Hydro Québec

staying power

annual report 2001

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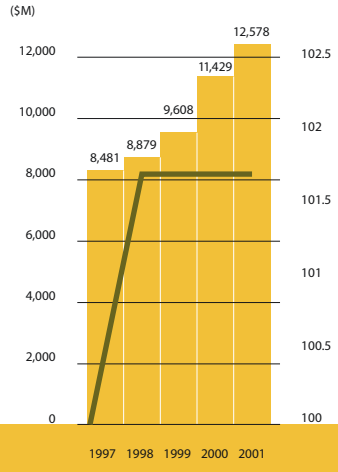
Corporate Profile

Hydro-Québec is a leading producer of energy and a major North American distributor. Its generating facilities have an installed capacity of 31,174 MW, and it uses water power to produce 96% of its total output. Its system includes 32,273 km of transmission lines and 106,448 km of distribution lines, approximately 9,000 km of which run underground. Its core mission is to supply Quebecers with sufficient electricity to meet their needs, under the best possible conditions. Hydro-Québec also does business with numerous electric utilities in the north-eastern United States, Ontario and New Brunswick, related mainly to short-term electricity sales and purchases. These transactions increase the security of its own electricity supply while also generating additional revenue. Hydro-Québec is known worldwide for its expertise, particularly in the areas of hydroelectric generation and high-voltage transmission. It maintains an active presence abroad, where it owns, builds or operates facilities in South America, Australia, the United States and China, among other places. Hydro-Québec has a single shareholder, the Québec government.

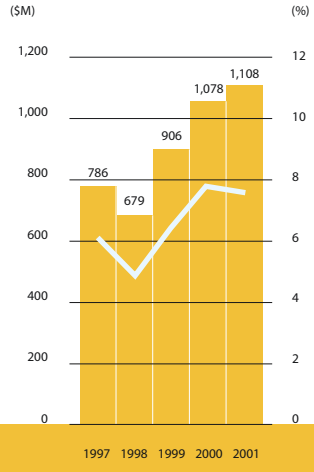
($M)	**2001**	2000	Change (%)
Operations and Dividends			
Revenue	**12,578**	11,429	10
Net income	**1,108**	1,078	3
Dividends	**554**	539	3
Balance Sheet			
Total assets	**59,861**	59,038	1
Long-term debt	**37,269**	34,965	7
Shareholder's equity	**14,834**	14,280	4
Cash Flows			
Operating activities	**3,463**	3,280	6
Investing activities	**(1,924)**	(3,621)	(47)
Financing activities	**(1,400)**	353	(497)
Cash and cash equivalents at end of year	**251**	112	124
Ratios (%)			
Return on equity	**7.6**	7.7	(1)
Return on revenue	**8.8**	9.4	(6)
Capitalization	**26.8**	26.2	2
Self-financing	**54.6**	48.7	12

Sales and Average Rate Increase Index



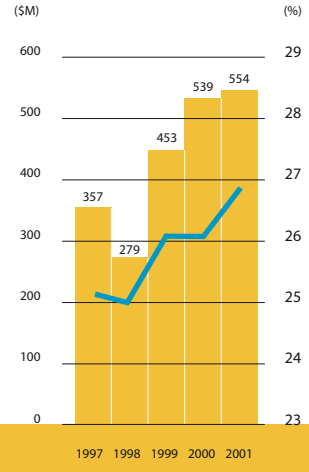
Sales continued to grow, topping $12 billion in 2001. Increased electricity transactions in the U.S. and electricity transmission revenue from recent investments outside Canada contributed to this growth.

Net Income and Return on Equity



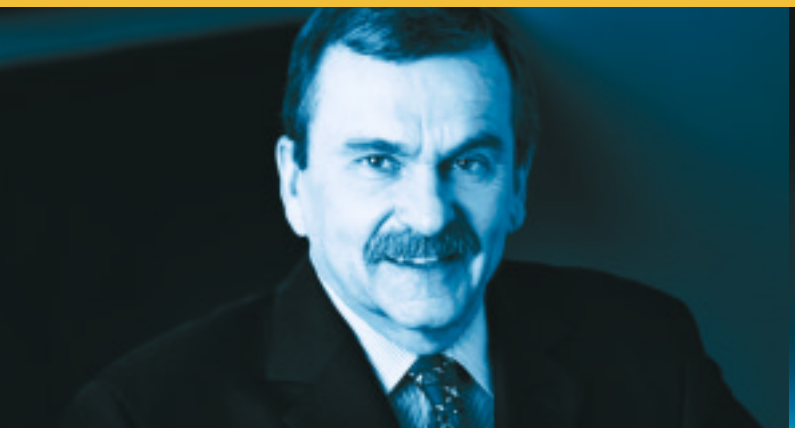
In line with its profitability objectives, Hydro-Québec continued to improve its financial position. Net income increased by $30 million to reach $1.1 billion and return on equity stood at 7.6%.

Dividends Paid and Capitalization



In the past five years, Hydro-Québec has paid its shareholder over $2 billion in dividends, while increasing its capitalization rate.

Steady growth in Hydro-Québec's profitability is the most effective way of keeping Québec electricity rates among the lowest in North America.



Jacques Laurent
Chairman of the Board of Directors

André Caillé
President and Chief Executive Officer

SUSTAINED GROWTH

In 2001, Hydro-Québec steered a steady course toward the objectives set out in its Strategic Plan, in particular by constantly offering its customers improved products and services. Altogether, Hydro-Québec's operations generated consolidated net income of $1,108 million, up 2.8% over last year. This excellent result is mainly attributable to an increased volume of transactions outside Québec, especially purchase/resale operations on the North American spot market, and the stability of financial expenses. The drop in short-term interest rates, as well as long-term refinancing at more advantageous rates, helped offset the negative impact of the weak Canadian dollar on our U.S.-dollar debt.

Transmission income grew substantially, in part because the operating results of Hydro-Québec TransÉnergie's international subsidiaries Transelec, in Chile, and Consorcio TransMantaro, in Peru, have been included in the 2001 financial statements. The increase also stems, to a lesser extent, from the operation of the DirectLink project in Australia.

Hydro-Québec intends to continue improving its profitability. For the company, this goal represents an important commitment to Québec as a whole. Its activities, both at home and abroad, benefit all Quebecers, whether in the form of direct and indirect economic spinoffs in all regions of the province, dividends paid to the Québec government, which uses them to meet Quebecers' needs, or ongoing improvements to its infrastructure and services.

A REVITALIZED COMPANY

A highlight of 2001 was the establishment of a new organizational structure. The deintegration of the company into four divisions, each headed by a president, fits in with the new regulatory framework governing the North American power industry. The four divisions are Hydro-Québec Distribution, Hydro-Québec TransÉnergie, established in 1997, Hydro-Québec Production and Hydro-Québec Ingénierie, approvisionnement et construction.

Hydro-Québec's new structure enables the company to adapt to current market conditions. It promotes the concentration of leading-edge expertise in each of the divisions, and gives them the necessary flexibility to adjust to their particular business environments. This structure also allows the divisions to seize growth opportunities in their respective markets and affords them full control over the services they offer, ultimately optimizing their results. Other components of the organization are Hydro-Québec's research institute as well as subsidiaries and affiliates operating in specific sectors.

Administrative and support functions are now grouped together under Corporate Management. We are confident that this new organization will help improve the quality and continuity of our services, while also supporting the profitable growth of a collective heritage that benefits all Quebecers.

A NEW DIVISION OF RESPONSIBILITIES

In 2001, Hydro-Québec made the provisions arising from Québec's energy regulations an integral part of its operations. Hydro-Québec Distribution is now responsible for supplying power to Québec customers. To fulfill this responsibility, the division purchases a heritage pool of 165 TWh/year from Hydro-Québec Production, at a regulated fixed price of 2.79 cents per kilowatthour. This volume forms the long-term core of Québec's electricity supply. It should be stressed that this is the lowest rate in North America for such a large quantity of power. Beyond this annual volume, Hydro-Québec Distribution must supply its Québec customers by issuing calls for tenders from suppliers on the marketplace. Hydro-Québec Production may respond to these calls for tenders.

In July 2001, the Régie de l'énergie (Energy Board) approved the *Code of Ethics on Conducting Calls for Tenders* to meet the native load beyond the heritage pool. Hydro-Québec Distribution then filed its first Electricity Supply Plan, designed to meet the portion of demand that will exceed the heritage pool by 2006 or 2007, as well as an application to issue a call for tenders in 2002.

SLOW GROWTH IN DEMAND

After averaging 2.7% a year between 1986 and 2001, growth in electricity demand should shrink to an annual rate of 1.2% over the next 15 years. This fall-off will stem from Québec's slow population growth and the development of a post-industrial economy—in other words, one that is energy-efficient, diversified and composed, to a large degree, of New Economy businesses.

In the medium range, looking toward 2006–2007, Québec's annual electricity demand could reach 167.2 TWh. This forecast is based on a scenario that includes energy conservation. Over the years, Hydro-Québec has implemented various programs for reducing energy consumption in all its customer categories, and in 2002 it will submit its Energy Efficiency Plan, focusing on energy conservation, to the Régie de l'énergie. The demand forecast also takes into account the economic downturn that began in early 2001, the extent and duration of which have become even harder to assess since the events of September 11 in the United States.

INCREASED GENERATING CAPACITY

The forecasts for growth in Québec demand, as well as new and profitable business opportunities in northeastern North America, have prompted Hydro-Québec Production to increase its generating capacity and to continue promoting the development of Québec's hydropower potential.

As a result, Hydro-Québec Production has initiated a number of projects. The division started work on a hydroelectric generating station on the Toulnustouc River. It obtained government authorization for the partial diversion of the Portneuf and Sault aux Cochons rivers to the Bersimis complex in order to optimize the output from the Bersimis generating facilities. In May 2001, it tabled a draft design report for the construction of Mercier hydroelectric station on the Gatineau River. In addition, draft design studies for a hydropower development to be built on the Péribonka River, north of Lac Saint-Jean, got under way.

The final decision on the plan to partially divert the Manouane River is expected in spring 2002. The project to rebuild the dam and dikes at Rapides-des-Quinze generating station was approved by the authorities concerned. Rehabilitation and upgrading work designed to ensure the long-term operability of our generating facilities also went ahead. In other projects, we broke ground on the new Grand-Mère hydroelectric plant and completed construction of Sainte-Marguerite-3 generating station. Finally, new agreements with the Crees will allow Hydro-Québec to construct Eastmain-1 hydroelectric generating station, and undertake draft design studies for Eastmain-1-A generating station and the partial diversion of the Rupert River.

Hydro-Québec Production still favors the hydropower option. However, the lengthy process of obtaining the necessary authorizations and then building hydroelectric generating stations does not allow such facilities to be commissioned in time to meet the demand forecast for 2005–2006 onward. Hydro-Québec has therefore decided to construct a gas-fired thermal generating station, the Suroît project, on property it owns next to the Beauharnois Canal. This combined-cycle power plant, which will have a capacity of approximately 800 MW and average annual output of 6.5 TWh, will use one of the most efficient thermal technologies available. It will help diversify the company's sources of supply and will provide additional capacity starting in the winter of 2006–2007.

Besides increasing its own generating capacity, Hydro-Québec Production may purchase electricity from independent power producers in Québec and on regional markets in northeastern North America to diversify its sources of supply. This practice assures the division of having the energy it needs to meet its commitments and take part in market growth.

A RELIABLE TRANSMISSION PROVIDER

To deliver power to its customers, Hydro-Québec relies on the Hydro-Québec TransÉnergie transmission system, which measures up to some of the most stringent strength and reliability standards in the North American industry. Much of the loop work planned following the ice storm of 1998 has been completed. In the event of a major power failure, most of the especially vulnerable regions will consequently have access to another supply source. As well, Hydro-Québec TransÉnergie still intends to build a 1,250-MW interconnection with Ontario, provided that the conditions allow for a reasonable return on its investment.

The deregulation of the transmission market means that the division now manages a large volume of power flows to and from neighboring systems, independent power producers and Hydro-Québec Distribution, resulting in further revenue for the company. Hydro-Québec TransÉnergie submitted an application to amend its transmission rates at public hearings held by the Régie de l'énergie. The Régie will hand down its decision in 2002.

Hydro-Québec TransÉnergie spearheads Hydro-Québec's activities on the international scene. Its expertise in the area of high-voltage transmission is in great demand. In 2001, the division was already involved in a number of major projects in Chile, Peru, Australia and the United States, among other countries, and it pursued its efforts at profitable development by promoting less capital-intensive projects.

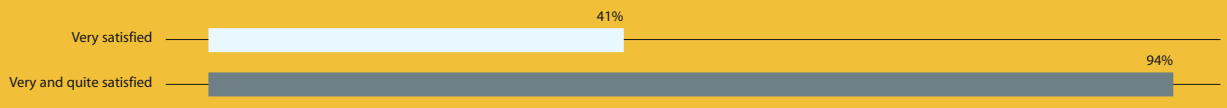
RENOWNED EXPERTISE AND SERVICES

To carry out its projects, the company relies on the expertise and services of Hydro-Québec Ingénierie, approvisionnement et construction, its engineering division, which has developed unique know-how over the years, particularly in the design and construction of large-scale generation and high-voltage transmission facilities.

GREATER MOTIVATION

The results posted in 2001 are the product of greater employee motivation throughout the company. As the year comes to a close, we wish to thank all those who have enabled us to better fulfill our mission, to improve the quality of our services and to increase our profitability.

Public Satisfaction



At the conclusion of 2001, Hydro-Québec is resolutely engaged in making changes in order to keep serving its customers well and continue growing in a fast-evolving industry.

To ensure its future, however, Hydro-Québec will have to meet a major challenge. It must hire and train a new generation of employees to carry on and improve the often unique expertise developed by our personnel in a variety of critical sectors. We fervently hope that this succession, which will be made up mainly of young graduates in all fields, will enable the company to continue its progress. Lastly, we hope these new recruits will find with us a stable, stimulating environment in which to deploy their talents.

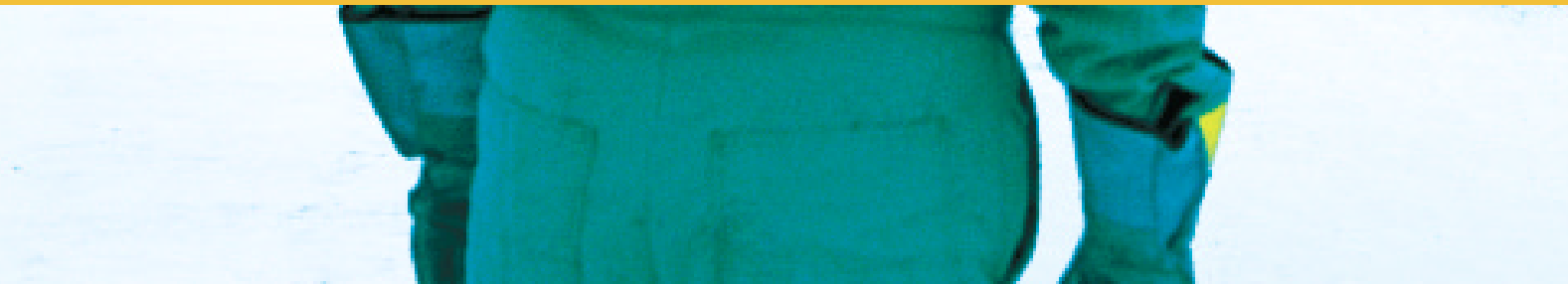
Jacques Laurent
Chairman of the Board of Directors

André Caillé
President and Chief Executive Officer

"Hydro-Québec Distribution continues to focus on improving system reliability and maintaining service quality in line with its customers' priority expectations."

— **Yves Filion,** President
Hydro-Québec Distribution

THE DIVISION'S 7,388 EMPLOYEES ARE RESPONSIBLE FOR ELECTRICITY SERVICE TO 2.8 MILLION QUÉBEC CUSTOMERS. THEY DO THEIR UTMOST TO RESTORE SERVICE AS QUICKLY AS POSSIBLE IN THE EVENT OF A POWER FAILURE.



the Distributor

power to the people

Reliable Power and Improved Service

The primary responsibility of Hydro-Québec Distribution is to supply Québec customers with the electricity they need. The division serves its approximately 2.8 million customers via a system of over 106,000 km of distribution lines, some 9,000 km of them underground. In spite of Québec's often difficult weather conditions and the fact that our customers are spread over a huge 1.7-million-km^2 territory, service quality continued to improve in 2001. This was reflected in an increase in the overall rate of customer satisfaction from 7.22 out of 10 in 2000 to 7.33 in 2001. Québec's electricity rates have not changed since 1998, and will remain at the same level until at least April 2004. In the meantime, Hydro-Québec will file a rate amendment application with the Régie de l'énergie. Any increases will be based on the rate of inflation and must allow the price of electricity in Québec to remain competitive. Access to affordable electricity is a major asset for the province's economy, and also contributes to the quality of life of all Quebecers. Following a new analysis of its markets' energy conservation potential, Hydro-Québec Distribution will submit a three-year Energy Efficiency Plan to the Régie de l'énergie in 2002. According to an initial estimate, new measures implemented across the entire customer base could generate 400 GWh of new energy savings by 2006, on top of the 2,500 GWh of energy savings already achieved during the 1990s.

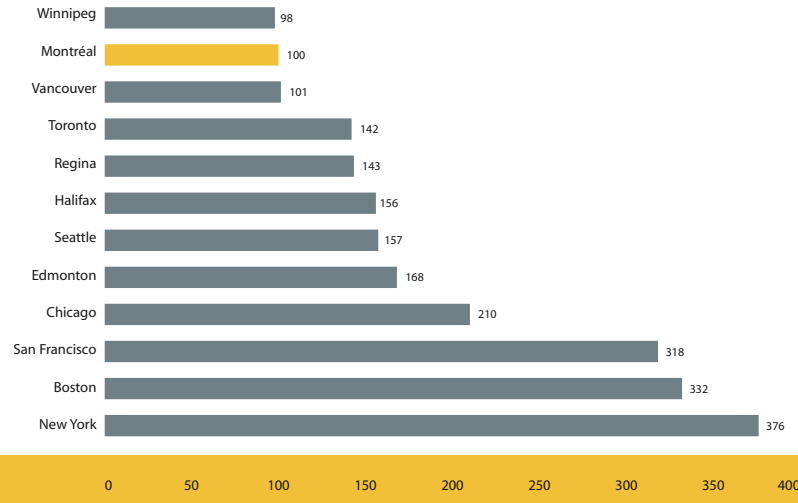
Yves Filion
President
Hydro-Québec Distribution

SUPPLY

A fundamental component of Hydro-Québec Distribution's mission is to supply Quebecers with electric power. Under the *Act to amend the Act respecting the Régie de l'énergie,* adopted by the Québec government in June 2000, Hydro-Québec Production must make 165 TWh available to Hydro-Québec Distribution for meeting domestic demand. Beyond that volume, Hydro-Québec Distribution must issue calls for tenders at regular intervals to all interested power producers, including Hydro-Québec Production. This will open up the province's wholesale market to competition.

- An initial Electricity Supply Plan to meet anticipated domestic power needs over the next 10 years was filed with the Régie.
- The division filed an application to launch an initial call for tenders in 2002 to meet additional anticipated needs in Québec starting in 2006–2007. This call for tenders is for 600 MW of capacity, which represents 4.1 TWh of energy annually.
- The Régie approved the *Code of Ethics on Conducting Calls for Tenders* guaranteeing fairness and impartiality in the awarding of supply contracts.

Comparative Index of Electricity Prices, Residential Customers—May 1, 2001*
(Montréal = 100)



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

Services

Hydro-Québec Distribution offers its customers products, services and technology-based solutions that fit their changing needs. The division handles customer requests from its Hydro*Direct* call centre locations in different parts of the province. It also promotes various energy conservation projects as a way of managing demand in Québec. It introduced an information and discussion process with the groups concerned, in preparation for tabling its Energy Efficiency Plan in 2002.

Residential customers

- The division continued its efforts to improve response speed and reliability at the Hydro*Direct* call centres.
- It also continued its collection efforts to limit financial losses from overdue accounts.
- A task force made up of representatives of Hydro-Québec and consumer associations continued its activities with a view to developing lasting solutions to assist the most economically disadvantaged customers.
- The range of high-quality products offered to customers, such as sales and rentals of water heaters, air conditioners and heating systems, was expanded.

Business customers

- Special representatives were designated for certain groups of business customers to personalize the services offered.
- Remote-reading meters were installed at business customers' premises. Customers with multiple bills can group them and choose their own billing date.
- The Régie approved Phase II of the Electrotechnology Implementation Support program, run by the Shawinigan laboratory of Hydro-Québec's research institute.
- Members of Senior Management met with close to 2,000 business customers to become better acquainted with their needs and inform them about the services available.

E-commerce

- Hydro-Québec's Web site was enhanced to allow customers of all categories to send change-of-address notices and meter readings, and to view and pay their electricity bills.

Service Quality	**2001**	2000	Change
Rate of new hookups on schedule	**93%**	88%	▲ 5%
Rate of meter reading	**96%**	96%	–
Rate of call response in under 20 seconds			
– Residential customers	**66%**	59%	▲ 7%
– Business customers	**69%**	62%	▲ 7%
Average hours of service interruption per customer—gross	**4.30**	3.20	▼ 34%
Average hours of service interruption per customer—adjusted	**2.62**	2.33	▼ 12%

Customers can reach us easily thanks to the Hydro*Direct* call centres.

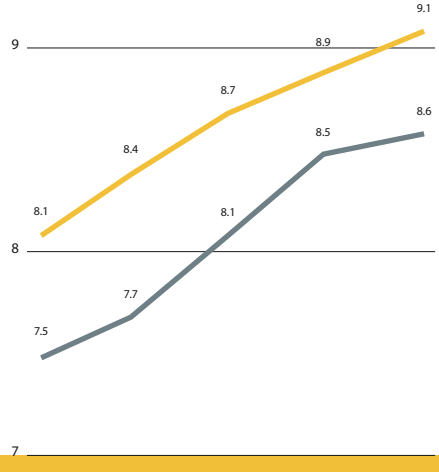
Large-power customers

Our large-power customers are industrial, commercial and institutional organizations that require more than 5 MW of power. Low, stable electricity rates are incentives to set up or maintain operations in Québec. Hydro-Québec Distribution endeavors to continuously improve communications with these customers and stay attuned to their needs. The 258 companies in this category consume 43% of all electricity delivered in Québec.

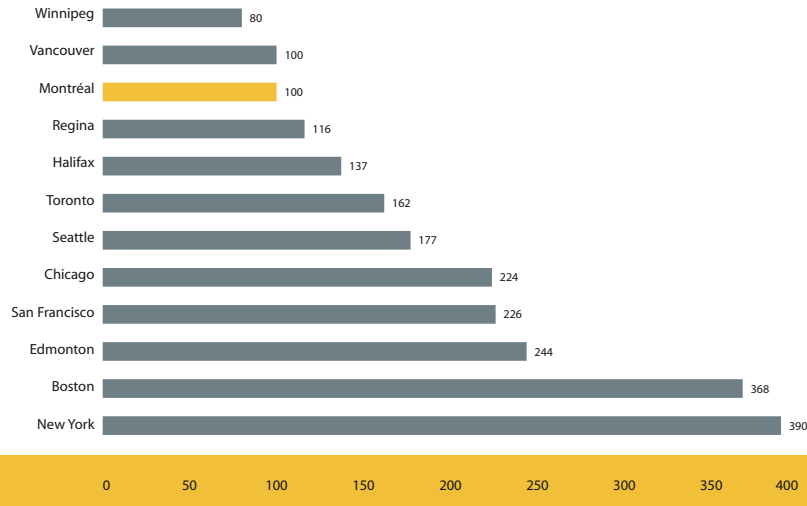
- Total consumption by large-power customers grew compared with 2000, despite the economic slowdown. Sales in this sector amounted to nearly 64 TWh, generating revenue of more than $2.2 billion.
- Communication with associations representing large-power customers increased.
- Work continued on implementation of a software platform providing large-power customers with continuous access to their daily consumption profile and other information of concern to them.
- The division made a firm commitment to large-power customers to maintain a business partnership based on quality and satisfaction, by offering them improved availability through one-stop access, a personalized business approach, high-quality power and real-time online communications, and by holding quality partnership sessions.
- The division filed for Régie approval of an emergency supply rate to meet the occasional needs of large customers.
- Networking activities were increased to encourage diversification in the Québec economy by attracting new business ventures, particularly in information technology and fibre optics.

