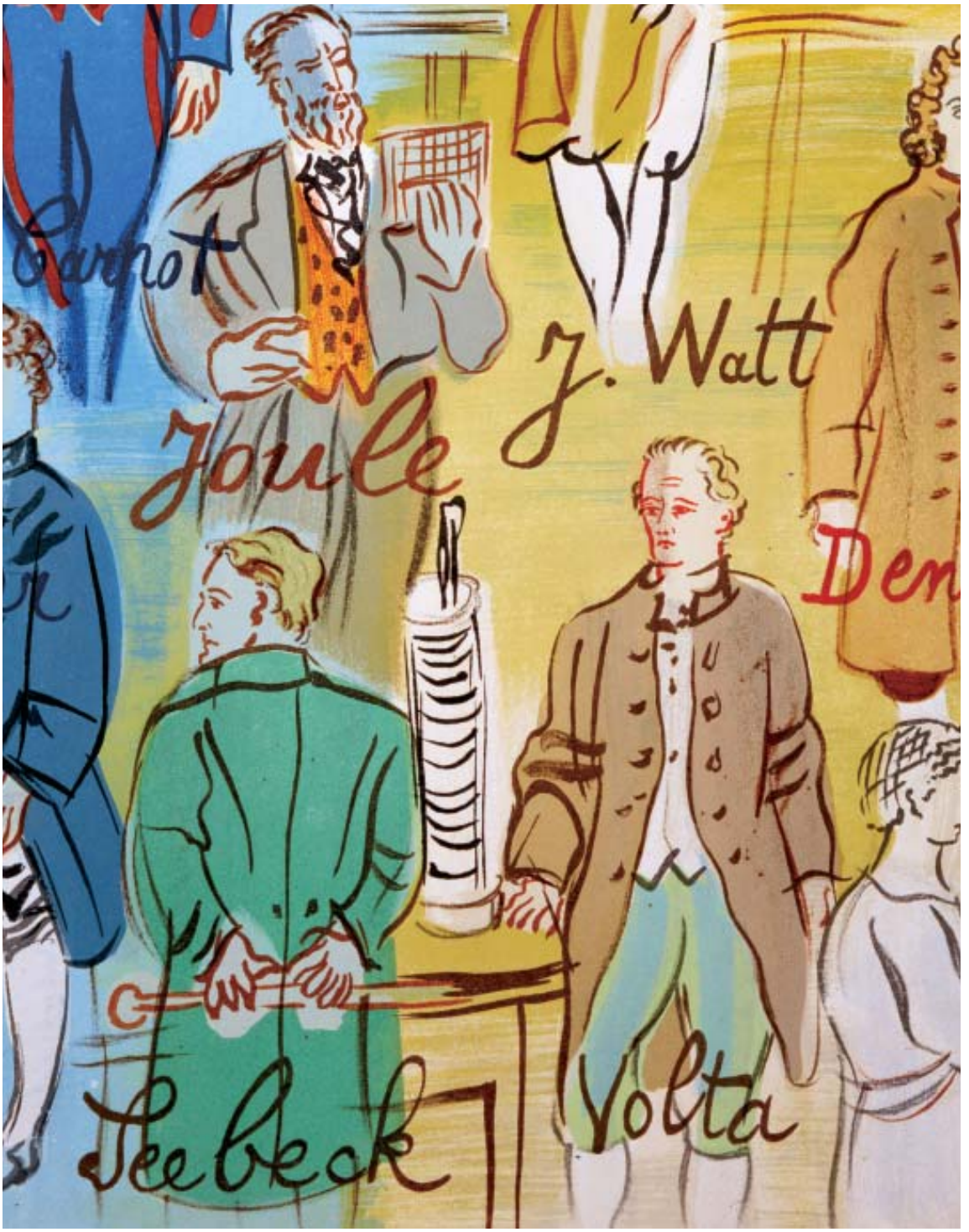

Hydro Québec

La Fée Électricité, Raoul Dufy

Hydro-Québec is proud to have *La Fée Électricité* (the electricity fairy) in its art collection. The painter Raoul Dufy produced this lithograph (10 panels, each measuring 1 m by 60 cm) in 1953 from the gigantic work he had created for the 1937 Exposition internationale in Paris.

This wall piece extols electricity and traces every stage of its history, from antiquity to the present. At the centre of the work, the gods of Olympus sit enthroned above a power station from which a huge spark is shooting out. There is a group of learned men on either side of this motif. They include Thales of Miletus, Archimedes and Aristotle, walking in the Sacred Wood. The work also depicts the first scientists who attempted to master the forces of nature, along with Faraday, Marie and Pierre Curie and others who were responsible for more recent discoveries.

The Power of Change

Joule, Watt, Volta … *La Fée Électricité* pays tribute to people who have had an impact on the history of electricity. At Hydro-Québec, men and women who are less well known, but no less determined, carry on the work of these inventors to advance that bright idea: electricity.

Since Hydro-Québec was created in 1944, much has been said about the ingenuity of some individuals, the physical toil of many others, and the desire of all to take on formidable challenges to bring power to all of Québec. The company's history has been marked by technical feats and world firsts: the building of the Manic-Outardes complex, the most ambitious project of its kind ever undertaken in Canada at the time; the construction of the La Grande complex in the James Bay region—"the project of the century"; the deployment of the world's first 735-kV line; and the development of the most extensive transmission system in North America. In addition to these enormous accomplishments, we must not forget the original ideas, both great and small, that have fueled our company's inventive spirit for 60 years.

Raoul Dufy, *La Fée Électricité*, 1953 © Raoul Dufy Estate / ADAGP (Paris) / SODRAC (Montréal) 2004

Hydro-Québec

is a major producer, transmission provider and distributor of electricity. It conducts research and promotional activities in the areas of energy and energy transformation and conservation, as well as all other energy-related fields. The Québec government is its sole shareholder.

In compliance with new industry rules, the company has separated its core operations into six autonomous divisions. It now competes freely with other power producers, while its transmission and distribution activities remain regulated.

Hydro-Québec Production
generates power and supplies Hydro-Québec Distribution with a heritage pool of electricity for the Québec market. It is also active on wholesale markets inside and outside Québec and carries out arbitrage and purchase/resale transactions.

Hydro-Québec TransÉnergie
operates the most extensive transmission system in North America and makes it available to customers inside and outside Québec. It is active abroad, especially in South America, where it operates transmission systems, markets its system management products and develops construction projects.

Hydro-Québec Distribution
is responsible for supplying Quebecers with electricity. In accordance with the *Act respecting the Régie de l'énergie,* the division has access to an annual heritage pool supplied by Hydro-Québec Production at a fixed price. To meet needs beyond this pool, Hydro-Québec Distribution issues calls for tenders from power producers, including Hydro-Québec Production.

Hydro-Québec Équipement
and Société d'énergie de la Baie James, a subsidiary of Hydro-Québec, are the prime contractors of construction projects for Hydro-Québec Production and Hydro-Québec TransÉnergie. They are known worldwide for their expertise, particularly in the areas of hydroelectric power generation and high-voltage transmission.

Hydro-Québec Technologie et développement industriel
is in charge of technological innovation, including research and technical support, industrial development of Hydro-Québec technologies and capital venturing.

Hydro-Québec Pétrole et gaz,
through Hydro-Québec's interest in Noverco, is active in the pipelining of natural gas, oil and liquid natural gas, and in natural gas distribution.

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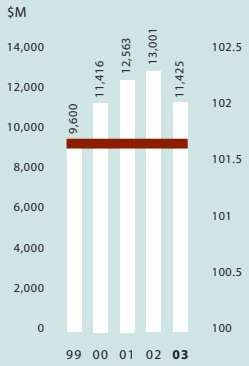
Financial Highlights

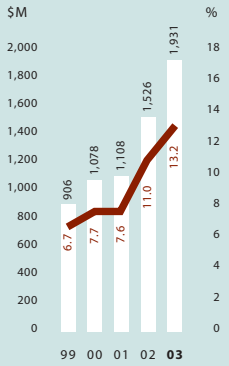
$M	2003	2002	Change (%)
Operations and dividends			
Revenue	**11,425**	13,001	(12)
Net income	**1,931**	1,526	27
Dividends	**965**	763	26
Balance sheet			
Total assets	**57,703**	59,098	(2)
Long-term debt, including current portion	**35,985**	39,664	(9)
Shareholder's equity	**15,127**	14,215	6
Cash flows			
Operating activities	**3,926**	3,866	2
Investing activities	**(2,473)**	(2,804)	(12)
Financing activities	**(1,550)**	(1,003)	55
Cash and cash equivalents at end of year	**191**	293	(35)
%			
Ratios			
Return on equity	**13.2**	11.0	2.2
Average cost of debt	**8.3**	8.4	(0.1)
Return on revenue	**16.9**	11.7	5.2
Capitalization	**29.9**	26.2	3.7
Self-financing	**53.9**	72.2	(18.3)

Sales and Average Rate Increase Index



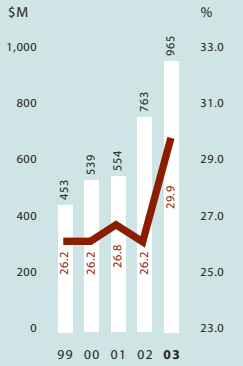
Sales totaled $11.4 billion, down 12.0% from 2002. This decrease stems from a large reduction in electricity trading outside Québec, due to strong growth in domestic demand and uncertainty in futures markets.

Net Income and Return on Equity[1]



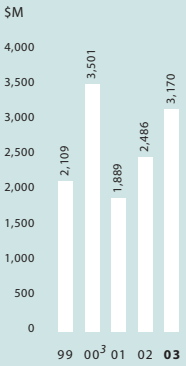
Net income rose to $1.9 billion, up $405 million over 2002. This increase can be attributed to lower financial expenses, as well as a reduction in depreciation, amortization and decommissioning charges, which had been higher in 2002 due to nonrecurring items.

Dividends Declared and Capitalization[1]



Dividends of $965 million, which corresponds to 50% of net income, were declared. This will be the seventh consecutive payment to our shareholder and the largest in our history. After the dividend payment, our capitalization rate will be 29.9%, thus exceeding the 25% threshold stipulated in the legislation.

Investments[2]



Cash from operations reached $3.9 billion and enabled us to finance $3.2 billion in investments, one of the largest capital outlays in the last ten years, as the year saw the resumption of our construction program. Our *Strategic Plan 2004–2008* provides for some $19 billion in investments over the next five years.

1. *Figures from 1999 to 2001 reflect reported data. The restated data are presented in Supplementary Information – Five-Year Review.*
2. *Excluding net change in short-term investments.*
3. *Including the acquisition of Transelec, the largest transmission provider in Chile, at a cost of $1.6 billion.*

Message from the Chairman of the Board and the President and Chief Executive Officer

Continuing Development

Hydro-Québec continued to grow in 2003. Consolidated net income totaled $1,931 million, up 26.5% over 2002.

The increase in net income stems largely from the reduction in financial expenses resulting from repayment of long-term debt and the appreciation of the Canadian dollar versus the U.S. dollar. The latter factor led to an exchange loss on U.S.-dollar-denominated transactions, which was offset by the corresponding reduction in financial expenses. Growth in net income was also driven by a decrease in depreciation, amortization and decommissioning expenditure, which had risen in 2002 due to nonrecurring items.

Sales in Québec showed a strong increase, spurred by a healthy economy. On markets outside Québec, optimized business transactions enabled Hydro-Québec Production to post substantial profits in spite of a lower export volume than the preceding year. The 4.0 TWh exported in 2003 generated a profit of $596 million; the year before, in comparison, exports of 12.6 TWh yielded $971 million.

Meeting Demand

In 2003, domestic consumption almost reached the level set aside as the heritage pool. Demand growth should average 1.3% per year between now and 2008, meaning that 177.5 TWh will then be required.

Additional supplies will consequently be necessary to fill short-term needs on the Québec market, and Hydro-Québec Distribution has already issued calls for tenders to meet demand. The division signed a contract in June with TransCanada Energy for the supply of 507 MW of electricity, starting in 2006, from a natural gas cogeneration plant to be built in Bécancour. Under the same call for tenders, it signed a contract with Hydro-Québec Production for the supply of 350 MW of baseload power and a further 250 MW of cycling power. These 20-year contracts have been approved by the Régie de l'énergie (Energy Board).

In May, Hydro-Québec Distribution also launched a call for tenders for 1,000 MW of electricity generated by wind turbines to be set up in the Gaspé Peninsula, the Magdalen Islands or the Matane area. Deliveries are scheduled to begin between December 1, 2006, and December 1, 2012. The division also retained three bids for the purchase of 74 MW of electricity generated by at least 75% biomass, starting in 2006–2007.

In addition to contributing to regional economies, the use of renewable energy sources will have positive environmental effects. In this regard, Hydro-Québec Distribution also launched a comprehensive energy efficiency plan designed to contain domestic demand growth and promote the efficient use of electricity. This plan, intended for all Hydro-Québec customers, targets 750 GWh in energy savings by 2006. It is based on an assessment of the residual potential for energy conservation in Québec, carried out in conjunction with the Agence de l'efficacité énergétique, and was approved by the Régie de l'énergie.

André Bourbeau
Chairman of the Board of Directors
André Caillé
President and Chief Executive Officer

Hydro-Québec Distribution also pursued its program of investment in its system in order to ensure reliability and long-term operability. It kept up its efforts to improve the services provided and adapt them to the needs of its different customers, by offering various tools to help customers better understand and manage their electricity consumption, for example.

To achieve the level of profitability authorized by the Régie de l'énergie, Hydro-Québec Distribution continued working to improve its efficiency and productivity, and maintained strict control over its costs. As well, it received the Régie's approval for a 3% rate increase effective January 2004.

A Collective Resource To Be Developed

Prompted by growth in Québec demand and the business opportunities afforded by external markets, Hydro-Québec Production plans to continue developing Québec's hydroelectric potential.

With the partial commissioning of Sainte-Marguerite-3 generating station, nearly 600 MW has been added to the system to meet market demand. The partial diversion of the Manouane River was completed in 2003, while work proceeded on Rocher-de-Grand-Mère, Eastmain-1 and Toulnustouc hydroelectric generating stations. Hydro-Québec Production is developing several other profitable hydropower projects, including Eastmain-1-A generating station and the partial diversion of the Rupert River, as well as Chute-Allard and Rapides-des-Cœurs generating stations. It also conducted technical studies on four hydroelectric developments with a total capacity of 1,500 MW on the Romaine River, in the Mingan region. At the same time, the division carried on its initiatives for refurbishing its facilities and improving their efficiency in order to increase the generating capacity of its fleet and ensure long-term operability.

With system rehabilitation and development projects totaling $3.2 billion during the year, Hydro-Québec once again acted as an economic lever, a role it had played in the 1980s, by creating jobs and generating substantial economic spinoffs throughout the province.

A Reliable Transmission System

Hydro-Québec TransÉnergie, for its part, pursued efforts to offer reliable service to power producers and wholesalers and to Québec distributors. The division already meets the highest North American industry standards, and provides extremely reliable transmission service. In 2003, it posted one of the best continuity indicators in its history.

During the year, Hydro-Québec TransÉnergie worked to bring the output from Hydro-Québec Production's new facilities onto its grid. Construction began on a line linking the new Toulnustouc generating station with Micoua substation and on a temporary line between Muskeg substation and the Eastmain workcamp. Reconstruction of the 120-kV Les Cèdres–Cornwall line, which belongs to Cedars Rapids Transmission Co., also got under way. The project will increase capacity on this part of the system.

With the commissioning of the Des Cantons–Hertel line, Hydro-Québec TransÉnergie completed most of the loop linking up the most vulnerable transmission lines, thereby increasing the security of Québec's power supply in the event of extreme weather. Our ability to maintain service throughout the province during the blackout that struck Ontario and the U.S. Northeast in summer 2003 shows the soundness of the investments made in recent years to strengthen the transmission system and assure Quebecers of reliable service.

Hydro-Québec TransÉnergie also kept up its international operations. In South America, it continued its activities in Peru and increased its presence in Chile by purchasing the assets of the country's northern transmission system. A new major partner—the International Finance Corporation, the World Bank Group member in charge of promoting private sector investments—injected US$60 million (C$87 million) into Transelec, Hydro-Québec's Chilean subsidiary. Hydro-Québec International also signed an agreement with Alusa, one of the largest private transmission providers in Brazil. The object of this alliance is to propose a new approach to the Brazilian government for accelerating the electrification of rural areas. The two partners have designed a system for the Brazilian market that allows power to be distributed directly from transmission lines. Last August, U.S. authorities gave Hydro-Québec TransÉnergie provisional authorization to operate the Cross Sound Cable, an underwater link it built between Long Island, N.Y., and Connecticut. As well, the division continued to operate the interconnections in Australia that are partly owned by Hydro-Québec International.

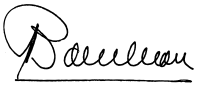
An Efficient Organization

Hydro-Québec continued modernizing its organizational structure. The divisions and some administrative units were assigned additional responsibilities, especially in control and strategic planning of their operations. Increasingly autonomous and accountable, they are all profit centres that play a critical role in the company's growth. A new division, Hydro-Québec Technologie et développement industriel, was established to ensure integrated management of technological innovation. Its mission includes working with the other divisions to develop new R&D avenues in energy efficiency in order to support the company's efforts in this field.

Finally, Hydro-Québec filed its *Strategic Plan 2004–2008* with the Québec government. We firmly believe that we can achieve the Plan's growth objectives because we are able to count on competent employees able to meet the many challenges posed by the company's rapid growth in a constantly changing environment. We signed collective agreements for the next five years with unions representing 80% of our unionized personnel. The fact that this was accomplished in a harmonious atmosphere and nine months before the current agreements expire attests to the shared desire to be involved in the development of a company of which we are all very proud. We thank all our employees for the professionalism they demonstrate daily, as well as for the confidence they show us and the support they provide.

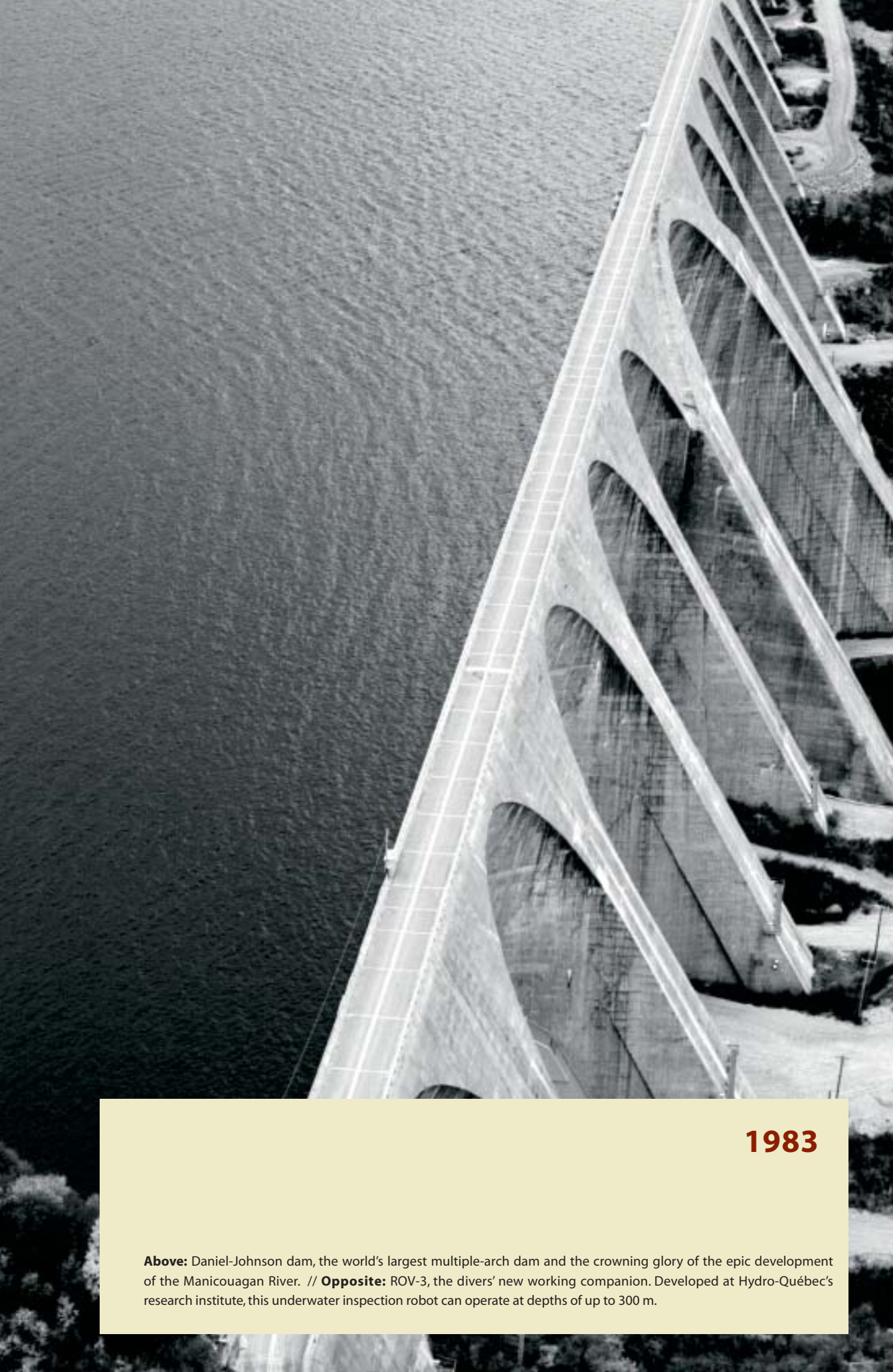
We are also grateful to the members of the Board of Directors for their support and loyal commitment to the company. The range of expertise each one offers plays a large part in expanding our horizons. We wish to thank outgoing Board members Pierre Bourgie, Vice Chairman of the Board for several years, Pierre Grand'Maison and Claude Munger. Our very special appreciation goes to Jacques Laurent for his contribution, as Chairman of the Board, to the company's development and the smooth running of the Board of Directors for the last two years. We welcome Gaston Blackburn and Louis Lagassé, who joined the Board during the past year.

At the end of 2003, we are proud to point out that Hydro-Québec, through its combined assets and the scope of its operations, remains one of the largest corporations in Québec. All of us together have contributed to its development, in terms of organization as well as accomplishments and results. We are determined to carry on our efforts to maintain its upward progress in order to continue supporting the Québec economy and create the wealth that benefits Québec society as a whole.



André Bourbeau
Chairman of the Board of Directors

André Caillé
President and Chief Executive Officer



1983

Above: Daniel-Johnson dam, the world's largest multiple-arch dam and the crowning glory of the epic development of the Manicouagan River. // **Opposite:** ROV-3, the divers' new working companion. Developed at Hydro-Québec's research institute, this underwater inspection robot can operate at depths of up to 300 m.

Are our facilities in good condition? Are they reliable and efficient? Every year, our generating fleet undergoes a complete checkup. To inspect submerged structures, operators of hydroelectric developments can now use an underwater robot, ROV-3. Robot inspection is rapid and safe, so generating units can be restored to service faster.

Hydro-Québec Production

Investing in Québec to Benefit from Market Growth

Hydro-Québec Production generates electricity and sells it on wholesale markets both inside and outside Québec.

For the Québec market, Hydro-Québec Production supplies Hydro-Québec Distribution with a heritage pool of up to 165 TWh of electricity per year, at a fixed price of 2.79 cents per kilowatthour. Beyond this volume, it competes freely in response to Hydro-Québec Distribution's calls for tenders. Under an initial call issued in 2002, it signed an agreement with Hydro-Québec Distribution to supply an additional 600 MW over a 20-year period starting in March 2007.

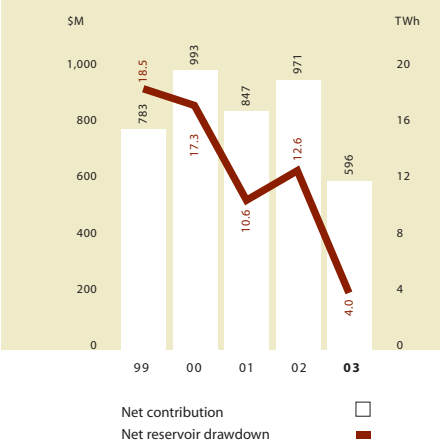
Hydro-Québec Production is also present on markets outside Québec. It operates its generating stations and reservoirs so as to import electricity when prices are low and export it when prices are higher. It also conducts profitable arbitrage and purchase/resale transactions on markets outside Québec.

The division sells the output from 51 hydroelectric generating stations, 5 thermal generating stations, 1 of them nuclear, and 1 wind farm, for a total installed capacity of 33,473 MW. As well, it has access to most of the generation from Churchill Falls power plant in Labrador, which has an installed capacity of 5,428 MW. Its hydroelectric developments include 25 large reservoirs, with a storage capacity of 172 TWh, and more than 560 dams and control structures. Its assets total $25.2 billion.

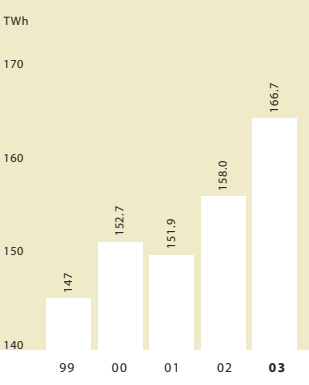
Rapid growth in electricity demand, in Québec in particular, has prompted the division to increase its generating capacity. To benefit from market growth, it plans mainly to commission new hydroelectric generating stations in Québec.

Hydro-Québec Production also makes the most of its expertise on the international scene—in Central America, China and Central Europe—through technical services contracts.

Net Electricity Exports



Electricity Sales to Hydro-Québec Distribution



Thierry Vandal
President, Hydro-Québec Production and Hydro-Québec Pétrole et gaz

Fixed assets as at December 31, 2003	$24.3 billion
Revenue in 2003	$6.1 billion
Net income in 2003	$1,741 million
Customers in 2003 (% of revenue)	
Hydro-Québec Distribution and other internal customers	75%
Other wholesale markets	24%
International market	1%
Total workforce as at December 31, 2003	3,549 employees
Regulatory regime	Heritage pool electricity (maximum volume of 165 TWh per year) at a fixed rate for Hydro-Québec Distribution Above that volume and outside Québec: free competition

Wholesale Markets

In 2003, because of strong growth in electricity demand in Québec, heritage pool deliveries to Hydro-Québec Distribution rose 5.5%. This in turn meant a considerable decline in net exports to markets outside Québec. Nevertheless, through optimized wholesaling operations and accurate market forecasts, Hydro-Québec Production once again recorded sizable profits from external markets. Exports brought in a net contribution of $596 million for a net reservoir drawdown of 4.0 TWh, compared with $971 million for 12.6 TWh in 2002.

- Deliveries to Hydro-Québec Distribution grew 5.5% to 166.7 TWh, up from 158.0 TWh in 2002, including 164.95 TWh of heritage electricity at a fixed price of 2.79 cents per kilowatthour. The maximum heritage pool volume was therefore almost reached in 2003. Revenue from sales to Hydro-Québec Distribution totaled $4.5 billion.
- The volume of net exports declined nearly 70% from 2002, due to the large increase in deliveries on the Québec market.
- A historical peak of 36,268 MW was reached on January 15, 2004, at 5:30 p.m.

Hydro-Québec Production manages its reservoirs in such a way as to maintain enough energy reserve at all times to offset a potential runoff deficit of 64 TWh over two consecutive years. It also maintains sufficient capacity reserve, representing approximately 10% of demand under its contracts, in compliance with the industry's current reliability criteria.

Generating Facility Operations

Hydro-Québec Production operates and maintains its generating assets with a view to optimizing their efficiency, ensuring long-term operability and guaranteeing a reliable power supply to its customers. It invests large amounts every year in refurbishing and refitting its facilities. In 2003, $380 million was allocated to this work.

Since 1990, the division has added some 4.2 TWh to the productivity of its assets, largely through the scheduled replacement of generating units at a number of power stations and careful management of energy-capable spillages.

