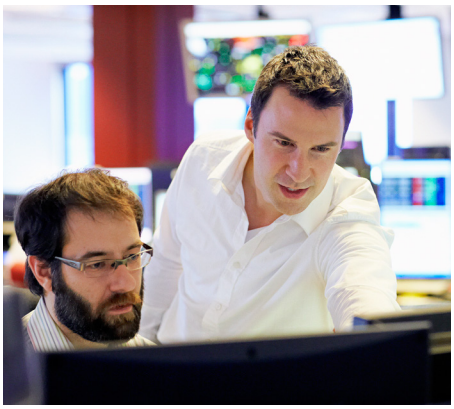
## Annual Report 2015

# Setting new sights with our clean energy



Hydro Québec | WORKING BETTER every day

# Our mission

We deliver reliable electric power and high-quality services. By developing hydraulic resources, we make a strong contribution to collective wealth and play a central role in the emergence of a low-carbon economy. As recognized leaders in hydropower and large transmission systems, we export clean, renewable power and commercialize our expertise and innovations on world markets.

1 Our key figures

2 Message from the Chairman of the Board

3 Message from the President and Chief Executive Officer

4 Our management team

**Review of Operations**

6 Our customers

12 Our achievements

18 Our employees

20 Our innovations

24 Our support for communities

**Financial Review**

25 Management's Discussion and Analysis

49 Consolidated Financial Statements

85 Five-Year Review

88 Consolidated Results by Quarter

**Corporate Administration**

90 Board of Directors

92 Activity Report of the Board of Directors and Board Committees

95 Governance

100 Our facilities

A GREEN RESOURCE

OVER 99%

of the power generated by Hydro-Québec is from renewables

GENERATING CAPACITY

36,912 MW

from 87 generating stations operated by Hydro-Québec

NET INCOME

$3,147M

in 2015

A CONTRIBUTION TO QUÉBEC'S FINANCES

$2,360M

dividend to be paid to the Québec government for 2015

A SOLID WORKFORCE

19,794

permanent and temporary employees

ELECTRICITY SALES

201.1 TWh

including 29.9 TWh in exports

RESIDENTIAL RATE

7.19¢/kWh

the lowest in North America

PURCHASES OF GOODS AND SERVICES

$2,827M

in Québec in 2015

# Message from the Chairman of the Board

**Michael D. Penner**
Chairman of the Board

## For Hydro-Québec, 2015 was marked by two highlights: the company's continued excellent financial health, and the departure of the man who served as its President and Chief Executive Officer for 10 years.

First of all, Hydro-Québec maintained a high level of profitability, with net income of $3.1 billion. Both Management and employees are to be congratulated for their engagement and their ability to produce results.

This solid performance is a striking illustration of the important role played by Hydro-Québec: not only does it provide clean, renewable power, but it is also a key actor and a true model of success held in high esteem by all Quebecers.

The year's achievements are all the more remarkable considering that Thierry Vandal, appointed President and Chief Executive Officer in April 2005, left the company last May after serving in that capacity for a decade—a period during which the company's profitability rose to unprecedented heights. I want to stress the rigor with which he managed the company and thank him for 10 years of loyal service. We will always remember his time at the helm of Canada's largest power company.

The Board of Directors designated Lise Croteau, Executive Vice President and Chief Financial Officer, to head the company on an interim basis until a new President and Chief Executive Officer could be appointed. As the first female top executive of Hydro-Québec, Ms. Croteau demonstrated excellent management skills during the two months in which she filled that position.

After Mr. Vandal's departure, the Board was anxious to find a high-calibre replacement. For this reason, it entrusted an external firm with a mandate to identify candidates for the position. The applications of high-level candidates from the U.S., Canada and Europe were studied attentively. Following a rigorous evaluation, we chose Éric Martel, whose impressive track record convinced the Board that he was the right person for the job.

The winds of change swept across the Board as well, with the arrival of five new members and the achievement of near-parity in terms of the number of women. To ensure ongoing improvement of its governance, the Board reorganized its committees, in particular by appointing new chairs and adding a new committee, namely Information Technologies.

During the year, the Board members participated in numerous meetings with Management as part of the work on the *Strategic Plan 2016–2020*, contributing significantly to a rethinking of the company's strategies.

With a view to constantly improving the ways in which it exercises its role, the Board organized training for the directors, who received some 20 hours of instruction on corporate governance from the Collège des administrateurs de sociétés. They also toured the Institut de recherche d'Hydro-Québec and the facilities of joint venture Technologies Esstalion.

In short, 2015 was a very interesting year—even exceptional in some respects—for Hydro-Québec. It marked the beginning of a new era under the leadership of Éric Martel, who will steer its destiny over the coming years.

# Message from the President and Chief Executive Officer

**Our electricity—more than 99% of which is produced from a clean, renewable source—gives us an undeniable business advantage on the North American energy market. Our vast expertise in power generation, transmission and distribution is also a major asset for our future expansion, not to mention our great innovation capability, which is already making Hydro-Québec a leading player in the field of ground transportation electrification.**

As we begin 2016, we have laid out a game plan built on four main priorities: improve customer service with a view to being one of the best within a few years; boost our productivity by banking on our employees' flexibility and creativity; ensure our long-term growth through clean-energy exports, strategic acquisitions and innovations that create value; and communicate better, and proactively, to make our achievements and successes more widely known.

It is imperative that Hydro-Québec, through its actions, regain its place as a source of pride for all Quebecers. That is the goal I have worked toward since I joined the company last July. But it is clear that we can do better yet, and we will devote all our efforts to this endeavor in the years ahead.

The company maintained a high level of profitability in 2015, with net income of $3.1 billion. This will allow us to pay the Québec government a dividend of $2.4 billion, a noteworthy contribution benefiting the entire community.

In 2015, our purchases of goods and services in Québec totaled $2.8 billion. This contribution to the province's economy will be maintained in 2016 with activities such as the ongoing work to complete the Romaine complex and construction of the Chamouchouane–Bout-de-l'Île project, which on its own represents a $1.1-billion investment.

A further highlight of 2015 was the groundwork carried out on our *Strategic Plan 2016–2020*, to be released shortly. In undertaking this process of deliberation that is of capital importance for the time ahead, we outlined the main thrusts of our future growth, which are destined to be subjects of collective pride in the coming years.

Our employees are central to our actions and our success. Through their efforts, we have accomplished great things in the past, and we will accomplish even greater things in the future. We thank them all for their engagement and for the success they have made possible. You are our company's pride!

We are excited to embark on a new era, one that will lead Hydro-Québec toward new horizons while it continues to play the role it has fulfilled since it was first established in 1944.

Lastly, we are grateful to the members of the Board of Directors for their highly constructive participation in the Board's work, particularly in discussions surrounding the approval of numerous capital projects in power generation, transmission and distribution.

To meet the challenges ahead and drive the economy as it always has, the company must, more than ever, set new sights with our clean energy.

**Éric Martel**
President and Chief Executive Officer

NET INCOME OF
**$3,147M**
IN 2015.

WE WILL PAY
A DIVIDEND OF
**$2,360M**
TO THE QUÉBEC
GOVERNMENT FOR 2015.

# Our management team

Éric Martel,
President and Chief Executive Officer

Daniel Richard,
President, Hydro-Québec Distribution

Richard Cacchione,
President, Hydro-Québec Production

André Boulanger,
President, Hydro-Québec TransÉnergie

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

Bruno Gingras,
Vice President – Human Resources

Élie Saheb,
Executive Vice President – Corporate Development, Strategic Planning and Innovation

Pierre-Luc Desgagné,
Vice President – Corporate Affairs and Secretary General

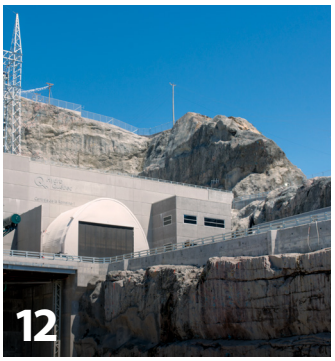
Lise Croteau,
Executive Vice President and Chief Financial Officer

Jean-Hugues Lafleur,
Vice President – Financing, Treasury and Pension Fund

David Murray,
Vice President – Information and Communication Technologies

# Review of Operations

Our customers




Our achievements

Our employees

Our innovations

Centraide
Nous tous, ici
24

Our support for communities

1

2

3

**1** // Doing live-line work in residential areas means we don't have to interrupt service to local customers. **2** // More flexible work schedules for our customer service representatives enables them to respond to a greater volume of requests during peak times in the morning and late afternoon. **3** // A line worker replaces an insulator on a pole in a wooded area.

## Ensuring customer satisfaction is a daily challenge, and everything we do must be guided by our willingness to take up this challenge. To offer quality services, we rely mainly on continuous improvement of our basic service and the development of new offerings.

**Basic service** // We are resolutely committed to improving our basic service. That is why we recently introduced a number of measures to deploy our field crews more effectively.

The massive rollout of the advanced metering infrastructure (AMI), which began in 2013, was completed three years ahead of schedule. Close to 3.7 million next-generation meters are now in operation. The new technology detects outages in real time, enabling us to quickly determine their extent and the number of customers affected. Field crews are sent to the right place to restore service as soon as possible.

Setting up the distribution management centre has helped improve planning of both routine operations and emergency repair work. With our new integrated platform for field data from the distribution system, including the AMI, the centre can continuously monitor the system as well as schedule and track any necessary action. By monitoring weather forecasts and analyzing imminent weather threats, the distribution management centre is able to anticipate the need to send out repair crews. It also allows for dynamic planning and control, which help reduce postponements of planned outages.

The MILE system (intelligent power line maintenance), gradually being rolled out throughout the distribution system, monitors line conditions in real time. It can determine the precise location of several types of electrical faults along with the most appropriate repairs. The information provided by MILE helps our engineers and technicians respond to customer complaints, optimize grid protection and diagnose faults causing recurrent outages. For instance, detection of an electrical fault resulting from a tree touching a power line will trigger the scheduling of vegetation control operations.

IN 2016, WE ARE AIMING AT WAIT TIMES OF 210 SECONDS OR LESS FOR

**80%**

OF CUSTOMER SERVICE CALLS.

**Service continuity** // To ensure the reliability of our service, we are taking action on several fronts.

With a view to improving grid performance, we are examining switching technologies that would enable us to automatically restore service to parts of the system and thus shorten power outages.

Another one of our improvement strategies involves targeted work on equipment. For example, replacing insulators in the Matapédia region will reduce the number of faults on the local distribution system and improve service quality.

Various system architecture improvements and buffer zone optimization projects will reduce the impact of outages. One of the projects involves using insulated conductors to prevent power failures caused by contact with trees.

In fact, the impact of vegetation on service continuity is one of our biggest challenges. We have launched a special tree felling and brush clearing project to reduce the number of trees coming into contact with conductors in bad weather. This is on top of our periodic clearing and felling operations.

Although we take many steps to improve system reliability, outside factors such as weather have a direct impact on the service provided to customers.

Rapid responses to outages are an essential component of customer service. The number of incidents varies from year to year, depending on unforeseeable factors such as equipment failure and weather events. Since we launched the Power Outages Web page and mobile app, customers have been able to monitor service interruptions. They can find out the area affected by an outage, the cause, the time it occurred, the progress of repairs and when power is expected to be restored.

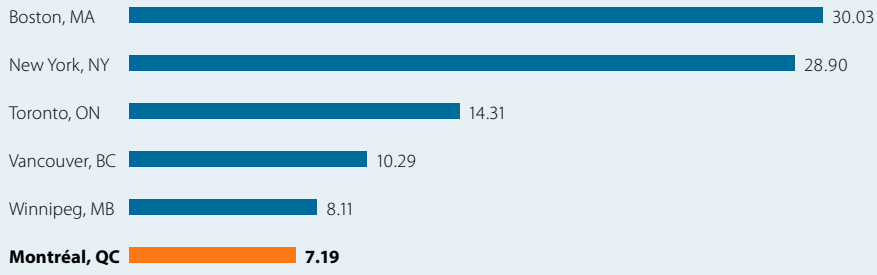
**Self-service** // Improved customer communication involves implementing telephone and Web self-service, including mobile apps, which will simplify access to our services and enable customers to manage their accounts and track their requests themselves.

Since April 2015, enhancements to our self-service features have enabled more customers to report changes of address on the Web, as well as through our interactive voice response telephone system.

In 2015, we designed a self-service system enabling customers to create and track requests for service connections and other work. Customers will be able to track their requests in their Customer Space and receive automated messages. We plan to start promoting this service in March 2016.

### LOWEST RATES IN NORTH AMERICA

Since 2009, Hydro-Québec rates for residential customers have been the lowest in North America. As at April 1, 2015, a Québec customer with a monthly consumption of 1,000 kWh paid 7.19¢/kWh. By way of comparison, residential customers in Toronto paid almost twice that, or 14.31¢/kWh. What's more, in accordance with our commitment, the rate increase requested for 2016–2017 is in line with inflation.



*WE NEED TO WORK BETTER AND BECOME LEADERS IN CUSTOMER SERVICE. EVERY DAY, WE STRIVE TO BE BETTER THAN WE WERE THE DAY BEFORE.*

## Our 2015 performance barometer

GENERAL SATISFACTION INDEX (%)

**82**

### SATISFACTION

The proportion of customers who said they were "very satisfied" or "quite satisfied" with Hydro-Québec was 82% in 2015—five points less than in 2014. This figure rose to 85% in the fourth quarter.

NUMBER OF COMPLAINTS

**5,762**

### COMPLAINTS

The number of complaints recorded this year, a total of 5,762 verbal or written, was about the same as in 2014. Better work organization and the rollout of a quality assurance process during the year enabled us to follow up on them more quickly.

AVERAGE CALL WAIT TIME (SECONDS) – RESIDENTIAL CUSTOMERS

**205**

### CALL WAIT TIME

In 2015, call wait time was slightly longer, due primarily to the large number of calls associated with the rollout of next-generation meters and the impact of a harsh winter on electricity bills.

PLANNED OUTAGES CARRIED OUT AS SCHEDULED (%)

**83**

### PLANNED OUTAGES

When we work on the distribution system, we sometimes have to interrupt service for reasons of public and worker safety. Many factors are taken into consideration, including the type of work, technical constraints, time needed, safety and the type of customers affected.

SYSTEM AVERAGE INTERRUPTION DURATION INDEX – UNADJUSTED (MINUTES)

**213**

### SERVICE CONTINUITY

At December 31, 2015, the unadjusted System Average Interruption Duration Index was 213 minutes, an excellent showing and well below the average for the past five years (316 minutes).

### OUR CUSTOMERS' RIGHT MOVES

When consumers become energy wise, they change their habits and make the right moves—ones that will benefit the entire community. Choosing energy-efficient appliances and electronics and taking steps to save electricity are among the moves they can make. That is why we launched the *Right Moves* campaign for residential customers in 2015. Readers are invited to watch our video clips at right-moves.hydroquebec.com/en/webseries. The campaign proposes a series of simple ways to be energy wise and save electricity without sacrificing comfort.

Thanks to the Confirm Payment feature, added in June, customers with next-generation meters whose service has been disconnected can confirm their payment and have their power reconnected rapidly.

With the Payment Arrangement feature, also available since June 2015, customers can easily make a payment arrangement for an overdue balance before their next bill is calculated.

We will be promoting the various self-service options more heavily, which should reduce the number of customer calls.

**Complaints management //** The effective handling of complaints is one of the many challenges a public utility like Hydro-Québec grapples with. A quick, appropriate response is always expected.

Although there were more complaints about the rollout of the advanced metering infrastructure (AMI), other types of complaints declined. This improvement is largely attributable to sustained communications efforts throughout the year, focusing on the chief sources of customer dissatisfaction.

For instance, we explained to customers—in particular those who were on the Equalized Payments Plan and had used more power than in the past—how their electricity bill had been impacted by the prolonged cold spells of winter 2014–2015. Information videos produced last winter for customer service representatives helped them better explain why electricity use was up over previous years.

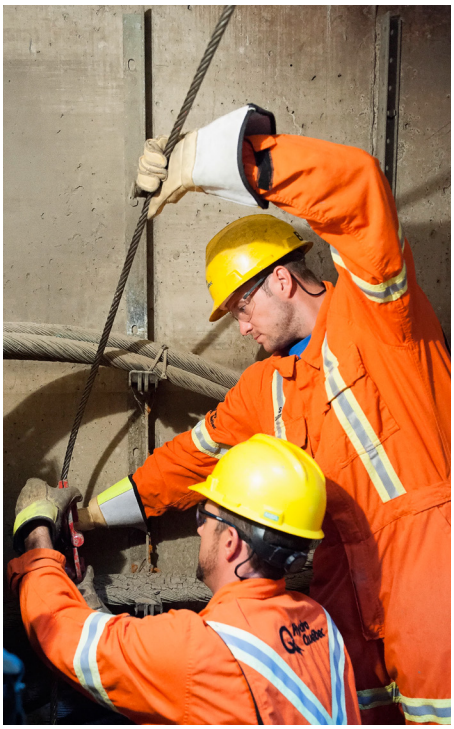
**Call wait time //** Call wait time is a key factor in the quality of services to residential and business customers.

We have set a precise target: reduce wait times for 80% of calls to 210 seconds or less, except for calls regarding collections.

**Planned outages //** Hydro-Québec gives advance notice to all customers who would be affected by a scheduled service interruption, so they can take steps to limit its impact on their activities. Since April 1, 2015, customers whose business would suffer too much have had the option, in some cases, of paying a flat fee to have the work done outside regular hours.

**Low-income households //** Low-income households spend a large part of their budget on their electricity bill. It is essential that we work with consumer associations to help such households find ways of lightening their burden. We offer a number of solutions, including installments based on ability to pay. Some 95,000 payment arrangements were made with low-income customers in 2015, a comparable number to the year before.

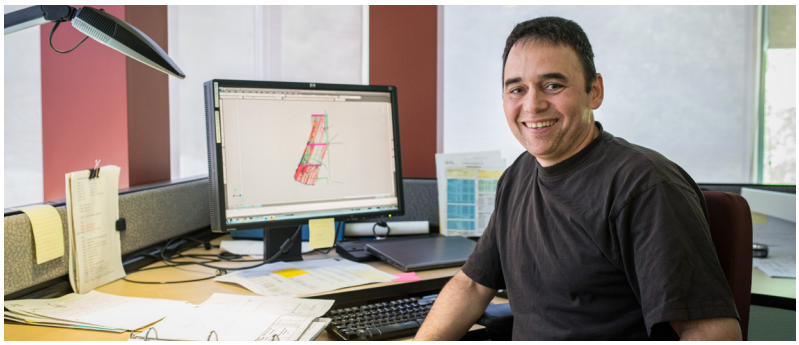
We have designed several energy efficiency programs for owners and managers of multiunit residential buildings, including programs involving windows and insulation, intended to help low-income customers save electricity. We also offer these customers energy-efficient products such as LED bulbs. Moreover, until December 31, 2015, they could receive financial assistance for replacing old refrigerators.



An experienced cable worker (right) coaches an apprentice.

## MORE FLEXIBLE WORK ORGANIZATION

In 2015, an innovative pilot project allowed customer service representatives and collection staff to work from home. The project confirmed that employees, the company and customers alike benefit from this telecommuting arrangement. In particular, the customer experience is improved through increased efficiency, greater flexibility in employee work schedules and better access to customer service during widespread outages.



*WE NEED TO IMPROVE TELEPHONE WAIT TIMES AND SERVE CUSTOMERS MORE RAPIDLY.*

More than 25,000 new customers were connected to the distribution system in 2015.

**Energy efficiency //** Thanks to efforts made since 2003 under the Energy Efficiency Plan, cumulative energy savings have reached 8.8 TWh—equivalent to the energy consumption of 500,000 households, and 10% more than the initial target set by the Québec government.

In 2015, we put the accent on raising customer awarness about the individual and collective benefits of changing certain habits. The *Right Moves* campaign offers tips to help customers be environmentally responsible and choose energy-efficient products. Making the right moves will help lower electricity bills and reduce the impact of energy use on the environment, which benefits the entire community and future generations.

We continued to promote energy-efficient products and equipment such as lighting, windows and patio doors, and heating, ventilation and air-conditioning systems, as well as water-saving products and equipment for efficient homes and swimming pools.

As part of our energy management service offering for industrial customers, we have increased the amount of financial assistance and technical support available at different stages of projects to implement ISO 50001 tools and practices. We are aiming for continuous improvement of the energy efficiency of industrial electrical equipment, which will help make our industrial customers more competitive.

Our program focusing on business customers' buildings has a new integrated-design component. Financial assistance now covers some of the differential costs of professional services, namely those of architects, architectural technicians, building engineers and energy simulation specialists.

In addition, our participation in the development of codes and standards helps improve the efficiency of equipment and systems. All these efforts contribute to market transformation.

### A MAJOR CONCERN

There is never a good time for a planned outage, but we always try to keep the interruption as short as we can and to affect as few customers as possible. Although such outages are inconvenient, they play a large part in reducing the number and frequency of power failures by allowing us to perform preventive maintenance and repairs. Keeping to the schedule for planned interruptions is an important aspect of our customer service.

**Peak power demand //** During the winter peak period, Hydro-Québec has to be able to count on all available capacity to meet customer demand, which is especially high on certain days or at certain times of day. In 2015, measures were taken to reach the capacity level that will be required in years to come.

After a public call for tenders, we entered into three 20-year agreements that will allow us to purchase 500 MW of firm capacity starting in winter 2018–2019.

We have also undertaken new demand response initiatives. In winter 2014–2015, we ran a pilot project that involved curtailing power to water heaters for short intervals during winter peak periods. The project confirmed that our residential customers suffered no loss of comfort as a result. Other aspects of this project will be studied in 2016 with a view to offering all residential customers the opportunity to take part in the new voluntary load curtailment program.

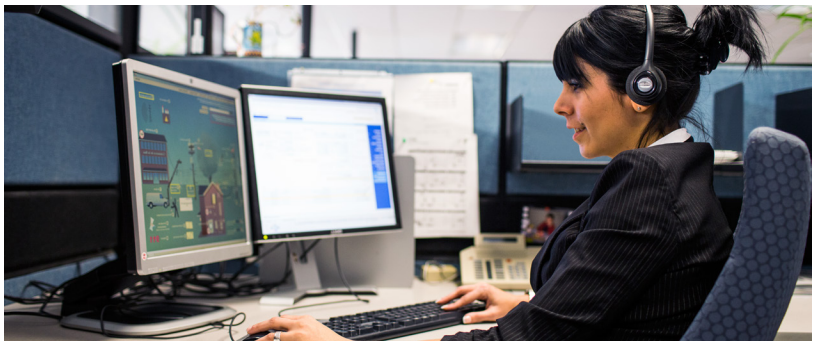
In addition, we are conducting a pilot project to encourage commercial and institutional customers to reduce their power demand in peak periods. At December 31, 2015, some 50 customers had agreed to participate, and we expect capacity needs to drop by 30 MW in winter 2015–2016 as a result. In the wake of this project's success, we will be introducing a new offering next year to commercial and institutional customers as well as to small- and medium-power industrial customers.

**Seasonal capacity exchange //** In May 2015, our subsidiary Marketing d'énergie HQ and the Independent Electricity System Operator of Ontario—which acts as the central hub of the Ontario power grid, operating the system in real time and ensuring sufficient supply to meet the province's energy needs—entered into an agreement for capacity exchanges through one of our interties in the Outaouais region. Under the agreement, Hydro-Québec will have access to additional capacity in winter, and Ontario will have access to the same quantities in summer. By leveraging the complementarity of the two provinces' needs, we can avoid building more generating stations to meet seasonal peaks in demand.