Rate studies in industrialized countries show that Hydro-Québec's rates are among the most competitive.

Satisfaction Levels—Large-Power Customers



Comparative Index of Electricity Prices, Large-Power Customers—May 1, 2001*
(Montréal = 100)



** Monthly bill (before taxes) for a demand of 5 MW, a consumption of 3,060 MWh and a load factor of 85%.*

Electricity service

Hydro-Québec Distribution has established an infrastructure along with a wide range of products and services for system planning, operation and maintenance that assure Quebecers of reliable, secure electricity delivery all year long. Its primary objective is to minimize the number and length of service interruptions. The division also aims to lessen the impact of extreme weather events by reinforcing its system. It works in close cooperation with municipalities to take the most appropriate measures to fulfill all its social and environmental responsibilities.

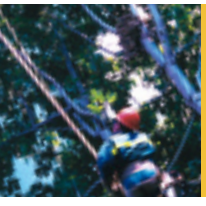
- Phase one of a program giving customers advance notice of any scheduled outage and informing them of the average service restoration time in case of a power failure was launched.
- Equipment maintenance programs have been implemented, making it easier to set priorities and conduct operations outside peak periods, in order to reduce the impact on customers and improve service continuity.
- Vegetation control operations were inventoried and agreements signed with property owners for the work to be done.
- A mobile transformer station was developed, allowing operations to be carried out on underground distribution lines without cutting off service to business customers.

RESEARCH AND TECHNOLOGICAL INNOVATION

The great distances between facilities, the performance level required of a distribution system subjected to harsh and fluctuating conditions, and the varied nature of the loads connected have fostered the development of technology-based solutions designed to ensure service continuity at a reasonable cost.

- The division selected the R&D projects most likely to improve power quality and service continuity, reduce system undergrounding costs and prolong equipment service life.
- A remote fault-signaling system for the distribution grid was developed.
- An agreement was signed with IATS, a French manufacturer of overhead line switches, to produce and market a remote-operated vacuum switch for overhead distribution lines. This technology is the product of a collaborative effort by IATS, Hydro-Québec's research institute, and Hydro-Québec Distribution.

Hydro-Québec Distribution plans to carry out 30 to 50 line undergrounding projects every year in heritage sites throughout the province. A committee set up by the Québec government determines the acceptability of projects submitted by the municipalities.



Vegetation control: the job that contributes the most to maintaining service continuity.

Lines are less and less visible in residential neighborhoods.

INFORMATION TECHNOLOGY DEVELOPMENT

The complexity of distribution system control and the wide range of operations necessary to meet the many expectations of the division's customers have led it to acquire flexible, highly efficient information technology tools.

- New system simulators were introduced in each distribution control centre to improve service quality and continuity.
- A Distribution Management System was deployed to handle service restoration priorities.

PRESERVING THE ENVIRONMENT

The division obtained an ISO 14001 registration certificate for its activities related to system maintenance in October 2000. This certification confirms the efforts expended to make the environment an integral part of the division's business processes and activities.

- Confirmation was received of the division's continued ISO 14001 certification, one year after implementation of the Environmental Management System.
- The division conducted 14,000 internal environmental assessments in order to systematically integrate environmental aspects into distribution system planning, construction and maintenance.
- As a representative of the Québec government, the division participated in the government program for undergrounding distribution systems in heritage, cultural and tourist sites, in cooperation with municipalities and telecommunications companies. Hydro-Québec Distribution is responsible for implementing this program, which will cost $300 million over four years; Hydro-Québec will contribute $200 million of that amount.
- Talks continued with the Québec union of municipalities on extending the underground grid into new residential neighborhoods.

EXPERTISE AND HUMAN RESOURCES

Hydro-Québec Distribution employees are in direct contact with the company's customers. They have all the information they need to respond quickly to the many different requests they receive.

- A succession plan was developed for all specialized and management positions, and skill profiles were updated.
- The work-related accident frequency rate fell from 5.42 per 200,000 hours worked in 2000 to 4.96 in 2001.
- A new process was introduced to heighten awareness of work accidents and analyze code violations; corrective measures were applied.

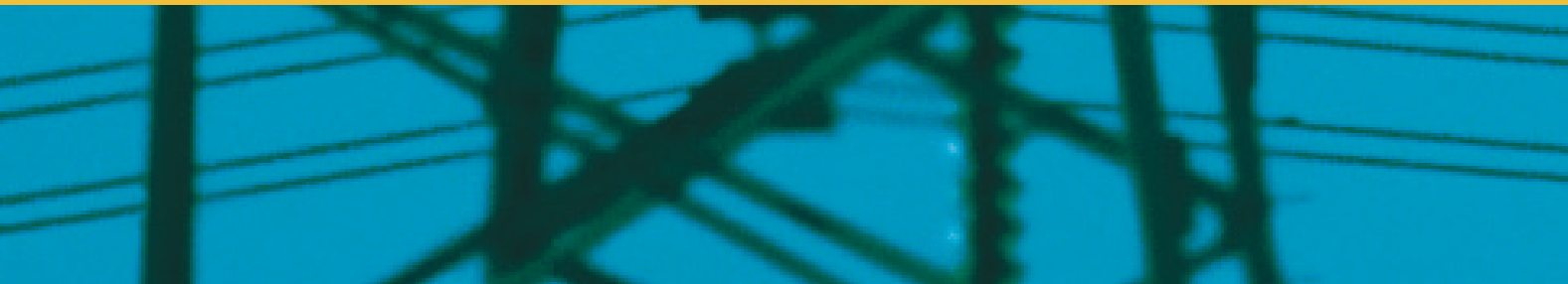
A meter reader, in daily contact with customers.

Communication with large-power customers is a priority.

"We firmly intend to remain a leader in power transmission. Because we meet the highest standards in the North American electricity industry, we can offer our customers here in Québec and beyond our borders service quality and continuity that are among the best in the world."

— **Jacques Régis,** President
Hydro-Québec TransÉnergie

THERE ARE MANY CALLS ON THE TRANSMISSION SYSTEM, WHICH IS THE MOST EXTENSIVE IN NORTH AMERICA. NOT ONLY DOES QUÉBEC DEMAND CONTINUE TO INCREASE, BUT POWER FLOWS TO AND FROM NEIGHBORING SYSTEMS, INDEPENDENT POWER PRODUCERS AND DISTRIBUTORS HAVE GROWN STEADILY SINCE THE POWER MARKET OPENED UP.



the Transmission Provider

power in motion

Strength and Security

Hydro-Québec TransÉnergie delivers electricity to its Québec customers. It also devotes substantial efforts to developing, maintaining and improving its transmission system. Its reliability and security standards comply with the criteria laid down by the Northeast Power Coordinating Council (NPCC), one of the 10 regional boards in the North American Electric Reliability Council (NERC). Following the deregulation of the North American power market, Hydro-Québec TransÉnergie opened up its system to other power producers and distributors, and now offers them transmission services at fair and nondiscriminatory rates. At year-end, 20 customers were accredited to transmit power over the Hydro-Québec TransÉnergie system. Hydro-Québec Distribution is the division's largest customer. In recent years, Hydro-Québec TransÉnergie has pursued a strategy of penetrating the most promising outside markets. A world leader in transmission system design, operation and maintenance, it plans to make the most of its technical know-how, its technological edge and the leadership of its personnel, especially in the United States and South America. Hydro-Québec TransÉnergie has one subsidiary, the management holding company TransÉnergie HQ, which in turn has four others: TransÉnergie U.S., whose mission is to acquire, develop and manage profitable strategic assets in power transmission; TransÉnergie Technologies, which markets the division's value-added technological products and solutions in Québec and worldwide; TransÉnergie Services, which provides expertise in transmission system planning and operation, both in Québec and worldwide; and TransÉnergie Australia, which offers transmission expertise in technical, commercial and regulatory aspects. At year-end, the Hydro-Québec TransÉnergie system comprised 32,273 km of lines, 504 substations and 15 interconnections with neighboring systems.

Jacques Régis
President
Hydro-Québec TransÉnergie

SERVICE CONTINUITY

As a result of the increase in domestic demand, coupled with the opening up of the power market, Hydro-Québec TransÉnergie must manage a growing volume of interchanges with neighboring systems, independent power producers and distributors. This calls for ongoing optimization of transmission system availability. To meet these needs on a continuous basis, Hydro-Québec TransÉnergie constantly works to strengthen its installations. Other projects are designed to enhance the capacity of its interconnections and improve access to resources outside Québec.

- The service interruption index was kept below the 0.65-hour threshold, averaging 0.51 hours per customer in 2001. This performance level was made possible by a number of steps taken to increase the strength of the Hydro-Québec TransÉnergie system.
- A transmission line running from Sainte-Marguerite-3 generating station, currently under construction, to Arnaud substation was completed.
- Work making the output from Beauharnois generating station available to the Montréal area was completed, thus increasing security of supply for the island.
- To ensure long-term operability, work amounting to $178 million was done on the system: mainly, replacing or refurbishing circuit breakers, replacing insulators in substations and on lines, and rebuilding the switchyards at Beauharnois.

SYSTEM DEVELOPMENT

To meet the growing demand, Hydro-Québec TransÉnergie is modernizing its facilities and optimizing their use through the careful management of power flows to and from neighboring systems, independent power producers and distributors. Its goal is to deliver high-quality electricity, in sufficient quantities and at the best possible cost, to all its customers.

- Two single-circuit lines were replaced by one double-circuit line running 10.8 km between Sherbrooke and Saint-François substations, in order to improve the performance of the 120-kV system that serves the Sherbrooke area.
- A second circuit and a third synchronous interconnection about 20 km long were commissioned between the Hydro-Québec TransÉnergie and Alcan systems, to increase security of supply to residents and industries in the Lac-Saint-Jean region.
- The division received its first long-term (one year) reservation of capacity use by a company other than Hydro-Québec, to carry 100 MW of firm power to the New York system.

PRESERVING THE ENVIRONMENT

Hydro-Québec TransÉnergie is constantly seeking ways to improve its environmental performance by incorporating this issue into every stage of facility construction, operation and maintenance. It implements various measures ensuring the best possible energy efficiency as well as the long-term preservation of balance within the biophysical and social environments that host its installations.

- Work on the implementation of an ISO 14001–compliant environmental management system continued, and the managers and employees concerned began conducting internal audits to familiarize themselves with this system.
- The first step of a two-part program to reduce ozone-depleting substances was launched.

Work at Beauharnois substation: increasing the security of supply to the island of Montréal.

INTERNATIONAL PRESENCE

Hydro-Québec TransÉnergie is always on the lookout for new outlets where its know-how can be put to good use. The resulting increase in revenue from foreign projects contributes to Hydro-Québec's long-term profitability.

Hydro-Québec TransÉnergie's foreign operations include marketing its expertise and value-added technology-based solutions, as well as developing projects and acquiring profitable assets.

- Construction began on the MurrayLink project in Australia, in partnership with SNC-Lavalin. The project involves building a 180-km interconnection between the states of Victoria and South Australia, along with two converter stations.
- A draft design study was completed by TransÉnergie U.S., in partnership with Hydro One, for the construction of an underwater interconnection linking Ontario and Pennsylvania via Lake Erie.

RESEARCH AND TECHNOLOGICAL INNOVATION

Hydro-Québec TransÉnergie relies on innovation to uphold its position as a leader in the transmission field. R&D remains a key strategy for ensuring medium- and long-term growth. These efforts focus mainly on improving system reliability and preserving long-term operability, enhancing the division's competitive position, developing interconnection capacity and maintaining power quality.

- Tests were developed to measure the effectiveness of thermal and mechanical methods for de-icing transmission lines and substation equipment.
- A pilot project at Châteauguay substation, aimed at limiting interconnection downtime by conducting equipment maintenance at times of low use, was evaluated.
- At a substation just outside Montréal, a new type of equipment, the variable-frequency transformer, was evaluated. Developed by General Electric of Canada, this technology is being applied for the first time anywhere in the world.
- A new research program was launched to improve equipment performance in 735-kV substations in cases of heavy ice accretion. The program is a joint effort by the Université du Québec à Chicoutimi industrial chair on atmospheric icing of power system equipment and Hydro-Québec's research institute.
- Research projects were assigned to the university and industrial chair on transmission lines at the Université de Sherbrooke's engineering faculty, covering damage detection using dynamic testing, line resistance to wind loads and ways to prevent towers from cascading.
- The 1965 introduction of the 735-kV transmission technology developed by Hydro-Québec received the award for the most outstanding technological innovation of the 20th century, presented by the Ordre des technologues professionnels du Québec.

Hydro-Québec received the award for the most outstanding technological innovation of the 20th century: 735-kV transmission.

I.T. AND TRANSMISSION

The efficiency of Hydro-Québec TransÉnergie is partly based on information technologies that help optimize system operation and maintenance activities.

- A new computer infrastructure, using Siemens-IBM technology, was introduced as part of the modernization of the System Control Centre.
- The division began implementing new system maintenance management software (MaximOM project).
- The last two stages in the startup of the Generation Rejection and Remote Load-shedding (GRRL) system, which works to prevent major power failures and maintain transmission system integrity in case of an exceptional event, were completed.

EXPERTISE AND HUMAN RESOURCES

To achieve Hydro-Québec TransÉnergie's objectives of growth and long-term operability, the commitment and competence of our employees are absolutely essential. In 2001 the division pursued various activities to increase employee motivation. It must also ensure a smooth succession, in particular among technical personnel, and offer training that keeps abreast of technological developments.

- The division continued the implementation of the skill management plan, which includes strategies for acquiring, maintaining and developing the necessary skills to ensure day-to-day management.
- Professional-development programs to prepare the next generation of employees were maintained.
- The division assumed an additional function, namely management of the unit in charge of the company's telecommunications, to provide greater synergy in transmission activities.
- A remote self-training module, intended for all Hydro-Québec TransÉnergie personnel, was introduced on the intranet site.
- The work safety code, which sets out safety principles to be followed by Hydro-Québec personnel and contractors, was updated.
- The frequency of work-related accidents fell from 4.7 per 200,000 hours worked in 2000 to 4.4 in 2001.
- The employee motivation index rose from 6.4 out of 10 in 2000 to 6.6 in 2001.

REGULATORY

Many Hydro-Québec TransÉnergie activities are governed by agencies responsible for ensuring reliability and nondiscriminatory marketing of transmission capacity. To operate on the new North American power market, Hydro-Québec TransÉnergie must comply with the requirements of the Régie de l'énergie, in Québec, and of the NERC, in the United States.

- The division filed its first rate case with the Régie requesting approval of new transmission rates that would allow a reasonable return on the rate base. It also requested certain amendments to Hydro-Québec's *Open-Access Transmission Tariff*.
- Hydro-Québec TransÉnergie, having sole responsibility for the reliability and security of Québec's transmission system, adopted an operating model based on the RTOs (Regional Transmission Organizations) in the U.S.

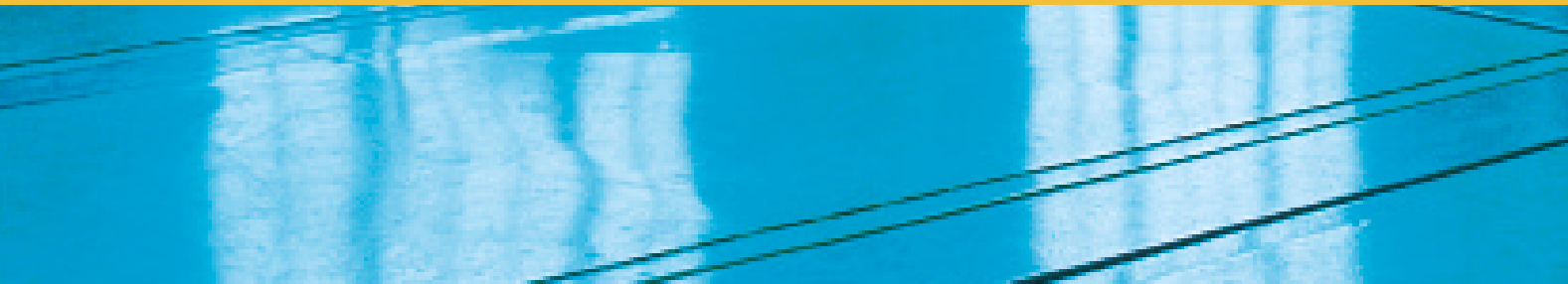
GRRL: a new automatic protection system is now operational.

IN 2001, HYDRO-QUÉBEC TRANSÉNERGIE POSTED SALES OF APPROXIMATELY $3 BILLION.

"Spurred by market growth in Québec and northeastern North America, Hydro-Québec Production will continue developing its generating capability, with particular emphasis on Québec's own hydropower potential."

— **Thierry Vandal,** President
Hydro-Québec Production

BEAUHARNOIS GENERATING STATION IS ONE OF THE OLDEST AND MOST POWERFUL IN QUÉBEC. ITS 38 UNITS OCCUPY BOTH SIDES OF A CANAL FOR NEARLY A KILOMETRE. MAJOR REHABILITATION WORK HAS GONE ON SINCE 1994 TO ADD SEVERAL DECADES TO THE SERVICE LIFE OF THIS STRATEGIC PLANT.



the Generator

Profitability and Growth

Hydro-Québec Production generates electricity and sells it on wholesale markets both inside and outside Québec. For the Québec market, the division supplies a heritage pool of up to 165 TWh per year, which it is obliged to sell at a fixed price of 2.79 cents per kilowatthour. Beyond this volume, it may compete freely in response to Hydro-Québec Distribution's calls for tenders. It conducts various transactions on markets outside Québec. These transactions, mainly short-term electricity sales and purchases, generate significant revenue, offer attractive profits and help optimize the use of our generating stations and reservoirs. The division operates generating facilities which are 93% hydroelectric in terms of installed capacity. It runs them under optimum cost and efficiency conditions, and takes the necessary measures to ensure their long-term operability. The division maintains a diversified portfolio of projects to increase its generating capacity and take advantage of market growth. As well, it secures other sources of supply by such means as long-term contracts with independent power producers in Québec, with the focus on renewable energy, including wind power. Hydro-Québec Production also makes the most of its expertise on foreign markets, such as South America, China and the United States, through targeted investments and technical services contracts.

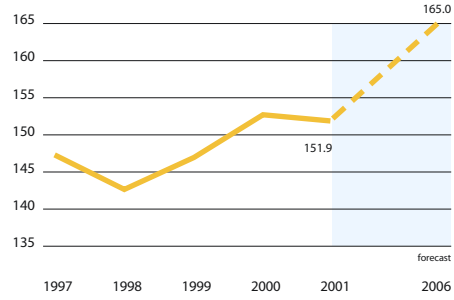
Thierry Vandal
President
Hydro-Québec Production

Hydro-Québec negotiates agreements with the Crees concerning two new James Bay projects: Eastmain-1, and Eastmain-1-A with partial diversion of the Rupert River.

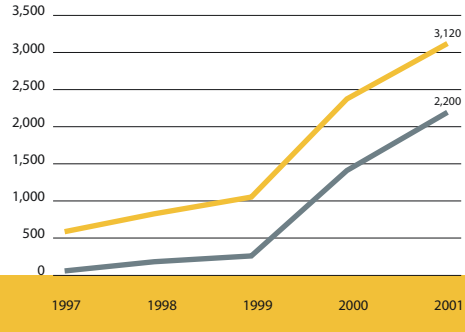
OPERATIONS AND PROJECTS

To seize business opportunities on the deregulated power market in Québec and the rest of North America, Hydro-Québec Production is optimizing the output of its existing generating facilities and breaking ground on new developments. Its generating fleet, which includes 51 hydroelectric generating stations on Québec's main drainage basins and 5 thermal generating stations, has a total installed capacity of 31,051 MW. Added to this is most of the generation from Churchill Falls power plant, in Labrador, which has a capacity of 5,428 MW. The hydroelectric developments also include 25 large reservoirs, with a storage capacity of 172 TWh, and 562 dikes and dams.

Electricity Sales to Hydro-Québec Distribution
(TWh)



Sales Outside Québec and Short-Term Purchases
($M)



- Construction continued on a new $450-million hydroelectric development to replace the existing facility at Grand-Mère.
- Construction began on an $800-million, 526-MW hydroelectric generating station on the Toulnustouc River.
- Agreements were signed with the Crees for the development of two hydropower projects in the James Bay region: the first is construction of Eastmain-1, with an installed capacity of 480 MW, at an estimated cost of $1.7 billion; the second is construction of Eastmain-1-A, with an installed capacity of about 770 MW, and partial diversion of the Rupert River, a project worth around $2.1 billion.
- Draft design studies began for the construction of a 450-MW generating station on the Péribonka River, involving an estimated potential investment of $1 billion.
- Draft design studies began for the construction of an 800-MW gas-fired power plant next to the Beauharnois canal, a potential investment of some $550 million. A memorandum of understanding was signed with the municipality of Melocheville and the Beauharnois-Salaberry RCM covering the project's local and regional economic spinoffs.
- Draft design studies began for the construction of a $500-million, 220-MW generating station on the Romaine River.
- Refurbishing work started on Pont-Arnaud and Chute-Garneau generating stations, which have a capacity of under 50 MW each, in preparation for a transfer of ownership.
- The $80-million refurbishing of Rapides-des-Quinze generating station got under way.
- Rehabilitation of Beauharnois and Bersimis-1 generating stations continued.
- The major overhaul of Manic-2 generating station and upgrading of Shawinigan-2 and Shawinigan-3 generating stations were completed.
- Projects for the partial diversion of the Portneuf and Sault aux Cochons rivers to the Betsiamites generating facilities were authorized by the Québec government.
- The Canadian Electricity Association recognized the outstanding performance of Rapides-Farmers generating station. The plant's no. 4 unit recorded the highest load factor in Canada: 99.93%.
- Some strategic IT projects were completed, including the deployment of MaximOM, a project to improve maintenance planning, and startup of the GESTEAU 2 system for monitoring runoff and optimizing reservoir management.

Manic-2 gets a new look.

WHOLESALE MARKETS

While supplying the heritage pool on the Québec market, Hydro-Québec Production is active on markets in northeastern North America. Its power sales and trading activities focus on the sale of surplus electricity produced in Québec, the purchase of electricity for banking and resale, and electricity purchase and sale transactions on the U.S. market.

- Sales to Hydro-Québec Distribution: 151.9 TWh at a fixed price of 2.79 cents per kilowatthour (heritage pool).
- Sales outside Québec: 42.4 TWh; these sales generated revenue of $3.1 billion, up 31% from 2000. Short-term electricity purchases totaled $2.2 billion.
- The 1998 agreement with Newfoundland and Labrador Hydro for Hydro-Québec's purchase of surplus electricity (130 MW) generated at Churchill Falls power plant was renewed for a term of three years.
- The major long-term sales contract with New England electric utilities expired.
- The dispute between Hydro-Québec and Vermont Joint Owners was settled by an international arbitration tribunal. The contract between the two parties is maintained until its expiry date in 2020, and Hydro-Québec will pay US$9 million for the nondelivery of power during the ice storm of 1998.

