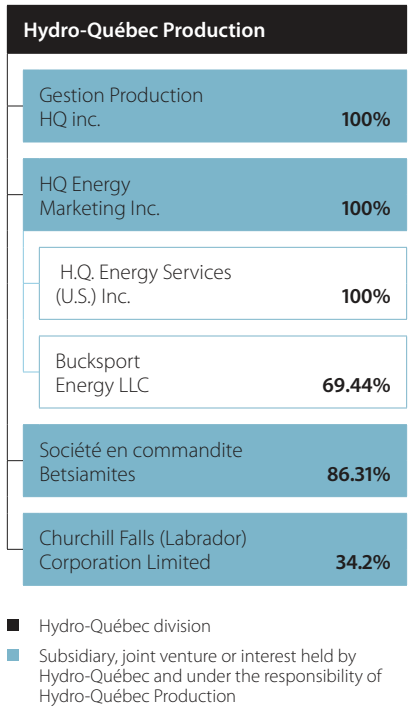
The **Distribution** segment recorded income before financial expenses of $449 million, as against $614 million in 2005. The variance is due to the fact that the increase in revenue from electricity sales was not sufficient to compensate for the rise in supply costs, in the regulatory deferral related to cost variances for electricity purchases in excess of the heritage pool, in operating expenses and in depreciation and amortization expense.

The **Construction** segment recorded a volume of activity of $1,999 million, compared to $2,059 million in 2005. As in the previous year, this high volume stems from several major projects.

Generation

Under the *Act respecting the Régie de l'énergie*, Hydro-Québec Production is required to provide Hydro-Québec Distribution with an annual maximum of 165 TWh of heritage pool electricity, at an average price of 2.79¢/kWh. The division sells its excess output on deregulated markets in northeastern North America, including Québec, at market prices. It may also respond to the Distributor's calls for tenders in a context of free competition.

The division operates 60 generating stations. Its capital projects have a twofold objective: to ensure the long-term operability of existing facilities and to continue development of Québec's hydroelectric potential.



Operating results

Hydro-Québec Production recorded net income of $2,114 million in 2006, compared to $1,873 million in 2005. The increase is mainly due to the recognition of a $234-million foreign exchange gain on debts and swaps denominated in U.S. dollars, in keeping with the hedge accounting treatment adopted.

Electricity sales to Hydro-Québec Distribution

In 2006, total electricity sales to Hydro-Québec Distribution reached 165.1 TWh, as against 165.9 TWh in 2005, a drop of 0.8 TWh. Revenue generated by these sales was up $40 million to reach $4,520 million.

The overall increase in revenue from electricity sales to Hydro-Québec Distribution, in spite of a lower sales volume, is attributable to the higher price of aluminum, partially offset by the stronger Canadian dollar; these factors together reduced the shortfall arising from special contracts and assumed by Hydro-Québec Production.

Electricity sales outside Québec

Electricity sales outside Québec generated revenue of $1,149 million for 14.5 TWh in 2006, compared to $1,464 million for 15.3 TWh in 2005. Short-term electricity sales earned $951 million for 12.1 TWh, compared to $1,290 million for 13.3 TWh in 2005. This $339-million decrease in sales revenue is mainly attributable to a drop in the volume of short-term purchase/resale transactions in 2006. Energy reserves were 114.3 TWh as at December 31, 2006, a 9.0-TWh increase over the same date in 2005.

Net electricity exports were $814 million, for a net reservoir drawdown of 7.0 TWh, comparable to the figures for 2005 ($830 million for 6.7 TWh). These activities generated a contribution of 11.6¢/kWh in 2006, compared to 12.4¢/kWh in 2005.

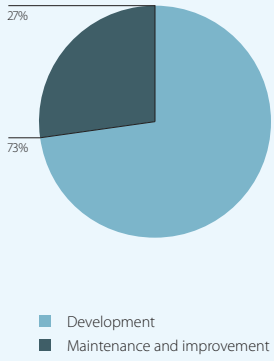
Other revenue

In 2006, the division recognized a $234-million foreign exchange gain on debts and swaps denominated in U.S. dollars. This amount represents the realization of a portion of the deferred foreign exchange gain presented on the balance sheet.

Electricity and fuel purchases

Electricity and fuel purchases amounted to $1,190 million in 2006, down $194 million from 2005. Short-term purchases for export totaled $371 million for 6.8 TWh, compared to $609 million for 8.0 TWh in 2005. The $238-million difference is mainly due to a drop in the volume of purchase/resale transactions on markets outside Québec.

Breakdown of 2006 Investments by Hydro-Québec Production



Operating expenses

Operating expenses totaled $742 million in 2006, up $32 million over 2005. The increase was chiefly due to a $14-million rise in pension costs.

Depreciation and amortization

Depreciation and amortization expense totaled $760 million in 2006, down $122 million from 2005, primarily as a result of the $113-million non-recurring expense recorded in 2005 following the write-off of the Grande-Baleine draft-design studies.

Investing activities

Investments in property, plant and equipment and intangible assets affecting cash amounted to $1,615 million in 2006. Of this amount, $1,174 million was earmarked for development activities, namely the continued construction of Mercier generating station and the Péribonka, Eastmain-1 (commissioned in 2006), Chute-Allard and Rapides-des-Cœurs developments, the government approvals process for the Eastmain-1-A/Sarcelle/Rupert project and the draft-design studies for the Romaine complex.

Hydro-Québec Production also invested $441 million in rehabilitating and refitting its fleet. Most of the investments were for Beauharnois, La Tuque, Outardes-3 and Outardes-4 generating stations as well as for the draft-design studies for the refurbishment of Gentilly-2 nuclear generating station. In addition, $45 million was devoted to a project to improve security at all facilities.

Transmission

Hydro-Québec TransÉnergie transmits power at the lowest possible cost while meeting the growing demand and customer expectations in terms of power quality. It ensures the reliability, long-term operability and optimal deployment of the power transmission system in Québec with a view to sustainable development. In this context, the division intends to become a world benchmark for quality and reliability in the integration of wind energy into a large power grid.

The division's transmission operations in Québec fall under the exclusive jurisdiction of the Régie de l'énergie.

Hydro-Québec TransÉnergie

Cedars Rapids Transmission Company, Limited **100%**

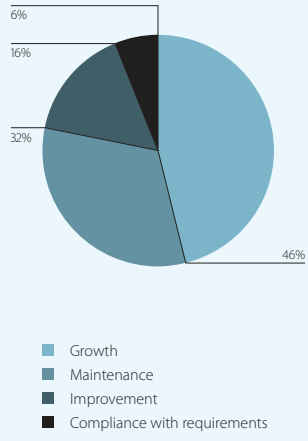
- Hydro-Québec division
- Subsidiary held by Hydro-Québec and under the responsibility of Hydro-Québec TransÉnergie

Regulatory affairs

In April 2006, the Régie granted the Transmission Provider, retroactively to January 1, 2005, a $170-million annual increase in transmission revenue for the native load in recognition of the cost of the transmission infrastructure required to meet demand growth in Québec. As a result of this decision, annual transmission revenue for the native load rose from $2,313 million to $2,483 million.

In a preliminary decision handed down on February 20, 2007, the Régie authorized Hydro-Québec TransÉnergie to modify its transmission rates effective January 1, 2007. This decision translates into an estimated annual increase of $57 million in native load transmission revenue, reflecting the cost of the infrastructure needed to meet demand growth in Québec. The Transmission Provider expects to receive the final decision from the Régie in March 2007.

Breakdown of 2006 Investments by Hydro-Québec TransÉnergie



Operating results

The division's net income was $632 million in 2006. This $252-million (66%) increase over 2005 was attributable to higher revenue following the retroactive adjustment in transmission rates granted by the Régie, which was partially offset by higher operating expenses and depreciation and amortization expense.

Revenue amounted to $2,841 million, up $347 million from 2005. The Régie's decision retroactive to January 1, 2005, concerning transmission revenue for the native load, caused revenue to increase by $340 million, or $170 million for 2005 and $170 million for 2006.

Operating expenses were $739 million, as against $701 million in 2005, for an increase of $38 million stemming, in particular, from a $13-million increase in pension costs.

Depreciation and amortization expense stood at $535 million, up $40 million from 2005, on account of the commissioning of new transmission equipment, among other factors.

Investing activities

In 2006, Hydro-Québec TransÉnergie invested $882 million in property, plant and equipment and intangible assets affecting cash, or $405 million for business development and $477 million for ongoing operations.

More than 45% of the capital outlay in 2006 was related to growth in demand for transmission services. The division increased the amounts invested in this area by 26% over 2005 in order to improve transmission system capacity and connect new generating stations to the grid.

In this regard, the projects to bring output onto the grid from Péribonka, Eastmain-1, Chute-Allard and Rapides-des-Cœurs generating stations required investments on the order of $166 million in 2006. The work to connect Péribonka generating station, slated for commissioning in June 2008, required investments of $73 million in 2006. The project consists in building a 161-kV line 128 km long between the new Péribonka and Simard substations. In 2006, the division completed the connection of Eastmain-1 powerhouse, a $129-million project into which $60 million was injected during the year. A 315-kV line 59 km long now connects the new Eastmain-1 substation to Nemiscau substation, bringing an additional 480 MW onto the grid. In February 2006, the Régie de l'énergie authorized a project to connect Chute-Allard and Rapides-des-Cœurs generating stations at a cost of $105 million, $33 million of which was invested during the year. The project consists in building a 230-kV line in two segments: a 30-km segment between these two generating stations, and a 31-km segment between Rapides-des-Cœurs generating station and Rapide-Blanc substation.

Hydro-Québec TransÉnergie invested $50 million in other assets, such as connecting the TransCanada Energy cogeneration plant to Bécancour substation and integrating output from Baie-des-Sables wind farm into the grid.

The division also invested $51 million in 2006 to finish connecting the community of Waskaganish to the transmission system. This project consisted in building a 69/25-kV substation in Waskaganish and a 69-kV line between this substation and Nemiscau substation (208 km). The work cost $74 million and was completed in December 2006.

More than half of the capital outlay made in 2006 was to ensure the long-term operability of the system and to maintain or increase service quality. In this regard, $106 million was earmarked for the ongoing project to secure the Québec City regional transmission system against extreme weather events. This $191-million project, it may be recalled, involves installing line de-icing equipment to secure the power supply from three 735-kV source substations, namely Laurentides, Jacques-Cartier and Lévis. The equipment should be commissioned in 2007.

Enhancing security at transmission facilities required investments of $29 million for three separate projects: physically securing strategic facilities against intrusion and ensuring public security ($16 million); building a central alarm station ($5 million); reinforcing facility monitoring and installing remote monitoring systems ($8 million) that will allow faster intervention in an emergency.

Distribution

Hydro-Québec Distribution provides electricity to the Québec market and delivers reliable power and quality services to its customers with a view to efficiency and sustainable development.

The division's activities are regulated by the Régie de l'énergie, which has exclusive jurisdiction to set electricity rates.

Hydro-Québec Distribution

Centre d'innovation sur le transport d'énergie du Québec (CITEQ) inc. **50%**

- Hydro-Québec division
- Interest held by Hydro-Québec and under the responsibility of Hydro-Québec Distribution

Regulatory affairs

In February 2006, the Régie approved an across-the-board rate adjustment of 5.3% that took effect on April 1, 2006. In light of an unusually mild winter in 2006, a reduction in forecasted growth in industrial consumption and higher-than-expected energy savings, the Régie authorized an across-the-board rate adjustment of 1.9%, effective April 1, 2007.

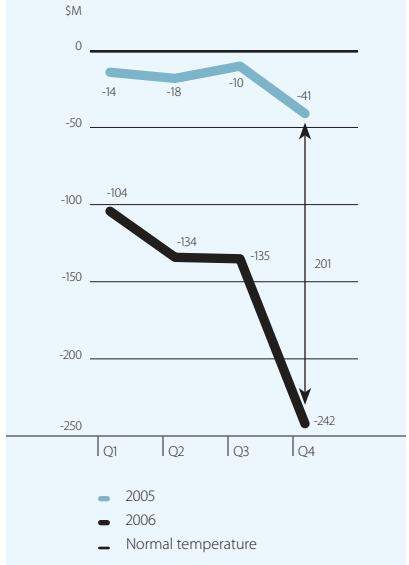
Supplying the Québec market

Hydro-Québec Distribution relies on various sources in order to supply the Québec market. To meet requirements in excess of the heritage pool (165 TWh) reserved for it by Hydro-Québec Production, the division issues short- and long-term calls for tenders. For requirements of less than three months, it may also buy electricity directly on the market, without a call for tenders, under an exemption granted by the Régie. It also relies on a framework agreement with Hydro-Québec Production to cover unexpected needs that it could not otherwise meet.

Hydro-Québec Distribution signed an agreement with Hydro-Québec Production in 2005 for balancing services to facilitate the integration of wind power. The Régie de l'énergie approved the agreement in February 2006. The deliveries of wind energy and of electricity generated by cogeneration and biomass, as provided for in long-term supply contracts, began in 2006.

The division also carried on its efforts in the area of energy efficiency. The *Strategic Plan 2006–2010* sets the annual energy savings target at 4.7 TWh by 2010, with an eventual target of 8 TWh by 2015.

Cumulative Effect of Temperature in Comparison to the Norm



Operating results

Hydro-Québec Distribution's net income was $42 million in 2006, down $188 million from 2005. The increase in revenue from electricity sales, basically as a result of rate adjustments, did not offset the rise in cost of supply, in the regulatory deferral related to cost variances for electricity purchases in excess of the heritage pool, in depreciation and amortization expense and in operating expenses.

It should be mentioned that the 2005 sale of assets held by HydroSolution had generated a non-recurring gain of $48 million.

Electricity Sales in Québec by Category

	Sales volume			Sales revenue		
	2006	2006–2005 change[a]		**2006**	2006–2005 change[a]	
Customer category	TWh	TWh	%	$M	$M	%
Residential and farm	**56.7**	(0.5)	(0.9)	**3,775**	85	2.3
General and institutional	**32.4**	(1.0)	(3.0)	**2,356**	72	3.2
Industrial	**73.3**	(0.2)	(0.3)	**3,022**	130	4.5
Other	**4.9**	(0.1)	(2.0)	**249**	4	1.6
Total	**167.3**	(1.8)	(1.1)	**9,402**	291	3.2

a) 2005 sales volume and revenue have been reclassified to reflect the presentation adopted for 2006.

Electricity sales revenue was up $291 million over 2005, mainly because of rate adjustments.

Factors in the 2006–2005 Change in Sales by Category

					Volume effects			Price effects	**Total**
Customer category	Baseload demand		Temperature		**Total**	Rate adjustments	Other	**Total**	
	TWh	$M	TWh	$M	$M	$M	$M	$M	$M
Residential and farm	1.7	111	(2.2)	(158)	**(47)**	144	(12)	**132**	**85**
General and institutional	(0.1)	8	(0.9)	(39)	**(31)**	95	8	**103**	**72**
Industrial	(0.2)	(24)	–	–	**(24)**	92	62	**154**	**130**
Other	0.1	4	(0.2)	(4)	**–**	10	(6)	**4**	**4**
Total	1.5	99	(3.3)	(201)	**(102)**	341	52	**393**	**291**

The 1.8-TWh net reduction in sales volume is a result of the unusually mild temperatures in 2006 and was mainly in the residential and farm category, which is more sensitive to temperature changes because of its heating requirements. This reduction was partially offset by the 1.5-TWh increase in baseload demand in this category, driven primarily by housing starts.

Sales revenue was also up in the industrial category as a result of rate adjustments and growth in sales revenue under special contracts following the increase in the price of aluminum, the effect of which was assumed by Hydro-Québec Production.

The cost of transmission service and of electricity and fuel purchases was up $276 million over 2005, taking into account the application of regulatory practices permitting the deferral of certain costs of transmission and supply.

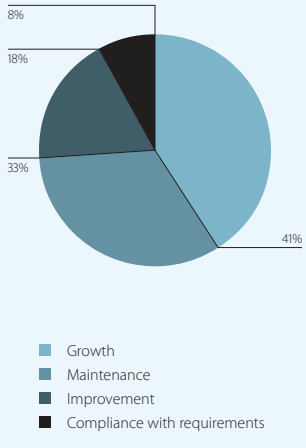
The cost of transmission service rose $340 million following a decision handed down by the Régie de l'énergie to grant Hydro-Québec TransÉnergie a $170-million annual increase, retroactive to January 1, 2005, in transmission revenue for the native load. This expense was completely offset by the recording of a regulatory asset, since the 2005 and 2006 rates had already been set when the Régie rendered its decision.

In addition, the division recorded a regulatory liability of $262 million to take into account the fact that the actual supply costs of electricity in excess of the heritage pool were lower than had been forecasted when the 2006 rates were set by the Régie.

Operating expenses were $1,071 million in 2006, versus $1,006 million in 2005. Extreme weather events in 2006 caused power failures and service restoration costs of $34 million, compared to $7 million in 2005. This, together with the $23-million rise in pension costs, accounts for most of the increase in operating expenses.

Depreciation and amortization expense totaled $570 million, or $81 million more than in 2005. The difference is attributable to the amortization of costs related to the Energy Efficiency Plan and to the rescission of Rate BT, for a combined total of $48 million, as well as the effect of facility commissionings in 2005 and 2006.

Breakdown of 2006 Investments by Hydro-Québec Distribution



Investing activities

Under the category of investments affecting cash, Hydro-Québec Distribution invested $690 million in property, plant and equipment and intangible assets in 2006.

Of this amount, $283 million went toward meeting the sustained growth in demand, including $190 million to hook up new customers. The division also invested $229 million to ensure long-term distribution system operability, and $125 million to improve quality of service, including nearly $100 million in the Customer Information System project and $13 million in the distribution system automation program, which will permit remote monitoring of system components, among other things.

Hydro-Québec Distribution also invested $149 million in the Energy Efficiency Plan. In 2006, energy efficiency programs generated savings of approximately 0.6 TWh.

Construction

Hydro-Québec Équipement carries out engineering and construction for hydroelectric development projects throughout Québec, except in the territory governed by the *James Bay and Northern Québec Agreement*, where such work is handled by Société d'énergie de la Baie James (SEBJ). The division also builds power transmission lines and substations throughout the province.

As engineering and environmental specialists, Hydro-Québec Équipement and SEBJ also offer the generation and transmission divisions a variety of services needed for draft-design studies, impact assessments and other energy-related projects. These services include technical and scientific studies, planning, cost estimates, design, architecture, land surveying and quality control.

Volume of activity

Hydro-Québec Équipement and SEBJ carried out activities worth a total of $1,999 million in 2006, compared to $2,059 million in 2005. As in 2005, this high volume can be attributed to several large-scale projects. Work done for Hydro-Québec Production totaled $1,254 million, versus $1,425 million in 2005, while work done for Hydro-Québec TransÉnergie totaled $719 million, versus $566 million in 2005.

Hydro-Québec Équipement

In 2006, Hydro-Québec Équipement carried out activities worth a total of $1,754 million, up $227 million (15%) from 2005. This sharp increase reflects the continuation or completion of many generation and transmission projects: construction of Mercier generating station and the Péribonka, Chute-Allard and Rapides-des-Cœurs developments; power plant rehabilitation at Beauharnois, La Tuque, Outardes-3 and Outardes-4; and connection of Péribonka, Eastmain-1, Chute-Allard and Rapides-des-Cœurs generating stations and the community of Waskaganish to the grid. The division also continued work to increase transmission system capacity, install line de-icing equipment at Lévis substation and enhance security at facilities.

Société d'énergie de la Baie James

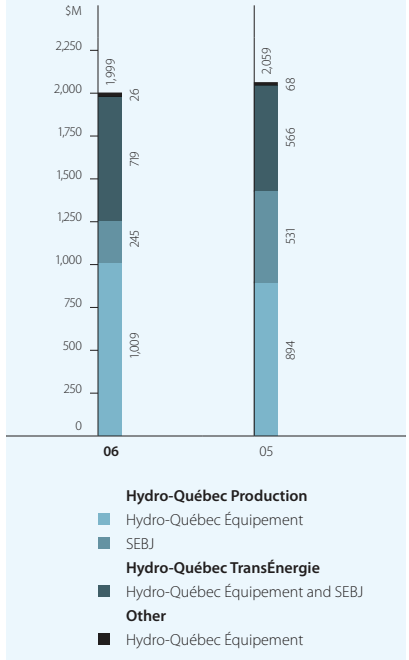
SEBJ's activities — mainly on behalf of Hydro-Québec Production — represented a total of $245 million in 2006, compared to $532 million in 2005. The reduction is due to the completion of the Eastmain-1 project: the generating station was commissioned in the second half of 2006. Concerning the Eastmain-1-A/Sarcelle/Rupert project, approval was obtained from the government of Québec on November 24, 2006, and the approval of the Governor in Council was received from federal authorities on December 14, 2006.