- Phase two of the $179-million rehabilitation of La Tuque generating station got under way. Three generating units will be replaced, increasing installed capacity by about 51 MW to reach 271 MW.
- Rehabilitation continued on the dam, spillway and generating station at Rapides-des-Quinze in order to ensure the long-term operability of these structures, some of which date back to 1923.
- Work began on replacing alternators and refurbishing intakes at Rapide-2 and Rapide-7 generating stations.
- At Bersimis-1, ongoing rehabilitation focused mainly on the generating units, station service, the control building and the intake and spillway civil works.
- Refitting work and generating unit overhaul continued at Outardes-3. This $143-million project will add approximately 254 MW to the station's installed capacity, bringing it to 1,010 MW.
- Refurbishing and refitting began at Outardes-4 generating station, where the installed capacity will increase by 56 MW to reach 686 MW, at an estimated cost of $141 million. Replacing the four turbines will optimize the overall output from the three power plants on the Rivière aux Outardes.
- Major rehabilitation continued at Beauharnois generating station with a view to extending the life of this plant, the fifth-largest in Québec.
- Rehabilitation work continued on Coteau-1, Coteau-3, Île-Juillet-1 and Île-Juillet-2 dams, upstream from Les Cèdres generating station.
- Refurbishing of Rivière-des-Prairies generating station got under way.
- The Canadian Nuclear Safety Commission renewed the operating permit for the waste management facility at Gentilly-2 nuclear generating station, without restriction, until December 2009.
- Technical studies for a major rehabilitation of Gentilly-2 continued. This project would extend the useful life of the 675-MW plant until 2035.
- The environmental impact assessment also continued on the project to expand the radioactive waste storage area.
- The measures introduced by the *Dam Safety Act* were applied.

Development Projects

Given the growth in electricity demand on all its markets, Hydro-Québec Production plans to continue and, to the extent possible, accelerate development of Québec's cost-effective hydroelectric potential.

Capital spending on construction and draft design studies for major new hydropower developments totaled $1.1 billion in 2003, a level not seen since the early 1990s.

Hydro-Québec Production continues to favor hydroelectric generation. New developments must meet the requirements of profitability, favorable reception by local communities and respect for the environment.

Projects under Construction

- Work continued on the 480-MW Eastmain-1 hydroelectric development, which is covered by the *Nadoshtin Agreement* with the Québec Crees. The project will cost an estimated $2.1 billion for the generating facilities alone. At the peak of construction, some 1,300 people were working on the site.
- Construction continued on a 526-MW hydroelectric development on the Toulnustouc River. The generating facilities are expected to cost $900 million and to start up operations in 2005. At the peak, some 1,500 people were employed on the site.
- Work proceeded on the $454-million Rocher-de-Grand-Mère generating station. The plant's installed capacity will be 220 MW, or 70 MW more than Grand-Mère generating station. Commissioning is scheduled for 2004.
- With the partial commissioning of the Sainte-Marguerite-3 hydropower development, close to 600 MW was added to the system in time for the 2003–2004 winter peak in demand. This generating station, which will have an installed capacity of 882 MW, provided a total output of 0.9 TWh in 2003.
- Construction began on a $120-million, 51-MW surface generating station at Mercier dam designed to harness the hydroelectric potential of Baskatong reservoir.
- The partial diversion of the Manouane River to the Bersimis complex was completed and went into operation. The $75-million project will increase net energy output by 0.3 TWh.

Opposite: Generation Optimization Centre. // Dam safety: our expertise is acknowledged worldwide. // Grand-Mère and Rocher-de-Grand-Mère generating stations. // Employees ready to meet the challenge.

Projects Awaiting Authorization

- The impact assessment continued for Eastmain-1-A generating station and the Rupert diversion. This $2.8-billion project will add 770 MW to installed capacity and increase annual output by nearly 7.7 TWh. It is covered by the *Boumhounan Agreement* with the Québec Crees. Construction should begin in 2006.
- The *Manitukapatakan Agreement* was signed with the Montagnais of Lac-Saint-Jean, and parallel agreements were reached with the Fjord-du-Saguenay and Maria-Chapdelaine regional county municipalities. Public hearings were held on the $1.1-billion project for a 385-MW hydroelectric generating station on the Péribonka River. Construction of this facility, which will produce 2.2 TWh per year, should commence in spring 2004.
- The impact assessment continued for the development of two new hydroelectric generating stations with a total capacity of around 127 MW at Chute Allard and Rapides des Cœurs in the upper Saint-Maurice region.
- Government approval was requested for the proposed 836-MW Suroît combined-cycle gas-fired generating station.

Technological Innovation

Hydro-Québec Production strives to improve the performance of its generating facilities, ensure their safety and long-term operability, and reduce their operating costs and the lead time involved in planning and building new projects through its research and development activities. In 2003, $27 million was allocated to technological innovation.

- Installation of the MATH hydraulic turbine analysis model was completed at La Grande-3 generating station and got under way at Manic-3. With this technology, the average output of the generating units at La Grande-3 improved by 1.1%.
- Performance tests were conducted on the ROV-3 underwater robot developed to inspect submerged structures. Its use improves diver safety, reduces inspection time and increases generating unit availability.
- Work continued on the development of diagnostic and maintenance tools for Gentilly-2 nuclear generating station.

Environment

Backed by more than 30 years' experience conducting environmental studies for hydropower developments, Hydro-Québec Production works to preserve the natural surroundings of sites where it builds or operates generating facilities, and to mitigate any impacts its activities have on the natural environment.

- ISO 14001 registration was maintained, for the third year in a row, for the environmental management system in the Generating Facilities Operation Department, without any concessions needed.
- The use of ozone-depleting substances (ODSs) was reduced through the elimination of all portable halon extinguishers and the replacement of equipment that contains chlorofluorocarbons (CFCs).
- The fishways at Chambly and Rivière-des-Prairies dams were improved.
- The fishway at Beauharnois dam was used by 60,000 eels during migration season, a substantial increase over 2002.
- Ongoing awareness and training sessions were provided for employees, enabling them to hone their environmental skills.

97% of our output is hydroelectric, resulting in lower atmospheric emissions throughout northeastern North America. From 1992 to 2000, our electricity exports helped avoid some 130 million metric tons of greenhouse gas emissions.

Human Resources

To continue moving forward in a competitive, changing business environment, Hydro-Québec Production counts on the competence, autonomy and motivation of its employees.

- The work-related accident frequency rate decreased from 4.65 in 2002 to 4.53 in 2003.
- An agreement was signed with technicians and clerical employees in the James Bay territory allowing recruitment from local labor markets and giving priority to hiring James Bay Crees.
- The overall employee motivation index held steady at 6.58 in 2003, compared with 6.61 in 2002.

International Activities

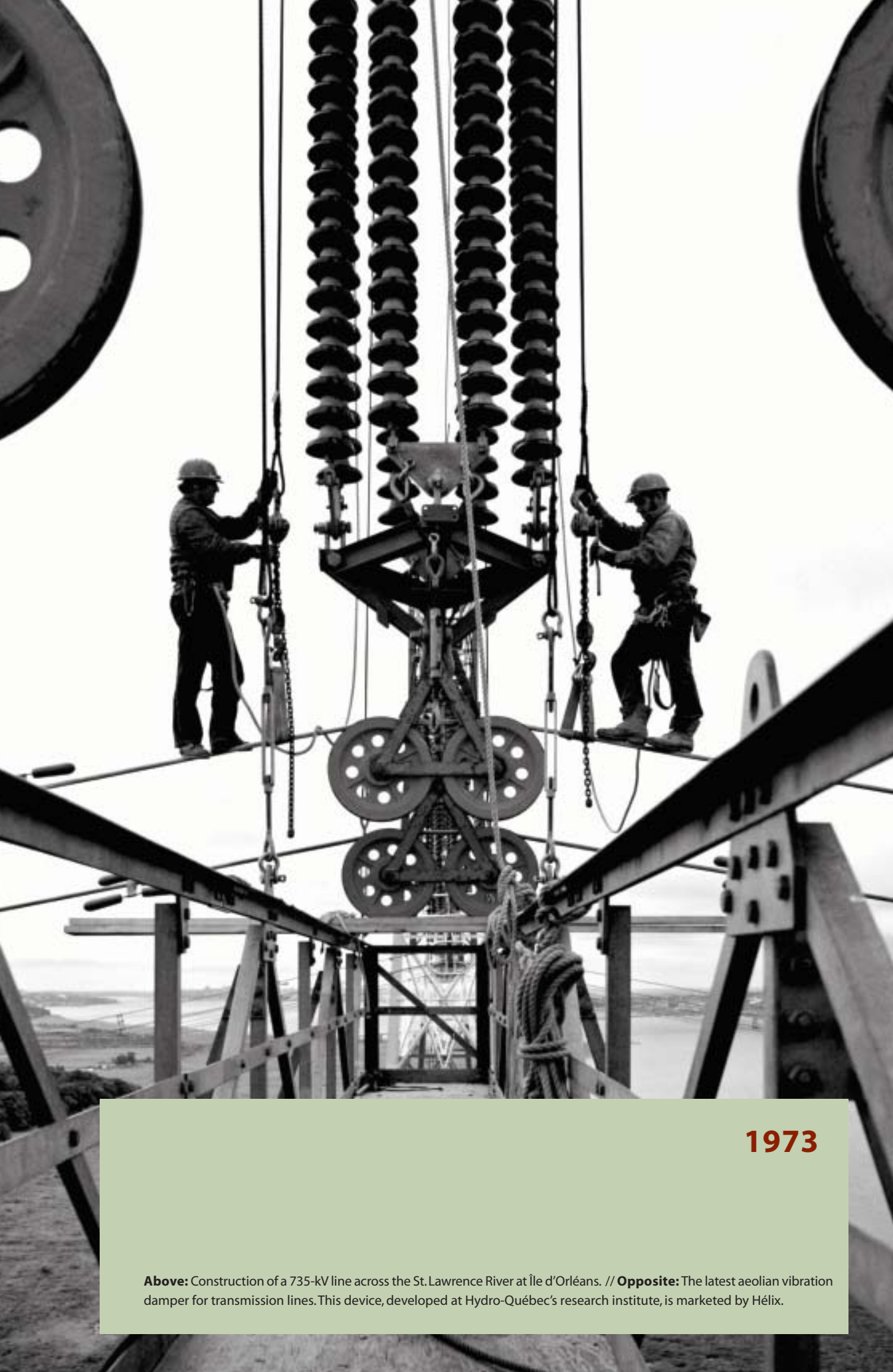
Hydro-Québec Production has interests in companies that generate electricity in China, Panama and Costa Rica. In addition, it offers professional services in the area of hydropower generation. In 2003, these activities generated $13.4 million in income, including $4.6 million for nonrecurring activities.

- In Poland, work began under a $20-million contract for the installation of hydrological and meteorological stations all across the country.

Hydro-Québec Pétrole et gaz

Hydro-Québec Pétrole et gaz continued operations in its two areas of activity. In the pipelining and distribution of natural gas, it recorded net income of $51 million resulting from Hydro-Québec's interest in Noverco, the holding company that owns Gaz Métro, the main distributor of natural gas in Québec. In oil and gas exploration, the division proceeded with the program begun in Québec in 2002.

- In the Gaspé Peninsula, the Galt 2 well was completed and the Galt 3 well was drilled, in partnership with Junex. Hydro-Québec's share of this work amounted to $1.3 million in 2003. The two wells are under evaluation.
- Seismic surveys were carried out on Anticosti Island and at Restigouche, at a cost of $4.8 million and $0.7 million, respectively. The data are currently being interpreted.
- An agreement was signed with Corridor Resources, which holds a Québec permit covering the geological structure known as Old Harry. Once the necessary approvals have been granted and the rights established, the division plans to explore this structure, which lies in the Gulf of St. Lawrence between the Magdalen Islands and Newfoundland and Labrador.



1973

Above: Construction of a 735-kV line across the St. Lawrence River at Île d'Orléans. // **Opposite:** The latest aeolian vibration damper for transmission lines. This device, developed at Hydro-Québec's research institute, is marketed by Hélix.

2003

Transmitting electricity hundreds of kilometres, under difficult weather conditions, in order to light every corner of Québec and brighten people's lives, takes brilliant people with nerves of steel. They have built reliable, efficient transmission and telecommunications networks that meet our customers' demands. Thanks to the commitment of our team, we now rank among North America's leading transmission providers.

Hydro-Québec TransÉnergie

Optimizing System Capacity in Québec and Beyond

Hydro-Québec TransÉnergie is a leader in transmission system design, operation and maintenance. It operates the most extensive transmission system in North America, with 32,539 km of lines, 18 interconnections allowing power interchange between Québec and the systems in Labrador, New Brunswick, Ontario and the U.S. Northeast, and more than 500 transmission substations. The division's fixed assets in Québec total $15.3 billion.

To take advantage of new business opportunities resulting from the opening up of the American wholesale market, Hydro-Québec unbundled its operations in 1997 and created Hydro-Québec TransÉnergie. In accordance with North American regulatory provisions, this division offers non-discriminatory access to Québec's transmission system to all customers on the wholesale market in northeastern North America. It also makes its interconnections available to customers both inside and outside Québec.

The capacity available on the Hydro-Québec TransÉnergie system is posted on the OASIS (Open Access Same-Time Information System) website. Hydro-Québec TransÉnergie has all the features of a Regional Transmission Organization, or RTO, as defined by the Federal Energy Regulatory Commission (FERC): exclusive authority for maintaining the reliability and security of Québec's asynchronous system and operating its facilities; size of load (over 36,000 MW at peak periods) and geographic scope; same tariff throughout the system; and independence with respect to Hydro-Québec's other activities.

In Québec, the division's operations are regulated by the Régie de l'énergie on the basis of cost of service. Both its rates and its capital projects must be approved by the Régie.

Hydro-Québec TransÉnergie plays an active part in the organizations that regulate the North American power industry: the Northeast Power Coordinating Council (NPCC) and the North American Electric Reliability Council (NERC).

The division also manages Hydro-Québec's telecommunications network, of which it is the largest user.

Opposite: The new Des Cantons–Hertel line. // New capacitors at Bergeronnes. // Variable-frequency transformer at Langlois—a world first.

Yves Filion
President, Hydro-Québec TransÉnergie

Fixed assets as at December 31, 2003	$17.3 billion
Revenue in 2003	$3.0 billion
Net income in 2003	$397 million
Customers in 2003 (% of revenue)	
Hydro-Québec Distribution	78%
Hydro-Québec Production	6%
International market	7%
Other	9%
Total workforce as at December 31, 2003	3,717 employees
Regulatory regime	Cost-based

Hydro-Québec TransÉnergie carefully maintains its facilities to ensure system reliability, efficiency and security.

Development in Québec

In 1999, Hydro-Québec TransÉnergie undertook major projects to ensure a more robust transmission system.

The division is responsible for large-power customers' connections to the bulk system. It also carries out work to bring new Hydro-Québec Production facilities onto the grid, as well as other power producers who wish to be connected.

- The line connecting Sainte-Marguerite-3 generating station to Arnaud substation was commissioned.
- Construction got under way on a 55.7-km, 315-kV line linking the Toulnustouc jobsite to Micoua substation.
- Work commenced on a 42-km, 69-kV temporary line between Muskeg substation and the Eastmain workcamp.
- Work also began on a 208-km, 69-kV line connecting Nemiscau substation and the future Waskaganish substation.
- A 145-km, 735-kV line between Des Cantons and Hertel substations was commissioned. This line increases security of the power supply to the Montérégie region, part of Montréal's South Shore and a large portion of the downtown and western boroughs. It will also secure the power supply to the Eastern Townships in case of emergency.
- A 72-km line, operated at 120 kV, was built for Cedars Rapids Transmission Co. between Les Cèdres, in Québec, and Cornwall, Ontario, to replace a line that was nearly a hundred years old.
- The number of series capacitors at Bergeronnes substation was increased to enhance the capacity of the three 735-kV lines running from Manicouagan substation to Lévis substation and to bring the new turbines at Outardes-3 generating station onto the grid. This project will also connect Toulnustouc generating station to Bergeronnes substation.
- A new automatic control system for remote undervoltage load shedding went into operation. The system is designed to prevent any voltage collapse on the 735-kV lines in the area around Montréal. It will increase transmission capacity to the region by about 1,000 MW in case of emergency.
- A new type of converter was tested at Langlois substation in different operating modes. It makes use of VFT technology (variable-frequency transformer), which facilitates two-way interchanges across our asynchronous system boundaries with Ontario and the United States.

- The process of replacing the system operations software began. This undertaking is intended to ensure long-term facility operability and improve switching and operational flexibility at seven telecontrol centres on the transmission system.
- The backup system at the Telecom Control Centre (TCC) was put into service. The system steps in to maintain supervisory control of the telecommunications network if the TCC is partially or totally destroyed.

Maintenance and Refurbishing

- Construction continued on two new control buildings at Boucherville substation. The facility will be equipped with ALCID, a system that manages automatic local controls and distributed-intelligence system control, and the static and electromechanical protection relays will be replaced by digital relays.
- The gross number of hours of service interruption was kept below the target of 0.65 hours per customer (excluding Hydro-Québec Distribution), with an average of 0.44 hours in 2003.
- The first circuit of a double-circuit 120-kV line was commissioned. This line, which runs on steel towers in the existing right-of-way between Dorion and Les Cèdres substations, will improve the performance of the 120-kV system that serves the Vaudreuil-Soulanges region.
- At Duvernay substation, refurbishing was carried out on a synchronous condenser, which supplies reactive power for regulating voltage on the system.
- Refurbishing continued at Central substation in order to increase supply capacity for the Montréal region.

International Development

Hydro-Québec TransÉnergie markets its power system management services and technology products internationally. It also develops construction projects and acquires transmission assets abroad.

From line route design to the establishment of strategic criteria and management of entire systems, Hydro-Québec TransÉnergie possesses advanced technology that has proven its worth.

Its international activities are concentrated in South America, the United States and Australia.

Opposite: New control buildings at Boucherville substation. // Hydro-Québec in Chile. // Using steam jets to de-ice transmission lines.

South America

- Hydro-Québec TransÉnergie owns, operates and maintains a transmission line, substations and an interconnection in the Peruvian Andes linking the country's north and south. The facilities, which it designed, were built by Société d'énergie de la Baie James.
- As majority shareholder, the division operates the transmission assets of HQI Transelec Chile S.A. (Transelec).
- Transelec purchased 958 km of lines from Sistema Interconectado del Norte Grande (SING), the northern section of the Chilean transmission system. With this nearly US$107-million (C$140-million) transaction, Hydro-Québec International now operates 8,234 km of transmission lines in Chile.
- An agreement was signed with Alusa, one of the largest private transmission providers in Brazil. The object of this alliance is to propose a new approach to the Brazilian government for accelerating the electrification of rural areas. The two partners have designed a system for the Brazilian market that allows power to be distributed directly from transmission lines.

United States

- The Cross Sound Cable was temporarily brought into service, in compliance with a directive of the U.S. Department of Energy. This underwater line links southwestern Connecticut and Long Island, N.Y.

Australia

- The division continued operating the 180-MW interconnection linking the states of New South Wales and Queensland. This project was developed by TransÉnergie U.S., in partnership with Hydro-Québec International and North Power.
- It also continued operating MurrayLink, a 180-km, 220-MW interconnection that links the states of Victoria and South Australia and supplies the southern part of the country.
- The MurrayLink interconnection achieved the status of regulated line. As a result of this decision by the local authority, its revenue is now regulated.

China

- A contract worth over $3 million was signed for the sale of real-time simulation tools to the China Electric Power Research Institute (CEPRI).

Technological Innovation

Tailored to suit customer requirements, the technological innovations developed by Hydro-Québec TransÉnergie make the most of the company's transmission expertise. Special control systems that manage the power system and safeguard it against disturbances caused by supply/load imbalances are among the division's innovations.

The greatest challenge Hydro-Québec TransÉnergie faces is maintaining the exceptional reliability of its transmission system.

In addition to offering enhanced flexibility, ease of use and performance, these new developments lead to time savings, productivity gains, improved skills and optimized use of transmission facilities.

To preserve its technological edge, Hydro-Québec TransÉnergie kept up its investments in research and development in 2003.

- In cooperation with Hydro-Québec's research institute, the division designed a new de-icing technique that uses steam jets on live lines of up to 330 kV. An industrial version is being developed.
- A revised version of the ElectroMagnetic Transients Program (EMTP-RV) software, with a fully redesigned graphic interface, was launched. This program enables real-time analysis of transient electromagnetic phenomena.
- Prototypes were developed in conjunction with the research institute to replace cooling system tubes and resistors in the strategic modules that keep converter units running smoothly.

Environment

In managing its facilities, Hydro-Québec TransÉnergie takes care to preserve the natural surroundings and people's living environment. This care is illustrated in the division's decision-making processes as well as its day-to-day operations.

- ISO 14001 registration was maintained for Hydro-Québec TransÉnergie's environmental management system.
- Safe herbicides were used to control vegetation in line rights-of-way and switchyards and around telecommunications facilities.

Human Resources

Hydro-Québec TransÉnergie counts on the expertise and motivation of its personnel to move ahead in its sphere of activity.

- The division's specialized shops and its Technical Skills Management Support unit obtained ISO 9001:2000 certification. To earn this certification, an administrative unit must demonstrate that it can consistently supply products that meet its customers' requirements.
- ISO/IEC 17025 (International Electrotechnical Commission) certification was maintained by the electrical maintenance centre (Trois-Rivières) and Jeanne-d'Arc (Montréal) laboratories.

1965

Above: A meter reader at work. // **Opposite:** New device for meter readers. It can be used as a hand-held computer for inputting meter readings, or can download readings automatically from some 100,000 meters equipped with special radiofrequency modules.

For decades, meters on customers' premises have measured electricity use. Our employees make sure that billing is accurate and based on actual consumption. We have 470 meter readers, who work with sturdy, ergonomic, hand-held computers equipped with high-performance software.

Hydro-Québec Distribution

Supply Quebecers with Electricity and Customized Services

Hydro-Québec Distribution supplies domestic markets with electricity and ensures the reliability of the distribution system in order to meet the demand at all times.

To fulfill this mission, Hydro-Québec Distribution has access to a heritage pool of 165 TWh of electricity per year, which Hydro-Québec Production is obliged to supply. To fill needs beyond this volume, the division issues calls for tenders from power producers. Every three years, it must file an Electricity Supply Plan with the Régie de l'énergie presenting the native load forecast for the next 10 years and stating how it plans to maintain a balance between supply and demand. According to the *Strategic Plan 2004–2008,* growth in demand over the next five years should average 1.3% per year, after energy efficiency initiatives are factored in.

Since the early 1960s, the company has encouraged its customers to make more efficient use of electricity. Hydro-Québec Distribution renewed its energy efficiency commitment in 2003 by launching a comprehensive energy efficiency plan that targets savings of at least 750 GWh by the end of 2006. This plan includes 16 programs intended for various customers, three of which are being implemented in conjunction with the Agence de l'efficacité énergétique.

In Québec, Hydro-Québec Distribution's operations are regulated by the Régie de l'énergie on a cost-of-service basis. The regulatory principles, the method used to determine the cost of service for the various customer categories, the division's rate of return and electricity rates in Québec must all be approved by the Régie.

Hydro-Québec Distribution consults and surveys its customers regularly in order to offer them high-quality services that meet their expectations. It expends considerable efforts to maintain and improve service continuity, for example. In 2003, the adjusted[1] and gross average number of hours of service interruption per customer totaled 2.10 and 3.22, respectively; these figures are comparable to the 2.05 and 3.30 hours posted in 2002.

Hydro-Québec Distribution continuously strives to improve its services, in such areas as the handling of requests as well as support related to account management and energy use, and adapt them to the needs of its different customer categories. Thanks to these efforts, customer satisfaction has remained stable.

After a rate freeze in effect since May 1998, the Régie approved a 3% rate increase effective January 1, 2004. Hydro-Québec Distribution aims to continue offering its customers good value for money by limiting its future rate hikes. To do so, the division has frozen its operating expenses and will keep them at their budgeted 2003 level until 2006.

1. Not including exceptional weather events.

Opposite: During Hurricane Isabel in the summer of 2003, Hydro-Québec sent about 130 employees to help restore service in New Jersey, Virginia and Pennsylvania. // Housing starts are on the rise in Québec. // The Call Centre received the "Flèche d'or" award.

André Boulanger
President, Hydro-Québec Distribution

Fixed assets as at December 31, 2003	$8.1 billion
Revenue in 2003	$8.7 billion
Net loss in 2003	$133 million
Customers in 2003 (% of revenue)	
Markets subject to the Rates Bylaw	93%
Individual contracts	6%
Unregulated	1%
Total workforce as at December 31, 2003	7,659 employees
Regulatory regime	Cost-based

Supply

- Three supply contracts were signed under an initial call for tenders issued in 2002, at an average cost of 6.1 cents per kilowatthour, including transmission. Beginning in 2007, Hydro-Québec Production will deliver 350 MW of baseload power produced by La Grande-2 generating station and 250 MW of cycling power from La Grande-1. Effective September 2006, TransCanada Energy will supply 507 MW of electricity produced by a natural gas cogeneration plant to be built in Bécancour.
- Following a call for tenders, bidders were selected for the purchase of 74 MW of electricity generated in Québec by at least 75% biomass feedstock and deliverable starting in 2006–2007 at an average cost of 6.9 cents per kilowatthour.
- A call for tenders was issued for the purchase of 1,000 MW of wind power. Deliveries are to begin in 2006 and to reach 1,000 MW in 2012.
- The Régie de l'énergie approved the rate provisions applicable to the interruptible electricity program, which large-power customers may join on a voluntary basis to allow the division to handle extreme weather events or supply problems during peak periods.
- The second progress report on the Electricity Supply Plan 2002–2011 was submitted to the Régie de l'énergie.

Customer Services

Hydro-Québec Distribution offers its customers high-quality service that meets their expectations, as evidenced by the high level of customer satisfaction. In the past several years, the division has made sustained efforts to continuously improve the reliability of its customers' power supply and develop new products and services. It has also designed various tools to help its customers understand and manage their electricity consumption better.

Residential Customers

- The residential customer satisfaction index remained at 7.4 out of 10.
- Sales volume in the residential and farm category grew 7.5% as a result of the strong home construction market and colder temperatures than the previous year.
- The number of residential customers electing to receive or pay their electricity bills online rose significantly to nearly 84,000 at the end of 2003, compared with 53,500 at the end of 2002.
- The Call Centre was awarded the Flèche d'or by the Association du marketing direct et de la relation clientèle for its employee committees set up to find solutions to work-related problems.

Business and Commercial Customers

- The satisfaction index for business customers held steady at 7.3 out of 10 in 2003. However, after rising considerably in 2002, the satisfaction index for commercial customers fell back to the level recorded in 2001, that is, 7.4 out of 10.
- Sales volume grew 3.6% as a result of colder temperatures than the year before, vigorous economic activity, especially in the construction and service industries, and the improved competitiveness of electricity relative to other energy sources.
- Under a new service, customers receive an Account Review, which provides an overview of annual billing for all their accounts, along with suggestions for improvements.
- Some new services were gradually introduced for customers with remote-metering equipment, including the ability to choose their meter-reading and billing dates, and various options for grouping multiple accounts. Altogether, 16,500 such meters were installed as at the end of 2003.
- Visilec, an optional, paid information service, was launched. Business customers equipped with networked meters now have access to their consumption data as recorded at 15-minute intervals.

Large-Power Customers (5 MW or more)

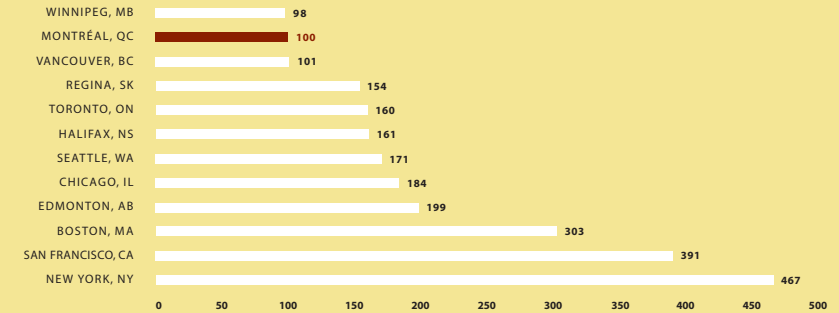
- Large-power customer satisfaction improved from 8.9 out of 10 in 2002 to 9.0 in 2003.
- The volume of large-power sales grew 5.2%, mainly in the aluminum, pulp and paper, and chemical industries, due to favorable business conditions.
- The division held 194 quality partnership sessions.
- It also continued helping customers improve their electricity-based industrial processes and providing consulting services in this area.
- Two programs for large-power customers were set up under the Energy Efficiency Plan 2003–2006: the Industrial Initiatives Program and the Industrial Analysis and Demonstration Program.