RESEARCH AND INNOVATION

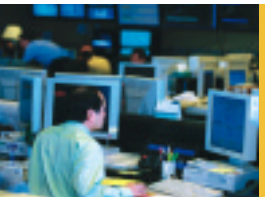
Hydro-Québec Production relies on technological innovation to continuously improve the performance of its generating facilities and ensure their long-term operability for future generations. The division concentrates its R&D activities in areas of strategic importance.

- Some 15 R&D projects worth more than $26 million altogether were continued, focusing on the long-term operability and improved performance of generating assets, their profitability in a restructured power market, and the development of new construction methods.

PRESERVING THE ENVIRONMENT

Hydropower, a renewable energy, plays a leading role in the division's growth plans and remains its preferred generation option. The division also sees to it that its facilities are maintained and operated with a view to environmental protection.

- ISO 14001 certification was obtained for plant operations.
- Environmental studies on mercury, greenhouse gases, and terrestrial and aquatic resources and habitats, as well as environmental follow-up at the La Grande complex, continued.



The energy trading floor is a hive of activity 24 hours a day.

Water samples for environmental studies underway in the James Bay region.

INTERNATIONAL PRESENCE

Market restructuring and energy needs in the developing countries offer attractive business opportunities and allow Hydro-Québec Production to utilize its employees' know-how. The division remained on the lookout for profitable international opportunities, including projects for the acquisition or management of strategic hydroelectric assets. It also continued developing technical assistance services in such market niches as specialized maintenance and refurbishing of hydroelectric generating stations, particularly in the United States.

- In Panama, the division continued operating the country's largest hydroelectric facility, Fortuna, in which Hydro-Québec has a 16.3% stake. The 2001 financial results exceeded expectations.
- In China, it continued the operation and development of Meiya Power Company, in which Hydro-Québec holds a 20% interest. Seven generating stations are in operation, and two new power plant projects were launched in 2001. Qingshan generating station, in which Hydro-Québec also has a stake, was commissioned.
- In 2001, professional services contracts were carried out mainly in China, Panama, Venezuela, Cameroon and Vietnam, for revenue of more than $6 million.
- A new company, Hydro Power Solutions, was set up to offer American companies services in the area of hydroelectric plant management, operation, maintenance and rehabilitation.

EXPERTISE AND HUMAN RESOURCES

To assure its customers of reliable, high-quality services, Hydro-Québec Production can count on well-qualified personnel: its 3,339 employees constantly keep their skills up to date. The division is also involved in a number of activities designed to motivate its people and increase the flexibility of the workforce.

- An extensive technical training program on job safety was drafted; new technologies will be used to deliver the training.
- The division continued the implementation of a succession plan to preserve its expertise.

At all times, Hydro-Québec Production maintains enough energy reserve to offset a potential runoff deficit of 64 TWh over two consecutive years, and a capacity reserve representing 10% to 12% of demand under its contracts.

Employee skills ensure quality and reliability.

"Our expertise is focused on delivering shared services and projects that help improve the performance and profitability of Hydro-Québec's other divisions."

— **Élie Saheb,** President
Hydro-Québec Ingénierie, approvisionnement et construction

IN 2004, THE NEW GRAND-MÈRE GENERATING STATION, ON THE SAINT-MAURICE RIVER, WILL REPLACE THE OLD ONE, WHICH IS OVER 85 YEARS OLD. THIS IS NOW THE LARGEST GOING JOBSITE IN QUÉBEC—AT THE PEAK OF CONSTRUCTION, MORE THAN 500 PEOPLE WORK THERE. WHAT'S MORE, 75% OF THE WORKERS ARE LOCAL.

the Builder

the power to construct

Shared Services with High Value Added

This division supplies expertise and shared services in engineering, procurement, construction project management and information technologies. It carries out generation and transmission projects, both for Hydro-Québec's other divisions and on the international scene. As part of its mission here in Québec, it participates in the development of the province's hydropower potential and transmission system, and works to ensure the long-term operability of the company's facilities. The division is also responsible for supplying the goods and services that support the company's mission and operations. It manages Hydro-Québec's real estate portfolio and its vehicle and air fleets. In addition, the division provides IT services and strategies, and performs engineering and construction work for Hydro-Québec's telecommunications projects. Through the subsidiary Société d'énergie de la Baie James (SEBJ), it carries out development projects in Québec as well as abroad on behalf of Hydro-Québec International. By offering diversified expertise, high-value-added services and economies of scale made possible by its volume of activity, Hydro-Québec Ingénierie, approvisionnement et construction is a strategic partner for the other Hydro-Québec divisions.

Élie Saheb
President
Hydro-Québec Ingénierie,
approvisonnement et construction

ENGINEERING AND CONSTRUCTION

In 2001, the engineering and construction units carried out work worth a total of $725 million. There was a slight slowdown compared to 2000, due to the timeframes involved in obtaining government authorization for several generation and transmission projects.

- Draft design studies were done for the partial diversion of the Manouane, Portneuf and Sault aux Cochons rivers and for new generating stations: Mercier, Romaine-1, Péribonka and Tabaret.
- Draft design studies were done for flood control in the Lake Kénogami drainage basin, on behalf of the Québec government.
- Refurbishing began or continued on Outardes-3, Bersimis-1, Beauharnois, Shawinigan-2 and Rapides-des-Quinze generating stations, and construction work was done on spillways at Pont-Arnaud and Chute-Garneau.
- Construction of Toulnustouc hydroelectric generating station (526 MW) started up.
- Installation of a 100-MW variable-frequency transformer—an innovative technology for connecting asynchronous systems—started up at Langlois substation.
- Work continued on the Sainte-Marguerite-3 hydroelectric development (882 MW).
- Work continued on the Grand-Mère hydroelectric development (220 MW).
- The new System Control Centre opened.
- Improvements were made in design and construction methods, offering customers annual savings of 2% on project costs.

After operating for more than 75 years, Rapides-des-Quinze generating station needed a major overhaul.

The new Grand-Mère plant under construction.

PROCUREMENT AND SERVICES

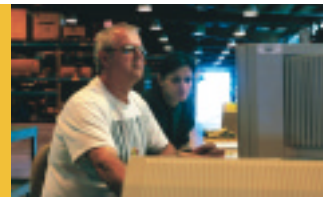
The procurement and services unit aims for the best price/quality ratio, in order to support its customers' operations and meet their needs, and adheres to high standards for product quality and supplier qualification. It has adopted various strategies for maintaining and even improving security of supply in strategic goods and services. This initiative enables it to take advantage of the best conditions available on the market and sustain the development of Québec's industrial infrastructure.

Considerable savings were achieved through new business practices, effective strategies, and supply and partnership agreements. In addition, a number of agreements were reached with local suppliers, maximizing the economic spinoffs throughout Québec.

- Commitments laid out in the policy "Our Acquisition of Goods and Services" were met.
- Goods and services worth a total of $1.6 billion were acquired: $682 million in goods, $23 million in rentals, $581 million in construction work and $276 million in professional services.
- Savings of $62 million have been achieved since January 2000 through the consolidation of needs, supplier agreements, and new business strategies and practices, as well as the review of product lines and technical specifications in cooperation with the business units.
- In the course of the renewal of the company's air fleet, the division acquired two 74-seater Dash 8 Q-400 aircraft to transport employees to northern regions.
- About 4% of the motor vehicle fleet was optimized; a 2001–2005 acquisition plan was implemented to ensure its long-term operability.
- Under the 2000–2004 master plan for real estate management, the use of the company's administrative offices in downtown Montréal was optimized.
- The division is responsible for a major contribution to sustaining the Québec economy: 93% of goods and services were purchased from Québec-based companies.

The performance, reliability and profitability of the company's generation and transmission facilities hinge on top-quality design and careful management of procurement and construction contracts.

It takes a lot of material and equipment to keep the company running.



Inside a warehouse: Hydro-Québec's purchases of goods and services are a powerful economic lever for Québec.

INFORMATION TECHNOLOGIES

The units responsible for information technologies provide strategies and services ranging from IT infrastructure to operation of office automation systems and tools. They support the divisions' key activities and guarantee the security of electronic communications with customers and partners. In addition, they are in charge of IT integration throughout the company, ensuring that employees can readily access these essential work tools. IT functions became the division's responsibility in 2001.

- IT development was rationalized, in cooperation with the divisions, to curb the growth of investments.
- New services designed to facilitate e-commerce and communications with customers and suppliers have been included on Hydro-Québec's Web site.
- A tool was made available to customers that allows them to access their account information and communicate with Hydro-Québec over secure Internet connections.
- Measures were implemented to ensure the security of strategic information systems and data confidentiality.
- Version 4.6 of SAP R/3 was introduced in the following sectors: equipment management, building and vehicle maintenance management, and management of human resources, training, finance and accounting.
- A software program was introduced to manage maintenance of generating stations and transmission substations.
- The division began implementing the company's new technological architecture, including a stable, secure, standardized IT environment for workstations.

Hydro-Québec Ingénierie, approvisionnement et construction Purchases by Administrative Region ($'000)[a]

Administrative region of Québec	Goods[b]	Services[c]	Total
Bas-Saint-Laurent (01)	2,149	3,452	5,601
Saguenay–Lac-St-Jean (02)	15,745	25,489	41,234
Capitale-Nationale (03)	29,505	63,856	93,361
Mauricie (04)	22,305	49,057	71,362
Estrie (05)	5,847	5,475	11,322
Montréal (06)	320,943	320,848	641,791
Outaouais (07)	8,399	3,986	12,385
Abitibi-Témiscamingue (08)	9,528	33,301	42,829
Côte-Nord (09)	7,828	48,537	56,365
Nord-du-Québec (10)	1,489	6,913	8,402
Gaspésie–Îles-de-la-Madeleine (11)	745	2,679	3,424
Chaudière-Appalaches (12)	13,496	24,241	37,737
Laval (13)	8,514	42,062	50,576
Lanaudière (14)	23,211	16,775	39,986
Laurentides (15)	9,262	45,822	55,084
Montérégie (16)	136,890	81,753	218,643
Centre-du-Québec (17)	13,861	42,025	55,886
Total	**629,717**	**816,271**	**1,445,988**

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

PRESERVING THE ENVIRONMENT

Sustainable development and environmental protection have always been priority values in Hydro-Québec's procurement and construction activities. The division pays particular attention to these issues, especially when developing draft designs for refurbishments or new construction.

- Environmental Management Systems were integrated into procurement and project management functions, in order to achieve a balance between profitability and environmental acceptability.
- In the procurement and services department, the territorial branches for northwestern and eastern Québec received ISO 14001 certification, and the branches for the Island of Montréal and south-central Québec maintained theirs.
- The projects and construction department, SEBJ and the environment unit of the expertise department also received ISO 14001 certification.
- An inventory was taken of ozone-depleting substances used by the company, and alternative solutions were developed.
- The recovery of residual hazardous materials from sites at the La Grande complex was completed.
- The division recovered 8,965 tonnes of residual hazardous materials from all over the province.

INTERNATIONAL PRESENCE

The division can count on the expertise and flexibility of its personnel to expand its foreign operations. It targets the following areas, in particular: rehabilitation and optimization of hydroelectric generating stations, installation of optical fibres on live power lines, development of power-grid control systems, and engineering and construction of interconnection lines. The division also works with other Hydro-Québec divisions and consulting engineers on foreign projects.

- The division carried out a technical assistance contract for the modernization of the national transmission control centre of the Algerian corporation Sonelgaz.
- It continued upgrading the transmission system control centre of the Bangladesh Power Development Board.
- Consulting services totaling $1.2 million were provided on projects in China, Cambodia, Algeria and Morocco.

An award of excellence for the new building at Beauharnois generating station.

EXPERTISE AND HUMAN RESOURCES

To achieve its objectives, the division must maintain and develop its employees' expertise.

- A succession program was set up to ensure the transfer of knowledge within the division.
- At SEBJ, a collective agreement was renewed with the United Steel Workers of America, promoting greater workforce flexibility.
- The overall satisfaction level of the division's employees rose to 8.07 out of 10 from 7.80 in 2000.
- The employee motivation index rose to 6.66 compared with 6.34 in 2000.

The Ordre des architectes du Québec singled out Hydro-Québec in its awards of excellence, Industrial Architecture category, for the design of the west extension on Beauharnois generating station, which underwent a major refurbishing.

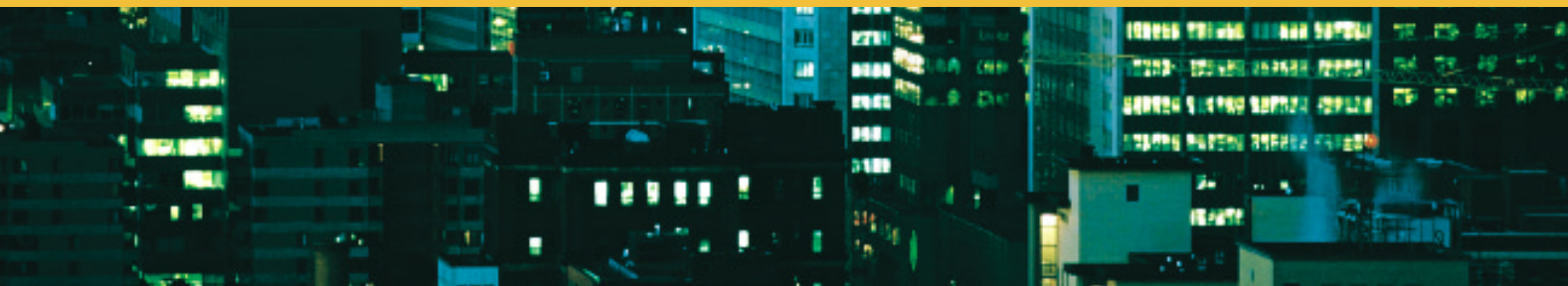
The Division at a Glance ($M)

	2001	2000
Revenue from operations	**1,162**	1,358
Principal customers		
Hydro-Québec Production	**452**	464
Hydro-Québec TransÉnergie	**375**	497
Hydro-Québec Distribution	**241**	237
Other	**94**	160
Person-years	**4,359**	4,435

Employee know-how:
a legacy we must pass on.

Technological innovation, R&D, environmental protection and human resources management are strategic sectors that bind the four divisions together and contribute to Hydro-Québec's presence and impact.

HYDRO-QUÉBEC'S HEAD OFFICE STANDS AT THE HUB OF MONTRÉAL'S ECONOMY.



Technological Innovation

Hydro-Québec makes extensive use of technology in its operations. Electricity plays a vital role in people's lives and the economy, and will only grow in importance in the future. To maintain its leadership, improve its performance and ensure its long-term growth in an increasingly competitive world, the company must continue to innovate.

The integrated innovation management program introduced in 2000 has yielded the hoped-for results. This new process allows researchers, users, business specialists and external partners to interact in order to better meet the company's business priorities.

The researchers and scientists at Hydro-Québec's research institute, who possess unique expertise developed over the last 30 years, are the cornerstone of the company's R&D activities. The institute has two main facilities, located in Varennes and Shawinigan.

The success of a company's innovation strategy also hinges on a sound knowledge of the business environment, the players involved and technological developments. To monitor these trends, Hydro-Québec has stepped up its business and technology intelligence-gathering.

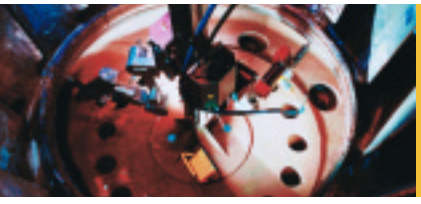
Lastly, Hydro-Québec embarked upon a technological roadmapping exercise in 2001, looking ahead 20 years, in consultation with the company's experts and other scientists in the energy field.

R&D

Hydro-Québec's research institute conducts R&D and tests in order to promote the commercialization and implementation of new technologies enabling the company to supply its customers with reliable power, at the lowest possible cost and with a concern for environmental protection. It operates in Varennes, Shawinigan and Montréal.

In 2001, the research teams worked on 65 projects linked to the company's core operations. In generation, their efforts focused on equipment performance, safety and profitability. Their transmission projects dealt with the protection, growth and long-term operability of the high-voltage system, a field in which Hydro-Québec is a world leader. In distribution, their research helped improve the reliability of overhead and underground grids and make maintenance work safer for crews. The teams also worked to improve products and processes connected with electricity applications.

- R&D investments in 2001 totaled $103 million. In 2000, Hydro-Québec was one of the 15 Canadian firms that spent $100 million or more on R&D.
- Tests began on experimental setups to check the mechanical behavior of new distribution lines under different climatic conditions.
- An innovation project designed to add 50% to the useful life of wood poles was completed.
- An agreement was signed with an industrial partner to commercialize a new wood pole treatment process that will make it easier for linemen to do their work.
- Remarkable results were obtained in hydraulic turbines: extended service life, new methods developed for *in situ* repairs using robots, and increased efficiency. With regard to efficiency, hydraulic turbine analysis models (known by their French acronym, MATH) have yielded savings of $3.5 million since 1998 and should generate recurring savings of $4.7 million after 2005.
- New de-icing techniques and strategies were developed for substations and transmission lines.
- Transmission research was conducted on various real-time control systems and on ways to improve system performance.
- An industrial partner set up a centre of excellence at the research institute's Shawinigan laboratory. The centre specializes in R&D on new electric drying processes for the lumber industry.
- The first prize in the Québec entrepreneurship competition, Technological Innovation category, was awarded to three researchers at the Shawinigan laboratory for their project on the electrosynthesis of chemicals.
- Simulation software is being installed and developed for electromagnetic transient phenomena (EMTP); this program examines transmission equipment characteristics and optimizes their design. A study of transient recovery voltages for circuit breakers, after series compensation on 735-kV lines, has generated savings of $60 million in the last decade or so. The EMTP software is being developed in partnership with EDF (France), Hydro One (Ontario), EPRI (United States) and CRIEPI (Japan).
- Hydro-Québec's research institute received ISO 14001 certification.
- Several of the institute's laboratories were registered under the new ISO/IEC 17025 standard.



Repair of a turbine runner, a job made easier by the robot Scompi.

CORPORATE VENTURE CAPITAL

Hydro-Québec endeavors to obtain a high rate of return on its venture capital investments, which it uses to exercise proactive technology monitoring and gain a better strategic understanding of the market. Through its venture capital subsidiary, Hydro-Québec CapiTech, it invests directly in companies at different stages of development and in other venture capital funds in the energy sector. In partnership with the private sector, the company also exploits the intellectual property resulting from its R&D activities through the subsidiary Hydro-Québec IndusTech, whose portfolio is managed by Hydro-Québec CapiTech.

- Managed venture capital portfolios of $395.9 million in investments or commitments.
- Seven direct investments and ten direct reinvestments totaling $30.9 million were made in 2001, bringing direct venture capital investments to $106 million.
- The company committed to a $21-million investment in a European fund, SAM Private Equity Energy Fund, making Hydro-Québec CapiTech the lead investor of this fund and bringing its venture capital fund commitments and investments to $47 million.
- An initial dividend of $7.5 million was paid to Hydro-Québec.
- Various activities were carried out for Hydro-Québec divisions in order to better meet their needs; these included publishing a strategic intelligence-gathering newsletter on new energy-related technologies; holding a forum on corporate venture capital in the energy sector, attended by 150 people, 50 of them representing Hydro-Québec; and carrying out studies on automated management of distribution systems, electric energy storage and modular nuclear reactors.
- An agreement was reached with Innovatech Québec to offer financial support for companies in Energy Valley, in the Mauricie region, a major hub of technological innovation.
- An agreement was reached between Hydro-Québec and two major European partners, Shell Hydrogen and Gesellschaft für Elektrometallurgie (GfE), to establish HERA Hydrogen Storage Systems, which is developing a hydrogen storage technology based on metal hydrides.
- A partnership was set up between Kerr-McGee Chemical and Hydro-Québec, in which each has a 50% stake, to finance the AVESTOR group. AVESTOR has been commissioned to develop and market the LMP (lithium-metal-polymer) battery, which emerged from the ACEP technology developed by Hydro-Québec's research institute and France's Centre National de la Recherche Scientifique.
- Two partnering arrangements were negotiated, refocusing the activities of Technologies M4 on producing two types of generators—an application of the motor-wheel technology developed in Hydro-Québec laboratories.

Metallic Power, a subsidiary of Hydro-Québec CapiTech, is developing and marketing a line of fuel cells using zinc-air technology.

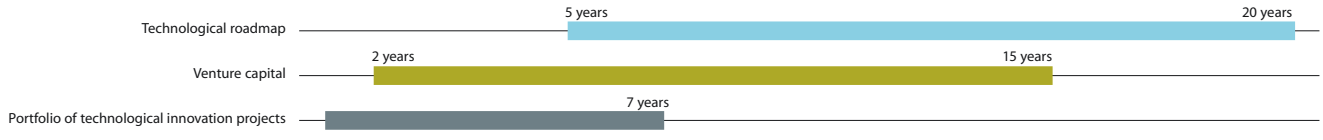
PLANNING FOR THE FUTURE AND LONG-TERM VIABILITY

In 2001, Hydro-Québec embarked upon a major technology forecasting exercise, looking ahead 20 years, in consultation with the in-house experts and other scientists in the energy field. The object of this exercise is to determine the future technologies that may have a substantial long-term impact on operations. It is performed using a planning tool called a technological roadmap, which anticipates technological changes that could affect the company's business structure and points to the areas in which proactive monitoring is needed.

- Five innovation projects were developed, allowing Hydro-Québec to continue playing a leadership role on the North American power market in the following areas:
  - Active system management in real time, so as to maximize returns on energy transactions: $500,000 in 2001.
  - Enhanced overall system efficiency, from generating stations to customers' premises: $500,000 in 2001.
  - Managing the emergence of distributed generation: $2 million in 2001.
  - Reducing transmission system constraints, through energy storage and transmission technologies: $500,000 in 2001.
  - Understanding the effects of climate change on runoff, electricity demand and operating facilities: $1.5 million in 2001, part of it within the OURANOS consortium.
- The company participated in the OURANOS consortium, which also includes eight Québec government departments, Environment Canada and all the Québec universities. The consortium's research activities are concentrated on climate modeling, sensitivity to climate change and quantification of impacts and adaptation scenarios. It will have a total budget of $28 million by 2004.

Technological innovation is an important growth tool and a major economic lever for Hydro-Québec.

Technological Initiative Horizon



Natural Gas Sector

Hydro-Québec's operations in the natural gas sector cover the pipelining of oil, natural gas and natural gas liquids, as well as the distribution of natural gas by the holding company Noverco Inc., in which the company has a stake. They also include monitoring the emergence and penetration of new distributed-generation technologies based on natural gas.

Hydro-Québec holds 41.2% of Noverco's share capital and two options on 9.2% of Noverco's shares.

Noverco's main subsidiary is Gaz Métropolitain and Company, Limited Partnership (GMCLP), in which it has a 77.4% stake through Gaz Métropolitain, inc., the general partner. GMCLP is involved in the distribution and pipelining of natural gas.

Noverco also holds a portion of the common shares of Enbridge Inc., the world's largest oil carrier and the largest natural gas distributor in Canada.

Hydro-Québec sits on the GMCLP and Enbridge boards of directors.