In 2015, 675 km of line were added to the distribution system, bringing the total to 116,258 km.

## MORE RESOURCES

We extended the contracts of more than 200 temporary customer service representatives who had been hired for the summer. They will stay on the job in 2016, and the strategy adopted during the year will determine whether they stay or leave after that. In addition, thanks to more flexible work schedules, our representatives are now able to handle a higher volume of requests during the morning and late afternoon peak hours.



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**1** // Romaine-1 generating station has been on stream since the end of 2015. **2** // Employees at work in the new Bélanger substation in Montréal's east end. **3** // Construction of the 315-kV line connecting Romaine-1 and Romaine-2 substations was completed in 2015.

We invested $940 million in construction of the Romaine complex in 2015. Work at the Romaine jobsites totaled 1,444 person-years, with Côte-Nord and Innu workers making up 43% of the labor force. Contracts awarded in the region amounted to $44 million. In addition, we invested $1,587 million in our transmission grid and $756 million in our distribution facilities throughout Québec.

**Substantial spinoffs //** For a fourth consecutive year, more than 1,000 workers were on the job at the Romaine hydroelectric complex during the peak of construction. Since the start of construction, the proportion of Côte-Nord workers has averaged about 45%. To date, work on the Romaine project has generated contracts worth over $3 billion, including nearly $800 million awarded to companies in the region.

**Work at the Romaine complex //** Romaine-1 generating station (270 MW), completed eight months ahead of schedule, has been producing electricity since November 2015. This is good news since, in Québec, consumption peaks in winter because 80% of homes are heated with electricity. Romaine-2 (640 MW), for its part, was commissioned in 2014.

The 28-km line connecting Romaine-1 to Romaine-2 is finished and the 315-kV section of Romaine-1 substation has been energized.

At the Romaine-3 site (395 MW), several milestones were reached during the year, including excavation of the generating station and headrace structures. The outer shell of the generating station was completed in mid-December, meaning that work crews are now protected from the elements. Concreting is under way on the generating station and intake, and will be completed in 2016. Fabrication of the generating units made steady progress and the first parts have been delivered to the site. At the same time, work is proceeding on the dam with a view to bringing the generating facility on stream in 2017.

OUR PURCHASES OF GOODS AND SERVICES IN QUÉBEC TOTALED

**$2,827M**

IN 2015.

We completed geological and geotechnical investigations at the Romaine-4 site (245 MW) in order to determine an exact location for each structure. We also started the detailed engineering.

**New 735-kV line //** The Chamouchouane–Bout-de-l'Île project calls for the construction of a 735-kV line extending more than 400 km from Chamouchouane substation, in the Lac-Saint-Jean region, to the future Judith-Jasmin substation, in Lanaudière. It also includes relocating a short segment of an existing 735-kV line so that it will end at Bout-de-l'Île substation, in Montréal. Clearing began on the line right-of-way in fall 2015.

This new 735-kV line will boost transmission capacity to load centres, which are concentrated in southern Québec, and will reinforce supply to the Montréal region. It will reduce transmission losses and increase operating flexibility for the main 735-kV system.

The line route has undergone a number of changes in response to the main concerns expressed by the community. The line will run within an existing right-of-way over more than a third of its route, including the most urbanized areas.

**Modified line next to the Pont Champlain //** To facilitate construction of the new Pont Champlain, we relocated a 1.9-km section of the 315-kV Hertel–Viger line. The completion date was moved up to summer 2015 at the request of Infrastructure Canada. Our crews went to considerable effort to carry out the work in record time, all while maintaining supply to downtown Montréal and limiting disruptions to bridge traffic. Altogether, six towers were dismantled and eight were built, including four double tubular towers. One of the new structures is the highest tubular tower in Québec.

### ACCELERATED ASSEMBLY

Construction of Romaine-1 generating station produced a first: a generating unit was assembled in less than 12 months, compared with the usual 14 to 16 months. This performance is the direct result of the strategies adopted by our work crews. For example, some of the parts were pre-assembled in the factory. In addition, the stator and rotor were assembled simultaneously in the service bay while the turbine pit was being concreted, and an additional overhead crane was installed to speed up the work. This crane will be dismantled for reuse at the Romaine-3 and Romaine-4 jobsites.

*WE'RE VERY WELL POSITIONED TO GROW OUR SALES ON WHOLESALE MARKETS IN EASTERN NORTH AMERICA.*

## A SOURCE OF CLEAN, RENEWABLE ENERGY

**We have access to a source of clean, renewable energy available in large quantities in Québec: water. Neighboring markets do not have this advantage and often have to resort to fossil fuels—natural gas, coal and oil—to generate their electricity.**

A number of initiatives to reduce GHG emissions are under way in neighboring markets. In 2015, three New England states issued a request for proposals (RFP) for clean energy and transmission. This is indicative of a change in perception in northeastern North America, where there is increasing recognition that our power is reliable and produces lower GHG emissions than most other sources.

Hydro-Québec already supplies 10% of the electricity consumed in New England, which has been one of our largest export markets for nearly 40 years. New England has the highest electricity prices of all the markets we serve outside Québec. This region is also seeking more clean energy on the wholesale market. Increasing our export capacity to this market will enable us to create value from our output.

We therefore worked closely with Eversource Energy, a major New England electricity distributor, to respond to the RFP. Our two organizations are collaborating on the Northern Pass Transmission line, which would link Des Cantons substation, in Estrie, to a substation in southern New Hampshire.

### 50TH ANNIVERSARY OF AN IMPORTANT WORLD FIRST

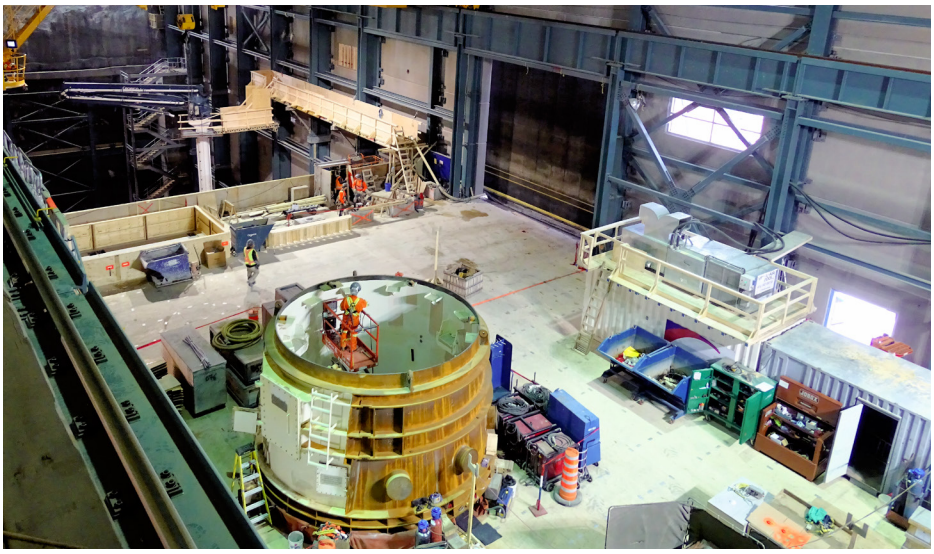
This year marks the 50th anniversary of an important world first that pushed back the limits of power transmission: the first ever 735-kV line was commissioned, linking the Manic-Outardes complex to the metropolitan areas of Québec and Montréal. Through the inventiveness of Jean-Jacques Archambault—a young engineer at Hydro-Québec—and his collaborators, it became possible to transmit more electricity over greater distances. This innovation would be instrumental in the hydroelectric development of the Baie-James region several years later and the construction of a generating fleet that uses a clean, renewable source to produce more than 99% of its output. The fact that Quebecers currently enjoy the lowest residential rates in North America can be credited to these advances. The adventure continues with the soon-to-be-completed 735-kV Chamouchouane–Bout-de-l'Île project. The new line, over 400 km long, will be an advantageous substitute for the original plan for bringing in power from the Romaine complex, which consisted in reinforcing the southern part of the grid.

**Rebuilding of De Lorimier substation //** To meet growing demand and ensure the long-term operability of facilities in the eastern part of downtown Montréal, we are rebuilding De Lorimier substation on the site of the existing substation. Two underground 315-kV lines to Viger substation, each approximately 7 km long, will also be built. Because of the limited space available and the surrounding built environment, the substation was designed with four storeys, two of them underground.

**Nord-du-Québec //** Waswanipi substation, commissioned in November 2015, is able to meet increased demand in and around the Cree community of Waswanipi. At the peak of construction, Cree workers accounted for 22% of the labor force on this project. North of the 55th parallel, construction of Akulivik thermal generating station was also completed. Electricity demand has been growing steadily in Akulivik in recent years, and the new 2,019-kW facility will meet the increasing needs of this Inuit community.

**Montréal region //** We continued work to meet demand growth and maintain service quality in northeastern metropolitan Montréal. Specifically, the 315-kV Mauricie–Lanaudière line and the 120-kV Pierre-Le Gardeur–Saint-Sulpice line were commissioned in order to meet increased demand and maintain system reliability in the Lanaudière region.

**Achievements throughout Québec //** Steps to reinforce the grid were taken in the Capitale-Nationale region (Duchesnay substation) and in Abitibi-Témiscamingue (Figuery substation). Farther north, in Baie-James, we replaced a static var compensator at Albanel substation to ensure long-term operability of our voltage control equipment.



Construction of the service bay at Romaine-3.

**Wind farm connection //** The output of several wind farms, including Frampton in Chaudière-Appalaches and Témiscouata II in Bas-Saint-Laurent, was brought onto the grid during the year. The lines required for these connections range from 0.2 to 5.0 km in length. In addition, we will soon be building a 230-kV tie line for Mesgi'g Ugju's'n (Rivière-Nouvelle) wind farm, in Gaspésie.

**Generating fleet sustainment and optimization //** Our hydroelectric facilities are designed to continue producing for decades, or even more than a century in some cases. This means they will be able to supply clean energy for future generations.

Hydro-Québec makes significant investments to ensure the long-term operability of its facilities and optimize their performance. Specialized teams are continually evaluating facility condition and performance in order to determine the type and urgency of work that may be required. In 2015, nearly $300 million was allocated to refurbishment and refitting, including major projects at Beauharnois, Rapides-des-Quinze, Les Cèdres, Rapide-2 and Rapide-7 generating stations.

When we rehabilitate hydroelectric facilities, we increase their installed capacity or efficiency whenever possible. For example, at the 2014–2015 winter peak, some 36 MW of additional capacity was supplied by new turbines installed in 2014 at Rapide-2, Rapide-7 and Jean-Lesage generating stations.

**Transmission asset management //** The load on our transmission grid continues to grow, and some assets are reaching the end of their useful lives. Maintaining system reliability and operability over the short and long term is an increasingly complex operation.

## OUR PROCUREMENT OF GOODS AND SERVICES

With several large projects planned for the coming years, we will need twice as much tower steel as in recent years. In 2015, we issued two calls for proposals totaling $65 million. As a result, three Québec companies will share contracts worth a total of $55 million. An analysis of the proposals received showed that inviting suppliers from other countries along with Québec businesses brought prices down by about 20%. In awarding contracts, we seek the right balance between economic spinoffs in Québec and the price paid, since our purchases have an impact on electricity rates. In 2015, our procurement of goods and services amounted to $3 billion, 93% of which went to Québec-based suppliers.

*WITH 63 HYDROELECTRIC GENERATING STATIONS, WE'RE ABLE TO PRODUCE POWER THAT'S OVER 99% CLEAN AND RENEWABLE.*

At Romaine-3 generating station, prefabricated panels are being used to speed up the work and reduce costs.

We are continuing to improve our asset management model, which is based on industry best practices and essentially involves harmonizing our maintenance and sustainment strategies. The goal is to ensure reliability at least cost while controlling the risk of failure. This integrated approach leads to better targeting of work on the system. Under our sustainment strategy, we plan to renew our infrastructure gradually (so as to minimize the impact on rates), following a predetermined order of priority. Our maintenance strategy and the necessary budget will be established accordingly.

According to a benchmarking study conducted by the Canadian Electricity Association (CEA), the performance of the Hydro-Québec transmission grid in terms of reliability and cost is better than the average for Canadian systems—testimony to the quality of our asset management model.

## GENERATING STATIONS AGING GRACEFULLY

We celebrated some major anniversaries in 2015: La Tuque generating station (294 MW) turned 75 and Jean-Lesage generating station (1,229 MW) turned 50. La Tuque, a run-of-river facility, is the second-largest generating station on the Saint-Maurice. It underwent a total three-stage overhaul, completed in 2015, that boosted its capacity by 60 MW and included modernization of the spillway. Manic-2, built on the Rivière Manicouagan, was renamed Jean-Lesage generating station in 2010 to mark the 50th anniversary of the election of Jean Lesage's "dream team." It was the first generating station in the Manic-Outardes complex to begin producing electricity, in 1965. Québec's ninth-largest facility in terms of installed capacity, it generates 214 MW more than when it was commissioned, thanks to the improvements made over the years.

**Safety around our facilities //** Hydroelectric facilities pose a danger to public safety. Hydro-Québec is anxious to keep the public informed and aware of these hazards. For example, in addition to warning buoys, we use stroboscopes or flashing lights as well as navigation warning and prohibition signs to keep boaters away from our generating stations.

**Environmental follow-up //** In 2015, seven of our hydroelectric developments were the subject of some 25 environmental follow-up studies. After five years of follow-up at the Eastmain/Sarcelle/Rupert complex, our teams have concluded that fish populations in the Rupert are doing well. This complex includes an ecological instream flow regime designed to preserve fish habitat: more water is released in spring, less in summer, a little more in fall and less in winter, to replicate natural fluctuations in the river. This environmental measure, combined with weirs built in the river, is achieving its objectives.

**Cooperation with Aboriginal people //** This year, we are celebrating the 40th anniversary of the *James Bay and Northern Québec Agreement* (JBNQA), an agreement that changed the course of history for the Cree and Inuit communities, but also for Hydro-Québec. The JBNQA allowed phases 1 and 2 of the La Grande complex to be built, along with the transmission lines carrying the power to load centres farther south.

As part of our development projects, we reach agreements with Aboriginal communities to ensure that they play an active role in building the structures, contribute to the environmental follow-up programs and benefit from substantial economic spinoffs.

For the development of the Eastmain/Sarcelle/Rupert complex, we worked closely with the Crees within the framework provided by the Niskamoon Corporation. This collaborative arrangement enables Crees affected by the hydroelectric project to adapt better to changes in their local environment.

**Optimization of information and communication technologies //** In October 2015, through the creation of the Vice-présidence – Technologies de l'information et des communications, all of Hydro-Québec's IT and telecommunications operations were merged. Grouping these activities together will improve service quality for these strategic company functions and optimize the use of resources.

**Strategic networks //** Hydro-Québec relies on its own telecommunications network to manage, monitor and control its power generation, transmission and distribution facilities. Among other functions, this network ensures the safe and reliable operation of automatic control and protection systems. In addition to using fibre optics and microwave links, Hydro-Québec has a mobile radiocommunication network deployed throughout Québec to facilitate fieldwork and ensure worker safety. A new wireless network has also been installed for communicating with the advanced metering infrastructure's next-generation meters.

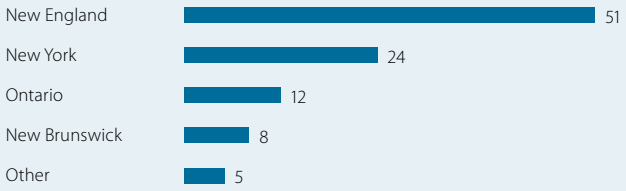
Land clearing operations for the 735-kV Chamouchouane–Bout-de-l'Île project.

## SALE OF CLEAN, RENEWABLE ENERGY

While our primary mission is to generate electricity for the Québec market, we have been selling our hydropower on wholesale markets outside Québec for a good 15 years or so. In 2015, more than 70% of our sales outside Québec went to New England and New York State, while 20% went to Ontario and New Brunswick. Smaller volumes were sold in transactions with markets in the PJM Interconnection (comprising electric utilities in 13 states in the eastern United States and the District of Columbia) and in the U.S. Midwest.

### SALES OUTSIDE QUÉBEC IN 2015

(%)



1

2

3

**1** // A transmission line crew in a right-of-way. **2** // Two employees planning refurbishment work at Beauharnois generating station.
**3** // A safety advisor inspecting a distribution substation.

# Our employees // Our succession

To meet the challenges posed in all our lines of business and achieve our performance goals, we need the engagement of all our employees. While applying the best possible management practices, we strive to maintain a stimulating work environment focused on specific goals that our employees can buy into.

**Employee engagement //** Our employees' engagement is essential to our success, since an engaged employee is willing to excel and adapts more readily to change. That is why we conduct an annual employee survey, *Écoute du personnel*.

In 2015, all of our employees were sent a questionnaire to measure their engagement. About 12,940 of them submitted replies, and the resulting overall engagement index was 67%, up from the previous year (62%). The results of this survey indicate what steps should be targeted to encourage employee contribution to the company's performance and maintain a safe, healthy work environment.

**Employee development //** We devoted 3% of our payroll to developing our human resources. Particular efforts were focused on rolling out the sixth edition of the Work Safety Code to 13,649 trade employees, technicians and contractors.

**A sought-after employer //** Hydro-Québec is an employer that attracts workers, as evidenced by the high volume of résumés we receive every year. It is nevertheless difficult to recruit candidates for certain high-tech jobs or in remote regions. The measures implemented include setting up resumé banks for certain jobs (such as computer support analyst or software developer) and networking with professional associations (the Ordre des comptables professionnels agréés du Québec and the Ordre des ingénieurs du Québec).

THE OVERALL ENGAGEMENT INDEX REACHED

**67%**

IN 2015.

**Our know-how //** To renew the know-how deemed essential to the smooth running of our operations, we are diversifying our professional development tools, for example by integrating interactive applications, self-directed training, structured mentoring and mapping of knowledge. Training is usually given near the workplace and is tailored to critical operating needs. We are constantly incorporating course evaluations and technological tools, which make the training more effective.

**Integrating new employees //** We have numerous specialized positions to fill. The skills development strategy instituted for this purpose advocates enablement and learning by doing. On-the-job coaching of new hires by experienced employees recognized in their respective fields helps speed up the training process and ensure uniform application of standards and methods, with the trainees performing a wide variety of tasks in an actual work environment. This strategy also yields considerable savings in time and money by substantially reducing training time.

Intelec is a nine-day orientation program for transmission system electricians that provides new employees with the basic knowledge needed for the tasks they will have to perform. During the year, 76% of the electricians with five years' experience or less received this additional training. Henceforth, all transmission system electricians arriving on the job will take the training.

**Management succession //** A large number of managers have retired in recent years, with more to follow in the near future. To lessen the impact of these departures, we go through an annual succession process designed to establish and develop pools of replacement candidates.

## PORTRAIT OF OUR WORKFORCE

Our employees work in nearly 150 locations throughout Québec. At December 31, 2015, our workforce consisted of 19,794 employees: 17,475 permanent and 2,319 temporary. Of this total, 14,045 are men and 5,749 are women. At a time when we are experiencing large numbers of retirements, we are taking the necessary steps to preserve and renew essential know-how in all our lines of business.

### NUMBER OF EMPLOYEES

AT DECEMBER 31

1

2

3

**1** // A technician checks the settings of the automatic stacker, which builds large-format lithium-ion batteries. **2** // The LineScout at work on a high-voltage transmission line. **3** // Researchers working on the development of tools for assessing electrical equipment service life.

In addition to innovating to optimize power systems, Hydro-Québec's research institute—the Institut de recherche d'Hydro-Québec (IREQ)—develops cutting-edge technologies and new avenues of innovation that will open up fresh markets for the company and create wealth for Québec. Already considered a leader in battery materials for use in electric vehicles and large-scale energy storage systems, IREQ is looking to consolidate its position and stimulate growth in this sector through commercial partnerships and the creation of companies to market the technologies it develops.

**An energy storage system prototype //** Within just a few months, Technologies Esstalion, a joint venture of Hydro-Québec and Sony (Japan), developed a prototype for a large-scale energy storage system. The prototype has a capacity of 1.2 MW and can store 1.2 MWh, equivalent to the average hourly consumption of 550 Québec homes. In addition to meeting part of the peak demand, the system could facilitate the integration of renewable energy sources into power grids—something many electric utilities around the world are trying to achieve. Tests are currently under way to assess how the storage system performs on the grid, specifically looking at its load-unload cycles and its ability to integrate capacity and energy.

**An innovation hub //** As a world-class innovation hub for battery materials used in electric vehicles and grid storage, IREQ is partnering with numerous international players in this field, including Sony (Japan), Arkema (France), BASF (Germany) and the DOE (U.S.). Its work on advanced materials, particularly for lithium-ion batteries, has resulted in 30 active licences and 848 patents in the last few years.

THE ENERGY STORAGE SYSTEM DEVELOPED BY TECHNOLOGIES ESSTALION CAN ACCUMULATE

1.2 MWh.

**The next generations of batteries //** Drawing on its standing, knowledge and significant intellectual property assets, as well as its solid expertise and unique facilities, IREQ is exploring a number of research avenues in its efforts to continually push the limits of science and technology.

Working with numerous high-profile international partners such as the Spanish company CIC Energigune, Singapore's Institute of Bioengineering and Nanotechnology, and Arkema and CEA Tech in France, IREQ is looking into a solid-state battery technology for the low-cost manufacture of safe, high-performance batteries for electric vehicles. Other projects include work with silica nanotubes to increase the storage capacity of rechargeable batteries for electric vehicles and mobile devices, and research on electrolytes to improve battery life.

Through these state-of-the-art projects, IREQ is becoming a central player in the field of batteries, attracting topnotch research partners to Québec to develop the battery-related facilities and technologies of the future.

**Proactive and collaborative R&D //** IREQ works with key players in the world power industry and in power-related research, bringing Québec's know-how to the international stage.

Enercon, a German wind turbine manufacturer, has joined forces with IREQ on a project for precise real-time modeling of advanced wind turbines. This is the first time Enercon has signed this type of agreement with a power company. The collaboration will improve our knowledge about wind turbines and their integration into the grid.

The China Electric Power Research Institute has been working with us to perfect the Hypersim power system simulator developed at IREQ. Through this collaboration, we have been able to speed up the simulator's development and share the risks and costs.

A key partnership with the United Kingdom's National Grid Electricity Transmission is centred on the development of IREQ's LineScout, a robot used to inspect high-voltage transmission lines. National Grid purchased an additional LineScout in 2015 and will participate in the development of an X-ray sensor for assessing corrosion levels inside cables, eliminating the need for the complex and risky operation of sampling.

### A HIGHLY EFFECTIVE TOOL

At Hydro-Québec, we devote considerable effort to improving our service quality and continuity. We have made grid reinforcement one of our strategic priorities with a view to reducing the frequency and duration of service interruptions to a minimum. This was the impetus behind the development and deployment of the MILE system for intelligent power line maintenance, a system that draws on the latest advances in measurement and information technology. MILE is able to locate faults with a high degree of precision before a power failure occurs and to determine their probable cause (contact with vegetation, equipment failure, conductor gallop, etc.). In 2015, MILE was used to identify the cause and exact location of repeated outages at a ski resort. MILE is a cutting-edge maintenance tool that improves service reliability for our customers.