Hydro-Québec Distribution maintains its competitive position by offering some of the lowest rates in North America. According to the comparative index of May 2003, Montréal ranks 2nd out of 12 North American cities for the price paid by residential customers, and 4th out of 21 for the price paid by large-power customers.

Comparative Indices of Electricity Prices at May 1, 2003

Residential Customers[1]

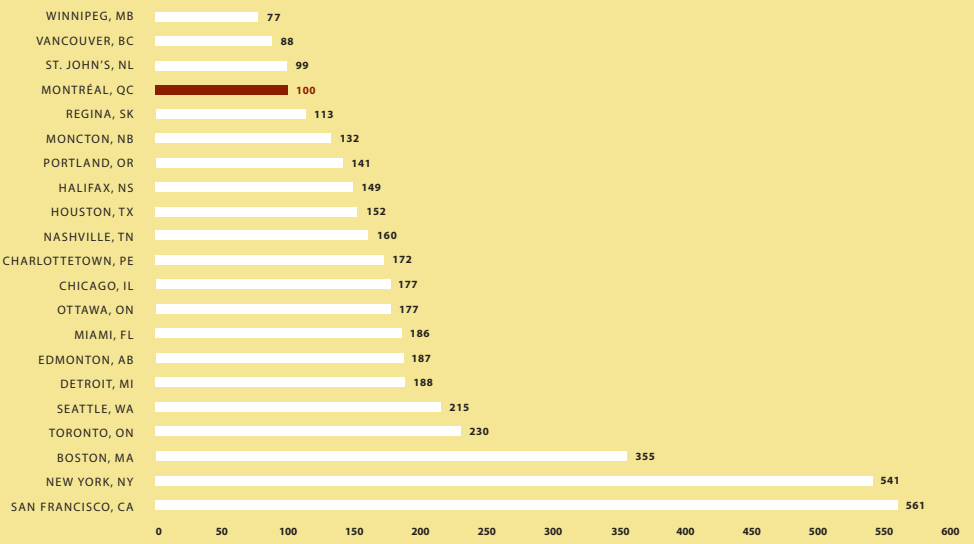
(Montréal = 100)



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

Large-Power Customers[1]

(Montréal = 100)



1. Monthly bill (before taxes) for 50 MW of power, at 120 kV and a load factor of 85%, and a consumption of 30,600 MWh.

Electricity Service

Hydro-Québec Distribution proposes various measures to increase the strength of its system and ensure its long-term operability, and to improve the quality of electricity service. One of the division's goals is to reduce the number and length of service interruptions affecting its customers in the event of power failures or scheduled outages. It works in close cooperation with municipalities to establish means of providing accurate information on major blackouts and speeding up service restoration.

In 2003, $407 million was invested in customer hookups and system improvement.

- The rate of new hookups on schedule was maintained at 93%, despite steady growth in the number of new customers.
- The customer satisfaction index for information received in the event of power failures remained essentially the same, at 7.3 out of 10, thanks to measures taken to improve the synergy between work crews and customer service centres. This index has risen sharply since 1999.
- A website was set up for municipalities, providing them with information on blackouts in their areas and enabling them to monitor the situation.
- The system reinforcement program continued. As at December 31, 2003, more than 65% of the work on lines located in areas with a high ice risk had been completed. Investment in this program totaled $13 million in 2003.
- The first stage in the underground grid rehabilitation plan concluded. In 2003, $21 million was invested in this program designed to maintain and improve service continuity in urban areas.
- Since 2001, the Québec government has authorized 22 projects under its program for undergrounding distribution systems. A total of $30 million has been budgeted for the burial of 18 km of grid.
- Safety awareness programs continued for students, the general public, skilled workers and emergency responders.
- A new stage was launched in the *Protégeons-nous !* campaign promoting public safety near Hydro-Québec facilities.

Opposite: The satisfaction of business and commercial customers is a constant concern. // Visilec, a new service for business customers. // The distribution system undergrounding program. // Reinforcing distribution lines.

SERVICE QUALITY

	2003	2002	Change
Rate of new hookups on schedule	**93%**	93%	_
Rate of meter reading	**96%**	96%	_
Rate of call response in 20 seconds or less			
Residential customers	**68%**	69%	↓ 1%
Business and commercial customers	**75%**	72%	↑ 3%
Rate of requests solved on the first call			
Residential customers	**82%**	81%	↑ 1%
Business and commercial customers	**67%**	65%	↑ 2%
Rate of customers notified in advance of scheduled outages			
Overall	**78%**	81%	↓ 3%
Customers significantly affected by outages	**68%**	66%	↑ 2%
Average hours of distribution service interruption per customer – gross (excluding Hydro-Québec TransÉnergie)	**3.22**	3.30	↓ 0.08
Average hours of distribution service interruption per customer – adjusted[1] (excluding Hydro-Québec TransÉnergie)	**2.10**	2.05	↑ 0.05

1. Not including exceptional weather events.

Technological Innovation

Hydro-Québec Distribution relies on R&D to achieve its objectives. It concentrates its efforts on the efficient use of electricity to help its customers remain competitive, and on technologies and processes that contribute to improved power supply reliability. It also seeks ways to enhance its own profitability.

- Development proceeded on an electrical infrared emitter intended to improve the efficiency of certain industrial processes such as drying in papermaking.
- A new consumption measurement software program was developed and introduced. The software has a number of uses, including calculating quantities of energy stolen.
- Central heat accumulators were developed, enabling commercial and institutional customers to manage their energy consumption better and reduce their electricity bills.
- A demonstration project for an intermediate-voltage underground grid was conducted.
- The cost-effectiveness of a new structural-analysis method for evaluating the residual mechanical strength of wood poles was demonstrated. This method will help extend their useful life.

Information Technologies

The information technologies developed by the company enable Hydro-Québec Distribution's customers to receive fast, accurate answers to their requests for information and to better monitor their consumption patterns. In addition to allowing system maintenance crews to take more rapid action, they speed up service restoration.

- Computer tools developed under the Energy Efficiency Plan 2003–2006 will allow residential customers and small businesses to obtain a customized energy diagnosis based on a questionnaire (available online or on paper), starting in 2004.
- A pilot project for computer-aided crew dispatching was carried out in Trois-Rivières.
- The meter-reading equipment was updated.

Customer Information System Project

In 2003, Hydro-Québec Distribution embarked on the first stage in developing a customer information system that will enable it to meet customers' expectations better and gain greater flexibility in fulfilling their changing needs. This major project for modernizing information systems will transform customer service business practices and processes. It will also help improve Hydro-Québec Distribution's efficiency in terms of cost control and management as well as its ability to adapt to regulatory requirements and changes. Deployment of the $320-million project will begin in 2005.

Environment

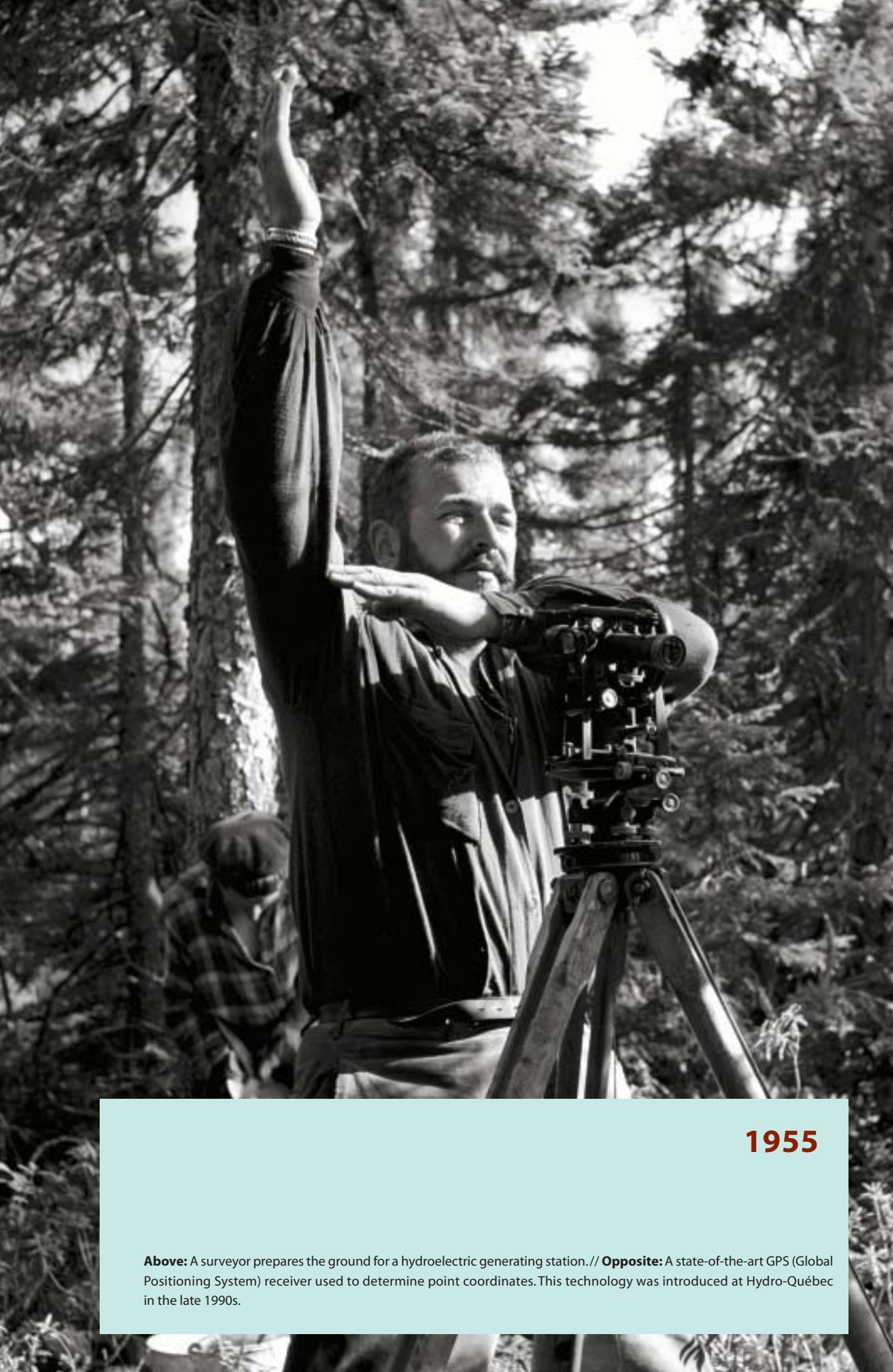
Environmental protection is an integral part of Hydro-Québec Distribution's operations. The division sees to it that its employees treat customers' property with respect and endeavors to prevent pollution risks. It also works to develop a more aesthetic infrastructure that blends in with the environment, in cooperation with telephone and cable television companies.

- ISO 14001 registration was maintained for distribution system operations.
- Customer service activities that could be registered to ISO 14001 in 2004 were identified and evaluated.
- Poles treated with a polymer additive continued to be used, while older ones were recovered for use as service poles.
- Under various pilot projects, three new types of equipment were tested with a view to optimizing the logistics of building the underground grid: a special cable pre-installed in a conduit, a wheel trencher, and a joint connection terminal for cabled networks (electricity, telephone and television) on which a street lamp can be mounted.

Human Resources

Customer satisfaction and service quality depend on the expertise and constant motivation of our employees. A number of measures taken in 2003 contributed to a better cooperative spirit and increased organizational stability.

- Letters of understanding were signed with the unions, promoting greater flexibility in the organization of work.
- A rapid recall system for trade employees was instituted in order to speed up emergency crew dispatching.
- New staffing methods were introduced to foster employee development and succession in the technical and clerical groups.
- The empowerment project for teams involved in distribution operations continued, leading to improved efficiency.
- The work-related accident frequency decreased to 4.10 per 200,000 hours worked in 2003, compared with 4.39 in 2002, as a result of awareness campaigns.
- Hydro-Québec Distribution also established a strategic workforce management framework for 2004–2008 designed to ensure adequate human resources to meet its business requirements.



1955

Above: A surveyor prepares the ground for a hydroelectric generating station. // **Opposite:** A state-of-the-art GPS (Global Positioning System) receiver used to determine point coordinates. This technology was introduced at Hydro-Québec in the late 1990s.

Shaping matter, harnessing the force of water to make light appear, and building high-voltage lines to carry electricity to load centres—our team constantly meets major technical and logistical challenges. With the experience we have gained in carrying out profitable environmentally and socially acceptable projects, we have become a leader in sustainable development.

Hydro-Québec Équipement

Building to Meet the Divisions' Needs on a Competitive Basis

Hydro-Québec Équipement and Société d'énergie de la Baie James (SEBJ), a subsidiary of Hydro-Québec, offer a full range of world-class consulting services in engineering, procurement, project management and construction of generation and transmission facilities. They carry out turnkey projects including environmental studies, information and public consultation sessions in host communities, draft designs and permitting.

Hydro-Québec Équipement is the prime contractor in the rehabilitation of hydroelectric generating stations, the construction of new hydropower facilities, and the reinforcement and expansion of the transmission system in Québec. The division must demonstrate great flexibility and innovativeness to shorten construction schedules, or production shutdowns in the case of refurbishing.

Hydro-Québec Équipement provides high-value-added services—the outcome of nearly 60 years of experience. Over the years, the division has built a solid reputation in Québec and around the world, thanks in particular to the hydropower and transmission projects it has carried out in both urban areas and remote regions. The Hydro-Québec power system is one of the most robust, reliable and competitive in North America, in spite of the often difficult weather conditions it is subjected to.

SEBJ, for its part, has developed expertise from its projects in northern Québec, where it has acquired an exceptionally thorough understanding of the natural environment, land use, and the health and welfare of Native populations. In addition to adapting its know-how to specific situations, SEBJ follows an approach of establishing harmonious communications with Native and other local communities. Through partnerships, it fosters the transfer of knowledge to people in the regions and optimizes the economic spinoffs from development projects.

The profitability of generation and transmission projects is an issue of prime importance to the company. Hydro-Québec Équipement and SEBJ have consequently adopted practices designed to optimize each of the projects entrusted to them, in order to reduce costs and lead times. In terms of cost and productivity, they compare favorably with other Québec contractors.

Opposite: Assembling a generating unit at Rocher-de-Grand-Mère generating station. // A spillway under construction at Toulnustouc. // Excavating the diversion tunnel at Eastmain-1.

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

Volume of activity as at December 31, 2003	$1.6 billion
Customers in 2003 (% of revenue)	
Hydro-Québec Production	66%
Hydro-Québec TransÉnergie	30%
Other	4%
Total workforce as at December 31, 2003	
Hydro-Québec Équipement	1,680 employees
Société d'énergie de la Baie James	242 employees
Regulatory regime	Free competition

Shorter lead times are a major issue for Hydro-Québec Équipement and its clients. To speed up permitting, the division is working with government to develop new procedures. By the end of 2003, permit deliveries had been shortened by several months. This new approach is in full compliance with the procedures for informing and consulting local communities, and the environmental impact assessments filed in support of projects are still as rigorous and thorough as ever.

Projects for Hydro-Québec Production

- Concreting was finished at the 220-MW Rocher-de-Grand-Mère generating station, and the gates of the main spillway were installed. Assembly began on the three generating units. Construction of the switchyard was completed.
- The diversion of the Toulnustouc River concluded, while construction of the rockfill dam began. Phase one concreting finished at the 526-MW generating station, and installation got under way on the steel linings in the penstocks. Concreting of the spillway is now 62% complete. As well, excavation continued on the headrace tunnel. At the peak, there were more than 1,500 workers on the site.
- Construction proceeded on the 480-MW Eastmain-1 hydroelectric development. The temporary workcamp was built, as well as an 85-km access road between the main dam and Nemiscau substation, and excavation work began. Since the project was launched, Native workers have formed 20 to 25% of the labor force, on average.
- Sainte-Marguerite-3 was partially commissioned (total installed capacity 882 MW).
- The partial diversion of the Manouane River to Pipmuacan reservoir and the Bersimis complex was completed and went into operation. The structures comprise an 8-km diversion canal, a control structure, three dikes and an overflow dam.
- Work started on the 51-MW Mercier generating station with the construction of the access road and awarding of the contract to manufacture the generating equipment.
- At the request of the Québec government, the spillways at Lake Kénogami were modernized and the first dike was built. After public hearings, the Bureau d'audiences publiques sur l'environnement (BAPE) published a report in October that was favorable to the project as a whole.
- The environmental impact statement was filed and public hearings were held by BAPE on the proposed 385-MW generating station on the Péribonka River.
- Field studies and design continued with a view to building two new hydroelectric generating stations at Chute Allard and Rapides des Cœurs.
- Impact assessment and draft-design studies proceeded for the 770-MW Eastmain-1-A hydroelectric generating station and the Rupert diversion in the James Bay region.
- An agreement was signed by the Québec and Canadian governments and the Crees on coordinating the environmental assessment processes applicable to the Eastmain-1-A/Rupert project.
- Desk studies got under way on the development of four hydroelectric generating stations totaling 1,500 MW on the Romaine River, on the North Shore of the St. Lawrence.

- Rehabilitation continued at Beauharnois generating station (1,658 MW) and repairs were made to the aprons of the compensating works at Île-Juillet-1 and Île-Juillet-2 dams.
- Rehabilitation also continued on the intakes and spillway at Rapides-des-Quinze generating station (95 MW).
- Work proceeded on the complete overhaul of the eight generating units at Bersimis-1 (1,125 MW).
- Refurbishing and refitting continued at Outardes-3 (824 MW).
- Work began on replacing alternators and refurbishing intakes at Rapide-2 and Rapide-7 generating stations, each of which has a capacity of 48 MW.
- Refurbishing and refitting began at Outardes-4 generating station (630 MW) and switchyard.
- Phase two of the rehabilitation of La Tuque generating station got under way. It will involve replacing three of the generating units with more powerful models.

Projects for Hydro-Québec TransÉnergie

- The Montérégie loop was completed with the commissioning of major structures designed to increase the security of power supply to Montréal and the Montérégie region. These include the 735-kV Saint-Césaire–Hertel line, an approximately 45-km section that can handle 65 mm of ice and winds of 110 km/h; the 735-kV Montérégie substation, which reduces the voltage from 735 to 120 kV in order to distribute electricity on the Montérégie system; and the 11-km, double-circuit 120-kV Montérégie–Leclerc line.
- A 100-MW variable-frequency transformer was added to Langlois substation in order to increase interconnection capacity with the New York and Ontario systems.
- A 72-km line, operated at 120 kV, between Les Cèdres substation in Québec and Cornwall, Ontario, was completed for Cedars Rapids Transmission Co. It replaces a line built in 1915.
- Series compensation equipment was added to the 735-kV Bergeronnes substation, to bring the additional output resulting from the refitting of Outardes-3 onto the grid.
- At Central substation in Old Montréal, two 120/25-kV transformers and nine 25-kV lines were added, the main building and the 120-kV busbars were refurbished, and the ALCID control system was deployed.
- At Boucherville substation, two new control buildings were erected and the ALCID system was added, at a total cost of $15 million.
- The third and last synchronous condenser at Duvernay substation was refurbished and returned to service.

Opposite: Refurbishing at Rapides-des-Quinze. // Replacing alternators at Rapide-7. // Hauling a transformer to Montérégie substation.

Expertise

Hydro-Québec Équipement and SEBJ have wide-ranging engineering expertise in generation, transmission and telecommunications, as well as in such leading-edge areas as technical surveys, geomatics and shop tests. This know-how allows the two organizations to design and develop optimal solutions for delivering efficient facilities at competitive prices. Through their activities, they also contribute to the growth of a great many engineering firms in Québec and to the development of their expertise in high-tech fields.

Environment

The environmental know-how of Hydro-Québec Équipement and SEBJ is based on more than 30 years' experience in northern regions as well as rural and urban areas. Every development or rehabilitation project undergoes a thorough environmental and archaeological evaluation to identify all impacts and plan for any mitigative measures and follow-up needed. Environmental compliance is monitored throughout the construction stage. The division's environmental management system has been certified ISO 14001–compliant.

- Inventories were carried out in the James Bay region in connection with the Eastmain-1-A generating station and Rupert diversion project, yielding new knowledge on the biodiversity of northern Québec.

Opposite: Engineering expertise, a heritage worth preserving. // Taking inventory in the James Bay region.

Human Resources

In 2003, Hydro-Québec Équipement conducted an in-depth review of its workforce requirements. It was consequently able to better identify vulnerable positions and take steps to ensure succession, particularly among management personnel. The division also introduced a training program on the partnerships between its units and with internal customers. As well, it reached agreements with the unions that provide for management methods better suited to the current business environment.

- An agreement was signed concerning the induction of new employees and transfer of knowledge. It will help diversify engineers' expertise through increased mobility on jobsites.
- An agreement on creating permanent seasonal positions and managing casual employees was signed. It is intended to improve flexibility in workforce management by creating seasonal jobs and reducing the number of recall lists.
- The work-related accident frequency rate decreased from 1.01 per 200,000 hours worked in 2002 to 0.58 in 2003.

1976

Above: Two scientists at Hydro-Québec's research institute hard at work. Nearly 400 researchers, engineers and technicians constantly give new meaning to the word "energy." // **Opposite:** An electric vehicle with a propulsion system using Hydro-Québec technologies should be available in Europe by 2006, marketed by the French consortium Société de Véhicules Électriques.

For over 30 years, the scientists at Hydro-Québec's research institute have been making technological breakthroughs. Their combined expertise makes our company a driving force in new energy-related technologies in Québec.

Hydro-Québec Technologie et développement industriel

Creating Value Through Integrated Management of Technological Innovation

Technological innovation plays a key role in sustaining the company's long-term performance and viability.

In 2003, the company formed a new division, Hydro-Québec Technologie et développement industriel, to reflect the great importance of technology. The division is in charge of integrated management of technological innovation. Its operations revolve around three complementary poles: innovation projects and technical support, which are carried out by Hydro-Québec's research institute; industrial development of the company's technologies, a role performed by Hydro-Québec IndusTech; and access to outside innovations through investments in groundbreaking companies in the energy industry, which are made by Hydro-Québec CapiTech.

Hydro-Québec invests more in R&D than any other Canadian electric utility, and its research teams enjoy worldwide renown. During the year, Hydro-Québec scientists received the Herman Halperin Electric Transmission and Distribution Award, as well as the award for the best research paper of the year, from the Institute of Electrical and Electronics Engineers (IEEE). These distinctions attest to the quality of their work in HV transmission line design and large power system stability.

Élie Saheb
President, Hydro-Québec Technologie et développement industriel

Innovation projects and technical support	
Commitments in 2003	$99 million
Customers in 2003 (% of commitments)	
Hydro-Québec Production	19%
Hydro-Québec TransÉnergie	22%
Hydro-Québec Distribution	27%
Other internal customers	18%
External customers	14%
Regulatory regime	Cost-based for activities related to Hydro-Québec TransÉnergie and Hydro-Québec Distribution
Industrial development – Hydro-Québec IndusTech	
Investments as at December 31, 2003	$272 million
Regulatory regime	Free competition
Venture capital – Hydro-Québec CapiTech	
Investments as at December 31, 2003	$183 million
Regulatory regime	Free competition
Total workforce as at December 31, 2003	620 employees

Opposite: Adjusting the arm of the underwater inspection robot. Our research institute employees are at the heart of our technological innovation. // AVESTOR battery and TM4 motor generator for mainly electric vehicles. // AVESTOR battery racks for telecommunications networks.

Innovation Projects and Technical Support

Hydro-Québec's research institute, with facilities in Varennes and Shawinigan, assists the divisions by offering them technical support and carrying out their technological innovation projects, in cooperation with various partners. Hydro-Québec Technologie et développement industriel also creates value from the technologies developed, by marketing intellectual property, for example.

The divisions determine innovation avenues and allocate financial resources to Hydro-Québec Technologie et développement industriel according to their priorities and business objectives.

TECHNOLOGICAL INNOVATION AVENUES

Core business

Generation	– Increase the long-term operability of dams and other structures – Improve the performance and long-term operability of generating facilities – Increase the profitability and acceptability of the generating fleet
Transmission	– Increase service life by 10% and cut maintenance costs by 10% – Reduce the cost of new lines and substations by 10% – Increase transmission capacity in certain corridors by 33% – Optimize transmission system management – Reduce the impact of extreme weather events by 50%
Distribution	– Improve the quality of electricity service – Reduce the cost of the underground grid by 50% – Reduce the net discounted cost of the overhead system by 10%
Customer services	– Develop electrotechnologies and new electricity applications that optimize energy efficiency, while prioritizing ones that are profitable for Hydro-Québec Distribution – Increase the energy efficiency of customers' existing electricity applications – Reduce Hydro-Québec Distribution's operating and energy supply costs – Improve customer satisfaction

The innovation portfolio also includes long-term projects stemming from the technological roadmap. This map is reviewed periodically to reflect the latest innovations and the main energy challenges. It allows Hydro-Québec Technologie et développement industriel to identify emerging technologies likely to disrupt Hydro-Québec's business environment.

- Nearly 400 researchers, engineers and technicians worked on some 90 technological innovation projects focusing on the divisions' core needs and on value creation in six areas of expertise: chemistry and materials; power system analysis, operation and control; electrical equipment; energy use; mechanical, metallurgical and civil; and automation and measurement.
- The energy performance of the company's Québec customers was supported by the efforts of the energy technology laboratory (LTE) in the field of electricity use.

- Our association continued with government and university partners in the OURANOS consortium, whose research is devoted to analyzing climate change with a view to developing long-term adaptation measures. In 2003, researchers simulated the impacts of these changes on the hydrological regimen of the Ottawa River.
- The division collaborated with more than 80 partners (multinationals, small and mid-size businesses, private and public research centres, and government agencies) with a view to bringing the products of R&D to the industrial production and marketing stages.
- Training in technology business development was set up in cooperation with the university/industry liaison offices of Québec universities and the Université de Moncton, in New Brunswick.
- Tests were conducted for external customers under service contracts such as the one signed in 2003 with ABB for the testing of transformer equipment in the high-voltage laboratory at Hydro-Québec's research institute.

Hydro-Québec IndusTech

Hydro-Québec IndusTech is a wholly owned subsidiary of Hydro-Québec. Its mission is to work with the private sector to pursue the industrial production and marketing of technologies that have resulted from Hydro-Québec's research activities and that offer new avenues for medium- and long-term growth. During the year, the division invested $40 million in Hydro-Québec IndusTech in the form of share capital, bringing the total to $272 million. Its portfolio comprises two startup companies—AVESTOR and TM4—as well as the PSEV project.

AVESTOR

AVESTOR, a joint venture of Hydro-Québec and Kerr-McGee Chemical, develops and markets a line of lithium-metal-polymer (LMP) batteries for the telecommunications market and, potentially, for energy markets and for electric/hybrid vehicles. As at December 31, 2003, the company had nearly 300 employees and total capitalization of $452 million.

- AVESTOR and Valere Power signed a joint marketing agreement for the telecommunications industry. Under this agreement, the two companies will integrate their products and work together to develop new technologies.
- Level 3 certification was obtained from Network Equipment Building Systems (NEBS) for the AVESTOR batteries, which also went through validation testing as part of the Underwriters Laboratories (UL) Component Recognition Program. These seals of approval from two organizations, both of which are internationally respected for the level of product safety they demand and the quality of the tests they use, confirm the sturdiness and very high performance level of AVESTOR batteries.
- The first extrusion line went into operation and production began, along with commercial deliveries of AVESTOR batteries to large telecom companies.

AVESTOR's LMP batteries (SE 48S60 and SE 48S70) ensure a continuous power supply to telecom infrastructures in the event of a power grid failure. They perform better than valve-regulated lead-acid batteries or nickel-cadmium batteries. They contain no liquid and thus pose no danger of leakage or charge dissipation. Reliable between –40°C and +65°C, they are guaranteed for 10 years and require no maintenance. A built-in remote supervisory control system allows their power to be increased and provides information on their usage and discharge level.