Its commitment to the natural gas sector is in line with the trend toward convergence of gas and electricity transmission and distribution companies throughout North America.

- Net income of $27 million in 2001 from the stake in Noverco was $7 million higher than in 2000. This increase is due to the improvement in Enbridge's operating results.
- Hydro-Québec and GMCLP participated in a demonstration project for a 60-kW microturbine operated in cogeneration mode (electricity and heat) at a customer's facility, to explore all facets of this developing technology.

Expanding Hydro-Québec's activities into the natural gas sector enables the company to meet Québec's energy needs better and offers it investment opportunities in a fast-growing field.

Michel Gourdeau
Executive Vice President
Natural Gas Sector

Human Resources

Like many other North American companies, Hydro-Québec must deal with the aging of much of its personnel. At the same time, technology is developing at such a rapid pace that the company must intensify its efforts to ensure succession in strategic positions.

The human resources department is responsible for helping Hydro-Québec meet these challenges and providing a qualified and motivated workforce so that the company can fulfill its mission. It therefore establishes employee recruitment, training and motivation programs, and defines HR management approaches and strategies in cooperation with the company's divisions. The department is also in charge of occupational health, as well as negotiating labor agreements with employee representatives.

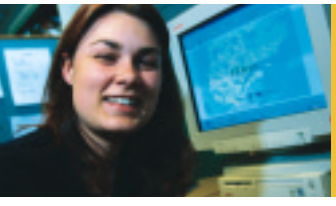
SUCCESSION

Because succession is an important issue that entails some risk, Hydro-Québec has developed an overall succession support plan. This plan must guarantee the continuity of know-how by providing efficient, targeted ways of passing on skills and maintaining employee loyalty.

- The department stepped up its efforts to fill 40% of personnel needs with new graduates for engineering and other specialized positions.
- Partnerships were established with schools and universities in order to meet the company's workforce needs; one such partnership led to the creation of the Institute for Electrical Engineering.
- Skills management techniques were applied, for example, distance learning tools for workplace training from a virtual campus.
- The department recruited supervisory personnel by seeking out people with management skills, setting up an evaluation centre and offering career plans for executives.

INDUSTRIAL RELATIONS

- A first collective agreement was signed with the Hydro-Québec specialists' union.
- The final touches were put on the empowerment program set up for Hydro-Québec trade employees—a program designed to improve the efficiency of work processes, encourage employee participation in these processes and ensure better cooperation between employees and managers.
- The provisions of the *Pay Equity Act* were applied company-wide, and 10 specific pay equity programs were developed in conjunction with unionized and non-unionized employee representatives.



We are planning for succession.

HEALTH AND SAFETY

- A team was formed to draw up an attendance management action plan. A number of measures were taken, including improved data collection, more detailed analysis of available management information, fuller statistics on absenteeism in the company, and identification of factors that help boost job attendance. In addition, new training sessions were given throughout the company, disability management was centralized, and health and safety tips were offered on the company's intranet site.
- Accident frequency fell to 4.07 per 200,000 hours worked from 4.39 the previous year, which is in line with industry levels.
- An integrated OHS management program was deployed, supplemented by the improvement plans and other measures adopted by the divisions.
- There has been a significant decrease in the severity of work-related accidents since 1992.

MOTIVATION

- The overall employee motivation index rose 0.31 points to its highest level ever: 6.64 out of 10. This increase is due to organizational stability, the empowerment program for trade employees and the company's solid performance.
- The learning map exercise, designed to foster a shared understanding among employees of the issues and challenges facing the company, drew to a close. This exercise had a positive effect on the employee motivation index.

Work-related accidents at Hydro-Québec decreased in 2001.

Environment

Hydro-Québec is concerned with sustainable development and makes careful use of the resources it employs to fulfill its mission. With hydropower accounting for 96% of its installed capacity, it generates clean, renewable energy, thus helping to protect the environment for future generations, both in Québec and beyond its borders.

In 1997, the company began introducing ISO 14001–compliant environmental management systems, a project due to be completed by 2003. This marked its commitment to incorporating environmental concerns into all its decision-making processes and all stages in the life cycle of its products, services and facilities. Through its sales outside Québec, the company helps neighboring power producers avoid atmospheric emissions, thus contributing to the fight against greenhouse gases in northeastern North America.

Most of the company's divisions and service units have already adopted a declaration of environmental principles to better meet ISO 14001 requirements. The environment unit, specifically, is in charge of following up on strategic environmental issues, recommending corporate strategies and assuring Senior Management that Hydro-Québec and its divisions are properly equipped to manage the environmental impact of the company's activities.

- All administrative units continued their efforts to secure or maintain ISO 14001 certification.
- The Fondation Hydro-Québec pour l'environnement, a non-profit organization set up to fund projects that contribute to long-term environmental protection through partnerships with communities, was officially launched. With an annual operating budget of approximately $1 million, the Foundation signed agreements with 14 environmental organizations in 8 regions of Québec in 2001.
- The company published the *Summary of Knowledge Acquired in Northern Environments from 1970 to 2000*, an overview of environmental studies carried out by Hydro-Québec over the last 30 years.

An audit of data for 2000 performed by Deloitte & Touche LLP in 2001 enables Hydro-Québec to place a power content label on the electricity it sells. Based on these data, each terawatthour sold by Hydro-Québec generates 40.1 times less CO_2 (carbon dioxide), 31.5 times less SO_2 (sulphur dioxide) and 28.7 times less NO_x (nitrous oxides) than the regional average for electric utilities in the six New England states, New York State, Ontario and New Brunswick.

Thirty years of valuable lessons from northern Québec, in and around the La Grande complex.

Fondation Hydro-Québec pour l'environnement

Projects that contribute to long-term environmental protection.

International Role

Hydro-Québec works continuously with the leading international organizations to promote the benefits of hydroelectricity. The company also provides power-related technical assistance to developing countries.

COOPERATION

- The company was involved in some 20 projects in French-speaking countries, both independently and in cooperation with the Institut de l'énergie et de l'environnement de la Francophonie, mainly in the areas of vocational training, environment and management. Hydro-Québec also participated in seven projects in other countries, including a demonstration project for the commissioning of hydroelectric generating stations in Iran.
- It continued to cooperate with research centres and maintained relations with international and government agencies and electric utilities.

e7

- A series of seminars was held in Thailand on environmental impact assessment under the auspices of the e7, an organization made up of nine of the largest electric utilities in the G7—companies that are determined to play an active role in the international debate on the environment and sustainable development. Hydro-Québec heads up this ongoing project, with contributions from three other e7 members: Enel (Italy), Kansai (Japan) and RWE (Germany).
- A report was drawn up in cooperation with American Electric Power and Électricité de France on the power industry's achievements and challenges in the realm of sustainable development. The report will be presented by the United Nations Environment Program to heads of state and government at the next World Summit on Sustainable Development, to be held in September 2002 in Johannesburg.

CIGRÉ

- As a member of the International Council on Large Electric Systems (CIGRÉ), Hydro-Québec was involved in organizing a competition for engineering students on the technical, economic, environmental and regulatory aspects of electricity generation and transmission. The winner will attend CIGRÉ's 39th session, where he or she will meet industry leaders and experts from around the world.

CONFERENCES

- In cooperation with Gaz Métropolitain, Hydro-Québec organized the 12th International Conference on Energy, attended by about a hundred people. The event was part of the Conference of Montreal, held under the theme "Free Trade in the Americas: Challenges and Perspectives".
- The company began organizing and promoting the ICOLD (International Commission on Large Dams) conference, to be held in Montréal from June 16 to 20, 2003. This event is expected to attract over 2,000 participants from all over the world. Attendees will be offered technical tours of facilities in several different regions of Canada.

An expert from Hydro-Québec takes part in a rural electrification project in Niger for the e7.

The 12th International Conference on Energy.

Community Involvement

Because Hydro-Québec is on the ground throughout Québec, its activities have considerable spinoff effects on local economies. Besides contributing to economic development, the company supports a large number of organizations working for the community through its donations and sponsorships.

The company concentrates its donation efforts on health, education and humanitarian aid. Its sponsorships are aimed more specifically at the cultural, socioeconomic and environmental spheres. The company also supports organizations and events that promote amateur sport, such as the Québec foundation for excellence in sports and the sports challenge competition for disabled athletes.

Hydro-Québec helps organizations working in different regions of Québec. Whether in Saguenay–Lac-Saint-Jean with the festival of new Québec cinema, in Mauricie with the Trois-Rivières international voice competition, or in Québec City with the Québec Winter Carnival, the goal remains the same: to encourage local initiatives that highlight the talent and creativity of Quebecers.

- The company supported a number of health-related projects of interest to all Quebecers, such as the program for preventing depression in young people, in cooperation with the Québec mental health foundation, and the CLARA project for breast cancer screening.
- It 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.
- Funding was granted to Québec universities for research and teaching.
- Scholarships were awarded to graduate and postgraduate students.
- The company sponsored 17 research chairs in various fields, including the nuclear engineering chair at the École polytechnique, the research chair in conducting polymers at the Université de Montréal, and the Université du Québec à Chicoutimi industrial chair on atmospheric icing of power system equipment.
- Support was provided for activities conducted by the Québec Literacy Foundation and the Learning Disabilities Association of Québec.
- The company made a total contribution of over $4 million to the annual United Way/Centraide campaign. To recognize the generosity shown by Hydro-Québec employees and pensioners over the past 25 years, Centraide of Greater Montréal presented Hydro-Québec with the "Solidaires 2000" award.
- The company continued to support the Lanaudière international festival, the Petite-Vallée song festival and the Montérégie regional environment council.
- It provided renewed support for the Orford music festival in the Eastern Townships.
- Support was provided for Pointe-aux-Outardes regional park in the North Shore region.
- Support was provided for the Abitibi-Témiscamingue international film festival.
- The company sponsored the Domaine Forget International Festival in Charlevoix, the Grand prix cycliste de la Beauce, the Tremblant music festival, the Parc de la rivière des Mille-Îles, the Tadoussac song festival and the Îles-de-la-Madeleine swim club.

Centraide: we beat our campaign target.

Strong support for cultural activities like the FrancoFolies de Montréal.

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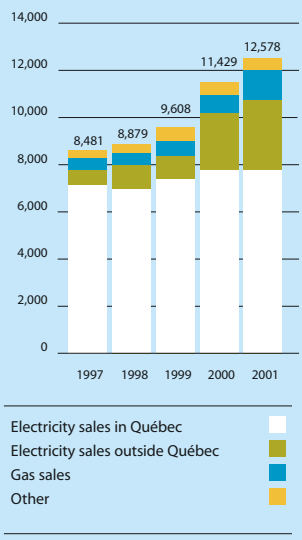
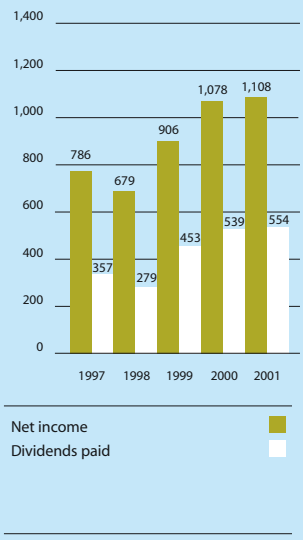
Overview

Net income grew for the third consecutive year to reach $1,108 million, up $30 million compared with the previous year. **Revenue** continued to grow and reached $12,578 million, up 10.1% from 2000. This growth was driven by increased electricity transactions in the United States and transmission revenue from our recent investments in international subsidiaries, including Transelec. **Dividends** amounted to $554 million and constituted the fifth consecutive payment to our shareholder. A cumulative amount of over $2 billion has been paid since 1997. **Funds from operations** totaled $3.5 billion, an increase of 5.6%, and were used to finance the entire investment program and pay down a portion of the long-term debt. **Paying down a portion of the Corporation's debt** will help lower financial expenses over the long term. A cumulative amount of over $1.5 billion has been repaid since 1999.

Sales
($M)



Net Income and Dividends Paid
($M)



financial review

Management's Discussion and Analysis reports on Hydro-Québec's consolidated and segmented results and consolidated financial position. Our analysis concludes with a brief discussion of our risk management strategy and outlook.

In our analysis, the consolidated group (Hydro-Québec) means the publicly owned corporation Hydro-Québec (the Corporation) and the companies in which it holds an interest, including its subsidiaries.

Results

GROWTH IN CONSOLIDATED RESULTS

Hydro-Québec maintained focus on its objectives of profitability and the creation of wealth for its shareholder and Québec society. For the third year in a row, Hydro-Québec improved its net income, which reached $1,108 million, up $30 million or 2.8% over the previous year. Moreover, the Corporation achieved this increase while fulfilling its commitment to keep rates frozen and enhancing service quality for all Québec customers.

In 2001, Hydro-Québec continued to grow with sales of $12.6 billion, up $1.1 billion or 10.1%. Increased transactions on U.S. markets and the electricity transmission revenue from our recent investments in our international subsidiaries, including Transelec, helped fuel this growth.

Despite the growth in sales, the profit margin was down slightly from 9.4% to 8.8%. This is due in part to a reduction in the volume of Québec-generated electricity sold to U.S. markets and to the decline in heating oil and natural gas prices on short-term energy markets in the U.S. Exceptionally mild temperatures in December also had an impact. In addition, a technical modification in the capital tax calculation, applied retroactively from 1995 on, had led to a reduction of the charge related to this tax, and thus to an improvement in the profit margin in 2000.

Total expenditure climbed by $1.1 billion to $8.1 billion as a result of short-term electricity purchases made as part of purchase/resale transactions on U.S. markets. These purchases alone accounted for $0.8 billion of this increase and totaled $2.2 billion. Inclusion of the results of new international subsidiaries also contributed to the increase.

We kept a firm handle on operating expenses in 2001; they stood at $2,134 million, the same level as the previous year. Depreciation, amortization and decommissioning expense stood at $1,845 million, compared with $1,896 million in 2000. This decrease was partly due to the effect of our project portfolio review in 2000. Tax expense rose by $66 million, or 12.6%, to $591 million. Had we not benefited from a refund in 2000 as a result of the technical modification mentioned above, the expense for 2001 would have been similar to that of the previous year.

Despite a weak Canadian dollar, our management strategy enabled us to keep our financial expenses under control. They were down by $19 million, or 0.6%, to $3,350 million in 2001 from $3,369 million in 2000.

In 2001, we reduced our interest expense by nearly $245 million. We took advantage of lower short-term interest rates on the variable portion of long-term debt, which we maintained at 25%. We also timed our financing transactions to take advantage of attractive long-term rates. Interest rates fell because of the U.S. economy's pronounced slowdown, which prompted the U.S. Federal Reserve to reduce its bank rate. The three-month London Interbank Offered Rate (LIBOR) dropped, on average, from 6.5% in 2000 to 3.8% in 2001. The rate for three-month Canadian bankers' acceptances also fell considerably, from 5.7% in 2000 to 4.0% in 2001.

The negative effect of the weak Canadian dollar on our U.S. dollar–denominated liabilities amounted to $175 million, but was partially offset by the positive impact of sales in U.S. dollars. The domestic economy experienced the repercussions of the U.S. economic downturn, with our dollar falling sharply against the U.S. dollar. The Canadian dollar averaged US$0.646 in 2001, compared with US$0.673 in 2000, a significant drop of US$0.027.

Finally, the acquisition of Transelec in October 2000 increased financial expenses by approximately $67 million for 2001.

OPERATING SEGMENTS

The new regulatory environment in North America has prompted most integrated electricity companies to reorganize their structures into operating segments: distribution, transmission and generation. After creating the division Hydro-Québec TransÉnergie in 1997 to comply with the rules governing the North American wholesale market, Hydro-Québec created three new divisions in 2001: Hydro-Québec Distribution, Hydro-Québec Production and Hydro-Québec Ingénierie, approvisionnement et construction. Implementing this structure changed the allocation of Hydro-Québec's activities, which are now organized as follows:

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

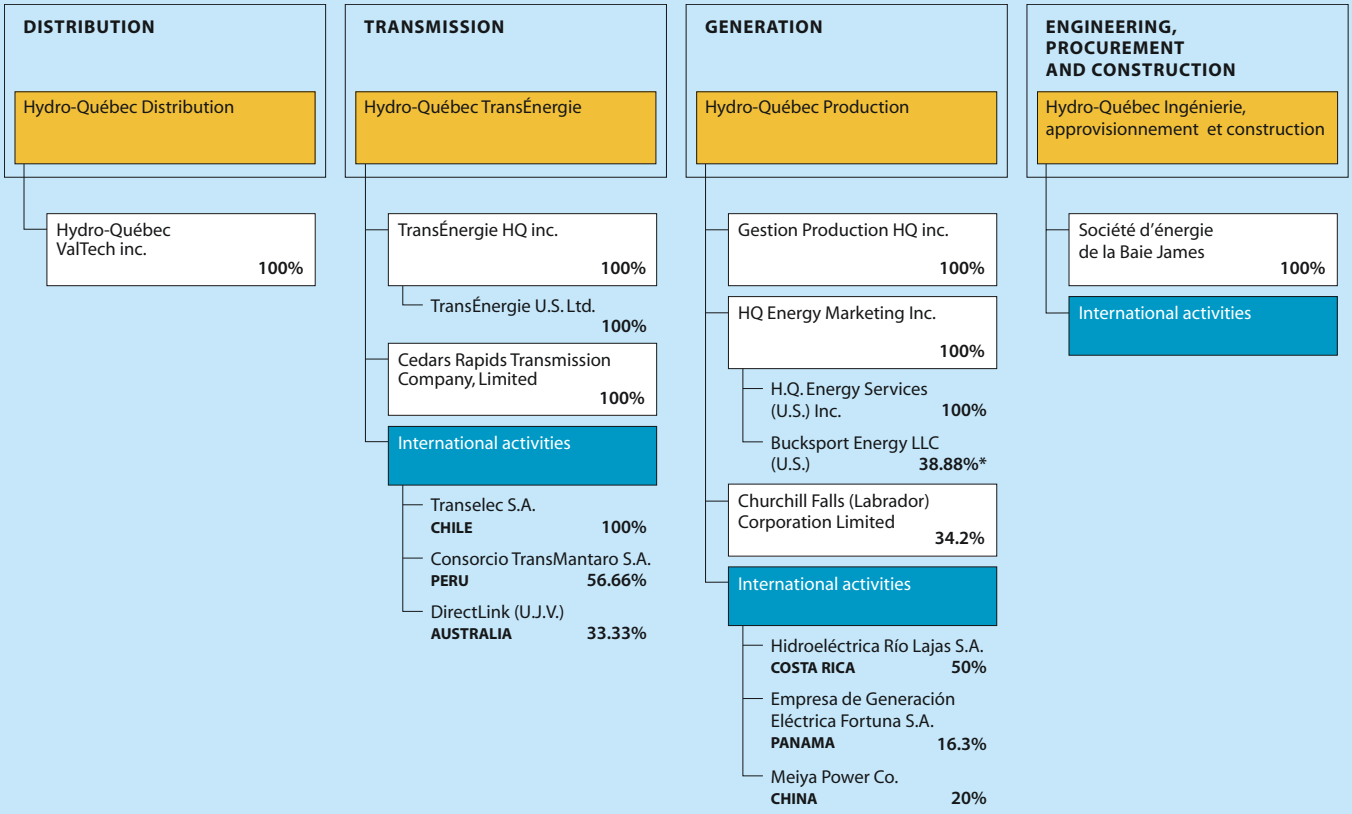
Transmission: Hydro-Québec TransÉnergie develops and operates the Corporation's transmission system and markets its transmission capacity. It manages and operates transmission systems internationally and also offers its expertise to carry out development projects. In addition, Hydro-Québec TransÉnergie manages and is the principal user of Hydro-Québec's telecommunications network.

Generation: Hydro-Québec Production operates and develops the Corporation's generating facilities and a number of foreign facilities. It also guarantees the supply of heritage pool electricity to the Québec market, sells electricity on external markets and engages in energy trading activities.

Engineering, Procurement and Construction: Hydro-Québec Ingénierie, approvisionnement et construction provides engineering services and carries out construction projects in Québec and in other parts of the world. It also provides services, especially with respect to procurement and information technology, to Hydro-Québec's business units.

Other: This heading includes activities related to the gas sector, research and development, corporate activities and financial services.

Major Operating Segments (Main Components)



* *Excludes HQI's 30.56% interest through Multinational Electricity and Gas Corporation.*

Division of Hydro-Québec
Subsidiary, joint venture or interest
International activities:
activities and/or subsidiaries, joint ventures or interests through HQI

SEGMENTED INFORMATION

Hydro-Québec's power distribution and transmission activities in Québec are regulated by the Régie de l'énergie du Québec, created in 1996 with the adoption of a new energy policy by the Québec government. These activities, like those of the gas sector, are subject to economic regulation based on the cost of providing service. Intersegment revenue and expenses associated with electricity sales are therefore recorded on the basis of the prevailing rates. Transmission rates were decreed by the government in 1997 and will remain in force pending Régie approval of the rate changes for which Hydro-Québec filed an application, hoping for a January 1, 2001, effective date. Moreover, electricity rates for Québec customers were set in 1998 and will remain frozen until April 2004 at the Québec government's request.

In 2000, the Québec government passed the *Act to amend the Act respecting the Régie de l'énergie*, under which Hydro-Québec Production must provide Hydro-Québec Distribution with a "heritage pool" of up to 165 TWh per year at a fixed price of 2.79 cents per kilowatthour (whether the electricity is generated or purchased) to meet the native load.

All intersegment revenue and expenses not related to electricity are valued at full cost. Revenue, operating expenses and purchases of electricity and fuel are earned or incurred directly by the segments.

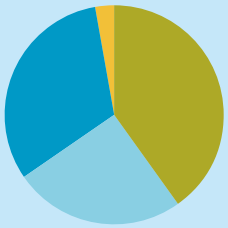
Depreciation, amortization and decommissioning expense relates to fixed or other assets allocated to the segments. Taxes and financial expenses are managed by the corporate units and allocated according to the nature of the expense. Taxes are thus generally allocated to the segments according to the net assets managed by the divisions. Financial expenses are allocated to the different segments based on the financing rates applied to the net assets of each segment. Lastly, expenses related to corporate activities, or corporate expenses, are generally allocated to the segments based on operating expenses.

Segmented Results
($M)

		Distribution	Transmission	Generation	EPC*	Other	Eliminations**	Hydro-Québec
Revenue	**2001**	**7,957**	**3,028**	**7,309**	**1,162**	**1,331**	**(8,209)**	**12,578**
	Change 2000–2001	45	252	695	(196)	275	78	1,149
External customers	**2001**	**7,934**	**301**	**3,218**	**20**	**1,120**	**(15)**	**12,578**
	Change 2000–2001	47	235	695	(88)	251	9	1,149
Intersegment revenue	**2001**	**23**	**2,727**	**4,091**	**1,142**	**211**	**(8,194)**	**–**
	Change 2000–2001	(2)	17	0	(108)	24	69	–
Net income (loss)	**2001**	**(454)**	**436**	**1,170**	**(16)**	**(28)**	**–**	**1,108**
	Change 2000–2001	(11)	37	(83)	14	73	–	30

* *Engineering, Procurement and Construction.*
** *Intersegment eliminations for consolidation purposes.*

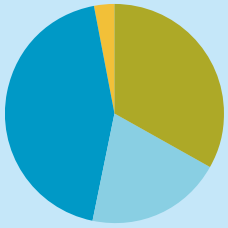
Revenue from Electricity Sales in Québec
(%)



2001

Residential and farm	40.1
General and institutional	25.3
Industrial	31.8
Other	2.8

Electricity Sales in Québec
(%)



2001

Residential and farm	33.4
General and institutional	20.0
Industrial	43.6
Other	3.0

DISTRIBUTION

In 2001, the Régie approved Hydro-Québec Distribution's proposed Call for Tenders and Contract Award Procedure and the *Code of Ethics on Conducting Calls for Tenders*. We submitted our Electricity Supply Plan to the Régie, and in 2002 we will issue a call for tenders to meet the portion of native load exceeding the 165-TWh heritage pool for 2006 and 2007.