*INNOVATION IS KEY TO FINDING NEW MARKETS AND DEVELOPING THEIR FULL COMMERCIAL POTENTIAL.*

## A COMMITMENT TO THE FUTURE

**The clean power generated by Hydro-Québec plays a key role in reducing greenhouse gas (GHG) emissions in a number of sectors, including ground transportation, which is a major source of emissions.**

In 2012, Hydro-Québec launched the Electric Circuit, the largest public charging network in Québec. Today the Electric Circuit has 130 partners and 577 charging stations, including 548 240-V stations and 29 fast-charge stations, in 16 of Québec's 17 administrative regions. In October 2015, the Electric Circuit issued a third call for tenders for the purchase of 240-V charging stations.

Hydro-Québec provided technical support to the city of Montréal and Taxelco, which launched the Téo taxi service in November. Our support to Taxelco consisted primarily in the installation of charging stations reserved for this entirely electric taxi fleet—the first of its kind in Canada.

To educate the public about the numerous advantages of electric vehicles in terms of costs, environmental impact and public health, the Electric Circuit regularly participates in events for the general public, including Branchez-Vous, Équiterre's Rendez-vous branchés, Expo-Sciences, Regroupement des amateurs de véhicules électriques (RAVÉ), the Montréal, Québec and Rimouski auto shows, and the Saint-Jean-sur-Richelieu and Gatineau hot-air balloon festivals.

The Electric Circuit witnessed exceptional growth, with 46,465 charges at its service points. This success confirms its leadership among North American public charging station networks.

### A ROBOTICS SUBSIDIARY

MIR Innovation is a new Hydro-Québec subsidiary active mainly in marketing robotics expertise and technology for the inspection and maintenance of generation and transmission facilities. Over the years, IREQ's robotics innovations have been tried and tested in terms of quality, performance and relevance, both at Hydro-Québec and at other power companies. Industry interest has led to various partnering and licensing agreements yielding significant revenue. Hydro-Québec is mobilizing its knowledge and expertise to develop new markets.

Technologies Esstalion, a joint venture of Hydro-Québec and Sony (Japan), has developed a large-scale energy storage system that can accumulate 1.2 MWh.

### Partnerships with universities //

Six university chairs were approved in 2015 by Hydro-Québec's chair committee and are currently awaiting funding confirmation from the National Sciences and Engineering Research Council of Canada. The chairs are in smart grids (Polytechnique), phytotechnology (Université de Montréal), cybersecurity (Concordia), commercialization of hydrometeorological data (Université de Sherbrooke), power system safety and stability (ÉTS) and asset management (UQTR).

Hydro-Québec's contribution to research in Québec universities, which totaled $6.1 million in 2015, furthered the development of scientific knowledge and highly qualified personnel.

### Advanced technological solutions //

IREQ develops advanced technological solutions to support the company's operations and open up growth avenues.

Our integrated method for generator diagnostics (MIDA) classifies generators according to their state of degradation, for better maintenance planning. As a result, turbines remain operational longer and generate more electricity. The MIDA technology was transferred under licence to the Russian company Irkutskenergo, providing Hydro-Québec with royalties while showcasing its expertise internationally.

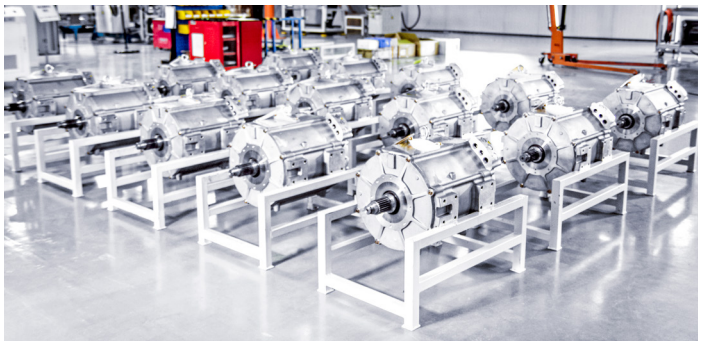
We used our integrated turbine deterioration prediction and diagnostics tool (PréDDIT) to measure the stress exerted on two of the turbines at Beauharnois generating station in 2013–2014 and one of the turbines at Bersimis-2 in 2015. The results indicated that, to reduce the risk of damage, we had to modify the start-up procedures of 16 generating units at Beauharnois and 2 units at Jean-Lesage generating station, and that we will soon have to do the same for 3 units at Bersimis-2. PréDDIT also provided us with information on the causes of the recurring cracks in the blades of three turbines at Bersimis-2. By improving operating and repair methods for these generating units, we will extend their useful lives by many years, leading to lower generating costs.

In early 2015, we implemented an innovative voltage control system in one of our transmission substations as a pilot project. Based on the conclusive results of this trial, we can now roll out the system in 11 of our transmission facilities at a unit cost of about $15,000, eliminating the need for a static var compensator valued at $80 million.

Closer modulation of heating, ventilation and air-conditioning systems in buildings could lead to a marked decrease in peak power demand. A pilot project carried out in early 2015 in five of Hydro-Québec's buildings indicated that a demand reduction of 15 MW could be achieved for the company's building inventory as a whole. This program will be extended to Hydro-Québec's other buildings and to its commercial and institutional customers in winter 2015–2016, with a peak shaving potential of 30 MW.

### A WORLD-CLASS PARTNERSHIP

TM4, a wholly owned subsidiary of Hydro-Québec, is partnering in a joint venture set up by French companies Peugeot Citroën and Exagon Motors, Hydro-Québec and the Québec government. Its role will be to develop an electric motor for a high-performance, high-efficiency powertrain currently in the design stage. This cutting-edge system will be a more advanced version of the TM4 MOTIVE series designed specifically for electric vehicles. The new powertrain will be designed and manufactured at TM4's facilities in Boucherville.



# Our support for communities // Our international presence

Our community investments support a host of activities throughout Québec, including community-interest projects funded by the Integrated Enhancement Program (IEP) and activities sustained by the Fondation Hydro-Québec pour l'environnement. Our support also takes the form of donations and sponsorships for organizations that play an active part in the cultural, social and economic life of Québec.

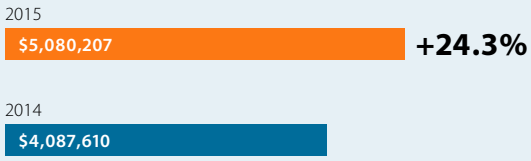
**Local or regional initiatives** // As part of transmission line or substation projects, our Integrated Enhancement Program (IEP) offers the host communities funding for local or regional initiatives related to municipal, community or recreational infrastructure, the environment, or community development.

In 2015, the IEP supported 16 initiatives totaling $1.6 million. For example, we granted nearly $60,000 to the municipality of Causapscal, in Gaspésie, for the development of rest areas, refurbishment of playing fields and installation of play structures at Parc de la Pointe. This funding was allocated in connection with the construction of a 120-kV tie line for Vents du Kempt wind farm. For the 230-kV Saint-Césaire–Bedford line project, the company granted the municipality of Saint-Césaire $154,000 to build a town well. Since its establishment in 1985, the IEP has contributed $123 million to 1,242 initiatives throughout Québec.

The Fondation Hydro-Québec pour l'environnement granted $964,485 to a variety of organizations in 2015, thereby helping to fund 16 initiatives for environmental protection, conservation and enhancement or for increased awareness of local environmental issues in nine administrative regions. For example, thanks to a private donation and a large financing package provided by the Foundation and other partners, the Centre de la nature du mont Saint-Hilaire was able to provide protection in perpetuity for the largest wetland in the regional county municipality of La Vallée-du-Richelieu. This 132-hectare property lies in the heart of the Saint-Denis-sur-Richelieu peatland area. Its acquisition for conservation purposes will help curb the pressure exerted by human activities on this type of environment. For more information on the Foundation's activities, go to: www.hydroquebec.com/fondation-environnement/en.

For more information on Hydro-Québec's activities related to sustainable development, go to: www.hydroquebec.com/sustainable-development.

The Hydro-Québec employees and pensioners' United Way/Centraide campaign raised $5,080,207 in 2015.




**Our donations and sponsorships** // We are actively involved in Québec social and cultural life, supporting various activities that focus on social and humanitarian assistance, education and health. The company is also associated with many cultural, environmental, socioeconomic, scientific and sporting events. We are proud to support a wide range of organizations, including the Orchestre symphonique de l'Estuaire, Université de Sherbrooke, Fondation du Dr Julien, Jeux du Québec, Expo-sciences in several regions in Québec, and the Centre Maria-Chapdelaine. Nearly 1,000 organizations received assistance totaling $16.8 million in 2015. For more information, go to: www.hydroquebec.com/publications/en/donations-sponsorships.

## AN ACTIVE PRESENCE ON THE INTERNATIONAL SCENE

Hydro-Québec is a founding member of the Global Sustainable Electricity Partnership (1992) and remains active within this international organization, which has its General Secretariat in Montréal. Made up of the leading electric utilities in Europe, Asia and the Americas, the Partnership promotes the use of sustainable energies in developing countries around the world. In May 2017, Hydro-Québec will host its 26th summit, focusing on the theme of electricity as a tool for reducing carbon footprint. We also belong to such international organizations as the World Energy Council (WEC) and the International Hydropower Association (IHA).

# Management's Discussion and Analysis

This Management's Discussion and Analysis should be read in conjunction with the consolidated financial statements of Hydro-Québec and the notes thereto. On January 1, 2015, Hydro-Québec adopted U.S. generally accepted accounting principles as its framework for accounting and presentation of financial information, and the 2014 comparative data have been restated according to this new framework. In addition, the consolidated financial statements take into account the decisions handed down by the Régie de l'énergie with respect to the transmission and distribution of electricity.

The financial information and tabular amounts presented herein are expressed in Canadian dollars, unless otherwise indicated.

This analysis, and especially the Outlook section, contains statements based on estimates and assumptions concerning future results and the course of events. Given the risks and uncertainties inherent in any forward-looking statements, Hydro-Québec's actual future results could differ from those anticipated. Finally, the information contained herein takes into account any significant event that occurred on or before February 19, 2016, the date of approval of this Annual Report by Hydro-Québec's Board of Directors.

## FINANCIAL REVIEW

### MANAGEMENT'S DISCUSSION AND ANALYSIS


**26** 2015 at a Glance

**27** Consolidated Results

**29** Cash and Capital Management

**31** Segmented Results

**42** Outlook

**43** Integrated Business Risk Management


### CONSOLIDATED FINANCIAL STATEMENTS


**47** Management's Report on Financial Information

**48** Independent Auditors' Report

**49** Consolidated Statements of Operations

**49** Consolidated Statements of Comprehensive Income

**50** Consolidated Balance Sheets

**51** Consolidated Statements of Changes in Equity

**52** Consolidated Statements of Cash Flows

**53** Notes to Consolidated Financial Statements

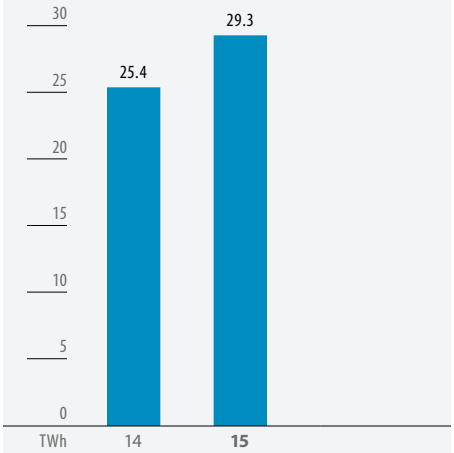

### COMPLEMENTARY DATA


**85** Five-Year Review

**88** Consolidated Results by Quarter

# 2015 at a Glance

**NET ELECTRICITY EXPORTS**




For a second consecutive year, Hydro-Québec's net income exceeded the $3-billion mark, totaling $3,147 million. Thanks to this good result, due mainly to a significant increase in net electricity exports, Hydro-Québec will again be able to pay a substantial dividend to its shareholder, the Québec government. For 2015, this amounts to $2,360 million.

## EXPORTS

The skillful development and deployment of the sales strategy, combined with optimal management of generating and transmission equipment, enabled the company to capitalize on business opportunities on external markets. Net electricity exports increased by 3.9 TWh compared to 2014 to a total of 29.3 TWh, contributing $902 million to net income. Reservoir storage reached the historic level of 126.9 TWh as at December 31, 2015.

## INVESTMENTS

The investment program totaled $3,440 million, due mainly to the continuation of major projects in the generation and transmission segments. At the Romaine hydroelectric complex, Hydro-Québec reached an important milestone at year end with the commissioning of the two units at Romaine-1 generating station (270 MW) and the connection of the station to the grid. The first unit was assembled in less than 12 months, whereas the usual time required is 14 to 16 months, and the Romaine-1 development was completed eight months ahead of the original schedule.

Another component of this project, Romaine-2 generating station (640 MW), was completed in 2014; as soon as it was commissioned, it began to help meet demand from Québec customers during the 2015 peak winter periods.

In the distribution segment, Hydro-Québec completed the large-scale rollout of the advanced metering infrastructure, which included installing some 3.7 million next-generation meters on customer premises throughout Québec. Finishing up on budget and three years ahead of schedule, this project is already helping the company increase its productivity, offer new services and optimize the management of its distribution network, and thus is having a positive impact on electricity rates for all Québec customers. It reflects Hydro-Québec's resolve to enhance both its operating efficiency and the quality of its customer services.

## CONTRIBUTION TO PUBLIC FINANCES

Thanks to the good result it recorded in 2015, Hydro-Québec will be able to pay a $2,360-million dividend to its shareholder, the Québec government. This dividend is in addition to the other sums paid to the government during the year, including $654 million in water-power royalties, $268 million in public utilities tax and $205 million in guarantee fees related to debt securities. These amounts, combined with economic spin-offs from the company's operations, will benefit all Quebecers.

# Consolidated Results

## NET INCOME

In 2015, Hydro-Québec posted net income of $3,147 million, compared to $3,325 million in 2014. Hydro-Québec Production's net electricity exports grew by $118 million. However, this increase was offset by two factors, namely a $202-million decrease in supplies provided by Hydro-Québec Production to Hydro-Québec Distribution, and a $120-million increase in depreciation and amortization expense.

## REVENUE

Revenue totaled $13,754 million, or $102 million more than in 2014. Revenue from electricity sales increased by $217 million to $13,362 million. Sales in Québec accounted for $11,662 million of this amount, an increase over the $11,516 million recorded in 2014. On markets outside Québec, revenue from electricity sales was $1,700 million, an increase of $71 million. Other revenue amounted to $392 million, compared to $507 million in 2014.

Revenue from Québec electricity sales grew by $146 million. The April 1, 2014 and 2015 rate adjustments, approved by the Régie de l'énergie and made to permit cost of service recovery, led to a $336-million increase in revenue. This increase was partially offset, however, by a $187-million decrease due to lower demand. The very cold temperatures in first quarter 2015, which were on average 5°C below the seasonal normal, pushed sales up by $125 million. This increase was counterbalanced, however, by a $109-million decrease resulting from the exceptionally mild temperatures recorded during the fourth quarter, especially in December, when temperatures were on average 6°C higher than normal.

Revenue from electricity sales on markets outside Québec increased by $71 million due to growth in Hydro-Québec Production's export revenue. This rise is attributable to higher volume and the impact of the Canadian dollar's depreciation, given that the vast majority of export sales are denominated in U.S. dollars. These elements were mitigated by the effect of lower prices on energy markets.

Other revenue decreased by $115 million to total $392 million, mainly because supply costs incurred in winter 2015 for electricity in excess of the heritage pool were lower than the previous year on account of market conditions.

## EXPENDITURE

Total expenditure was $8,158 million, compared to $7,902 million in 2014.

Operating expenses amounted to $2,527 million, compared to $2,366 million in 2014, in particular because of the impact of inflation and indexing. The increase is also attributable to growth in operations, related among other things to the commissioning of Romaine-2 generating station at the end of 2014 and the expansion of the company's transmission and distribution systems. Furthermore, Hydro-Québec's resolve to enhance service quality and reliability for all customers led it to step up its maintenance activities.

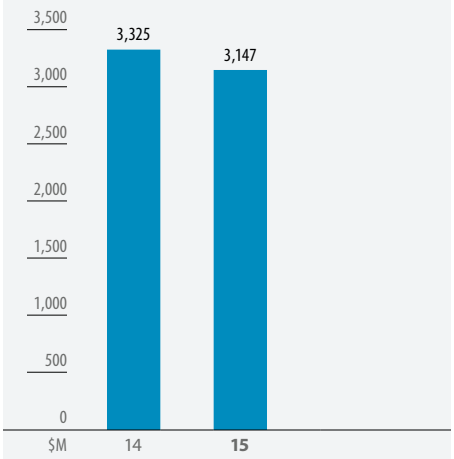
Electricity and fuel purchases totaled $1,938 million, a $30-million decrease compared to 2014. This change is due to a $90-million reduction in Hydro-Québec Production's supply costs, owing in particular to a decrease in short-term electricity purchases made by the division as part of its business operations outside Québec. Third-party supplies purchased by Hydro-Québec Distribution increased by $68 million, primarily on account of wind power and biomass energy purchases, which increased by $189 million and $44 million, respectively, and which were offset by a $151-million reduction in short-term market purchases on account of market conditions. In addition, fuel oil purchases for off-grid generating stations decreased by $25 million.

Depreciation and amortization expense amounted to $2,713 million, an increase of $120 million compared to 2014 that is partly due to the commissioning of property, plant and equipment, notably the two units at Romaine-2 generating station at the end of 2014, and the rollout of the advanced metering infrastructure.

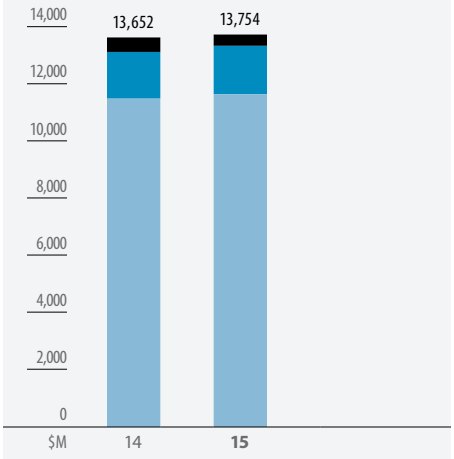
Taxes were $980 million, comparable to the $975 million posted in 2014.

Financial expenses totaled $2,449 million in 2015, compared to $2,425 million in 2014.

**NET INCOME**




**REVENUE**



| | 2015 | 2014 |
|---|---|---|
| **OPERATIONS AND DIVIDEND ($M)** | | |
| Revenue | **13,754** | 13,652 |
| Operating income | **5,596** | 5,750 |
| Net income | **3,147** | 3,325 |
| Dividend | **2,360** | 2,535 |
| **BALANCE SHEETS ($M)** | | |
| Total assets | **75,199** | 73,108 |
| Property, plant and equipment | **61,558** | 60,413 |
| Long-term debt, including current portion and perpetual debt | **45,983** | 44,752 |
| Equity | **19,475** | 17,961 |
| **FINANCIAL RATIOS** | | |
| Interest coverage[a] | **2.20** | 2.23 |
| Return on equity from continuing operations (%)[b] | **14.9** | 16.1 |
| Profit margin (%)[c] | **22.9** | 24.4 |
| Capitalization (%)[d] | **30.1** | 28.9 |
| Self-financing (%)[e] | **82.8** | 56.4 |

a) Sum of operating income and net investment income divided by interest on debt securities.

b) Income from continuing operations divided by average equity less average accumulated loss from discontinued operations for prior years and average accumulated other comprehensive income. For 2015 and 2014, average equity less average accumulated loss from discontinued operations for prior years and average accumulated other comprehensive income amounted to $21,091 million and $20,602 million, respectively. Hydro-Québec did not record any amount with respect to discontinued operations in 2015 or 2014, such that net income corresponds to income from continuing operations.

c) Net income divided by revenue.

d) Equity divided by the sum of equity, long-term debt, current portion of long-term debt, perpetual debt, borrowings and derivative instrument liabilities, less derivative instrument assets and sinking fund.

e) Cash flows from operating activities less dividend paid, divided by the sum of cash flows from investing activities, excluding net disposal or acquisition of short-term investments, and repayment of long-term debt.

Note: Comparative figures for 2014 have been restated to conform to U.S. generally accepted accounting principles.

# Cash and Capital Management

## OPERATING ACTIVITIES

Cash flows from operating activities totaled $6.2 billion in 2015, compared to $5.9 billion in 2014. These funds were used to pay the dividend for 2014 and to finance a large portion of the investment program, among other things.

## INVESTING ACTIVITIES

In 2015, Hydro-Québec invested $3.4 billion in property, plant and equipment and intangible assets, compared to $3.8 billion in 2014. Of this total, $1.7 billion was invested in development projects and $1.7 billion in maintaining or improving asset quality.

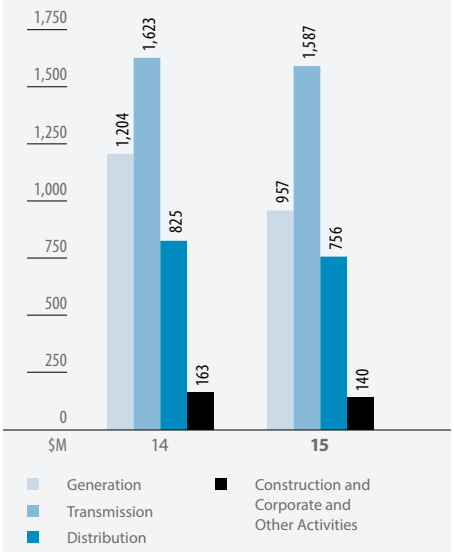
Hydro-Québec Production's investments totaled $957 million. A large portion of this amount, $663 million, was devoted to development activities, mainly the ongoing construction of the Romaine hydroelectric complex. The amounts allocated to asset maintenance and improvement totaled $294 million. For instance, refurbishment continued at Beauharnois, Les Cèdres and Rapides-des-Quinze generating stations.

Capital spending at Hydro-Québec TransÉnergie totaled $1,587 million in 2015. Of this amount, $727 million was used to connect new hydroelectric and wind power facilities to the grid and increase transmission capacity. Projects included the completion of the 315-kV section of Romaine-1 substation and the 315-kV line connecting it to Romaine-2 substation, and continued deployment of the 735-kV Romaine-4–Montagnais line, as part of the expansion of the transmission system in the Minganie region. The division also launched construction of a line extending more than 400 km between Chamouchouane substation, in the Lac-Saint-Jean region, and the future Judith-Jasmin substation in the outskirts of Montréal, and continued to bring output onto the grid from the wind farms built following Hydro-Québec Distribution's 2005 and 2009 calls for tenders (for 2,000 MW and 289.9 MW, respectively). Investments of $860 million were also made in transmission asset sustainment and reliability, which mainly involved replacing equipment and modernizing facilities.

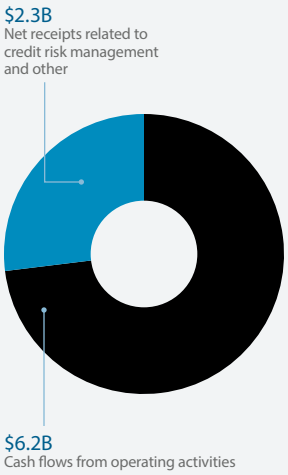
Hydro-Québec Distribution invested $756 million, mainly to handle its growing customer base, ensure the long-term operability of the distribution system and enhance service quality. Of this amount, $228 million was allocated to the advanced metering infrastructure, whose large-scale rollout was completed in fall 2015.