- A test bench was developed for a battery for nuclear generating stations, with an initial series of prototypes delivered to Gentilly-2.
- At Hydro-Québec IndusTech's request, a second-generation traction battery prototype (GenII) was developed and produced to meet the specifications of Société de Véhicules Électriques, a consortium created by two French companies, Dassault and Heuliez.
- A team of electrochemistry specialists at Hydro-Québec's research institute took part in developing the third generation of batteries for mainly electric vehicles.

TM4

TM4, a company wholly owned by Hydro-Québec, designs and markets high-energy-density electrodynamic solutions, which are customized for the transportation industry and distributed generation. These solutions are derived from technologies developed under the research institute's motor-wheel project. As at December 31, 2003, the company had 45 employees and capitalization of $24 million.

- The company has built up a portfolio of customers that includes manufacturers of all-electric and hybrid vehicles as well as stationary generating systems.
- TM4 qualified as a preferred supplier to Société de Véhicules Électriques.
- The TM4 motor generator was designed, combining an electric motor with a range extender.
- Generators producing 40 kW and 75 kW were developed for hybrid vehicles.
- A 170-kW power generation system coupled with a fuel-fired engine was developed for stationary generator sets.

PSEV Project

The PSEV (Propulsion Systems for Electric Vehicles) project is intended to facilitate strategic partnerships with manufacturers of mainly electric vehicles incorporating AVESTOR and TM4 technologies.

- A cooperation agreement was signed with Société de Véhicules Électriques for the development of propulsion systems.
- Stationary and mobile bench testing was conducted on the propulsion system incorporating the TM4 drive chain and AVESTOR's LMP traction battery.

Hydro-Québec CapiTech

Hydro-Québec CapiTech is a wholly owned subsidiary of Hydro-Québec. It was established to invest venture capital in energy-related technology companies with products and services likely to foster the growth of Hydro-Québec's activities and improve its divisions' performance.

Hydro-Québec CapiTech has $154 million, 84% of its portfolio, directly invested with partners in companies at the seed capital, pre-startup, startup or growth stage in Québec, Canada and abroad.

It also has indirect investments in the form of holdings in international funds. These enable it to develop an extensive network of strategic and financial partners in the energy market and offer business opportunities for the subsidiary itself or for Hydro-Québec's divisions. They also allow it to gather technological and market intelligence, in conjunction with managers in the divisions, to support their innovation strategies.

- The subsidiary managed direct stakes in 33 companies (16 in Québec, 5 in the rest of Canada, and 12 abroad).
- Direct reinvestments totaled $9 million. No investments were made in new companies.
- Hydro-Québec CapiTech managed indirect investments totaling $29 million, or 16% of its portfolio, in four international funds: Nth Power Technologies Fund I, Nth Power Technologies Fund II, EnerTech Capital Partners II and the European SAM Private Equity Energy Fund.
- Indirect reinvestments totaled $5 million.

1963

Above: An employee operating a card punch in the early 1960s. // **Opposite:** The computer mouse has become a must. Every day, a team responds to some 1,000 calls from employees with hardware or software problems.

More than ever, the company's mission depends on the use of sophisticated computer systems. We need look no further than the call centres that handle all customer services, or the intranet, a new virtual work tool. The punch cards of yesterday have given way to the computer mouse, and our employees now work to the beat of its familiar click!

Corporate Services

Human Resources and Shared Services

Human Resources

The Human Resources Directorate develops and manages employee programs for health and safety, remuneration and benefits, succession, development and motivation. It negotiates labor agreements with employee representatives. Together with the divisions, it endeavors to prevent work-related accidents.

In 2003, nine months ahead of schedule, Hydro-Québec renewed its collective agreements with unions representing over 80% of its unionized employees. The signing of these five-year agreements will help the company achieve its business objectives by creating a positive work atmosphere.

- Collective agreements were renewed with six of Hydro-Québec's employee unions: the technologists' union (CUPE local 957), the trade employees' union (CUPE local 1500), the technical and clerical employees' union (CUPE local 2000), as well as the engineers' union, the distribution system employees' union, and the brotherhood of Hydro-Québec special constables.
- An approach and tools were developed to help divisions improve employee attendance and productivity, and to better monitor changes in labor costs.
- Efforts continued in risk management relating to succession and the transfer of skills.
- The employee satisfaction level improved to 8.20 out of 10, an increase of 0.09 over the previous year. The employee motivation index declined to 6.58 out of 10 at the end of 2003, compared with 6.69 at the end of 2002.
- The work-related accident frequency rate fell to 3.49 per 200,000 hours worked in 2003, down from 3.60 in 2002.

Shared Services Centre

The Shared Services Centre provides a range of support services enabling the divisions and corporate units to devote all their energy to core operations. The consolidated organization of services and careful management of the Centre's activities mean that high-quality products and services can be delivered at lower cost. By developing greater synergy with its clients, the Centre helps improve their efficiency and optimize the acquisition of goods and services.

The Centre's services include computer-based solutions, IT operations, office automation systems, transportation services, procurement, management of materials, documents and real estate, and environmental services. In 2003, this list grew still further with the addition of payroll and accounts payable services and a centre for management software skills. The telecommunications services previously provided by Connexim were also transferred to the Shared Services Centre.

- The storage infrastructure was optimized through the allocation of specific facilities to Hydro-Québec TransÉnergie, among other measures.
- The office space vacancy rate throughout the province fell to less than 1%.
- A computer data storage system was set up to reduce costs.
- Online invoicing was introduced for some large suppliers.
- A computer security awareness campaign was run to ensure adequate protection of the company's strategic information.
- Some 11,542 metric tons of residual hazardous materials were recovered from all over Québec.
- ISO 14001 certification was obtained for the Shared Services Centre's environmental management system.
- Tools were developed to allow the Centre's client units and divisions to monitor their consumption of goods and services.
- Overall satisfaction among internal clients climbed to 92%, a 9% increase over 2002.
- Telecommunications employees, assets and operations were brought back from Connexim to Hydro-Québec.

Procurement of Goods and Services

In accordance with the policy "Our Acquisition of Goods and Services," Hydro-Québec kept up its initiatives to ensure security of supply of goods and services, by limiting the risks associated with using a sole supplier in certain markets, certifying goods from a number of different suppliers to diversify sources and establishing a list of companies that can supply Hydro-Québec Production in emergencies.

In addition, to increase efficiency and reduce costs, the company continued to consolidate purchases and utilized its market knowledge to develop innovative, effective strategies.

To maintain the quality of its supplies, Hydro-Québec ensured that its strategic suppliers made the transition needed to meet ISO 9001:2000 requirements by the end of 2003.

Opposite: Employee motivation is essential to the company's success. // The work-related accident frequency rate declined in 2003. // New tools for clients of the Shared Services Centre.

In 2003, close to 93% of goods and services were purchased from Québec-based suppliers. These purchases play an important role in sustaining the economy in every region of the province.

The business practices arising from the policy "Our Acquisition of Goods and Services" ensure equitable treatment for all suppliers. The number of complaints and claims from external suppliers and organizations rose from 18 in 2002 to 20 in 2003, but has remained fairly stable for a number of years.

Purchases of goods and services inside and outside Québec totaled $2,294 million: $919 million in goods, $31 million in rentals, $998 million in specialized services and other work, and $346 million in professional services. These purchases are up 27% over the previous year, largely because of the increase in the number of projects carried out by Hydro-Québec Équipement, Hydro-Québec TransÉnergie and Hydro-Québec Distribution.

HYDRO-QUÉBEC ACQUISITIONS BY ADMINISTRATIVE REGION[a]

$'000 Administrative region of Québec	Services[b]	Goods (purchase and rental)	Total
Abitibi-Témiscamingue (08)	22,115	7,456	29,571
Bas-Saint-Laurent (01)	5,477	1,786	7,263
Capitale-Nationale (03)	133,200	52,313	185,513
Centre-du-Québec (17)	37,539	17,985	55,524
Chaudière-Appalaches (12)	56,572	11,319	67,891
Côte-Nord (09)	75,840	13,120	88,960
Estrie (05)	7,323	4,428	11,751
Gaspésie–Îles-de-la-Madeleine (11)	3,702	794	4,496
Lanaudière (14)	20,275	49,436	69,711
Laurentides (15)	65,497	16,461	81,958
Laval (13)	54,851	18,555	73,406
Mauricie (04)	73,643	27,451	101,094
Montérégie (16)	130,298	203,434	333,732
Montréal (06)	512,978	370,785	883,763
Nord-du-Québec (10)	7,276	3,438	10,714
Outaouais (07)	5,328	9,052	14,380
Saguenay–Lac-Saint-Jean (02)	79,550	28,015	107,565
Total	**1,291,464**	**835,828**	**2,127,292**

a) Amounts billed by suppliers located in the administrative region.
b) Specialized services, professional services and other work.

Opposite: Water, a renewable energy source. // The Robert-Bourassa development. Hydropower accounts for 97% of our output. // Wild leek, a protected species. // Wind power plays a part in sustainable development.

Environment and Sustainability

In 2003, after publishing environmental performance reports annually since 1995, the company released its first sustainability report. This report, drawn up in accordance with international standards, describes the action taken by Hydro-Québec to promote sustainable development as it pertains to the company's customers and employees, local communities and the general public. The concept of sustainability means balancing environmental protection, social equity and economic development.

Some 95% of the power generated or purchased by Hydro-Québec comes from renewables (hydroelectricity, wind power, biomass and waste reclamation). The company promotes the use of renewable energy by continuing to develop Québec's cost-effective hydropower potential, thereby significantly reducing greenhouse gas emissions and improving air quality throughout northeastern North America.

At Hydro-Québec, over 200 environmental specialists work to protect and enhance the environment in conjunction with the development and operation of generation, transmission and distribution facilities. The company has been committed to implementing ISO 14001–compliant environmental management systems since 1997 to ensure ongoing improvement of its environmental performance.

It maintains close relations with local communities, social and economic organizations and citizens' groups in order to establish the partnerships needed to harmoniously integrate its projects and activities while maximizing spinoffs.

- The company published the *Sustainability Report 2002*. The sustainable development consulting firm Stratos ranked it third out of 35 similar reports by Canadian companies, and first among reports by public utilities.
- A total of 35 agreements (compared with 31 in 2002) were signed with local community representatives. These included partnering arrangements, agreements for the leasing of Hydro-Québec properties for community purposes and agreements under the Integrated Enhancement Program.

- Hydro-Québec promoted hydroelectricity on the international scene as a means of contributing to sustainable development. The company played an active role in the First International Summit on Sustainable Use of Water for Energy, at the 3rd World Water Forum; it was involved in the five-year research program Hydropower Good Practices, which is part of the International Energy Agency's Hydropower Agreement; and it attended the COP9 Hydropower – Climate Change Mitigation & Adaptation conference held by the International Hydropower Association.
- The company launched the Mérite environnemental d'Hydro-Québec, an award given to employees who take action to protect or enhance the environment at work and in their communities.
- The Fondation Hydro-Québec pour l'environnement funded 10 environmental projects, to which it allocated a total of $1 million. One of the projects involved reintroducing striped bass, a species of fish that had completely disappeared from the St. Lawrence River in the 20th century.

From 1999 to 2002, each terawatthour sold by Hydro-Québec generated 34 times less CO_2, 27 times less SO_2 and 22 times less NO_x than the average for terawatthours sold by the six New England states, New York State, Ontario and New Brunswick.

Opposite: The Montréal FestiBlues International. // The Trois-Rivières international voice festival. // Awarding prizes to young amateur athletes.

Community Involvement

Hydro-Québec plays a part in the economic development of Québec through its province-wide operations, which generate substantial spinoffs. It also supports numerous causes by donating to organizations involved in health, education and humanitarian aid. The company devotes a considerable amount of money to sponsoring events, particularly in the scientific, cultural, socioeconomic, environmental and sustainable development spheres, as well as amateur sport. In addition, Hydro-Québec encourages its employees to volunteer. Over 180 of them participated in a program that provides up to $1,000 in funding to community organizations where a Hydro-Québec employee is a volunteer. In 2003, these contributions exceeded $167,000.

Health and Humanitarian Aid

- The company supported research activities at Québec university hospitals and other major institutions such as the Montréal Heart Institute, the Montréal university geriatric institute and the Robert-Giffard hospital research centre.
- Assistance was provided to several foundations and many patient-support organizations.

Education

- The company sponsored 15 research chairs at various Québec universities, mainly in the technology, social, health and environment fields.
- A total of $8 million, to be provided in installments from 2003 to 2012, was donated to the Université du Québec à Montréal, mainly for scholarships awarded under the "Cœur des sciences" project.
- A contribution totaling $3 million, to be paid out from 2003 to 2013, was made to the Université du Québec à Trois-Rivières to support the development of the Hydrogen Research Institute.
- Scholarships and internships at Hydro-Québec were awarded to six Native students at the college and university levels.
- Hydro-Québec renewed its commitment to the Conseil de développement du loisir scientifique for Science Fairs, and renewed its sponsorship of the Québec delegation to the International Science Fair.
- The company renewed its support for the Literacy Foundation through its participation in the Gift of Reading initiative during the 2003 holiday season.

Culture

- Hydro-Québec was the title sponsor for such popular major events as the Québec City Summer Festival, the FestiBlues International de Montréal, the Petite-Vallée song festival and the international voice competition in Trois-Rivières.
- Support was provided to regional theatres including the Théâtre de l'Arbre-muse, the Théâtre de l'Écluse, the Théâtre À Cœur ouvert and Les Amis de Chiffon.
- The company supported music ensembles across Québec, such as the Saguenay–Lac-Saint-Jean, Trois-Rivières and Abitibi-Témiscamingue symphony orchestras.
- Hydro-Québec renewed its commitment to the Journées de la culture, for which it is the main sponsor, for the next three years.
- The company was the main sponsor of the Centaur Theatre and the Saidye Bronfman Centre for the Arts for the fourth consecutive year.
- The Essor awards were given out, along with a $5,000 scholarship. The object of these awards is to introduce students to the arts and culture in order to favor the development of new artistic talent.

Environment

- Hydro-Québec renewed its association with the Reford Gardens biodiversity education centre.
- A total of $12 million, spread out from 2003 to 2014, was donated to Université Laval for scholarships and for the creation of an institute for environment, development and society.
- The company contributed to Explos-Nature, an organization devoted to increasing environmental and scientific awareness among young people.
- Support was provided to various environmental organizations, including the Association québécoise de vérification environnementale, the Association québécoise pour l'évaluation d'impacts, the Fédération québécoise pour le saumon atlantique and the Fondation de la faune du Québec.

Sports

- The company renewed its sponsorship of the sports challenge competition for athletes with disabilities for 2003, 2004 and 2005.
- Young amateur athletes were awarded 18 scholarships worth $3,000 each through the Quebec Foundation for Athletic Excellence.
- Hydro-Québec continued its association with the Jeux du Québec for its 2003 summer and winter finals.

As in past years, Hydro-Québec employees and pensioners made a major contribution to the United Way, donating $2.5 million in 2003. Hydro-Québec doubled this amount, as it traditionally does, bringing the total donation to $5 million. This amount does not include the more than $628,000 donated directly to organizations that work with the poor.

Opposite: The United Way umbrella march.

Socioeconomic Activities

- Hydro-Québec took part in conferences organized by the Fédération Québécoise des Municipalités, the Union des municipalités du Québec and the Fondation Rues principales, as well as the Foire des villages organized by Solidarité rurale du Québec.
- It established partnerships with economic development organizations such as the Québec association of economic development professionals, the Council of Food Processing and Consumer Products, the Québec industrial research association, the Québec Mineral Exploration Association and the Québec association of local development centres.
- The company sponsored the Grands Prix du tourisme québécois.
- It took part in the YWCA Foundation's Women of Distinction Awards.
- Hydro-Québec participated in the International Chamber of Commerce World Congress, the Conference of Montreal and the Saturn awards given out by the Fédération des agricultrices du Québec.
- The company worked with organizations devoted to preparing the next generation of professionals, such as the Regroupement des jeunes gens d'affaires du Québec and Les Jeunes Entreprises du Québec; it also took part in the Young People and Occupational Health and Safety at Work forum and the 8th Québec skills competition.

CONTRIBUTION TO QUÉBEC SOCIETY

$M	**2003**	2002
Donations	**6.8**	5.1
Sponsorships	**11.7**	9.05
Research chairs	**1.4**	1.8
Fondation Hydro-Québec pour l'environnement	**0.77**	0.45

International Role

Cooperation

In 2003, Hydro-Québec conducted 29 international cooperative projects in 16 countries. For the most part, these projects involved training and technical assistance programs offered to managers of national electric companies or energy ministries in developing countries.

- At the request of the Vietnamese government, we organized a seminar on the conversion of waste into energy. The event was held in February in Hanoi. Several Québec companies presented existing technologies, allowing Vietnamese authorities to choose solutions that suited their needs.
- We worked on a project with the Institut de l'énergie et de l'environnement de la Francophonie (IEPF), as part of our involvement in cooperative efforts among French-speaking countries. The project consisted in putting a data bank entitled *L'énergie dans le monde* on the IEPF website. The data bank was developed by Hydro-Québec over the last few years, and is one of the few energy-related search tools available in French.

Events

- We organized the 21st Congress of the International Commission on Large Dams (ICOLD), which was held in June in Montréal. The event brought together more than 1,000 decision makers, experts, engineers, geologists and other specialists in dams from some 60 countries around the world. A trade exhibition allowed a hundred or so companies to showcase their know-how and forge business connections.
- We organized the first joint symposium of the International Conference on Large Power Systems (CIGRE) and the Institute of Electrical and Electronics Engineers–Power Engineering Society (IEEE–PES). The two organizations chose Montréal to host this international symposium entitled Quality and Security of Electric Power Delivery Systems. The event took place in October and was attended by some 300 delegates from 42 countries.

Opposite: Marie-José Nadeau, who chaired the organizing committee for CIGB-ICOLD Montréal 2003, with (left to right) Gerard Verzeni, President of the Canadian Dam Association; C.V.J. Varma, President of ICOLD; André Huberteau, President of the Trade Exhibition; Sam Hamad, Québec Minister of Natural Resources; Paul T. Adams, President of the Canadian Hydropower Association; and Ted Moses, Grand Chief of the Grand Council of the Crees in Québec.

Management's Discussion and Analysis

This Management's Discussion and Analysis should be read in conjunction with the Consolidated Financial Statements of Hydro-Québec and the notes thereto. The Consolidated Financial Statements take into account certain regulatory accounting practices that differ from the accounting practices applied in unregulated enterprises. These practices relate specifically to certain deferred charges and fixed assets in service or disposed of as well as their depreciation and to the capitalization of financial expenses to fixed assets under construction. 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. Finally, it should be noted that certain financial and operating data for previous years have been reclassified to respect the presentation adopted in the current year.

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Overview

Net income continued to increase, reaching $1.9 billion, up $405 million from 2002. This increase results from a major decrease in financial expenses as well as the depreciation, amortization and decommissioning expenditure. The latter expenditure was higher in 2002 because certain nonrecurring items were taken into account.

Financial expenses declined by $324 million, or 10.6%, amounting to $2.7 billion for the year. This decrease results from the net repayment of long-term debt, in particular in the last two years, and the appreciation of the Canadian dollar versus the U.S. dollar. The decline resulting from the appreciation of the Canadian dollar offset the foreign exchange loss on our business transactions in U.S. dollars.

Revenue totaled $11.4 billion or $1.6 billion less than in 2002. This decline is the result of a reduction in the volume of electricity sales outside Québec. These sales decreased by $2.1 billion or 38.4 TWh, leading to a parallel reduction of $1.7 billion or 29.1 TWh in purchases outside Québec. There was also a considerable increase in domestic demand, on the order of 8.5 TWh, which generated additional revenue of $466 million as compared to 2002. To meet this increased demand in Québec, we were forced to reduce our volume of net electricity sales on external markets.

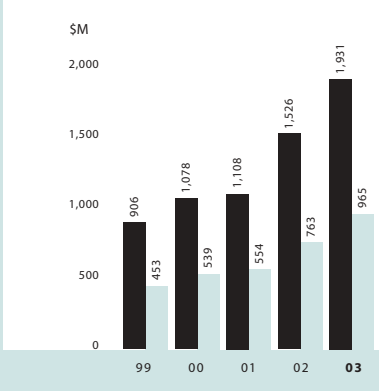
Return on equity stood at 13.2%, compared to 11.0% in 2002, while the **return on revenue** rose to 16.9%, up 5.2%.

Cash from operations amounted to $3.9 billion, which is comparable to 2002 levels. It was used to finance our **investments**, which totaled $3.2 billion in 2003, as compared to $2.5 billion in 2002. Investments made in 2003 were among the highest in the last ten years and related mainly to the Generation and Transmission segments.

Long-term debt, including the current portion, totaled $36.0 billion, down $3.7 billion from 2002. This decline is due to the net repayment of $0.7 billion, made in part using the prefinancing arranged in November 2002, and to the effect of the appreciation of the Canadian dollar on our debt denominated in U.S. dollars. It should be noted that the appreciation of the Canadian dollar also resulted in a substantial variation in the debt-related deferred charges. The Corporation therefore presented a deferred foreign exchange gain of $1.1 billion related to debt as at December 31, 2003, on the balance sheet under Other long-term liabilities, compared to a deferred foreign exchange loss related to debt of $2.3 billion as at December 31, 2002, presented under Deferred charges.

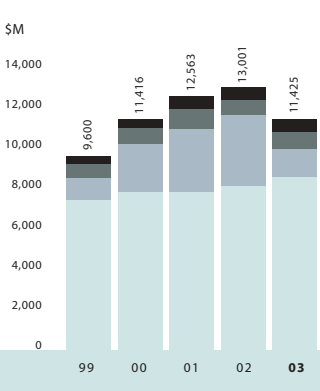
Declared dividends were $965 million, as compared to $763 million in 2002. They will constitute the largest payment made to our shareholder in our history.

Net Income[1] and Declared Dividends

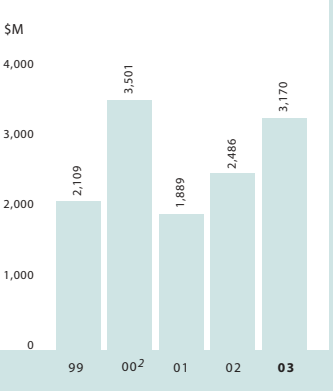


1. *Figures from 1999 to 2001 reflect reported net income. Restated net income is presented in Supplementary Information – Five-Year Review.*

Revenue



Investments[1]



1. *Excluding net change in short-term investments.*
2. *Including the acquisition of Transelec, the largest transmission provider in Chile, at a cost of $1.6 billion.*

Consolidated Results

In this Management's Discussion and Analysis, Hydro-Québec refers to the group formed by the publicly owned corporation Hydro-Québec (the "Corporation") and enterprises in which it has an ownership interest.

Our analysis initially focuses on Hydro-Québec's consolidated results and its financial position, except for financing activities, which relate only to the Corporation, as well as integrated business risk management. We then present the operating results, investing activities and risk management for each segment, followed by our outlook for 2004.

Operating Results

Hydro-Québec's net income totaled $1,931 million, up $405 million from the amount reported in 2002. This increase is attributable to active debt management, which reduced financial expenses, and to a decrease in the depreciation, amortization and decommissioning expenditure, which was higher in 2002 as a result of nonrecurring items. As in 2002, Hydro-Québec improved its financial ratios overall. Thus, return on equity reached 13.2%, compared to 11.0% in 2002, the return on revenue rose from 11.7% to 16.9%, and interest coverage rose from 1.56 to 1.66.

Sales decreased by $1,576 million to a total of $11,425 million, mainly as the result of a $2,123-million decline in electricity sales outside Québec. We considerably reduced our electricity trading activities on external markets in 2003, given the substantial increase in Québec demand, as well as uncertainty on futures markets and high credit risks. As a result, our sales outside Québec generated $1,344 million, compared to $3,467 million in 2002.

On the other hand, sales on the Québec market rose to $8,578 million, compared to $8,112 million in 2002. This $466-million increase is mainly due to a strong economy and colder temperatures in the first quarter, and, to a lesser extent, to the application in 2003 of a price indexation clause in certain industrial contracts.

Total expenditure amounted to $6,729 million, down $1,658 million (19.8%) from 2002. This decline is mainly attributable to a $1,731-million reduction in electricity purchases stemming from a decrease in our trading activities. The operating expenditure reached $2,246 million as compared to the $2,209 million recorded last year (a 1.7% increase), whereas the depreciation, amortization and decommissioning expenditure totaled $1,916 million, compared to $2,062 million in 2002. If not for the adjustments made in 2002 to reflect, among other things, imputed interest associated with the decommissioning of Gentilly-2 nuclear generating station and the write-off of certain suspended draft design projects, this expenditure would have been up approximately 2%, due primarily to the commissioning of new equipment.

Financial expenses totaled $2,734 million, compared to $3,058 million in 2002, a decrease of $324 million (10.6%). This decrease is mainly the result of three factors, which served as leverage in managing the debt. First, the average value of the Canadian dollar rose from US$0.637 in 2002 to US$0.714 in 2003. This 12.1% appreciation alone, which offset the foreign exchange loss on our business transactions in U.S. dollars, accounts for almost half of the reduction in our financial expenses. The Corporation also repaid $730 million of its long-term debt, bringing the net repayment to $1,244 million for the last two years. Finally, as was the case in 2002, we took advantage of low interest rates to optimize long-term financing transactions and to reduce the costs related to the variable-interest debt, which we are maintaining around 25% of our total indebtedness.

Operations and Dividends $M	**2003**	2002
Revenue	**11,425**	13,001
Net income	**1,931**	1,526
Dividends	**965**	763
Balance Sheet $M		
Total assets	**57,703**	59,098
Fixed assets	**50,865**	49,694
Long-term debt, including current portion	**35,985**	39,664
Shareholder's equity	**15,127**	14,215
Ratios		
Return on equity (%)	**13.2**	11.0
Average cost of debt (%)	**8.3**	8.4
Return on revenue (%)	**16.9**	11.7
Capitalization (%)	**29.9**	26.2
Self-financing (%)	**53.9**	72.2
Interest coverage	**1.66**	1.56

Financial Position

Operating Activities

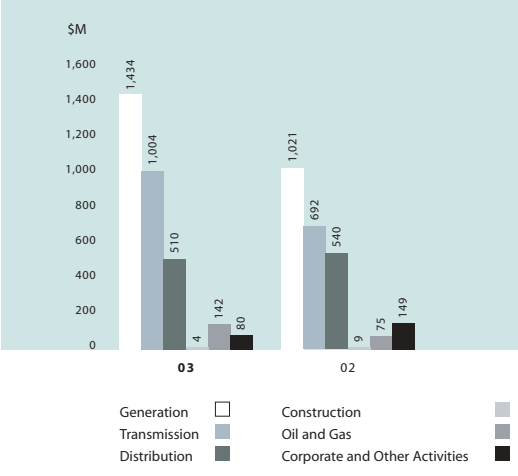
Operating activities generated cash of $3,926 million in 2003, which is comparable to 2002 levels. These amounts were used to finance our renewed investment activity. Increased capital investment, combined with increased repayment of debt due, led to a lower self-financing ratio, which went from 72.2% in 2002 to 53.9% in 2003.

Investing Activities

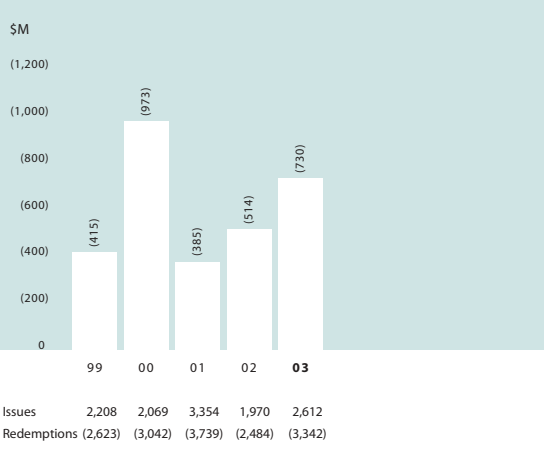
In 2003, Hydro-Québec embarked on a series of major capital projects. Investments totaled $3.2 billion compared to $2.5 billion in 2002, an increase of $0.7 billion (28.0%). Almost half of amounts invested in 2003 related to construction projects for generating facilities, including Eastmain-1, Toulnustouc, Rocher-de-Grand-Mère, and the Eastmain-1-A generating station and Rupert partial diversion draft design project. Hydro-Québec TransÉnergie invested $0.7 billion in its transmission system in Québec, including construction of the Montérégie loop, while Hydro-Québec Distribution invested $0.5 billion in connection with its current operations. Finally, Hydro-Québec invested $0.5 billion through its subsidiaries, mainly in the Transmission segment through Hydro-Québec International and in the Oil and Gas segment through Noverco.