Hydro-Québec Équipement

Société d'énergie de la Baie James **100%**

- Hydro-Québec division
- Subsidiary held by Hydro-Québec and under the responsibility of Hydro-Québec Équipement

Breakdown of Construction Segment Activities



Note: Certain comparative figures have been reclassified to reflect the presentation adopted for 2006.

Corporate and Other Activities

This heading includes corporate activities, the Shared Services Centre, the Technology Group and the subsidiaries Hydro-Québec International and TransÉnergie HQ.

Results

Corporate and Other Activities generated net income of $944 million in 2006, versus a net loss of $228 million in 2005. This increase is basically attributable to the implementation of the plan to sell off foreign holdings in 2006.

Corporate Activities

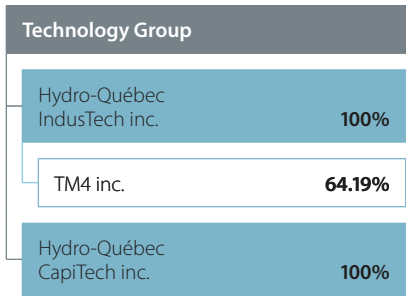
Corporate activities consist of financial services, human resources and corporate affairs, the latter including coordination of strategic planning and of cases to be submitted to the Régie de l'énergie.

The Finance Group manages debt, financial expenses and financial risks (such as interest rate and foreign exchange risks) for the entire Corporation and then allocates the financial expenses to the operating segments. In addition, the Group oversees risk management activities by the divisions and corporate units, while also providing tax and accounting expertise for all the Corporation's business segments. Additionally, it is responsible for producing and analyzing the consolidated financial statements, including segmented information, and for managing the pension plan, whose assets amount to nearly $13 billion.

Shared Services Centre

The Shared Services Centre provides divisions and corporate units with the support services they require to efficiently perform their activities. These services include procurement of goods and services, real estate management, accounting services, document management, material management, transportation services, office automation services and IT solutions. The Centre's mandate is to provide its customers with quality services tailored to their needs at the lowest possible cost so that they can focus on their core operations.

The Shared Services Centre's revenue totaled $651 million in 2006, as against $624 million in 2005. The rise is a result of pension cost growth as well as increased demand related to facilities security and IT solutions (Customer Information System project).



Technology Group

Created in 2006, the Technology Group is made up primarily of the Telecommunications unit, Hydro-Québec's research institute, and the subsidiaries Hydro-Québec IndusTech and Hydro-Québec CapiTech. The Group's mandate is to ensure the integrated management of technological innovation as well as the implementation and operation of an integrated architecture for all of Hydro-Québec's telecommunications systems.

Operating results

The Technology Group had a net loss of $66 million in 2006, compared to a net loss of $181 million in 2005. The difference is due to the downward revaluation of its investment portfolio in 2005.

Telecommunications unit

The Telecommunications unit helps to increase the efficiency of divisions and corporate units by offering its customers integrated telecommunications solutions that are high-performance, innovative and aligned with Hydro-Québec's business priorities.

Revenue generated by telecommunications activities amounted to $309 million in 2006, as against $290 million in 2005. The increase was due to the large-scale program under way to enhance security at facilities.

Institut de recherche d'Hydro-Québec

Hydro-Québec's research institute provides technical assistance to the divisions and carries out technological innovation projects to support their operations and ensure the Corporation's long-term development. Hydro-Québec allocates approximately $100 million annually to the institute's activities.

Hydro-Québec IndusTech

The mission of Hydro-Québec IndusTech is to partner with the private sector in the industrialization and marketing of technologies resulting from Hydro-Québec's research activities. Since the Corporation decided on October 31, 2006, to terminate the activities of AVESTOR, Hydro-Québec IndusTech now has only a single ownership interest, TM4. In 2006, Groupe Industriel Marcel Dassault, Hydro-Québec's partner in this company, increased its stake from 18.3% to 35.8%.

Hydro-Québec CapiTech

The venture capital company Hydro-Québec CapiTech invests in businesses that offer energy-related services and technology products.

Investing activities

In 2006, the Technology Group's investments totaled $101 million, of which $73 million was earmarked for maintaining asset quality and $18 million for meeting growth in demand for telecommunications services.

Hydro-Québec International

Almost all of the foreign holdings owned by Hydro-Québec through Hydro-Québec International were sold in 2006, generating $964 million in income from discontinued operations, versus a $9-million loss in 2005. This result is largely attributable to the $813-million gain on the sale of the interest in Transelec.

Hydro-Québec received approximately $1.9 billion from the sale of these holdings. At the end of 2006, Hydro-Québec International still had a 33% investment in DirectLink, in Australia, for which a sales agreement was signed in December 2006. The closing of the transaction took place on February 28, 2007, after the government approvals required in Australia were obtained.

Income from Hydro-Québec International's continuing operations amounted to $29 million in 2006, as against a $20-million loss in 2005. The 2006 result is primarily due to $36 million in interest income related to funds generated by the sale of foreign holdings.

TransÉnergie HQ

TransÉnergie HQ, a wholly owned subsidiary of Hydro-Québec, recorded net income of $27 million in 2006, versus a net loss of $0.3 million in 2005. The difference is chiefly attributable to the sale, in 2006, of its interest in Cross-Sound Cable Company, LLC, which generated a $29-million gain.

Outlook

In 2007, Hydro-Québec expects to earn about $2.5 billion in income from continuing operations, according to the financial outlook in the *Strategic Plan 2006–2010*. This projection takes into account the payment of water-power royalties by Hydro-Québec Production, which will be gradually phased in as of 2007.

Hydro-Québec plans to invest $4.5 billion during 2007. More than 60% of this amount will be devoted to development and growth activities. Based on debt maturities, cash from operations and the implementation in 2006 of the plan for selling off our foreign holdings, the Corporation's financial requirements will be more modest than in previous years.

Hydro-Québec Production will continue to increase hydroelectric production capacity through further development of its work in progress: Mercier generating station; the Péribonka, Chute-Allard and Rapides-des-Cœurs developments; completion of the draft-design studies for the Romaine complex; and start-up of construction of the Eastmain-1-A/Sarcelle/Rupert project in January 2007. The division will also continue to provide balancing services to compensate for fluctuations in wind power and thereby facilitate the integration of this type of energy into the grid.

Hydro-Québec TransÉnergie will continue to enhance service quality and the reliability and security of the power transmission system. The division will also continue to bring new generating capacity onto the power grid, including output from Chute-Allard, Rapides-des-Cœurs and Péribonka generating stations and from wind farms built in response to the Distributor's first tender call for wind power. In addition, the work begun in 2006 on the new interconnection with Ontario will go forward in 2007. The division also intends to commission the line de-icing equipment at Lévis substation and to continue refurbishment of the substation's synchronous condensers.

Hydro-Québec Distribution will continue to deliver reliable electricity in sufficient quantities to its Québec customers, while favoring renewable energy sources and carrying on its efforts to promote energy efficiency. It will therefore invest in various distribution grid automation programs and in the deployment of the Customer Information System, slated to be fully commissioned in 2008. The division intends to invest additional resources in the Energy Efficiency Plan in light of the new reduction targets, which have risen from 4.1 to 4.7 TWh by 2010, and to 8 TWh by 2015. Finally, it will take delivery of wind farm energy under long-term contracts signed in 2005, following the call for tenders issued in 2003.

Integrated Enterprise Risk Management

For several years now, Hydro-Québec has practised integrated risk management, enabling it to ascertain the main risks involved in its operations and to better manage the resulting uncertainties.

The company's major units are central to the process. They manage the risks associated with their activities and participate in reviews every four months. In concrete terms, each unit must, during its annual planning process, determine and assess its main risks and then develop mitigation measures to ensure that the residual risks are at acceptable levels. The units report on their risk management activities to the Management Committee, which then serves as a risk management committee to ensure the monitoring and management of risks. The resulting consolidated portfolio of risks is submitted to the Board of Directors with the Strategic Plan or the annual Business Plan and is reported on annually. The diagram below illustrates the risk management process at Hydro-Québec.

Hydro-Québec's Annual Risk Management Process

a) The Management Committee and division committees act as risk management committees.

Financial risks

The company's results are subject to financial risks associated with unfavorable fluctuations in interest rates, exchange rates and aluminum prices. In order to limit their short-term impact on financial results, these three factors are managed actively, in an integrated fashion and according to criteria determined on the basis of the company's risk tolerance. In addition, Hydro-Québec relies on certain offsetting factors that mitigate its financial risks over the medium and long term. For example, the company holds debts denominated in U.S. dollars as a hedge against sales in this currency; the effect of exchange rate fluctuations on sales is thus counterbalanced by exchange gains or losses on debts in U.S. dollars. The impact of fluctuations in real interest rates on the cost of new borrowings is partly mitigated by the inverse effect of these fluctuations on pension costs. Lastly, unfavorable fluctuations in the cost of capital and pension costs can be partially recovered by adjustments in the cost of service of regulated divisions.

Generation

One of the principal uncertainties that Hydro-Québec faces is natural runoff. Hydro-Québec Production must ensure that it is able to meet its commitments to supply the heritage pool of electricity to Hydro-Québec Distribution and fulfill its contractual obligations. In concrete terms, this means being able to cover a natural runoff deficit of 64 TWh over two consecutive years, and 98 TWh over four consecutive years. To meet this requirement, the division applies a variety of mitigation measures and follows up on them rigorously. In particular, it manages its energy reserves on a multiyear basis and maintains an adequate margin between its generating capacity and its commitments. This allows the division to compensate for runoff shortages, replenish its reserves or take advantage of business opportunities. In addition, Hydro-Québec regularly reports to the Régie de l'énergie on its energy and capacity reserves.

The wholesaling operations of Hydro-Québec Production's trading floor are subject to credit and market risks. These are carefully monitored and rigorously managed by a team of specialists who quantify them, see to the application of checks and balances, submit daily reports to Senior Management and make sure that the limits approved by Management and the Board of Directors are observed. Lastly, the company manages its exposure to market risks through various means, including the ongoing monitoring of market positions and the use of hedging derivatives.

Transmission

Several factors, such as extreme weather and equipment failures, may cause service interruptions or result in the unavailability of part of the transmission system. The multifaceted strategy adopted by Hydro-Québec TransÉnergie to prevent these problems includes implementing the standards set by the North American Electric Reliability Council and the Northeast Power Coordinating Council, as well as measures to maintain and improve transmission facilities and extend their service life.

Over the next few years, the Transmission Provider must not only ensure adequate transmission capacity to supply the grids of Hydro-Québec Distribution and other customers, but also connect new power plants to the grid and integrate new generating options, particularly wind power. To succeed, the division is counting on the integrated planning of its transmission operations and capital projects, as well as the optimization of its project management process. In coming years, it will work to integrate wind power into its grid without compromising stability and reliability.

Distribution

Hydro-Québec Distribution is responsible for supplying electricity to Québec customers. Faced with uncertainties related to the growth in demand, including unpredictable weather, the division uses various methods to counter the ensuing risk. It negotiates flexibility clauses with its suppliers, is constantly refining its method of forecasting short-term demand and makes use of peak demand management tools such as voltage reduction and options to reduce deliveries to large-power customers. With a view to better energy use, the Distributor is pursuing its efforts to limit growth in demand through energy conservation. These efforts include developing new terms and conditions for energy efficiency programs, seeking innovative energy efficiency solutions and simplifying access to the various programs.

In addition, to maintain the quality of electricity service, the Distributor takes steps to ensure the long-term operability of the distribution system and applies a series of measures including an integrated strategy for system interventions related to asset renewal, system maintenance and vegetation control.

Construction

The booming construction market, strong demand for skilled labor and market-specific inflation are exerting upward pressure on Hydro-Québec's project costs. The company has developed strategies to mitigate the impacts of economic conditions on its procurement activities and construction projects. It is also reviewing its project management methods to optimize project execution.

Corporate and Other Activities

Environmental protection is a central concern of Hydro-Québec. All units whose operations may have a significant impact on the environment have implemented ISO 14001 – certified environmental management systems. In addition, every year, the company reviews its management of environmental issues and publishes a Sustainability Report.

Hydro-Québec is also concerned with information security and the risks associated with the misuse of information technologies. It regularly assesses how well its information systems are protected against intrusions and implements the necessary security measures, particularly by maintaining an antivirus expertise centre, using filtering devices, monitoring its systems, managing identities and access, and instituting an incident and vulnerability management plan.

In addition, to manage biohazards, Hydro-Québec has established an emergency response plan to limit the spread of infectious diseases among employees and ensure continuity of service.

Management Report

Hydro-Québec's consolidated financial statements and all additional information contained in the Annual Report are the responsibility of Management and are approved by the Board of Directors. The consolidated financial statements have been prepared by Management in accordance with Canadian generally accepted accounting principles and with decisions handed down by the Régie de l'énergie with respect to the transmission and distribution of electricity. They include amounts determined based on Management's best estimates and judgment. Financial information presented elsewhere in the Annual Report is consistent with the information provided in the consolidated financial statements.

Management maintains an internal control system which includes communicating Hydro-Québec's code of ethics and a code of conduct to employees, primarily to ensure the proper management of resources and the orderly conduct of business. The objective of this system is to provide reasonable assurance that the financial information is pertinent and reliable and that the assets of Hydro-Québec are adequately recorded and safeguarded. An internal auditing process allows evaluation of the sufficiency and effectiveness of control, as well as of Hydro-Québec's policies and procedures. Recommendations ensuing from this process are submitted to Management and the Audit Committee.

The Board of Directors is responsible for corporate governance. It assumes its responsibility for the consolidated financial statements principally through its Audit Committee, composed solely of independent directors, who do not hold full-time positions within the Corporation or in one of its subsidiaries. The Audit Committee's mandate is to ensure that the consolidated financial statements present fairly Hydro-Québec's financial position, the results of its operations and its cash flows, and to recommend the financial statements to the Board of Directors for approval. The Audit Committee meets regularly with Management, the General Auditor and the external auditors to discuss the results of their audits and their findings with respect to the integrity and the quality of the presentation of Hydro-Québec's financial information and the effectiveness of its internal control systems. The General Auditor and the external auditors have full and unrestricted access to the Audit Committee, with or without Management present.

The external auditors are appointed by the Québec government, the sole shareholder of the Corporation. The 2006 consolidated financial statements have been audited jointly by the external auditors, KPMG LLP and Ernst & Young LLP.

Michael L. Turcotte

Chairman of the Board

Thierry Vandal

President and
Chief Executive Officer

Daniel Garant

Executive Vice President,
Finance and
Chief Financial Officer

Montréal, Québec
February 9, 2007

Auditors' Report

To the Minister of Finance of Québec:

We have audited the consolidated balance sheets of Hydro-Québec as at December 31, 2006 and 2005, and the consolidated statements of operations, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of Hydro-Québec's Management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by Management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Hydro-Québec as at December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended, in accordance with Canadian generally accepted accounting principles. As required by the *Auditor General Act* (R.S.Q., c. V-5.01), we report that, in our opinion, except for the prospective application of changes in accounting policies described in Note 2 to the consolidated financial statements, these principles have been applied on a basis consistent with that of the preceding year.

KPMG LLP

Chartered Accountants

Ernst & Young LLP

Chartered Accountants

Montréal, Québec

February 9, 2007

Consolidated Statements of Operations

Years ended December 31 In millions of Canadian dollars	Notes	**2006**	2005
Revenue		**11,161**	10,888
Expenditure			
Operations		**2,394**	2,248
Electricity and fuel purchases		**1,315**	1,496
Depreciation and amortization	4	**2,007**	2,023
Taxes	5	**529**	594
Regulatory deferrals	3	**(93)**	(11)
		6,152	6,350
Operating income		**5,009**	4,538
Financial expenses	6	**2,212**	2,187
Income from continuing operations		**2,797**	2,351
Income (loss) from discontinued operations	7	**944**	(99)
Net income		**3,741**	2,252

Consolidated Statements of Retained Earnings

Years ended December 31 In millions of Canadian dollars	Note	**2006**	2005
Balance at beginning of year		**13,075**	11,949
Net income		**3,741**	2,252
		16,816	14,201
Dividends declared	18	**2,342**	1,126
Balance at end of year		**14,474**	13,075

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Balance Sheets

As at December 31 In millions of Canadian dollars	Notes	2006	2005
ASSETS			
Current assets			
Cash and cash equivalents		**52**	16
Short-term investments	16	**3,177**	322
Accounts receivable		**1,700**	1,764
Swaps		**1,389**	685
Materials, fuel and supplies		**365**	343
Assets held for sale	7	**11**	145
		6,694	3,275
Property, plant and equipment	8	**51,813**	50,373
Investments	9	**232**	221
Swaps		**1,093**	1,749
Intangible assets	10	**923**	854
Other assets	11	**2,462**	1,794
Assets held for sale	7	**31**	2,166
		63,248	60,432
LIABILITIES			
Current liabilities			
Borrowings	16	**25**	20
Accounts payable and accrued liabilities		**1,833**	1,929
Dividends payable	18	**2,342**	1,126
Accrued interest		**971**	927
Regulatory liability	3	**251**	–
Current portion of long-term debt	12	**1,352**	3,148
Liabilities related to assets held for sale	7	**1**	172
		6,775	7,322
Long-term debt	12	**34,139**	31,279
Asset retirement obligations	13	**431**	282
Other long-term liabilities	14	**2,719**	2,581
Long-term liabilities related to assets held for sale	7	**7**	1,213
Perpetual debt	15	**337**	379
		44,408	43,056
SHAREHOLDER'S EQUITY	18		
Share capital		**4,374**	4,374
Retained earnings		**14,474**	13,075
Translation adjustments		**(8)**	(73)
		18,840	17,376
		63,248	60,432
Commitments and contingencies	21		

The accompanying notes are an integral part of the consolidated financial statements.

Norman E. Hébert Jr.

Chair of the Audit Committee

Michael L. Turcotte

Chairman of the Board

Consolidated Statements of Cash Flows

Years ended December 31 In millions of Canadian dollars	Notes	2006	2005
Operating activities			
Net income		**3,741**	2,252
(Income) loss from discontinued operations	7	**(944)**	99
Income from continuing operations		**2,797**	2,351
Adjustments			
Depreciation and amortization	4	**2,007**	2,023
Amortization of debt premiums, discounts and issue expenses	6	**1**	28
Exchange gain		**(470)**	(99)
Difference between contributions paid and pension cost		**(95)**	(155)
Regulatory deferrals	3	**(93)**	(11)
Other		**(54)**	(15)
Change in non-cash working capital items	19	**(87)**	279
		4,006	4,401
Investing activities			
Property, plant and equipment and intangible assets		**(3,348)**	(3,282)
Long-term investments		**12**	8
Disposal of investments, net of divested cash and cash equivalents	7	**2,022**	–
Energy Efficiency Plan	3	**(149)**	(91)
Net change in short-term investments		**(2,807)**	(251)
Other		**(6)**	(34)
		(4,276)	(3,650)
Financing activities			
Issuance of long-term debt		**3,781**	3,855
Repayment of long-term debt at maturity and sinking fund redemption		**(1,862)**	(1,805)
Redemption of long-term debt		**(789)**	(757)
Inflows resulting from credit risk management		**1,140**	340
Outflows resulting from credit risk management		**(975)**	(1,120)
Net change in short-term borrowings		**5**	(24)
Dividends paid		**(1,126)**	(1,350)
Other		**9**	5
		183	(856)
Change in foreign exchange on cash and cash equivalents		**–**	(1)
Cash flows from continuing operations		**(87)**	(106)
Cash flows from discontinued operations	7	**52**	101
Net change in cash and cash equivalents		**(35)**	(5)
Cash and cash equivalents at beginning of year		**92**	97
Cash and cash equivalents at end of year		**57**	92
Cash and cash equivalents			
Continuing operations		**52**	16
Discontinued operations		**5**	76
		57	92
Supplementary cash flow information	19		

The accompanying notes are an integral part of the consolidated financial statements.