Hydro-Québec Équipement et services partagés and Société d'énergie de la Baie James carry out engineering, construction and refurbishment projects for Hydro-Québec Production and Hydro-Québec TransÉnergie.

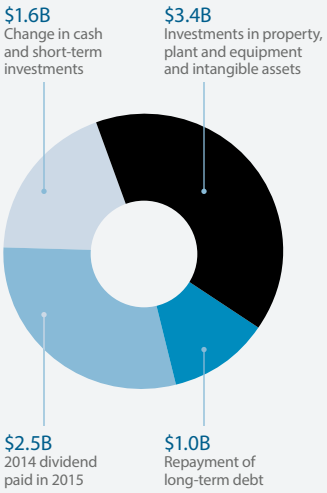
**INVESTMENTS IN PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS BY SEGMENT**



**SOURCES OF FUNDS IN 2015**




**USES OF FUNDS IN 2015**




## FINANCING ACTIVITIES

The depreciation of the Canadian dollar led to net cash receipts of $1.8 billion under credit risk mitigation agreements signed by the company. As a result, Hydro-Québec did not carry out any public financing activities in 2015.

### SOURCES OF FINANCING

| Type of financing | Amount authorized by the Board of Directors | Market | Outstanding as at December 31, 2015 |
|---|---|---|---|
| Operating credit lines | C$ or US$1,000 million[a] | | – |
| Credit facility[b] | US$2,000 million[c] | | – |
| Commercial paper[b] | US$3,500 million or equivalent in C$ | United States or Canada | C$8.5 million |
| Medium-term notes[b] | US$3,000 million or equivalent in other currencies<br>C$20,000 million or equivalent in US$ | United States<br>Canada | US$340 million[d]<br>C$12,202 million[d] |

a) Of this amount, available balances of US$200 million and $247 million in Canadian or U.S. dollars are covered by operating credit line agreements with financial institutions.
b) Guaranteed by the Québec government.
c) Includes a US$750-million swing loan.
d) Corresponds to net proceeds from the issuance of medium-term notes.

### CREDIT RATINGS

| | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|
| | Commercial paper | Long-term debt | Outlook/ trend | Commercial paper | Long-term debt | Outlook/ trend |
| U.S. agencies | | | | | | |
| Moody's | **P-1** | **Aa2** | **Stable** | P-1 | Aa2 | Stable |
| Standard & Poor's | **A-1+** | **A+** | **N/A**[a] | A-1+ | A+ | N/A[a] |
| Fitch Ratings | **F1+** | **AA–** | **Negative** | F1+ | AA– | Negative |
| Canadian agency | | | | | | |
| DBRS | **R-1 (middle)** | **A (high)** | **Stable** | R-1 (middle) | A (high) | Stable |

a) Standard & Poor's does not provide an outlook for Hydro-Québec's credit rating. However, it has given the Québec government, Hydro-Québec's shareholder and guarantor, a "stable" outlook.

## DIVIDEND AND CAPITALIZATION

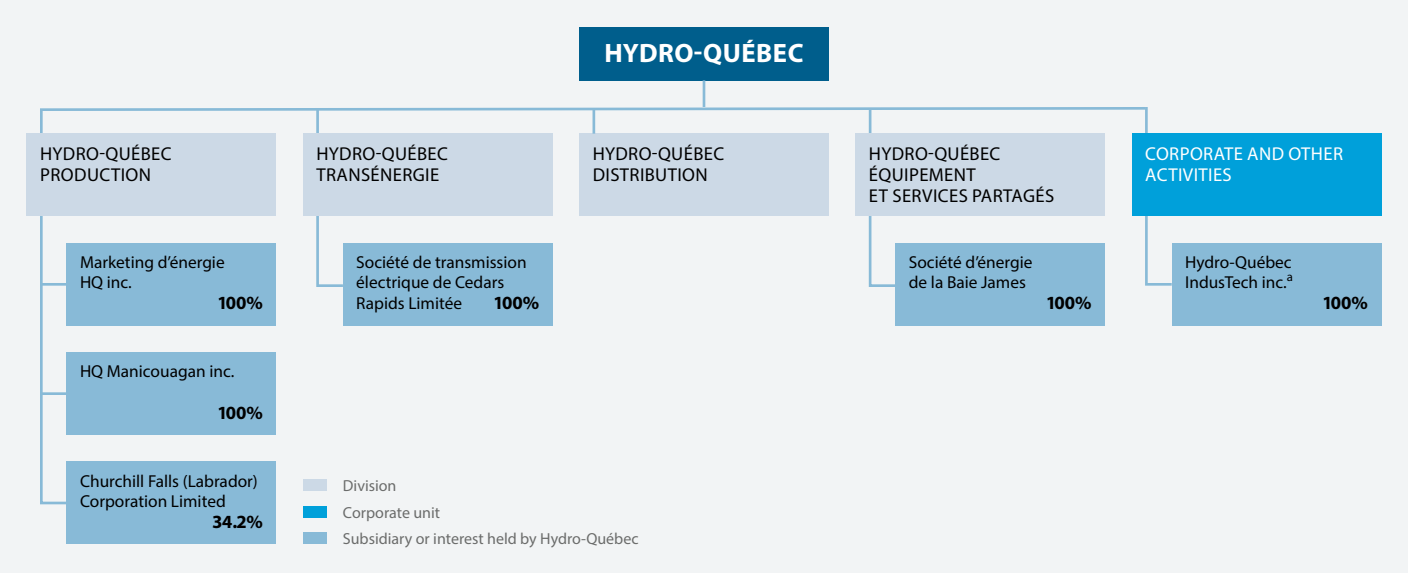
The dividend payable to the Québec government for 2015 is $2,360 million. Once this dividend is factored in, the capitalization rate was 30.1% as at December 31, 2015.

# Segmented Results

## OPERATING SEGMENTS

As in 2014, Hydro-Québec had four operating segments in 2015, namely Generation, Transmission, Distribution and Construction, as well as activities grouped under Corporate and Other Activities.

The following organization chart presents Hydro-Québec's principal first-tier interests:




a) Subsidiary owned by Hydro-Québec and placed under the responsability of Groupe – Développement de l'entreprise, planification stratégique et innovation.

**Generation:** Hydro-Québec Production operates and develops Hydro-Québec's generating facilities. It generates electricity for the Québec market and exports power to wholesale markets in northeastern North America.

**Transmission:** Hydro-Québec TransÉnergie operates and develops Hydro-Québec's power transmission system. It markets system capacity and manages power flows throughout Québec.

**Distribution:** Hydro-Québec Distribution operates and develops Hydro-Québec's distribution system and supplies electricity to the Québec market. It also carries on activities related to electricity sales in Québec as well as customer services and promoting energy efficiency.

**Construction:** Hydro-Québec Équipement et services partagés and Société d'énergie de la Baie James (SEBJ) design, build and refurbish generating and transmission facilities, mainly for Hydro-Québec Production and Hydro-Québec TransÉnergie.

The following tables present information on segment results and assets:

| | | | | | | **2015** |
|---|---|---|---|---|---|---|
| Segmented financial information ($M) | Generation | Transmission | Distribution | Construction | Corporate and Other Activities | Hydro-Québec[a] |
| Revenue | **6,624** | **3,308** | **11,834** | **2,098** | **1,683** | **13,754** |
| Net income | **2,130** | **558** | **364** | **–** | **95** | **3,147** |
| Total assets | **33,108** | **20,944** | **13,425** | **58** | **7,829** | **75,199** |

| | | | | | | 2014 |
|---|---|---|---|---|---|---|
| Segmented financial information ($M) | Generation | Transmission | Distribution | Construction | Corporate and Other Activities | Hydro-Québec[a] |
| Revenue | 6,766 | 3,252 | 11,777 | 2,281 | 1,698 | 13,652 |
| Net income | 2,301 | 560 | 343 | – | 121 | 3,325 |
| Total assets | 32,500 | 20,323 | 13,695 | 65 | 6,696 | 73,108 |

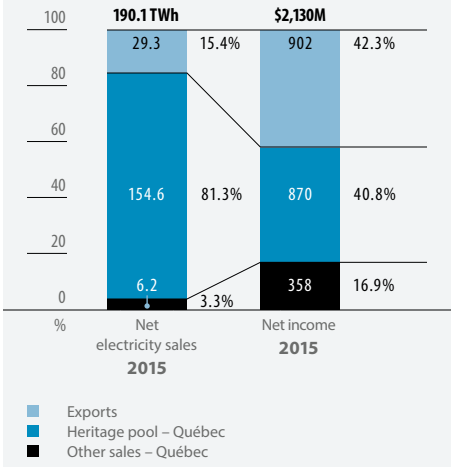
a) Includes the intersegment eliminations presented in Note 20 to the consolidated financial statements.

# Generation

## 2015 AT A GLANCE

| | |
|---|---|
| Revenue | $6.6B |
| Net income | $2,130M |
| Contribution of net exports to net income | $902M |
| Customers (% of revenue from electricity sales) | |
| *Hydro-Québec Distribution* | 74% |
| *Other* | 26% |
| Sales volume | |
| *Hydro-Québec Distribution* | 160.8 TWh |
| *Other* | 29.9 TWh |
| Property, plant and equipment as at December 31 (including work in progress) | $30.8B |
| Investments in property, plant and equipment and intangible assets | $957M |
| Reservoir storage as at December 31 | 126.9 TWh |

**NET ELECTRICITY SALES AND NET INCOME OF HYDRO-QUÉBEC PRODUCTION, BY MARKET**




In 2015, net exports by Hydro-Québec Production accounted for only 15% of sales volume, but generated 42% of the division's net income.

Under the *Act respecting the Régie de l'énergie*, Hydro-Québec Production is required to provide Hydro-Québec Distribution with a base volume of up to 165 TWh of heritage pool electricity annually. It may also compete for contracts under Hydro-Québec Distribution's open tendering process and sells electricity on wholesale markets as well.

The division operates 63 generating stations. Its capital projects serve a twofold objective: to ensure the long-term operability of existing facilities and to continue development of Québec's hydroelectric potential.

## OPERATING RESULTS

Hydro-Québec Production posted net income of $2,130 million in 2015, compared to $2,301 million in 2014. Net electricity exports totaled $1,645 million, or $118 million more than the $1,527 million recorded a year earlier, due mainly to higher volume. However, electricity sales to Hydro-Québec Distribution decreased by $202 million to $4,883 million. This difference was the result of the combined effect of lower market prices in 2015 than 2014 and lower volume. Depreciation and amortization expense increased by $50 million.

### ELECTRICITY SALES IN QUÉBEC

*Sales to Hydro-Québec Distribution*

The total volume of electricity sales to Hydro-Québec Distribution was 160.8 TWh in 2015, compared to 165.5 TWh in 2014. Revenue from these sales decreased by $202 million compared to $5,085 million in 2014, chiefly because peak supplies in winter 2015 were provided at lower market prices than the previous winter. The decrease is also due to lower volume resulting from the mild temperatures recorded in the fourth quarter of 2015 as well as lower demand.

### ELECTRICITY SALES OUTSIDE QUÉBEC

Electricity sales outside Québec amounted to $1,700 million, compared to $1,629 million the previous year.

Net electricity exports, which factor in short-term electricity purchases, totaled $1,645 million for 29.3 TWh, a $118-million increase compared to $1,527 million for 25.4 TWh in 2014. This rise is mainly due to volume growth of 3.9 TWh or $143 million. In addition, since the vast majority of export sales are denominated in U.S. dollars, the depreciation of the Canadian dollar also had a positive impact, accounting for $114 million of the increase in net exports. However, these elements were mitigated by lower prices on energy markets, which had a negative impact of $139 million.

As at December 31, 2015, reservoir storage stood at the historic level of 126.9 TWh, compared to 103.7 TWh as at December 31, 2014. This increase was mainly attributable to natural water inflows that were 24.3 TWh higher than normal in 2015. The energy reserve fully meets the criteria set for management of risks related to the security of the energy supply.

### ELECTRICITY AND FUEL PURCHASES

Electricity and fuel purchases totaled $960 million in 2015, compared to $1,045 million in 2014. The decrease is partly due to a reduction in short-term electricity purchases made as part of business operations outside Québec.

### DEPRECIATION AND AMORTIZATION

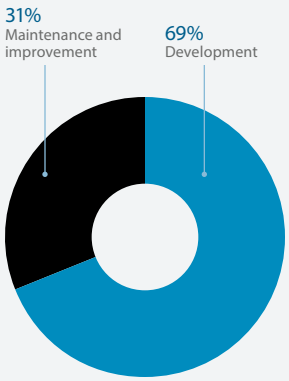
Depreciation and amortization expense totaled $766 million in 2015, compared to $716 million in 2014. This $50-million increase is due, among other things, to the commissioning of the two units at Romaine-2 generating station at the end of 2014.

## INVESTING ACTIVITIES

Investments in property, plant and equipment and intangible assets totaled $957 million in 2015. Of this amount, $663 million went toward development activities, mainly the construction of the Romaine hydroelectric complex, which reached another milestone at year end with the commissioning of a second generating station, Romaine-1 (270 MW).

Hydro-Québec Production also invested $294 million in asset sustainment and optimization. Work included refurbishment at Beauharnois, Les Cèdres and Rapides-des-Quinze generating stations.

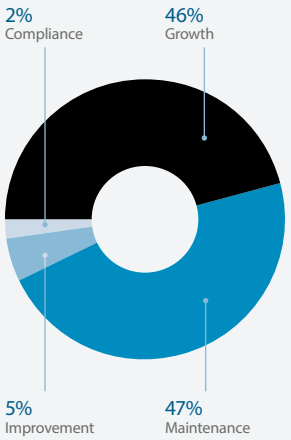
**BREAKDOWN OF 2015 INVESTMENTS BY HYDRO-QUÉBEC PRODUCTION**



# Transmission

| 2015 AT A GLANCE | |
|---|---|
| Revenue | $3.3B |
| Net income | $558M |
| Customers (% of revenue) | |
| *Hydro-Québec Distribution* (native-load transmission service) | 85% |
| *Hydro-Québec Production and other North American wholesalers* (point-to-point transmission service) | 11% |
| Other | 4% |
| Property, plant and equipment as at December 31 (including work in progress) | $20.6B |
| Investments in property, plant and equipment and intangible assets | $1,587M |

**BREAKDOWN OF 2015 INVESTMENTS BY HYDRO-QUÉBEC TRANSÉNERGIE**




Hydro-Québec TransÉnergie operates and develops Hydro-Québec's power transmission system, the most extensive in North America. It markets system capacity and manages power flows throughout Québec, offering non-discriminatory access to its system to all market players, in compliance with applicable regulatory requirements.

The division's operations are regulated by the Régie de l'énergie.

## RATE CASE

For 2015, the revenue authorized by the Régie de l'énergie for transmission rate-setting purposes totaled $3,180 million, namely $2,802 million for native-load transmission and $378 million for short- and long-term point-to-point transmission services. These amounts represent increases of $37 million and $4 million, respectively, compared to 2014.

In November 2015, the Régie approved the adoption of U.S. generally accepted accounting principles as the accounting framework for regulatory purposes and the application of all changes related thereto effective July 10, 2015. This decision was further to a joint application made by Hydro-Québec TransÉnergie and Hydro-Québec Distribution.

## OPERATING RESULTS

Hydro-Québec TransÉnergie's net income was $558 million in 2015, comparable to the $560 million recorded in 2014. The increased transmission income from Hydro-Québec Distribution was offset by growth in financial expenses.

## INVESTING ACTIVITIES

In 2015, Hydro-Québec TransÉnergie invested $1,587 million in property, plant and equipment and intangible assets, namely $727 million for growth projects and $860 million for asset sustainment and reliability projects. The purpose of growth projects is to connect new hydroelectric facilities and wind farms to the grid or to increase transmission capacity in response to higher load demand or new customer requests. The asset sustainment and reliability projects involve keeping facilities in good operating condition, maintaining and improving service quality and complying with the legal and regulatory requirements for operating a power transmission system.

Growth projects under way in 2015 included continued work to connect the Romaine complex as part of the expansion of the transmission system in the Minganie region. In concrete terms, Hydro-Québec TransÉnergie invested $286 million to build Romaine-1 substation, the 315-kV line connecting it to Romaine-2 substation, and the 735-kV Romaine-4–Montagnais line. Romaine-1 generating station was connected to the grid in 2015. The division also continued to integrate the output from wind farms built in response to the calls for tenders issued by Hydro-Québec Distribution in 2005 (2,000 MW) and 2009 (289.9 MW), for $71 million and $28 million, respectively. In addition, it allocated $34 million to the launch of the 735-kV Chamouchouane–Bout-de-l'Île project, an amount that also includes the transmission asset sustainment and system reliability component of the project.

In the asset sustainment and reliability category, Hydro-Québec TransÉnergie invested $779 million in upgrading equipment and facility modernization, including $49 million to replace two static var compensators at Albanel substation and $33 million to build the new Fleury substation.

# Distribution

Hydro-Québec Distribution provides electricity to the Québec market and delivers reliable power and quality services to its customers with a view to efficiency and sustainable development. In this context, it also promotes energy efficiency among its customers.

The division's activities are regulated by the Régie de l'énergie, which has exclusive jurisdiction to set electricity rates. These rates are established to permit service cost recovery and a reasonable return on the rate base.

## RATE CASES

In March 2015, the Régie de l'énergie authorized an average increase of 2.9% in all Hydro-Québec electricity rates except the large-power industrial rate (Rate L), for which the increase was set at 2.5%. In accordance with the *Act respecting the Régie de l'énergie*, the indexing of the price of heritage pool electricity does not apply to Rate L customers, which explains the smaller increase. The new rates went into effect on April 1, 2015.

In July, Hydro-Québec Distribution filed an application with the Régie for a 1.9% rate adjustment for all customers except Rate L customers, for which the requested adjustment was 1.2%. The new rates would take effect on April 1, 2016. The main reasons for the 1.9% adjustment are the impact of the very cold temperatures during the previous two winters, the cost of new supplies brought onto the grid as ordered by the Québec government and the indexing of the price of the heritage pool. Other factors, including the company's productivity gains and the decrease in the cost of service, reduced the increase requested.

In November, the Régie approved the adoption of U.S. generally accepted accounting principles as the accounting framework for regulatory purposes and the application of all changes related thereto effective July 10, 2015. This decision was further to a joint application made by Hydro-Québec Distribution and Hydro-Québec TransÉnergie.

In early December, further to this decision and the adjustment of some of the parameters of its initial application, Hydro-Québec Distribution filed an update in which it changed the rate increase requested for April 1, 2016, to 1.7%, in line with the rate of inflation.

The cumulative average rate adjustment index for 1998 to 2015 is 128.4, while the Consumer Price Index for the same period is 138.6.

The ruling of the Régie de l'énergie on this application is expected in early 2016.

## SUPPLYING THE QUÉBEC MARKET

Hydro-Québec Distribution depends on various sources to supply the Québec market, including the heritage pool of 165 TWh, which it purchases from Hydro-Québec Production. It also issues short- and long-term calls for tenders. For requirements of less than three months, it may also buy electricity directly on the market, without tendering, under an authorization granted by the Régie de l'énergie. For unforeseen needs that cannot be met otherwise, the division relies on a framework agreement with Hydro-Québec Production that covers the period from January 1, 2014, to December 31, 2016. The agreement was approved by the Régie in December 2013.

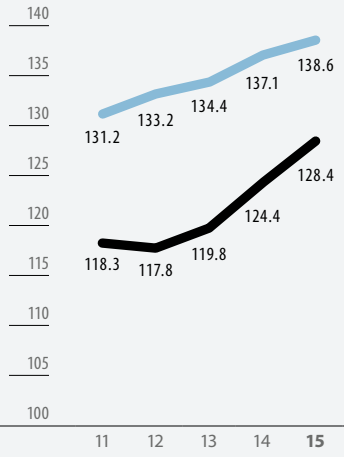
In October 2015, Hydro-Québec Distribution filed a second progress report on the Electricity Supply Plan 2014–2023 with the Régie de l'énergie. This follow-up provided an updated demand forecast for the Québec market and outlined the events that have influenced supply planning and the division's actions since the first progress report on the plan, filed in November 2014.

Finally, Hydro-Québec Distribution is continuing its efforts to promote energy efficiency. In 2015, cumulative energy savings amounted to 8.8 TWh, which is equivalent to the amount of power used by 500,000 households, and is 10% higher than the target initially set by the Québec government.

## 2015 AT A GLANCE

| | |
|---|---|
| Revenue | $11.8B |
| Net income | $364M |
| Market segments (% of revenue from electricity sales) | |
| *Residential* | 45% |
| *Commercial, institutional and small industrial* | 32% |
| *Large industrial* | 20% |
| *Other* | 3% |
| Property, plant and equipment as at December 31 (including work in progress) | $9.7B |
| Investments in property, plant and equipment and intangible assets | $756M |
| Rate increase effective April 1, 2015 (excluding Rate L) | 2.9% |

**AVERAGE RATE ADJUSTMENT INDEX AND CONSUMER PRICE INDEX**



## OPERATING RESULTS

Hydro-Québec Distribution recorded net income of $364 million in 2015, compared to $343 million in 2014, an increase of $21 million. Revenue from electricity sales increased by $146 million, mainly on account of the April 1, 2014 and 2015 rate adjustments, whose impact was mitigated by lower demand. Other revenue decreased, essentially because supply costs for electricity in excess of the heritage pool during winter peak periods were lower than the previous year. Electricity purchases and transmission costs decreased by $88 million due to the combined effect of three factors: supplies purchased from Hydro-Québec Production decreased by $202 million, while supplies purchased from third parties increased by $93 million and transmission costs incurred with Hydro-Québec TransÉnergie rose by $29 million. Depreciation and amortization expense increased by $60 million compared to 2014.

### ELECTRICITY SALES IN QUÉBEC BY SEGMENT

| | Sales volume | | | Sales revenue | | |
|---|---|---|---|---|---|---|
| | **2015** | 2015–2014 change | | **2015** | 2015–2014 change | |
| Market segment | TWh | TWh | % | $M | $M | % |
| Residential | **66.6** | (1.5) | (2.2) | **5,222** | 60 | 1.2 |
| Commercial, institutional and small industrial | **45.3** | 0.1 | 0.2 | **3,774** | 117 | 3.2 |
| Large industrial | **54.2** | (1.5) | (2.7) | **2,350** | (39) | (1.6) |
| Other | **5.2** | – | – | **316** | 8 | 2.6 |
| Total | **171.3** | (2.9) | (1.7) | **11,662** | 146 | 1.3 |

### FACTORS IN THE 2015–2014 CHANGE IN SALES BY SEGMENT

| | Volume effects | | | | | Price effects | | | **Total** |
|---|---|---|---|---|---|---|---|---|---|
| | Baseload demand | | Temperatures | | **Total** | Rate adjustments | Other | **Total** | |
| Market segment | TWh | $M | TWh | $M | $M | $M | $M | $M | $M |
| Residential | (1.2) | (88) | (0.3) | (11) | **(99)** | 168 | (9) | **159** | **60** |
| Commercial, institutional and small industrial | 0.1 | 1 | – | 2 | **3** | 117 | (3) | **114** | **117** |
| Large industrial | (1.5) | (98) | – | – | **(98)** | 40 | 19 | **59** | **(39)** |
| Other | – | (2) | – | 1 | **(1)** | 11 | (2) | **9** | **8** |
| Total | (2.6) | (187) | (0.3) | (8) | **(195)** | 336 | 5 | **341** | **146** |

## ELECTRICITY SALES IN QUÉBEC

Revenue from electricity sales amounted to $11,662 million, a $146-million increase compared to 2014 due to the April 1, 2014 and 2015 rate adjustments, whose impact was mitigated by lower demand in the residential and industrial segments, mainly the pulp and paper industry.