Most of the engineering and construction projects of Hydro-Québec Production and Hydro-Québec TransÉnergie are carried out by Hydro-Québec Équipement and Société d'énergie de la Baie James.

Investments by Segment



Net Repayment of the Corporation's Long-Term Debt



	99	00	01	02	03
Issues	2,208	2,069	3,354	1,970	2,612
Redemptions	(2,623)	(3,042)	(3,739)	(2,484)	(3,342)

Financing Activities

Borrowings amounted to $2,612 million in 2003, compared to $1,970 million in 2002. Most of the amounts borrowed in 2003, which were added to the $500 million in prefinancing arranged in November 2002, were used by the Corporation to repay $2,523 million of its debt due and to make some early redemptions at advantageous rates. The net repayment of long-term debt totaled $730 million in 2003, bringing the total amount repaid in the last five years to $3,017 million.

As in 2002, all financing was obtained on the Canadian market. Of the various capital markets, the Canadian market currently offers the lowest financing costs due to strong investor demand.

During the first six months of 2003, the Corporation issued three series of variable-interest notes maturing in 2006–2007 for a value of $990 million. These series represent 37.9% of total financing for the year.

As for long-term debt, firm markets and the substantial decrease in interest rates enabled the Corporation to issue $1.0 billion in bonds maturing in February 2035, bringing the nominal value of this series close to $2.3 billion.

Finally, it should be pointed out that cash inflows of $364 million were generated through transactions in connection with agreements which the Corporation signed with certain counterparties to mitigate the related credit risk.

Financial Risks

The financial risks associated with the volatility of interest rates, exchange rates and the price of aluminum are subject to active integrated management. The objective is to limit the impact of unfavorable fluctuations on the Corporation's results according to criteria determined each year based on risk tolerance.

PREAUTHORIZED FUNDING SOURCES

The Corporation has access to the following preauthorized funding sources:

Type of financing	Authorized volume	Market	Outstanding at December 31, 2003
Credit	US$350M or equivalent in C$		–
	C$40M		–
	US$50M		–
Standby credit	US$1,500M		
Commercial paper[1]	US$2,250M or	United States	
	equivalent in C$	Canada	C$46M
Medium-term notes[1]	US$3,000M or equivalent		
	in other currency	United States	US$829M
	US$4,000M or equivalent		
	in other currency	Euromarket	US$1,368M
	C$8,000M	Canada	C$7,022M

1. *Guaranteed by the Government of Québec.*

CREDIT RATINGS

The Corporation's credit ratings are presented in the table below:

	2003	2002
U.S. agencies		
Moody's	**A1 positive**	A1 positive
Fitch Ratings	**AA– stable**	AA– stable
Standard & Poor's	**A+ stable**	A+ stable
Canadian agency		
DBRS	**A positive**	A stable

Dividends and Capitalization Rate

The year-end capitalization rate of 31.2% authorized the declaration of dividends totaling $965 million, which represents 50% of net income. After dividends have been paid to the shareholder, the capitalization rate will stand at 29.9%, compared to 26.2% in 2002. This increase is attributable to our sound financial performance in 2003 and to the reduction of the debt.

Dividends declared in 2003 will constitute the seventh consecutive payment made to our shareholder and will bring the total amounts paid since 1998 to $3.9 billion.

Integrated Business Risk Management

Risk management has been an integral part of our activities for a long time. Originally concentrated on financial risks, in 1997 it was extended to include all our operations. Due to integrated control measures implemented in all divisions, we ensure the effective management of our principal risks, in particular those relating to runoff, temperature variations and financial transactions. The Board of Directors assumes a continuous oversight role and always sees the big picture for all our business risks. Additional information on risk management activities specific to each segment is presented in the corresponding section.

The year 2003 was marked by the preparation of the *Strategic Plan 2004–2008*. During this process, we asked each segment to participate in analyzing the risks related to our strategic business objectives. The corporate unit in charge of integrating the results ensured that the principal business risks had been taken into account and then submitted this analysis to the Board Finance Committee.

Segmented Information

In 1997, the Corporation created the Hydro-Québec TransÉnergie division to comply with the trade rules of the North American wholesale market. It then further segregated its operations, creating other divisions to benefit from market restructuring.

Today, its operating activities are divided into the same segments as in 2002: Generation, Transmission, Distribution, Construction, and Oil and Gas, as well as Corporate and Other Activities. However, the organizational structure has been streamlined as follows:

- Hydro-Québec Production and Hydro-Québec Pétrole et gaz are now headed up by the same president.
- Each division and corporate unit was given responsibility for its own strategic planning. However, the Corporate Affairs and General Secretariat Group is in charge of coordination.
- We have created a new division, Hydro-Québec Technologie et développement industriel, whose results are grouped under Corporate and Other Activities. Among other functions, this division includes Hydro-Québec's research institute and subsidiaries Hydro-Québec IndusTech and Hydro-Québec CapiTech, all of which previously fell under the responsibility of Research and Strategic Planning. This department, which has now been abolished, was also part of Corporate and Other Activities.

Segment Highlights

Since debt and financial expenses are managed for the Corporation as a whole and allocated among the various segments, income before financial expenses is presented below for each segment. In 2003, as in 2002, the decrease in financial expenses allowed the improvement of each segment's results.

The **Generation** segment recorded income before financial expenses of $2,912 million, versus $2,915 million in 2002. The reduction in net electricity exports was offset by a decrease in the depreciation, amortization and decommissioning expenditure, which was higher in 2002 due to nonrecurring items.

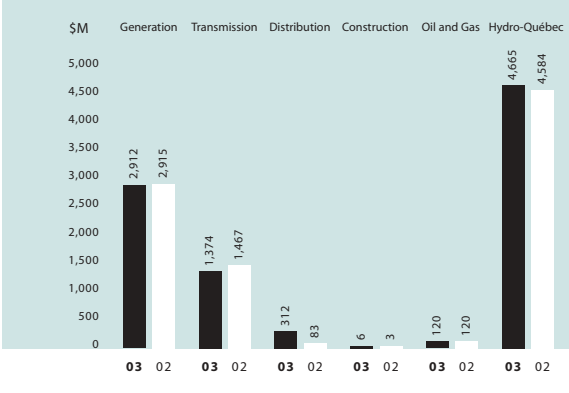
The **Transmission** segment recorded income before financial expenses of $1,374 million, versus $1,467 million in 2002. This decrease is attributable to a decline in demand for long-term point-to-point service.

The **Distribution** segment recorded income before financial expenses of $312 million, compared to $83 million in 2002. This improvement is essentially attributable to the growth in electricity sales in Québec spurred by colder temperatures in the first quarter and a strong economy.

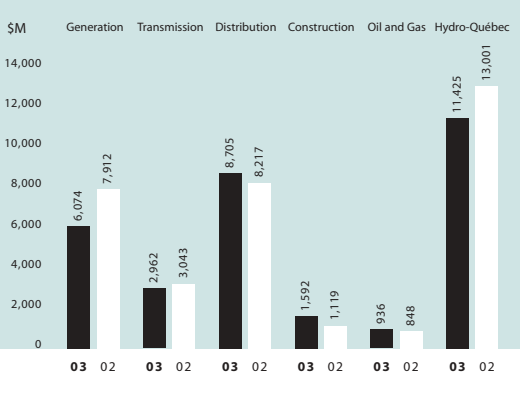
The **Construction** segment recorded sales of $1,592 million, compared to $1,119 million in 2002. This increase stems from the resumption of construction by Hydro-Québec Production and Hydro-Québec TransÉnergie.

The **Oil and Gas** segment recorded income before financial expenses of $120 million, which is comparable to the amount recorded in 2002. The higher return on Hydro-Québec's interest in Noverco was offset by costs associated with the end of Phase I of the gas exploration program initiated in 2002, which were expensed in 2003.

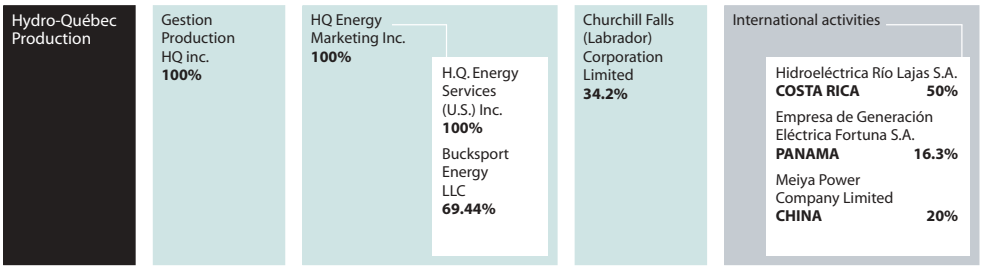
Income Before Financial Expenses



Revenue



Segment results are presented in note 22 to the Consolidated Financial Statements.



Generation

Hydro-Québec Production provides Hydro-Québec Distribution with a maximum of 165 TWh of heritage pool electricity annually, at a fixed price of 2.79 cents per kilowatthour. Over and above this volume, it sells its output on wholesale markets, including Québec, at competitive market prices.

The division operates 57 generating stations. Through its investments, it assures the long-term operability of existing facilities and the development of hydroelectric potential.

Operating Results

Hydro-Québec Production recorded net income of $1,741 million in 2003, compared to $1,563 million in 2002, an 11.4% increase mainly attributable to the decrease in financial expenses and the depreciation, amortization and decommissioning expenditure. If not for the active management approach taken and favorable market conditions, the decline in the contribution of business transactions to the division's net income would have been more significant.

Electricity Sales to Hydro-Québec Distribution

In 2003, electricity sales to Hydro-Québec Distribution totaled 166.7 TWh, including 1.75 TWh of non-heritage electricity. In 2002, they had reached 158.0 TWh. Sales to the Distributor therefore increased by 8.7 TWh or 5.5% in 2003, and the associated revenue increased by $263 million to total $4,513 million.

Electricity Sales Outside Québec

Electricity sales outside Québec totaled 15.8 TWh in 2003, for sales of $1,344 million. The sharp decline compared to 2002 levels is mainly attributable to a reduction in trading transactions beyond the short term, owing to uncertainty on futures markets and high credit risks for a number of counterparties in the industry throughout the year. The net reservoir drawdown for sales outside Québec totaled 4.0 TWh in 2003, compared to 12.6 TWh in 2002. This decrease served to offset the substantially greater deliveries in Québec in 2003. The remaining sales, 11.8 TWh in 2003, reflect energy trading mainly on U.S. markets, as was the case in 2002. It should be noted that the net reservoir drawdown of 4.0 TWh translated into a net contribution of $596 million in 2003, compared to $971 million in 2002 for a net drawdown of 12.6 TWh.

Other Electricity Sales

There was a 5.0% ($38-million) decline in sales on international markets carried out through entities under the responsibility of Hydro-Québec Production.

Electricity and Fuel Purchases

Electricity and fuel purchases reached $1,494 million in 2003, down $1,753 million from the previous year. This decrease essentially represents the decline in purchases associated with lower revenues from financial trading on futures markets. Electricity purchased mainly for resale on U.S. and Ontario markets totaled $701 million in 2003, for a purchase volume of 11.1 TWh.

Depreciation, Amortization and Decommissioning

The depreciation, amortization and decommissioning expenditure totaled $694 million in 2003, down $134 million from 2002. This decrease is mainly attributable to two nonrecurring expenditures recorded in 2002 and resulting from the adjustment in the provision for decommissioning Gentilly-2 nuclear generating station to reflect imputed interest, and from the write-off of suspended draft design projects, including the one on the Ashuapmushuan River, which was declared a heritage river.

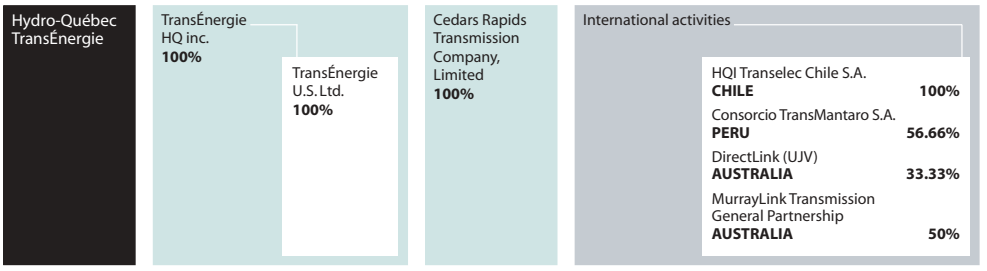
Investing Activities

In 2003, Hydro-Québec Production's capital expenditure (including intangible assets) totaled $1,431 million. Of this amount, $359 million was spent on upgrading and improving generating facilities. This work focused on modernizing power stations, maintaining or increasing their performance and extending their useful lives. The key projects for 2003 were the ongoing rehabilitation of Beauharnois, Rapides-des-Quinze, Outardes-3, Bersimis-1, Rapide-2 and Rapide-7. Work also continued on technical studies for a major rehabilitation of Gentilly-2 nuclear generating station.

The division also spent $1,072 million on hydroelectric projects intended to increase generating capacity. This amount was allocated to ongoing construction work on the Rocher-de-Grand-Mère, Toulnustouc and Eastmain-1 projects, as well as to the Manouane diversion and the Eastmain-1-A and Rupert diversion draft design project. Sainte-Marguerite-3 was partially commissioned in 2003 and energy-capable spillages at this facility stopped in early November.

Risk Management

Hydro-Québec Production closely monitors and manages its principal business risks. The division's key risk concerns runoff fluctuations. This risk is covered by a reserve comprising various items, including reservoir energy reserves, which can effectively cover a runoff deficit of 64 TWh over two consecutive years. Current market and credit risk management policies and practices are in line with industry best practices.



Transmission

Hydro-Québec TransÉnergie's mission is to transmit power that meets customer quality expectations at the lowest possible cost. The division must ensure the reliability, security, long-term operability and optimal development of the transmission system in Québec, where its operations fall under the exclusive jurisdiction of the Régie de l'énergie. It also manages Hydro-Québec's telecommunications network.

A world leader in transmission, Hydro-Québec TransÉnergie uses its expertise and technological edge in high-voltage transmission to manage and operate systems and carry out development projects abroad.

Operating Results

Net income reached $397 million in 2003, compared to $389 million in 2002, an $8-million increase. Reduced financial expenses, partially offset by lower sales in regulated activities, account for the change.

Total sales reached $2,962 million, down $81 million from 2002. The decrease is due to lower demand for long-term point-to-point service (reservation and transmission from receiving point to delivery point). Regulated activities accounted for 86.2% of sales.

Financial expenses dropped by $101 million to settle at $977 million. Two key factors account for this decrease: the Corporation's decreased financial expenses and a positive exchange rate fluctuation of $28 million related to the division's international operations and resulting from the appreciation of the Chilean peso against the U.S. dollar.

Investing Activities

In 2003, Hydro-Québec TransÉnergie's capital expenditure (including intangible assets) totaled $1,002 million, including $596 million for regulated activities, $110 million for unregulated activities and $296 million for international activities.

Regulated Activities

The Montérégie loop cost $165 million in 2003. Of this amount, $23 million was spent on bringing Montérégie substation onto the 120-kV grid and $67 million on building the 735-kV Hertel–Des Cantons line. This 145-km line was commissioned in December 2003. The Montérégie loop project is part of the transmission system reinforcement program implemented after the 1998 ice storm. The new facilities are designed to enhance system reliability throughout southeastern Québec, including Montréal.

The division is always on the lookout for new technologies that will increase its interconnection capacity at minimum cost. In 2003, it spent $12 million to install a new type of converter at Langlois substation enabling the direct interchange of 100 MW of additional electricity with neighboring systems.

At Sainte-Marguerite-3, the switchyard and the 315-kV line to Arnaud substation were commissioned in 2003, bringing the new generating station onto the grid. The total cost of the project was $250 million.

Unregulated Activities

Cedars Rapids Transmission Company built a transmission line operated at 120 kV to replace a line that was almost 100 years old. The line was commissioned in January 2004. A total of $35 million was spent on this project in 2003.

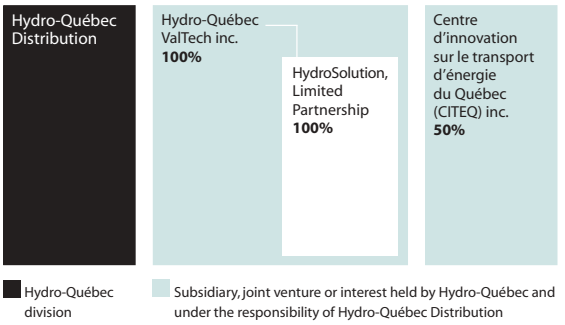
Following the blackout in Ontario and the U.S. Northeast on August 14, 2003, the U.S. Department of Energy provisionally authorized commercial operation of the Cross Sound Cable underwater line.

International Activities

HQI Transelec Chile (Transelec) acquired the transmission assets of the northern system in Chile for US$107 million (C$140 million). To carry out this transaction, Hydro-Québec International took in a new investor in Transelec: the International Finance Corporation (IFC), a World Bank member whose mission is to promote private investment. The IFC injected US$60 million (C$87 million) into Transelec in exchange for preferred shares. Since October 2000, Transelec has owned the transmission system in central Chile.

Risk Management

In 2003, Hydro-Québec TransÉnergie began integrating risk management into every component of the planning process. This integration helped the division identify the transmission and telecommunications facilities that play a key role in delivering value-added service and maintaining system reliability and integrity. It was thus able to focus closely on these components when operating and maintaining its facilities.



Distribution

The mission of Hydro-Québec Distribution, whose activities are regulated on a cost-of-service basis, is to provide a reliable power supply and quality services to Québec customers. This means that it must have a supply portfolio that meets customer requirements at all times. Beyond the annual heritage pool of 165 TWh, Hydro-Québec Distribution uses supply contracts at market prices. In August 2003, the Régie de l'énergie approved the first electricity supply contracts concluded by the division under a call for tenders issued in 2002. These contracts, totaling some 1,107 MW, will take effect in 2006.

In May 2003, the Régie de l'énergie ruled on the regulatory principles applicable to the Distributor and on most of the economic and accounting factors that must be taken into consideration in determining the cost of service. These principles were used to determine the Distributor's revenue and to prepare the application to amend electricity rates that was filed by Hydro-Québec Distribution in the fall of 2003. Lifting the rate freeze that had been in effect since 1998, the Régie approved a 3.0% rate hike for January 1, 2004.

Operating Results

Hydro-Québec Distribution reduced its net loss by $276 million compared to 2002, bringing it to $133 million. This improved performance was basically driven by rising electricity sales that contributed $206 million more to the division's gross margin than last year.

Steady Growth in Electricity Sales in Québec

ELECTRICITY SALES IN QUÉBEC BY CATEGORY[1]

	Sales Volume			Sales Revenue		
	2003	Change 2003–2002		**2003**	Change 2003–2002	
	TWh	TWh	%	**$M**	$M	%
Residential and farm	**57.2**	4.0	7.5	**3,504**	259	8.0
General and institutional	**32.3**	1.4	4.5	**2,096**	92	4.6
Industrial	**72.6**	3.2	4.6	**2,742**	111	4.2
Other	**5.0**	0.2	4.2	**236**	12	5.4
Total[2]	**167.1**	8.8	5.6	**8,578**	474	5.8

1. *The data for 2002 were restated following the reclassification of certain service contracts among the various categories.*
2. *In 2003, Hydro-Québec Distribution purchased 166.7 TWh from Hydro-Québec Production, that is, 164.95 TWh of heritage electricity and 1.75 TWh to cover rates not included in the heritage pool, including Rate BT. The division also procured 0.4 TWh of electricity from other sources.*

STRONG GROWTH IN DEMAND

Strong housing starts in Québec and growth in industrial production drove up demand by approximately 6.8 TWh, or $335 million.

Buoyed by favorable business conditions, mainly in the aluminum, pulp and paper and chemical industries, customer demand in the industrial category alone drove sales up by 3.2 TWh, generating additional revenue of $117 million.

In 2003, stable inflation and low interest rates stimulated residential construction and consumption. These factors explain the growth of sales in the residential and farm category, up 2.4 TWh for additional revenue of $148 million. Demand in the general and institutional category was up by 1.1 TWh, or $66 million, from 2002.

VERY COLD WINTER TEMPERATURES

Colder temperatures in 2003, especially in the first quarter, generated additional sales of 2.0 TWh or $126 million compared to 2002. The increase is primarily attributable to the residential and farm category, as heating requirements make it the most sensitive to climatic changes.

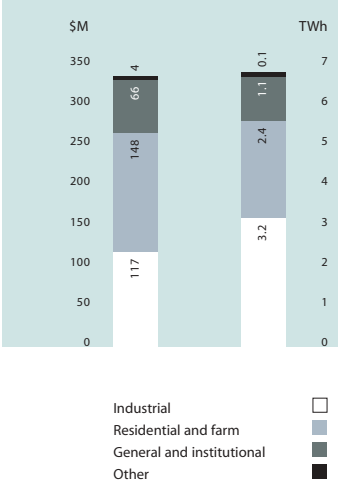
OTHER FACTORS

The significant appreciation of the Canadian dollar against the U.S. dollar drove down revenue denominated in the latter currency. On the other hand, the application of an indexation clause to electricity prices in the contracts of certain industrial customers had a positive impact on the revenue of Hydro-Québec Distribution.

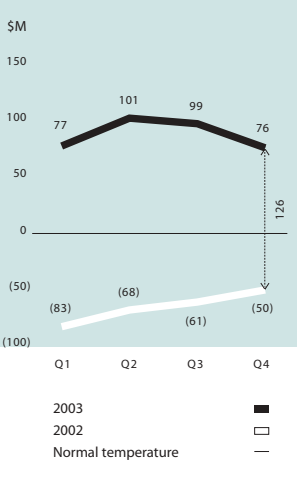
Unregulated Activities

The division's unregulated activities are the responsibility of Hydro-Québec ValTech. In 2003, this subsidiary's net income reached $10 million, up $5 million from the preceding year.

Increase in Demand by Category



Cumulative Effect of Temperature in Comparison to the Norm



Investing Activities

In 2003, Hydro-Québec Distribution's capital expenditure (including intangible assets) reached $553 million in the course of its ongoing operations.

Of this amount, $546 million was spent on regulated activities in compliance with the budget approved by the Régie de l'énergie. In particular, the division spent $221 million on asset maintenance, including $39 million on the Customer Information System (CIS) project. The purpose of the project, initiated in 2003, is to revamp the division's commercial and business practices and modernize its information systems. Implementation of the CIS is slated for 2007. Hydro-Québec Distribution had to invest $191 million to meet the growth in demand, including $158 million to supply new customers. It also invested $87 million to upgrade the distribution system and $47 million to meet government requirements, among other things.

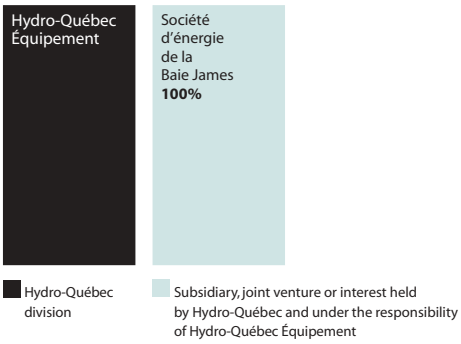
Lastly, in addition to capital expenditure (including intangible assets), the division spent $10 million on the Energy Efficiency Plan 2003–2006. This commercial program, which will cost an estimated total of $125 million, should translate into energy savings of at least 750 GWh in 2006.

Risk Management

Among its principal business risks, Hydro-Québec Distribution must prevent shortages for Québec customers, whether caused by increasing demand, very cold temperatures or other factors. To limit this risk, the division filed an initial supply plan with the Régie de l'énergie in October 2001 and related amendments in 2002 and 2003. In August 2003, the Régie approved three contracts concluded by Hydro-Québec Distribution after an initial call for tenders with a view to meeting demand growth in upcoming years. In 2003, the division also issued new calls for tenders, which are now at various stages of completion.

Service continuity is another of the division's imperatives. For several years now, Hydro-Québec Distribution has taken steps to ensure the long-term operability of its system and enhance service quality. Major investments in line reinforcement, preventive maintenance and vegetation control are some of the initiatives taken to reduce hours of service interruption.

Achieving the rate of return targeted in the *Strategic Plan 2004–2008* is largely contingent on the Régie's decisions concerning the rate hike applications. These hikes, combined with strict cost control and improved efficiency and productivity, will allow the division to reach and maintain the authorized rate of return.



Construction

Hydro-Québec Équipement carries out engineering and construction projects related to hydroelectric development throughout Québec, except on 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). Hydro-Québec Équipement also builds power transmission lines and substations throughout the Québec territory.

As an engineering and environmental specialist, Hydro-Québec Équipement also undertook or continued surveys and draft design studies amounting to more than $52 million in 2003. Besides optimizing the government authorization process, the main purpose of these mandates is to produce data and reports to support major initiatives such as the Romaine hydroelectric complex.

Volume of Activity

In 2003, the work carried out by the Construction segment totaled $1,592 million, compared to $1,119 million in 2002, a 42.2% increase that reflects renewed capital spending by Hydro-Québec. Work done for Hydro-Québec Production totaled $1,057 million, versus $707 million in 2002, while work for Hydro-Québec TransÉnergie reached $484 million, compared with $335 million in 2002.

In all, the current projects of Hydro-Québec Équipement and SEBJ will add 136 MW of installed power to the Corporation's generating capacity by 2004 and more than 2,000 MW by 2008.

Hydro-Québec Équipement

In 2003, Hydro-Québec Équipement carried out activities worth $1,232 million, up $197 million or 19.0% from 2002. This sharp increase reflects continuing work on many projects in the Generation and Transmission segments: power plant rehabilitation, construction of facilities, development of hydroelectric potential, and transmission system reinforcement.

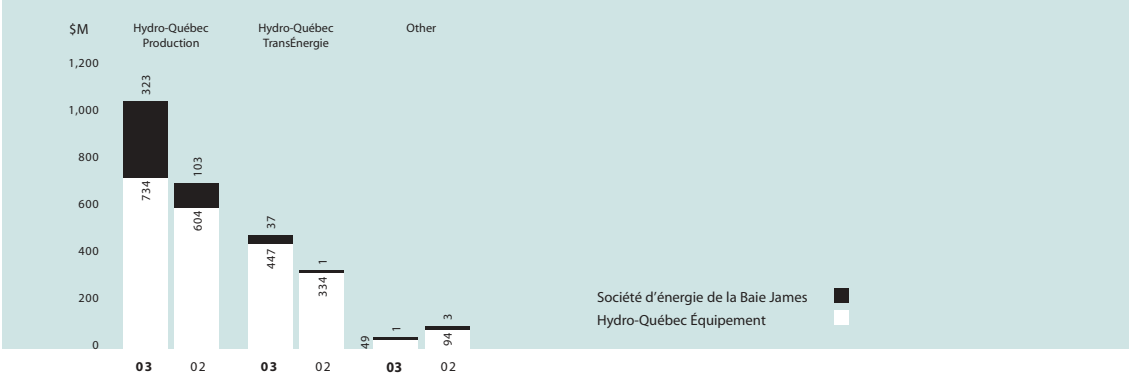
Société d'énergie de la Baie James

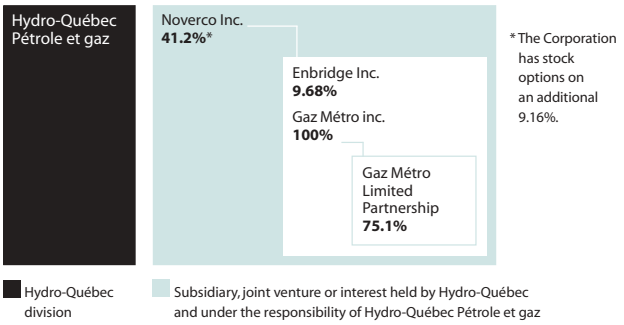
SEBJ's activities—mainly on behalf of Hydro-Québec Production—represented a total investment of $358 million in 2003, compared to $107 million in 2002. This strong increase is basically attributable to ongoing construction of the Eastmain-1 project. SEBJ also pursued draft design studies for Eastmain-1-A generating station and the Rupert diversion.