Years ended December 31, 2006 and 2005
Amounts in tables are in millions of Canadian dollars, unless otherwise indicated.

Under the provisions of the Hydro-Québec Act, *the government corporation Hydro-Québec (the "Corporation") is mandated to supply power and to pursue endeavors in energy-related research and promotion, energy conversion and conservation, and any field connected with or related to power or energy. The Corporation is required, in particular, to supply a base volume of up to 165 TWh a year of heritage pool electricity for the Québec market, as set out in the* Act respecting the Régie de l'énergie.

Note 1 Significant Accounting Policies

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP) and reflect the decisions of the Régie de l'énergie (the "Régie"). These decisions affect the timing of the recognition of certain transactions in the consolidated operations, resulting in the recognition of regulatory assets and liabilities, which the Corporation considers it is likely to recover or settle subsequently through the rate-setting process.

Regulation

The *Act respecting the Régie de l'énergie* grants the Régie exclusive authority to determine or modify the rates and conditions under which electricity is transmitted and distributed by the Corporation. The Corporation's electricity transmission and distribution activities in Québec are therefore regulated. Under this legislation, rates are set by reasoned decision of three commissioners after public hearings. Moreover, the Act stipulates that rates are determined on a basis that allows for recovery of the cost of service plus a reasonable return on the rate base.

The Régie and the Corporation both belong to the Québec government reporting entity. However, the Régie is an independent, quasi-judicial economic regulatory agency accountable to the National Assembly of Québec through the Minister of Natural Resources and Wildlife.

TRANSMISSION

The Corporation's power transmission rates were determined in decision D-2006-66, in which the Régie authorized a modification of power transmission rates effective January 1, 2005. The impact of this decision is essentially a $170-million increase in the annual cost of transmission service for the native load, which is not integrated into the Corporation's electricity rates. The transmission rates include a 8.34% return on the rate base, as authorized by the Régie following decision D-2005-63. This return assumes a capital structure with 30% shareholder's equity.

DISTRIBUTION

The Corporation's electricity rates were determined in decisions D-2005-48 and D-2006-46, in which the Régie granted across-the-board rate increases of 1.2% and 5.33%, effective April 1, 2005, and April 1, 2006, respectively. The return on the rate base authorized by the Régie and set at 8.4% in 2005 was 7.75% in 2006, assuming a capital structure with 35% shareholder's equity.

Scope of consolidation

The consolidated financial statements include the accounts of the Corporation, its subsidiaries and its joint ventures as well as those of variable interest entities (VIEs) where Hydro-Québec is the primary beneficiary (referred to collectively as Hydro-Québec). Interests in joint ventures are accounted for using the proportionate consolidation method. Investments in companies over which Hydro-Québec can exercise significant influence are accounted for on an equity basis.

Use of estimates

The preparation of consolidated financial statements in accordance with GAAP requires that Management make estimates and assumptions that affect the amounts recognized as assets and liabilities, the disclosures required regarding contingent assets and liabilities at the date of the consolidated financial statements and the amounts recognized as revenue and expenditure for the years in question. The estimates relate to unbilled electricity deliveries, the useful life of property, plant and equipment, asset retirement and employee future benefit obligations, among other things. Actual results could differ from those estimates.

Revenue

Revenue is recognized when electricity is delivered or services are rendered. Revenue from sales of electricity in Québec is recorded on the basis of cyclical billings and also includes revenue accrued in respect of unbilled electricity deliveries.

Income taxes

In Canada, the Corporation and most of its holdings are exempt from paying income taxes since they are government-owned. Entities operating in foreign countries pay income taxes according to the tax rules in effect in the country where they derive revenue and the application of a tax treaty between Canada and the country concerned, if any such treaty exists.

The taxable entities use the liability method to account for income taxes.

Foreign currency translation

SELF-SUSTAINING FOREIGN OPERATIONS

The financial statements of foreign operations that are self-sustaining in terms of financial and operational management are translated according to the current rate method using the foreign currency as the measuring unit. Under this method, assets and liabilities are translated into Canadian dollars at the exchange rate in effect at the balance sheet date, and revenue and expenditure are translated at the average exchange rates in effect during the period. Exchange gains or losses resulting from the translation of the financial statements of these foreign operations are presented under Translation adjustments in Shareholder's equity on the balance sheet.

INTEGRATED FOREIGN OPERATIONS AND FOREIGN CURRENCY TRANSACTIONS

In the case of foreign operations that are integrated in terms of financial and operational management, as well as foreign currency transactions, accounts stated in foreign currencies are translated according to the temporal method. Under this method, monetary assets and liabilities are translated into Canadian dollars at the exchange rate in effect at the balance sheet date, and non-monetary items are translated at the historical rate. Revenue and expenditure resulting from foreign currency transactions are translated into Canadian dollars at the average exchange rates in effect during the period.

The exchange gains or losses resulting from the translation of monetary items are included in the statement of operations, unless they relate to hedging items for future sales in U.S. dollars, in which case they are deferred to the year in which such sales are made in accordance with Accounting Guideline AcG-13 of the *Canadian Institute of Chartered Accountants (CICA) Handbook*, Hedging Relationships.

Cash, cash equivalents and short-term investments

Cash and cash equivalents consist of cash on hand and liquid short-term investments with a maturity of three months or less from the date of acquisition. Investments with a maturity of more than three months are presented under Short-term investments.

Short-term investments are recorded at the lower of unamortized cost and fair value.

Sinking funds

Sinking funds are made up of Hydro-Québec debentures and are deducted from long-term debt.

Sinking fund securities are carried at unamortized cost. The difference between the cost and the par value at maturity is amortized over the remaining term of the security.

Materials, fuel and supplies

Inventories of materials, fuel and supplies are valued at the lower of cost and net realizable value. Cost is determined by the average cost method.

Property, plant and equipment

Property, plant and equipment are carried at cost, which comprises materials, labor, other costs directly related to construction activities, and financial expenses capitalized during construction. Property, plant and equipment also include the discounted value of asset retirement obligations. Contributions from third parties are applied against the cost of the related property, plant and equipment.

Financial expenses capitalized to property, plant and equipment under construction are determined using the average cost of the Corporation's long-term debt at the end of the previous year. When the property, plant and equipment under construction relate to regulated transmission and distribution activities, such financial expenses take return on shareholder's equity into account. The portion that corresponds to return on shareholder's equity is included in Revenue in the consolidated operations.

Property, plant and equipment are depreciated over their useful life, primarily using the sinking fund method, at a rate of 3%. Under the *Hydro-Québec Act*, the depreciation period is a maximum of 50 years. The depreciation periods for the principal categories of property, plant and equipment are as follows:

Hydraulic generation	40 to 50 years
Thermal generation, including nuclear	15 to 50 years
Transmission substations and lines	30 to 50 years
Distribution substations and lines	25 to 40 years

When unregulated property, plant and equipment are retired, the cost of such assets and the cost of their dismantlement, net of accumulated depreciation and salvage value, are charged to operations for the year. When regulated property, plant and equipment are retired, these costs are charged to a separate account and amortized over a maximum period of 10 years, using the sinking fund method, at a rate of 3%.

Maintenance and repair costs are charged to operations as incurred.

Long-term investments

Hydro-Québec holds an interest in a venture capital company whose mission is to make strategic investments. The investments held by this company, which would normally be consolidated or accounted for on an equity basis or at cost, are accounted for at fair value. The fair value is determined according to the quoted market price at the balance sheet date in the case of listed shares, and according to valuation methods recognized by the financial markets in the case of unlisted shares. Other long-term investments are recorded at cost, unless there has been a loss in value that is other than a temporary decline, in which case the investments are written down to fair value.

Intangible assets

Intangible assets are recorded at cost. This cost includes expenses directly associated with activities for developing or obtaining computer software for internal use. Financial expenses are capitalized over the development period.

Intangible assets with an indefinite useful life are not amortized. These assets are tested for impairment annually or more frequently if events indicate a potential impairment in value. The excess of the carrying amount over the fair value is recorded in the statement of operations for the period in which the impairment is determined.

Intangible assets with a finite useful life are amortized over their useful life. The amortization methods and periods used for these assets are as follows:

Software and licences	straight-line and sinking fund at 3%	3 to 10 years
Rights	sinking fund at 3%	40 to 50 years
Environmental studies	sinking fund at 3%	5 years
Patents	sinking fund at 3%	20 years

Impairment of long-lived assets

Hydro-Québec reviews the carrying amount of its property, plant and equipment and its amortizable intangible assets whenever events or changes in circumstances indicate that the expected undiscounted net cash flows could be lower than the carrying amount of the property and assets. An impairment loss corresponding to the amount by which the carrying amount exceeds fair value is recognized, if applicable.

Employee future benefits

The Corporation offers all of its employees a contributory defined-benefit pension plan based on final pay, as well as other post-retirement and post-employment benefits.

The cost of pension benefits and other post-retirement benefits provided in exchange for services rendered during the year is calculated using the projected benefit method prorated on years of service. It is based on Management's best assumptions of expected plan asset performance, salary escalation, the increase in health care costs, retirement ages of employees and other actuarial factors.

In order to establish its employee future benefit obligations, the Corporation has adopted the following policies:

- Past service costs arising from plan amendments and transitional balances relating to the pension plan and other post-retirement benefits as at January 1, 1999, are amortized over periods not exceeding active employees' average remaining years of service, which totaled 12 years as at January 1, 2006 (13 years as at January 1, 2005), using the straight-line method.

- Amortization of actuarial gains or losses is recognized in the statement of operations for the year if the unamortized net actuarial gain or loss at the beginning of the year exceeds 10% of the value of the accrued benefit obligations or 10% of the market-related value of the plan assets, whichever is greater. The amortization corresponds to the excess divided by active employees' average remaining years of service.

- The expected return on pension plan assets is based on a market-related value determined by using a five-year moving average for equity securities and by valuing other asset classes at fair value.

Note 1 Significant Accounting Policies (continued)

Asset retirement obligations

The Corporation accounts for asset retirement obligations in the period in which these legal obligations are incurred when a reasonable estimate of their fair value can be made. The corresponding costs of asset retirement are added to the carrying amount of the related asset and are amortized over its useful life. In subsequent financial years, any change due to the passage of time is charged to operating expenses for the current year (accretion expense) and the corresponding amount is added to the carrying amount of the liability. Changes resulting from revisions to the timing or the amount of the undiscounted cash flows are recognized as an increase or decrease in the carrying amount of the liability under Asset retirement obligations, and the corresponding retirement cost adjustment is accounted for as part of the carrying amount of the related asset.

The cash flows required to settle asset retirement obligations are estimated on the basis of studies that use various assumptions concerning the methods and timing to be adopted for the retirement. The Corporation periodically reviews the valuation of these cash flows in light of the underlying assumptions and estimates, possible technological advances, and changes in the standards and regulations governing the decommissioning of nuclear generating stations.

Debt premiums, discounts and issue expenses

Debt premiums, less discounts and issue expenses, are deferred and amortized over the term of the borrowings and presented under Other long-term liabilities.

Derivative instruments

As part of its integrated risk management, Hydro-Québec uses various derivative instruments to manage foreign exchange, interest rate and market risk, including exposure to fluctuating energy and commodity prices. In the case of hedging operations, the Corporation formally documents all relationships between hedging instruments and hedged items. Such documentation involves associating all derivatives with forecasted and probable transactions or with specific assets and liabilities on the balance sheet. The Corporation also formally measures the effectiveness of hedging relationships at their inception and then quarterly thereafter.

Derivative instruments designated as hedges in effective hedging relationships are accounted for using hedge accounting. The different types of hedging relationships in which the Corporation engages are as follows:

MANAGEMENT OF RISK ASSOCIATED WITH LONG-TERM DEBT AND SALES IN U.S. DOLLARS

- Foreign exchange risk — Currency swaps used to manage exchange risk related to long-term debt and sales in U.S. dollars are translated at the closing exchange rates in effect at the balance sheet date. Debit balances are reported as Swaps, while credit balances are presented under Long-term debt. Gains or losses on currency swaps related to long-term debt are included in the statement of operations under Financial expenses, while gains or losses on currency swaps related to U.S.-dollar sales are deferred to maturity and recognized as Revenue in the statement of operations in the year the sales are made.

- Interest rate risk — Interest rate swaps used to modify long-term exposure to interest rate risk are accounted for on an accrual basis and presented in the statement of operations under Financial expenses. The corresponding amounts payable or receivable are recorded as adjustments to accrued interest.

MANAGEMENT OF SHORT-TERM FINANCIAL RISK

- Foreign exchange risk — To manage short-term foreign exchange risk, the Corporation transacts options and forwards, which are recorded at cost. Gains or losses realized on these instruments are deferred and recognized in the statement of operations in the same period and component as the hedged item.

- Interest rate risk — The Corporation uses options, interest rate swaps and forward rate agreements to manage short-term interest rate risk. The instruments are accounted for at cost, and the related realized gains or losses are deferred and recognized in the statement of operations in the same period and component as the hedged item.

- Market risk — To manage market risk exposure, the Corporation contracts mainly options, commodity swaps and commodity futures. Risk management instruments for fluctuating energy or aluminum prices are accounted for at cost, and the related gains or losses are deferred and recognized in the statement of operations in the same period and component as the hedged item.

If a derivative instrument no longer satisfies hedging conditions or is sold or liquidated, or if Hydro-Québec terminates its designation as a hedging relationship, hedge accounting ceases to be applied on a prospective basis. The fair value of the derivative instrument is then recorded and deferred to be included in the statements of operations in the periods in which the hedged item affects operations. If the hedged item ceases to exist, the gains or losses previously deferred are immediately recognized in the statement of operations.

For derivative instruments to which hedge accounting cannot be applied, realized and unrealized changes in fair value are recognized in the statement of operations in the periods in which they occur.

The fair value of derivative instruments is based on the spot rates or on the forward rates or prices in effect at market closing at the balance sheet date. In the absence of this information for a given instrument, Management uses the forward rate or price for an equivalent instrument. In the case of options, valuation models recognized by financial markets are used to estimate the fair value.

Comparative information

Certain figures of the previous year have been reclassified in order to conform to the presentation adopted in the current year.

Note 2 Changes in Accounting Policies

Recent changes

2006

NON-MONETARY TRANSACTIONS

On January 1, 2006, Hydro-Québec adopted the recommendations of *CICA Handbook* Section 3831, Non-monetary Transactions, which supersedes Section 3830, also entitled Non-monetary Transactions. This standard requires that a non-monetary asset or liability exchanged or transferred in a non-monetary transaction be measured at its fair value where the criterion of "commercial substance" is met. The adoption of these recommendations had no impact on the consolidated financial statements.

CONDITIONAL ASSET RETIREMENT OBLIGATIONS

On April 1, 2006, Hydro-Québec adopted the recommendations in the CICA's Emerging Issues Committee Abstract EIC-159, Conditional Asset Retirement Obligations. This abstract states how to account for conditional asset retirement obligations when the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. A liability for the fair value of an asset retirement obligation must be recognized in the period in which it is incurred when a reasonable estimate of fair value can be made. The adoption of these recommendations had no impact on the consolidated financial statements.

2005

INVESTMENT COMPANIES

On January 1, 2005, Hydro-Québec prospectively adopted the recommendations in CICA Accounting Guideline AcG-18, Investment Companies. Under AcG-18, investment companies are required to account for their investments at fair value in certain cases where these investments would normally have been consolidated or accounted for on an equity basis or at cost. Criteria are provided to determine whether a company should be classified as an investment company. Companies that do not meet the criteria are required to consolidate or account for their investments using the equity method. The guideline also provides instructions for circumstances where fair value must be used in the consolidated financial statements of the parent company or the entity exercising significant influence over the investment company. Since the adoption of this guideline, the venture capital investments held by a subsidiary have been accounted for at fair value, whereas previously, they had been accounted for at cost. The adoption of these recommendations had no significant impact on the consolidated financial statements.

CONSOLIDATION OF VARIABLE INTEREST ENTITIES

On January 1, 2005, Hydro-Québec retroactively applied the recommendations in CICA Accounting Guideline AcG-15, Consolidation of Variable Interest Entities, without restating the figures for the preceding year. This guideline provides the consolidation principles applicable to certain entities (VIEs) that are subject to control on a basis other than ownership of voting interests. It prescribes consolidation of an entity when the reporting enterprise is the primary beneficiary. The primary beneficiary is the enterprise with variable interests that will absorb a majority of the VIE's expected losses, receive a majority of its expected residual returns, or both. The guideline also requires disclosure of certain information when the reporting enterprise has a significant variable interest in a VIE that it has not consolidated. The adoption of these recommendations had no significant impact on the consolidated financial statements.

DETERMINING WHETHER AN ARRANGEMENT CONTAINS A LEASE

On January 1, 2005, Hydro-Québec adopted the recommendations in the CICA's Emerging Issues Committee Abstract EIC-150, Determining Whether an Arrangement Contains a Lease. The abstract provides guidance for determining whether an arrangement comprising a transaction or a series of related transactions that does not take the legal form of a lease but conveys a right to use a tangible asset in return for a payment or series of payments is within the scope of *CICA Handbook* Section 3065, Leases. Since January 1, 2005, the provisions of the abstract have applied to arrangements agreed to, committed to, modified or acquired in business combinations. The adoption of these recommendations had no significant impact on the consolidated financial statements.

DISCLOSURES BY ENTITIES SUBJECT TO RATE REGULATION

On December 31, 2005, Hydro-Québec adopted the recommendations in CICA Accounting Guideline AcG-19, Disclosures by Entities Subject to Rate Regulation. AcG-19 recommends that the existence and nature of all forms of rate regulation, as well as their effects on the consolidated financial statements, be disclosed in the notes to the consolidated financial statements.

Future changes

FINANCIAL INSTRUMENTS, HEDGES AND COMPREHENSIVE INCOME

In 2005, the CICA released *CICA Handbook* sections 3855, 3865 and 1530, respectively entitled Financial Instruments – Recognition and Measurement, Hedges and Comprehensive Income.

Section 3855 specifies when a financial instrument must be accounted for on the balance sheet and at what amount: in some cases at fair value, while in other cases at a value based on cost. It also specifies how gains and losses on financial instruments should be presented.

Section 3865 replaces the guidance for hedging relationships that was previously included in AcG-13, in particular the guidance for the designation and documentation of hedging relationships. These new recommendations specify how hedge accounting is applied and the required disclosures to be made by an entity applying hedge accounting.

Section 1530 establishes standards for the reporting and display of comprehensive income. Comprehensive income includes, in addition to net income, all changes in equity during a period attributable to transactions and other events from non-owner sources. Comprehensive income and its components must be presented in a financial statement with the same prominence as the other financial statements.

These sections will apply to the Corporation's interim and annual financial statements relating to financial years beginning on January 1, 2007, and beyond. The Corporation is currently examining the impact that these new standards will have on its consolidated financial statements.

FINANCIAL INSTRUMENTS – DISCLOSURE AND PRESENTATION

In 2005, the CICA released *CICA Handbook* Section 3861, Financial Instruments – Disclosure and Presentation, which supersedes Section 3860, also entitled Financial Instruments – Disclosure and Presentation. This Section establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information to be disclosed about them. It will apply to the Corporation's interim and annual financial statements relating to the 2007 financial year. In 2006, the CICA released *CICA Handbook* sections 3862 and 3863, respectively entitled Financial Instruments – Disclosures and Financial Instruments – Presentation, which supersede Section 3861. Section 3862 amends the disclosure requirements under Section 3861, whereas Section 3863 maintains the presentation requirements in Section 3861. These sections will apply to the Corporation's interim and annual financial statements relating to financial years beginning on January 1, 2008, and beyond. The CICA allows these sections to be applied to the Corporation's interim and annual financial statements relating to the 2007 financial year, in place of Section 3861.