Sales volume totaled 171.3 TWh, compared to 174.2 TWh in 2014, a 2.9-TWh decrease. On the one hand, the very cold temperatures in first quarter 2015, which were on average 5°C below the seasonal normal, pushed sales volume up by 1.4 TWh. This increase was counterbalanced, however, by an equivalent decrease during the fourth quarter resulting from the exceptionally mild temperatures recorded at year end, especially in December, when temperatures were on average 6°C higher than normal. Temperatures therefore had a positive impact of $224 million in 2015, compared to $232 million in 2014. On the other hand, there was a 2.6-TWh or $187-million reduction in demand, mainly because of a 1.5-TWh decrease in demand from large industrial customers, essentially because of reduced production capacity in the pulp and paper sector.

## OTHER REVENUE

The change in the net amounts that Hydro-Québec is entitled to receive from customers or is required to pay to them, recognized as other revenue, was $139 million in 2015. The change is mainly due to variances in supply costs for electricity in excess of the heritage pool. These led to the recognition of an amount of $120 million receivable from customers, a $202-million decrease compared to 2014, given that supply costs in winter 2015 were lower than the previous winter because of market conditions.

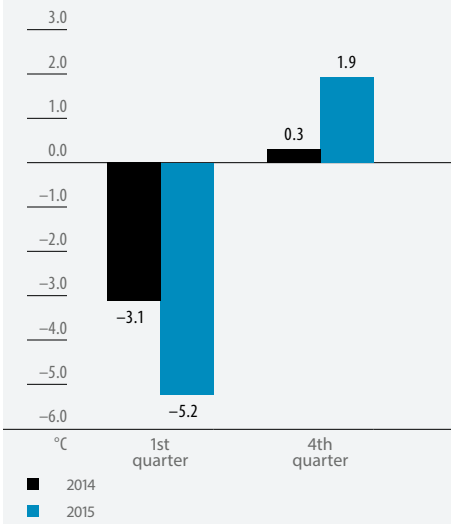
## ELECTRICITY PURCHASES AND TRANSMISSION COSTS

Electricity purchases and transmission costs decreased by $88 million compared to 2014. Supplies from Hydro-Québec Production were $202 million lower due to the combined effect of a reduction in market prices in 2015 and decreased volume resulting from the very mild temperatures recorded in the fourth quarter. Supplies purchased from third parties increased by $93 million, primarily on account of wind power and biomass energy purchases, which increased by $189 million and $44 million, respectively, and which were offset by a $151-million reduction in short-term market purchases. Thirteen new wind farms came on stream at the end of 2014 and during 2015. Finally, transmission costs incurred with Hydro-Québec TransÉnergie rose by $29 million.

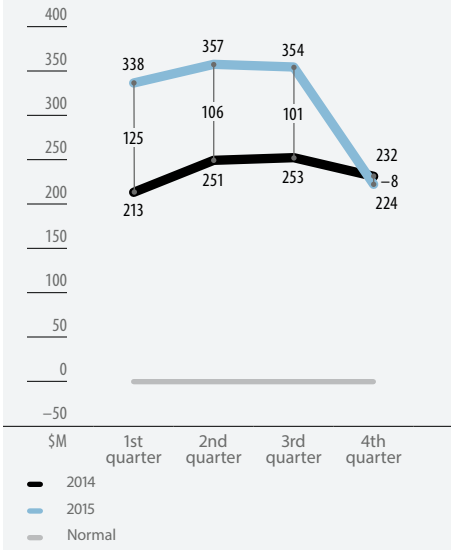
## DEPRECIATION AND AMORTIZATION

Depreciation and amortization expense amounted to $806 million compared to $746 million in 2014, a $60-million increase resulting essentially from the rollout of the advanced metering infrastructure.

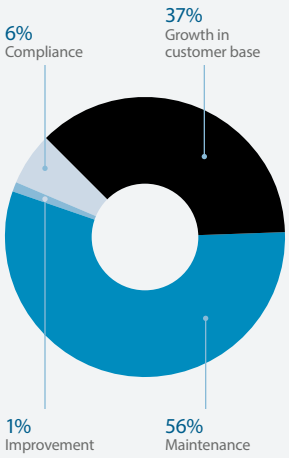
**VARIANCES FROM TEMPERATURE NORMALS – MONTRÉAL**




**CUMULATIVE IMPACT OF TEMPERATURE COMPARED TO THE NORMAL**



**BREAKDOWN OF 2015 INVESTMENTS BY HYDRO-QUÉBEC DISTRIBUTION**




## INVESTING ACTIVITIES

In 2015, Hydro-Québec Distribution's investments in property, plant and equipment and intangible assets totaled $756 million.

Of this amount, $280 million went toward handling the growth of the Québec customer base, including $165 million for new customer connections. The division also invested $422 million in asset sustainment, of which $228 million was allocated to the rollout of the advanced metering infrastructure. This included completing the large-scale rollout of next-generation meters in fall 2015, after installing some 3.7 million of these units on customer premises throughout Québec, 1.2 million of which were installed in 2015. The new infrastructure will make it possible to offer new services and optimize management of the distribution system. Furthermore, Hydro-Québec Distribution allocated $9 million to enhancing service quality, including $5 million for IT projects aimed at expanding the range of online self-service options.

# Construction

The Construction segment includes activities related to the projects carried out by Hydro-Québec Équipement et services partagés[1] and by Société d'énergie de la Baie James (SEBJ).

Hydro-Québec Équipement et services partagés is responsible for construction and refurbishment projects throughout Québec, except in the territory governed by the *James Bay and Northern Québec Agreement* (JBNQA). SEBJ builds generating facilities in the territory governed by the JBNQA (north of the 49th parallel) and may also carry out certain projects elsewhere in Québec and outside the province.

As engineering, construction and environmental specialists, Hydro-Québec Équipement et services partagés and SEBJ also offer Hydro-Québec Production and Hydro-Québec TransÉnergie a variety of services needed for draft-design studies, impact assessments and other undertakings in the context of energy-related projects. These services include technical and scientific surveys, planning, cost estimates, design, architecture, geomatics and quality control.

## VOLUME OF ACTIVITY

Hydro-Québec Équipement et services partagés and SEBJ carried out activities amounting to a total of $2,098 million in 2015, compared to $2,281 million the previous year. As in 2014, their workload can be attributed to several large-scale projects. Work done for Hydro-Québec Production totaled $798 million, compared to $1,001 million in 2014, while work done for Hydro-Québec TransÉnergie totaled $1,254 million, compared to $1,228 million in 2014.

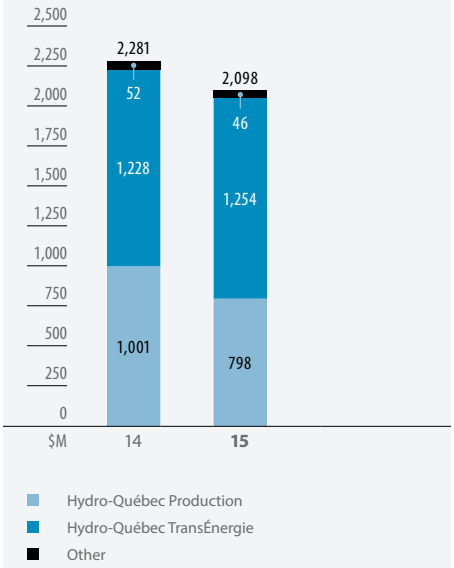
## MAIN PROJECTS

In the area of power generation, Hydro-Québec Équipement et services partagés continued the construction of the Romaine complex, which reached another important milestone at year end with the commissioning of Romaine-1 generating station (270 MW). Progress was also made on the refurbishment of Beauharnois, Les Cèdres and Rapides-des-Quinze generating stations. For Hydro-Québec TransÉnergie, the division continued work related to connecting the Romaine complex, building several substations and replacing the two static var compensators at Albanel substation. In addition, it moved a segment of the Hertel–Viger line to allow construction of the new Pont Champlain and began work on the Chamouchouane–Bout-de-l'Île project after obtaining the necessary approvals in spring 2015. Finally, it worked on upgrading various facilities in the main transmission system while pursuing other projects to increase transmission system capacity.

## 2015 AT A GLANCE

| | |
|---|---|
| Volume of activity | **$2.1B** |
| Main customers | |
| *Hydro-Québec Production* | **38%** |
| *Hydro-Québec TransÉnergie* | **60%** |

**BREAKDOWN OF CONSTRUCTION SEGMENT ACTIVITIES**




1. The operations of the Direction principale – Centre de services partagés are included under Corporate and Other Activities.

# Corporate and Other Activities

The Corporate and Other Activities heading includes all corporate activities, the Groupe – Développement de l'entreprise, planification stratégique et innovation, the Vice-présidence – Technologies de l'information et des communications and the Direction principale – Centre de services partagés.

## RESULTS

Corporate and Other Activities recorded net income of $95 million in 2015.

### CORPORATE ACTIVITIES

Corporate activities consist of the Groupe – Direction financière et contrôle, the Vice-présidence – Affaires corporatives et secrétariat général, the Vice-présidence – Financement, trésorerie et caisse de retraite and the Vice-présidence – Ressources humaines.

The Groupe – Direction financière et contrôle is responsible for overseeing financial, regulatory and management accounting frameworks as well as integrated business risk management. It also has the task of producing and analyzing the company's consolidated financial statements. Its other duties include financial planning, taxation, control and disbursements related to employees, retirees and suppliers.

The Vice-présidence – Affaires corporatives et secrétariat général develops strategies and provides support and advisory services in the areas of communications, public affairs, sustainable development and ethics, as well as relations with governments, communities and partner organizations. It is also responsible for services and expertise related to legal affairs and coordinates the company's activities in the electrification of ground transportation. The Secrétariat général provides administrative support to the Board of Directors and Board committees as well as to Hydro-Québec subsidiaries. The Secretary General also assists the Chairman of the Board of Directors in performing his duties and the President and Chief Executive Officer in carrying out the company's mandate.

The Vice-présidence – Financement, trésorerie et caisse de retraite is in charge of meeting the company's financing requirements, managing its treasury and maintaining relations with Hydro-Québec bondholders and rating agencies. It also acts as trustee of Hydro-Québec's pension fund. In 2015, the pension fund's rate of return was 10.4%, in spite of difficult market conditions. Over the past 10 years, it has posted an average annual return of 7.6%, placing it in the first decile of Canadian pension funds of comparable size. As at December 31, 2014, the date of the most recent actuarial valuation, the pension plan showed a funding surplus of $3.8 billion, which means that the assets held on that date were sufficient to cover future pension costs. The pension plan's funding ratio was 122%.

The Vice-présidence – Ressources humaines develops strategies, guidelines, frameworks, corporate programs and objectives in matters pertaining to human resources management, labor relations, compensation and employee benefits, organizational performance, health and safety, as well as training and skills development. It also makes sure that Management can count on optimum human resources conditions. Moreover, it is responsible for all measures to ensure the safety of personnel and third parties as well as the security of Hydro-Québec's assets and facilities.

## GROUPE – DÉVELOPPEMENT DE L'ENTREPRISE, PLANIFICATION STRATÉGIQUE ET INNOVATION

The Groupe – Développement de l'entreprise, planification stratégique et innovation combines the Vice-présidence – Développement des affaires, acquisitions et stratégies, the Direction principale – Institut de recherche d'Hydro-Québec and the Direction principale – Gestion des filiales. Its mandates include guiding strategic planning, finding and acting on business opportunities to grow Hydro-Québec's activities on external markets, leading activities involving scientific and technological innovation, and marketing the company's innovations.

## VICE-PRÉSIDENCE – TECHNOLOGIES DE L'INFORMATION ET DES COMMUNICATIONS

The mandate of the Vice-présidence – Technologies de l'information et des communications is to ensure the optimal management of telecommunications and information system infrastructure. With this in mind, it has continued to implement an integrated vision for systems governance, architecture, development, operations and cybersecurity. It offers the divisions and corporate units technology solutions designed to increase their productivity and efficiency in line with Hydro-Québec's business priorities, thereby contributing to the company's overall performance.

In 2015, this unit posted revenue of $622 million, compared to $616 million in 2014.

### Investing activities

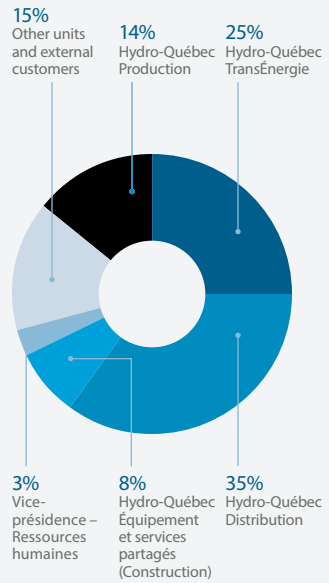
In 2015, the investments made by the Vice-présidence – Technologies de l'information et des communications totaled $100 million, and were allocated to maintaining asset quality.

## DIRECTION PRINCIPALE – CENTRE DE SERVICES PARTAGÉS

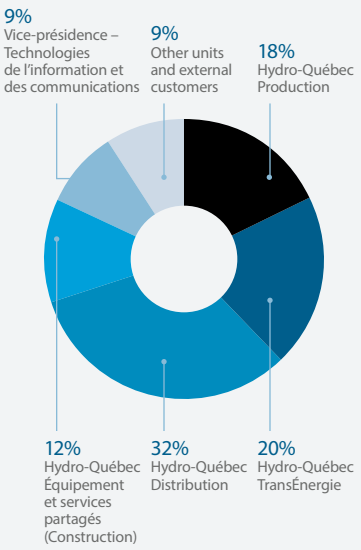
The Direction principale – Centre de services partagés, which is part of Hydro-Québec Équipement et services partagés, develops strategies, guidelines and frameworks pertaining to procurement and services common to the entire company. It provides divisions and corporate units with support services adapted to their needs, so that they can focus on their core activities. These services include procurement of goods and services, real estate management, vehicle fleet management and materials management, as well as management of food, accommodation and air transportation services.

Its revenue totaled $490 million in 2015, compared to $506 million in 2014.

**BREAKDOWN OF 2015 REVENUE: VICE-PRÉSIDENCE – TECHNOLOGIES DE L'INFORMATION ET DES COMMUNICATIONS**




**BREAKDOWN OF 2015 REVENUE: DIRECTION PRINCIPALE – CENTRE DE SERVICES PARTAGÉS**



# Outlook

Hydro-Québec will be releasing its *Strategic Plan 2016–2020* during 2016. The Plan will address four main priorities, namely improving customer service, proactive internal and external communications, productivity and growth.

In its 2015–2016 budget tabled in March 2015, the Québec government set Hydro-Québec's target net income at $2.75 billion for the financial year beginning on April 1, 2015. This outlook, which is lower than for the previous year, assumes normal temperatures in winter 2016 and takes into account the discontinuation of recognizing deferred foreign exchange gains, as the company had been doing under a strategy implemented in 2002.

Hydro-Québec is targeting net income on the order of $2.5 billion for the year ending December 31, 2016.

The company plans to invest approximately $3.9 billion in 2016, most of which will be allocated to the operations of Hydro-Québec TransÉnergie ($1.9 billion) and Hydro-Québec Production ($1.1 billion). More than half of Hydro-Québec's investments will be earmarked for facility maintenance and improvements. The remainder will go toward growth and development activities.

**Hydro-Québec Production** will continue its work on the Romaine complex jobsites in the course of developing Québec's hydroelectric potential. Two of the four generating stations in this major project, Romaine-2 and Romaine-1, were commissioned in 2014 and 2015, respectively. The other two will be phased in by 2020. In addition, the division will continue investing to ensure the long-term operability of its facilities and optimize their efficiency.

**Hydro-Québec TransÉnergie** will devote a large part of its investments to the 735-kV Chamouchouane–Bout-de-l'Île project, connecting the Romaine complex as part of the expansion of the transmission system in the Minganie region and bringing the Mesgi'g Ugju's'n (Rivière-Nouvelle) wind farm onto the grid. The division will also continue to invest in facility maintenance and improvement activities to ensure the reliability and long-term operability of its transmission assets and enhance service quality. Among other initiatives in this regard is the ongoing plan to develop the transmission system on the island of Montréal, which includes the construction of the new Fleury and De Lorimier substations and their 315-kV tap lines.

**Hydro-Québec Distribution** will continue to deliver reliable power and high-quality services to Québec customers. It will make further investments to handle the growth of the Québec customer base and to maintain and improve the quality of its facilities. In addition, with a view to enhancing service quality, it will expand the range of online self-serve options to make it easier for customers to manage their accounts.

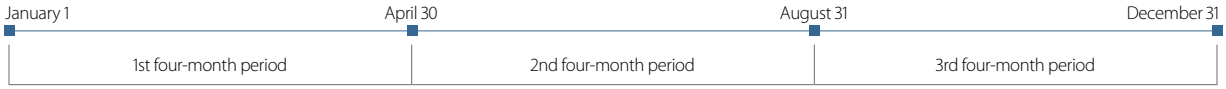
# Integrated Business Risk Management

Hydro-Québec applies an integrated business risk management process as part of its ongoing activities. This process is supported by various control, communication and assessment mechanisms that enable it to monitor risk developments on a dynamic basis.

The company's divisions and corporate units are central to the process. As part of their ongoing activities, they manage the risks to which they are exposed and reassess them on a regular basis, daily in some cases. In concrete terms, each division and corporate unit must determine and assess its main risks and then develop and apply mitigation measures to ensure that residual business risks are at a level acceptable to Hydro-Québec. The divisions and corporate units report on their risk management activities and follow-up to the Management Committee, which then acts as a risk management committee to provide overall monitoring of business risks.

This approach makes it possible to create a consolidated portfolio of residual business risks during the annual planning process. The consolidated portfolio is presented to the Board of Directors with the Business Plan, which includes a sensitivity analysis indicating the impact of certain risks on projected net income.

## ANNUAL INTEGRATED BUSINESS RISK MANAGEMENT PROCESS




| | | | |
|---|---|---|---|
| | | | **Business Plan** |
| Hydro-Québec Units | Division and corporate unit monitoring plans covering main business risks | | |
| | Division and corporate unit risk management reports – April review in the form of highlights | Division and corporate unit risk management reports – August review in the form of highlights | |
| | | Identification of risks and validation by managers reporting to the President and CEO | Preparation or revision of division and corporate unit portfolios of residual business risks – Supporting documents for evaluations |
| Hydro-Québec Management | **Management Committee** (in risk management mode) | **Management Committee** (in risk management mode) | **Management Committee** (in risk management mode) |
| | Review of risk management reports | Review of risk management reports | Review and discussion of each division's or corporate unit's portfolio of residual business risks |
| | | | **Management Committee acting as the Risk Management Committee with the President and CEO as CRO**[a] |
| | | | Review of the company's consolidated portfolio of residual business risks, risk map and probability of attaining projected net income |
| Board of Directors | | | **Audit Committee** |
| | | | Analysis of the company's integrated management process for residual business risks |
| | | | **Finance Committee** |
| | | | Analysis of the company's consolidated portfolio of residual business risks, risk map and probability of attaining projected net income |
| | | | **Board of Directors** |
| | | | Examination of the company's consolidated portfolio of residual business risks, risk map and probability of attaining projected net income |

a) Chief Risk Officer

## FINANCIAL RISKS

In the course of its operations, Hydro-Québec carries out transactions that expose it to certain financial risks, such as market, liquidity and credit risk. Systematic follow-up and the adoption of strategies that include the use of derivative instruments considerably reduce exposure to such risks and their impact on results.

To manage market and credit risk, a team of specialists that is independent of the units carrying out the transactions constantly monitors a number of risk indicators related to financial and energy transactions, and recommends risk-reduction strategies and controls.

### MARKET RISK

Hydro-Québec's results are subject to three main types of market risk: currency risk, interest rate risk and risk associated with energy and aluminum prices. Fluctuations in the Canadian dollar's exchange rate relative to the U.S. dollar affect revenue from sales denominated in U.S. dollars as well as the cost of U.S. dollar–denominated debt. Interest rate fluctuations affect financial expenses and pension costs. Finally, energy price fluctuations affect revenue from wholesale markets, while aluminum price fluctuations have an impact on revenue from special contracts with certain large industrial customers in Québec.

The three types of market risk are subject to active integrated management based on the use of derivative financial products. The purpose of such management is to limit the impact of market risk on Hydro-Québec's results, according to strategies and criteria established based on the company's risk tolerance. In addition, market risk over the medium and long term is mitigated by the offsetting effect between the impact of a general increase or decrease in interest rates on financial expenses, on the one hand, and the impact of such an increase or decrease on pension costs, on the other.

Hydro-Québec's pension costs are also subject to the risk of fluctuation in the fair value of investments held in the pension fund portfolio. To manage this risk, the company relies on asset diversification and on investment management strategies that include the use of derivatives.

### LIQUIDITY RISK

Liquidity risk is the risk that a company may have difficulty meeting commitments related to its financial liabilities. This type of risk may translate into difficulties accessing sources of financing for its investment program.

Hydro-Québec's liquidity risk is mitigated by several factors, including substantial cash flows generated by operating activities, access to a preauthorized standby credit facility and a diversified portfolio of highly liquid financial instruments.

### CREDIT RISK

Credit risk is the risk that a counterparty may not meet its contractual obligations. Hydro-Québec is exposed to credit risk related to receivables through ongoing electricity sales in Québec. These sales are billed at rates that provide for cost recovery according to conditions approved by the Régie de l'énergie. The company is also exposed to credit risk related to the cash equivalents, short-term investments and derivative instruments traded with financial institutions and other issuers and, to a lesser extent, with North American energy companies under Hydro-Québec Distribution supply contracts and Hydro-Québec Production energy transactions on markets outside Québec.

Exposure to credit risk is mitigated by the implementation of limits and frameworks for risk concentration and level of exposure by counterparty. To ensure compliance with such limits and frameworks, Hydro-Québec takes a proactive approach based on various controls and monitoring reports. These enable it to react quickly to any event that could have an impact on the financial condition of its counterparties. In addition, the company generally does business with counterparties that have a high credit rating. It also enters into agreements to limit the market value of the main portfolios of derivative instruments.

## OPERATIONAL RISKS

### GENERATION

One of the principal uncertainties that Hydro-Québec faces relates to natural water inflows. Hydro-Québec Production must ensure that it is able to meet its commitments to supply the annual heritage pool of up to 165 TWh to Hydro-Québec Distribution and fulfill its contractual obligations. In concrete terms, this means being able to cover a natural inflow deficit of 64 TWh over two consecutive years, and 98 TWh over four consecutive years. To manage this risk, the division applies a variety of mitigation measures and closely monitors them. For instance, it manages its reservoir storage on a multiyear basis and maintains an adequate margin between its generating capacity and its commitments. This allows the division to compensate for variations in runoff, replenish its reserves or take advantage of business opportunities. Hydro-Québec regularly reports to the Régie de l'énergie on the generating capacity and energy reserve of Hydro-Québec Production.

In addition to runoff uncertainties, Hydro-Québec Production's export activities on wholesale markets are subject to market risk and the risk of unavailability of generating and transmission equipment. Market risk results from fluctuations in electricity and fuel prices, and is mitigated by ongoing monitoring of trends on wholesale markets and the use of hedging derivative instruments. The risk of unavailability of generating and transmission equipment is mitigated through maintenance and upgrade programs.