Risk Management

Rising electricity demand over the long term will have a strong impact on the Construction segment's activities. In upcoming years its volume of activity, now rising, will be contingent on several major generation projects and on securing the necessary approvals. This is why steps have been taken to speed up the authorization process without compromising thoroughness or quality. Promising breakthroughs have already been made for certain projects, including the Péribonka River development.

Activities of the Construction Segment





Oil and Gas

Hydro-Québec Pétrole et gaz comprises Hydro-Québec's interest in Noverco and activities intended to tap eastern Québec's oil and gas potential. The division's earnings come exclusively from Noverco's operations.

In 2003, oil and gas exploration was limited to a few sites on the Gaspé Peninsula and Anticosti Island.

Operating Results

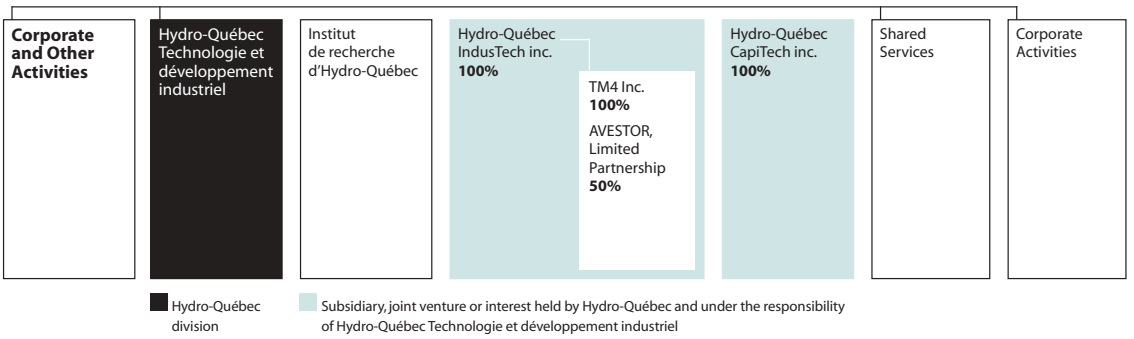
The division's net income totaled $35 million, which is comparable to 2002. Hydro-Québec's interest in Noverco generated net income of $51 million, up $13 million from the $38 million posted in 2002. However, all oil and gas exploration activities related to the end of Phase I of the gas exploration program initiated in 2002 were expensed in 2003.

Investing Activities

The overall investments of Hydro-Québec Pétrole et gaz totaled $142 million, a $67-million increase compared to the $75 million spent in 2002. They basically correspond to Hydro-Québec's share in the investments of Gaz Métro Limited Partnership.

Risk Management

The risk management strategy of Hydro-Québec Pétrole et gaz consists mainly of hedging transactions applying to the debt of Noverco, the holding company that controls Gaz Métro, which handles its own risk management. To limit the risks related to oil and gas exploration, the division exercises tight control over the total amount of financial commitments in these operations.



Corporate and Other Activities

The heading Corporate and Other Activities covers the new division Hydro-Québec Technologie et développement industriel, shared services and all corporate activities.

Results

Results show a net loss of $109 million compared to a $55-million net loss in 2002. The 2003 loss is mainly due to the activities of Hydro-Québec Technologie et développement industriel.

Hydro-Québec Technologie et développement industriel

Created in 2003, Hydro-Québec Technologie et développement industriel handles the integrated management of technological innovation, including the creation of value from Hydro-Québec technologies. It comprises Hydro-Québec's research institute and two subsidiaries, Hydro-Québec IndusTech and Hydro-Québec CapiTech, among others.

In 2003, amounts spent on technological innovation—mainly through Hydro-Québec's research institute—reached $99 million.

INSTITUT DE RECHERCHE D'HYDRO-QUÉBEC

The mission of Hydro-Québec's research institute is to provide technical support and carry out innovation projects intended to support the divisions' sound performance and ensure the Corporation's long-term viability. Its work is focused on Hydro-Québec's core businesses—the generation, transmission and distribution of electricity.

HYDRO-QUÉBEC INDUSTECH

Hydro-Québec IndusTech oversees the industrial production and marketing of technologies resulting from Hydro-Québec's research activities in partnership with the private sector. Its portfolio currently comprises interests in AVESTOR, TM4 and the PSEV project (Propulsion Systems for Electric Vehicles).

Hydro-Québec IndusTech recorded a $46-million net loss in 2003, compared to a net loss of $24 million in 2002. The 2003 loss resulted from the fine-tuning of AVESTOR's production line and the adaptation of the lithium-metal-polymer (LMP) battery for electric vehicles under the PSEV project.

HYDRO-QUÉBEC CAPITECH

The venture capital company Hydro-Québec CapiTech invests in energy businesses that market or are about to market promising technologies, thereby giving the Corporation privileged access to outside innovations.

Hydro-Québec CapiTech recorded a $37-million net loss versus a $29-million net loss in 2002. These losses reflect the poor performance of venture capital funds over the past three years. Hydro-Québec CapiTech was obliged to write down its investment portfolio and consequently recognized a $35-million permanent decline in value.

Shared Services

The Shared Services Centre manages a number of activities, including procurement of goods and services and information technology. Its twofold objective is to support the divisions and corporate units by providing quality services at the lowest possible cost on a partnership basis, and to enable them to concentrate exclusively on their core businesses.

In 2003, the Shared Services Centre's activities totaled $618 million.

Corporate Activities

Corporate activities include finance, human resources, corporate affairs and strategic planning coordination. In 2003, certain components of these activities were taken over by the divisions or the Shared Services Centre, specifically strategic planning and various financial services such as internal control, accounting transactions and systems operation.

The Finance Department manages debt and financial expenses for the entire Corporation and then allocates the financial expenses to the operating segments. As in 2002, the steep decline in financial expenses—by $324 million—improved the results of each segment.

Investing Activities

Total investments amounted to $80 million in 2003. The acquisition of Connexim's assets and the development and purchase of information systems accounted for more than half of this amount, while investments by Hydro-Québec IndusTech and Hydro-Québec CapiTech amounted to $23 million.

Outlook

In 2004, Hydro-Québec will work towards achieving the objectives described in its *Strategic Plan 2004–2008:* increase generating capacity in Québec, maintain customer service quality and create value for the shareholder and for Québec society. The targeted net income of $1.8 billion is based on tight control of operating expenses and on a decline in transactions outside Québec. However, the scaleback of such transactions will not compromise our presence on outside markets; we will still be able to profit from any business opportunities that arise.

Hydro-Québec Production will continue to increase its generating capacity by developing Québec's hydroelectric potential. **Hydro-Québec TransÉnergie** will concentrate on offering transmission services that meet customers' reliability and quality requirements while remaining profitable. **Hydro-Québec Distribution** will focus on security of supply, service quality and profitability.

In 2004, Hydro-Québec's investment program will approach $3.7 billion. Much of this will be funneled into projects to develop generating capacity: ongoing construction of the Eastmain-1 and Toulnustouc developments; start of construction of a new power station on the Péribonka River; ongoing work on the Eastmain-1-A/Rupert diversion draft design study; completion and commissioning of Rocher-de-Grand-Mère generating station; ongoing rehabilitation of Beauharnois, Outardes-3, Outardes-4, Rapides-des-Quinze, Rapide-2 and Rapide-7; construction of Mercier generating station and rehabilitation of its dam. Based on debt maturities and cash from operations, we anticipate a borrowing program of just over $2.0 billion in 2004.

Improving service quality, as well as transmission and distribution network reliability and security, will continue to be major concerns. Aside from investments to refurbish equipment, we will continue work on line de-icing and reinforcing the high-voltage transmission system as well as programs to underground, automate and strengthen the distribution system. In addition, following the commissioning of the Montérégie loop in December 2003, we will start to bring Montérégie substation onto the grid.

Two calls for tenders are slated for 2004 in order to meet short-term power supply requirements. The first will be in the spring to meet 2005 requirements, and the second in the fall to meet 2005 and 2006 requirements, depending on changes in demand. Hydro-Québec Distribution will also issue one or more calls for tenders with a view to meeting long-term demand. For 2004, Hydro-Québec Distribution's needs will be fully met by Hydro-Québec Production, and sales in excess of the 165-TWh heritage pool will be made at market prices.

Energy efficiency remains a prime concern that affects all of Hydro-Québec's marketing activities—commercial and technological research, communications, sales programs and consulting services. With this in mind, we will continue to implement our Energy Efficiency Plan 2003–2006, approved by the Régie de l'énergie in 2003.

To boost the development of our customer services, we will continue to focus on consulting services, partnerships with industrial customers and the development of tools such as the CIS and the Internet customer relations centre.

Lastly, we plan to maintain our international presence, especially in South America.

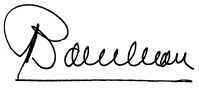
Management Report

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 financial statements have been prepared by Management in accordance with Canadian generally accepted accounting principles and in accordance with decisions handed down by the Régie de l'énergie with respect to the transmission and distribution of electricity and the distribution of natural gas in Québec. The financial statements include amounts determined based on Management's best estimates and judgment. Financial information presented elsewhere in the Annual Report is in accordance with the information provided in the financial statements.

Management maintains an internal control system which 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 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 efficiency 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 directors who do not hold full-time positions within the Corporation or in one of its subsidiaries. This committee's mandate is to ensure that the financial statements present fairly Hydro-Québec's financial position, the results of its operations and its cash flows. The Audit Committee meets regularly with Management, the General Auditor and the external auditors to discuss the results of their audits as well as their findings with respect to the integrity and 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's presence.

The consolidated financial statements have been audited jointly by the external auditors, Samson Bélair/Deloitte & Touche s.e.n.c.r.l. and PricewaterhouseCoopers LLP, who were appointed by the shareholder.



André Bourbeau
Chairman of the Board
of Directors

André Caillé
President and
Chief Executive Officer

Daniel Leclair
Vice President – Finance
and Chief Financial Officer

Montréal, Québec
February 16, 2004

Auditors' Report

To the Minister of Finance of Québec:

We have audited the consolidated balance sheet of Hydro-Québec as at December 31, 2003, and the consolidated statements of operations, retained earnings and cash flows for the year 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 audit.

We conducted our audit 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, 2003, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles as described in note 1. As required by the *Auditor General Act (R.S.Q., c. V-5.01)*, we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Samson Bélair
Deloitte & Touche s.e.n.c.l.

Chartered Accountants

PricewaterhouseCoopers LLP

Chartered Accountants

Montréal, Québec
February 16, 2004

Consolidated Financial Statements

Consolidated Statement of Operations

For the year ended December 31 $M	notes	**2003**	2002
Revenue		**11,425**	13,001
Expenditure			
Operations		**2,246**	2,209
Electricity and fuel purchased		**1,956**	3,536
Depreciation, amortization and decommissioning	3	**1,916**	2,062
Taxes	4	**611**	580
		6,729	8,387
Operating income		**4,696**	4,614
Financial expenses	5	**2,734**	3,058
Income before non-controlling interest		**1,962**	1,556
Non-controlling interest		**31**	30
Net income		**1,931**	1,526

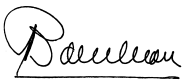
Consolidated Statement of Retained Earnings

For the year ended December 31 $M	note	**2003**	2002
Balance at beginning of year		**9,897**	9,134
Net income		**1,931**	1,526
		11,828	10,660
Dividends	18	**965**	763
Balance at end of year		**10,863**	9,897

Consolidated Balance Sheet

As at December 31 $M	notes	2003	2002
ASSETS			
Fixed assets	6	**50,865**	49,694
Current assets			
Cash and cash equivalents		**191**	293
Investments		**250**	939
Accounts receivable		**1,867**	1,924
Financial assets related to debt	10	**101**	34
Materials, fuel and supplies		**426**	418
		2,835	3,608
Other long-term assets			
Investments	7	**794**	852
Trust for nuclear waste management	8	**24**	20
Deferred charges	9	**1,126**	3,391
Financial assets related to debt	10	**884**	325
Goodwill	11	**298**	302
Intangible assets	12	**711**	760
Government reimbursement for the 1998 ice storm		**166**	146
		4,003	5,796
		57,703	59,098
LIABILITIES AND EQUITY			
Long-term debt	13	**34,356**	36,695
Current liabilities			
Borrowings		**72**	68
Dividends payable		**965**	763
Accounts payable		**1,604**	1,467
Accrued interest		**970**	1,157
Current portion of long-term debt	13	**1,629**	2,969
		5,240	6,424
Other long-term liabilities	14	**2,211**	908
Perpetual debt	15	**440**	632
Non-controlling interest		**329**	224
Shareholder's equity	18		
Share capital		**4,374**	4,374
Retained earnings		**10,863**	9,897
Translation adjustment		**(110)**	(56)
		15,127	14,215
		57,703	59,098

Yvon Lamontagne
Chairman of the Audit Committee



André Bourbeau
Chairman of the Board of Directors

Consolidated Statement of Cash Flows

For the year ended December 31 $M	note	2003	2002
Operating activities			
Net income		**1,931**	1,526
Depreciation and amortization of fixed assets and intangible assets		**1,785**	1,796
Amortization of deferred charges		**157**	320
Change in non-cash working capital items	19	**(76)**	6
Other		**129**	218
		3,926	3,866
Investing activities			
Fixed assets and intangible assets		**(3,133)**	(2,456)
Long-term investments		**26**	(40)
Net change in short-term investments		**697**	(318)
Other		**(63)**	10
		(2,473)	(2,804)
Financing activities			
Issue of long-term debt		**2,349**	2,093
Maturity of long-term debt and sinking fund redemption		**(2,699)**	(2,102)
Repayment in advance of long-term debt		**(897)**	(462)
Receipts resulting from credit risk management		**257**	51
Net change in short-term borrowings		**(4)**	(25)
Dividends paid		**(763)**	(554)
Other		**207**	(4)
		(1,550)	(1,003)
Change in foreign exchange on cash and cash equivalents		**(5)**	(17)
Net change in cash and cash equivalents		**(102)**	42
Cash and cash equivalents at beginning of year		**293**	251
Cash and cash equivalents at end of year		**191**	293
Supplementary information			
Interest paid		**2,393**	2,696

Complementary Notes to Consolidated Financial Statements

Amounts shown in tables are in millions of Canadian dollars except where indicated otherwise.

Note 1 // Significant Accounting Policies

Under the provisions of the *Hydro-Québec Act*, the publicly owned 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 consolidated financial statements include the accounts of the Corporation, its subsidiaries, all of which are wholly owned, and its joint ventures (collectively "Hydro-Québec").

Regulation

The *Act respecting the Régie de l'énergie* grants the Régie de l'énergie exclusive authority to determine or modify the rates and conditions under which electricity is transmitted and distributed by the Corporation. Consequently, electricity transmission and distribution activities in Québec are said to be regulated. Moreover, this act stipulates that rates are determined on a basis that allows for recovery of the cost of service plus a fair rate of return on the rate base.

The Corporation's electricity transmission operations are subject to decision D-2002-95, handed down by the Régie de l'énergie in April 2002. In this decision, the Régie established the cost of service and granted a rate of return of 9.72% on the rate base, assuming a capital structure with 30% shareholder's equity.

On December 15, 2003, the Régie de l'énergie handed down interim decision D-2003-232, granting the Distributor a uniform 3% rate increase effective January 1, 2004. This decision followed the May 2003 decision in which the Régie recognized, among other things, certain regulatory and accounting principles to be applied with respect to the rate application relating to the Corporation's power distribution operations. The other changes requested, including the rate at which financial expenses are capitalized to fixed assets under construction, will be addressed in a subsequent decision.

The joint venture Noverco Inc. wholly owns Gaz Métro inc., whose main subsidiary, Gaz Métro Limited Partnership, is involved primarily in the distribution of natural gas by pipeline in Québec. Most aspects of the limited partnership's operations are monitored and controlled by the Régie de l'énergie.

The consolidated financial statements take into account certain regulatory accounting practices that differ from the accounting practices applied in unregulated enterprises. These practices relate specifically to certain deferred charges and fixed assets in service or disposed of as well as their depreciation and to the capitalization of financial expenses to fixed assets under construction.

Consolidation

Interests in joint ventures are accounted for using the proportionate consolidation method. Investments in companies over which Hydro-Québec can exercise a significant influence are accounted for on an equity basis, whereas venture capital investments are generally recorded at cost. Other long-term investments are also recorded at cost.

The operations and cash flows of Noverco Inc. and of Hydro-Québec International (HQI) holdings are consolidated with a one-quarter lag. The financial positions of these companies disclosed in the consolidated balance sheet of Hydro-Québec are as at September 30.

Use of estimates

The preparation of consolidated financial statements in accordance with Canadian generally accepted accounting principles requires that Management make estimates and assumptions that affect the amounts reported in the financial statements. Actual amounts could differ from those estimates.

Revenue

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

Income taxes

The Corporation and certain of its subsidiaries have not recorded any income taxes since they are government-owned and therefore exempt from paying income taxes in Canada.

The incorporated subsidiaries and joint ventures subject to income tax use the liability method to account for income taxes.

Foreign currency translation

Revenue and expenditure resulting from transactions in foreign currencies are translated into the Canadian dollar equivalent at exchange rates in effect at the transaction date. Monetary assets and liabilities are translated into Canadian dollars at the closing exchange rates in effect at the balance sheet date, and non-monetary items are translated at exchange rates in effect at the transaction date.

The exchange gains or losses resulting from the translation of monetary items are included in the statement of operations, unless they relate to liabilities hedging sales in U.S. dollars, in which case they are deferred to the year such sales are made.

The financial statements of the main foreign operations considered to be 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. Exchange gains or losses are presented as a translation adjustment under Shareholder's equity. The financial statements of foreign operations considered to be integrated in terms of financial management and operations are translated according to the temporal method.

Fixed assets

Fixed assets are carried at cost, which comprises materials, labor, other costs directly contributing to construction activities and financial expenses capitalized during construction.

The costs of fixed assets under construction are transferred to fixed assets in service when construction is completed and the facilities are in commercial operation. For generating facilities, the costs are transferred in installments as generating units are completed and commissioned.

Fixed assets are depreciated over their useful lives, primarily under the sinking fund method, at a rate of 3%. Fixed assets related to gas transmission and distribution are depreciated using the straight-line method. Under the *Hydro-Québec Act*, the depreciation period is restricted to a maximum of 50 years. The depreciation periods for the main classes of fixed assets are as follows:

– Hydraulic generation	45 to 50 years
– Thermal generation, including nuclear	15 to 30 years
– Transmission substations and lines	30 to 50 years
– Distribution substations and lines	25 to 40 years
– Gas distribution and transmission	25 to 35 years

Financial expenses capitalized to fixed assets under construction are determined using the average cost of long-term debt of the Corporation at the end of the previous year. Financial expenses capitalized to fixed assets under construction related to regulated transmission activities take a return on shareholder's equity into account. The portion that corresponds to the return on shareholder's equity is included in Revenue in the statement of operations.

When unregulated fixed assets are disposed of, 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. Upon disposal of regulated fixed assets, these costs are charged to a separate account and depreciated over a maximum period of 10 years, under the sinking fund method, at a rate of 3%.

Note 1 // Significant Accounting Policies (continued)

Cash and cash equivalents and short-term investments

Cash and cash equivalents comprise cash and liquid short-term investments with a maturity of three months or less from the date of acquisition. Investments with a maturity of three to twelve months are disclosed separately under Current assets in the balance sheet.

Short-term investments are shown at unamortized cost. The book value of the investments approximates their fair value.

Employee future benefits

The Corporation offers all 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, and is based on best estimate economic and demographic assumptions as determined by Management.

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 on a straight-line basis over the employees' expected average remaining years of service. The transitional obligation relating to post-employment benefits is amortized on a straight-line basis over a period of five years.
- Amortization of actuarial gains or losses is recognized in the expense 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 obligation or 10% of the market-related value of the assets of the plan fund, whichever is greater. Amortization corresponds to the excess divided by employees' expected 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 held, and by valuing other asset classes at their fair value.
- The value of the contribution holiday granted to employees for the year is disclosed as a reduction of service cost, as contributions deemed paid and amortized using the method for amortizing actuarial gains and losses.

Goodwill and intangible assets

The excess of the cost of investments in subsidiaries and joint ventures over the share of the fair value of the net assets acquired is recorded as goodwill. Intangible assets are recorded at cost.

Goodwill and intangible assets with indefinite useful lives 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 value over the fair value is recorded in the year in which the impairment is determined.

Intangible assets with definite useful lives are amortized over their useful lives. They are amortized according to the following methods and periods:

- Software, licences and patents	straight-line	3 to 15 years
- Rights	sinking fund at 3%	40 years
- Environmental studies	sinking fund at 3%	5 years

Sinking funds

Sinking funds are created through the purchase of the Corporation's debentures, Government of Canada bonds, or bonds issued or guaranteed by the Québec government. The Corporation's debentures are deducted from long-term debt, while the other securities are presented as Financial assets related to debt.

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

Derivative instruments

Hydro-Québec uses various derivative instruments to manage foreign exchange and interest rate risk associated with long-term debt, foreign exchange risk related to sales and the risk related to fluctuating energy and raw material prices.

According to corporate policy, in order for a derivative instrument to qualify for hedge accounting, Hydro-Québec must be reasonably certain that the risk will materialize and that the hedge will be effective throughout the hedging period.

When the conditions for applying hedge accounting are not satisfied or hedging is discontinued, derivative instruments are valued at market value. Derivative instruments used for trading purposes, such as forward contracts, options and swaps, as well as open positions on energy trading, are also valued at market value. Realized and unrealized changes in fair value are recognized in the statement of operations as they occur.

The fair value of derivative instruments is based on the spot rates or 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 available forward rate or price for an equivalent instrument. Different valuation models recognized by financial markets are used to estimate the fair value of options.

Currency swaps used to manage exchange risk related to principal payments on long-term debt and sales in U.S. dollars are translated at the closing exchange rates in effect at the balance sheet date. Those that constitute financial assets are presented as Financial assets related to debt, while those representing financial liabilities are presented as Long-term debt. Gains or losses on currency swaps related to payments on long-term debt are included in the statement of operations, while gains or losses on currency swaps related to sales in U.S. dollars are deferred to maturity, that is, the year the sales are made.

Interest rate exchanges, all of which are accounted for as hedges and which arise from currency swap agreements used to change long-term exposure to interest rate risk, are matched to interest expense on the borrowings to which they are related. The corresponding amounts payable or receivable are recorded as adjustments to accrued interest.

Derivative instruments (foreign exchange forward contracts, options and swaps) used in the short term to manage financial risk over a period of no more than three years are recorded at cost, in accordance with hedge accounting. Realized gains or losses related to these instruments are deferred and charged to operations on a basis consistent with the recognition of the gains or losses of the underlying reverse risk position.

When employed for hedging purposes, derivative instruments used to manage risks related to energy price fluctuations are accounted for at cost and the related gains or losses are deferred and charged to operations on a basis consistent with the recognition of the gains and losses of the underlying reverse risk position.

Decommissioning of nuclear generating station

The future costs of decommissioning Gentilly-2 nuclear generating station are charged progressively to operations and reflected in Other long-term liabilities. These estimated costs essentially relate to the cost of dismantling the station and removal of the irradiated fuel, increased by the interest capitalized annually to the accrued amounts. Interest is calculated at the expected nominal rate on Hydro-Québec's long-term borrowings. Future decommissioning costs are charged to operations annually under a sinking fund method over the remaining useful life of the plant.

Note 1 // Significant Accounting Policies (continued)

The Corporation revises these costs periodically based on the various assumptions and estimates underlying the calculations, possible technological advances and changes in the standards and regulations governing the decommissioning of nuclear generating stations. The restatements resulting from these revisions are accounted for on a prospective basis.

Reclassification

Some figures of the previous year have been reclassified in order to respect the presentation adopted in the current year.

Note 2 // Changes in Accounting Policies

Disclosure of guarantees

On January 1, 2003, Hydro-Québec adopted the recommendations of Accounting Guideline 14 (AcG-14) of the *Canadian Institute of Chartered Accountants* (CICA) *Handbook* entitled "Disclosure of Guarantees." Under this Guideline, Hydro-Québec is required to disclose significant information on its guarantees, regardless of the probability that it will have to make payments under these guarantees. Note 21, entitled "Commitments and Contingencies," presents the disclosures required on guarantees.

Disposal of long-lived assets and discontinued operations

On May 1, 2003, Hydro-Québec adopted the recommendations of Section 3475 of the *CICA Handbook* entitled "Disposal of Long-Lived Assets and Discontinued Operations." This new section establishes standards for recognition, measurement and disclosure relating to disposals of long-lived assets. It also provides criteria for classifying assets held for sale and requires that these assets be presented at the lower of their carrying value and their fair value less disposal costs. Finally, it provides criteria for classifying a disposal as a discontinued operation and specifies the presentation of and disclosures for discontinued operations and other disposals of long-lived assets. The adoption of this standard did not have an impact on the financial statements.

Note 3 // Depreciation, Amortization and Decommissioning

	2003	2002
Depreciation of fixed assets	**1,672**	1,670
Amortization of intangible assets	**113**	126
Decommissioning of nuclear generating station	**28**	77
Write-off of projects	**30**	108
Other	**73**	81
	1,916	2,062

Note 4 // Taxes

	2003	2002
Capital tax	**301**	281
Tax on gross revenue as municipal real estate tax on certain immovables	**235**	228
Municipal, school and other taxes	**75**	71
	611	580

Note 5 // Financial Expenses

	2003	2002
Interest		
Interest on debt securities	**2,785**	2,935
Amortization of borrowing discount and expenses	**44**	45
	2,829	2,980
Exchange loss	**105**	222
Loan guarantee fees	**186**	188
	291	410
Less		
Capitalized financial expenses	**357**	305
Net investment income	**29**	27
	386	332
	2,734	3,058

Note 6 // Fixed Assets

	In service	Accumulated depreciation	Under construction	2003 Total
Generation				
Hydraulic	25,629	6,312	3,277	**22,594**
Thermal, including nuclear	2,427	1,351	60	**1,136**
Other	832	334	58	**556**
	28,888	7,997	3,395	**24,286**
Transmission				
Substations and lines	20,605	5,066	611	**16,150**
Other	2,324	1,275	49	**1,098**
	22,929	6,341	660	**17,248**
Distribution				
Substations and lines	9,758	3,066	214	**6,906**
Other	1,948	976	146	**1,118**
	11,706	4,042	360	**8,024**
Construction	60	47	2	**15**
Oil and Gas	1,360	469	10	**901**
Other	858	547	80	**391**
	65,801	19,443	4,507	**50,865**

	In service	Accumulated depreciation	Under construction	2002 Total
Generation				
Hydraulic	24,145	5,877	3,484	21,752
Thermal, including nuclear	2,429	1,253	41	1,217
Other	839	311	61	589
	27,413	7 441	3,586	23,558
Transmission				
Substations and lines	19,306	4,653	1,145	15,798
Other	2,234	1,207	110	1,137
	21,540	5,860	1,255	16,935
Distribution				
Substations and lines	9,636	2,912	214	6,938
Other	1,982	1,073	92	1,001
	11,618	3,985	306	7,939
Construction	62	45	7	24
Oil and Gas	1,323	442	7	888
Other	800	517	67	350
	62,756	18,290	5,228	49,694

As at December 31, 2003, the Corporation had cumulative costs related to suspended draft design projects amounting to $307 million ($336 million as at December 31, 2002). These costs, for which financial expenses are not capitalized, are presented as fixed assets under construction.

As the Corporation anticipates carrying out some of these projects at a later date, it periodically reviews the cumulative costs of its draft design projects.

During such reviews, Management must use estimates and make assumptions that have an impact on the amounts reported for draft design projects at the balance sheet date. Such projects are assessed in terms of profitability based on 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 projects.

When a major project related to regulated fixed assets is discontinued, the costs determined to be non-recoverable are not recorded as operations expenditure but are deferred and amortized over a period of three years using the straight-line method.