Note 2 Changes in Accounting Policies (continued)

EQUITY

In 2005, the CICA released *CICA Handbook* Section 3251, Equity, which supersedes Section 3250, Surplus. Section 3251 establishes standards for the presentation of equity as a result of the new requirements in Section 1530, Comprehensive Income. It will apply to the Corporation's interim and annual financial statements relating to financial years beginning on January 1, 2007, and beyond. In 2006, the CICA released *CICA Handbook* Section 1535, Capital Disclosures, requiring disclosure of how capital is managed by Management. This Section will apply to the Corporation's interim and annual financial statements relating to financial years beginning on January 1, 2008, and beyond.

ACCOUNTING CHANGES

In 2006, the CICA released *CICA Handbook* Section 1506, Accounting Changes. This Section prescribes the criteria for changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. It will apply to the Corporation's interim and annual financial statements relating to financial years beginning on January 1, 2007, and beyond. The adoption of the recommendations in this new Section is not expected to have any significant impact on the consolidated financial statements.

Note 3 Effects of Rate Regulation on the Consolidated Financial Statements

The following information describes the impact on the consolidated financial statements of accounting methods and practices adopted by the Corporation in accordance with decisions handed down by the Régie with respect to regulated activities.

Regulatory assets and liabilities

VARIANCES IN ANNUAL COST OF TRANSMISSION SERVICE FOR THE NATIVE LOAD

Variances in the annual cost of transmission service for the native load resulting from modification of power transmission rates authorized by the Régie, where electricity rates have already been set, are charged to a separate account. The financial expenses for variances charged to this account are capitalized at the rate of return authorized by the Régie on the rate base until such time as they are included in the rate base and amortization begins. This accounting practice, which relates to the Corporation's power distribution activities, was authorized by the Régie in decisions D-2003-93 and D-2006-34.

In decision D-2006-66, the Régie authorized a modification of power transmission rates effective January 1, 2005. The impact of this decision is essentially a $170-million increase in the annual cost of transmission service for the native load, which is not integrated into current electricity rates. In application R-3610-2006 filed with the Régie to set the rates applicable as of April 1, 2007, the Corporation in its activities as power distributor proposed that its next application include a mechanism for amortizing the 2005 and 2006 increases, which amount to $340 million, plus capitalized financial expenses of $15 million as at December 31, 2006. Were these activities not regulated, no reduction in expenditure would have been recognized in the consolidated financial statements, and net income for 2006 would have been $355 million lower.

NET COSTS RELATED TO RETIREMENT OF PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

When property, plant and equipment or intangible assets are retired, the cost of such assets and of their dismantlement, net of accumulated amortization and salvage value, are charged to a separate account and amortized over a maximum period of 10 years, using the sinking fund method at a rate of 3%. The Régie authorized this accounting practice in decisions D-2002-95 and D-2003-93, which relate to the Corporation's power transmission and distribution activities, respectively. Were these activities not regulated, the related costs would be charged to operations for the year, and net income for 2006 would have been $17 million higher ($19 million lower in 2005).

COSTS RELATED TO THE ENERGY EFFICIENCY PLAN

The costs related to implementation of the Plan, such as specific energy conservation programs, are charged to a separate account and amortized over 10 years on a straight-line basis, except for the costs incurred prior to January 1, 2006, which are amortized over five years. This period begins in the year after the costs were recorded. For costs charged to this account, the financial expenses are capitalized at the rate of return authorized by the Régie on the rate base until such time as they are included in the rate base and amortization begins. This accounting practice relates to the Corporation's power distribution activities and was authorized by the Régie in decisions D-2002-25, D-2002-288 and D-2006-56. Were these activities not regulated, the costs would normally be charged to operations in the year in which they are incurred, and net income for 2006 would have been $121 million lower ($80 million in 2005).

COSTS INCURRED UNTIL THE RESCISSION OF DUAL-ENERGY RATE BT

The costs incurred until the rescission of dual-energy Rate BT were charged to a separate account and have been amortized on a straight-line basis over five years since the rescission date of April 1, 2006. These costs mainly include the deficit resulting from the variance between the supply cost recognized by the Régie and the prevailing price of energy, multiplied by the quantity of electricity delivered to customers at Rate BT between January 1, 2004, and March 31, 2006. For costs charged to this account, the financial expenses were capitalized at the rate of return authorized by the Régie on the rate base until March 31, 2006. This accounting practice was authorized by the Régie in decisions D-2004-47, D-2004-170 and D-2006-34, which relate to the Corporation's power distribution activities. Were these activities not regulated, the costs would be charged to operations in the year in which they are incurred, and net income for 2006 would have been $49 million lower ($55 million in 2005).

COSTS RELATED TO A MAJOR DISCONTINUED PROJECT

A power transmission system project was discontinued in 2005. The costs deemed to be irrecoverable are deferred and amortized over three years on a straight-line basis. The Régie authorized this accounting practice in decision D-2002-95, which relates to the Corporation's power transmission activities. Were these activities not regulated, the costs would have been charged to operations for 2005, and net income for 2006 would have been $10 million higher ($20 million lower in 2005).

COST VARIANCE RELATED TO ELECTRICITY PURCHASES IN EXCESS OF THE HERITAGE POOL

Since January 1, 2005, volume and price variances between the actual costs of electricity purchases in excess of the heritage pool and the costs forecasted in the rate cases and recognized by the Régie for rate-setting purposes have been recorded in a separate account. In 2006, a positive variance between the forecasted costs and actual costs resulted in the recognition of a regulatory liability, whereas in 2005, the opposite situation justified recognition of a regulatory asset. For the 2005 variances charged to this account, financial expenses were capitalized at the rate of return authorized by the Régie on the rate base. This accounting practice was authorized by the Régie in decisions D-2005-34, D-2005-132 and D-2006-34, which relate to the Corporation's power distribution activities. Were these activities not regulated, the actual costs would be charged to operations in the year in which they are incurred, and net income for 2006 would have been $245 million higher ($13 million lower in 2005).

COSTS RELATED TO THE DE-ICING SYSTEM AT LÉVIS SUBSTATION

Certain costs related to the Lévis substation de-icing system, a project designed in the wake of the 1998 ice storm to secure the transmission lines supplying the greater Québec City area, have been charged to a separate account. Once the de-icing system is commissioned, these costs will be depreciated according to the sinking fund method at 3%, over a period corresponding to the average remaining useful life of the assets that will be enhanced by this project. For costs charged to this account, the financial expenses are capitalized at the rate of return authorized by the Régie on the rate base until such time as they are included in the rate base and amortization begins. The Régie authorized this accounting practice in decision D-2004-175, which relates to the Corporation's power transmission activities. Were these activities not regulated, the costs would be charged to operations in the year in which they are incurred, and net income for 2006 would have been $11 million lower ($1 million in 2005).

Regulatory assets (liabilities)

	Expected years of amortization	**2006**	2005
Variances in annual cost of transmission service for native load[a]	Conditions to be determined by the Régie	**355**	–
Net costs related to retirement of property, plant and equipment and intangible assets	2007 – 2016	**241**	258
Costs related to Energy Efficiency Plan	2007 – 2016	**252**	131
Costs incurred until rescission of dual-energy Rate BT	2007 – 2011	**125**	76
Costs related to a major discontinued project	2007	**10**	20
Cost variance related to electricity purchases in excess of 2005 heritage pool[a]	2007	**30**	13
Costs related to de-icing system at Lévis substation	2007 – 2047	**12**	1
		1,025	499
Cost variance related to electricity purchases in excess of 2006 heritage pool[a]	Conditions to be determined by the Régie	**(251)**	–
		(11)	–
		(262)	–
		763	499

a) Corresponds to Regulatory deferrals of $93 million presented in the Consolidated Statements of Operations, net of financial expenses of $17 million ($11 million and $2 million, respectively, in 2005).

RISKS AND UNCERTAINTIES

The risks and uncertainties related to the above regulatory assets and liabilities are subject to periodic monitoring and assessment. Once the Corporation considers that it is no longer likely that the net carrying amount of a regulatory asset or liability will be taken into account in setting future rates, this amount is recognized in the statement of operations in the year in which the conclusion is reached.

Other regulatory practices

Under Régie decisions D-2002-95 and D-2003-93, the compensation granted by the Québec government for the 1998 ice storm was applied against the cost of new property, plant and equipment constructed; it is amortized over the remaining life of the retired assets, with the exception of the portion equivalent to the unamortized cost of these assets, which is amortized over 10 years. The sinking fund method, at a rate of 3%, is used in both cases. Were these activities not regulated, the compensation would be amortized over the useful life of the new property, plant and equipment constructed.

In decisions D-2002-95 and D-2004-47, the Régie prescribed capitalizing financial expenses to property, plant and equipment under construction and intangible assets under development according to the authorized rates of return on the rate bases. These rates, which are set using methods approved by the Régie, take into account a component associated with the cost of the debt and a component associated with the return on shareholder's equity. Were these activities not regulated, financial expenses would be capitalized using the average cost of the Corporation's long-term debt.

Under Régie decisions D-2002-95 and D-2003-93, the cost of dismantling assets that were retired and replaced, net of the salvage value, is added to the cost of the new assets constructed. Were these activities not regulated, these costs would be charged to operations.

Under Régie decisions D-2006-76 and D-2006-76R, contributions received for relocation or modification projects relating to certain transmission grid assets are charged to a separate account and applied against property, plant and equipment. These contributions are amortized over the average useful life of assets for each project, using the sinking fund method, at a rate of 3%. Were these activities not regulated, the contributions would be amortized over the useful life of each fixed asset concerned.

Note 4 Depreciation and Amortization

	2006	2005
Property, plant and equipment	**1,745**	1,712
Intangible assets	**114**	109
Regulatory assets	**111**	51
Deferred charges	**13**	16
Write-off of projects	**24**	135
	2,007	2,023

Note 5 Taxes

	2006	2005
Capital tax	**261**	330
Tax on public services	**230**	229
Municipal, school and other taxes	**38**	35
	529	594

Note 6 Financial Expenses

	2006	2005
Interest		
Interest on debt securities	**2,465**	2,277
Amortization of debt premiums, discounts and issue expenses	**1**	28
	2,466	2,305
Exchange gain	**(21)**	(1)
Loan guarantee fees paid to the shareholder	**158**	155
	137	154
Less		
Capitalized financial expenses	**312**	249
Net investment income	**79**	23
	391	272
	2,212	2,187

Note 7 Discontinued Operations and Assets Held for Sale

2006

In 2005, Hydro-Québec adopted a plan to sell off some of its foreign holdings. The related assets and liabilities were therefore classified as being held for sale. Further to the adoption of this plan, the following transactions took place in 2006:

- On January 18, 2006, Hydro-Québec concluded the sale of its interest in Hidroeléctrica Río Lajas S.A., through its wholly owned subsidiary Hydro-Québec International (HQI), for a cash consideration of $5 million, giving rise to a loss of $0.3 million.
- On February 27, 2006, Hydro-Québec concluded the sale of its interest in Cross-Sound Cable Company, LLC, for a cash consideration of $182 million, giving rise to a $29-million gain. The transaction included the sale of units held and the repayment of the loan granted by Hydro-Québec to Cross-Sound Cable Company, LLC.
- On March 29, 2006, Hydro-Québec concluded the sale of its interest in MurrayLink HQI Australia Pty Ltd, through HQI, for a cash consideration of $60 million. This transaction gave rise to a $2-million loss.
- On June 30, 2006, Hydro-Québec sold its interest in HQI Transelec Chile S.A. (Transelec), through HQI, for a cash consideration of $1.8 billion. This transaction gave rise to a gain of $813 million, net of $225 million in related income taxes. The sales contract further provides for price adjustments according to the market value of the regulated trunk transmission asset base, which is currently being evaluated by a consortium of independent experts, and to the retroactive effect of this valuation on Transelec's revenue for the period from March 13, 2004, through June 30, 2006. In Management's opinion, these adjustments should result in an additional gain which will be recognized when the ministerial order setting the rates is made known.
- On August 1, 2006, Hydro-Québec concluded the sale of its interest in HQI Latin America Ltd. (Fortuna generating station in Panama), through HQI, for a cash consideration of $113 million. This transaction gave rise to a gain of $38 million.
- On December 12, 2006, Hydro-Québec concluded the sale of its interest in Consorcio TransMantaro S.A., through HQI, for a cash consideration of $84 million. This transaction gave rise to a gain of $39 million.

On December 5, 2006, Hydro-Québec signed an agreement to sell its interest in HQI Australia Pty Ltd, held through HQI, for a cash consideration of AU$57 million. This transaction should result in a gain that will be recognized on closing, once the necessary approvals have been obtained from the Australian government. As at December 31, 2006, the related assets and liabilities were presented as being held for sale.

For purposes of segmented information, the results of foreign holdings are classified under Corporate and Other Activities.

2005

On July 15, 2005, Hydro-Québec concluded the sale of the principal assets held by its subsidiary HydroSolution, Limited Partnership, for a cash consideration of $92 million, resulting in a gain of $48 million. HydroSolution is part of the Distribution segment for purposes of segmented information.

The following table presents operating results and cash flows from the interests presented as discontinued operations:

	2006	2005
Operations		
Revenue	**256**	347
Gain (loss) before net gain on disposal	**27**	(147)
Gain on disposal, net of $252 million in related income taxes	**917**	48
Income (loss) from discontinued operations	**944**	(99)
Cash flows		
Operating activities	**11**	83
Investing activities	**64**	45
Financing activities	**(18)**	(33)
Change in foreign exchange on cash and cash equivalents	**(5)**	6
Cash flows from discontinued operations	**52**	101

The assets and liabilities sold, as at the disposal date, were as follows:

	2006	2005
Cash and cash equivalents	**135**	–
Other current assets	**69**	–
Long-term assets	**2,176**	42
Current liabilities	**187**	–
Long-term liabilities	**1,291**	–
	902	42

Note 8 Property, Plant and Equipment

				2006
	In service	Accumulated depreciation	Under construction	**Total**
Generation				
Hydraulic	31,132	7,708	2,752	**26,176**
Thermal, including nuclear	2,677	1,755	123	**1,045**
Other	759	322	37	**474**
	34,568	9,785	2,912	**27,695**
Transmission				
Substations and lines	20,186	6,097	594	**14,683**
Other	753	515	30	**268**
	20,939	6,612	624	**14,951**
Distribution				
Substations and lines	10,905	3,940	225	**7,190**
Other	1,803	1,013	101	**891**
	12,708	4,953	326	**8,081**
Construction	47	31	1	**17**
Corporate and Other Activities	2,111	1,159	117	**1,069**
	70,373	22,540	3,980	**51,813**

				2005
	In service	Accumulated depreciation	Under construction	Total
Generation				
Hydraulic	28,727	7,209	3,528	25,046
Thermal, including nuclear	2,538	1,614	95	1,019
Other	781	315	26	492
	32,046	9,138	3,649	26,557
Transmission				
Substations and lines	19,511	5,689	527	14,349
Other	752	525	17	244
	20,263	6,214	544	14,593
Distribution				
Substations and lines	10,463	3,620	219	7,062
Other	1,923	1,118	70	875
	12,386	4,738	289	7,937
Construction	51	34	2	19
Corporate and Other Activities	2,551	1,373	89	1,267
	67,297	21,497	4,573	50,373

As at December 31, 2006, the Corporation had cumulative costs related to suspended draft-design studies totaling $15 million ($37 million as at December 31, 2005). These costs, for which financial expenses are not capitalized, are presented as property, plant and equipment under construction. As the Corporation anticipates carrying out some of these projects in the longer term, it periodically reviews the cumulative costs of these draft-design studies. During such reviews, Management must use estimates and make assumptions that have an impact on the amounts reported for draft-design studies at the balance sheet date. The projects are assessed in terms of eventual profitability based on the expected prevailing market conditions at the time of their commissioning, compliance with sustainable development principles and how well they are received by local communities. A significant change in the assessment based on these criteria could result in a reduction of the balance for draft-design studies.

Note 9 Investments

	Note	2006	2005
At equity			
Churchill Falls (Labrador) Corporation Limited	21	**69**	60
CITEQ inc.		**(5)**	(5)
		64	55
At cost			
Churchill Falls (Labrador) Corporation Limited			
Bonds[a]	21	**52**	54
Other		**62**	63
		114	117
At fair value			
Venture capital[b]		**54**	49
		54	49
		232	221

a) These 7.5% bonds, with a par value of $58 million in 2006 ($59 million in 2005) and due in 2010, are secured by a general mortgage.

b) Both the gross and net unrealized gains on investments held by the venture capital company amounted to $13 million as at December 31, 2006 (losses of $26 million as at December 31, 2005). Net losses of $2 million were realized in 2006 (gains of $6 million in 2005).

Note 10 Intangible Assets

			2006
	Cost	Accumulated amortization	Net carrying amount
Subject to amortization			
Software and licences[a]	1,147	652	**495**
Rights	113	40	**73**
Environmental studies	134	118	**16**
Patents	8	2	**6**
	1,402	812	**590**
Not subject to amortization			
Servitudes			**333**
			923

a) The net carrying amount includes $311 million in assets under development.

			2005
	Cost	Accumulated amortization	Net carrying amount
Subject to amortization			
Software and licences[a]	980	546	434
Rights	110	37	73
Environmental studies	126	109	17
Patents	44	38	6
	1,260	730	530
Not subject to amortization			
Servitudes			324
			854

a) The net carrying amount includes $215 million in assets under development.

Note 11 Other Assets

	Notes	2006	2005
Accrued benefit assets	20	**1,115**	1,020
Regulatory assets	3	**1,025**	499
Deferred charges		**153**	95
Government reimbursement for the 1998 ice storm[a]		**123**	138
Nuclear fuel waste management trust fund[b]		**36**	32
Goodwill[c]		**10**	10
		2,462	1,794

a) Payable in quarterly installments of $6 million until January 15, 2014, and a final installment of $1 million on April 15, 2014. These installments include interest calculated at an annual rate of 7.2%.

b) In order to meet its financial obligations, the Corporation deposited an initial amount of $20 million in a trust fund in 2002. It is required to deposit an additional $4 million per year in the same trust fund until the Government of Canada decides on the proposal to be adopted, based on the recommendations made by the waste management organization in November 2005. The Corporation has been making the required payments since 2002. The sums are invested in short-term marketable securities, and the interest accrued is kept in the trust fund.

c) For purposes of segmented information, goodwill is classified under the Generation segment.

Note 12 Long-Term Debt

Composition and maturities

Debentures, other long-term debt and swaps representing financial liabilities, translated into Canadian dollars at the closing exchange rates in effect at the balance sheet date, are summarized in the following table. These amounts are presented by year of maturity and take the sinking funds into account.

							2006	2005
	Corporation's debt							
Maturity	Canadian dollars	U.S. dollars	Other currencies	Sinking funds	Total	Subsidiaries	Total	Total
2006	–	–	–	–	–	–	**–**	3,148
2007	600	734	22	(6)	1,350	2	**1,352**	1,669
2008	87	182	1,248	–	1,517	3	**1,520**	1,289
2009	1,889	35	6	(349)	1,581	4	**1,585**	1,869
2010	705	29	–	(352)	382	4	**386**	684
2011	1,880	1,083	91	–	3,054	4	**3,058**	–
1 to 5 years	5,161	2,063	1,367	(707)	7,884	17	**7,901**	8,659
6 to 10 years	1,150	1,949	612	–	3,711	20	**3,731**	6,063
11 to 15 years	3,045	1,149	11	–	4,205	–	**4,205**	2,396
16 to 20 years	1,958	3,305	–	–	5,263	–	**5,263**	5,549
21 to 25 years	1,129	2,660	–	–	3,789	–	**3,789**	3,291
26 to 30 years	4,657	50	–	–	4,707	–	**4,707**	5,703
31 to 35 years	3,790	–	–	–	3,790	–	**3,790**	1,765
36 to 40 years	1,028	–	–	–	1,028	–	**1,028**	12
41 to 45 years	98	–	–	–	98	–	**98**	70
46 to 50 years	56	–	–	–	56	–	**56**	28
51 to 55 years	507	–	–	–	507	–	**507**	479
56 to 60 years	416	–	–	–	416	–	**416**	412
	22,995[a]	11,176	1,990	(707)	35,454[b]	37	**35,491**	34,427
Less								
Current portion	600	734	22	(6)	1,350	2	**1,352**	3,148
	22,395	10,442	1,968	(701)	34,104	35	**34,139**	31,279

a) Includes $192 million and $419 million in zero-coupon bonds, reported at their discounted value at a semiannually computed interest rate of 10.95% and 10.67%, respectively. Their par value will reach $282 million and $1,729 million in 2010 and 2020, respectively. Other bonds, reported at their discounted value and amounting to $1,261 million, will have a total par value of $1,333 million at maturity.

b) Includes $33,436 million in bonds guaranteed by the Québec government as at December 31, 2006 ($32,014 million as at December 31, 2005).