The segment's results were down slightly by $11 million in 2001. However, total revenue was up $45 million to $7,957 million, despite a rate freeze introduced in May 1998 that will remain in effect until 2004.

During 2001, growth in distribution operations and improvements in service quality put upward pressure on Hydro-Québec Distribution's expenses.

Slight Drop in Total Electricity Sales in Québec

The increased demand in 2001 was not enough to offset the effect of milder temperatures in December. As a result, electricity sales in Québec were down slightly by 0.6 TWh or 0.4% from 2000, and revenue totaled $7,803 million.

— Increased demand despite the economic slowdown

Demand was up 1.6 TWh, which translated into additional revenue of $90 million compared with 2000. However, growth in demand was slower due to the downturn in the economy.

Demand in the residential and farm category grew most appreciably with 0.7 TWh in increased sales volume generating additional revenue of $52 million. Stronger housing starts, coupled with a higher rental occupancy rate and lower interest rates, drove up demand for electricity in this category.

Electricity Sales in Québec, by Category

		Sales			Sales revenue	
	2001	Change 2000–2001		**2001**	Change 2000–2001	
	TWh	TWh	%	$M	$M	%
Residential and farm	**50.8**	(0.9)	(1.7)	**3,131**	(36)	(1.1)
General and institutional	**30.4**	(0.1)	(0.3)	**1,973**	(29)	(1.4)
Industrial	**66.3**	0.3	0.5	**2,482**	77	3.2
Other	**4.7**	0.1	2.2	**217**	(3)	(1.4)
Total	**152.2**	(0.6)	(0.4)	**7,803**	9	0.1

distribution

service quality and reliability

2000–2001 Sales Variation Factors, by Category

		Demand		Temperature		Leap year	Other factors
	TWh	$M	TWh	$M	TWh	$M	$M
Residential and farm	0.7	52	(1.4)	(91)	(0.2)	(11)	14
General and institutional	0.2	4	(0.2)	(7)	(0.1)	(5)	(21)
Industrial	0.5	29	0.0	0	(0.2)	(6)	54
Other	0.2	5	(0.1)	(2)	0.0	(1)	(5)
Total	**1.6**	**90**	**(1.7)**	**(100)**	**(0.5)**	**(23)**	**42**

In 2001, the industrial category was hit particularly hard by the repercussions of an economic slowdown made worse by the aftermath of September 11, which undermined business confidence. As a result, this category experienced a significant decline in growth compared with 2000. Nevertheless, demand was up 0.5 TWh, generating $29 million in additional revenue, due to the arrival of major new customers in the chemicals and metal smelting and refining industries.

— One of the warmest Decembers in 60 years

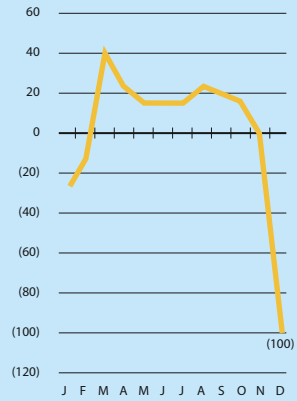
Very mild temperatures, particularly in December, were responsible for a $100-million drop in revenue in 2001 compared with 2000. This decrease is largely attributable to the residential and farm category, whose heating requirements make it more sensitive to climatic changes than other categories.

— Other variation factors

A decrease of 0.5 TWh in sales and $23 million in revenue for 2001 was caused by the fact that the previous year was a leap year and thus included an extra day of consumption. The industrial sector benefited from the effect of the exchange rate on sales in U.S. dollars.

Cumulative Effect of Temperature Variations Between 2001 and 2000 on Sales Revenue

($M)

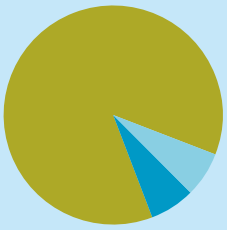


Other Activities

A gain of nearly $10 million resulted from the sale to COGNICASE of our interest in M3i, an integrated outage management software design firm in the power distribution field. In connection with this transaction, we signed a licence agreement with COGNICASE for our Distribution Management System software, which generated $9 million in royalties in 2001.

Hydro-Québec Distribution is continuing its disinvestment strategy in its international activities, concentrating instead on technical assistance services that provide a lucrative return. Activities are carried out by a limited number of resources, with an emphasis on Québec business partnerships.

Revenue
($B)



2001

Regulated activities	2.60
International	0.20
Other	0.20

TRANSMISSION

The stability and reliability of our power transmission grid remains a constant concern in our efforts to meet our customers' growing needs. With this in mind, Hydro-Québec TransÉnergie pursued its system reliability improvement program. Furthermore, several measures were taken to ensure the long-term operability of the transmission system, including a number of modernization projects.

During public hearings held by the Régie de l'énergie, Hydro-Québec TransÉnergie presented arguments to show that its applications to increase transmission rates effective January 2001 were fair and legitimate. A decision from the Régie is expected in the first quarter of 2002. Until the new rates are approved, the effective rates will be those decreed by the Québec government in March 1997.

To ensure business development, Hydro-Québec TransÉnergie is on the lookout for new opportunities on international markets. We were able to capitalize on a number of significant opportunities because of, among other things, global recognition of our high-voltage power transmission know-how. In 2001, considerable business was generated in South America through the activities of Transelec (Chile) and Consorcio TransMantaro S.A. (Peru), as well as in Australia through our merchant line project, DirectLink. As at December 31, 2001, international assets accounted for $2 billion or 11% of total assets of $18 billion.

Growth in Revenue

Sales topped $3 billion, for a total of $3,028 million compared with $2,776 million in 2000, an increase of $252 million or 9%, primarily due to international activities. In 2001, net income reached $436 million, up $37 million or 9% over the previous year.

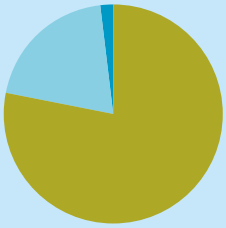
Our revenue from regulated transmission operations showed no change, as the rates are still those set by the 1997 decree. Most of our revenue came from Hydro-Québec Distribution and was related to the transmission requirements of Québec customers.

The strong growth in international sales compared with 2000 was due, in particular, to the inclusion in 2001 of the results of Transelec, the largest power transmission company in Chile. Transelec was acquired through Hydro-Québec International in the fourth quarter of 2000. It had sales totaling $205 million, and accounted for over 82% of all foreign sales.

Total expenditure amounted to $2,592 million, up $215 million or 9%. The inclusion of foreign transmission operations accounts for $197 million of this increase.

transmission
value-added service

Electricity Sales by Hydro-Québec Production
(%) excluding sales on international markets



2001

Sales to Hydro-Québec Distribution	78.1
Short-term contracts and trading	20.0
Long-term contracts	1.9

GENERATION

In addition to guaranteeing the supply of heritage pool electricity to the Québec market, Hydro-Québec Production, our generating division, is an active player on the regional energy markets in the northeastern part of the continent. Its activities are focused on selling surplus electricity generated in Québec, purchasing electricity for resale and conducting price arbitraging. In 2001, Hydro-Québec Production took advantage of favorable terms on the markets, which enabled it to achieve sales of $3 billion outside Québec.

The segment's net income amounted to $1.2 billion in 2001, down $83 million from 2000. This drop was mainly due to a 7.1-TWh decrease in sales of Québec-generated electricity on U.S. markets in 2001. However, this decrease in volume was partially offset by better selling prices.

Sales topped $7 billion for the first time. Revenue was up $695 million from 2000, totaling $7,309 million. This growth was mainly due to an increase in selling prices and energy trading volumes on U.S. markets.

Electricity Sales to Hydro-Québec Distribution

Electricity sales to this division amounted to $151.9 TWh or $4.1 billion in 2001 and accounted for 56% of revenue and 78% of total sales. Sales saw very little change compared with 2000. Weather and economic conditions put a damper on expected growth in this market.

Sales to Hydro-Québec Distribution are conducted according to the terms and conditions established by the Québec government in 2000, namely a fixed price of 2.79 cents per kilowatthour, which is adjusted to take certain contracts into account.

Electricity Sales Outside Québec

Since the opening of wholesale markets to competition, electricity sales outside Québec have grown significantly from $0.6 billion in 1997 to over $3 billion in 2001. They reached 42.4 TWh in 2001, representing $3.1 billion in revenue, up $733 million from the preceding year. Of these sales, 32.2 TWh were in connection with energy trading on U.S. markets and 10.2 TWh with sales of Québec-generated electricity on markets outside Québec, mainly in the U.S. Northeast.

Lastly, we continue to assert our presence on international markets. Activities carried out through our foreign interests, primarily in Panama, yielded $38 million in electricity sales this year, up $7 million over 2000.

Electricity and Fuel Purchased

Electricity and fuel purchases rose from $1.8 billion to $2.7 billion, up $902 million or 49%. Short-term electricity purchases directly related to energy trading transactions outside Québec were almost entirely responsible for this growth.

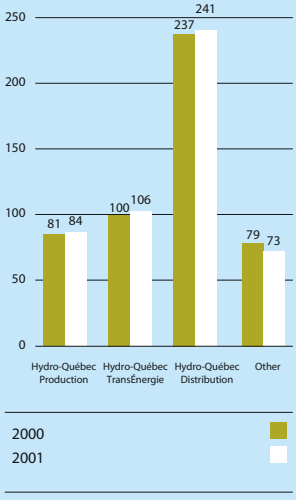
ENGINEERING, PROCUREMENT AND CONSTRUCTION

Hydro-Québec Ingénierie, approvisionnement et construction, our engineering, procurement and construction division, carried out activities valued at $1.2 billion in 2001, comprising $0.5 billion in shared services and $0.7 billion in engineering and construction projects. Shared services are those offered to other divisions of the Corporation and encompass, among other things, procurement, information technology, building management and ground and air transportation services.

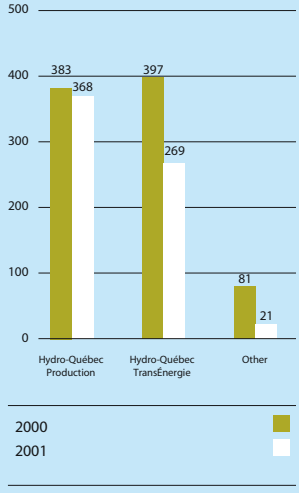
Activities related to shared services increased slightly by 1.4%, mainly due to the growing needs of internal customers.

Activities related to engineering and construction projects reached $0.7 billion in 2001, compared with $0.9 billion in 2000. A delay in obtaining government authorizations caused us to postpone work on the transmission grid loop projects in the Montérégie and Outaouais regions, as well as construction of an interconnection with the Ontario grid. Nevertheless, the division posted an increase in generation projects and undertook draft design studies for the construction of retaining structures (Lake Kénogami), new hydroelectric generating stations (Romaine-1, Péribonka, etc.) and refurbishment work on several generating facilities in Québec (Beauharnois, Bersimis-1, Shawinigan-2, etc.).

Operations Related to Shared Services
($M)



Operations Related to Engineering and Construction Projects
($M)



engineering, procurement and construction

expertise focused on performance and profitability

OTHER

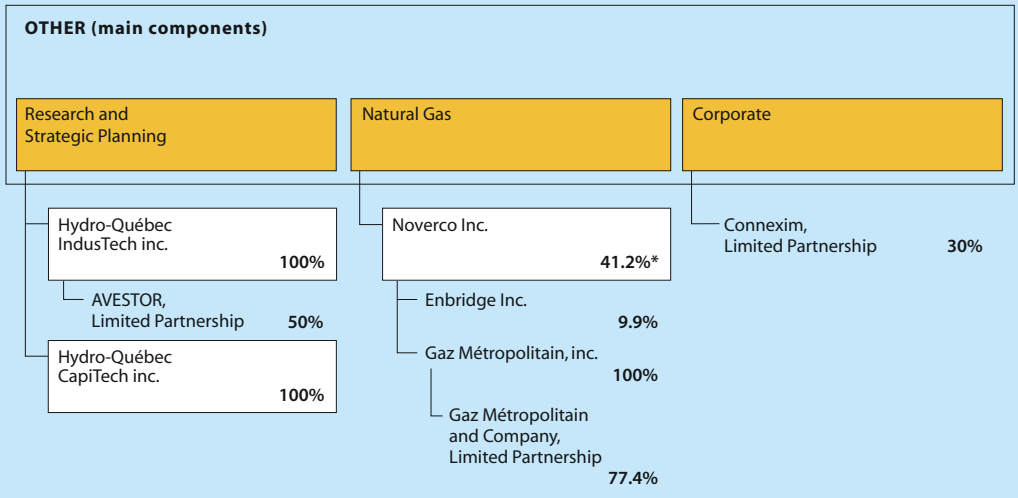
In 2001, the Other segment recorded a net loss of $28 million, compared with a loss of $101 million the previous year. This improvement stemmed largely from the periodic review of our R&D portfolio, conducted in 2000.

In order to pursue development of the rechargeable lithium-metal-polymer battery technology, Hydro-Québec formed a partnership in 2001 with a U.S. firm. The new partners plan to market the batteries to telecommunications companies, automotive manufacturers and power utilities. As a result of the partnership, the ACEP battery technology was transferred to the AVESTOR limited partnership, and development activities to enhance the technology were stepped up, resulting in higher expenses during the year.

Hydro-Québec CapiTech, which makes venture capital investments in energy technology, ended 2001 with a $7 million loss, $1 million more than in 2000. Although Hydro-Québec CapiTech recorded gains when investments were disposed of early in the year, deteriorating economic conditions throughout 2001 dragged down the value of certain holdings in its portfolio.

However, our interest in Noverco generated net income of $27 million in 2001, up $7 million over the previous year, due to Enbridge's improved operating results.

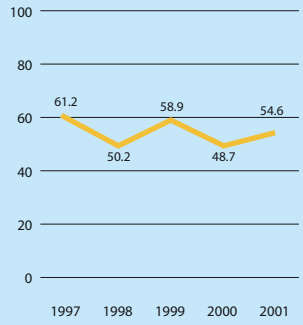
Finally, a $7 million gain in the first quarter on the sale of part of our stake in the telecommunications company Connexim helped improve net income for this segment.



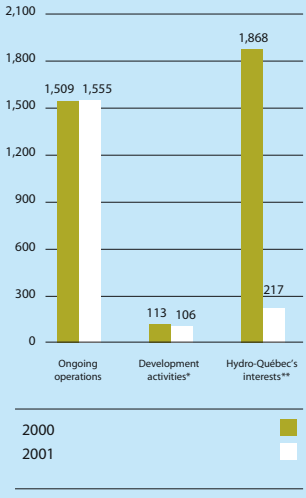
** The Corporation holds purchase options on an additional 9.2% of the shares.*

Financial Position

Self-Financing Ratio
(%)



Investments by Type of Activity
($M)



* Excludes $136 million ($690 million in 2000) corresponding to the Corporation's investment in its interests.
** Includes eliminations for consolidation purposes.

OPERATING ACTIVITIES

For 2001, operating activities generated cash of $3,463 million, up $183 million or 5.6% over 2000. The cash generated during the year was used to finance Hydro-Québec's investment program and repay short-term borrowings. The self-financing ratio stood at 54.6% in 2001, an increase of 12.1% over the previous year. In 2000, the $1.6-billion acquisition of Transelec had brought down the self-financing ratio.

INVESTING ACTIVITIES

In 2001, overall investments totaled $1,878 million, down $1,612 million or 46% from the preceding year. This decrease stemmed primarily from the major investment made by Hydro-Québec in 2000, through Hydro-Québec International (HQI), to acquire Transelec, Chile's largest power transmission company.

Investment activities fall into three categories: ongoing operations, development activities, and Hydro-Québec's interests. Ongoing operations encompass amounts invested in the normal course of the Corporation's business. This year, we invested $1,555 million, mainly to ensure long-term operability and meet domestic demand. Development activities, which totaled $106 million in 2001, comprised Hydro-Québec's investments in business and technological development as well as those related to international activities. Investments made through Hydro-Québec's interests, for all segments combined, totaled $217 million and were concentrated primarily in the Transmission segment and in natural gas (under Other).

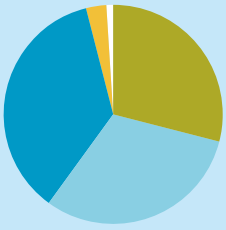
Much of the spending on energy-related construction projects by the Hydro-Québec divisions is carried out by Hydro-Québec Ingénierie, approvisionnement et construction, the Corporation's engineering, procurement and construction division. In 2001, investment was mostly in the Transmission and Generation segments, and was focused on major generating station refurbishment, construction of new facilities, transmission network reinforcement and hydroelectric capacity development.

Distribution

In 2001, we invested $455 million to continue ongoing activities in the Distribution segment, $151 million of which was allocated for the renewal of aging or inadequate distribution grid equipment in order to accommodate a larger electrical load.

To satisfy growing customer demand, we also injected $120 million into projects to ensure power supply to customers, including system extensions to connect new customers.

Ongoing Operations
(%)



2001	$M	%
Distribution	455	29
Transmission	477	31
Generation	562	36
Engineering, Procurement and Construction	51	3
Other	10	1

Transmission

We invested $477 million in the Transmission segment's ongoing operations in 2001. To ensure long-term operability, we continued investing in the Beauharnois generating station rehabilitation project. In 2001, $31 million was allocated primarily for network integration of the new switchyard west of the generating station and initial construction work on a substation east of the facility.

In addition, to prolong the service life and improve the reliability of transmission grid equipment, we spent $116 million on transformer and switchgear work. Similarly, we spent $9 million out of a total investment of $64 million in 2001 to finish upgrading the hardware and software of the System Control Centre (SCC), which was commissioned during the year.

The Corporation also invested $9 million in the Toulnustouc project. The work began in 2001 with construction of the 69-kV line needed to supply power to the work site.

Through our subsidiary HQI, we spent $105 million to pursue and expand our international activities in Chile, Peru and Australia. These investments are part of Hydro-Québec TransÉnergie's international strategy and are intended to promote its technology expertise in high-voltage power transmission. Of these funds, $95 million was injected into our Chilean subsidiary Transelec to readjust its capital structure, among other things.

Investments made through Hydro-Québec interests reached $64 million in 2001 and mainly comprised fixed assets. Of this amount, $41 million was spent on international activities, through Hydro-Québec's interests in Chile, Peru and Australia. TransÉnergie HQ's American subsidiary, TransÉnergie U.S., continues to capitalize on its technical know-how to develop merchant line projects, in which the pricing is exclusively market-based. The subsidiary thus spent $17 million on fixed assets for construction work on a high-voltage direct-current underwater interconnector, the Cross Sound Cable. This merchant line will connect the Connecticut and Long Island, N.Y., power grids and will improve power supply in the area.

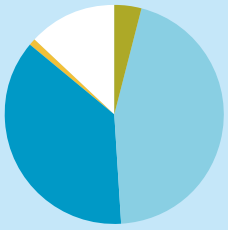
Generation

In the Generation segment, $562 million was invested in ongoing operations, including $300 million to ensure long-term operability of the generating plant.

One of the most important projects in this segment is construction of the new Grand-Mère hydroelectric facility, which began in 2000 and will continue until the end of 2004. In 2001, $74 million went to perform major excavation work and complete 30% of the concrete work on the generating station, water intake and main spillway.

The segment's other large projects share a common goal of ensuring long-term operability and consist of generating station rehabilitation and refurbishment work, for which investments totaled $100 million. The projects are aimed at modernizing existing generating facilities, maintaining their performance, and extending their useful lives. In particular, $40 million was spent on rehabilitation of Beauharnois generating station, primarily to refurbish and modernize the generating units and refurbish and reinforce the main powerhouse structure.

Development Activities*
(%)



2001	$M	%
Distribution	10	4
Transmission	108	45
Generation	89	37
Engineering, Procurement and Construction	3	1
Other	32	13

* Includes $136 million corresponding to the Corporation's investment in its interests.

The Sainte-Marguerite-3 generating station project received $234 million in 2001 and will enable us to meet growing demand in all markets. Construction and equipment installation were completed during the year, and the tests and inspections necessary to commission the generating units began according to the plan established at the start of the year. Commissioning of the facilities was delayed due to technical problems encountered when the headrace tunnel was filled with water.

Development activities include construction of a 526-MW hydroelectric generating station on the Toulnustouc River. We have met the Québec and Canadian government environmental criteria and, in 2001, received the necessary government authorizations to carry out the work. The new project, at a cost of some $800 million, will be implemented over the next few years, and commissioning is scheduled for 2005. In 2001, we invested $56 million in this project to cover, in particular, the draft design studies, the partnership agreements with the First Nations communities and the initial road rehabilitation and headrace tunnel excavation work.

Engineering, Procurement and Construction and Other

The EPC segment invested $20 million to ensure long-term operability and, more specifically, implement a new version of its integrated management software package.

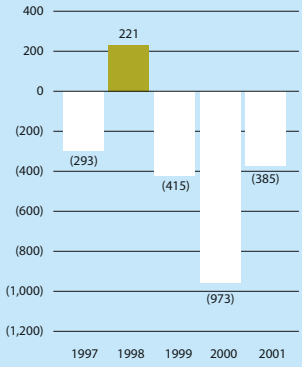
Under Other, the Corporation invested $32 million in development activities, including $28 million in the form of capitalization of Hydro-Québec CapiTech, which provides the Corporation with commercial and technological intelligence through its venture capital activities. Hydro-Québec CapiTech manages energy-related venture capital funds and directly invests in companies that develop and market technologies likely to contribute to the growth of the Corporation's divisions.

In addition, a $164-million interest in Hydro-Québec IndusTech resulted from the transfer of lithium-metal-polymer battery technology to AVESTOR, the joint venture created in 2001. The investment did not entail an outflow of cash during the year because it constituted recognition of the value of research conducted in the field over the past years.

Lastly, a total of $182 million was invested through Hydro-Québec's interests in 2001, excluding $53 million associated with inflows from investment disposals made during the year. Most of this amount, $129 million, is our share of investments by Gaz Métropolitain and Company, Limited Partnership (GMCLP), held through Noverco. GMCLP's investments primarily covered fixed assets and deferred expenses related to natural gas costs, in particular transportation and storage. These costs can be recovered from customers by means of an automatic rate recovery mechanism approved by the Régie de l'énergie. Furthermore, in 2001 Hydro-Québec CapiTech invested $38 million in capital ventures.

Change in the Corporation's Long-Term Financing

($M)



2001

Net borrowing

Net repayment

($M)

	1997	1998	1999	2000	2001
Issues	1,931	2,472	2,208	2,069	3,354
Redemptions	(2,224)	(2,251)	(2,623)	(3,042)	(3,739)

FINANCING ACTIVITIES

Financing the Corporation

The 2001 borrowing program was one of the largest in recent years, due mainly to the higher volume of maturing debt. The Corporation raised a total of $3,354 million on the markets, compared with an average of $2 billion for the preceding years. It completed 87% of its initial program, which anticipated borrowings of $3,877 million. In addition, the US$376 million short-term loan incurred as part of temporary financing for the fall 2000 acquisition of Transelec was repaid. The Corporation also paid down its long-term debt by approximately $385 million, the third net repayment in as many years.