Another risk to which Hydro-Québec Production is exposed stems from temperature variations and changes in Québec market demand compared to forecasts. These factors have an impact on the division's electricity sales to Hydro-Québec Distribution and may affect the volume available for its export sales.

The risks related to Hydro-Québec Production's export activities are quantified in an integrated fashion by a team of specialists that is independent of the unit carrying out the transactions. This team sees to the application of controls, presents daily reports to Senior Management and ensures compliance with the limits approved by Management and the Board of Directors.

### TRANSMISSION

Several factors, such as extreme weather and equipment failure, may cause service interruptions or result in the unavailability of part of the transmission system. The multifaceted strategy adopted by Hydro-Québec TransÉnergie to prevent these problems includes implementing the standards of the North American Electric Reliability Corporation and the Northeast Power Coordinating Council, as well as measures to maintain and improve transmission facilities and optimize their useful life. It is worth noting that Hydro-Québec TransÉnergie's Direction – Contrôle des mouvements d'énergie (system control unit) is Reliability Coordinator for transmission systems in Québec, a role it was assigned by the Régie de l'énergie in 2007.

Hydro-Québec TransÉnergie must ensure adequate transmission capacity to supply Hydro-Québec Distribution and other customers, as well as transmission system security and reliability. To do so, the division relies, among other things, on a strategy of ensuring long-term operability of transmission assets and on a process for optimal management of annual peak load.

### DISTRIBUTION

The main risk related to power distribution is continuity of service. To manage this risk, Hydro-Québec applies a series of measures that include vegetation control, the implementation of an asset maintenance program and a strategy for asset renewal, as well as compliance with applicable standards for overhead and underground systems. Moreover, to reduce the length of service interruptions, the vast majority of which are caused by adverse weather conditions, the division has adopted new technologies for rapid detection of outages, faster service restoration and remote management of certain incidents.

Hydro-Québec Distribution must also deal with fluctuations in demand (under normal climate conditions) due to the economic and energy situation, which have an impact on results. When demand is lower than the forecasts presented in the rate filing, the division cannot recover from customers all the costs related to power distribution and power transmission through the Hydro-Québec TransÉnergie system. To counter the impact of this risk, the division constantly fine-tunes its method of forecasting demand for electricity.

### CONSTRUCTION

One of the principal risks that Hydro-Québec Équipement et services partagés must deal with is pressure on project costs, due to such factors as the rising cost of labor in the construction industry, higher prices for certain materials or products and events that affect project schedules. There is also a risk related to the quality and delivery time for components.

Regarding construction time, the division makes respecting schedules a top priority despite the constraints inherent in large-scale capital projects. This is particularly important in the current context of the construction industry in Québec, in which new legislative and regulatory measures may have an impact on workflows and on Hydro-Québec's ability to work with certain suppliers. An active monitoring process and contingency measures have been put in place to mitigate the most probable impacts of this situation.

To meet its commitments and continue to apply high quality and safety standards, Hydro-Québec Équipement et services partagés has implemented a number of measures that reduce its risk exposure. Specifically, the division closely monitors project schedules, costs and the main deliverables, an approach that enables it to ensure that projects are progressing as planned or to take any necessary corrective action. It maintains ongoing relations with the relevant organizations and government departments to stay abreast of future amendments to laws and regulations that could affect construction costs and deadlines, among other things. It also monitors key indicators for trends in prices and the rate of activity in the construction industry. In addition, it develops procurement strategies that promote competition, sustainable supplies and maintaining expertise in its markets, and it adjusts its project completion strategies according to economic conditions, in consultation with its customers.

Finally, new trade agreements will take effect in 2016 and 2017, particularly the Public Procurement chapter of the *Trade and Cooperation Agreement Between Ontario and Québec*, which will apply to Hydro-Québec's operations as of September 1, 2016. These agreements will affect the company's procurement processes.

### CORPORATE AND OTHER ACTIVITIES

Environmental protection and conservation are among Hydro-Québec's central concerns. The majority of activities that have a significant impact on the environment are governed by an ISO 14001–certified environmental management system. In addition, every year, the company reviews its management of environmental issues and provides an overview of the situation in this regard in its Sustainability Report.

Hydro-Québec is also concerned with information security and the risks associated with confidentiality and with the loss of availability or integrity of systems and data as a result of a malicious act, error or natural disaster. The company regularly assesses how well its information systems are protected against threats and implements the necessary security measures. These measures include an information and communications technology security program, a process for anticipating security threats and a strategy for adapting to changes in them, an antivirus expertise centre, Internet filtering, a security monitoring centre, management of identities and access, and management of incidents and vulnerabilities.

Furthermore, Hydro-Québec has implemented a series of physical, technological and human measures to ensure the safety of individuals (employees, suppliers and the public) as well as the security of its assets and facilities. Based on risk and threat assessment and analysis, these measures vary according to the strategic importance of the asset concerned, developments in the company's business environment and various external factors. Physical protection and cybersecurity activities are now handled by the same corporate unit, which fosters an integrated approach and strengthens the company's overall security.

Finally, Hydro-Québec has a corporate emergency response plan to ensure the continuity of its operations and its mission in case of an exceptional event. The corporate plan integrates the emergency response plans and activities of the business units with the aim of strengthening and improving coordination of the efforts of all internal and external responders, including public authorities.

# Management's Report on Financial Information

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

Management maintains an internal control system whose objective is to provide reasonable assurance that financial information is relevant and reliable and that Hydro-Québec's assets are appropriately recorded and safeguarded. In particular, this system includes Hydro-Québec's policies and directives, and involves communicating Hydro-Québec's rules of ethics and Code of Conduct to employees, to ensure the proper management of resources and the orderly conduct of business. An internal auditing process allows evaluation of the sufficiency and effectiveness of controls, as well as of Hydro-Québec's policies and directives. Recommendations ensuing from this process are submitted to Management and the Audit Committee.

The Board of Directors is responsible for corporate governance. It assumes its responsibility for the consolidated financial statements principally through its Audit Committee, composed solely of independent directors, who do not hold full-time positions within Hydro-Québec or in one of its subsidiaries. The Audit Committee is responsible for ensuring that the consolidated financial statements present fairly Hydro-Québec's financial position, results of operations and cash flows, and for recommending the consolidated financial statements to the Board of Directors for approval. The Audit Committee meets with Management, the Internal Auditor and the independent auditors to discuss the results of their audits and the resulting findings with respect to the integrity and the quality of Hydro-Québec's financial reporting as well as its internal control system. The Internal Auditor and the independent auditors have full and unrestricted access to the Audit Committee, with or without Management present.

The 2015 and 2014 consolidated financial statements have been audited jointly by the Auditor General of Québec, KPMG LLP and Ernst & Young LLP.

**/s/ Michael D. Penner**
Chairman of the Board

**/s/ Éric Martel**
President and Chief Executive Officer

**/s/ Lise Croteau**
Executive Vice President and Chief Financial Officer

Montréal, Québec
February 19, 2016

# Independent Auditors' Report

To the Minister of Finance of Québec:

## REPORT ON CONSOLIDATED FINANCIAL STATEMENTS

We have audited the accompanying consolidated financial statements of Hydro-Québec, which comprise the consolidated balance sheets as at December 31, 2015 and 2014, the consolidated statements of operations, comprehensive income, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

### MANAGEMENT'S RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with United States generally accepted accounting principles, and for such internal control as Management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### OPINION

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Hydro-Québec as at December 31, 2015 and 2014, and its consolidated results of operations and its consolidated cash flows for the years then ended in accordance with United States generally accepted accounting principles.

## REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the *Auditor General Act* (CQLR, c. V-5.01), we report that, in our opinion, given the retroactive application of the change in financial reporting framework described in Note 21 to the consolidated financial statements, the standards have been applied for the year ended December 31, 2015, in the same way as the previous year.

**/s/ KPMG LLP**[1]

**/s/ Ernst & Young LLP**[2]

**/s/ Guylaine Leclerc, FCPA auditor, FCA**
Auditor General of Québec

Montréal, Québec

February 19, 2016

1. CPA auditor, CA, public accountancy permit No. A120220
2. CPA auditor, CA, public accountancy permit No. A109499

# Consolidated Financial Statements

## CONSOLIDATED STATEMENTS OF OPERATIONS

| Years ended December 31<br>In millions of Canadian dollars | Notes | 2015 | 2014<br>(Note 21) |
|---|---|---|---|
| **Revenue** | | **13,754** | 13,652 |
| **Expenditure** | | | |
| Operations | | **2,527** | 2,366 |
| Electricity and fuel purchases | | **1,938** | 1,968 |
| Depreciation and amortization | 4 | **2,713** | 2,593 |
| Taxes | 5 | **980** | 975 |
| | | **8,158** | 7,902 |
| **Operating income** | | **5,596** | 5,750 |
| Financial expenses | 6 | **2,449** | 2,425 |
| **Net income** | | **3,147** | 3,325 |

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| Years ended December 31<br>In millions of Canadian dollars | Notes | 2015 | 2014<br>(Note 21) |
|---|---|---|---|
| **Net income** | | **3,147** | 3,325 |
| **Other comprehensive income** | | | |
| Change in deferred gains on items designated as cash flow hedges | 15 | **2,015** | 929 |
| Reclassification to results of deferred gains on items designated as cash flow hedges | 15 | **(1,595)** | (541) |
| Actuarial gains (losses) and past service (costs) credits for employee future benefits | 18 | **64** | (696) |
| Reclassification to results of net actuarial losses and past service costs (credits) for employee future benefits | 18 | **243** | 225 |
| | | **727** | (83) |
| **Comprehensive income** | | **3,874** | 3,242 |

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

## CONSOLIDATED BALANCE SHEETS

| As at December 31<br>In millions of Canadian dollars | Notes | 2015 | 2014<br>(Note 21) |
|---|---|---|---|
| **ASSETS** | | | |
| **Current assets** | | | |
| Cash and cash equivalents | | **2,648** | 1,271 |
| Short-term investments | | **1,895** | 1,664 |
| Accounts receivable and other receivables | 15 | **2,242** | 2,171 |
| Derivative instruments | 15 | **274** | 172 |
| Regulatory assets | 3 | **122** | 182 |
| Materials, fuel and supplies | | **212** | 199 |
| | | **7,393** | 5,659 |
| Property, plant and equipment | 7 | **61,558** | 60,413 |
| Intangible assets | 8 | **1,014** | 1,062 |
| Investments | 9 | **859** | 863 |
| Derivative instruments | 15 | **128** | 91 |
| Regulatory assets | 3 | **3,939** | 4,559 |
| Other assets | 10 | **308** | 461 |
| | | **75,199** | 73,108 |
| **LIABILITIES** | | | |
| **Current liabilities** | | | |
| Borrowings | | **9** | 23 |
| Accounts payable and accrued liabilities | | **2,278** | 2,257 |
| Dividend payable | 16 | **2,360** | 2,535 |
| Accrued interest | | **913** | 907 |
| Asset retirement obligations | 11 | **85** | 79 |
| Derivative instruments | 15 | **299** | 159 |
| Regulatory liabilities | 3 | **49** | – |
| Current portion of long-term debt | 12 | **2,059** | 906 |
| | | **8,052** | 6,866 |
| Long-term debt | 12 | **43,613** | 43,579 |
| Asset retirement obligations | 11 | **780** | 804 |
| Derivative instruments | 15 | **5** | 60 |
| Regulatory liabilities | 3 | **392** | 350 |
| Other liabilities | 13 | **2,571** | 3,221 |
| Perpetual debt | 14 | **311** | 267 |
| | | **55,724** | 55,147 |
| **EQUITY** | 16 | | |
| Share capital | | **4,374** | 4,374 |
| Retained earnings | | **16,546** | 15,759 |
| Accumulated other comprehensive income | | **(1,445)** | (2,172) |
| | | **19,475** | 17,961 |
| | | **75,199** | 73,108 |
| Commitments and contingencies | 19 | | |

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

On behalf of the Board of Directors,

**/s/ Michelle Cormier**
Chair of the Audit Committee

**/s/ Michael D. Penner**
Chairman of the Board

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

| Years ended December 31<br>In millions of Canadian dollars | Notes | Share capital | Retained earnings | Accumulated other comprehensive income | Total equity |
|---|---|---|---|---|---|
| Balance as at January 1, 2015 | 16 | **4,374** | **15,759** | **(2,172)** | **17,961** |
| Net income | | **–** | **3,147** | **–** | **3,147** |
| Other comprehensive income | 16 | **–** | **–** | **727** | **727** |
| Dividend | 16 | **–** | **(2,360)** | **–** | **(2,360)** |
| Balance as at December 31, 2015 | | **4,374** | **16,546** | **(1,445)** | **19,475** |
| Balance as at January 1, 2014 | 21 | 4,374 | 14,969 | (2,089) | 17,254 |
| Net income | | – | 3,325 | – | 3,325 |
| Other comprehensive income | 16 | – | – | (83) | (83) |
| Dividend | 16 | – | (2,535) | – | (2,535) |
| Balance as at December 31, 2014 | | 4,374 | 15,759 | (2,172) | 17,961 |

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| Years ended December 31<br>In millions of Canadian dollars | Notes | **2015** | 2014<br>(Note 21) |
|---|---|---|---|
| **Operating activities** | | | |
| Net income | | **3,147** | 3,325 |
| Adjustments to determine net cash flows from operating activities | | | |
| Depreciation and amortization | 4 | **2,713** | 2,593 |
| Amortization of premiums, discounts and issue expenses related to debt securities | | **159** | 147 |
| Excess of net cost recognized over amounts paid for employee future benefits | | **161** | 27 |
| Other | | **209** | (184) |
| Regulatory assets and liabilities | | **(56)** | (103) |
| Change in non-cash working capital items | 17 | **(98)** | 68 |
| | | **6,235** | 5,873 |
| **Investing activities** | | | |
| Additions to property, plant and equipment | | **(3,340)** | (3,675) |
| Additions to intangible assets | | **(100)** | (140) |
| Net (acquisition) disposal of short-term investments | | **(218)** | 43 |
| Other | | **14** | 17 |
| | | **(3,644)** | (3,755) |
| **Financing activities** | | | |
| Issuance of long-term debt | | **13** | 1,511 |
| Repayment of long-term debt | | **(1,044)** | (2,702) |
| Cash receipts arising from credit risk management | 15 | **8,220** | 3,521 |
| Cash payments arising from credit risk management | 15 | **(6,397)** | (2,596) |
| Net change in borrowings | | **(19)** | (11) |
| Dividend paid | | **(2,535)** | (2,207) |
| Other | | **486** | 198 |
| | | **(1,276)** | (2,286) |
| **Foreign currency effect on cash and cash equivalents** | | **62** | 6 |
| **Net change in cash and cash equivalents** | | **1,377** | (162) |
| **Cash and cash equivalents, beginning of year** | | **1,271** | 1,433 |
| **Cash and cash equivalents, end of year** | | **2,648** | 1,271 |
| Supplementary cash flow information | 17 | | |

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

# Notes to Consolidated Financial Statements

Years ended December 31, 2015 and 2014

Amounts in tables are in millions of Canadian dollars, unless otherwise indicated.

*Under the provisions of the* Hydro-Québec Act, *Hydro-Québec 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. Hydro-Québec is required, in particular, to supply a base volume of up to 165 TWh a year of heritage pool electricity for the Québec market, as set out in the* Act Respecting the Régie de l'énergie. *As a government corporation, Hydro-Québec is exempt from paying income taxes in Canada.*

## **NOTE 1** // Significant Accounting Policies

Hydro-Québec's consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles (U.S. GAAP) since January 1, 2015. These consolidated financial statements are therefore Hydro-Québec's first annual consolidated financial statements prepared in accordance with U.S. GAAP.

The new accounting framework has been applied retrospectively to all the periods presented in these consolidated financial statements. Note 21, First-Time Application of U.S. GAAP, presents the impact of the changeover to U.S. GAAP on the financial position and operating results for 2014, namely reconciliations with the amounts previously reported in the consolidated financial statements prepared in accordance with Canadian generally accepted accounting principles, as set out in Part V of the *CPA Canada Handbook*, "Pre-Changeover Accounting Standards" (Canadian GAAP).

Management is of the opinion that these consolidated financial statements include all the necessary adjustments to present fairly, in all material respects, the consolidated financial position of Hydro-Québec.

Management has reviewed events occurring until February 19, 2016, the date of approval of these consolidated financial statements by the Board of Directors, to determine whether circumstances warranted the recording or presentation of events after the balance sheet date.

### REGULATION

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

Under U.S. GAAP, it is acknowledged that rate regulation may affect the timing of the recognition of certain transactions in the consolidated results, giving rise to the recognition of regulatory assets and liabilities, which Hydro-Québec considers it is likely to recover or settle subsequently through the rate-setting process.

When the Transmission Provider or the Distributor has adequate assurance that certain costs incurred may likely be recovered in future rates, such costs are deferred and recognized as assets. When it is probable that the Transmission Provider or the Distributor will be required to reimburse customers, or when costs have been recovered but will be incurred in the future, a liability is recognized. The balances of these assets and liabilities are amortized over the recovery periods approved by the Régie.

### SCOPE OF CONSOLIDATION

The consolidated financial statements include the accounts of Hydro-Québec and its subsidiaries as well as those of variable interest entities where Hydro-Québec is the primary beneficiary. All intercompany balances and transactions were eliminated at the time of consolidation.

Investments in joint ventures are accounted for on an equity basis. These investments are initially recognized at cost, and their carrying amount is increased or decreased by an amount equal to Hydro-Québec's share of the changes in the joint ventures' net assets after the date of acquisition. Hydro-Québec's share of the joint ventures' results is recognized in results. Dividends received from the joint ventures are applied against the carrying amount of the investments.

### USE OF ESTIMATES

The preparation of financial statements in accordance with U.S. GAAP requires that Management make estimates and assumptions that affect the amounts recognized as assets and liabilities, the disclosures regarding contingent assets and liabilities at the date of the consolidated financial statements and the amounts recognized as revenue and expenditure for the years at issue. The estimates relate, among other things, to revenue, which includes estimated amounts for electricity delivered but not billed; the carrying amount of regulatory assets and liabilities; the useful life of property, plant and equipment and intangible assets for calculating the depreciation and amortization expense; cash flows; the expected timing of payments; and the discount rates used to determine asset retirement obligations and employee future benefits. These rates are based on economic and actuarial assumptions. Actual results could differ from those estimates and such differences could be significant.

### REVENUE

Hydro-Québec supplies the Québec market with electricity and also sells power on wholesale markets in Canada and the United States. In addition, it is active in arbitrage transactions. Revenue from electricity sales and arbitrage transactions is recognized on delivery. Arbitrage transactions are recognized net of related electricity purchases.

Revenue also includes certain amounts that Hydro-Québec is entitled to receive from customers or is required to pay to them in the future. These amounts relate, among other things, to the supply of electricity in excess of the heritage pool, to transmission services and to climate conditions. These items give rise to financial assets and liabilities that are reported in Accounts receivable and other receivables and Other assets or in Accounts payable and accrued liabilities and Other liabilities, based on their maturities.

Other revenue is recognized on delivery of the goods or services.

## FOREIGN CURRENCY TRANSLATION

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rate in effect at the balance sheet date, and non-monetary items are translated at the historical exchange rate. Revenue and expenditure arising from foreign currency transactions are translated into Canadian dollars at the exchange rate in effect at the transaction date. The exchange gains or losses resulting from the translation of monetary items are included in results.

The financial statements of foreign operations whose functional currency is not the Canadian dollar are translated according to the current rate method. Under this method, assets and liabilities are translated into Canadian dollars at the exchange rate in effect at the balance sheet date, and revenue and expenditure are translated at the average exchange rate in effect during the period. The exchange gains or losses resulting from the translation of the financial statements of these foreign operations are presented in Accumulated other comprehensive income under Equity on the balance sheet.

## FINANCIAL INSTRUMENTS

*Cash and cash equivalents*

Cash and cash equivalents include investments with a maturity of three months or less from the date of acquisition.

*Short-term investments*

Short-term investments, classified as available-for-sale debt securities, consist of money market instruments with a maturity of more than three months from the date of acquisition and are recognized at fair value. Changes in fair value are recorded in Other comprehensive income until they are realized, at which time they are reclassified to results. Interest on these investments, calculated using the effective interest method, is recognized in results.

*Receivables – Accounts receivable*

Accounts receivable are recognized at the amount invoiced, net of the allowance for doubtful accounts. This allowance is based on the status of customer files and the recovery experience for each age group of accounts. Receivables are written off during the period in which the accounts are deemed uncollectible.

*Other receivables and financial liabilities*

Other receivables presented under Accounts receivable and other receivables, receivables presented under Other assets and the government reimbursement for the 1998 ice storm, also presented in Other assets, less any impairment losses, as well as financial liabilities presented under Accounts payable and accrued liabilities and Other liabilities, borrowings, the dividend payable, accrued interest, long-term debt and perpetual debt, are measured at amortized cost using the effective interest method. Amortized cost includes transaction costs as well as premiums and discounts, if applicable. Interest is recognized in results.

*Derivative instruments*

Derivative instruments are recognized at fair value at the balance sheet date. Changes in fair value are recognized in results for the period in which they occur, except in the case of derivative instruments designated as hedges in a cash flow hedging relationship. The net balances of derivative instruments that are transacted with the same counterparty, that are the subject of an enforceable master netting arrangement, and that meet the conditions for set-off are presented on the balance sheet.

As part of its integrated business risk management, Hydro-Québec uses derivative instruments to manage its market risk, consisting of currency risk, interest rate risk and risk resulting from fluctuating energy and aluminum prices. It applies cash flow or fair value hedge accounting to eligible hedging relationships that it designates as hedges, and formally documents these relationships. Among other things, this process involves associating derivative instruments with specific assets or liabilities on the balance sheet, or with probable anticipated transactions. Hydro-Québec ensures that hedging relationships are highly effective in offsetting the designated risk exposure initially and then monthly thereafter. In addition, for hedges of anticipated transactions, it assesses the probability of the occurrence of those transactions designated as hedged items at least on a quarterly basis.

In the case of a cash flow hedge, the effective portion of changes in the fair value of an instrument designated as a hedge is recognized under Other comprehensive income, while the ineffective portion is immediately recognized in results, under the line item affected by the hedged item. Amounts included in Accumulated other comprehensive income are reclassified to results, also under the line item affected by the hedged item, during the periods in which the hedged item affects results. If a derivative instrument no longer satisfies hedging conditions, if it has expired or is sold, terminated or exercised, or if Hydro-Québec cancels its designation as a hedging item, hedge accounting ceases to be applied on a prospective basis. Previously accumulated gains and losses in Other comprehensive income continue to be carried forward to be reclassified to results during the same periods as the hedged item. If the hedged item ceases to exist or if it becomes likely that the hedged anticipated transactions will not occur, the gains or losses carried forward are immediately reclassified to results.

In the case of a fair value hedge, changes in the fair value of the derivative instrument, including those related to the ineffective portion of the hedge, are recognized in results under the line item affected by the hedged item. Offsetting changes in the fair value of the hedged item attributable to the hedged risk are recognized as adjustments to this item's carrying amount and are offset against results.

Cash flows attributable to derivative instruments designated as hedges are presented in the statement of cash flows based on the same classification as the hedged item.