Note 12 Long-Term Debt (continued)

Breakdown of debt by currency at time of issuance and impact of swaps and sinking funds

The following table summarizes long-term debt, including the current portion, in Canadian dollars and foreign currencies. Also shown are the effects of currency swaps and sinking funds allocated to repay debt.

				2006	2005
	Long-term debt				
	In Canadian dollars and foreign currency	At closing exchange rates as at the balance sheet date[a]	Swaps	Total	Total
Corporation's debt					
Canadian dollars	22,288	22,288	–	**22,288**	20,975
U.S. dollars	8,628	11,176	(2,279)	**8,897**	8,810
Other currencies					
Euros	673	1,245	(138)	**1,107**	1,107
Yen	4,500	50	–	**50**	336
Pounds sterling	240	599	(65)	**534**	534
Swiss francs	96	96	–	**96**	96
		1,990	(203)	**1,787**	2,073
		35,454	(2,482)	**32,972**	31,858
Subsidiaries' debt					
U.S. dollars	32	37	–	**37**	135
		35,491	(2,482)	**33,009**	31,993

a) Includes $1,400 million in financial liabilities composed of currency swaps and $707 million in Hydro-Québec securities held in the sinking funds as at December 31, 2006 (respectively $1,797 million and $1,070 million as at December 31, 2005).

Breakdown of debt by currency at time of issuance and at time of repayment

The following table shows the breakdown of debt, net of sinking funds, translated into Canadian dollars after taking swaps into account, according to the currency at time of issuance and time of repayment:

	2006		2005	
	At time of issuance	At time of repayment	At time of issuance	At time of repayment
Corporation's debt				
Canadian dollars	**22,288**	**29,140**	20,975	26,201
U.S. dollars	**8,897**	**3,832**[a]	8,810	5,657[a]
Other currencies	**1,787**	**–**	2,073	–
	32,972	**32,972**	31,858	31,858
Subsidiaries' debt				
U.S. dollars	**37**	**37**	135	135
	33,009	**33,009**	31,993	31,993

a) Of this amount, 98.8% was used to hedge sales in U.S. dollars as at December 31, 2006 (89.8% as at December 31, 2005).

Interest rates

The following table shows Hydro-Québec's interest rates, which take into account nominal interest rates on borrowings, debt premiums, discounts and issue expenses, and the effect of interest rate swaps:

%				**2006**	2005
Maturity	Canadian dollars	U.S. dollars	Other currencies	Weighted average	Weighted average
1 to 5 years	6.38	7.25	6.33	**6.51**	5.06
6 to 10 years	10.76	8.62	11.53	**9.83**	8.58
11 to 15 years	10.78	9.61	4.88	**10.46**	10.21
16 to 20 years	9.93	8.38	–	**8.95**	9.61
21 to 25 years	6.65	9.24	–	**8.45**	8.72
26 to 30 years	5.99	–	–	**5.99**	6.11
31 to 35 years	5.16	–	–	**5.16**	5.36
36 to 40 years	4.80	–	–	**4.80**	6.52
41 to 45 years	6.44	–	–	**6.44**	6.44
46 to 50 years	–	–	–	**–**	–
51 to 55 years	6.62	–	–	**6.62**	6.62
Weighted average	6.90	8.81	9.70	**7.51**	7.76

The variable-rate portion of Hydro-Québec's debt amounted to 7.3%, or 8.2% including perpetual debt, as at December 31, 2006 (19.0%, or 20.0% including perpetual debt, as at December 31, 2005). For information purposes, a 1% change in interest rates would have changed the consolidated net income by $31 million ($62 million in 2005), if the impact of derivative instruments used to manage short-term financial risk were excluded (Note 16).

Fair value

As at December 31, 2006, the fair value of Hydro-Québec's debt amounted to $46,729 million ($44,977 million as at December 31, 2005). Net of sinking funds and after swaps, it totaled $45,626 million ($43,719 million as at December 31, 2005).

Fair value is obtained by discounting future cash flows, based on forward and closing interest rates as at the balance sheet date for similar instruments available on financial markets. Changes in fair value reflect sensitivity to market interest rates. However, Management intends to hold these debt securities until maturity. Therefore, as at December 31, 2006, Hydro-Québec did not foresee any significant repayments that could result in the realization of this fair value.

Hydro-Québec has undrawn standby credit facilities, of which US$2,000 million expires in 2011. Any borrowings under these lines of credit will bear interest at a rate based on the London Interbank Offered Rate (LIBOR). A US$750-million swing line loan at the U.S. base rate is included in the US$2,000-million credit facility.

Note 13 Asset Retirement Obligations

Liabilities arising from asset retirement obligations relate to the cost of dismantling Gentilly-2 nuclear generating station at the end of its useful life, the removal of irradiated nuclear fuel resulting from its operation and the dismantling of oil tanks and of certain thermal generating stations.

Hydro-Québec has also identified asset retirement obligations relating to thermal generating stations and power transmission lines for which no liability has been recorded since it expects to use these assets for an undetermined period. These relate to property, plant and equipment for which the Corporation does not have sufficient information to accurately establish a maturity schedule for the obligation. A liability stemming from these asset retirement obligations will be accounted for in the period in which there is sufficient information to establish such a schedule.

The aggregate carrying amount of the asset retirement obligations is as follows:

				2006
	Dismantling of nuclear generating station	Removal of irradiated nuclear fuel	Dismantling of other assets	Total
Balance at beginning of year	172	92	18	**282**
Liabilities incurred	–	2	–	**2**
Accretion expense	14	10	1	**25**
Liabilities settled	–	–	(3)	**(3)**
Revision of estimated cash flows and expected timing of payments	102	23	–	**125**
Balance at end of year	288	127	16	**431**

				2005
	Dismantling of nuclear generating station	Removal of irradiated nuclear fuel	Dismantling of other assets	Total
Balance at beginning of year	162	82	20	264
Liabilities incurred	–	1	–	1
Accretion expense	10	9	1	20
Liabilities settled	–	–	(3)	(3)
Balance at end of year	172	92	18	282

The carrying amount of the asset retirement obligations is based on the following key assumptions:

	Dismantling of nuclear generating station[a]	Removal of irradiated nuclear fuel[a]	Dismantling of other assets
Total undiscounted amount of the estimated cash flows required to settle the obligations			
As at December 31, 2006	795	598	18
As at December 31, 2005	463	519	21
Expected timing of payment of the cash flows required to settle the obligations			
As at December 31, 2006	Between 2011 and 2057	Between 2007 and 2159	Between 2007 and 2031
As at December 31, 2005	Between 2012 and 2050	Between 2012 and 2047	Between 2006 and 2031
Credit quality – adjusted risk-free rate at which the estimated cash flows have been discounted (%)			
Initial recognition of obligations	6.4	6.4	6.4
Subsequent recognition of additional obligations	5.5	5.5	–

a) When Gentilly-2 nuclear generating station was designed, the Corporation planned to operate it for 30 years, until 2013. The Corporation initiated a draft-design study to evaluate whether its useful life could be extended by approximately 28 years through refurbishment. If the refurbishment is not carried out, Management could decide to decommission the station a few years earlier for technical and economic reasons. Pending the decision, the consolidated financial statements reflect end-of-life in 2011 for purposes of calculating the depreciation of the station and the amortization of the decommissioning costs. Consequently, once the decision is made, the estimated undiscounted cash flows and the expected timing of payment of the cash flows required to settle the obligations could change and thus, asset retirement obligations and decommissioning costs as well as the depreciation, amortization and accretion expenses, as recorded in these consolidated financial statements, may vary significantly based on the end-of-life date retained and the increase inherent in the method used to calculate depreciation and amortization. Inflation rates varying between 1.8% and 3.6% were used to determine the asset retirement obligations. As at December 31, 2006, the net carrying amount of Gentilly-2 was $643 million ($623 million as at December 31, 2005).

Note 14 Other Long-Term Liabilities

	Notes	2006	2005
Deferred exchange gain		**1,229**	1,454
Debt premiums, discounts and issue expenses		**694**	322
Accrued benefit liability	20	**544**	497
Credit risk management		**128**	149
Accounts payable		**113**	159
Regulatory liability	3	**11**	–
		2,719	2,581

Note 15 Perpetual Debt

Perpetual notes in the amount of US$289 million as at December 31, 2006 (US$325 million as at December 31, 2005) bear interest at a rate determined semiannually based on LIBOR, plus 0.0625%. They are guaranteed by the Québec government and are redeemable only at the Corporation's option. In 2006, a portion amounting to US$36 million was redeemed on the secondary market and then canceled. No portion was redeemed in 2005. Various derivative instruments recorded at fair value are used to mitigate the exchange risk associated with this debt.

As at December 31, 2006, the fair value of the perpetual notes was $347 million ($383 million as at December 31, 2005). As at December 31, 2006 and 2005, the rate for these notes was 5.6% and 4.2%, respectively.

Note 16 Financial Instruments

Derivative instruments

MANAGEMENT OF RISK ASSOCIATED WITH LONG-TERM DEBT AND SALES IN U.S. DOLLARS

Hydro-Québec engages in currency swaps and forward contracts in order to manage the foreign exchange risk associated with repayments of principal on long-term debt, interest payments and sales in U.S. dollars. In 2006, a $234-million foreign exchange gain was recognized on debts and swaps denominated in U.S. dollars. In keeping with the adopted hedge accounting treatment, this amount, which represents the realization of a portion of the deferred foreign exchange gain recorded on the balance sheet, has been incorporated under Revenue. Firm U.S.-dollar sales extending until 2016 are designated in the Corporation's hedging relationships. Some currency swaps provide for the exchange of interest rates in order to modify interest rate risk exposure over the long term. Interest rate swaps that do not allow for exchanges of principal are also used to manage this risk.

The valuation of these swaps and forward contracts, with terms to maturity through 2033, indicated a positive fair value of $392 million as at December 31, 2006 (positive fair value of $8 million as at December 31, 2005).

The following table shows the notional amounts of these swaps, expressed in Canadian dollars and other currencies:

						2006[a]	2005[a]
Maturity	1 to 5 years	6 to 10 years	11 to 15 years	16 to 20 years	More than 20 years	Total	Total
Swaps							
Canadian dollars	1,290	(829)	(1,078)	(3,201)	(3,035)	**(6,853)**	(5,226)
U.S. dollars	(1,039)	395	960	2,650	2,359	**5,325**	3,617
Other currencies							
Yen	2,500	1,000	1,000	–	–	**4,500**	25,600
Euros	612	61	–	–	–	**673**	673
Pounds sterling	40	200	–	–	–	**240**	240
Swiss francs	97	–	–	–	–	**97**	97
Forward contracts							
U.S. dollars	36	–	–	–	–	**36**	477

a) Figures in parentheses represent amounts to be paid.

MANAGEMENT OF SHORT-TERM FINANCIAL RISK

In managing short-term financial risks, Hydro-Québec assesses, on an ongoing basis, the overall impact of variations in exchange rates, interest rates and commodity prices. In order to manage its foreign exchange risk exposure, it traded in options and foreign currency forward contracts. The notional amount of the open positions as at December 31, 2006, was $137 million, with $131 million in purchase contracts and $6 million in sales contracts ($731 million as at December 31, 2005, that is, $389 million in purchase contracts and $342 million in sales contracts). In order to manage fluctuating interest rates, it traded in options, swaps and forward rate agreements. For information purposes, a 1% variance in interest rates would have resulted in a $2-million variance in net income as at December 31, 2006 ($55 million as at December 31, 2005). Finally, to manage the exposure of its revenue to commodity price fluctuations, Hydro-Québec transacted options, swaps and commodity futures for which the open positions as at December 31, 2006, totaled 153,925 tonnes of aluminum (136,500 tonnes of aluminum as at December 31, 2005).

Hydro-Québec also uses derivative instruments to manage market risks resulting from fluctuations in energy prices, and for trading purposes in order to act on business opportunities in markets outside Québec. To hedge these risks, it traded in electricity swaps whose open positions as at December 31, 2006, were for 2.7 TWh (0.3 TWh as at December 31, 2005).

Note 16 Financial Instruments (continued)

The fair value of these instruments is presented by specific risk in the following table. The amounts maturing in 2007 will total $40 million.

	2006		2005	
	Carrying amount	Fair value	Carrying amount	Fair value
Foreign exchange risk				
Forward exchange contracts and options				
Financial assets	**–**	**–**	–	8
Financial liabilities	**–**	**–**	–	(43)
	–	**–**	–	(35)
Interest rate risk				
Forward rate agreements, options and swaps				
Financial assets	**5**	**5**	24	39
Financial liabilities	**–**	**–**	(3)	(4)
	5	**5**	21	35
Risk of changes in energy and commodity prices				
Forward contracts, options and swaps				
Financial assets	**7**	**67**	16	16
Financial liabilities	**(4)**	**(32)**	(2)	(95)
	3	**35**	14	(79)
	8	**40**	35	(79)

Other financial instruments

The carrying amount of investments, accounts receivable, the nuclear fuel waste management trust fund, current borrowings, accounts payable and accrued liabilities, dividends payable and accrued interest approximates their fair value, due to their short-term maturities. The carrying amount of the government reimbursement for the 1998 ice storm approximates its fair value, which is estimated by discounting the expected cash flows based on effective interest rates for instruments with similar conditions and maturities. As at December 31, 2006, the weighted average interest rate on short-term investments was 4.19% (3.26% as at December 31, 2005), whereas it was 4.19% on current borrowings (2.81% as at December 31, 2005).

Credit risk

Derivative instruments include an element of risk since a counterparty might not meet its obligations. However, this risk is moderate as Hydro-Québec generally deals with Canadian and international financial institutions with high credit ratings. Credit risk exposure is reduced by applying a credit policy to limit credit risk concentration and a counterparty credit risk assessment and monitoring program, as well as by setting credit limits, where necessary. With the main financial institutions with which it engages in derivatives trading, Hydro-Québec enters into agreements limiting the market value of the derivatives portfolio. As at December 31, 2006, no counterparty had defaulted on its obligations toward Hydro-Québec regarding investments and derivatives.

Hydro-Québec is also exposed to credit risk associated with accounts receivable. However, this exposure is limited due to Hydro-Québec's large and diverse customer base. Consequently, Management does not consider Hydro-Québec to be exposed to a material credit risk.

Note 17 Interests in Joint Ventures

The proportionate share of the joint venture items included in the consolidated financial statements is presented in the table below. These joint ventures consist of the interests managed by the Technology Group and Hydro-Québec Production. In 2005, this share also included interests in various foreign joint ventures, mainly held through HQI, which were disposed of in 2006.

	2006	2005
Operations		
Revenue	**34**	21
Expenditure and financial expenses	**34**	19
Income (loss) from discontinued operations	**43**	(89)
Net income (loss)	**43**	(87)
Balance sheets		
Current assets	**63**	56
Long-term assets	**38**	295
Current liabilities	**25**	56
Long-term liabilities	**34**	114
Net assets	**42**	181
Cash flows		
Operating activities	**(4)**	(5)
Investing activities	**(2)**	(1)
Financing activities	**5**	6
Discontinued operations	**11**	5
Net change in cash and cash equivalents	**10**	5

Note 18 Shareholder's Equity

The authorized share capital consists of 50,000,000 shares with a par value of $100 each, of which 43,741,090 shares were issued and paid-up.

Under the *Hydro-Québec Act*, the dividends to be paid by the Corporation are declared once a year by the Québec government, which also determines the terms and conditions of payment. For a given financial year, they cannot exceed the distributable surplus, equal to 75% of the year's net operating revenue and net investment income, less interest on debt securities and amortization of debt premiums, discounts and issue expenses. This calculation is based on the consolidated financial statements.

However, in respect of a given financial year, no dividend may be declared in an amount that would have the effect of reducing the capitalization rate to less than 25% at the end of the year. The Québec government declares the dividends for a given year within 30 days after the Corporation has sent it the financial data related to the distributable surplus. Upon expiry of the prescribed period, any portion of the distributable surplus that has not been subject to a dividend declaration may no longer be distributed to the shareholder as a dividend.

For 2006, the Québec government declared dividends of $2,342 million ($1,126 million in 2005), which is less than the maximum permitted.

The dividends declared are deducted from the retained earnings of the year for which they were declared.

Note 19 Supplementary Cash Flow Information

	2006	2005
Change in non-cash working capital items		
Accounts receivable	**114**	44
Materials, fuel and supplies	**(20)**	(24)
Accounts payable and accrued liabilities	**(228)**	275
Accrued interest	**47**	(16)
	(87)	279
Investing activities not affecting cash		
Increase in property, plant and equipment and intangible assets	**303**	29
Interest paid	**2,042**	2,245
Income taxes paid	**258**	21

Note 20 Employee Future Benefits

The Corporation's pension plan (the "Pension Plan") is a funded plan that ensures pension benefits based on the number of years of service and an average of the five best years of earnings. These benefits are indexed annually based on a rate which is the greater of the inflation rate, up to a maximum of 2%, and the inflation rate less 3%.

The Corporation also offers other post-retirement and post-employment benefits. Post-retirement benefits are provided by group life, medical and hospitalization plans, which are contributory plans with contributions adjusted annually. Post-employment benefits are under non-contributory salary insurance plans, which pay short- and long-term disability benefits. Most of these plans are not funded, with the exception of the long-term disability salary insurance plan, which is fully funded, and the supplementary group life insurance plan, which is partially funded.

The Corporation's employee benefit plans are defined benefit plans. Accrued benefit obligations of these plans, valued by independent actuaries, and assets, at fair value, are valued as at December 31 of each year. The most recent actuarial valuation for purposes of Pension Plan funding was as at December 31, 2005, and the next valuation should be performed no later than December 31, 2008.

Note 20 Employee Future Benefits (continued)

The following tables present information concerning the Corporation's employee future benefit plans:

	Pension Plan		Other plans	
	2006	2005	**2006**	2005
Accrued benefit obligations				
Balance at beginning of year	**11,925**	10,256	**837**	688
Current service cost	**331**	293	**34**	31
Employee contributions	**54**	38	**–**	–
Benefit payments and refunds	**(420)**	(387)	**(43)**	(39)
Interest on obligations	**618**	616	**42**	42
Actuarial losses (gains)	**212**	1,109	**(20)**	115
Balance at end of year	**12,720**	11,925	**850**	837
Plan assets at fair value				
Balance at beginning of year	**11,331**	9,982	**51**	49
Actual return on plan assets	**1,497**	1,387	**2**	2
Employee contributions	**54**	38	**–**	–
Current contributions by the Corporation	**319**	307	**11**	9
Special contributions by the Corporation	**62**	34	**–**	–
Benefit payments and refunds	**(420)**	(387)	**(8)**	(9)
Administrative fees	**(32)**	(30)	**–**	–
Balance at end of year	**12,811**	11,331	**56**	51
Surplus (deficit) at end of year	**91**	(594)	**(794)**	(786)
Unamortized past service costs	**256**	295	**–**	–
Unamortized net actuarial loss	**1,833**	2,536	**156**	181
Unamortized transitional (asset) obligation	**(1,065)**	(1,217)	**94**	108
Accrued benefit asset (liability)	**1,115**	1,020	**(544)**	(497)

Additional disclosures with respect to plan assets

At year end, assets of the plans at fair value consisted of:

	Pension Plan		Other plans	
%	**2006**	2005	**2006**	2005
Equities	**53**	55	**–**	–
Bonds	**33**	31	**91**	90
Short-term investments	**8**	8	**5**	6
Real estate investments	**5**	5	**–**	–
Other	**1**	1	**4**	4
	100	100	**100**	100

Assets of the plans include the following securities issued by the Corporation and the Québec government:

	Pension Plan		Other plans	
	2006	2005	**2006**	2005
Bonds	**961**	763	**51**	46

Cash payments

Cash payments made by the Corporation for employee benefit plans consist of the contributions paid to funded plans and benefits paid to employees and pensioners under unfunded plans. The cash payment details are as follows:

	2006	2005
Contributions by the Corporation		
Pension Plan	**381**	341
Other funded plans	**11**	9
Benefit payments		
Unfunded plans	**35**	32
Cash payments	**427**	382

The Corporation and its employees resumed their contributions to the Pension Plan on December 15, 2003. The employee and employer contribution rates increase by 1% and 1.8%, respectively, each year up to no more than 5.2% of pensionable earnings. In 2006, contributions amounted to 3% of pensionable earnings for employees and 5.2% for the Corporation (2% and 3.6%, respectively, in 2005).