The Corporation was again guided in its financing decisions by a policy of securing its cash requirements at the lowest possible cost and reducing the funding risk. The attainment of these objectives must be coordinated with the diversification of funding sources and rigorous hedging of exchange risk exposure.

Once again, the lowest costs were found on the Canadian market. Most of our financing transactions—66%—were therefore carried out in Canada. Financing activities were particularly intense early in the year, as more than one-third of debt matured in the first quarter. Close to $1 billion was borrowed in January on the Canadian medium-term note market. These issues proved popular with the various groups of investors.

In late January, we successfully reopened a bond issue bearing 6.5% interest, launched in 2000, in order to increase the amount outstanding by $500 million. The nominal value of the series, which matures in 2011, consequently rose to $1.3 billion.

We also capitalized on narrower credit spreads between U.S. and Québec government bond yields to issue U.S. dollar–denominated debt for the first time since 1996. A US$750-million issue, maturing in 10 years and bearing 6.3% interest, was floated on the global market. The issue was greeted positively, particularly by U.S. investors, who made up the majority of buyers. Because of our participation in the U.S. market, we were able to diversify our investor base and ensure that our involvement in the Canadian market would be less frequent and meet with a more enthusiastic response.

The remainder of our financing transactions consisted of medium-term notes that were strategically issued over the course of the year. Most of these notes mature between 2004 and 2006.

Finally, the Corporation has access to the following preauthorized funding sources:

Type of financing	Authorized volume	Market	Outstanding at December 31, 2001
Credit	US$350M or equivalent in C$	Canada	–
	C$65M	Canada	–
	US$50M	United States	–
Standby credit	US$1,500M	Eurodollar	–
Commercial paper	US$2,250M or equivalent in C$	United States	
		Canada	$42M

Credit Ratings

The following table summarizes the Corporation's credit ratings:

	2001	2000
U.S. agencies		
Moody's	**A1**	A2
Fitch Ratings	**AA-**	AA-
Standard & Poor's	**A+**	A+
Canadian agency		
DBRS	**A**	A

In 2001, Moody's, the New York credit rating agency, raised the credit rating of the Province of Québec and, consequently, Hydro-Québec from A2 to A1. The agency was motivated in its decision by the province's improved fiscal situation, zero budget deficit and lower accumulated debt, among other factors.

Financing the Corporation's Interests

In terms of the Corporation's interests, the highlight was undoubtedly the long-term refinancing of Transelec, which consisted of a US$465M loan maturing in 10 years and bearing 7.875% interest, and a loan on local markets in the amount of 9.2 million indexed Chilean pesos, or approximately US$242 million, bearing 6.2% interest. This financing transaction earned Hydro-Québec International the Deal of the Year Award from Latin Finance magazine, published by the Euromoney group.

Dividends, Capitalization and Interest Coverage

With a year-end capitalization rate of 27.5%, Hydro-Québec declared dividends of $554 million, or 50% of net income. After the dividends were paid to the shareholder, the capitalization rate stood at 26.8%, compared with 26.2% in 2000.

Moreover, the decrease in financial expenses significantly improved Hydro-Québec's interest coverage, from 1.37 times interest expense in 2000 to 1.43 in 2001.

Risks and Outlook

RISK MANAGEMENT

Over the last few years, Hydro-Québec has incorporated an integrated business risk management strategy into its decision-making process. The strategy covers all divisions and enables Hydro-Québec to determine the key risk factors for each. These factors are then integrated into a business risk portfolio. Integrated risk management provides a clearer picture of potential risks affecting the business, thereby furthering Hydro-Québec's ability to anticipate and manage risk more effectively. The result is improved business performance.

The year 2001 saw the publication of the *Strategic Plan 2002–2006*. Hydro-Québec continued to integrate in-house risk determination and assessment tools into its divisions' operations, and the determined risks were analyzed and considered in preparing the orientations stated in the Plan. The risk determination and assessment tools consist primarily of grids or questionnaires and are also tailored to issues specific to certain activities, such as the development of international transmission projects. The year also saw the preparation of action plans for several major risks, in particular as regards the retention and transfer of knowledge in order to perpetuate know-how. Other action plans, such as those related to runoff risk, were integrated into management activities.

Hydro-Québec also continued to work with Québec research agencies such as the Centre interuniversitaire de recherche en analyse des organisations (CIRANO) to develop tools better suited to its needs.

A management chart for tracking changes during the year in quantifiable key risks was approved by Senior Management. The chart will be generated on a regular basis in 2002 so that Management and Board members can systematically monitor each major risk affecting the business over the course of the year, while taking into account actual year-to-date results.

OUTLOOK

Business Environment

The past few years have been marked by major changes in the Québec and North American electricity markets. Of late, the most important factors influencing Hydro-Québec's business operations have been electricity market liberalization and the regulatory environment. To adapt to these changes, we have adopted an organizational structure that allows us to use our strengths to full advantage.

Strategic Plan 2002–2006

In submitting its *Strategic Plan 2002–2006*, Hydro-Québec reaffirmed its intention to grow the business and improve overall performance so as to generate new wealth for Quebecers. Accordingly, we are retaining the orientations of the *Strategic Plan 2000–2004* with a view to consolidating our gains to date. The divisions, which are tasked with seeking and seizing new business opportunities in their respective markets, are responsible for transforming the Strategic Plan orientations into practical actions.

2002 Financial Outlook

Current economic conditions are having a decisive impact on our ability to reach our objectives. The economic slowdown that commenced in late 2000 intensified in 2001, and the repercussions of the events of September 11, 2001, will likely delay an economic recovery. However, government measures to restart the economy, along with the expansionist monetary policies of the Bank of Canada and the U.S. Federal Reserve, hold out the promise of a recovery in the second half of 2002. Moreover, the across-the-board drop in fuel prices in the last six months of 2001 should help drive the economic upturn. The Québec economy is nonetheless expected to remain sluggish in 2002, before regaining its full potential in 2003.

In light of the slow growth in economic activity, we have opted for a conservative scenario in planning our purchase/resale transactions on external markets. We also anticipate moderate growth in the demand for electricity in Québec. Hydro-Québec remains nonetheless on course to meet the *Strategic Plan 2002–2006* profitability objectives, and net income should once again top $1.1 billion in 2002.

Moreover, an amendment to the accounting standard for foreign currency translation (effective January 1, 2002) eliminates the method of deferring and amortizing exchange gains and losses resulting from the translation of monetary assets and liabilities denominated in foreign currencies. In order to reduce the impact of the increased volatility on our financial results, we have adapted our foreign exchange risk management strategy. The standard is to be applied retroactively and will reduce 2002 retained earnings by approximately $1.3 billion.

In 2002, the investment program should approximate $2.7 billion. Almost 65% of this amount will be earmarked for ongoing operations to prolong the service life of our assets and complete our program to reinforce and enhance our transmission and distribution systems. Our 2002 borrowing program is expected to total $1.6 billion. Our operations should generate cash of $3.5 billion, which will meet a little over 65% of our cash requirements, estimated at $5.1 billion.

Management Report

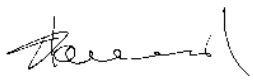
Hydro-Québec's consolidated financial statements and all additional information contained in the Annual Report are the responsibility of Management and are approved by the Board of Directors. Management's responsibility also includes the selection of appropriate accounting practices in accordance with Canadian generally accepted accounting principles, taking into account generally accepted accounting methods and practices of regulatory bodies. As required, Management makes informed judgments and prepares the most appropriate estimates of the outcome of events and transactions, with due consideration given to materiality. Financial information contained elsewhere in the Annual Report is consistent with that in the financial statements.

Management, in keeping with its responsibilities, maintains a control system, designed among other things to provide reasonable assurance that the assets of Hydro-Québec are adequately recorded and safeguarded and that the accounting records form an appropriate basis for the preparation of reliable financial statements. 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.

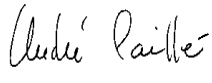
The Board of Directors assumes its responsibility for the consolidated financial statements principally through its Audit Committee, composed solely of directors who do not hold full-time positions within the Corporation or in one of its subsidiaries. This committee's mandate is to ensure that the financial 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 review the results of their audits and the reports on Hydro-Québec's accounting methods and policies and on the control systems. The General Auditor and the external auditors have full and unrestricted access to the Audit Committee, with or without Management's presence.

Hydro-Québec has also established a code of ethics and a code of conduct primarily to ensure the proper management of its resources and the orderly conduct of business.

The consolidated financial statements have been audited jointly by accounting firms Samson Bélair/ Deloitte & Touche and PricewaterhouseCoopers LLP.



Jacques Laurent
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 21, 2002

Auditors' Report

To the Minister of Finance of Québec:

We have audited the consolidated balance sheet of Hydro-Québec as at December 31, 2001, 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, 2001, 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
Chartered Accountants

PricewaterhouseCoopers LLP
Chartered Accountants

Montréal, Québec
February 21, 2002

CONSOLIDATED STATEMENT OF OPERATIONS

For the year ended December 31		**2001**	2000
In millions of dollars	notes		
Revenue		**12,578**	11,429
Expenditure			
Operations		**2,134**	2,135
Electricity and fuel purchased		**3,532**	2,408
Depreciation, amortization and decommissioning	2	**1,845**	1,896
Taxes	3	**591**	525
		8,102	6,964
Operating income		**4,476**	4,465
Financial expenses	4	**3,350**	3,369
Income before non-controlling interest		**1,126**	1,096
Non-controlling interest		**18**	18
Net income		**1,108**	1,078

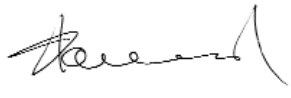
CONSOLIDATED STATEMENT OF RETAINED EARNINGS

For the year ended December 31		**2001**	2000
In millions of dollars	note		
Balance at beginning of year		**9,906**	9,367
Net income		**1,108**	1,078
		11,014	10,445
Dividends	15	**554**	539
Balance at end of year		**10,460**	9,906

CONSOLIDATED BALANCE SHEET

As at December 31		2001	2000
In millions of dollars	notes		
ASSETS			
Fixed assets	5	**50,044**	49,887
Current assets			
Cash and cash equivalents		**251**	112
Investments		**617**	569
Accounts receivable		**1,766**	1,861
Financial assets related to debt		**106**	89
Materials, fuel and supplies		**427**	407
		3,167	3,038
Other long-term assets			
Investments	6	**841**	750
Deferred charges	7	**5,031**	4,309
Financial assets related to debt	8	**299**	372
Other assets	9	**479**	682
		6,650	6,113
		59,861	59,038
LIABILITIES AND EQUITY			
Long-term debt	10	**37,269**	34,965
Current liabilities			
Borrowings		**88**	1,774
Dividends payable		**554**	539
Accounts payable		**1,343**	1,398
Accrued interest		**1,201**	1,264
Current portion of long-term debt		**3,087**	3,406
		6,273	8,381
Other long-term liabilities	11	**755**	673
Perpetual debt	12	**552**	552
Non-controlling interest		**178**	187
Shareholder's equity	15		
Share capital		**4,374**	4,374
Retained earnings		**10,460**	9,906
		14,834	14,280
		59,861	59,038

Yvon Lamontagne
Chairman of the Audit Committee



Jacques Laurent
Chairman of the Board of Directors

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended December 31		**2001**	2000
In millions of dollars	note		
Operating activities			
Net income		**1,108**	1,078
Depreciation of fixed assets		**1,696**	1,587
Amortization of deferred charges		**590**	449
Change in non-cash working capital items	16	**57**	24
Other		**12**	142
		3,463	3,280
Investing activities			
Fixed assets		**(1,810)**	(1,812)
Business acquisition		**–**	(1,576)
Long-term investments		**21**	(65)
Net change in short-term investments		**(46)**	(131)
Other		**(89)**	(37)
		(1,924)	(3,621)
Financing activities			
Issue of long-term debt		**4,544**	2,200
Maturity of long-term debt and sinking fund redemption		**(3,471)**	(2,317)
Repayment in advance of long-term debt		**(289)**	(737)
Receipts resulting from credit risk management		**25**	–
Net change in short-term borrowings		**(1,827)**	1,678
Dividends paid		**(539)**	(453)
Other		**157**	(18)
		(1,400)	353
Net change in cash and cash equivalents		**139**	12
Cash and cash equivalents at beginning of year		**112**	100
Cash and cash equivalents at end of year		**251**	112
Supplementary information			
Interest paid		**3,018**	2,967

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 have been prepared in accordance with Canadian generally accepted accounting principles and take into account generally accepted accounting methods and practices recognized by regulatory bodies. The regulatory accounting practices adopted by the Corporation, which differ from the accounting practices applied in unregulated enterprises, relate specifically to certain deferred charges, such as those concerning canceled major projects and personnel reduction and renewal measures, and the depreciation of fixed assets that are disposed of.

CONSOLIDATION

The consolidated financial statements include the accounts of the Corporation, its subsidiaries, all of which are wholly owned, and its interests in jointly controlled enterprises (collectively "Hydro-Québec").

Interests in jointly controlled enterprises, that is, 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 Hydro-Québec consolidated balance sheet are as at September 30.

GOODWILL

The excess of the cost of investments in subsidiaries and joint ventures over the fair value of the share of the net assets acquired is recorded as goodwill and amortized on a straight-line basis over a period not exceeding 40 years. Each year, Hydro-Québec reviews the book value of goodwill to determine if there has been a permanent impairment in value by measuring the estimated fair value of the investments using the discounted cash flow method.

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.

The joint venture Noverco Inc. wholly owns Gaz Métropolitain, inc., whose main subsidiary, Gaz Métropolitain and Company, Limited Partnership, is involved primarily in the distribution of natural gas by pipeline. Most aspects of the limited partnership's operations are monitored and controlled by the Régie de l'énergie. In exercising its authority, the Régie de l'énergie makes decisions that influence the adoption and use of certain accounting policies, in particular those with respect to employee future benefits, income taxes and certain deferred charges.

REVENUE

Revenue from sales of electricity is recorded on the basis of cyclical billings and also includes revenue accrued in respect of electricity delivered but as yet unbilled.

Note 1 — Significant Accounting Policies (continued)

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 into Canadian dollars at exchange rates in effect at the transaction date.

The exchange gains or losses resulting from the translation of current monetary items are included in the consolidated statement of operations. Those resulting from the translation of long-term monetary items are deferred to the date of repayment when they relate to liabilities hedged by future revenue streams in U.S. dollars. In all other cases, they are deferred and amortized on a straight-line basis over the remaining term of the asset or liability.

Currency swaps used to manage exchange risk related to principal payments on long-term debt and future revenue streams 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 these currency swaps are deferred and amortized on a straight-line basis over their remaining terms.

Hydro-Québec uses the temporal method for translating the financial statements of foreign operations considered to be integrated in terms of financial and operational management. The financial statements of the foreign operations considered to be self-sustaining in terms of financial and operational management are translated on a current rate basis using the foreign currency as the measuring unit, except for a subsidiary of Hydro-Québec International, which uses the U.S. dollar.

FIXED ASSETS

Fixed assets are carried at cost, which comprises materials, labor, other costs directly contributing to construction activities and borrowing costs capitalized during construction. Capitalized borrowing costs are based on the previous year's average cost of long-term debt issued by the Corporation.

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

Fixed assets are depreciated over their useful life. 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:

Distribution substations and lines	25 to 40 years
Transmission substations and lines	30 to 50 years
Hydraulic generation	45 to 50 years
Nuclear generation	25 to 30 years
Thermal generation, other than nuclear	15 to 30 years
Administrative and service buildings	50 years
Construction, operating and research equipment	3 to 30 years

Note 1 **Significant Accounting Policies** (continued)

Fixed assets are depreciated according to the sinking fund method at the rate of 3%, with the exception of construction, operating and research equipment, which is depreciated according to the straight-line method.

Upon disposal, the cost of fixed assets and the cost of their dismantlement, net of accumulated depreciation and salvage value, are charged to a separate account and amortized over a maximum period of 10 years, according to the sinking fund method, at the rate of 3%. However, when the fixed assets are replaced, the cost of dismantlement, less the salvage value, is added to the cost of the new fixed assets and then depreciated according to the method appropriate to the new asset.

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 amortized cost. The book value of the investments approximates their fair value.

DEFERRED CHARGES

- Marketing programs and development expenses

Deferred charges related to marketing programs and development expenses are amortized on a straight-line basis over a maximum of five years starting the year after the year in which they were incurred.

- Canceled major projects

Capital expenditure project costs are reviewed periodically. Costs deemed irretrievable at the time of cancellation of a major project are deferred and amortized on a straight-line basis over a period of three years.

PERSONNEL REDUCTION AND RENEWAL MEASURES

The Corporation introduced various temporary measures to facilitate the reduction and renewal of its personnel from 1997 to 2000. The most significant of these measures involved improvements to the Pension Plan as well as severance pay, the cost of which is amortized on a straight-line basis over a period of 60 months, beginning the month following each individual commitment. The cost of the measures relating to the Pension Plan is included in the accrued benefit obligation of the Pension Plan, the cost of severance pay is presented as Deferred charges, and the amortization is recorded in Expenditure – Operations.

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. Government issued or guaranteed bonds 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.

Note 1 — Significant Accounting Policies (continued)

DERIVATIVE INSTRUMENTS

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

Interest exchanges, which arise from swap agreements used to change long-term interest rate exposure, are matched to interest expense on the borrowings to which they are related.

Derivative instruments used in the short term to manage financial risk over a period of no more than three years are recorded at cost. Gains or losses realized are deferred and charged to operations on a basis consistent with the recognition of the gains or losses of the underlying position.

When derivative instruments are used to manage risks related to energy-price fluctuations, they constitute hedges. 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 position.

Derivative instruments used for trading purposes are valued at market value. Changes in value are recognized in the statement of operations in the period in which they occur.

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 dismantling the station and removing the irradiated fuel.

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.

USE OF ESTIMATES

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

RECLASSIFICATION

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

Note 2_ Depreciation, Amortization and Decommissioning

	2001	2000
Depreciation of fixed assets	**1,696**	1,587
Amortization of marketing programs	**14**	67
Amortization of canceled major projects	**44**	43
Amortization of development expenses	**9**	33
Write-off of projects	**1**	81
Decommissioning of nuclear generating station	**13**	12
Other	**68**	73
	1,845	1,896

Note 3_ Taxes

	2001	2000
Capital tax	**284**	243
Tax on gross revenue as municipal real estate tax on certain immovables	**228**	218
Municipal, school and other taxes	**79**	64
	591	525

Note 4_ Financial Expenses

	2001	2000
Interest		
Interest on debt securities	**3,105**	3,231
Amortization of borrowing discount and expenses	**53**	58
	3,158	3,289
Less		
Capitalized borrowing costs	**248**	239
Net investment income	**51**	42
	299	281
	2,859	3,008
Exchange loss	**306**	174
Loan guarantee fees	**185**	187
	3,350	3,369

Note 5_ Fixed Assets

				2001
	In service	Accumulated depreciation	In progress	**Total**
Distribution				
Substations and lines	9,310	2,652	201	**6,859**
Administrative and service buildings	672	197	5	**480**
Construction, operating and research equipment	718	519	57	**256**
Sundry	707	392	17	**332**
	11,407	3,760	280	**7,927**
Transmission				
Substations and lines	19,735	4,434	785	**16,086**
Administrative and service buildings	276	103	–	**173**
Construction, operating and research equipment	1,906	964	123	**1,065**
Sundry	26	16	90	**100**
	21,943	5,517	998	**17,424**
Generation				
Hydraulic	23,965	5,500	2,885	**21,350**
Nuclear	1,645	794	19	**870**
Thermal, other than nuclear	773	365	3	**411**
Administrative and service buildings	599	126	2	**475**
Construction, operating and research equipment	280	195	23	**108**
Sundry	211	75	67	**203**
	27,473	7,055	2,999	**23,417**
Engineering, Procurement and Construction				
Administrative and service buildings	214	82	4	**136**
Construction, operating and research equipment	400	262	19	**157**
	614	344	23	**293**
Other				
Administrative and service buildings	62	28	14	**48**
Construction, operating and research equipment	218	182	4	**40**
Sundry	1,324	439	10	**895**
	1,604	649	28	**983**
	63,041	17,325	4,328	**50,044**

Note 5__ Fixed Assets (continued)

				2000
	In service	Accumulated depreciation	In progress	Total
Distribution				
Substations and lines	8,904	2,376	244	6,772
Administrative and service buildings	678	181	6	503
Construction, operating and research equipment	665	472	64	257
Sundry	659	340	7	326
	10,906	3,369	321	7,858
Transmission				
Substations and lines	19,253	4,019	839	16,073
Administrative and service buildings	272	95	2	179
Construction, operating and research equipment	1,814	878	131	1,067
Sundry	25	2	41	64
	21,364	4,994	1,013	17,383
Generation				
Hydraulic	23,827	5,087	2,462	21,202
Nuclear	1,638	724	11	925
Thermal, other than nuclear	699	336	70	433
Administrative and service buildings	599	113	1	487
Construction, operating and research equipment	255	177	24	102
Sundry	206	53	56	209
	27,224	6,490	2,624	23,358
Engineering, Procurement and Construction				
Administrative and service buildings	209	72	3	140
Construction, operating and research equipment	358	216	24	166
	567	288	27	306
Other				
Administrative and service buildings	60	26	1	35
Construction, operating and research equipment	231	189	5	47
Sundry	1,290	404	14	900
	1,581	619	20	982
	61,642	15,760	4,005	49,887

Note 5— **Fixed Assets** (continued)

As at December 31, 2001, the Corporation had cumulative costs related to suspended draft design projects amounting to $514 million ($509 million as at December 31, 2000), recorded under Fixed assets in progress. The Corporation has therefore ceased capitalizing the related borrowing expenses.

As certain projects have longer completion timelines, their cumulative costs are periodically reviewed.

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.

Note 6— Investments

	2001	2000
At cost		
Noverco Inc. (note 14)		
Notes[a]	**141**	141
Churchill Falls (Labrador) Corporation Limited (note 18)		
Bonds[b]	**58**	59
Other[c]	**269**	181
	468	381
At equity		
Enbridge Inc.	**211**	207
Churchill Falls (Labrador) Corporation Limited (note 18)	**39**	35
Connexim, Limited Partnership	**32**	41
Meiya Power Company Limited	**91**	86
	373	369
	841	750

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, 7.50%, due 2002 through 2010 (par value of $64 million in 2001 and $65 million in 2000).
c) Includes venture capital investments at a cost of $118 million and with a fair value of $118 million as at December 31, 2001 ($90 million and $143 million as at December 31, 2000). The fair value of listed shares is based on the trading price at the balance sheet date; the fair value of unlisted shares is cost.

Note 7 — Deferred Charges

	2001	2000
Deferred charges related to debt[a]	**3,974**	3,191
Employee future benefit asset (note 17)	**635**	545
Marketing programs	**53**	49
Development expenses	**53**	91
Canceled major projects	**–**	44
Personnel reduction and renewal measures	**60**	117
Other	**256**	272
	5,031	4,309

a) Mainly comprises a deferred exchange loss of $3,838 million ($3,063 million as at December 31, 2000).

Note 8 — Financial Assets Related to Debt

	2001	2000
Currency swaps	**316**	232
Sinking funds	**89**	229
	405	461
Less		
Current portion	**106**	89
	299	372

Note 9 — Other Assets

	2001	2000
Goodwill	**297**	302
Government reimbursement for the 1998 ice storm[a]	**182**	380
	479	682

a) Corresponds to compensation payments, from 2003 to 2007, in the amount of $182 million for the net cost of restoring the system. As at December 31, 2000, the balance also included an amount of $186 million for reimbursement of the cost of emergency measures that was received during 2001.