Note 7 // Investments

	notes	**2003**	2002
At cost			
Noverco Inc.	17		
Notes [a]		**142**	141
Churchill Falls (Labrador) Corporation Limited	21		
Bonds [b]		**56**	57
Other [c]		**189**	230
		387	428
At equity			
Enbridge Inc.		**258**	244
Churchill Falls (Labrador) Corporation Limited	21	**48**	45
Connexim, Limited Partnership [d]		**–**	35
Meiya Power Company Limited		**101**	98
Other		**–**	2
		407	424
		794	852

a) Subordinate debentures (interest rate based on the annual average rate of Government of Canada bonds with terms of over 10 years plus 4.45%) due in 2031, redeemable.
b) Bonds secured by a general mortgage bearing interest at 7.5%, due in 2010, par value of $62 million in 2003 ($63 million in 2002).
c) Includes venture capital investments at a book value of $101 million and with a fair value of $70 million as at December 31, 2003 ($122 million and $117 million as at December 31, 2002). The fair value of listed shares is based on the trading price at the balance sheet date; the fair value of unlisted shares is determined according to several different valuating methods.
d) During the year, all of the units held in this company were sold.

Note 8 // Trust for Nuclear Waste Management

On November 15, 2002, *An Act Respecting the Long-Term Management of Nuclear Fuel Waste* came into force. This legislation calls for nuclear energy companies that are owners of such waste in Canada to form a waste management organization as a separate legal entity and to set up a trust with a financial institution in order to finance the implementation of the nuclear fuel waste management proposal that will be adopted by the Government of Canada. In order to fulfill the financial responsibilities incumbent on nuclear fuel waste owners, the Corporation deposited an initial amount of $20 million in a trust within 10 days of the date the Act came into force. It will also be required to deposit an additional $4 million per year in the same trust until the waste management organization determines the amount to be paid by each nuclear plant owner. The Corporation made the required payment in 2003. The interest accumulated on trust assets is returned to the trust.

Note 9 // Deferred Charges

	note	**2003**	2002
Deferred foreign exchange loss		**–**	2,290
Other deferred charges related to debt		**–**	45
Accrued benefits asset	20	**844**	752
Other		**282**	304
		1,126	3,391

Note 10 // Financial Assets Related to Debt

	2003	2002
Currency swaps and contracts	**981**	291
Sinking funds	**4**	68
	985	359
Less		
Current portion	**101**	34
	884	325

Note 11 // Goodwill

The changes in the book value of goodwill per reportable segment are as follows:

	Generation	Transmission	Oil and Gas	Total
Balance as at January 1, 2003	10	70	222	**302**
Changes in foreign exchange	–	(2)	–	**(2)**
Other	–	–	(2)	**(2)**
Balance as at December 31, 2003	10	68	220	**298**

The Corporation performed annual impairment tests and no reduction in the value of goodwill was identified.

Note 12 // Intangible Assets

			2003
	Cost	Accumulated amortization	Total
Subject to amortization			
Software and licences	611	381	**230**
Rights	110	33	**77**
Environmental studies	118	95	**23**
Patents	38	15	**23**
	877	524	**353**
Not subject to amortization since January 1, 2002			
Servitudes	497	139	**358**
	1,374	663	**711**

			2002
	Cost	Accumulated amortization	Total
Subject to amortization			
Software and licences	560	279	281
Rights	109	29	80
Environmental studies	112	95	17
Patents	36	9	27
	817	412	405
Not subject to amortization since January 1, 2002			
Servitudes	496	141	355
	1,313	553	760

The Corporation performed annual impairment tests and no reduction in the value of non-amortizable intangible assets was identified.

Note 13 // Long-Term Debt

Composition and maturities

Debentures, other long-term debt and currency 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 include the sinking funds.

				Debt of the Corporation			**2003**	2002
Year of maturity	Canadian dollars	U.S. dollars	Other currencies	Sinking funds	Total	Subsidiaries and joint ventures	Total	Total
2003	–	–	–	–	–	–	**–**	2,969
2004	1,410	156	48	(5)	1,609	20	**1,629**	1,730
2005	1,629	657	155	(172)	2,269	196	**2,465**	2,702
2006	1,471	1,596	289	(100)	3,256	76	**3,332**	3,251
2007	1,321	587	25	(78)	1,855	251	**2,106**	1,621
2008	176	18	1,237	–	1,431	273	**1,704**	–
1 to 5 years	6,007	3,014	1,754	(355)	10,420	816	**11,236**	12,273
6 to 10 years	3,686	2,817	110	(95)	6,518	921	**7,439**	8,147
11 to 15 years	166	519	592	(21)	1,256	124	**1,380**	2,961
16 to 20 years	4,742	2,645	–	(91)	7,296	77	**7,373**	7,889
21 to 25 years	10	1,231	–	(13)	1,228	83	**1,311**	1,492
26 to 30 years	1,146	2,287	–	(70)	3,363	63	**3,426**	4,023
31 to 35 years	3,149	–	–	(87)	3,062	–	**3,062**	2,146
36 to 40 years	278	–	–	–	278	–	**278**	280
41 to 45 years	–	–	–	–	–	–	**–**	–
46 to 50 years	50	–	–	–	50	–	**50**	50
51 to 55 years	–	–	–	–	–	–	**–**	–
56 to 60 years	430	–	–	–	430	–	**430**	403
	19,664[a]	12,513	2,456	(732)[b]	33,901[c]	2,084	**35,985**	39,664
Less								
Current portion	1,410	156	48	(5)	1,609	20	**1,629**	2,969
	18,254	12,357	2,408	(727)	32,292	2,064	**34,356**	36,695

a) Includes $139 million and $307 million in zero-coupon bonds, reported at their discounted value at a semiannually compounded 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 $1,157 million, will reach a par value of $1,333 million on maturity.

b) The sinking funds include a special fund created for the majority of the significant discounted debt. It totaled $152 million as at December 31, 2003 ($81 million as at December 31, 2002).

c) Includes $32,812 million in bonds guaranteed by the Québec government ($36,596 million as at December 31, 2002).

Allocation of debt by currency at time of issue and impact of financial assets related to debt

The following table summarizes long-term debt, including the current portion, in Canadian dollars and other currencies. Also shown are the effects of currency swaps and sinking funds allocated to repay debt, which are presented on the balance sheet under Financial assets related to debt.

	Long-term debt		Financial assets related to debt	**2003**	2002
	In Canadian dollars and other currencies	At the closing exchange rates at the balance sheet date[a]	Currency swaps and sinking funds	Total	Total
Debt of the Corporation					
Canadian dollars	19,084	19,084	(3)	**19,081**	18,304
U.S. dollars	9,053	12,361	(787)	**11,574**	15,939
Other currencies					
Euros	673	1,234	(127)	**1,107**	1,260
Yen	39,500	548	(23)	**525**	637
Pounds sterling	240	573	(39)	**534**	763
Swiss francs	97	101	(5)	**96**	96
		2,456	(194)	**2,262**	2,756
		33,901	(984)	**32,917**	36,999
Subsidiaries and joint ventures[b]		2,084	(1)	**2,083**	2,306
		35,985	(985)	**35,000**	39,305

a) Includes $923 million in financial liabilities composed of currency swaps ($474 million as at December 31, 2002) and $732 million in Hydro-Québec securities held in the sinking funds ($561 million as at December 31, 2002).

b) Long-term debt composed of $831 million in Canadian dollars, $930 million in U.S. dollars, $319 million in Unidades de Fomento (indexed Chilean pesos) and $3 million in Chinese renminbi ($818 million in Canadian dollars, $1,163 million in U.S. dollars, $321 million in Unidades de Fomento and $4 million in Chinese renminbi as at December 31, 2002).

Allocation of debt by currency at time of issue and at time of repayment

The following table shows the allocation of debt, net of sinking funds, converted into Canadian dollars after taking swaps into account, according to the currency at time of issue and time of repayment.

	2003		2002	
	At time of issue	At time of repayment	At time of issue	At time of repayment
Debt of the Corporation				
Canadian dollars	**19,081**	**20,439**	18,304	17,778
U.S. dollars	**11,574**	**12,478**[a]	15,939	19,221[a]
Other currencies	**2,262**	**–**	2,756	–
	32,917	**32,917**	36,999	36,999
Debt of the subsidiaries and joint ventures				
Canadian dollars	**831**	**831**	818	818
U.S. dollars	**930**	**677**	1,163	916
Other currencies	**322**	**575**	325	572
	2,083	**2,083**	2,306	2,306
	35,000	**35,000**	39,305	39,305

a) Represents 94% of the balances as at December 31, 2003 (100% as at December 31, 2002), hedging sales in U.S. dollars.

Note 13 // Long-Term Debt (continued)

Interest rates

The Hydro-Québec interest rates presented in the following table take into account nominal interest rates on borrowings, the related discounts and expenses, and the effect of interest rate swaps.

Year of maturity	Canadian dollars	U.S. dollars	Other currencies	**2003** Weighted average	2002 Weighted average
1 to 5 years	3.95	8.45	4.70	**5.24**	4.65
6 to 10 years	8.26	6.22	13.86	**7.37**	6.98
11 to 15 years	5.93	7.60	8.98	**7.81**	7.70
16 to 20 years	10.61	8.96	9.28	**10.01**	9.97
21 to 25 years	8.23	8.46	–	**8.45**	8.57
26 to 30 years	6.67	9.18	–	**8.30**	8.44
31 to 35 years	6.15	–	–	**6.15**	6.26
36 to 40 years	6.41	–	–	**6.41**	6.41
41 to 45 years	–	–	–	**–**	–
46 to 50 years	6.44	–	–	**6.44**	6.44
51 to 55 years	–	–	–	**–**	–
56 to 60 years	6.62	–	–	**6.62**	6.62
Weighted average	7.80	8.25	7.15	**7.94**	7.95

The variable-rate portion of Hydro-Québec's debt amounted to 24.5%, or 25.4% after perpetual debt, as at December 31, 2003 (23.2%, or 24.4% after perpetual debt, as at December 31, 2002). For information purposes, a change of 1% in the interest rate would change net income by $90 million ($97 million in 2002), not including the impact of derivative instruments used to manage short-term financial risk (note 16).

Fair value

As at December 31, 2003, the fair value of Hydro-Québec's debt, net of sinking funds and after swaps, amounted to $44,409 million ($49,231 million as at December 31, 2002).

Fair value is obtained by discounting future cash flows, based on term and closing interest rates as at the balance sheet date for similar instruments available on financial markets. Changes in fair value reflect sensitivity to financial market interest rates. However, Management intends to retain these debt securities until maturity. Therefore, as at December 31, 2003, Hydro-Québec did not foresee any significant debt repayments that could result in the realization of this fair value.

Hydro-Québec has undrawn revolving standby credits totaling US$1,500 million and expiring in 2004 and 2006. Any borrowing under these lines of credit will bear interest at a rate based on the London Interbank Offered Rate (LIBOR).

Note 14 // Other Long-Term Liabilities

	note	2003	2002
Accounts payable		**281**	355
Accrued benefit liability	20	**414**	376
Deferred foreign exchange gain		**1,138**	–
Other deferred credits related to debt		**173**	–
Decommissioning of nuclear generating station [a]		**205**	177
		2,211	908

a) When Gentilly-2 nuclear generating station was designed, the Corporation planned to operate it for 30 years, until 2013. In 2001, it initiated a draft design study to evaluate whether its useful life could be extended by 25 years through rehabilitation. If the rehabilitation is not carried out, the plant could be decommissioned a few years earlier, depending on technical and economic factors. Pending the decision, the financial statements continue to reflect the end of life in 2013 for purposes of calculating the depreciation and decommissioning costs of the plant. Once the decision is made, future decommissioning and depreciation costs may vary significantly from the amounts reported in these financial statements based on the end-of-life date retained and the increase inherent in the methods used to calculate depreciation and amortization and the costs of decommissioning. As at December 31, 2003, the net book value of Gentilly-2 was $730 million, and the portion for which a provision remained to be made for future decommissioning costs approximated $630 million, based on end of life in 2013.

Note 15 // Perpetual Debt

Perpetual notes in the amount of US$340 million (US$400 million as at December 31, 2002) bear interest at a rate established semiannually based on LIBOR. They are guaranteed by the Québec government and are only redeemable at the Corporation's option. In 2003, a portion amounting to US$60 million was purchased on secondary markets and then canceled. Also during the year, the perpetual notes ceased to naturally hedge the sales in U.S. dollars. However, various derivative instruments recorded at fair value are used to reduce the exchange risk.

As at December 31, 2003, the fair value of these notes was $402 million ($540 million as at December 31, 2002). As at December 31, 2003 and 2002, the LIBOR for perpetual notes was 1.25% and 1.94%, respectively.

Note 16 // Financial Instruments

Derivative instruments

Derivative instruments used by Hydro-Québec for hedging purposes are always associated with a reverse risk position.

Hydro-Québec concludes currency swaps in order to manage the foreign exchange risk associated with payments of principal on long-term debt, interest payments and sales in U.S. dollars. Some of these currency swaps allow for interest rate exchanges to change long-term exposure to interest rate risk. Interest rate swaps that do not allow for exchanges of principal are also used to manage this risk.

The valuation of these swaps, with terms through 2030, showed a positive fair value of $427 million (positive fair value of $407 million as at December 31, 2002). The following table shows the notional amount of these swaps, expressed in Canadian dollars or other currencies.

	2003[a]	2002[a]
Canadian dollars	**(1,358)**	526
U.S. dollars	**(433)**	(1,991)
Other currencies		
Yen	**39,500**	46,500
Euros	**673**	727
Pounds sterling	**240**	300
Swiss francs	**97**	97
Unidades de Fomento (indexed Chilean pesos)	**(7)**	(7)

a) Figures in parentheses represent amounts to be paid.

Note 16 // Financial Instruments (continued)

In managing short-term financial risks, Hydro-Québec assesses, on an ongoing basis, the overall impact of variations in exchange rates, interest rates and the prices of commodities. Hydro-Québec holds options and forward contracts designed to hedge several positions. It also uses derivative instruments to manage market risks resulting from fluctuations in energy prices. The fair value of these instruments is presented by specific risk in the following table. These derivative instruments mature through June 2006.

The fair value of derivative instruments reflects the amount that Hydro-Québec would receive (financial assets) or pay (financial liabilities) as at the balance sheet date in terminating these instruments.

	2003	2002
Exchange risk		
Foreign exchange forward contracts and options		
Financial assets	**11**	22
Financial liabilities	**(75)**	(7)
	(64)	15
Interest rate risk		
Forward rate agreements, options and swaps		
Financial assets	**11**	7
Financial liabilities	**(25)**	(101)
	(14)	(94)
Risk of change in energy and commodity prices		
Forward contracts, options and swaps		
Financial assets	**12**	29
Financial liabilities	**(52)**	(18)
	(40)	11
	(118)	(68)

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 also reduced by applying a credit policy limiting credit risk concentration and a customer credit risk evaluation program, as well as by adopting credit limits, where necessary. As at December 31, 2003, Hydro-Québec did not foresee any material loss arising from a counterparty's default.

In addition, credit risk exposure with respect to trade receivables is limited due to Hydro-Québec's large and diverse client base. Management estimates that Hydro-Québec is not exposed to a major credit risk.

Note 17 // Interests in Joint Ventures

The share of the principal joint venture items included in the consolidated financial statements is presented in the following table. These joint ventures specifically include the interest in Noverco Inc. and the Corporation's interests in various foreign joint ventures, mainly through HQI.

	2003	2002
Operations		
Revenue	**940**	933
Expenditure and financial expenses	**883**	871
Non-controlling interest	**27**	29
Net income	**30**	33
Balance sheet		
Current assets	**157**	170
Long-term assets	**1,553**	1,925
Current liabilities	**143**	213
Long-term liabilities	**937**	1,102
Non-controlling interest	**202**	216
Net assets	**428**	564
Cash flows		
Operating activities	**138**	156
Investing activities	**(134)**	(121)
Financing activities	**20**	(5)
Net change in cash and cash equivalents	**24**	30

Noverco Inc.

Hydro-Québec holds 41.2% of the outstanding common shares of Noverco Inc. and options on an additional 9.16%. Under the Noverco Inc. shareholders' agreement, it agreed to mechanisms enabling the joint owners to convert their interests into liquidities under certain conditions.

Noverco Inc. disclosed unrecorded future income taxes of $88 million in 2003 ($94 million in 2002) on the regulated activities in Gaz Métro, Limited Partnership (GMLP). Taxes on income from regulated activities are recorded using the taxes payable method, since it is expected that future income taxes will be included in the rates approved by Canadian regulatory bodies, i.e. the Régie de l'énergie and the National Energy Board, as thus passed on to customers.

GMLP recognizes pension and other retirement benefits in its statement of operations as the amounts are disbursed, in accordance with regulatory practice.

Foreign joint ventures

Hydro-Québec holds interests in joint ventures, primarily through HQI. These joint ventures are essentially involved in the operation and construction of transmission systems and hydroelectric generating stations. They mainly operate in South and Central America and Australia.

Note 18 // Shareholder's Equity

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

Under the *Hydro-Québec Act*, any 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 fiscal year, they cannot exceed the distributable surplus, equal to 75% of the year's operating income and net investment income, less interest on debt securities and amortization of borrowing discounts and expenses. This calculation is made on the basis of the consolidated financial statements.

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

For 2003, the Québec government declared dividends of $965 million, which is less than the maximum permitted.

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

Note 19 // Change in Non-Cash Working Capital Items

	2003	2002
Accounts receivable	**14**	(99)
Materials, fuel and supplies	**(8)**	7
Accounts payable	**103**	142
Accrued interest	**(185)**	(44)
	(76)	6

Note 20 // Employee Future Benefits

The Corporation's pension plan (the "Pension Plan") is a funded plan that ensures pension benefits based on years of service and average five best years of earnings. The post-retirement and post-employment benefits offered by the Corporation also include group life, medical and hospitalization, and salary insurance plans. However, 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 following tables present information concerning the defined benefit plans, established by independent actuaries:

	2003 Pension Plan	2002 Pension Plan	**2003** Other plans	2002 Other plans
Accrued benefit obligation				
Balance at beginning of year	**7,937**	7,231	**564**	511
Current service cost	**244**	220	**24**	22
Benefit payments and refunds	**(329)**	(319)	**(34)**	(31)
Interest on obligation	**517**	484	**36**	34
Actuarial losses	**98**	321	**1**	28
Adjustments arising from plan amendments	**161**	–	**–**	–
Balance at end of year	**8,628**	7,937	**591**	564
Plan assets at fair value				
Balance at beginning of year	**8,326**	9,149	**46**	40
Actual return on plan assets	**1,246**	(480)	**1**	1
Employee contributions	**6**	6	**–**	–
Hydro-Québec's contributions	**1**	–	**7**	12
Benefit payments and refunds	**(329)**	(319)	**(5)**	(7)
Administrative fees	**(33)**	(30)	**–**	–
Balance at end of year	**9,217**	8,326	**49**	46
Surplus (deficit) at end of year	**589**	389	**(542)**	(518)
Unamortized past service costs	**391**	270	**–**	1
Unamortized net loss (gain)	**1,385**	1,766	**(7)**	(9)
Unamortized transitional obligation (asset)	**(1,521)**	(1,673)	**135**	150
Accrued benefit asset (liability)	**844**	752	**(414)**	(376)
Significant actuarial assumptions (%)				
Discount rate	**6.67**	6.58	**6.67**	6.58
Expected rate of return on plan assets	**7.07**	7.45	**3.31**	3.00
Salary escalation rate [a]	**3.41**	3.15	**–**	–

a) This rate is a weighted average rate, which takes salary increases into account as well as promotion opportunities while in service.

As at December 31, 2003, health-care costs were based on an annual growth rate of 8.3% in 2004. Thereafter, based on the assumption used, this rate gradually decreases until it reaches the ultimate rate of 3.9% in 2014. A change of 1% in this annual growth rate would have the following impact:

	1% increase	1% decrease
Impact on the cost of services rendered and the interest on the accrued benefit obligation for the year (%)	3	(2)
Impact on the accrued benefit obligation at end of year (%)	30	(24)

Note 20 // Employee Future Benefits (continued)

Plan assets include securities issued by the Corporation and certain related companies. These securities are grouped under the following asset classes:

	2003 Pension Plan	2002 Pension Plan	**2003** Other plans	2002 Other plans
Bonds and debentures	**547**	551	**–**	–
Shares	**26**	7	**–**	–
Short-term investments	**–**	27	**41**	40
	573	585	**41**	40
Plan expense (credit) for the year				
Current service cost[a]	**214**	197	**24**	22
Administrative fees[b]	**33**	30	**–**	–
Interest on obligation	**517**	484	**36**	34
Expected return on plan assets	**(743)**	(754)	**(1)**	(1)
Amortization of transitional obligation (asset)	**(152)**	(152)	**15**	14
Amortization of net actuarial loss (gain)	**–**	–	**(1)**	2
Amortization of past service costs	**40**	78	**–**	–
Expense (credit) for the year	**(91)**	(117)	**73**	71

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 chargeable to the Pension Plan are fully billed by the Corporation.

During the year, some amendments were made to the Pension Plan following agreements reached between the Corporation and its unions. These amendments, in effect since January 1, 2004, are for the most part temporary provisions. They mainly affect the bridging annuity and normal retirement annuity, the cost of optional forms of annuity and an extension of the buyback program introduced in 2000.

Beginning in 2004, the Corporation and all its employees will resume contributions to the Pension Plan.

Note 21 // Commitments and Contingent Liabilities

Electricity purchased

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. Under this agreement, the Corporation could be required to provide additional funding to service the debt of CF(L)Co and to pay its expenses should CF(L)Co be unable to do so. 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 also 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, 2003, the Corporation was committed under 83 contracts to purchase electricity from other power producers for an installed capacity of about 2,200 MW. It expects to purchase approximately 8.5 TWh of energy annually over the initial term of these contracts, which extend through 2029. The majority of these contracts include renewal clauses.

Guarantees

In the normal course of business, Hydro-Québec grants guarantees to third parties for indemnification purposes, mainly for energy purchase transactions. It also enters into agreements as part of its international operations and in the field of electrotechnology.

As at December 31, 2003, the potential maximum amount the Corporation may have to pay under these letters of credit or agreements totaled $470 million. Of this amount, $397 million relates to the purchase of energy, and a liability in the amount of $28 million has been recorded accordingly. Some guarantees expire from 2004 to 2019, and others do not have maturity dates.

Capital expenditures

The Corporation expects to invest approximately $3,400 million in fixed assets in 2004.

Agreements entered into with Natives and regional county municipalities

Hydro-Québec has entered into various agreements related to capital projects with Natives and regional county municipalities. The amounts paid are based on the work carried out.

Litigation

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

Note 22 // Segmented Information

Hydro-Québec has five operating segments, plus Corporate and Other Activities:

Generation: Hydro-Québec Production operates and develops the Corporation's generating facilities in Québec and a number of foreign facilities. It also sells electricity on external markets and engages in energy trading activities. It participates in the Québec wholesale market by responding to calls for tenders from Hydro-Québec Distribution.

Transmission: Hydro-Québec TransÉnergie develops and operates the Corporation's transmission system in Québec, in addition to managing and operating foreign transmission systems and carrying out development projects abroad. The division also manages Hydro-Québec's telecommunications network.

Distribution: Hydro-Québec Distribution develops and operates the Corporation's distribution system and is responsible for sales and service to Québec customers.

Construction: Hydro-Québec Équipement and SEBJ are involved in energy-related engineering services and construction projects in Québec and in other parts of the world.

Oil and Gas: Hydro-Québec Pétrole et gaz comprises all activities related to the pipeline transmission of oil, natural gas and liquid natural gas, as well as gas distribution. Activities arising from the *Québec Oil and Gas Exploration Plan 2002–2010* are also included in this segment.

Corporate and Other Activities: Corporate and Other Activities include corporate activities such as financial services, human resources, corporate affairs, the activities of the Shared Services Centre, notably procurement and computer services, and the activities managed by Hydro-Québec Technologie et développement industriel, i.e., research, technical support, industrial development of Hydro-Québec technologies, and capital venturing.

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 note 1.

Intersegment transactions related to electricity sales are recorded based on the supply and transmission rates provided under the *Act respecting the Régie de l'énergie*. The Act sets a commodity rate for a maximum annual volume of heritage pool electricity of 165 TWh for Québec markets. This volume was almost reached in 2003.

Other intersegment products and services are valued at full cost.

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

Segments

	Generation	Transmission	Distribution	Construction	Oil and Gas	Corporate and Other Activities	Intersegment and Other	**2003** Total
Revenue								
– External customers	1,511	321	8,661	11	936	(15)	–	**11,425**
– Intersegment	4,563	2,641	44	1,581[a]	–	786	(9,615)	**–**
Depreciation, amortization and decommissioning	694	622	437	5	76	82	–	**1,916**
Financial expenses	1,171	977	445	–	85	56	–	**2,734**
Net income (loss)	1,741	397	(133)	6	35	(109)	(6)	**1,931**
Capital expenditures (including intangibles)	1,431	1,002	553	4	62	85	(4)	**3,133**
Total assets	25,218	18,479	9,931	244	1,820	952	1,059[b]	**57,703**

	Generation	Transmission	Distribution	Construction	Oil and Gas	Corporate and Other Activities	Intersegment and Other	2002 Total
Revenue								
– External customers	3,638	309	8,180	7	848	19	–	13,001
– Intersegment	4,274	2,734	37	1,112[a]	–	720	(8,877)	–
Depreciation, amortization and decommissioning	828	639	445	4	67	79	–	2,062
Financial expenses	1,352	1,078	492	–	85	51	–	3,058
Net income (loss)	1,563	389	(409)	3	35	(55)	–	1,526
Capital expenditures (including intangibles)	1,033	702	525	8	49	139	–	2,456
Total assets	24,605	18,268	9,755	251	1,771	984	3,464[b]	59,098

a) Intersegment revenue generated by the Construction segment includes an amount of $1,177 million ($963 million in 2002) that corresponds to capital expenditures in respect of its client segments.
b) Includes assets related to long-term financing that have not been allocated to the operating segments or to Corporate and Other Activities.

Geographical information

	2003 Revenue	**2003** Fixed assets and goodwill	2002 Revenue	2002 Fixed assets and goodwill
Québec	**9,572**	**48,790**	9,040	47,772
Canada, outside Québec	**182**	**29**	362	2
United States	**1,373**	**372**	3,305	401
Chile	**207**	**1,599**	204	1,468
Other countries	**91**	**373**	90	353
	11,425	**51,163**	13,001	49,996

Supplementary Information – Five-Year Review

Consolidated Financial Information

$M	**2003**	2002	2001	2000	1999
OPERATIONS					
Revenue	**11,425**	13,001	12,563	11,416	9,600
Expenditure					
Operations	**2,246**	2,209	2,119	2,122	1,904
Electricity and fuel purchased	**1,956**	3,536	3,532	2,408	1,109
Depreciation, amortization and decommissioning	**1,916**	2,062	1,845	1,896	1,731
Taxes	**611**	580	591	525	592
	6,729	8,387	8,087	6,951	5,336
Operating income	**4,696**	4,614	4,476	4,465	4,264
Financial expenses	**2,734**	3,058	3,350	3,369	3,345
Income before non-controlling interest	**1,962**	1,556	1,126	1,096	919
Non-controlling interest	**31**	30	18	18	13
Reported net income	**1,931**	1,526	1,108	1,078	906
Restatement of financial expenses*	**–**	–	513	205	(317)
Restated net income*	**1,931**	1,526	595	873	1,223
SUMMARY OF BALANCE SHEET					
Reported total assets	**57,703**	59,098	59,861	59,038	56,808
Restated total assets*	**–**	–	58,663	58,881	57,150
Long-term debt	**34,356**	36,695	37,269	34,965	36,016
Reported shareholder's equity	**15,127**	14,215	14,834	14,280	13,741
Restated shareholder's equity*	**–**	–	13,539	13,513	13,175
ANNUAL INVESTMENTS					
Fixed and intangible assets	**3,133**	2,456	1,810	1,812	1,642
Other	**37**	30	79	1,689	467
Total investments	**3,170**	2,486	1,889	3,501	2,109
FINANCIAL RATIOS					
Interest coverage[a]	**1.66**	1.56	1.43	1.37	1.33
Reported capitalization (%)[b]	**29.9**	26.2	26.8	26.2	26.2
Restated capitalization (%)[b*]	**–**	–	25.0	25.1	25.4
Self-financing (%)[c]	**53.9**	72.2	54.9	49.0	59.3
Reported return on equity (%)[d]	**13.2**	11.0	7.6	7.7	6.7
Restated return on equity (%)[d*]	**–**	–	4.4	6.5	9.6
Reported return on revenue (%)[e]	**16.9**	11.7	8.8	9.4	9.4
Restated return on revenue (%)[e*]	**–**	–	4.7	7.7	12.7

** The financial expenses have been restated as a result of the retroactive application of the foreign currency translation accounting standard. As a result, some of the financial information has been restated.*

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 financial assets related to debt.
c) Cash from 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 divided by revenue.