Moreover, after the actuarial valuation for funding purposes dated December 31, 2005, was submitted to the Régie des rentes du Québec, the Corporation made an additional contribution of $242 million in 2006 to cover current service costs and a special contribution of $62 million to cover the actuarial deficit ($254 million and $34 million, respectively, in 2005).

Elements of accrued benefit cost recognized for the year

	Pension Plan		Other plans	
	2006	2005	**2006**	2005
Current service cost[a]	**331**	293	**34**	31
Administrative fees[b]	**32**	30	**–**	–
Interest on obligations	**618**	616	**42**	42
Actual return on plan assets	**(1,497)**	(1,387)	**(2)**	(2)
Actuarial losses (gains)	**212**	1,109	**(19)**	115
(Credit) cost before adjustments required to recognize the long-term nature of employee future benefits	**(304)**	661	**55**	186
Difference between actual and expected return on assets	**802**	703	**–**	–
Difference between actuarial (gains) losses on accrued benefit obligations and actuarial losses recognized	**(99)**	(1,070)	**25**	(114)
Difference between adjustments for plan amendments and amortization of past service costs	**39**	44	**–**	–
Amortization of transitional (asset) obligation	**(152)**	(152)	**14**	14
	590	(475)	**39**	(100)
Cost recognized for the year	**286**	186	**94**	86

a) For the long-term disability salary insurance plan, current service cost corresponds to the cost of new disability cases for the year.

b) Administrative fees billed to the Pension Plan by the Corporation amounted to $12 million for 2006 ($12 million for 2005).

Significant actuarial assumptions

The following actuarial assumptions, used to determine the accrued benefit obligations and cost of the plans, result from a weighted average:

	Pension Plan		Other plans	
%	**2006**	2005	**2006**	2005
Accrued benefit obligations				
Rate at end of year				
Discount rate	**5.20**	5.30	**5.20**	5.30
Salary escalation rate[a]	**3.38**	3.89	**–**	–
Accrued benefit cost recognized				
Rate at end of prior year				
Discount rate	**5.30**	6.03	**5.30**	6.03
Expected long-term rate of return on plan assets	**6.25**	6.52	**4.07**	3.68
Salary escalation rate[a]	**3.30**	3.87	**–**	–

a) This rate takes into account salary increases and promotion opportunities while in service.

As at December 31, 2006, health care costs were based on an annual growth rate of 7.6% in 2007. Thereafter, based on the assumption used, this rate will gradually decrease until it ultimately reaches 3.9% in 2015. A 1% change in this annual growth rate would have had the following impact for 2006:

	1% increase	1% decrease
Impact on current service cost and interest cost on accrued benefit obligations for the year	4	(4)
Impact on accrued benefit obligations at end of year	47	(38)

Note 21 Commitments and Contingencies

Electricity purchases

On May 12, 1969, the Corporation signed a contract with Churchill Falls (Labrador) Corporation Limited (CF(L)Co) whereby the Corporation undertook to purchase substantially all the output from Churchill Falls generating station, which has a rated capacity of 5,428 MW. Expiring in 2016, this contract will be automatically renewed for a further 25 years under agreed-upon terms and conditions. On June 18, 1999, the Corporation and CF(L)Co entered into a contract to guarantee the availability of 682 MW of additional power until 2041 for the November 1 to March 31 winter period.

As at December 31, 2006, the Corporation was committed under 97 contracts to purchase electricity from other power producers, for an installed capacity of about 3,960 MW. It expects to purchase approximately 13 TWh of energy annually over the terms of these contracts, which extend through 2045. The majority of these contracts include renewal clauses.

The Corporation expects to make the following minimum payments on its electricity purchase contracts over the next five years:

2007	942
2008	1,047
2009	1,132
2010	1,166
2011	1,189

Guarantees

Hydro-Québec grants guarantees to third parties for indemnification purposes in connection with its energy-related transactions on markets outside Québec. These guarantees are issued under long-term agreements and agreements governing its involvement in organized markets. These markets require that each participant provide guarantees enabling it to meet its obligations in the event of a payment default by another participant. Hydro-Québec also grants guarantees as part of its international operations and in the field of electrotechnology.

As at December 31, 2006, the potential maximum amount Hydro-Québec could have to pay under letters of credit or guarantees totaled $386 million. Of this amount, $313 million relates to the purchase of energy, for which a liability in the amount of $26 million has been recorded. Some guarantees expire between 2007 and 2019, while others do not have maturity dates.

Hydro-Québec provided guarantees to the purchasers of its interests concerning all its representations and warranties in the sales agreements, for which no liability was recorded. The maximum quantifiable contingent risk under these guarantees is approximately $322 million. The representations and warranties of the Corporation apply for a period ending no later than December 12, 2007, except with respect to the contingent tax liabilities and certain other customary representations which remain in effect until the applicable limitation periods expire.

In accordance with the terms and conditions of certain debt securities issued outside Canada, the Corporation has a commitment to increase the amount of interest paid to non-residents in the event of changes to Canadian tax legislation governing the taxation of non-residents' income. The Corporation cannot estimate the maximum amount it might have to pay under such circumstances. Should an amount become payable, the Corporation has the option of redeeming most of the securities in question.

Under the agreement with CF(L)Co, the Corporation could be required to provide additional funding if CF(L)Co were unable to pay its expenses and service its debt. The maximum amount that the Corporation could be required to pay cannot be reasonably evaluated, however, since it is not stated in the agreement and since the amount payable would depend on the outcome of future events whose nature and probability cannot be determined. To date, the Corporation has not had to pay any amount under this agreement.

Investments

The Corporation expects to invest approximately $4 billion in property, plant and equipment and intangible assets in 2007.

Agreements entered into with Aboriginal communities and regional county municipalities

Hydro-Québec has entered into various agreements related to capital projects and intangible assets with Aboriginal communities and regional county municipalities. The commitments under these agreements are recorded under Long-term debt if they fall within the definition of a liability, and the consideration is accounted for under Property, plant and equipment and Intangible assets.

Litigation

In the normal course of business, Hydro-Québec is sometimes party to claims and legal proceedings. Management is of the opinion that adequate provisions have been made for any disbursements that could result from these legal actions. Consequently, it does not foresee any adverse effect of such contingent liabilities on Hydro-Québec's consolidated operating results or financial position.

Note 22 Related Party Transactions

In the normal course of business, Hydro-Québec enters into various business transactions with the Québec government and its organizations, as well as with other government corporations. These transactions are measured at the exchange amount.

Other transactions with the Québec government are described elsewhere in the consolidated financial statements.

Note 23 Segmented Information

Hydro-Québec carries on its activities in the four reportable segments defined below. The non-reportable segments and other activities are grouped together under Corporate and Other Activities for reporting purposes. A Technology Group was formed in 2006, basically covering activities related to technology development and telecommunications. These activities are presented under Corporate and Other Activities and include the transmission system telecommunications activities previously included in the Transmission segment.

Generation: Hydro-Québec Production operates and develops the Corporation's generating facilities. This division also sells electricity on external markets and engages in energy trading. Hydro-Québec Production provides Hydro-Québec Distribution with a base volume of up to 165 TWh of heritage pool electricity annually at an average price of 2.79¢/kWh. In excess of this volume, it can participate in Hydro-Québec Distribution's calls for tenders in a context of free market competition.

Transmission: Hydro-Québec TransÉnergie develops and operates the Corporation's electric power transmission system in Québec.

Distribution: Hydro-Québec Distribution develops and operates the Corporation's distribution system and is responsible for sales and services to Québec customers. It also ensures the security of the supply of electricity to the Québec market.

Construction: Hydro-Québec Équipement carries out engineering and construction work related to hydroelectric development projects throughout Québec, except on the territory governed by the *James Bay and Northern Québec Agreement*, where Société d'énergie de la Baie James assumes this responsibility. Hydro-Québec Équipement also carries out projects for the construction of power transmission lines and substations throughout Québec.

Corporate and Other Activities: The corporate units support the divisions in the achievement of their business objectives. They include the Technology Group, the Finance Group, the Human Resources and Shared Services Group, as well as Corporate Affairs and General Secretariat. The Shared Services Centre brings together services offered throughout the Corporation, including goods and services procurement, real estate management, material and transportation service management, and information technology. Corporate and Other Activities also includes activities related to exporting Hydro-Québec's expertise abroad.

The amounts presented for each segment are based on the financial information used to establish the consolidated financial statements. The accounting policies used to calculate these amounts are as described in notes 1 and 3.

Intersegment transactions related to electricity sales are recorded based on the supply and transmission rates provided for by the *Act respecting the Régie de l'énergie*. The Act sets a commodity rate for a base volume of up to 165 TWh of heritage pool electricity for the Québec market.

The other intersegment products and services are valued at full cost.

Hydro-Québec derives the bulk of its revenue in Québec, and substantially all its property, plant and equipment is located in the province. In 2006, revenue from outside Quebec amounted to $1,368 million, with $1,054 million coming from the United States ($1,665 million and $1,387 million, respectively, in 2005).

The following tables contain information related to operations and assets by segment:

							2006
	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Intersegment eliminations	Total
Revenue							
External customers	1,594	32	9,488	–	48	(1)	**11,161**
Intersegment	4,570	2,809	55	1,999	1,146	(10,579)	**–**
Depreciation and amortization	760	535	570	7	144	(9)	**2,007**
Financial expenses	1,058	724	407	(1)	23	1	**2,212**
Income from continuing operations	2,114	632	42	2	–	7	**2,797**
Net income	2,114	632	42	2	944	7	**3,741**
Total assets	28,674	15,879	11,424	214	7,272	(215)	**63,248**
Investments in property, plant and equipment and intangible assets							
Affecting cash	1,615	882	690	4	157	–	**3,348**
Not affecting cash	273	14	16	–	–	–	**303**

							2005
	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Intersegment eliminations	Total
Revenue							
External customers	1,708	27	9,181	6	15	(49)	10,888
Intersegment	4,532	2,467	55	2,053	1,074	(10,181)	–
Depreciation and amortization	882	495	489	5	152	–	2,023
Financial expenses	1,050	691	384	–	61	1	2,187
Income (loss) from continuing operations	1,873	380	172	5	(71)	(8)	2,351
Net income (loss)	1,873	380	230	5	(228)	(8)	2,252
Total assets	27,482	15,553	10,556	242	6,831	(232)	60,432
Investments in property, plant and equipment and intangible assets							
Affecting cash	1,780	723	645	6	128	–	3,282
Not affecting cash	9	12	8	–	–	–	29

Consolidated Financial Information

$M	2006	2005	2004	2003	2002
OPERATIONS					
Revenue	**11,161**	10,888	10,341	10,197	11,852
Expenditure					
Operations	**2,394**	2,248	2,157	2,070	2,022
Electricity and fuel purchases	**1,315**	1,496	1,464	1,380	3,022
Depreciation and amortization	**2,007**	2,023	1,862	1,768	1,877
Taxes	**529**	594	606	567	537
Regulatory deferrals	**(93)**	(11)	–	–	–
	6,152	6,350	6,089	5,785	7,458
Operating income	**5,009**	4,538	4,252	4,412	4,394
Financial expenses	**2,212**	2,187	2,084	2,492	2,778
Income from continuing operations	**2,797**	2,351	2,168	1,920	1,616
Income (loss) from discontinued operations	**944**	(99)	267	18	(31)
Net income	**3,741**	2,252	2,435	1,938	1,585
SUMMARY OF BALANCE SHEETS					
Total assets	**63,248**	60,432	58,118	57,823	59,247
Long-term debt	**34,139**	31,279	32,567	34,402	36,754
Shareholder's equity	**18,840**	17,376	16,220	15,128	14,208
INVESTMENTS FOR CONTINUING OPERATIONS AFFECTING CASH					
Property, plant and equipment and intangible assets	**3,348**	3,282	3,071	2,739	2,232
Other	**(1,879)**	117	(854)	(45)	24
Total investments	**1,469**	3,399	2,217	2,694	2,256
FINANCIAL RATIOS					
Interest coverage[a]	**2.06**	2.00	1.79	1.73	1.63
Capitalization (%)[b]	**36.1**	34.2	32.8	29.8	26.2
Self-financing (%)[c]	**86.5**	58.6	78.4	56.3	73.4
Return on equity (%)[d]	**20.7**	13.4	15.5	13.2	11.5
Profit margin from continuing operations (%)[e]	**25.1**	21.6	21.0	18.8	13.6

a) Sum of operating income and net investment income divided by gross interest expense.

b) Shareholder's equity divided by the sum of shareholder's equity, long-term debt, perpetual debt, short-term borrowings and current portion of long-term debt, less swaps and sinking funds.

c) Cash flows from continuing operations less dividends paid, divided by the sum of investments, long-term debt maturities and sinking fund redemptions.

d) Net income divided by average shareholder's equity.

e) Net income from continuing operations divided by revenue.

Note: Throughout the Five-Year Review and the Consolidated Results by Quarter, certain comparative figures have been reclassified to reflect the presentation adopted for 2006.

Operating Statistics

	2006	2005	2004	2003	2002
GWh					
Electricity sales					
In Québec					
Residential and farm	**56,722**	57,269	58,002	57,217	53,231
General and institutional	**32,440**	33,463	33,137	32,314	31,695
Industrial	**73,297**	73,447	69,722	72,546	68,535
Other	**4,878**	4,998	5,026	5,014	5,111
	167,337	169,177	165,887	167,091	158,572
Outside Québec					
Canada/U.S. (long-term)	**2,384**	2,068	1,930	2,047	2,219
Canada/U.S. (short-term)	**12,074**	13,274	12,462	13,739	51,980
	14,458	15,342	14,392	15,786	54,199
Total electricity sales	**181,795**	184,519	180,279	182,877	212,771
$M					
Revenue from electricity sales					
In Québec					
Residential and farm	**3,775**	3,690	3,690	3,504	3,246
General and institutional	**2,356**	2,284	2,234	2,096	2,058
Industrial	**3,022**	2,892	2,751	2,742	2,577
Other	**249**	255	247	236	231
	9,402	9,121	8,922	8,578	8,112
Outside Québec					
Canada/U.S. (long-term)	**198**	174	179	207	233
Canada/U.S. (short-term)	**951**	1,290	905	1,138	3,233
	1,149	1,464	1,084	1,345	3,466
Total revenue from electricity sales	**10,551**	10,585	10,006	9,923	11,578
As at December 31					
Number of customer accounts in Québec					
Residential and farm	**3,501,709**	3,450,455	3,399,776	3,343,271	3,295,544
General and institutional	**295,618**	283,616	282,748	281,997	281,696
Industrial	**12,032**	12,796	13,117	13,383	13,509
Other	**5,767**	5,643	5,634	5,812	5,793
Total customer accounts	**3,815,126**	3,752,510	3,701,275	3,644,463	3,596,542
kWh/customer account					
Average annual consumption in Québec					
Residential and farm	**16,318**	16,720	17,203	17,237	16,247
General and institutional	**112,010**	118,168	117,352	114,651	112,695
Industrial	**5,904,382**	5,668,738	5,262,038	5,395,359	5,129,097
Other	**855,039**	886,406	878,211	864,110	872,780

Operating Statistics (continued)

	2006	2005	2004	2003	2002
MW					
Installed capacity[a]					
Hydroelectric	**32,973**	32,299	31,622	31,347	30,392
Nuclear	**675**	675	675	675	675
Other thermal	**1,665**	1,595	1,593	1,592	1,592
Wind	**2**	2	2	2	2
Total installed capacity	**35,315**	34,571	33,892	33,616	32,661
GWh					
Total energy requirements[b]	**199,447**	200,179	193,025	194,792	192,916
MW					
Peak power demand in Québec[c]	**36,251**	33,636	34,956	36,268	34,989
km					
Lines (overhead and underground)					
Transmission	**32,826**	32,544	32,487	32,434	32,314
Distribution[d]	**108,883**	108,344	107,423	106,568	105,871
	141,709	140,888	139,910	139,002	138,185

a) Hydro-Québec also has access to almost all the output from Churchill Falls generating station (5,428 MW) and purchases all the output from six privately owned wind farms with a total installed capacity of 320 MW. In addition, 1,206 MW are available under agreements with other independent suppliers.

b) Total energy requirements consist of kilowatthours delivered within Québec and to neighboring systems.

c) For the winter beginning in December, including interruptible power. The 2006–2007 winter peak occurred at 5:30 p.m. on February 5, 2007.

d) These figures include off-grid systems but exclude private systems, lines under construction and 44-kV lines (transmission).

Other Information

	2006	2005	2004	2003	2002
%					
Rate increases					
Average increase from January 1 to December 31	**4.3**	1.3	4.1	–	–
Inflation rate	**2.0**	2.2	1.9	2.8	2.2
Number of employees[a]					
Permanent as at December 31	**19,116**	19,009	18,835	18,317	18,025
Temporary (year's average)	**3,799**	3,577	3,567	3,596	3,632
Women (%)	**30.6**	29.8	29.4	28.9	28.5

a) Excludes employees of subsidiaries and joint ventures.

Consolidated Results by Quarter

$M	1st quarter	2nd quarter	3rd quarter	4th quarter	**2006** 12-month period
				(unaudited)	(audited)
Revenue	3,199	2,598	2,443	2,921	**11,161**
Expenditure					
Operations	559	564	591	680	**2,394**
Electricity and fuel purchases	363	284	303	365	**1,315**
Depreciation and amortization	489	496	487	535	**2,007**
Taxes	153	89	143	144	**529**
Regulatory deferrals	–	–	–	(93)	**(93)**
	1,564	1,433	1,524	1,631	**6,152**
Operating income	1,635	1,165	919	1,290	**5,009**
Financial expenses	530	555	585	542	**2,212**
Income from continuing operations	1,105	610	334	748	**2,797**
Income from discontinued operations	24	832	63	25	**944**
Net income	1,129	1,442	397	773	**3,741**

$M	1st quarter	2nd quarter	3rd quarter	4th quarter	2005 12-month period
				(unaudited)	(audited)
Revenue	3,116	2,451	2,452	2,869	10,888
Expenditure					
Operations	533	582	558	575	2,248
Electricity and fuel purchases	332	344	390	430	1,496
Depreciation and amortization	482	447	467	627	2,023
Taxes	148	115	159	172	594
Regulatory deferrals	–	–	–	(11)	(11)
	1,495	1,488	1,574	1,793	6,350
Operating income	1,621	963	878	1,076	4,538
Financial expenses	579	564	530	514	2,187
Income from continuing operations	1,042	399	348	562	2,351
Income (loss) from discontinued operations	12	3	43	(157)	(99)
Net income	1,054	402	391	405	2,252

Thierry Vandal
President and Chief Executive Officer

Marie-José Nadeau
Executive Vice President,
Corporate Affairs and Secretary General

Daniel Garant
Executive Vice President,
Finance and Chief Financial Officer

Élie Saheb
Executive Vice President,
Technology

Maurice Charlebois
Executive Vice President,
Human Resources and Shared Services

Board of Directors

Michael L. Turcotte[a, b, c, d, e, f, g, h, i, j, k, l]
Chairman of the Board,
Hydro-Québec
Appointed November 17, 2005, for a four-year term

Normand Bergeron
Deputy Minister of Natural Resources and
Wildlife, Gouvernement du Québec
Appointed May 2, 2005

Joseph Benarrosh[d, e, g]
President, JJDS Capital inc.
Appointed December 5, 2001, for a five-year term

Gaston Blackburn[c, d, h]
President, G. Blackburn Inc.
Appointed September 10, 2003, for a five-year term

Anik Brochu[b]
General Manager,
Chambre de commerce de Val-d'Or
Appointed September 13, 2006, for a four-year term

Andrée Corriveau[d, e, k]
President, Extensio Inc.
Appointed September 25, 2002, for a five-year term

Hélène F. Fortin[f, l]
CA, Partner, GHL – Chartered Accountants
Appointed October 25, 2006, for a three-year term

Bernard Gaudreault[b, l]
Director
Appointed December 5, 2001, for a five-year term

Thierry Vandal[a, b, c, d, e, f, g, h, i, j, k]
President and Chief Executive Officer,
Hydro-Québec
Appointed April 6, 2005, for a three-year term

Norman E. Hébert Jr.[b, j, l]
President and Chief Executive Officer,
Groupe Park Avenue
Appointed April 7, 2004, for a three-year term

Louis Lagassé[a, f, g, i, j]
Chairman and Chief Executive Officer
Media5 Corporation
Appointed September 10, 2003, for a five-year term

Paul Larocque[c, h]
Mayor, Bois-des-Filion
Appointed December 5, 2001, for a five-year term

Jacques Leblanc[h, l]
President, Gestion Jacques Leblanc inc.
Appointed April 7, 2004, for a three-year term

Michel Plessis-Bélair[a, d, f, g]
Vice-Chairman and Chief Financial Officer,
Power Corporation of Canada
Appointed April 7, 2004, for a three-year term

Marie-France Poulin[c, i, j]
Executive Vice President, Groupe Camada inc.
Appointed April 7, 2004, for a three-year term

Marie-Anne Tawil[d, e, i]
President, Les Investissements Iron Hill Inc.
Appointed December 7, 2005, for a five-year term

On March 20, 2006, the Board learned of the death of Yvon Lamontagne, director, Chair of the Audit Committee and financial expert. Anik Brochu replaced him as director on September 13, 2006, and Norman E. Hébert Jr. was appointed Chair of the Audit Committee. In addition, the term of Michel Noël de Tilly, who was appointed on March 8, 2001, for five years, ended during the year; Mr. de Tilly was director, Chair of the Distribution Committee and member of the Audit Committee. Hélène F. Fortin replaced him as director on October 25, 2006. Lastly, Régis Labeaume, director, Chair of the Transmission Committee and member of the Human Resources Committee, tendered his resignation effective December 31, 2006.