Note 10 — 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 take into account the requirements of the sinking funds.

						2001	2000
	Debt of the Corporation						
Year of maturity	Canadian dollars	U.S. dollars	Other currencies	Total	Subsidiaries and joint ventures	**Total**	Total
2001	–	–	–	–	–	**–**	3,406
2002	520	2,085	450	3,055	32	**3,087**	2,990
2003	1,430	1,199	293	2,922	383	**3,305**	2,858
2004	1,485	32	56	1,573	26	**1,599**	1,185
2005	1,543	652	171	2,366	162	**2,528**	2,298
2006	416	1,760	425	2,601	28	**2,629**	–
1 to 5 years	5,394	5,728	1,395	12,517	631	**13,148**	12,737
6 to 10 years	2,999	1,703	1,296	5,998	1,117	**7,115**	5,242
11 to 15 years	1,133	2,530	609	4,272	86	**4,358**	5,100
16 to 20 years	2,722	1,928	13	4,663	103	**4,766**	2,755
21 to 25 years	1,956	2,516	–	4,472	91	**4,563**	6,152
26 to 30 years	1,084	3,297	–	4,381	136	**4,517**	3,981
31 to 35 years	1,143	–	–	1,143	40	**1,183**	2,109
36 to 40 years	209	–	–	209	67	**276**	209
41 to 45 years	2	–	–	2	–	**2**	4
46 to 50 years	50	–	–	50	–	**50**	50
51 to 55 years	–	–	–	–	–	**–**	–
56 to 60 years	378	–	–	378	–	**378**	32
	17,070[a]	17,702	3,313	38,085[b]	2,271	**40,356**	38,371[b]
Less							
Current portion	520	2,085	450	3,055	32	**3,087**	3,406
	16,550	15,617	2,863	35,030	2,239	**37,269**	34,965

a) Includes $113 million and $249 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. A specific sinking fund was created for this debt and totaled $30 million as at December 31, 2001. Other bonds, reported at their discounted value and amounting to $1,097 million, will reach a par value of $1,333 million on maturity.

b) Includes $36,835 million in bonds guaranteed by the Québec government ($36,108 million as at December 31, 2000).

Note 10 Long-Term Debt (continued)

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 currency units. 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.

				2001	2000
		Long-term debt	Financial assets related to debt		
	In Canadian dollars and currency units	At closing exchange rates at balance sheet date[a]	Currency swaps and sinking funds	**Total**	Total
Debt of the Corporation					
Canadian dollars	17,070	17,070	(88)	**16,982**	16,779
U.S. dollars	10,887	17,702	(172)	**17,530**	16,003
Other currencies					
Japanese yen	57,500	876	(82)	**794**	882
Deutsche marks	974	860	(39)	**821**	1,317
Pounds sterling	300	786	(20)	**766**	999
Swiss francs	97	96	–	**96**	229
French francs	2,500	695	–	**695**	654
		3,313	(141)	**3,172**	4,081
		38,085	(401)	**37,684**	36,863
Subsidiaries and joint ventures[b]		2,271	(4)	**2,267**	1,047
		40,356	(405)	**39,951**	37,910

a) Includes $945 million of financial liabilities composed of currency swaps ($765 million as at December 31, 2000) and $452 million of Hydro-Québec securities held in the sinking funds ($240 million as at December 31, 2000).

b) Includes $835 million in Canadian dollars, $1,092 million in U.S. dollars, $336 million in Unidades de Fomento (indexed Chilean pesos) and $4 million in Chinese renminbi ($809 million in Canadian dollars, $236 million in U.S. dollars and $2 million in Chinese renminbi as at December 31, 2000).

Note 10 Long-Term Debt (continued)

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 the currency at time of repayment.

	2001		2000	
	At time of issue	At time of repayment	At time of issue	At time of repayment
Debt of the Corporation				
Canadian dollars	**16,982**	**17,371**	16,779	17,477
U.S. dollars	**17,530**	**20,313**[a]	16,003	19,099[a]
Other currencies	**3,172**	**–**	4,081	287
	37,684	**37,684**	36,863	36,863
Debt of subsidiaries and joint ventures				
Canadian dollars	**835**	**835**	809	809
U.S. dollars	**1,092**	**937**	236	236
Other currencies	**340**	**495**	2	2
	2,267	**2,267**	1,047	1,047
	39,951	**39,951**	37,910	37,910

a) These balances are 83% hedged by future revenue streams in U.S. dollars (76% as at December 31, 2000).

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.

				2001	2000
Year of maturity	Canadian dollars	U.S. dollars	Other currencies	Weighted average	Weighted average
1 to 5 years	3.62	6.54	3.65	**4.87**	7.08
6 to 10 years	6.20	4.78	5.51	**5.56**	7.37
11 to 15 years	10.87	8.40	10.27	**9.29**	9.72
16 to 20 years	11.06	9.73	3.26	**10.50**	10.24
21 to 25 years	9.94	8.69	6.20	**9.16**	9.78
26 to 30 years	6.68	9.13	–	**8.46**	9.03
31 to 35 years	6.34	–	–	**6.34**	6.51
36 to 40 years	6.41	–	–	**6.41**	6.43
41 to 45 years	6.56	–	–	**6.56**	6.29
46 to 50 years	6.44	–	–	**6.44**	6.45
51 to 55 years	–	–	–	**–**	–
56 to 60 years	6.62	–	–	**6.62**	6.33
Weighted average	8.02	8.24	6.81	**8.05**	8.82

Note 10 — **Long-Term Debt** (continued)

The variable-rate portion of Hydro-Québec's debt amounted to 24.6%, or 25.6% after perpetual debt, as at December 31, 2001 (25.2%, or 26.3% after perpetual debt, as at December 31, 2000). For information purposes, a change of 1% in the interest rate would change net income by $104 million ($101 million in 2000), not including the impact of derivative instruments used to manage short-term financial risk (Note 13).

FAIR VALUE

As at December 31, 2001, the fair value of Hydro-Québec's debt, net of sinking funds and after swaps, amounted to $47,468 million ($45,019 million as at December 31, 2000).

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, 2001, 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 between 2002 and 2006. Any borrowing under these lines of credit will bear interest at a rate based on the London Interbank Offered Rate (LIBOR).

Note 11 — Other Long-Term Liabilities

	2001	2000
Accounts payable	**312**	275
Employee future benefit liability (note 17)	**343**	311
Decommissioning of nuclear generating station	**100**	87
	755	673

Note 12 — Perpetual Debt

Perpetual notes in the amount of US$400 million 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. These notes are shown on the balance sheet at the exchange rate in effect on the date of issue ($637 million at the closing exchange rate in effect at the balance sheet date). As at December 31, 2001, their fair value was $566 million ($520 million as at December 31, 2000). As at December 31, 2001 and 2000, the LIBOR for perpetual notes was 3.09% and 6.88%, respectively.

Note 13 — 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 future revenue streams 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.

Note 13 Derivative Instruments (continued)

The valuation of these swaps, with terms through 2017, showed a negative fair value of $338 million (negative fair value of $318 million as at December 31, 2000).

The following table shows the notional amount of these swaps, expressed in Canadian dollars or other currencies.

	2001[a]	2000[a]
Canadian dollars	**(389)**	(698)
U.S. dollars	**(1,768)**	(2,136)
Other currencies		
Japanese yen	**57,500**	65,500
Deutsche marks	**856**	1,456
Pounds sterling	**300**	310
Swiss francs	**97**	247
French francs	**2,500**	2,500
Euros	**61**	–
Unidades de Fomento (indexed Chilean pesos)	**(4)**	–

a) Figures in parentheses represent amounts to be paid.

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 raw materials. 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 October 2004.

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.

	2001	2000
Exchange risk		
Forward exchange contracts and options		
Financial assets	**38**	39
Financial liabilities	**(2)**	(43)
	36	(4)
Interest rate risk		
Forward rate agreements, options and swaps		
Financial assets	**33**	1
Financial liabilities	**(89)**	–
	(56)	1
Risk of change in energy and raw material prices		
Forward contracts, options and swaps		
Financial assets	**32**	30
Financial liabilities	**(60)**	(21)
	(28)	9
	(48)	6

Note 13_ **Derivative Instruments** (continued)

The fair value of derivative instruments is based on the spot rates or forward rates or prices in effect at market closing as at the balance sheet date. Without this information for a given instrument, Management refers to 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.

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 deals only with Canadian and international financial institutions with high credit ratings. Credit risk exposure is also reduced by applying a credit policy limiting credit risk concentrations and a customer credit risk evaluation program, as well as by adopting credit limits, where necessary. As at December 31, 2001, Hydro-Québec did not foresee any material loss arising from counterparty default.

Note 14_ 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 through Hydro-Québec International.

	2001	2000
Operations		
Revenue	**1,148**	864
Expenditure and financial expenses	**1,095**	807
Non-controlling interest	**18**	18
Net income	**35**	39
Balance sheet		
Current assets	**186**	191
Long-term assets	**1,793**	1,687
Current liabilities	**216**	256
Long-term liabilities	**1,096**	1,028
Non-controlling interest	**174**	180
Net assets	**493**	414
Cash flows		
Operating activities	**125**	92
Investing activities	**(121)**	(144)
Financing activities	**(1)**	63
Net change in cash and cash equivalents	**3**	11

NOVERCO INC.

Hydro-Québec holds 41% of the outstanding common shares of Noverco Inc. and options on an additional 9%. Under the Noverco Inc. shareholders' agreement, the Corporation agreed to mechanisms enabling the joint owners to convert their interests into liquidities under certain conditions.

Note 14__ **Interests in Joint Ventures** (continued)

Noverco Inc., through its interest in Gaz Métropolitain and Company, Limited Partnership (GMCLP), disclosed unrecorded future income taxes of $98 million on regulated activities in its 2001 financial statements using the tax liability method ($141 million in 2000 with the deferral method). In the past, the Régie de l'énergie and the National Energy Board have allowed these future income taxes to be included in GMCLP's rates as they become payable.

GMCLP charges pension and other retirement benefits to income as the amounts are disbursed, in accordance with regulatory practice.

FOREIGN JOINT VENTURES

The Corporation holds interests in joint ventures 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 15__ 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 2001, the Québec government declared dividends of $554 million, which is less than the maximum permitted.

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

ACCOUNTING CHANGE IN 2002

In December 2001, the Canadian Institute of Chartered Accountants published a revised version of *CICA Handbook* Section 1650, "Foreign Exchange Translation". The revised accounting standard abolishes the method of deferring and amortizing unrealized exchange gains and losses on foreign currency–denominated monetary items recorded in the balance sheet. The change applies to years beginning on or after January 1, 2002, and its application is retroactive.

As at January 1, 2002, initial application of these recommendations will reduce retained earnings by approximately $1,300 million.

Note 16 — Change in Non-Cash Working Capital Items

	2001	2000
Accounts receivable	**26**	30
Materials, fuel and supplies	**(23)**	(24)
Accounts payable	**92**	31
Accrued interest	**(38)**	(13)
	57	24

Note 17 — Employee Future Benefits

The Corporation offers all its employees a contributory defined benefit pension plan, based on final pay. The Corporation's pension plan (the "Pension Plan") is a funded plan that ensures pension benefits based on number of years of service and average five best years of earnings. The Corporation also offers its active and retired employees other benefits including 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 cost of pension benefits and other 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.

The following table presents information concerning the defined benefit plans, established by independent actuaries:

Note 17 — Employee Future Benefits (continued)

	2001 Pension Plan	2000 Pension Plan	**2001** Other plans	2000 Other plans
Accrued benefit obligation				
Balance at beginning of year	**6,966**	5,988	**522**	460
Current service cost	**214**	171	**19**	16
Benefit payments and refunds	**(321)**	(322)	**(31)**	(26)
Interest on obligation	**451**	436	**33**	32
Actuarial losses (gains)	**(79)**	647	**(20)**	40
Adjustments arising from plan amendments	**–**	–	**(12)**	–
Adjustments arising from personnel reduction programs	**–**	46	**–**	–
Balance at end of year	**7,231**	6,966	**511**	522
Plan assets at fair value				
Balance at beginning of year	**9,452**	8,958	**31**	31
Actual return on plan assets during the year	**33**	831	**1**	–
Employee contributions	**13**	3	**–**	–
Hydro-Québec contributions	**–**	1	**13**	4
Benefit payments and refunds	**(321)**	(322)	**(5)**	(4)
Administrative fees	**(28)**	(19)	**–**	–
Balance at end of year	**9,149**	9,452	**40**	31
Surplus (deficit) at end of year	**1,918**	2,486	**(471)**	(491)
Unamortized past service costs[a]	**256**	278	**–**	–
Unamortized net loss (gain)[b]	**194**	(428)	**(39)**	(19)
Unamortized transitional obligation (asset)[a]	**(1,825)**	(1,977)	**165**	193
Unamortized adjustments arising from personnel reduction programs[c]	**92**	186	**2**	6
Accrued benefit asset (liability)	**635**	545	**(343)**	(311)
Significant actuarial assumptions (%)				
Discount rate	**6.62**	6.61	**6.62**	6.61
Expected rate of return on plan assets[d]	**7.67**	7.90	**4.98**	5.59
Salary escalation rate[e]	**2.95**	2.95	**–**	–

a) Past service costs arising from plan amendments and transitional balances relating to the Pension Plan and other defined retirement benefits as at January 1, 1999, are amortized on a straight-line basis over the employees' expected average remaining service life. The transitional obligation relating to salary insurance plans is amortized on a straight-line basis over a period of five years.

b) 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 service life.

c) Adjustments arising from personnel reduction programs are amortized on a straight-line basis over a period of 60 months, beginning the month following each individual commitment.

d) 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.

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

As at December 31, 2001, health-care costs were based on an annual growth rate of 7.9% in 2002. Thereafter, based on the assumption used, this rate gradually decreases until it reaches the ultimate rate of 3.7% in 2012.

Note 17__ 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:

	2001	2000	**2001**	2000
	Pension Plan	Pension Plan	Other plans	Other plans
Bonds and debentures	**689**	742	**–**	–
Shares	**12**	10	**–**	–
Short-term investments	**–**	20	**35**	31
	701	772	**35**	31
Plan expense (credit)				
Current service cost, net of employee contributions[a]	**185**	157	**19**	16
Administrative fees[b]	**28**	19	**–**	–
Interest on obligation	**451**	436	**32**	33
Expected return on plan assets	**(718)**	(650)	**(1)**	(1)
Amortization of transitional obligation (asset)	**(152)**	(152)	**16**	16
Amortization of net actuarial gain	**–**	–	**(1)**	(1)
Amortization of adjustments arising from personnel reduction programs	**94**	90	**4**	4
Amortization of past service costs	**22**	22	**–**	–
Expense (credit) for the year	**(90)**	(78)	**69**	67

a) The value of the contribution holiday granted to employees for the year is disclosed net of service cost of contributions deemed paid and amortized using the method for amortizing actuarial gains and losses. 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.

The Corporation and most of its employees have benefited from a Pension Plan contribution holiday since May 10, 1999.

During the year, changes were made to the funding formula for the supplementary group life insurance plan. These changes came into force in September and apply to all individuals insured under the plan, except for engineers, researchers and specialists, and retirees in those categories. These amendments, coupled with certain changes to the assumptions used, result in a reduction of $12 million in the accrued benefit obligation of Other plans.

Note 18 — 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 energy generated at 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, 2001, the Corporation was committed under 77 contracts to purchase electricity from independent power producers for a potential capacity of about 810 MW. The Corporation expects to purchase approximately 4 TWh of energy annually over the initial term of these contracts, which extend through 2029. The majority of these contracts include renewal clauses.

GUARANTEES

Hydro-Québec had issued letters of credit or guarantees for an amount of $1,504 million as at December 31, 2001.

CAPITAL EXPENDITURES

The Corporation expects to invest approximately $2,000 million in fixed assets in 2002.

LITIGATION

In the normal course of business, Hydro-Québec is party to claims and legal proceedings. Management is of the opinion that the outcome of these legal actions, which can currently be determined with reasonable certainty, will not have an adverse effect on the financial position or consolidated operating results of Hydro-Québec, given the provision for such expenditures.

Most of the claims that the Corporation received in respect of the 1998 ice storm have been withdrawn.

Note 19 — Segmented Information

Hydro-Québec's operations are divided into four segments based on its organizational structure, which reflects the method of managing the Corporation's activities:

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

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. The division also manages Hydro-Québec's telecommunications network.

Generation: Hydro-Québec Production operates and develops the Corporation's generating facilities in Québec as well as a number of foreign facilities. The division also sells electricity on external markets and engages in energy trading activities.

Engineering, Procurement and Construction: Hydro-Québec Ingénierie, approvisionnement et construction provides engineering services and constructs power facilities nationally and internationally. The division also provides other services, particularly in procurement and information technology, to Hydro-Québec's business units.

Other: This segment comprises research and development, corporate activities, financial services and activities related to the gas sector.

The amounts presented for each segment are based on the financial information used to establish the consolidated financial statements. The accounting policies used in each segment 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 to amend the Act respecting the Régie de l'énergie*. The supply rate is determined in the Act for a maximum annual volume of heritage pool electricity consumption of 165 TWh. This volume was not reached in 2001.

The transmission rates used are those decreed by the Québec government in March 1997 pending a decision of the Régie de l'énergie with respect to the application for a transmission rate increase effective January 2001. Should changes be made, they would only affect intersegment revenue.

Note 19__ Segmented Information (continued)

Other intersegment products and services are valued at full cost.

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

SEGMENTS

	Distribution	Transmission	Generation	EPC[a]	Other	Intersegment[b]	**2001 Total**
Revenue							
External customers	7,934	301	3,218	20	1,120	(15)	**12,578**
Intersegment	23	2,727	4,091	1,142[c]	211	(8,194)	**–**
Depreciation, amortization and decommissioning	429	578	671	66	101	–	**1,845**
Financial expenses	573	1,139	1,502	20	122	(6)	**3,350**
Net income (loss)	(454)	436	1,170	(16)	(28)	–	**1,108**
Capital expenditures	482	549	664	53	62	–	**1,810**
Total assets	9,545	18,223	24,275	533	2,282	5,003	**59,861**

	Distribution	Transmission	Generation	EPC[a]	Other	Intersegment[b]	2000 Total
Revenue							
External customers	7,887	66	2,523	108	869	(24)	11,429
Intersegment	25	2,710	4,091	1,250[c]	187	(8,263)	–
Depreciation, amortization and decommissioning	416	554	735	54	137	–	1,896
Financial expenses	591	1,060	1,578	33	107	–	3,369
Net income (loss)	(443)	399	1,253	(30)	(101)	–	1,078
Capital expenditures	429	695	603	30	55	–	1,812
Total assets	9,781	18,065	24,390	571	2,091	4,140	59,038

a) Engineering, Procurement and Construction.
b) Includes assets related to long-term financing that have not been allocated to the operating segments.
c) Intersegment revenue generated by the EPC segment includes an amount of $653 million ($786 million in 2000) that corresponds to capital expenditures in respect of its customers.

GEOGRAPHICAL INFORMATION

	2001		2000	
	Revenue	Fixed assets and goodwill	Revenue	Fixed assets and goodwill
Québec	**9,100**	**48,071**	8,862	48,027
Canada, outside Québec	**114**	**2**	113	–
United States	**3,055**	**277**	2,331	226
Chile	**222**	**1,639**	–	1,597
Other countries	**87**	**352**	123	339
	12,578	**50,341**	11,429	50,189

CONSOLIDATED FINANCIAL INFORMATION

In millions of dollars	**2001**	2000	1999	1998	1997
OPERATIONS					
Revenue	**12,578**	11,429	9,608	8,879	8,481
Expenditure					
Operations	**2,134**	2,135	1,912	1,681	1,724
Electricity and fuel purchased	**3,532**	2,408	1,109	899	529
Depreciation, amortization and decommissioning	**1,845**	1,896	1,731	1,589	1,545
Taxes	**591**	525	592	610	583
	8,102	6,964	5,344	4,779	4,381
Operating income	**4,476**	4,465	4,264	4,100	4,100
Financial expenses	**3,350**	3,369	3,345	3,410	3,308
Income before non-controlling interest	**1,126**	1,096	919	690	792
Non-controlling interest	**18**	18	13	11	6
Net income	**1,108**	1,078	906	679	786
SUMMARY OF BALANCE SHEET					
Total assets	**59,861**	59,038	56,808	57,336	55,238
Long-term debt	**37,269**	34,965	36,016	37,833	37,172
Shareholder's equity	**14,834**	14,280	13,741	13,288	12,888
ANNUAL INVESTMENTS					
Fixed assets	**1,810**	1,812	1,642	2,092	1,590
Other	**68**	1,678	456	234	527
Total investments	**1,878**	3,490	2,098	2,326	2,117
FINANCIAL RATIOS					
Interest coverage[a]	**1.43**	1.37	1.33	1.25	1.27
Capitalization (%)[b]	**26.8**	26.2	26.2	25.0	25.1
Self-financing (%)[c]	**54.6**	48.7	58.9	50.2	61.2
Return on equity (%)[d]	**7.6**	7.7	6.7	5.2	6.2
Return on revenue (%)[e]	**8.8**	9.4	9.4	7.6	9.3

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 provided 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 figures for previous years have been reclassified to reflect the presentation of the current year.

OPERATING STATISTICS	2001	2000	1999	1998	1997
In millions of kilowatthours					
ELECTRICITY SALES					
In Québec					
Residential and farm	**50,850**	51,666	49,315	47,701	51,246
General and institutional	**30,360**	30,490	29,765	28,815	29,560
Industrial	**66,343**	65,950	63,409	61,773	61,837
Other	**4,659**	4,651	4,500	4,519	4,648
	152,212	152,757	146,989	142,808	147,291
Outside Québec					
Long-term sales	**4,116**	6,844	8,711	8,101	8,072
Short-term sales	**38,698**	30,479	16,012	10,464	7,170
	42,814	37,323	24,723	18,565	15,242
Total sales	**195,026**	190,080	171,712	161,373	162,533
In millions of dollars					
REVENUE FROM SALES					
In Québec					
Residential and farm	**3,131**	3,167	3,034	2,906	3,066
General and institutional	**1,973**	2,002	1,963	1,894	1,885
Industrial	**2,482**	2,405	2,236	2,214	2,162
Other	**217**	220	215	213	218
	7,803	7,794	7,448	7,227	7,331
Outside Québec					
Long-term sales	**326**	377	427	391	350
Short-term sales	**2,794**	2,003	624	423	246
	3,120	2,380	1,051	814	596
Total revenue from sales	**10,923**	10,174	8,499	8,041	7,927
At December 31					
NUMBER OF CUSTOMER ACCOUNTS					
In Québec					
Residential and farm	**3,257,361**	3,228,610	3,206,211	3,182,033	3,157,096
General and institutional	**280,796**	281,107	280,383	280,067	280,396
Industrial	**13,215**	13,081	12,732	12,803	13,002
Other	**5,919**	5,941	5,986	6,066	6,222
Outside Québec	**86**	86	88	61	52
Total customer accounts	**3,557,377**	3,528,825	3,505,400	3,481,030	3,456,768
In kilowatthours/customer					
AVERAGE ANNUAL CONSUMPTION					
In Québec					
Residential and farm	**15,680**	16,058	15,381	15,050	16,309
General and institutional	**108,061**	108,604	106,157	102,826	105,390
Industrial	**5,045,862**	5,109,828	4,980,295	4,787,677	4,720,382
Other	**785,666**	779,911	751,720	735,514	741,899

OPERATING STATISTICS	2001	2000	1999	1998	1997
In thousands of kilowatts					
INSTALLED CAPACITY[a]					
Hydroelectric	**28,906**	29,246	29,235	29,203	29,203
Thermal[b]	**2,266**	2,266	2,270	2,269	2,194
Wind	**2**	–	–	–	–
Total installed capacity	**31,174**	31,512	31,505	31,472	31,397
In millions of kilowatthours					
TOTAL REQUIREMENTS[c]	**186,645**	197,895	187,999	176,236	182,263
In thousands of kilowatts					
PEAK POWER REQUIREMENTS[d]	**32,616**	33,767	35,577	35,275	32,305
In kilometres					
LINES (OVERHEAD AND UNDERGROUND)					
Transmission and subtransmission	**32,273**	32,283	32,227	32,144	32,036
Distribution	**107,139**	106,448	105,898	105,705	104,640
	139,412	138,731	138,125	137,849	136,676

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 the output from the 133 turbines (each rated 100 MW) at Matane and Cap-Chat wind farms. Hydro-Québec also has access to the generation from two power plants in Panama and Costa Rica (rated 300 MW and 10 MW respectively).
b) Includes Gentilly-2 nuclear power station (rated capacity 675 MW).
c) Total requirements include kilowatthours delivered within Québec and to neighboring systems.
d) Total power requirements at the annual peak for Québec needs for the winter beginning in December, including interruptible power. The annual peak for Québec needs in winter 2001–2002 occurred at 6 p.m. on January 31, 2002.