Note: Throughout the Supplementary Information section, certain financial and operating figures for previous years have been reclassified to reflect the presentation of the current year.

Supplementary Information – Five-Year Review (continued)

Operating Statistics

GWh	**2003**	2002	2001	2000	1999
Electricity sales					
In Québec					
Residential and farm	**57,217**	53,222	50,850	51,666	49,315
General and institutional	**32,314**	30,903	30,360	30,490	29,765
Industrial	**72,546**	69,336	66,343	65,950	63,409
Other	**5,014**	5,111	4,659	4,651	4,500
	167,091	158,572	152,212	152,757	146,989
Outside Québec					
Canada/U.S. (long-term)	**2,047**	2,219	3,691	6,428	8,218
Canada/U.S. (short-term)	**13,739**	51,980	38,698	30,479	16,012
	15,786	54,199	42,389	36,907	24,230
Other countries	**484**	482	425	416	493
Total electricity sales	**183,361**	213,253	195,026	190,080	171,712
$M					
Revenue from electricity sales					
In Québec					
Residential and farm	**3,504**	3,245	3,131	3,167	3,034
General and institutional	**2,096**	2,004	1,973	2,002	1,963
Industrial	**2,742**	2,632	2,482	2,405	2,236
Other	**236**	231	217	220	215
	8,578	8,112	7,803	7,794	7,448
Outside Québec					
Canada/U.S. (long-term)	**207**	235	288	346	392
Canada/U.S. (short-term)	**1,137**	3,232	2,794	2,003	624
	1,344	3,467	3,082	2,349	1,016
Other countries	**38**	40	38	31	35
Total revenue from electricity sales	**9,960**	11,619	10,923	10,174	8,499
At December 31					
Number of customer accounts in Québec					
Residential and farm	**3,343,271**	3,295,537	3,257,361	3,228,610	3,206,211
General and institutional	**281,997**	281,079	280,796	281,107	280,383
Industrial	**13,383**	14,133	13,215	13,081	12,732
Other	**5,812**	5,793	5,919	5,941	5,986
Total customer accounts	**3,644,463**	3,596,542	3,557,291	3,528,739	3,505,312
kWh/customer account					
Average annual consumption in Québec					
Residential and farm	**17,237**	16,244	15,680	16,058	15,439
General and institutional	**114,777**	110,000	108,061	108,604	106,218
Industrial	**5,273,005**	5,070,645	5,045,862	5,109,828	4,966,438
Other	**864,110**	872,780	785,666	779,911	746,764

Supplementary Information – Five-Year Review (continued)

Operating Statistics

MW	2003	2002	2001	2000	1999
Installed capacity[a]					
Hydroelectric	**31,347**	30,392	30,386	30,389	30,378
Thermal[b]	**2,267**	2,267	2,266	2,266	2,270
Wind	**2**	2	2	–	–
Total installed capacity	**33,616**	32,661	32,654	32,655	32,648
GWh					
Total requirements[c]	**194,792**	192,916	186,645	197,895	187,999
MW					
Peak power requirements in Québec[d]	**36,268**	34,989	30,080	30,412	31,470
km					
Lines (overhead and underground)					
Transmission	**32,539**	32,314	32,273	32,283	32,227
Distribution[e]	**106,568**	105,871	105,352	104,872	104,382
	139,107	138,185	137,625	137,155	136,609

a) In addition to the output of its own generating stations, Hydro-Québec has access to most of the generation from Churchill Falls power plant, which has a rated capacity of 5,428 MW, and to all of the output from the 133 turbines in the Matane and Cap-Chat wind farms with a total installed capacity of 100 MW.
b) Includes Gentilly-2 nuclear generating station (rated 675 MW).
c) Total requirements include kilowatthours delivered within Québec and to neighboring systems.
d) Total power requirements at the annual domestic demand peak for the winter beginning in December, including interruptible power. The 2003–2004 winter peak for Québec occurred at 5:30 p.m. on January 15, 2004.
e) These figures include off-grid systems but exclude private systems, lines under construction and 44-kV lines (transmission). The figures reported for 1999 to 2002 have been restated accordingly.

Other Information

%	2003	2002	2001	2000	1999
Rate increases					
Average increase at May 1	**–**	–	–	–	–
Inflation rate	**2.8**	2.2	2.5	2.7	1.7
Number of employees[a]					
Permanent at December 31	**18,317**	18,025	17,679	17,277	17,277
Temporary (year's average)	**3,596**	3,632	3,545	3,399	3,126
Women (%)	**28.9**	28.5	28.3	28.6	27.9

a) Excludes employees of subsidiaries and joint ventures.

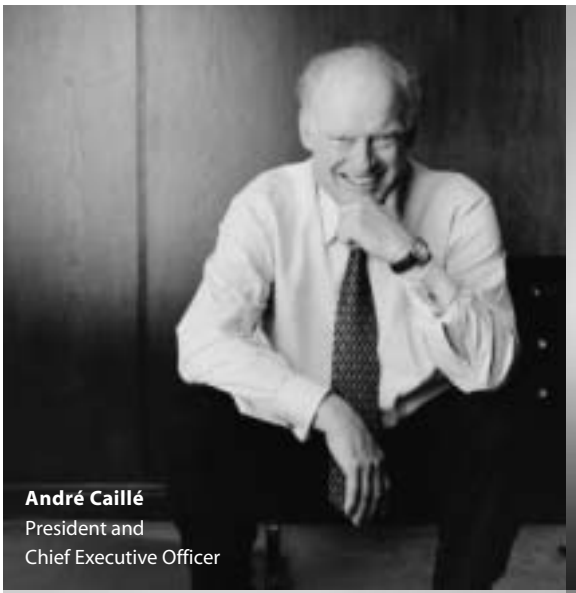
Supplementary Information

Consolidated Results by Quarter

$M	1st quarter	2nd quarter	3rd quarter	4th quarter (unaudited)	**2003** 12-month period (audited)
Revenue	3,605	2,683	2,422	2,715	**11,425**
Expenditure					
Operations	488	533	597	628	**2,246**
Electricity and fuel purchased	625	551	386	394	**1,956**
Depreciation, amortization and decommissioning	483	476	520	437	**1,916**
Taxes	160	164	148	139	**611**
	1,756	1,724	1,651	1,598	**6,729**
Operating income	1,849	959	771	1,117	**4,696**
Financial expenses	836	625	624	649	**2,734**
Income before non-controlling interest	1,013	334	147	468	**1,962**
Non-controlling interest	9	15	4	3	**31**
Net income	1,004	319	143	465	**1,931**

$M	1st quarter	2nd quarter	3rd quarter	4th quarter (unaudited)	2002 12-month period (audited)
Revenue	3,572	2,981	3,352	3,096	13,001
Expenditure					
Operations	486	539	549	635	2,209
Electricity and fuel purchased	972	777	1,087	700	3,536
Depreciation, amortization and decommissioning	465	480	515	602	2,062
Taxes	159	173	144	104	580
	2,082	1,969	2,295	2,041	8,387
Operating income	1,490	1,012	1,057	1,055	4,614
Financial expenses	792	774	763	729	3,058
Income before non-controlling interest	698	238	294	326	1,556
Non-controlling interest	8	11	7	4	30
Net income	690	227	287	322	1,526

Corporate Management



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Executive Vice President,
Human Resources and Shared Services

Board of Directors

André Bourbeau [a, b, c, d, e, f, g, h, i]
Chairman of the Board of Directors,
Hydro-Québec

André Caillé [a, b, c, d, e, f, g, h, i]
President and Chief Executive Officer,
Hydro-Québec

Michel Boivin
Deputy Minister of Natural Resources,
Gouvernement du Québec

Joseph Benarrosh [f]
President, JJDS Capital inc.

Gaston Blackburn
President, G. Blackburn inc.

Daniel Boulard [e, j]
Partner, Martin, Boulard et Associés, CA

Andrée Corriveau [i]
President and Chief Executive Officer,
IFC Montréal – International Finance Centre

Alain Forand [d, f]
Major General (retired),
Canadian Forces,
Department of National Defence

Bernard Gaudreault [b, j]
President and Chief Executive Officer,
Phil Gaudreault et fils Itée

Régis Labeaume [h, i]
President and Chief Executive Officer,
Fondation de l'entrepreneurship

Louis Lagassé
Notary
Chairman and Chief Executive Officer,
Media5 Corporation

Yvon Lamontagne [a, e, g, j]
Chairman of the Board of Directors,
SCOR Canada Reinsurance Company (Toronto)

Paul Larocque [a, g]
Notary
Mayor, Bois-des-Filion
President, Infrastructures Transport

Sophie Martin [d, h, i]
Barrister and Solicitor, Desjardins Ducharme
Stein Monast

Michel Noël de Tilly [a, b, c, j]
Chairman of the Board of Directors, SEPAQ

Serge Racine [h]
Director

Louise Roy [c]
President, L.R. Services-conseils en
environnement et communautés
Member, Canada's National Advisory
Committee on the North American
Agreement on Environmental Cooperation

Board Committees

a Executive Committee
b Distribution
c Environment and Corporate Social Responsibility
d Ethics and Corporate Governance
e Finance
f Pension Fund Management
g Generation
h Human Resources
i Transmission
j Audit

Corporate Governance

Hydro-Québec's Board of Directors is concerned with maintaining the highest possible standards for corporate governance. It therefore subscribes to the corporate governance guidelines established by the Canadian stock exchanges, even though, legally speaking, it is not required to abide by them because it is not a publicly traded company.

Mission

The Board administers the company's business in accordance with the *Hydro-Québec Act,* the *Companies Act* and the energy policies of the Québec government. Its most important functions involve the analysis and adoption of the Strategic Plan, which describes the company's main orientations, and the annual business plan, which comprises the capital and operating budgets along with the annual performance objectives for members of the management team. Other functions include the monthly review of financial results, the four-month review of management results, the annual evaluation of integrated business 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.

Independence

A majority of members of the Board come from outside the company. In fact, only one director—the President and Chief Executive Officer—is a member of Senior Management. 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* based on the *Regulation respecting the ethics and professional conduct of public office holders.*

Information

Directors are all offered a complete information session on the energy sector and Hydro-Québec's business environment and principal activities. They also receive a director's guide describing the company's specific technical, business and regulatory context, along with the roles and responsibilities of a Board member.

Operation

The Board benefits from the expertise and experience of its members, who work on 10 committees: Executive Committee, Distribution, Environment and Corporate Social Responsibility, Ethics and Corporate Governance, Finance, Pension Fund Management, Generation, Human Resources, Transmission and Audit. After every committee meeting, a report by the committee chair is presented at the next Board meeting. The Ethics and Corporate Governance Committee is responsible for assessing the Board's performance and operation. The Executive Committee may exercise the Board's powers, except those reserved to the Board by law.

The Mérite AAPI 2003 award, presented by the Association sur l'accès et la protection de l'information.

Access to Documents and Protection of Personal Information

Hydro-Québec takes the necessary measures to assure its customers, suppliers and employees of the confidentiality of the personal information it possesses, in accordance with the *Act respecting Access to documents held by public bodies and the Protection of personal information*.

In 2003, the company continued implementing its action plan for the protection of personal information, formulated in 2001. In addition, it adopted a management rule governing the collection, recording, use and disclosure of personal information during the hiring process. The business practice regarding access to information and the protection of personal information was revised, specifically the section on validating consent. Training sessions on the new business practice were offered to all those involved.

Hydro-Québec received the Mérite AAPI 2003 award, given out for the first time by the Association sur l'accès et la protection de l'information, for its guide on access to documents and the protection of personal information handed out to all current employees in June 2002 and given to new employees as well. This publication explains the main concepts of the *Act respecting Access to documents held by public bodies and the Protection of personal information* and provides practical advice on proper conduct in the situations most commonly encountered in the company.

In October 2003, the company presented a brief to the Parliamentary Committee on Culture, commenting on the five-year report tabled by Québec's access to information commission. Hydro-Québec suggested measures for disseminating more information, for example by using the company's website.

Deintegration

Hydro-Québec has 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.

These units must comply with set rules of ethics. The *Code of Ethics on Conducting Calls for Tenders* governs the electricity supply process. Its main purpose is to ensure that calls for tenders are conducted fairly for all electricity suppliers.

The *Standards of Conduct* describe the unbundling of Hydro-Québec's transmission operations from the wholesale merchant function, and govern the interfaces between the transmission provider and Hydro-Québec's other affiliates, regardless of whether they are active in merchant operations and whether their activities are regulated. This Code was amended in 2003 at the request of the Régie de l'énergie.

Sarbanes-Oxley Act

In 2002, the Audit Committee of the Board of Directors asked management to study the provisions of the *Sarbanes-Oxley Act,* enacted in the United States on July 30, 2002, even though Hydro-Québec is not subject to the provisions of this law. The company therefore analyzed the law as well as comparable Canadian draft legislation and regulations concerning corporate governance.

The Audit Committee worked closely with Hydro-Québec's Finance Department and the office of the General Auditor to ensure that the company adopts the best practices regarding corporate governance. A number of rules were implemented and others are currently being studied. Among other measures, in 2003:

- Rules related to the independence of the company's external auditors were adopted.
- The *Code of Ethics and Rules of Professional Conduct for Directors and Executives of Hydro-Québec* was amended to make it applicable to senior executives in charge of financial services, such as the company's controller and the controllers of divisions, corporate groups and units that report to the President and Chief Executive Officer, as well as to prohibit directors who are on the Audit Committee from having an interest in the company or any of its subsidiaries and from receiving fees for consulting or for any other similar service.

The members of the Audit Committee carefully monitor the progress of these activities and the related studies at each of its meetings.

Language Guidelines

Efforts to improve the quality of French used at Hydro-Québec continued during the year. A number of proficiency courses were offered to employees in grammar, business correspondence, report writing and other subjects. More than 860 people attended the 84 sessions that were given. In addition, various promotional and awareness activities were organized to highlight Francofête, a celebration of French language and culture.

Report of Activities of the Board of Directors and Board Committees

The Board of Directors is composed of a maximum of 16 members appointed by the Québec government for terms of no more than five years, as well as the President and Chief Executive Officer, who is appointed by the Board with government approval. The Deputy Minister of Natural Resources is an ex officio, non-voting member of the Board.

The Board of Directors met 11 times in 2003 and its committees met 46 times.

During the year, the Board approved Hydro-Québec's main business objectives for the next five years. These objectives, which are presented in the *Strategic Plan 2004–2008,* mainly focus on service quality and value creation, with an emphasis on five key areas: quality of customer service, employee motivation and expertise, value creation for the shareholder and Québec society, sustainable development, and organizational efficiency.

The Board also monitored the progress of the company's business plans, objectives and financial results, as well as those of its major wholly owned subsidiaries.

Distribution

The Distribution Committee's role is to advise the Board on Hydro-Québec Distribution's activities regarding the procurement of electricity for Québec consumers. In particular, it examines the Electricity Supply Plan, the *Code of Ethics on Conducting Calls for Tenders,* the calls for tenders and the suppliers chosen.

In 2003, the committee concentrated on calls for tenders issued for wind power and biomass generation. It also examined the development of the Customer Information System, which will significantly change customer service business practices and procedures, and the Electricity Supply Plan 2002–2011. Lastly, it analyzed various requests related to electricity rate increases before they were submitted to the Régie de l'énergie.

Environment and Corporate Social Responsibility

The Environment and Corporate Social Responsibility Committee advises the Board on environmental management, public health and safety, community relations, social responsibility and corporate image. The committee receives all reports and violation notices related to environmental incidents.

During the year, the committee reviewed environmental studies concerning various hydroelectric projects. It also examined the summary of environmental inspections performed in 2002, the impact of Québec's Water Policy and Hydro-Québec's plan to promote hydropower and environmental performance. In addition, it studied the environmental report prepared for the Board of Directors, as well as the 2002 environmental communication plan, and it reviewed the activities carried out in 2002 by the Fondation Hydro-Québec pour l'environnement and the Foundation's projects for 2003. Finally, the committee reviewed the statement of donations and sponsorships and the report on research chairs funded by the company in 2002.

Ethics and Corporate Governance

The Ethics and Corporate Governance Committee ensures that Hydro-Québec is managed in accordance with the highest standards of ethics and corporate governance and with the relevant laws and regulations. The committee also provides advice on the application and enforcement of the *Code of Ethics and Rules of Professional Conduct for Directors, Executives and Controllers of Hydro-Québec*. It makes recommendations on rules applicable to the company's business.

In 2003, the committee analyzed accountability reports on the application of corporate policies, particularly the provisions of the policy "Our Corporate Governance" that relate to ethics and to the French language. The committee examined the application of the rules of ethics and analyzed the actions taken in 2003 regarding the application of the *Charter of the French Language*. It also focused its attention on the policy "Our Acquisition of Goods and Services," which covers four main aspects: security of supply, quality, efficiency of procurement procedures and economic spinoffs. Lastly, the committee looked at new trends in corporate governance so as to uphold the highest standards in this regard.

Finance

The function of the Finance Committee is to advise the Board on financial matters, especially financing, management of corporate funds, insurance, banking, the business plan and ensuing annual budget, financial risk management and integrated business risk management.

This year, the committee focused on the efforts involved in harmonizing Canadian accounting standards with American and European practices. It also analyzed the annual accountability report on the company's assets, in accordance with the policy "Our Assets."

Pension Fund Management

The role of the Pension Fund Management Committee is to advise the Board on investment management and performance, evaluation of portfolio managers and the management of the pension plan, including changes in pension obligations.

This year, the committee again recommended that the Board update the management policy for pension fund investments in order to adapt certain terms of application to the current situation, and that it adopt a new pension plan financing policy. In addition, it reviewed the performance of the pension fund portfolio and specialized portfolio managers, as well as the financial health of Hydro-Québec's pension plan.

Generation

The Generation Committee advises the Board on Hydro-Québec Production's activities, particularly those relating to bids it submits to Hydro-Québec Distribution in response to calls for tenders. It also plays a role in foreign investment and in the activities of the power generation subsidiaries.

During the year, the committee looked specifically at the various generating station rehabilitation projects as well as the signing of partnering agreements with regional county municipalities affected by the Péribonka hydroelectric development project.

Human Resources

The main role of the Human Resources Committee is to advise the Board on recruitment, total compensation, hiring, management, training and succession, including the hiring, appointment, performance review and compensation of the President and Chief Executive Officer and other senior executives.

Opposite: Robert Bourassa (1933–1996) at the 1979 inauguration of La Grande-2 generating station. // The boardroom was named after Robert Bourassa, former premier of Québec, in recognition of his vision for the development of hydropower.

In 2003, the committee turned its attention to the company's application of the policy "Our Human Resources." It examined the results of the workforce succession support plan, as well as more specific issues such as the management of absenteeism and overtime. It also focused on negotiations with the company's main unions regarding the renewal of their collective agreements. The committee considered recommendations on the modification of some elements in the company's organizational structure and the assignment of certain responsibilities within Senior Management. In addition, it analyzed certain aspects of the variable compensation of the President and Chief Executive Officer, senior executives and employees in terms of the company's performance objectives.

Transmission

The Transmission Committee advises the Board on issues relating to Hydro-Québec TransÉnergie, particularly those to be submitted to the Régie de l'énergie, as well as on foreign investment and the activities of the transmission subsidiaries.

In 2003, the committee examined the budget for refurbishing various substations. It also focused on the acquisition of the transmission assets belonging to Sistema Interconectado del Norte Grande (SING) by HQI Transelec Chile S.A., as well as the construction of an interconnection linking New Jersey and Long Island (New Jersey Cable project). In addition, it analyzed various cases to be submitted to the Régie de l'énergie by Hydro-Québec TransÉnergie.

Audit

The main function of the Audit Committee is to assure the Board of Directors that the financial statements accurately present the company's financial position, that internal controls are adequate and effective, and that suitable mechanisms are being applied to identify and manage the major internal and external risks to which the company is exposed. It is composed of independent members, including one financial expert, Yvon Lamontagne. The committee reads the internal audit reports and resulting action plans. It meets regularly with the external auditors.

During the year, the committee examined the results of audit requests as well as the company's financial statements. It analyzed the study committee's report on the *Sarbanes-Oxley Act* and monitored the progress of work carried out over the year. It adopted various rules, including rules for the independence of external auditors. It recommended changes to the *Code of Ethics and Rules of Professional Conduct for Directors and Executives of Hydro-Québec* to make it applicable to the company's controller and the controllers of divisions, corporate groups and units that report to the President and Chief Executive Officer, and to ensure the independence of the members of the Audit Committee.

The committee also considered several action plans, including those related to the safety of transmission and generation facilities, preventive maintenance on the distribution system, financial risk management and the handling of outdated computer equipment that could contain personal information.

Code of Ethics and Rules of Professional Conduct for Directors, Executives and Controllers of Hydro-Québec

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 corporation, 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 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 Chairman of the Board and 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 company;

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 website (www.hydroquebec.com).

Generating Facilities at December 31, 2003

Installed capacity in kW

Hydroelectric generating stations[a]

Robert-Bourassa	5,616,000	Laforge-1	877,800	Paugan	201,975
La Grande-4	2,778,750	Bersimis-2	844,550	Rapide-Blanc	201,600
La Grande-3	2,418,059	Outardes-3	823,650	Manic-1	184,410
La Grande-2-A	2,106,000	Carillon	752,080	Shawinigan-3	183,600
Beauharnois	1,657,980	Outardes-4	630,400	Chelsea	150,700
Manic-5	1,527,600	Outardes-2	471,750	Grand-Mère	149,575
La Grande-1	1,436,400	Brisay	469,300	Rapides-des-Îles	146,520
Manic-3	1,244,400	Laforge-2	319,200	La Gabelle	136,580
Bersimis-1	1,124,803	Trenche	302,400	Les Cèdres	135,000
Manic-5-PA	1,064,000	Beaumont	243,000	Première-Chute	130,320
Manic-2	1,023,930	La Tuque	219,600	Other (18 generating stations	
Sainte-Marguerite-3	882,000[b]	Shawinigan-2	202,601	rated less than 100,000 kW)	689,930

Thermal generating stations

Gentilly-2 (nuclear)	675,000	Bécancour, La Citière and		Other	
Tracy (conventional)	600,000	Cadillac (gas turbine)	870,200	(24 diesel units)	121,880

Wind farm

Saint-Ulric (3 wind turbines)	2,250

Installed capacity at December 31, 2003

Hydroelectric (52)	31,346,463
Thermal (29)	2,267,080
Wind (1)	2,250
Total	**33,615,793**[c]

Hydroelectric generating stations under construction

Capacity in kW

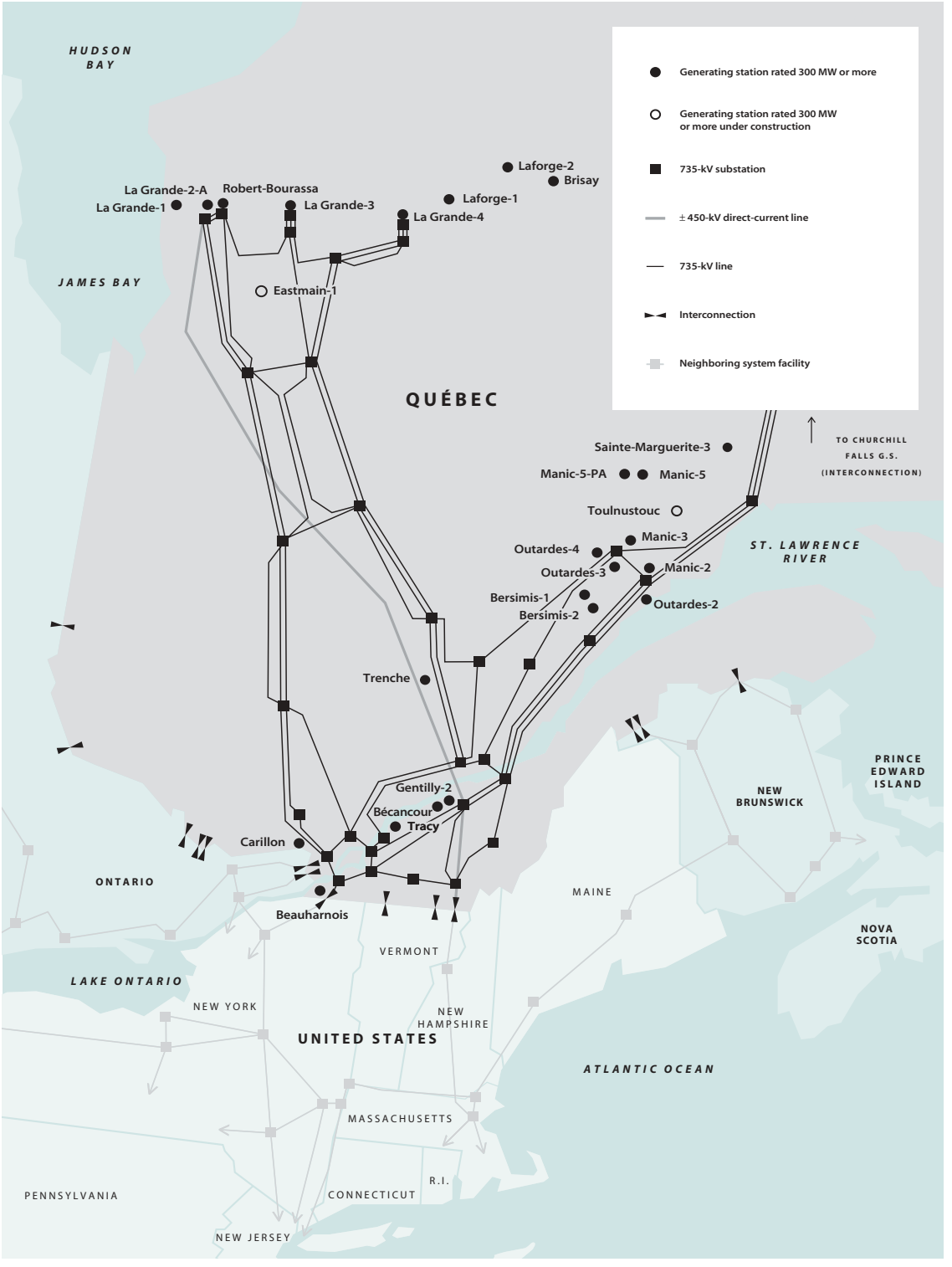
Toulnustouc	526,000
Eastmain-1	480,000
Rocher-de-Grand-Mère	220,000
Mercier	50,500

a) The installed capacity of a generating station is equivalent to that of its generating units operating in winter conditions (water temperature 5°C).
b) Sainte-Marguerite-3 is partially in service; its installed capacity at December 31, 2003, was close to 600 MW.
c) In addition to the installed capacity of its own generating stations, Hydro-Québec has access to most of the output from Churchill Falls, which has a rated capacity of 5,428 MW, and to all of the output from 133 wind turbines at Matane and Cap-Chat with a total installed capacity of 100 MW.

Transmission Facilities at December 31, 2003

Voltage	Substations (number)	Lines (km)
765 and 735 kV	38	11,527
± 450 kV DC	2	1,218
315 kV	60	5,013
230 kV	50	2,976
161 kV	40	1,870
120 kV	215	6,546
69 kV or less	101	3,389
Total	**506**	**32,539**

Major Facilities



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Hydro-Québec International
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 business unit is responsible for foreign operations in its spheres of competence.
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conducts energy transactions including sales, purchases and exchanges in Canada as well as in the U.S. through H.Q. Energy Services (U.S.).
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Noverco,
a holding company in which Hydro-Québec has a stake, controls a large number of companies involved primarily in the distribution and transmission of natural gas.
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Units of Measure

$M	millions of dollars
$B	billions of dollars
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)

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Hydro-Québec wishes to thank all the employees whose photos appear in this Annual Report.

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Hydro Québec

Raoul Dufy, *La Fée Électricité* (detail), 1953 © Raoul Dufy Estate / ADAGP (Paris) / SODRAC (Montréal) 2004