Hydro-Québec assesses its contracts to determine if they meet the definition of a derivative or if they include an embedded derivative, which must be separated from its host contract. If such is the case, the contract or the embedded derivative is recognized at fair value on the balance sheet.

All futures or forward contracts on non-financial items that can be settled on a net basis and whose price is closely tied to the non-financial item bought or sold are recorded at the date of settlement if there is a probability of receipt or delivery in accordance with expected requirements.

### FAIR VALUE

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

In accordance with the applicable standards, Hydro-Québec classifies the fair value measurements of assets and liabilities according to a three-level hierarchy, based on the type of inputs used in making these measurements:

- Level 1: Quoted prices (unadjusted) on active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2: Inputs other than quoted prices included within Level 1 that are observable either directly or indirectly; and
- Level 3: Unobservable inputs.

### MATERIALS, FUEL AND SUPPLIES

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

### PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are carried at cost, which comprises materials, labor, other costs directly related to construction activities, and financial expenses capitalized during construction. Property, plant and equipment also include draft-design costs for projects whose technical feasibility has been demonstrated, whose profitability has been estimated, and for which Management deems that it will in all likelihood have the necessary resources for completion. The discounted value of retirement obligations related to property, plant and equipment as well as that of agreements with local communities meeting the definition of a liability are added to the carrying amount of the property, plant and equipment concerned. Moreover, contributions from third parties are applied against the cost of the related property, plant and equipment.

Property, plant and equipment are depreciated over their useful life, using the straight-line method, starting in the month following the date of commissioning. The depreciation periods for the principal categories of property, plant and equipment are as follows:

| | |
|---|---|
| Hydraulic generation | 40 to 120 years |
| Thermal generation | 15 to 50 years |
| Transmission substations and lines | 30 to 85 years |
| Distribution substations and lines | 25 to 60 years |
| Other property, plant and equipment | 5 to 50 years |

When property, plant and equipment are retired, their cost, net of accumulated depreciation and salvage value, is recognized in the results for the year.

Maintenance and repair costs are recognized in results when incurred.

### LEASES

Capital leases, which have the effect of transferring substantially all the risks and benefits incident to ownership of the leased property to Hydro-Québec, are presented under Property, plant and equipment. They are recognized on their effective date at the fair value of the leased property or, if it is lower, at the present value of the minimum lease payments. Capital leases include contracts that qualify as lease agreements providing for the transfer of the right to use the asset in question. They are amortized over the useful life of the asset or over the term of the contract, if it is less.

Payments under operating leases, where the lessor does not transfer substantially all the risks and benefits incident to ownership of property, are recognized in results throughout the term of the lease agreement.

### INTANGIBLE ASSETS

Intangible assets are recorded at cost.

The cost of internally developed computer software is capitalized when it meets capitalization criteria. The related financial expenses are capitalized over the development period.

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

Intangible assets with a finite useful life, namely software and licences, as well as patents, are amortized over their useful life according to the straight-line method over the following periods:

| | |
|---|---|
| Software and licences | 3 to 10 years |
| Patents | 20 years |

### CAPITALIZED FINANCIAL EXPENSES

Financial expenses capitalized to property, plant and equipment under construction and to internally developed computer software related to non-regulated activities are determined on the basis of the cost of debt and recognized as a deduction from financial expenses in the consolidated results. Financial expenses capitalized to property, plant and equipment under construction that are related to rate-regulated transmission or distribution activities also take into account the return on equity of the activities concerned. The portion that corresponds to return on equity is included in Revenue in the consolidated results.

### IMPAIRMENT OF LONG-LIVED ASSETS

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

## EMPLOYEE FUTURE BENEFITS

*Pension plan and other post-retirement benefits*

Hydro-Québec offers all its employees a contributory defined-benefit pension plan based on final pay (the Pension Plan), as well as other post-retirement benefits. It accounts for its obligations under the Pension Plan and these other benefits after deducting the fair value of their respective assets.

Benefit costs and obligations under the Pension Plan and other post-retirement benefits provided in exchange for current service are calculated according to the projected benefit method prorated on years of service. They are determined using a discount rate and are based on Management's best estimates, in particular concerning the expected return on plan assets, salary escalation, the increase in health care costs, and employees' retirement ages. Plan assets are measured at fair value at the balance sheet date.

In order to establish the benefit costs and its obligations under the Pension Plan and other post-retirement benefits, Hydro-Québec has adopted the following policies:

- The discount rate is based on the average rate of the interest rate curve on the measurement date of high-quality Canadian corporate bonds and takes into account the expected cash flows associated with the projected benefit obligations.
- Actuarial gains and losses are recognized in Other comprehensive income for the period in which they occur. Thereafter, amortization of actuarial gains or losses is recognized in Operating expenses if the unamortized net actuarial gain or loss at the beginning of the year exceeds 10% of the value of the projected benefit obligations or 10% of the market-related value of the plan assets, whichever is greater. The amortization corresponds to the excess divided by active employees' average remaining years of service.
- Past service costs (credits) arising from amendments to the Pension Plan and other post-retirement benefits are initially recognized in Other comprehensive income, and thereafter are amortized in Operating expenses using the straight-line method over periods not exceeding active employees' average remaining years of service.
- The expected return on Pension Plan assets is based on a market-related value determined by using a five-year moving average value for equity securities and by measuring other asset classes at fair value.

The unamortized balances of net actuarial losses and of past service costs (credits) recognized in Accumulated other comprehensive income for employee future benefits to be recovered in future rates are recognized as a regulatory asset.

*Post-employment benefits*

Hydro-Québec offers all its employees post-employment benefits, including a long-term disability salary insurance plan that provides for the payment of long-term defined benefits.

The post-employment benefit cost and obligation are recognized at the time of the event giving rise to the obligation to pay benefits. The cost of these benefits, including all related actuarial gains and losses, is recognized in results for the period.

## ASSET RETIREMENT OBLIGATIONS

Hydro-Québec accounts for asset retirement obligations in the period in which the legal obligations with respect thereto arise, provided that a reasonable estimate of their fair value can be made. The corresponding costs of asset retirement are added to the carrying amount of the related long-lived asset and are amortized over its useful life. In subsequent years, any change due to the passage of time is recognized in operating expenses for the current year (accretion expense) and the corresponding amount is added to the carrying amount of the liability. Changes resulting from revisions to the timing or the amount of the undiscounted cash flows are recognized as an increase or decrease in the carrying amount of the liability arising from asset retirement obligations, and the corresponding amount is added to the carrying amount of the related asset or deducted up to a maximum of its carrying amount, with any excess then being recognized in results. When the asset reaches the end of its useful life, any change is immediately recognized in results. The actual costs incurred to settle asset retirement obligations are applied against liabilities. During the final settlement of such an obligation, the difference between the balance of the obligation and the actual cost incurred is recognized as a gain or a loss in results.

The cash flows required to settle asset retirement obligations are estimated on the basis of studies that use various assumptions concerning the methods and timing to be adopted for the retirement. Hydro-Québec periodically reviews the measurement of these obligations in light of the underlying assumptions and estimates, potential technological advances, and changes in applicable standards, laws and regulations.

## AGREEMENTS WITH LOCAL COMMUNITIES

Hydro-Québec has entered into various agreements with the local communities concerned by certain capital projects. The amounts under these agreements are recognized in Long-term debt if they fall within the definition of a liability, and the offsetting item is recognized in Property, plant and equipment. The recognized amounts are determined by discounting the future cash flows related to these agreements. The discount rate used is the interest rate on Hydro-Québec bonds at the date of initial recognition. Subsequently, in the case of agreements with indexed cash flows, the cash flows are subject to an annual re-estimate that can result in a change in the discount rate.

## RELATED PARTY TRANSACTIONS

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

In addition, as a government corporation, Hydro-Québec provides the Québec government with financial data prepared in accordance with International Financial Reporting Standards so that it can prepare its consolidated financial statements.

## NOTE 2 // Changes to Accounting Policies

### STANDARDS ADOPTED IN 2015

*Inventory*

In July 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-11, *Inventory (Topic 330): Simplifying the Measure of Inventory*. This standard requires that inventory whose cost is determined using the weighted average cost or the first-in, first-out method be measured prospectively at the lower of cost or net realizable value. Hydro-Québec opted for an early adoption as of January 1, 2015.

*Debt issuance costs*

In April 2015, the FASB issued ASU 2015-03, *Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*. This standard requires that debt issuance costs be presented retrospectively on the balance sheet as a direct deduction from the carrying amount of the relevant debt liability. Hydro-Québec opted for an early adoption as of January 1, 2015.

### STANDARDS ISSUED BUT NOT YET EFFECTIVE

*Intangible assets*

In April 2015, the FASB issued ASU 2015-05, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*. This standard, which clarifies the circumstances in which a cloud computing arrangement includes an internal-use software licence, will apply to interim and annual financial statements for periods beginning on or after January 1, 2016. It is not expected to have any significant impact on Hydro-Québec's consolidated financial statements.

*Consolidation*

In February 2015, the FASB issued ASU 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*. This standard amends the guidance concerning entities that must be fully consolidated during the preparation of consolidated financial statements. It will apply retrospectively to interim and annual financial statements for periods beginning on or after January 1, 2016. Hydro-Québec is currently examining the impact of this standard on its consolidated financial statements.

*Statements of operations*

In January 2015, the FASB issued ASU 2015-01, *Income Statement—Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*. This standard will apply to interim and annual financial statements for periods beginning on or after January 1, 2016. It is not expected to have any significant impact on Hydro-Québec's consolidated financial statements.

*Revenue*

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This standard provides guidance on the recognition of revenue at the time that goods or services are transferred to a client, for an amount that reflects the payment which the entity expects to receive in exchange for the goods or services. In August 2015, the FASB published ASU 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, which defers the effective date of the standard by one year, such that it will apply retrospectively to interim and annual financial statements for periods beginning on or after January 1, 2018. Hydro-Québec is currently examining the impact of this standard on its consolidated financial statements, but does not intend early adoption.

## NOTE 3 // Regulation

### RATES

*Changeover to U.S. GAAP*

In decision D-2015-189, the Régie authorized changes, effective July 10, 2015, to certain accounting policies applied by the Transmission Provider and the Distributor for rate-setting purposes, given the application of U.S. GAAP to Hydro-Québec's rate-regulated power transmission and distribution activities as of that date. The changes relate to the recognition of certain development expenses and some current and future costs associated with the Energy Efficiency Plan (EEP) as regulatory assets. They also concern the recognition of employee future benefits and asset retirement obligations, as well as the depreciation of property, plant and equipment related to rate-regulated activities.

*Transmission*

Hydro-Québec's power transmission rates for 2015 and 2014 were determined in Régie decisions D-2015-031 and D-2014-049, effective January 1, 2015, and January 1, 2014, respectively. The authorized return on the rate base was set at 6.97% in 2015 and 7.05% in 2014, assuming a capitalization with 30% equity.

*Distribution*

Hydro-Québec's electricity rates for the rate years beginning on April 1, 2015, and April 1, 2014, respectively, were determined in decisions D-2015-033 and D-2014-052, in which the Régie authorized average increases of 2.86% and 4.27% for all rates except Rate L, for which the authorized increases were 2.49% and 3.45%. The authorized return on the rate base was set at 7.08% in 2015 and 7.14% in 2014, assuming a capitalization with 35% equity.

The following information describes the impact on the consolidated financial statements of the accounting policies and practices adopted by Hydro-Québec in accordance with the Régie's decisions with respect to its rate-regulated activities.

## REGULATORY ASSETS

*Costs related to the EEP*

Eligible EEP costs incurred are recognized in a separate account and amortized over a 10-year period using the straight-line method. Amortization begins the year after the one in which the costs are recognized. The costs recognized in this account bear interest at the rate of return authorized by the Régie on the rate base until such time as amortization begins. This accounting practice was authorized by the Régie in decision D-2015-189, which relates to Hydro-Québec's power distribution activities.

*Costs related to the de-icing system at Lévis substation*

Certain costs related to the Lévis substation de-icing system, designed in the wake of the 1998 ice storm to secure the transmission lines supplying the greater Québec area, were recognized in a separate account. These costs have been depreciated using the straight-line method starting from the date of commissioning of the de-icing system, over a period corresponding to the average remaining useful life of the assets enhanced by the system. The costs bore interest at the rate of return authorized by the Régie on the rate base until such time as they were included in the rate base and amortization began. This accounting practice was authorized by the Régie in decision D-2004-175, which relates to Hydro-Québec's power transmission activities.

*Costs related to projects pending approval by the Régie*

Costs related to projects that were included in a rate application, but that are pending approval at the time the decision on the rate application is handed down, are recognized in a separate account until the projects are approved by the Régie and amortized over the subsequent year. These costs bear interest at the rates prescribed by the Régie until such time as amortization begins. This accounting practice was authorized by the Régie in decisions D-2011-039, D-2012-024, D-2012-059 and D-2014-035, which relate to Hydro-Québec's power transmission and distribution activities.

*Costs related to a suspension agreement*

The Régie authorized an agreement regarding the temporary suspension of deliveries from a generating station in May 2014. The offsetting entry for the financial liability recorded with regard to this agreement was recognized in a separate non-interest-bearing account, and the adjustments related to subsequent changes in this liability are recognized in the same account. The costs related to the suspension agreement are recovered in the rates on an annual basis, depending on the amounts billed. This accounting practice was authorized by the Régie in decision D-2014-086, which relates to Hydro-Québec's power distribution activities. In decision D-2015-179, the Régie approved an agreement regarding the use of this generating station during peak demand periods. This agreement was still not in force as at December 31, 2015.

*Development costs*

Eligible development costs are recognized in a separate non-interest-bearing account and are amortized over a five-year period using the straight-line method. Amortization begins the year after the one in which the costs are recognized. This accounting practice was authorized by the Régie in decision D-2015-189, which relates to Hydro-Québec's power transmission and distribution activities.

*Employee future benefits*

The unamortized balances of net actuarial losses and of past service costs (credits) recognized in Accumulated other comprehensive income for employee future benefits to be recovered in future rates are recognized in a separate, non-interest-bearing account. This regulatory asset, which concerns Hydro-Québec's power transmission and distribution activities, is amortized when the unamortized balances are reclassified as a cost component of employee future benefits. The Régie's specific approval was not required because recovery of the cost of employee future benefits in the rates had already been approved.

REGULATORY ASSETS

| | Expected years of amortization | **2015** | 2014 |
|---|---|---|---|
| Costs related to the EEP | 2016–2025 | **800** | 904 |
| Costs related to the de-icing system at Lévis substation | 2016–2047 | **6** | 7 |
| Costs related to projects pending approval by the Régie | – | **–** | 37 |
| Costs related to a suspension agreement | 2016–2018 | **356** | 510 |
| Development costs | 2016–2020 | **17** | 21 |
| Employee future benefits | As of 2016 | **2,877** | 3,262 |
| Other | To be determined | **5** | – |
| | | **4,061** | 4,741 |
| Short-term regulatory assets | | **122** | 182 |
| Long-term regulatory assets | | **3,939** | 4,559 |

## REGULATORY LIABILITIES

*Deferred expense accounts related to the changeover to U.S. GAAP*

The impacts of changes in accounting policies as a result of the changeover to U.S. GAAP, other than those concerning pension cost, have been recognized in separate accounts whose disposal method has not yet been established. The amounts recognized in these accounts bear interest at the rates prescribed by the Régie. The changes concern the recognition of employee future benefits other than the Pension Plan and the recognition of asset retirement obligations, as well as the review of useful lives for depreciation purposes of property, plant and equipment related to rate-regulated activities. They were authorized by the Régie in decision D-2015-189, which relates to Hydro-Québec's power transmission and distribution activities.

*Depreciation of property, plant and equipment*

Prior to July 10, 2015, the useful life of property, plant and equipment was limited to 50 years for rate-setting purposes. Since then, this limit no longer applies, provided that the weighted average useful life of all property, plant and equipment of the Transmission Provider, on the one hand, and of the Distributor, on the other hand, does not exceed 50 years. The differences in the depreciation expense resulting from the application of useful lives limited to 50 years for rate-setting purposes until July 9, 2015, were recognized in a separate, non-interest-bearing account and are amortized at the same rate as the property, plant and equipment concerned.

*Past service costs under the Pension Plan*

The unamortized balance of past service costs under the Pension Plan that has already been recovered in the rates and will be reflected in the results of future years has been recognized in a separate, non-interest-bearing account. This regulatory liability is amortized when the past service costs recognized in Accumulated other comprehensive income are reclassified as a cost component of employee future benefits.

REGULATORY LIABILITIES

| | Expected years of amortization | **2015** | 2014 |
|---|---|---|---|
| Deferred expense accounts related to the changeover to U.S. GAAP | To be determined | **49** | – |
| Depreciation of property, plant and equipment | 2016–2115 | **366** | 317 |
| Past service costs under the Pension Plan | 2016–2022 | **26** | 33 |
| | | **441** | 350 |
| Short-term regulatory liabilities | | **49** | – |
| Long-term regulatory liabilities | | **392** | 350 |

*Risks and uncertainties*

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

## OTHER REGULATORY PRACTICES

Under Régie decisions D-2002-95 and D-2003-93, the compensation granted by the Québec government for the 1998 ice storm was applied against the cost of newly constructed property, plant and equipment. It is amortized over the remaining useful life of the retired assets, with the exception of the portion equivalent to the unamortized cost of these assets, which is amortized over a 10-year period. The straight-line method of depreciation is used in both cases.

In decisions D-2002-95 and D-2004-47, the Régie prescribed capitalizing financial expenses to property, plant and equipment under construction related to rate-regulated activities, according to the authorized rates of return on the rate bases. These rates, which are set using methods approved by the Régie, take into account a component associated with the cost of the debt and a component associated with the return on equity. The component associated with return on equity totaled $49 million in 2015 ($61 million in 2014).

Under Régie decisions D-2002-95 and D-2003-93, the cost of dismantling retired and replaced assets for which no asset retirement obligation was recognized is added, net of the salvage value, to the cost of the newly constructed assets. Under Régie decision D-2011-039, which relates to Hydro-Québec's power transmission activities, the costs of restoring sites associated with replaced assets are also added to the cost of newly constructed assets.

Under Régie decisions D-2006-76 and D-2006-76R, contributions received for relocation or modification projects relating to certain transmission grid assets are recognized in a separate account and applied against property, plant and equipment. These contributions are amortized over the average useful life of assets for each project, using the straight-line method.

Finally, the legal and regulatory context in which Hydro-Québec operates gives it the right to receive from its customers or the obligation to pay to them, as the case may be, the amounts corresponding to any variance between the actual amount of certain specific items and the amount provided in rate filings for these items. They therefore give rise to financial assets or liabilities that are recovered or settled over a period of one to five years. These assets bear interest at the rates prescribed by the Régie until such time as amortization begins.

The following table presents the net balance of financial assets and liabilities:

FINANCIAL ASSETS AND LIABILITIES

| | **2015** | 2014 |
|---|---|---|
| Variances in supply costs for electricity in excess of the heritage pool | **368** | 377 |
| Revenue variances related to climate conditions | **32** | 52 |
| Variances in the costs related to major outages | **–** | 27 |
| Variances in pension cost | **(8)** | (22) |
| Variances in the expense related to the activities of the Bureau de l'efficacité et de l'innovation énergétiques | **8** | (29) |
| Other | **17** | 6 |
| | **417** | 411 |
| Presented as follows: | | |
| Accounts receivable and other receivables | **215** | 32 |
| Other assets | **226** | 379 |
| Other liabilities | **(24)** | – |

Regulatory assets and liabilities and financial assets and liabilities are not included in the rate base, except for costs related to the EEP, costs related to the de-icing system at Lévis substation, and development costs.

## NOTE 4 // Depreciation and Amortization

| | 2015 | 2014 |
|---|---|---|
| Property, plant and equipment | **2,160** | 2,099 |
| Intangible assets[a] | **164** | 150 |
| Regulatory assets and liabilities | **297** | 248 |
| Retirement of capital assets | **92** | 96 |
| | **2,713** | 2,593 |

a) For the period from 2016 to 2020, amortization of intangible assets that have already been recognized should be as follows: $163 million in 2016, $144 million in 2017, $75 million in 2018, $44 million in 2019 and $19 million in 2020.

## NOTE 5 // Taxes

| | 2015 | 2014 |
|---|---|---|
| Water-power royalties[a] | **660** | 656 |
| Public utilities tax[b] | **268** | 252 |
| Municipal, school and other taxes[c] | **52** | 67 |
| | **980** | 975 |

a) Water-power royalties payable to the Québec government totaled $654 million in 2015 ($651 million in 2014), including a balance due of $3 million as at December 31, 2015 (balance receivable of $3 million as at December 31, 2014).

b) The public utilities tax is payable to the Québec government.

c) Including $32 million payable to the Québec government in 2015 under the *Act Respecting Energy Efficiency and Innovation* ($21 million in 2014), of which a balance of $7 million was outstanding as at December 31, 2015 (nil as at December 31, 2014).

## NOTE 6 // Financial Expenses

| | 2015 | 2014 |
|---|---|---|
| Interest on debt securities | **2,552** | 2,594 |
| Net exchange gain | **(69)** | (25) |
| Guarantee fees related to debt securities[a] | **205** | 205 |
| | **2,688** | 2,774 |
| Less | | |
| Capitalized financial expenses | **211** | 318 |
| Net investment income | **28** | 31 |
| | **239** | 349 |
| | **2,449** | 2,425 |

a) Guarantee fees related to debt securities are paid to the Québec government.

## NOTE 7 // Property, Plant and Equipment

| | 2015 | | | |
|---|---|---|---|---|
| | In service | Accumulated depreciation | Under construction | Net carrying amount |
| **Generation** | | | | |
| Hydraulic | 45,462 | 16,772 | 1,752 | **30,442** |
| Thermal | 405 | 384 | – | **21** |
| Other | 776 | 463 | 21 | **334** |
| | 46,643 | 17,619 | 1,773 | **30,797** |
| **Transmission** | | | | |
| Substations and lines | 29,210 | 11,116 | 1,321 | **19,415** |
| Other | 2,454 | 1,417 | 114 | **1,151** |
| | 31,664 | 12,533 | 1,435 | **20,566** |
| **Distribution** | | | | |
| Substations and lines | 13,830 | 6,221 | 360 | **7,969** |
| Other | 3,335 | 1,683 | 101 | **1,753** |
| | 17,165 | 7,904 | 461 | **9,722** |
| **Construction** | 39 | 21 | – | **18** |
| **Corporate and Other Activities** | 1,148 | 777 | 84 | **455** |
| | 96,659[a] | 38,854[a] | 3,753 | **61,558** |

| | 2014 | | | |
|---|---|---|---|---|
| | In service | Accumulated depreciation | Under construction | Net carrying amount |
| **Generation** | | | | |
| Hydraulic | 44,322 | 16,089 | 2,007 | 30,240 |
| Thermal | 662 | 637 | – | 25 |
| Other | 750 | 442 | 10 | 318 |
| | 45,734 | 17,168 | 2,017 | 30,583 |
| **Transmission** | | | | |
| Substations and lines | 27,750 | 10,514 | 1,505 | 18,741 |
| Other | 2,334 | 1,352 | 133 | 1,115 |
| | 30,084 | 11,866 | 1,638 | 19,856 |
| **Distribution** | | | | |
| Substations and lines | 13,444 | 5,967 | 411 | 7,888 |
| Other | 3,141 | 1,672 | 136 | 1,605 |
| | 16,585 | 7,639 | 547 | 9,493 |
| **Construction** | 40 | 20 | – | 20 |
| **Corporate and Other Activities** | 1,135 | 768 | 94 | 461 |
| | 93,578[a] | 37,461[a] | 4,296 | 60,413 |

a) As at December 31, 2015, the cost and accumulated depreciation of property, plant and equipment in service under capital leases amounted to $699 million and $127 million, respectively ($616 million and $96 million as at December 31, 2014).