OTHER INFORMATION	2001	2000	1999	1998	1997
(%)					
RATE INCREASES					
Average increase at May 1	**0**	0	0	1.6	1.6
Inflation rate	**2.5**	2.7	1.7	0.9	1.6
NUMBER OF EMPLOYEES[a]					
Permanent at December 31	**17,679**	17,277	17,277	17,468	17,164
Temporary (year's average)	**3,545**	3,399	3,126	3,379	3,252
Women (%)	**28.3**	28.6	27.9	27.4	27.0

a) Excludes employees of subsidiaries and joint ventures.

CONSOLIDATED RESULTS BY QUARTER

					2001
	1st quarter	2nd quarter	3rd quarter	4th quarter	12-month period
In millions of dollars				(unaudited)	(audited)
Revenue	3,837	2,904	2,762	3,075	**12,578**
Expenditure					
Operations	469	545	512	608	**2,134**
Electricity and fuel purchased	1,055	802	831	844	**3,532**
Depreciation, amortization and decommissioning	457	486	477	425	**1,845**
Taxes	156	174	151	110	**591**
	2,137	2,007	1,971	1,987	**8,102**
Operating income	1,700	897	791	1,088	**4,476**
Financial expenses	938	832	808	772	**3,350**
Income (loss) before non-controlling interest	762	65	(17)	316	**1,126**
Non-controlling interest	7	11	2	(2)	**18**
Net income (loss)	755	54	(19)	318	**1,108**

					2000
	1st quarter	2nd quarter	3rd quarter	4th quarter	12-month period
In millions of dollars				(unaudited)	(audited)
Revenue	2,933	2,544	2,914	3,038	11,429
Expenditure					
Operations	464	509	474	688	2,135
Electricity and fuel purchased	352	470	878	708	2,408
Depreciation, amortization and decommissioning	447	447	463	539	1,896
Taxes	157	156	141	71	525
	1,420	1,582	1,956	2,006	6,964
Operating income	1,513	962	958	1,032	4,465
Financial expenses	831	852	843	843	3,369
Income before non-controlling interest	682	110	115	189	1,096
Non-controlling interest	7	12	1	(2)	18
Net income	675	98	114	191	1,078

Corporate Management

"Ensure growth, protect the environment, provide for succession, manage carefully and communicate clearly: those are the responsibilities of Hydro-Québec's executives."

André Caillé
President and Chief Executive Officer

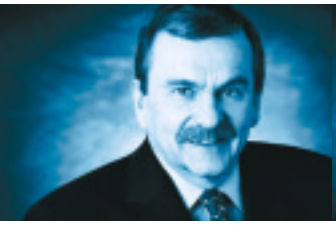
Marie-José Nadeau
Executive Vice President – Corporate Affairs and Secretary General

Daniel Leclair
Vice President – Finance and Chief Financial Officer

Roger Lanoue
Vice President – Research and Strategic Planning

Maurice Charlebois
Vice President – Human Resources

Board of Directors



Jacques Laurent [a, b, c, d, e, f, g]
Chairman of the Board
of Directors, Hydro-Québec
Senior Partner,
Gowling Lafleur Henderson,
Barristers and Solicitors

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

Pierre Bourgie [a, e, f]
Vice Chairman of the Board
of Directors, Hydro-Québec
President and Chief Executive
Officer, Société financière
Bourgie 1996 inc.

Michel Boivin
Deputy Minister of Natural
Resources, Gouvernement
du Québec

Joseph Benarrosh [f]
President, JJDS Capital inc.

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

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

Bernard Gaudreault [b, h]
President and Chief
Executive Officer,
Phil Gaudreault et fils ltée

Pierre Grand'Maison [a, b, d, h]
President and Chief Executive
Officer, Thermoplast inc.

Régis Labeaume [g]
Official Representative,
Québec – Optics City

Yvon Lamontagne [a, e, h]
Mission Delegate to
the President, AXA Canada

Paul Larocque [a]
Notary
Mayor, Bois-des-Filion

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

Claude Munger [c]
Director

Michel Noël de Tilly [a, b, c, h]
Associate Secretary General,
Ministère du Conseil exécutif,
Gouvernement du Québec

Serge Racine [g]
Director

Louise Roy [c]
President,
L.R. Services-conseils

Board Committees

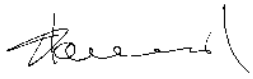
a Executive Committee
b Distribution
c Environment and Corporate Social Responsibility
d Ethics and Corporate Governance
e Finance
f Pension Fund Management
g Human Resources
h Audit

Acknowledgments

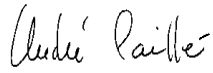
We would like to pay special thanks to L. Jacques Ménard, Chairman of the Board of Directors from 1996 to 2001. His sharp intellect, his in-depth knowledge of the rules of the financial marketplace, his leadership role in the adoption of corporate governance standards and his careful analysis of the needs of Hydro-Québec and its employees contributed to the success of his time with us. In a changing business environment rife with growth opportunities, Mr. Ménard worked closely with the President and Chief Executive Officer and the company's other executives to ensure the introduction of new practices in deregulated power market transactions, financial engineering, and corporate management.

We wish to express our appreciation to the members of the Board of Directors and Senior Management for their determination to make Hydro-Québec a dynamic organization that is capable of seeing to its continued growth and prosperity while remaining faithful to its traditional commitments.

Our special gratitude goes to Jean-Paul Beaulieu, Robert Brouillette, Charles G. Cavell, Éric Gourdeau, Francine Harel-Giasson, Gérald Lemoyne, Michèle Poirier and Francine Ruest-Jutras, who left the Board in 2001. We extend a warm welcome to Joseph Benarrosh, Michel Boivin, Bernard Gaudreault, Régis Labeaume, Paul Larocque, Sophie Martin and Louise Roy, who joined the Board during the year.



Jacques Laurent
Chairman of the Board of Directors



André Caillé
President and Chief Executive Officer

Corporate Governance

Hydro-Québec's Board of Directors is concerned with maintaining the highest possible standards for corporate governance. It therefore fully subscribes to the corporate governance guidelines established by 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 members of Senior Management. The Board regularly receives and analyzes the subsidiaries' activity reports, financial results and accountability reports.

INDEPENDENCE

A majority of Board members 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 and Executives 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 through the analyses done by the seven Board committees: Audit, Finance, Human Resources, Ethics and Corporate Governance, Environment and Corporate Social Responsibility, Pension Fund Management, and Distribution. After every committee meeting, a report by the chair of the committee in question 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 by law.

During the past year, Hydro-Québec set up a committee for the protection of personal information, as required by the government action plan. Chaired by the President and Chief Executive Officer, the committee entrusted the company's General Auditor with the task of drawing up an overall status report. An action plan was then formulated; its implementation will continue in 2002. Hydro-Québec is taking the necessary measures to guarantee its customers, suppliers and employees 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*.

The company also republished its code of conduct and circulated it to all employees and pensioners. This update incorporates the new realities stemming from market deregulation, more widespread use of the Internet and Hydro-Québec's higher profile on the international stage. The code is based on the five fundamental values that guide the company: integrity, loyalty, respect, discretion and equity. It is intended to provide a better understanding of the ethical principles laid out in the policy "Our Corporate Governance."

Language Guidelines

The directive for the application of the *Charter of the French Language* was revised to take into account the provisions of the *Act to amend the Charter of the French Language*, as well as changes in the company's activities and needs. The revised directive came into effect in September 2001, and a cue sheet to help in its implementation was made available to all personnel.

Efforts to improve the quality of the French used at Hydro-Québec continued during the year. Several proficiency courses were offered, in grammar, business correspondence, report writing, and other subjects. More than 800 employees signed up and 75 sessions were given. The company published a generation maintenance vocabulary as a new technical-language tool. Finally, various promotional and awareness activities were organized to highlight the Semaine du français et de la francophonie, a week-long event celebrating French language and culture.

Hydro-Québec's standing committee on language continued its work, meeting once in 2001. It presented the Office de la langue française with its annual report on the application of the government's policy on the use of French in information technologies.

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 10 times in 2001, with an attendance rate of about 82%. The Executive Committee held 10 meetings, while the other committees held 32 in all. The Board welcomed a new Chairman and seven new members. It also set up a Distribution Committee to deal chiefly with activities related to ensuring an adequate supply of electricity for Hydro-Québec Distribution.

The Board authorized the creation of three new divisions, in addition to Hydro-Québec TransÉnergie: Hydro-Québec Distribution, Hydro-Québec Production and Hydro-Québec Ingénierie, approvisionnement et construction. This decision is in line with the new North American regulatory environment, which has prompted most previously integrated companies in the power industry to adopt a new structure based on areas of activity.

During the year, the Board laid out Hydro-Québec's principal strategies for the next five years. These are set forth in the *Strategic Plan 2002–2006* and mainly involve improving the company's overall performance by focusing its efforts on the following five issues: quality of customer service, employee motivation and expertise, creating value for the shareholder and Québec society, technological innovation, and efficiency and synergy of activities.

Finally, the Board monitored changes in the business plans, objectives and financial results of Hydro-Québec and its wholly owned subsidiaries.

ETHICS AND CORPORATE GOVERNANCE

The Ethics and Corporate Governance Committee ensures that Hydro-Québec is well 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 and Executives of Hydro-Québec*. It makes recommendations on rules applicable to the company's business.

The committee's activities included analyzing accountability reports on the application of corporate policies and the 2001 edition of the code of conduct for Hydro-Québec employees. It also proposed the creation of a Distribution Committee to ensure a functional separation between Hydro-Québec Distribution and Hydro-Québec Production in terms of the procurement of electricity.

ENVIRONMENT AND CORPORATE SOCIAL RESPONSIBILITY

The Environment and Corporate Social Responsibility Committee provides advice 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 analyzed the accountability report on the application of corporate policies on environmental and social responsibility issues and reviewed environmental studies concerning various hydroelectric projects. It also examined the summary of environmental inspections carried out in 2000 as well as the 2001 environmental inspection program. In addition, it reviewed the statement of donations and sponsorships and the report on research chairs funded by the company in 2000. Finally, the committee studied the environmental report prepared for the Board of Directors.

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 recommended that the Board update the management policy for pension fund investments in order to adapt certain terms of application to the current situation. It also reported on the follow-up of the changes made.

The committee also reviewed the performance of the pension plan portfolio and specialized portfolio managers, as well as the possibility of forming strategic alliances with certain organizations for investments in specific management areas.

DISTRIBUTION

The Distribution Committee was established on September 14, 2001, to advise the Board or the Executive Committee on Hydro-Québec Distribution's activities regarding the procurement of an electricity supply for Québec consumers. In particular, it examines the Electricity Supply Plan, the procedure for tendering and awarding power supply contracts, the *Code of Ethics on Conducting Calls for Tenders*, the calls for tenders and the suppliers chosen.

In 2001, the committee looked specifically at Hydro-Québec Distribution's Electricity Supply Plan as well as the application to issue an initial call for tenders to meet electricity needs starting in 2006–2007, both of which were filed with the Régie de l'énergie.

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.

The committee's focus this year was on producing a management chart for tracking the company's main quantifiable risks and on examining the impact of adopting new accounting standards for currency conversion.

HUMAN RESOURCES

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

In 2001, the committee turned its attention to the workforce succession plan and job attendance. It also considered the matter of pay equity, the hiring program for new graduates and the creation of new divisions within the company.

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. The committee reads the internal audit reports and resulting action plans.

During the year, the committee continued its consideration of the issue of electricity theft. It examined projects to replace the customer information system and introduce an online transactional service for billing and payment. It also reviewed several action plans, including those related to energy risk management, customer complaints and the special program for reinforcing the distribution system.

PART I

Interpretation and application

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

a) **"Act"** means the *Hydro-Québec Act,* R.S.Q. c. H-5, as amended from time to time;

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

c) **"Board"** means the Board of Directors of the Corporation;

d) **"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 as Schedule D;

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) **"Corporation"** means Hydro-Québec;

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

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 Corporation or a non-profit association or group that has no financial link with the Corporation or is not incompatible with the objects of the Corporation;

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

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

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

m) **"subsidiary"** means a legal person or corporation controlled directly or indirectly by the Corporation.

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 and to the President and Chief Executive Officer and the other executives of the Corporation.

The directors and the President and Chief Executive Officer are also subject to the *Regulation respecting the ethics and professional conduct of public office holders* (Order-in-Council 824-98 of June 17, 1998 as amended).

PART II

Ethical principles and general rules of professional conduct

3. The director or executive is appointed to contribute to the achievement of the mission of the Corporation 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 Corporation by the Act and the good administration of the property it owns as mandatary of the State.

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

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

- a vision of the Corporation 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 Corporation as a government-owned business corporation, which include customer satisfaction, an understanding of business, respect for employees, quality improvement, respect for the environment, partnership with local communities and protection of the future;
- the principles set out in the basic policies of the Corporation, 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 or executive is required, in the performance of his duties, to respect the ethical principles and rules of professional conduct provided in the Act, the *Regulation respecting the ethics and professional conduct of public office holders* (Order-in-Council 824-98 of June 17, 1998 as amended) as appropriate, and those defined in this Code. In case of discrepancy, the more demanding rules and principles apply.

In case of doubt, act according to the spirit of these principles and rules.

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

4. The director or executive shall not merge the assets of the Corporation with his own; he may not use the assets of the Corporation 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 or executive has ceased to hold his position.

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

5.1 The director or executive 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 or executive shall make decisions without regard for any partisan political considerations.

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

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

6.2 The director or executive 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 or executive may not, in the performance of his duties, deal with a person who has ceased to be a director or executive of the Corporation 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 Corporation is a party and about which he has information not available to the public.

7.2 After ceasing his duties, no director or executive may disclose confidential information he has obtained or give anyone advice based on information not available to the public concerning the Corporation 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 Corporation is a party and about which he has information not available to the public.

8. The director or executive 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 A director or executive who intends to be a candidate for elected 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 Executive Committee.

PART III
Duties and obligations of directors and executives with respect to conflicts of interest

Prevention of conflicts of interest

9. The director or executive 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 Corporation 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 Corporation, 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 Corporation.

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 or executive of the Corporation who serves as director or executive 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 he works full-time for the enterprise and the profit-sharing program is closely linked with the individual performance of the director or executive 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 or executive who:

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

b) has a direct or indirect interest in an enterprise that is a party to a contract with the Corporation or a subsidiary or is a director, executive 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 information of any kind to any employee, executive or director of the Corporation 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.

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 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;

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

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

15. The director or executive 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 Corporation, 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 or executive.

17. The director or executive shall notify the Chairman of the Board in writing of the rights he may invoke against the Corporation, 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 or executive 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 A and containing the following information:

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

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

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

A director or executive 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 or executive 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 Corporation, who keeps them at the disposal of the members of the Board and the Ethics and Corporate Governance Committee.

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

Waivers

20. This Code does not apply:

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

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

c) to owning interests through a blind trust whose beneficiary cannot know its make-up;

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

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

f) to a directors' liability insurance agreement; or

g) to the owning of shares issued or guaranteed by the Corporation, 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 shall submit to the Chairman of the Board and the Secretary of the Corporation the attestation appearing in Schedule B.

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

PART IV
Remuneration

20.2 The director or executive, 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 Corporation.

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

20.4 A director or executive 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 or executive 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 or executive 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 or executive is not covered by sections 20.2 to 20.6.

20.8 For the application of sections 20.2 to 20.6, "public sector" means the bodies, institutions and corporations referred to in Schedule C.

The period covered by the severance allowance or payment referred to in subsections 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 a salary in his former 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 Corporation appointed by the Government.

The Chairman of the Board is the competent authority with respect to other directors or executives of the Corporation.

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

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 or executive 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 or executive 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 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 or executive who is accused of violations of ethics or the rules of professional conduct.

24. The Secretary of the Corporation 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 and executives 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 or executive 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 or executive 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 respecting the ethics and professional conduct of public office holders* or this Code has been violated, the competent authority may impose either of the following penalties:

a) for an executive, 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 Executive Committee. 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 Executive Committee 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 or executive shall render an account and restore to the Corporation any profits earned or benefits received as a result of or on the occasion of a violation of the provisions of this Code.

31. A director's vote shall not be a casting vote if it is made in violation of the provisions of this Code or associated with such a violation, or if the director fails to produce the attestation contemplated by section 18.

The schedules may be consulted on Hydro-Québec's Web site (www.hydroquebec.com).

Hydroelectric	Installed capacity (kW)		Installed capacity (kW)		Installed capacity (kW)
Robert-Bourassa	5,328,000	Brisay	446,500	Rapides-des-Quinze	94,560
La Grande-4	2,650,500	Laforge-2	304,000	Chute-des-Chats	89,300
La Grande-3	2,304,000	Trenche	302,400	Bryson	61,000
La Grande-2-A	1,998,000	Beaumont	243,000	Hart-Jaune	48,450
Beauharnois	1,652,380	La Tuque	219,600	Rivière-des-Prairies	48,300
Manic-5	1,421,600	Shawinigan-2	202,601	Rapide-2	48,000
La Grande-1	1,368,000	Paugan	201,975	Rapide-7	48,000
Manic-3	1,183,200	Rapide-Blanc	201,600	Chute-Hemmings	28,800
Bersimis-1	1,054,503	Shawinigan-3	183,600	Hull-2	27,280
Manic-5-PA	1,010,800	Manic-1	172,170	Lac-Robertson	23,760
Manic-2	882,720	Chelsea	150,700	Sept-Chutes	21,600
Laforge-1	837,900	Grand-Mère	149,575	Drummondville	16,200
Bersimis-2	798,000	Rapides-des-Îles	146,520	Saint-Narcisse	15,000
Outardes-3	699,200	Les Cèdres	144,000	Chute-Bell	9,900
Carillon	654,500	La Gabelle	136,580	Mitis-1	6,400
Outardes-4	588,800	Première-Chute	124,200	Mitis-2	4,250
Outardes-2	453,900	Rapides-Farmers	98,250	Chute-Burroughs	1,600

Thermal	Installed capacity (kW)		Installed capacity (kW)		Installed capacity (kW)
Nuclear		La Romaine	4,934	Kangiqsujuaq	1,520
Gentilly-2	675,000	Obedjiwan	4,900	L'Île-d'Entrée	1,190
Oil		Blanc-Sablon*	4,800	Quaqtaq	1,085
Tracy	600,000	Kuujjuaq	3,935	Ivujivik	1,050
Gas-turbine		Kuujjuarapik	3,405	Kangirsuk	1,050
Bécancour	428,200	Inukjuak	2,990	Umiujaq	1,050
La Citière	280,000	Povungnituk	2,870	Akulivik	850
Cadillac	162,000	Port-Menier	2,790	Tasiujaq	850
Diesel		Weymontachie	2,220	Aupaluk	550
Îles-de-la-Madeleine	67,200	Salluit	2,000	Clova	530
La Tabatière*	6,800	Kangiqsualujjuaq	2,000	Saint-Augustin*	400

Wind farms	Installed capacity (kW)
Saint-Ulric	2,250

Total installed capacity at December 31, 2001**	(kW)
Hydroelectric generating stations (51)	28,905,674
Thermal generating stations (29)	2,266,169
Wind farm (1)	2,250
Total	**31,174,093**

Under construction	Capacity (kW)
Sainte-Marguerite-3 (hydro)	882,000
Toulnustouc (hydro)	526,000

* Kept in reserve since the commissioning of Lac-Robertson generating station.
** Hydro-Québec also has access to most of the output from Churchill Falls power plant, which has a rated capacity of 5,428 MW, and to all the output from 133 turbines (each rated 100 MW) at Matane and Cap-Chat wind farms.

HUDSON BAY
QUÉBEC
JAMES BAY
La Grande-2-A
Robert-Bourassa
La Grande-1
La Grande-3
La Grande-4
Laforge-2
Brisay
Laforge-1
Sainte-Marguerite-3
To Churchill Falls G.S.
(interconnection)
Manic-5-PA
Manic-5
Toulnustouc
Manic-3
Outardes-4
Outardes-3
Manic-2
ST. LAWRENCE
RIVER
Bersimis-1
Bersimis-2
Outardes-2
Trenche
Gentilly-2
Bécancour
Tracy
Carillon
Beauharnois
ONTARIO
LAKE ONTARIO
NEW YORK
UNITED STATES
VERMONT
NEW
HAMPSHIRE
MAINE
ATLANTIC OCEAN
NEW
BRUNSWICK
PRINCE
EDWARD
ISLAND
NOVA
SCOTIA
Generating station rated 300 MW or more
Generating station rated 300 MW
or more under construction
735-kV substation
735-kV line
± 450-kV direct-current line
Interconnection with neighboring system
Neighboring system

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Hydro-Québec International (HQI) is responsible for investment and the sale of professional services outside Canada and the U.S. Since HQI has entrusted Hydro-Québec with the management of its operations, each Hydro-Québec business unit is responsible for foreign operations in its spheres of competence.

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Hydro-Québec CapiTech is a corporate venture capital company that invests in companies selling energy-related technologies and services.

75 René-Lévesque Blvd. West
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Montréal, Québec H2Z 1A4
CANADA
Telephone: (514) 289-4783

Société d'énergie de la Baie James chiefly provides world-class services in engineering and in carrying out construction projects in the energy industry, both locally and internationally.

855 Sainte-Catherine Street East
20th floor
Montréal, Québec H2L 4P5
CANADA
Telephone: (514) 840-4228

HQ Energy Marketing conducts energy transactions including sales, purchases and exchanges in Canada as well as in the U.S. through H.Q. Energy Services (U.S.).

75 René-Lévesque Blvd. West
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Montréal, Québec H2Z 1A4
CANADA
Telephone: (514) 289-4304

Noverco, a holding company in which Hydro-Québec has a stake, controls a large number of companies involved primarily in the transmission and distribution of natural gas.

75 René-Lévesque Blvd. West
8th floor
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The following publications can be downloaded from our Web site **(www.hydroquebec.com)** or ordered at **1 800 363-7443**.

Strategic Plan 2002–2006
Annual Report 2001 (this document)
Environmental and Social Report 2001
Financial Profile 2001–2002

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)
GWh	gigawatthour (one million kilowatthours)
TWh	terawatthour (one billion kilowatthours)

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