Board Committees

a Executive Committee
b Distribution (DC)
*c Environment and Corporate Social Responsibility (ECSRC)**
d Environment and Corporate Governance (ECGC)
*e Ethics and Corporate Governance (ETCGC)**
f Finance (FC)
g Pension Plan Financial Management (PPFMC)
h Generation (GC)
i Human Resources (HRC)
*j Technology***
k Transmission (TC)
l Audit (AC)

* *The Environment and Corporate Social Responsibility Committee and the Ethics and Corporate Governance Committee merged on May 12, 2006, to become the Environment and Corporate Governance Committee.*

** *The Technology Committee was abolished in February 2006.*

Corporate Governance

Hydro-Québec's Board of Directors adopts practices that are in line with the key principles set forth in the new corporate governance legislation. It follows the guidelines set by the Canadian Securities Administrators to the extent that they apply to a government-owned utility like Hydro-Québec even though, legally speaking, it is not required to do so because the company is not publicly traded.

Mandate

The Board administers the company's business in accordance with the *Hydro-Québec Act* and its regulations and with the *Companies Act*. Its most important functions are set out in Hydro-Québec Bylaw No. 633 on the exercise of power by Hydro-Québec's Board of Directors and other administrative measures. The Board analyzes and adopts the Strategic Plan, which defines the company's main objectives, and the annual Business Plan, which establishes the budgets for each division and unit, and sets the company's annual performance targets. Other Board functions include the monthly review of financial results, the four-month review of management results, the annual evaluation of integrated enterprise risk management, and the selection and evaluation of senior executives. The Board regularly receives and analyzes the subsidiaries' activity reports, financial results and accountability reports. It also approves major capital projects in generation, transmission and distribution.

Independence

A total of 15 Board members come from outside the company, and only one director — the President and Chief Executive Officer — is a member of Senior Management. The government appoints a Chair from among the Board members. The Board is responsible for compliance, at all times, with the rules stated in the *Code of Ethics and Rules of Professional Conduct for Directors, Executives and Controllers of Hydro-Québec*, which are based on the *Regulation respecting the ethics and professional conduct of public office holders*. Any nonfulfillment of the obligations defined in this code is drawn to the attention of the Chairman of the Board, who also chairs the Environment and Corporate Governance Committee.

Compensation

Compensation for all Board members, except the Chairman and the President and Chief Executive Officer, is set out in Order in Council No. 610-2006 as amended by Order in Council No. 962-2006. Compensation consists of a basic annual retainer of $16,000, plus a meeting fee of $750 for each Board or committee meeting. In addition, according to the order in council, a yearly supplement of $5,000 is paid to the chairs of ethics and governance, audit, and human resources committees.

Director training

Directors all receive information on the energy sector and Hydro-Québec's business environment and principal activities. They are also given a director's manual describing the company's specific technical, business and regulatory contexts, as well as the roles and responsibilities of Board members. In addition, the members of Board committees receive manuals describing the committee's mandate and a series of backgrounders and reports to facilitate understanding of the issues and decision making. External training is also available to complement directors' knowledge.

Deintegration

In 1997, Hydro-Québec created an organizational structure that allows some units to work independently from each other while remaining part of the same company. That is the principle of deintegration, or unbundling.

The operations of these units are subject to set rules of ethics. The electricity procurement process is governed by the *Code of Ethics on Conducting Calls for Tenders*, which was adopted by Hydro-Québec Distribution and approved by the Board of Directors and the Régie de l'énergie. The code ensures that calls for tenders are conducted fairly for all electricity suppliers. The Régie follows up annually on its application.

Hydro-Québec TransÉnergie abides by the *Transmission Provider Code of Conduct* approved by the Régie in 2004. This code governs the relations between the Transmission Provider and other Hydro-Québec divisions, and its purpose is to prevent any form of preferential treatment or cross-subsidization. Breaches of the code are made public on the OASIS (Open Access Same-Time Information System) Web site: **www.hydroquebec.com/transenergie/oasis/en/conduite.shtml**.

Access to documents and protection of personal information

Hydro-Québec is concerned about protecting the personal information it possesses on its customers, suppliers and employees and ensuring public access to information. Accordingly, it takes the necessary measures to ensure the confidentiality of this information, in accordance with the *Act respecting Access to documents held by public bodies and the Protection of personal information*. Measures undertaken in 2006 include training offered to over 5,000 employees to ensure the confidentiality of personal information on human resources.

Hydro-Québec's Personal Information Protection Committee, which is chaired by the President and Chief Executive Officer, monitors the implementation of the company's action plan and the development of new computer systems containing personal information on employees and customers. In 2007, the committee's mandate will be expanded to include access to information.

To facilitate access to the information it possesses, Hydro-Québec publishes many documents on its Web site, **www.hydroquebec.com/publications/en**. A section of the site is also devoted to access to information and the protection of personal information (**www.hydroquebec.com/publications/en/others/acces_information.html**), describing how to make an access to information request and who to send it to.

In 2006, Hydro-Québec received 223 requests under the *Act respecting Access to documents held by public bodies and the Protection of personal information*. Most of the requests were granted, except for a small number that were denied due mainly to facility security issues or to opposition by a third party to the disclosure of information belonging to it.

Policy on the independence of external auditors

Hydro-Québec has introduced various mechanisms to enable the Audit Committee to ensure that external auditors remain independent:

- A process whereby any assignment to be given to external auditors is analyzed first to ensure that it will not affect their independence; external auditors are not authorized to provide services that fall within the prohibited category
- Rules requiring prior approval of all requisitions for services sent to the external auditors
- Reports to the Audit Committee on the fees billed by the external auditors
- Measures to guarantee compliance with partner rotation rules

External auditors' fees

KPMG LLP and Ernst & Young LLP are the joint auditors for Hydro-Québec for 2006. Professional fees billed by external auditors in 2006 for services other than auditing and certification amounted to less than 13% of the total $5.3 million in fees billed.

Language guidelines

Efforts to maintain the quality of French used at Hydro-Québec continued during the year. Various proficiency courses in French were offered to employees. In addition, the terminology, toponymy and language resources that are available to all employees were enhanced.

Ethics

Hydro-Québec attaches great importance to ethics in all of its employees' activities. The concept of ethics has been included in official company guidelines since 1988. The purpose of these guidelines is to set, for the company and its employees, high standards of judgment and behavior in professional activities.

As a government-owned utility, Hydro-Québec must demonstrate exemplary probity. Loyalty, integrity, respect, discretion and fairness are fundamental values reflecting Hydro-Québec's social commitment to its customers and the entire community. Ethical standards and rules resulting from these values are set out in the *Code of Ethics and Rules of Professional Conduct for Directors, Executives and Controllers of Hydro-Québec*, shown on page 104 of this Annual Report, and in the *Code of Conduct* for employees, which was revised in 2006 to take account of changes in the work context. It is available at **www.hydroquebec.com/profile**.

Internal control system

Management maintains an internal control system that meets the demanding requirements of the internationally recognized framework developed by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. This includes communicating Hydro-Québec's code of ethics and code of conduct to employees, primarily to ensure the proper management of resources and the orderly conduct of business. The objective of this system is to provide reasonable assurance that financial information is pertinent and reliable and that Hydro-Québec's assets are adequately recorded and safeguarded. This system complements and supports the integrated enterprise risk management process. An internal audit process helps in determining if the internal control system is sufficient and effective and in assessing the company's policies and procedures; it also includes a performance audit to ensure the efficiency, effectiveness and cost effectiveness of operations. The General Auditor and the external auditors have full and unrestricted access to the Audit Committee, with or without Management present.

Sustainable development

Published simultaneously with the Annual Report, the *Sustainability Report 2006* describes the company's main sustainable development initiatives and reports on its sustainable energy choices and progress made in this area. This report is based on *Global Reporting Initiative Guidelines*. It and previous years' reports can be consulted at **www.hydroquebec.com/sustainable-development**, which provides additional information on the company's performance in sustainable development.

Activity Report of the Board of Directors and Board Committees

The Board of Directors met 13 times in 2006, including meetings held by conference call, and its committees met 44 times.

The Board benefits from the expertise and experience of its members, who sit on nine committees: Environment and Corporate Governance (created from the May 2006 merger of Environment and Social Responsibility and Ethics and Corporate Governance), Audit, Human Resources, Finance, Pension Plan Financial Management, Generation, Transmission, Distribution, and the Executive Committee. Committee members may obtain opinions from outside experts on topics relevant to their areas of expertise according to an established procedure. After every committee meeting, the chair presents a verbal report on the agenda items at the next Board meeting.

During the year, the Board approved Hydro-Québec's *Strategic Plan 2006 – 2010* and modifications made to it to reflect the most recent forecasts of growth in electricity demand in Québec. In addition, it authorized the sale of interests held by the company in Australia, Chile, Costa Rica, Panama, Peru and the United States. It also approved the relaunching of the project to build a 1,250-MW asynchronous interconnection with Ontario and the rebuilding of a diesel generating station at a new site in the northern village of Kuujjuaq, as well as various generation projects including refurbishment of Melville dam, at the Shawinigan complex.

The Board's recurring deliberations dealt with the objectives and financial results of Hydro-Québec and its wholly owned subsidiaries, as well as financial management of the company's pension plan, investment projects and requests to the Régie de l'énergie such as the application for a change in electricity rates and the application related to conditions for transmission services.

Director Attendance at Meetings of the Board of Directors and Board Committees in 2006

Director	Board	DC*	ECSRC	ETCGC	ECGC	FC	PPFMC	GC	HRC	TC	AC
Michael L. Turcotte	13/13	4/4	1/1	3/3	3/3	3/3	4/4	5/5	10/10	3/3	9/9
Thierry Vandal	13/13	4/4	1/1	2/3	2/3	3/3	4/4	3/5	9/10	3/3	
Normand Bergeron	11/13										
Joseph Benarrosh	9/13			3/3	3/3	2/2**	4/4				
Gaston Blackburn	11/13		1/1					5/5			
Anik Brochu	5/5										
Andrée Corriveau	12/13			3/3	3/3					3/3	
Hélène F. Fortin	3/3										6/6
Bernard Gaudreault	13/13	4/4							1/1**	1/1**	9/9
Norman E. Hébert Jr.	9/13	2/4									7/9
Régis Labeaume	9/13								6/10	2/3	
Louis Lagassé	10/13					1/3	3/4		9/10		
Paul Larocque	10/13		1/1					4/5			
Jacques Leblanc	12/13							5/5	1/1**		8/9
Michel Plessis-Bélair	8/13				0/2	3/3	4/4				
Marie-France Poulin	12/13		1/1						9/10		
Marie-Anne Tawil	12/13			2/2	2/3				4/5		

* *See committee names on page 99.*
** *Substitute.*

Environment and Corporate Governance

The Environment and Corporate Governance Committee assures the Board of Directors that Hydro-Québec adopts the best rules of ethics and corporate governance. It develops the competency and experience profiles used to appoint Directors, establishes criteria to evaluate the performance of the Board and its members and oversees the induction and training program for directors. It also deals with issues involving the environment and corporate social responsibility.

In early 2006, the Environment and Corporate Social Responsibility Committee, now merged with the Ethics and Corporate Governance Committee, examined the *Annual Report 2005* of the Fondation Hydro-Québec pour l'environnement, reviewed the projects supported by the foundation and considered donation requests submitted to it. The Ethics and Corporate Governance Committee analyzed Hydro-Québec's *Strategic Plan 2006 – 2010* and its main objectives. The issue of director compensation was also referred to the committee, as were the results of the self-evaluation survey conducted by the Board. Seven meetings were held in 2006.

Since its creation in May, the Environment and Corporate Governance Committee has studied the report on environmental compliance and legislation and has also analyzed the company's major contributions to organizations working in health and humanitarian aid, culture, sports, education and youth, social and economic affairs, and the environment.

Audit

The main function of the Audit Committee is to recommend that the Board of Directors approve the financial statements of Hydro-Québec and of its pension plan. It must also ensure that the financial statements accurately reflect the company's financial position and changes to it, and that internal controls are adequate and effective. The committee approves the annual audit plan and supervises internal audit operations. It submits its recommendations on external auditors' fees to the Board and meets periodically with auditors. In addition, every year, it examines the integrated enterprise risk management process.

The committee met nine times in 2006. It examined internal and external audit results and reviewed various internal audit reports and related action plans, particularly those aimed at ensuring the sound governance of information technologies, protection of financial systems and retention of competencies in order to achieve Hydro-Québec's business objectives. In addition, it examined the company's financial statements and those of Hydro-Québec International.

Human Resources

The main role of the Human Resources Committee is to advise the Board on corporate policies and strategies regarding total compensation, labor relations and health and safety, as well as policies on workforce planning and employee development, motivation and performance. In addition, it assesses the organization of Senior Management, succession planning, and the recruitment, annual evaluation, compensation, working conditions and annual performance objectives of the President and Chief Executive Officer and other senior executives.

The committee met 10 times during the year. It examined some organizational changes, including the creation of the Technology Group. The committee studied the evaluation of objectives for the President and Chief Executive Officer, senior executives and employees in general. It worked on several specific issues, particularly succession planning for Senior Management, attendance and the change in overtime hours since 2003.

Finance

The role of the Finance Committee is to advise the Board on the directions, policies, strategies and overall objectives of Hydro-Québec involving financing, borrowing, insurance, banking, risk management, and any other subject affecting the company's finances. In addition, every year, it examines the company's consolidated portfolio of internal and external risks.

The committee met three times in 2006. A major part of its work was examining and monitoring the company's annual borrowing, guarantee, financial risk management, swap and sinking fund programs. The committee also examined the four-month reviews of Hydro-Québec's *Business Plan 2006*.

Pension Plan Financial Management

The role of the Pension Plan Financial Management Committee is to advise the Board on the directions, policies, strategies and overall objectives established for various aspects of Hydro-Québec's pension plan — namely the Pension Plan Funding Policy, Pension Fund Investment Management Policy, actuarial valuations of the plan, choice of the benchmark portfolio, the plan's financial situation, plan expenses and any other aspect of pension fund management.

The committee met four times over the year. It examined the overall financial health of the pension plan and, in cooperation with the Human Resources Committee, paid particular attention to the projected costs of the plan until 2011. It studied proposed modifications to Hydro-Québec's Pension Fund Investment Management Policy to reflect projected changes in the benchmark portfolio. In addition, the committee reviewed the performance of the pension plan portfolio and specialized portfolio managers.

Generation

The Generation Committee advises the Board on bids that Hydro-Québec Production submits to Hydro-Québec Distribution in response to calls for tenders, in order to ensure respect of the principal of deintegration between the two units. It also provides advice on any other issues involving the Generator.

During the five meetings held in 2006, the committee looked specifically at hydropower projects; the rehabilitation, refurbishing and refitting of generating stations; and agreements with various Aboriginal communities and Hydro-Québec TransÉnergie.

During the year, the committee also monitored the management of energy reserves and compliance with energy and capacity reliability criteria, in light of Hydro-Québec's commitment to demonstrate to the Régie de l'énergie that it maintains sufficient energy reserves at all times to offset a potential runoff deficit.

Transmission

The Transmission Committee advises the Board on issues relating to Hydro-Québec TransÉnergie that require Board approval, as well as on any other major issue linked to the division's activities, particularly those to be submitted to the Régie de l'énergie.

The committee met three times in 2006. It examined the project to integrate wind farm generation and projects to connect these farms to the company's transmission system, the construction or refurbishing of substations, the construction of transmission lines and the replacement of microwave links between Micoua and Saguenay substations and between Bersimis-1 and Bersimis-2 generating stations. It also examined the application to amend Hydro-Québec TransÉnergie's service conditions for 2007.

Distribution

The Distribution Committee's role is to advise the Board of Directors on Hydro-Québec Distribution's activities regarding the electricity supply for Québec consumers, especially cases that must be filed with the Régie de l'énergie, and any other matter related to those activities of the Distributor that require Board approval.

The committee met four times in 2006. It examined the application to modify rates applicable April 1, 2007, and the Distributor's procurement strategy to meet energy and capacity demand for 2006 and 2007. It also followed up on the *Electricity Supply Plan 2005–2014*.

In addition, it continued to monitor the progress of the Customer Information System, specifically the implementation strategy for the third phase of the project. This project aims to modernize the company's information systems and revamp the commercial practices and business procedures related to sales and customer service.

In December, the committee examined the terms and conditions of a new framework agreement between Hydro-Québec Production and Hydro-Québec Distribution which went into effect on January 1, 2007. This agreement defines the method for calculating electricity volumes sold to the Distributor above and beyond the heritage pool.

Part I – Interpretation and application

1. In this Code, unless the context indicates otherwise:

a) **"director"** means, with respect to the Company, a member of the Board of Directors of the Company, whether or not working full-time within the Company;

b) **"Committee"** or "Ethics and Corporate Governance Committee" means the Ethics and Corporate Governance Committee established by resolution of the Board of October 17, 1997 (HA-173/97), a copy of which is attached in Schedule D;

c) **"spouse"** includes marriage partners and persons living as if married for more than one year;

d) **"Board"** means the Board of Directors of the Company;

e) **"contract"** includes a proposed contract;

f) **"control"** means the direct or indirect ownership of securities, including shares, conferring more than 50% of voting rights or economic interest without this right depending on the occurrence of a particular event or allowing the election of the majority of directors;

g) **"controller"** means the controller of the Company and the controllers of divisions or groups or units reporting to the President and Chief Executive Officer of the Company;

h) **"executive"** with respect to the Company means any contractual manager whose employment conditions are subject to the approval of the Board;

i) **"enterprise"** means any form that can be taken by the organization for the production of goods or services or any other business of a commercial, industrial or financial nature or any group seeking to promote certain values, interests or opinions or to exercise an influence on public officials; however, this does not include the Company or a non-profit association or group that has no financial link with the Company or is not incompatible with the objects of the Company;

j) **"affiliated enterprise"** means a legal person or company in which the Company owns, directly or indirectly, securities, including shares, conferring more than 10% of voting rights or economic interest;

k) **"immediate family"** means spouse and dependent children;

l) **"subsidiary"** means a legal person or company controlled directly or indirectly by the Company.

m) **"Regulation"** means the *Regulation respecting the ethics and professional conduct of public office holders* (Order-in-Council 824-98 of June 17, 1998 (1998) 130 G.O. II., 3474, pursuant to sections 3.01 and 3.02 of the *Act respecting the Ministère du Conseil exécutif,* R.S.Q., c. M-30), as amended from time to time;

n) **"Company"** means Hydro-Québec.

2. In this Code, the prohibition to perform an act also applies to any attempt to perform it and any participation in it or incitement to perform it.

2.1 This Code applies to the directors, the President and Chief Executive Officer, other executives of the Company and its controllers.

The directors and the President and Chief Executive Officer are also subject to the Regulation.

Part II – Ethical principles and general rules of professional conduct

3. The director, executive or controller is appointed to contribute to the achievement of the Company's mission in the best interest of Québec. Accordingly, he is expected to use his knowledge, abilities and experience in a way that will promote the effective, fair and efficient accomplishment of the objectives assigned to the Company by law and the good administration of the property it owns as mandatary of the State.

His contribution shall be made with respect for the law and with honesty, loyalty, prudence, diligence, efficiency, application and fairness.

3.1 The director, executive or controller respects the following principles in the performance of his duties:

- a vision of the Company that seeks to make it a world leader in the energy industry by developing its expertise for the benefit of its customers, employees and shareholder and by working with partners in business ventures;
- the values underlying the activities of the Company as a government-owned business Company, which include customer satisfaction, a "business first" approach, respect for employees, quality improvement, respect for the environment, partnership with local communities and safeguarding the future; and
- the principles set out in the basic policies of the Company, expressing commitments and conveying a business culture with regard to customers, human resources, acquisition of assets and services, business partners, finance, assets, the environment, social role and corporate governance.

3.2 The director, executive or controller is required, in the performance of his duties, to respect the ethical principles and rules of professional conduct provided by law, the Regulation as applicable, and those defined in this Code. In case of discrepancy, the more stringent rules and principles apply.

When in doubt, act according to the spirit of these principles and rules.

A director, executive or controller who, at the request of the Company, serves as director or member of an undertaking or a company, is held to the same standards.

4. The director, executive or controller shall not merge the assets of the Company with his own; he may not use the assets of the Company or information he obtains as a result of his duties for his own profit or the profit of others. These obligations continue even after the director, executive or controller has ceased to hold his position.

5. The director, executive or controller shall seek, in the performance of his duties, only the interest of the Company to the exclusion of his own interest or that of others.

5.1 The director, executive or controller is bound to discretion in regard to anything that comes to his knowledge in or during the performance of his duties and is at all times bound to maintain the confidentiality of such information.

5.2 In the performance of his duties, the director, executive or controller shall make decisions without regard for any partisan political considerations.

The Chairman of the Board, the director working full-time within the Company, the executive and the controller shall demonstrate reserve in the public expression of their political opinions.

6. The director, executive or controller may not directly or indirectly grant, solicit or accept a favor or an undue advantage for himself or for a third party.

In particular, he may not accept or solicit an advantage from a person or undertaking doing business with the Company or a subsidiary or acting in the name of or on behalf of such a person or undertaking if this advantage is intended or likely to influence him in the performance of his duties or generate expectations of this nature.

6.1 The director, executive or controller shall, in making decisions, avoid allowing himself to be influenced by offers of employment.

6.2 The director, executive or controller may not accept any gift or hospitality except what is customary and modest in value.

Any other gift or hospitality shall be returned to the giver.

7. The director may not make a commitment to a third party or grant them any guarantee relative to a vote he may be asked to make or any decision whatsoever that the Board may be asked to make.

7.1 The director, executive or controller may not, in the performance of his duties, deal with a person who has ceased to be a director, executive or controller of the Company for less than one year if this person is acting on behalf of a third party with respect to a proceeding, negotiation or other transaction to which the Company is a party and about which he has information not available to the public.

7.2 After ceasing his duties, no director, executive or controller may disclose confidential information he has obtained or give anyone advice based on information not available to the public concerning the Company or any other undertaking or company with which he had direct and substantial dealings during the year preceding the date on which he ceased his duties.

In the year following that date, he may not act on behalf or on account of another party with respect to a procedure, negotiation or other transaction to which the Company is a party and about which he has information not available to the public.

8. The director, executive or controller shall collaborate with the Chairman of the Board or the Ethics and Corporate Governance Committee on an issue of ethics or professional conduct when asked to do so.

8.1 The director, executive or controller who intends to be a candidate for elective office shall inform the Chairman of the Board of this intention.

The Chairman of the Board or President and Chief Executive Officer with the same intention shall inform the Secretary General of the Conseil exécutif.

Part III – Duties and obligations of directors, executives and controllers with respect to conflicts of interest

Prevention of conflicts of interest

9. The director, executive or controller shall avoid placing himself in a situation in which his personal interest is in conflict with the duties of his position or in which reasonable doubt is cast on his ability to perform these duties with undivided loyalty.

A director who is employed full-time within the Company or one of its subsidiaries shall also avoid performing duties or being bound by commitments that prevent him from devoting the time and attention that the normal exercise of his duties requires.

As for other directors, they shall be sure to devote the time and attention reasonably required in the circumstances for the execution of their duties.

10. No director holding a full-time office with the Company, under pain of forfeiture of office, may have any direct or indirect interest in an undertaking, company or association that puts his personal interest in conflict with that of the Company.

However, such forfeiture is not incurred if that interest devolves to him by succession or gift, provided that he renounces or disposes of it with all possible dispatch. Meanwhile, sections 12, 13, 15 and 18 apply to this director.

Every other director who has an interest in an undertaking shall, on pain of forfeiture of his office, comply with the provisions of sections 12, 13, 15 and 18.

11. A director, executive or controller of the Company who serves as director, executive or controller of an affiliated enterprise shall be specifically authorized by the shareholder or shareholders who control the enterprise concerned to:

a) hold shares, rights or any other security issued by such enterprise and conferring voting rights or economic interest in it or the right to subscribe or buy such shares, rights or securities;

b) benefit from any profit-sharing program, unless this director, executive or controller works full-time for the enterprise and the profit-sharing program is closely linked with the individual performance of the director, executive or controller within the affiliated enterprise;

c) benefit from a pension plan granted by the affiliated enterprise if he does not hold a full-time position within the enterprise; or

d) benefit from any advantage granted in advance in the case of a change of control of the affiliated enterprise.

12. A director, executive or controller who:

a) is party to a contract with the Company or a subsidiary; or

b) has a direct or indirect interest in an enterprise that is a party to a contract with the Company or a subsidiary or is a director, executive, controller or employee of this enterprise;

shall disclose the nature and extent of his interest in writing to the Chairman of the Board.

The same applies to a director who has a direct or indirect interest in any issue being considered by the Board of Directors.

The director shall at all times abstain from conveying any information of any kind to any employee, controller, executive or director of the Company with respect to this contract or interest.

The director shall abstain from deliberating or voting on any question linked to this interest and avoid trying to influence the related decision. The director shall also withdraw from the meeting for the duration of deliberations and voting on this question.

12.1 A director who is a member of the Audit Committee of the Board of Directors may not have an interest in the Company or a subsidiary. In particular, he may not accept from the Company or a subsidiary fees with respect to consulting, consulting services or any other similar service.

13. The disclosure required by section 12 occurs, in the case of a director, during the first meeting:

a) in the course of which the contract or question concerned is under study;

b) following the time at which the director who had had no interest in the contract or question concerned acquires such interest;

c) following the time at which the director acquires an interest in the already concluded contract; or

d) following the time at which any person with an interest in a contract or a question under study becomes a director.

14. An executive or controller who is not a director shall make the disclosure required in section 12 immediately after:

a) having learned that the contract or question concerned was or will be studied at a meeting;

b) having acquired the interest, if it is acquired after the contract was concluded or the decision made; or

c) having become an executive or controller, if he becomes one after acquiring the interest.

The executive or controller may not try to influence the directors' decision in any way.

15. The director, executive or controller shall make the disclosure required in section 12 as soon as he has knowledge of a contract contemplated by this section which, as part of the normal business of the Company, does not require the approval of the directors.

16. Sections 12 to 15 apply also when the interest concerned is held by a member of the immediate family of the director, executive or controller.

17. The director, executive or controller shall notify the Chairman of the Board in writing of the rights he may invoke against the Company, by indicating their nature and their value, as soon as these rights come into existence or when he acquires knowledge of them.

18. The director, executive or controller shall submit to the Chairman of the Board, within 60 days of being appointed and on January 31 of each year in which he remains in office, an attestation in the form provided in Schedule B and containing the following information:

a) the name of any enterprise in which the director, executive or controller owns, directly or indirectly, securities or assets, including common shares, specifying the nature and quantity in number and proportion of securities owned and value of assets;

b) the name of any enterprise for which he performs functions or in which he has an interest in the form of a debt, right, priority, mortgage or significant commercial or financial benefit; and

c) to the best of his knowledge, the information specified in the preceding paragraphs concerning his employer and the corporation, company or enterprise of which he is owner, shareholder, director, executive or controller.

A director, executive or controller to whom the provisions of paragraphs a) to c) do not apply shall fill out an attestation to that effect and present it to the Chairman of the Board.

The director, executive or controller shall also produce such an attestation within 60 days of the occurrence of a significant change in its content.

The attestations presented pursuant to this section are treated as confidential.

19. The Chairman of the Board submits the attestations received pursuant to sections 12 to 18 to the Secretary of the Company, who keeps them at the disposal of the members of the Board and the Ethics and Corporate Governance Committee.

Moreover, the Secretary of the Company notifies the Ethics and Corporate Governance Committee of any failure to satisfy the obligations provided for in sections 12 to 18 as soon as the Secretary becomes aware of them.

Waivers

20. This Code does not apply:

a) to owning securities when the size of the holding probably does not place the director, executive or controller in a conflict of interest;

b) to owning an interest by way of a mutual fund in whose management the director, executive or controller plays no role directly or indirectly;

c) to owning interests through a blind trust whose beneficiary cannot know its makeup;

d) to owning a minimum number of shares required to be eligible as director of a corporation;

e) to an interest which, by its nature and extent, is common to the public at large or a particular sector in which the director, executive or controller operates;

f) to a directors' liability insurance agreement; or

g) to the owning of shares issued or guaranteed by the Company, a government or municipality under the same conditions for everyone.

Attestation

20.1 Within sixty days of the adoption of this Code by the Board, each director, executive or controller shall submit to the Chairman of the Board and the Secretary of the Company the attestation appearing in Schedule C.

Each new director, executive or controller shall do the same within sixty days of his appointment to this position.

Part IV – Remuneration

20.2 The director, executive or controller, for the exercise of his duties, is entitled solely to the remuneration related to those duties. Such remuneration may not include, even partially, monetary advantages such as those established, in particular, by a profit-sharing plan based on the variation in the value of shares or on a stake in the capital stock of the Company.

20.3 A director, executive or controller dismissed for just and sufficient cause may not receive a severance allowance or payment.

20.4 A director, executive or controller who quits his duties, who has received or is receiving a severance allowance or payment and who holds an office, employment or any other remunerated position in the public sector during the period corresponding to that allowance or payment shall refund the part of the allowance or payment covering the period for which he receives a salary or shall cease to receive it during that period.

However, if the salary he receives is lower than that he received previously, he shall be required to refund the allowance or payment only up to the amount of his new salary, or he may continue to receive the part of the allowance or payment that exceeds his new salary.

20.5 Anyone who has received or is receiving a severance allowance or payment from the public sector and receives a salary as director, executive or controller during the period corresponding to that allowance or payment shall refund the part of the allowance or payment covering the period for which he receives a salary or shall cease to receive it during that period.

However, if the salary he receives as director, executive or controller is lower than that he was receiving previously, he shall be required to refund the allowance or payment only up to the amount of his new salary, or he may continue to receive the part of the allowance or payment that exceeds his new salary.

20.6 A President and Chief Executive Officer who has ceased to perform his duties, who has received so-called assisted departure measures and who, within two years after his departure, accepts an office, employment or any other remunerated position in the public sector shall refund the sum corresponding to the value of the measures received by him, up to the amount of the remuneration received, by the fact of his return to the public sector, during that two-year period.

20.7 Part-time teaching by a director, executive or controller is not covered by sections 20.4 to 20.6.

20.8 For the application of sections 20.4 to 20.6, "public sector" means the bodies, institutions and companies referred to in the Regulation in Schedule A.

The period covered by the severance allowance or payment referred to in 20.4 and 20.5 shall correspond to the period that would have been covered by the same amount if the person had received it as salary in his prior office, employment or position.

Part V – Application of the code

Competent authorities

20.9 The Associate Secretary General for Senior Positions of the Ministère du Conseil exécutif is the competent authority for the application of this Code with respect to the Chairman of the Board and the other directors of the Company appointed by the Government.

The Chairman of the Board is the competent authority with respect to all directors of wholly owned subsidiaries, executives or controllers of the Company.

The Chairman of the Board shall ensure observance of the ethical principles and rules of professional conduct by the directors, executives and controllers of the Company.

21. The Ethics and Corporate Governance Committee has as its mission to advise the competent authority with respect to ethics and professional conduct.

The Committee also performs the duties invested in it by the resolution appearing in Schedule D and performs any other duties related to ethics entrusted to it by the Board.

In the performance of its duties, the Ethics and Corporate Governance Committee may become acquainted with the attestations contemplated by section 19.

22. When a director, executive or controller is accused of a violation of ethics or the rules of professional conduct, the Committee is responsible for collecting all relevant information. It makes a report of its findings to the competent authority and recommends appropriate measures, if any.

The competent authority notifies the director, executive or controller of the alleged violations and the possible penalties. It informs him that he has seven days in which to respond and if he requests, to be heard on this matter.

23. The Committee may render advisory opinions to directors, executives or controllers on the provisions of this Code and their application to specific cases, even hypothetical ones. It is not required to limit its views to the terms contained in the request.

23.1 In order to allow an appropriate decision to be made in the case of an urgent situation requiring fast response or in an alleged case of serious misconduct, the competent authority may temporarily relieve of his duties, with remuneration, the director, executive or controller who is accused of violations of ethics or the rules of professional conduct.

24. The Secretary of the Company keeps records in which are stored the statements, disclosures and attestations that must be submitted to it under this Code, the reports, decisions and advisory opinions of the Committee and the decisions of the competent authority with respect to ethics and professional conduct.

The Secretary shall also take the necessary steps to ensure the confidentiality of the information provided by the directors, executives and controllers pursuant to this Code.

25. The Committee may consult and receive opinions from outside counsel or experts on any issue it considers appropriate.

26. A director, executive or controller does not violate the provisions of this Code if he has obtained in advance a favorable decision from the Committee on the following conditions:

a) the decision was obtained before the facts on which it was based became a reality;

b) the decision was submitted to the Board;

c) all of the relevant facts were fully disclosed to the Committee exactly and completely; and

d) the director, executive or controller has complied with all the requirements of the decision.

27. The Committee and the competent authority preserve the anonymity of complainants, applicants and informers unless there is a clear intention to do otherwise. They may not be forced to reveal information likely to disclose their identity except if the law or a court so requires.

Penalties

28. Upon concluding that a provision of the law, the Regulation or this Code has been violated, the competent authority may impose either of the following penalties:

a) for an executive or a controller, the appropriate penalty, which can extend as far as termination of employment; and

b) for a director, reprimand, suspension without remuneration for a maximum of three months, or removal from the Board.

However, when the competent authority is the Associate Secretary General contemplated by section 20.9, the penalty is imposed by the Secretary General of the Conseil exécutif. If the penalty proposed consists of the removal of a public office holder appointed or designated by the Government, it can only be imposed by the latter; in this case, the Secretary General of the Conseil exécutif may immediately suspend the public office holder without remuneration for a period not exceeding 30 days.

Any penalty imposed on a director and the decision to temporarily relieve him of his duties must be in writing and give the reasons therefor.

29. In the case of a violation of section 10, the competent authority records in writing the forfeiture of office of the violator.

30. The director, executive or controller shall render an account and restore to the Company any profits earned or benefits received as a result of or on the occasion of a violation of the provisions of this Code.

31. A director's vote shall not be a casting vote if it is made in violation of the provisions of this Code or associated with such a violation, or if the director fails to produce the attestation contemplated by section 18.

The schedules may be consulted on Hydro-Québec's Web site (**www.hydroquebec.com**).

Generating and Transmission Facilities *as at December 31, 2006*

Generation Installed capacity in MW

Hydroelectric generating stations

The installed capacity of a hydroelectric generating station is equivalent to that of its generating units operating in winter conditions (water temperature 5°C).

Robert-Bourassa	5,616
La Grande-4	2,779
La Grande-3	2,417
La Grande-2-A	2,106
Beauharnois	1,673
Manic-5	1,528
La Grande-1	1,436
Manic-3	1,244
Bersimis-1	1,125
Manic-5-PA	1,064
Manic-2	1,041
Outardes-3	1,026
Sainte-Marguerite-3	884
Laforge-1	878
Bersimis-2	845
Carillon	752
Outardes-4	708
Toulnustouc	553
Eastmain-1	507
Outardes-2	472
Brisay	469
Laforge-2	319
Trenche	303
Beaumont	270
La Tuque	240
Rocher-de-Grand-Mère	230
Rapide-Blanc	204
Paugan	202
Shawinigan-2	200
Manic-1	184
Shawinigan-3	184
Rapides-des-Îles	176
Chelsea	153
Première-Chute	130
La Gabelle	129
Les Cèdres	126
Grand-Mère	105
Other (18 generating stations rated less than 100 MW)	695

Nuclear generating station

Gentilly-2	675

Other thermal generating stations

Tracy (conventional)	660
Bécancour, La Citière and Cadillac (gas turbine)	881
Other (24 diesel plants)	124

Wind farm

Saint-Ulric (3 wind turbines)	2

Installed capacity MW

Hydroelectric (55)	32,973
Nuclear (1)	675
Other thermal (28)	1,665
Wind (1)	2
Total	**35,315**

Other sources of supply MW

Churchill Falls generating station — Churchill Falls (Labrador) Corporation Limited[a]	5,428
Six privately owned wind farms[b]	320
Agreements with other independent power producers[c]	1,206

a) Hydro-Québec has access to almost all the output.
b) Hydro-Québec purchases all the output.
c) Hydro-Québec has access to this output.

Hydroelectric generating stations under construction MW

Péribonka	385
Chute-Allard and Rapides-des-Cœurs	139
Mercier	51

Transmission

Voltage	Lines (km)	Substations (number)
765 and 735 kV	11,422	38
450 kV DC	1,218	2
315 kV	5,127	63
230 kV	2,976	50
161 kV	1,877	40
120 kV	6,600	213
69 kV or less	3,606	102
Total	**32,826**	**508**

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Hydro-Québec International (HQI)
is responsible for investment and the sale of professional services outside Canada and the U.S.

Since HQI has entrusted Hydro-Québec with the management of its operations, each Hydro-Québec division is responsible for foreign operations in its spheres of competence.

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Hydro-Québec IndusTech
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Units of measure

¢/kWh	cents ($0.01) per kilowatthour
$M	millions of dollars
$B	billions of dollars
kV	kilovolt (one thousand volts)
kW	kilowatt (one thousand watts)
MW	megawatt (one million watts)
GW	gigawatt (one million kilowatts)
kWh	kilowatthour (one thousand watthours)
MWh	megawatthour (one million watthours)
GWh	gigawatthour (one million kilowatthours)
TWh	terawatthour (one billion kilowatthours)
km	kilometre
m	metre

The following publications may be obtained from our Web site **www.hydroquebec.com** or by calling 1 800 363-7443:

Annual Report 2006 (this document)

Sustainability Report 2006

Financial Profile 2006–2007

Hydro-Québec wishes to thank all the employees whose photos appear in this Annual Report.

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Legal Deposit — 1st quarter 2007
Library and Archives Canada
Bibliothèque et Archives nationales du Québec
ISBN 978-2-550-48984-9
ISBN 978-2-550-48985-6 (PDF)
ISSN 0702-6706
2006G300A

Ce document est également publié en français.

www.hydroquebec.com

Hydro Québec

2006G300A