## NOTE 8 // Intangible Assets

| | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated amortization | Net carrying amount | Cost | Accumulated amortization | Net carrying amount |
| **Subject to amortization** | | | | | | |
| Software and licences | 1,849 | 1,277 | **572** | 1,753 | 1,134 | 619 |
| Patents | 25 | 14 | **11** | 24 | 13 | 11 |
| | 1,874 | 1,291 | **583** | 1,777 | 1,147 | 630 |
| **Not subject to amortization** | | | | | | |
| Servitudes | | | **426** | | | 419 |
| Rights | | | **5** | | | 13 |
| | | | **431** | | | 432 |
| | | | **1,014** | | | 1,062 |

Additions corresponding to internally developed software totaled $91 million in 2015 ($113 million in 2014).

## NOTE 9 // Investments

| | 2015 | 2014 |
|---|---|---|
| **At equity** | | |
| Churchill Falls (Labrador) Corporation Limited (34.2%) | **231** | 217 |
| Société en commandite Hydroélectrique Manicouagan (60.0%)[a] | **621** | 626 |
| | **852** | 843 |
| **Other** | **7** | 20 |
| | **859** | 863 |

a) This investment includes the unamortized excess of the purchase price over the underlying net carrying amount of the assets of Société en commandite Hydroélectrique Manicouagan as at the acquisition date, which is composed of unamortizable intangible assets of $282 million and amortizable assets of $273 million (respectively, $282 million and $284 million in 2014).

In 2015, electricity purchases from Churchill Falls (Labrador) Corporation Limited [CF(L)Co] and Société en commandite Hydroélectrique Manicouagan totaled $110 million and $81 million, respectively ($102 million and $78 million in 2014).

## NOTE 10 // Other Assets

| | 2015 | 2014 |
|---|---|---|
| Government reimbursement for the 1998 ice storm[a] | **66** | 66 |
| Receivables[b] | **226** | 380 |
| Other | **16** | 15 |
| | **308** | 461 |

a) In accordance with the terms and conditions in effect since January 1, 2013, the full amount of the reimbursement will be paid no later than October 15, 2019, and interest calculated at the Bankers' Acceptance Rate for a 12-month term will be paid on an annual basis.

b) Assets of $226 million related to variances between the actual amount of certain specific items and the amount provided in rate filings for these items ($379 million as at December 31, 2014).

# **NOTE 11** // Asset Retirement Obligations

Liabilities arising from asset retirement obligations relate to the costs of dismantling Gentilly-2 nuclear generating station, the removal of spent nuclear fuel resulting from its operation, and the dismantling of thermal generating stations and certain fuel tanks and transmission substations.

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

| | 2015 | | | |
|---|---|---|---|---|
| | Dismantling of nuclear generating station[a] | Removal of spent nuclear fuel[a] | Dismantling of other assets | Total |
| Balance, beginning of year | 483 | 242 | 158 | **883** |
| Liabilities incurred | – | – | 2 | **2** |
| Accretion expense | 26 | 15 | 4 | **45** |
| Liabilities settled | (45) | (2) | (24) | **(71)** |
| Revision of estimated cash flows and expected timing of payments | – | – | 6 | **6** |
| Balance, end of year | 464 | 255 | 146 | **865** |
| Less | | | | |
| Current portion | 55 | 11 | 19 | **85** |
| | 409 | 244 | 127 | **780** |

| | 2014 | | | |
|---|---|---|---|---|
| | Dismantling of nuclear generating station[a] | Removal of spent nuclear fuel[a] | Dismantling of other assets | Total |
| Balance, beginning of year | 529 | 248 | 175 | 952 |
| Liabilities incurred | – | – | 5 | 5 |
| Accretion expense | 30 | 14 | 5 | 49 |
| Liabilities settled | (76) | (3) | (17) | (96) |
| Revision of estimated cash flows and expected timing of payments | – | (17) | (10) | (27) |
| Balance, end of year | 483 | 242 | 158 | 883 |
| Less | | | | |
| Current portion | 36 | 5 | 38 | 79 |
| | 447 | 237 | 120 | 804 |

a) The Québec government has provided an irrevocable financial guarantee of up to $685 million to the Canadian Nuclear Safety Commission for the performance of Hydro-Québec's obligations with regard to the cost of dismantling Gentilly-2 generating station and the removal of spent nuclear fuel.

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

| | Dismantling of nuclear generating station | Removal of spent nuclear fuel | Dismantling of other assets |
|---|---|---|---|
| Estimated cash flows (in constant dollars) required to settle the obligations[a] | | | |
| 2015 | 1,159 | 664 | 188 |
| 2014 | 1,180 | 647 | 194 |
| Expected timing of payment of the cash flows required to settle the obligations | | | |
| 2015 | Between 2016 and 2066 | Between 2016 and 2164 | Between 2016 and 2092 |
| 2014 | Between 2015 and 2066 | Between 2015 and 2164 | Between 2015 and 2092 |
| Discount rate (%)[b] | | | |
| Initial recognition of obligations | 6.4 | 6.4 | Between 1.1 and 6.4 |
| Subsequent recognition of obligations | Between 4.3 and 5.7 | Between 3.6 and 5.7 | Between 1.0 and 4.4 |

a) Inflation rates varying between 1.9% and 3.7% were used to determine the asset retirement obligations.

b) The discount rates are the credit-adjusted risk-free rates.

### HYDRO-QUÉBEC TRUST FOR MANAGEMENT OF NUCLEAR FUEL WASTE

Under the *Nuclear Fuel Waste Act* (NFWA), which came into force in 2002, the owners of nuclear fuel waste in Canada were required to set up a management organization, the Nuclear Waste Management Organization, and each of them was required to establish a trust fund to finance the cost of long-term management of its nuclear fuel waste.

In April 2009, the Government of Canada approved a formula for financing the costs of the approach adopted for long-term nuclear fuel waste management. The amounts deposited in the trust funds can only be used to finance the implementation of this approach.

Hydro-Québec has made all the payments required under the NFWA. As at December 31, 2015, the investments held in the Hydro-Québec trust fund were composed of debt securities issued by Hydro-Québec, the fair value of which totaled $153 million ($140 million as at December 31, 2014).

The Hydro-Québec Trust for Management of Nuclear Fuel Waste is considered a variable interest entity of which Hydro-Québec is the primary beneficiary.

## NOTE 12 // Long-Term Debt

Long-term debt is mainly composed of bonds, medium-term notes and other debts, including liabilities under agreements entered into with local communities. The following table presents a breakdown of the debt, including the current portion, at amortized cost, by currency at the time of issue and at the time of repayment. Forward contracts and currency swaps traded for currency risk management purposes related to long-term debt were taken into account in determining the percentages of debt by currency at the time of repayment.

| | **2015** | | | | 2014 | | | |
|---|---|---|---|---|---|---|---|---|
| | | | At time of issue | At time of repayment | | | At time of issue | At time of repayment |
| | In Canadian dollars and other currencies | At closing exchange rates as at the balance sheet date | % | % | In Canadian dollars and other currencies | At closing exchange rates as at the balance sheet date | % | % |
| **Hydro-Québec's debt** | | | | | | | | |
| Canadian dollars[a, b] | 33,953 | **33,953** | **75** | **100** | 34,295 | 34,295 | 78 | 100 |
| U.S. dollars | 8,098 | **11,212** | **25** | **–** | 8,094 | 9,388 | 21 | – |
| Other currencies | | | | | | | | |
| Euros | 60 | **91** | **–** | **–** | 60 | 85 | – | – |
| Pounds sterling | – | **–** | **–** | **–** | 200 | 361 | 1 | – |
| Yen | 1,000 | **12** | **–** | **–** | 1,000 | 10 | – | – |
| | | **45,268** | **100** | **100** | | 44,139 | 100 | 100 |
| Plus | | | | | | | | |
| Adjustment for fair value hedged risk | | **404** | | | | 346 | | |
| | | **45,672** | | | | 44,485 | | |
| Less | | | | | | | | |
| Current portion | | **2,059** | | | | 906 | | |
| | | **43,613** | | | | 43,579 | | |

a) Including non-interest-bearing debts other than bonds and medium-term notes whose discounted value was $1,345 million as at December 31, 2015 ($1,317 million as at December 31, 2014).

b) Certain debts carry sinking fund requirements. An amount of $701 million ($588 million as at December 31, 2014) is presented under Short-term investments for this purpose.

The table below presents the amortized cost, at the balance sheet date, of the tranches of long-term debt maturing over the next five years:

| | |
|---|---|
| 2016 | 2,059 |
| 2017 | 1,442 |
| 2018 | 1,163 |
| 2019 | 1,128 |
| 2020 | 2,349 |

### INTEREST RATES

The following table shows interest rates on bonds and medium-term notes, which take into account contractual rates, premiums, discounts and issue expenses, as well as the effect of forward contracts and swaps traded to manage long-term risks related to debt. As at December 31, 2015, the variable rate portion of the bonds and notes totaled 14.5% (14.1% as at December 31, 2014).

| % | | | | **2015** | 2014 |
|---|---|---|---|---|---|
| Maturity | Canadian dollars | U.S. dollars | Other currencies | Weighted average | Weighted average |
| 1 to 5 years | 7.11 | 1.35 | 5.21 | **6.32** | 1.89 |
| 6 to 10 years | 9.38 | 8.39 | – | **8.84** | 9.34 |
| 11 to 15 years | 5.91 | 9.76 | – | **9.66** | 8.94 |
| 16 to 20 years | 5.21 | – | – | **5.21** | 7.05 |
| 21 to 25 years | 5.11 | – | – | **5.11** | 5.62 |
| 26 to 30 years | 4.89 | – | – | **4.89** | 5.11 |
| 31 to 35 years | 4.47 | – | – | **4.47** | 4.89 |
| 36 to 40 years | 3.98 | – | – | **3.98** | 4.47 |
| 41 to 45 years | 6.53 | – | – | **6.53** | 3.98 |
| 46 to 50 years | – | – | – | **–** | 6.53 |
| Weighted average | 5.07 | 8.91 | 5.21 | **5.39** | 5.43 |

### CREDIT FACILITY AND LINES OF CREDIT

Hydro-Québec has an undrawn credit facility of US$2,000 million, including a US$750-million swing loan, which will expire in 2020. Any debt securities will bear interest at a rate based on the London Interbank Offered Rate (LIBOR), except for the swing loan, which is at the U.S. base rate. Hydro-Québec also has access to undrawn operating lines of credit, which are renewed automatically in the absence of notice to the contrary and bear interest at the prime rate. As at December 31, 2015, the available balances on these lines of credit were US$200 million and $247 million in Canadian or U.S. dollars.

## NOTE 13 // Other Liabilities

| | Note | **2015** | 2014 |
|---|---|---|---|
| Employee future benefit liabilities | 18 | **2,174** | 2,705 |
| Accounts payable[a] | | **397** | 516 |
| | | **2,571** | 3,221 |

a) Including a $239-million financial liability related to an agreement regarding the temporary suspension of deliveries from a generating station, which was approved by the Régie in May 2014 ($365 million as at December 31, 2014). The current portion, presented under Accounts payable and accrued liabilities, totaled $117 million as at December 31, 2015 ($145 million as at December 31, 2014). This financial liability, including the current portion, represents a discounted amount of $356 million ($510 million as at December 31, 2014) and contained an outstanding amount, payable in U.S. dollars, of $22 million (US$16 million) as at December 31, 2015 ($38 million, or US$33 million, as at December 31, 2014). As at December 31, 2015, the effective rate of this liability was 1.56% (1.53% as at December 31, 2014).

## NOTE 14 // Perpetual Debt

Perpetual notes in the amount of $311 million (US$225 million) as at December 31, 2015, and of $267 million (US$230 million) as at December 31, 2014, bear interest at LIBOR, plus 0.0625%, as calculated semiannually. As at December 31, 2015 and 2014, the rates applicable to the perpetual notes were 0.6% and 0.4%, respectively.

The perpetual notes are redeemable at Hydro-Québec's option. In 2015, portions totaling $6 million (US$5 million) were repurchased on the secondary market and then canceled ($9 million, or US$8 million, in 2014). Various derivative instruments are used to mitigate the currency risk associated with the perpetual debt.

## NOTE 15 // Financial Instruments

In the course of its operations, Hydro-Québec carries out transactions that expose it to certain financial risks, such as market, liquidity and credit risk. Exposure to such risks and the impact on results are reduced through careful monitoring and implementation of strategies that include the use of derivative instruments.

### MARKET RISK

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in market prices. Hydro-Québec is exposed to three main types of market risk: currency risk, interest rate risk and risk associated with energy and aluminum prices. Active integrated management of these three types of risk aims to limit exposure to each risk to an acceptable level and reduce their overall impact on results.

### MANAGEMENT OF LONG-TERM RISK

*Management of risk associated with sales in U.S. dollars*

Currency risk – Hydro-Québec uses currency swaps to manage currency risk associated with probable U.S.-dollar sales, designating them as cash flow hedges. The impact of these hedging transactions on results is recognized in Revenue.

*Management of risk associated with debt*

Currency risk and interest rate risk – Hydro-Québec uses forward contracts and currency swaps to manage the currency risk associated with long-term debt and perpetual debt, as well as forward contracts and interest rate swaps to modify long-term exposure to interest rate risk. When designated as hedging items, these derivative instruments are recognized as cash flow hedges or fair value hedges, depending on the risk hedged. The impact on results of foreign currency hedging transactions and those associated with debt interest rates is recognized in Financial expenses.

The following table shows the notional amounts, expressed in Canadian dollars and foreign currencies, of forward contracts and swaps used to manage long-term risk:

| | **2015**[a] | 2014[a] |
|---|---|---|
| **Forward contracts** | | |
| U.S. dollars | **2,230** | 2,233 |
| **Swaps** | | |
| Canadian dollars | **(9,400)** | (7,941) |
| U.S. dollars | **6,042** | 6,042 |
| Other currencies | | |
| Euros | **61** | 61 |
| Pounds sterling | **–** | 200 |
| Yen | **1,000** | 1,000 |

a) Figures in parentheses represent amounts to be paid.

### MANAGEMENT OF SHORT-TERM RISK

Currency risk – Hydro-Québec uses forward contracts to manage its foreign currency risk exposure over the short term. When designated as hedging items, these derivative instruments are recognized as cash flow hedges. The impact of currency risk hedging transactions on results is recognized in the line item affected by the hedged item, namely Revenue, Electricity and fuel purchases, or Financial expenses. The notional amount of open positions as at December 31, 2015, was US$1,129 million in currency sales contracts (US$500 million as at December 31, 2014).

Interest rate risk – Hydro-Québec uses interest rate swaps and forward rate agreements to manage short-term interest rate risk. When designated as hedging items, these derivative instruments are recognized as cash flow hedges. The impact on results of transactions to hedge short-term interest rate risk is recognized in the line item affected by the hedged item, namely Financial expenses.

Price risk – Hydro-Québec uses mainly commodity futures and swaps to manage risk resulting from fluctuations in energy and aluminum prices. When designated as hedging items, these derivative instruments are recognized as cash flow hedges. The impact on results of transactions to hedge the risk related to energy and aluminum prices is recognized in the line item affected by the hedged item, namely Revenue or Electricity and fuel purchases. In this context, Hydro-Québec has traded electricity futures and swaps for which open positions as at December 31, 2015, totaled 20.0 TWh (14.9 TWh as at December 31, 2014). As at December 31, 2015, there was no open position for natural gas futures (1.3 million MMBtu as at December 31, 2014) or for aluminum swaps (100,000 tonnes as at December 31, 2014).

## LIQUIDITY RISK

Liquidity risk is the risk that an entity will have difficulty meeting commitments related to its financial liabilities.

Hydro-Québec's exposure to this risk is reduced by: significant cash flows from operating activities; a diversified portfolio of highly liquid or readily convertible instruments traded with high-quality counterparties; preauthorized sources of financing; the ability to access capital markets; the diversification of financing sources; and management of the volume of floating-rate debt and debt repayable in foreign currency.

Moreover, as at December 31, 2015, $43,672 million in long-term debt, perpetual debt and borrowings, net of the sinking fund, was guaranteed by the Québec government ($40,939 million as at December 31, 2014).

## CREDIT RISK

Credit risk is the risk that one party to a financial asset will fail to meet its obligations.

Hydro-Québec is exposed to credit risk related to cash and cash equivalents, short-term investments and derivative instruments traded with financial institutions. It is also exposed to credit risk related to accounts receivable and other receivables, which arises primarily from its day-to-day electricity sales in and outside Québec. Credit risk is limited to the carrying amount presented under assets on the balance sheet, which approximates fair value.

*Cash and cash equivalents, short-term investments and derivative instruments*

In order to reduce its credit risk exposure, Hydro-Québec deals with a number of issuers and financial institutions with high credit ratings, most of which are Canadian. In addition, it applies policies to limit risk concentration as well as various monitoring programs and sets credit limits for each counterparty. Through prior agreements, it can also limit the market value of the main derivative instrument portfolios. Any variation in market value beyond the agreed-upon limit results in a cash receipt or payment. As at December 31, 2015, substantially all counterparties dealing with Hydro-Québec had a credit rating of A or better, and none of them had defaulted on their obligations to Hydro-Québec.

*Accounts receivable and other receivables*

Exposure to credit risk from electricity sales is limited due to Hydro-Québec's large and diverse customer base. Management believes that Hydro-Québec is not exposed to a significant credit risk, particularly because sales in Québec are billed at rates that allow for recovery of costs based on the terms and conditions set by the Régie. Moreover, Hydro-Québec holds as collateral customer deposits totaling $115 million ($103 million as at December 31, 2014), of which $30 million ($27 million as at December 31, 2014) is recognized in Accounts payable and accrued liabilities and $85 million ($76 million as at December 31, 2014) in Other liabilities.

The value of accounts receivable and other receivables, net of the related allowance for doubtful accounts, is presented in the following table:

| | **2015** | 2014 |
|---|---|---|
| Accounts receivable[a] | **1,626** | 1,826 |
| Other receivables[b] | **616** | 345 |
| | **2,242**[c] | 2,171[c] |

a) Including unbilled electricity deliveries, which totaled $1,093 million as at December 31, 2015 ($1,209 million as at December 31, 2014).

b) Including a $189-million financial guarantee ($105 million in 2014) covering certain derivative instruments held at year end.

c) Including US$229 million (US$159 million in 2014) translated at the exchange rate in effect at the balance sheet date.

The allowance for doubtful accounts receivable amounted to $273 million as at December 31, 2015 ($336 million as at December 31, 2014).

## FAIR VALUE OF DERIVATIVE INSTRUMENTS

The following tables present the fair value of derivative instruments by type and depending on whether they are designated as fair value hedges or cash flow hedges, or not designated as hedges:

| | | | | **2015** |
|---|---|---|---|---|
| | Derivatives designated as fair value hedges | Derivatives designated as cash flow hedges | Derivatives not designated as hedges | Total gross value of derivatives |
| **Assets** | | | | |
| Contracts – Currency risk | – | 1,682 | 157 | **1,839** |
| Contracts – Currency risk and interest rate risk | 1 | – | – | **1** |
| Contracts – Interest rate risk | 573 | – | – | **573** |
| Contracts – Price risk | – | 219 | 84 | **303** |
| | 574 | 1,901 | 241 | **2,716** |
| **Liabilities** | | | | |
| Contracts – Currency risk | – | (139) | (2,398) | **(2,537)** |
| Contracts – Currency risk and interest rate risk | – | – | – | **–** |
| Contracts – Interest rate risk | – | (7) | (6) | **(13)** |
| Contracts – Price risk | – | (24) | (44) | **(68)** |
| | – | (170) | (2,448) | **(2,618)** |
| Total | 574 | 1,731 | (2,207)[a] | **98**[b] |

| | | | | 2014 |
|---|---|---|---|---|
| | Derivatives designated as fair value hedges | Derivatives designated as cash flow hedges | Derivatives not designated as hedges | Total gross value of derivatives |
| **Assets** | | | | |
| Contracts – Currency risk | – | 415 | 565 | 980 |
| Contracts – Currency risk and interest rate risk | 1 | – | – | 1 |
| Contracts – Interest rate risk | 513 | 8 | – | 521 |
| Contracts – Price risk | – | 164 | 44 | 208 |
| | 514 | 587 | 609 | 1,710 |
| **Liabilities** | | | | |
| Contracts – Currency risk | – | (652) | (870) | (1,522) |
| Contracts – Currency risk and interest rate risk | (66) | – | – | (66) |
| Contracts – Interest rate risk | (1) | (13) | (9) | (23) |
| Contracts – Price risk | – | (20) | (35) | (55) |
| | (67) | (685) | (914) | (1,666) |
| Total | 447 | (98) | (305)[a] | 44[b] |

a) These derivative instruments are mainly traded as part of Hydro-Québec's risk management. As at December 31, 2015, $(2,331) million was in consideration of amounts received or disbursed [$(508) million as at December 31, 2014] with respect to agreements to limit the market value of the main portfolios of derivative instruments. These agreements arise from frameworks applied by Hydro-Québec to reduce its credit risk exposure and limit risk concentration.

b) Except for measurements of exchange-listed derivative instruments, which were nil as at December 31, 2015 [$(1) million as at December 31, 2014] and which are Level 1 measurements, fair value measurements of derivative instruments are Level 2 measurements. These measurements are obtained by discounting future cash flows, which are estimated on the basis of spot rates or forward rates or prices (foreign exchange rates, interest rates, and energy or aluminum prices) in effect on the balance sheet date and take into account the credit risk assessment. The valuation techniques make use of observable market data.

The offsetting of derivative instruments is shown in the table below:

| | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|
| | Total gross value of derivatives | Amounts offset[a] | Total net value presented on the balance sheet | Total gross value of derivatives | Amounts offset[a] | Total net value presented on the balance sheet |
| **Assets** | | | | | | |
| Short-term | 452 | (178) | **274** | 582 | (410) | 172 |
| Long-term | 2,264 | (2,136) | **128** | 1,128 | (1,037) | 91 |
| | 2,716 | (2,314) | **402** | 1,710 | (1,447) | 263 |
| **Liabilities** | | | | | | |
| Short-term | (2,550) | 2,251 | **(299)** | (965) | 806 | (159) |
| Long-term | (68) | 63 | **(5)** | (701) | 641 | (60) |
| | (2,618) | 2,314 | **(304)** | (1,666) | 1,447 | (219) |
| Total | 98 | – | **98** | 44 | – | 44 |

a) The amounts offset are related to contracts traded according to International Swaps and Derivatives Association (ISDA) guidelines and constituting enforceable master netting arrangements. Such master netting arrangements apply to all derivative instrument contracts traded over the counter.

Moreover, although certain derivatives cannot be offset, margin calls on derivative instruments may result in amounts received from or paid to clearing agents, based on the fair value of the instruments concerned. As at December 31, 2015, $316 million had been received on this basis ($103 million as at December 31, 2014); offsetting items are presented in Accounts payable and accrued liabilities under Current liabilities on the balance sheet.

The impact of derivative instruments on results and other comprehensive income is presented in the tables below. It should be noted that most derivative instruments traded are designated as cash flow hedges or fair value hedges and therefore reduce the volatility of results, except for the ineffective portion of the hedges, which is insignificant. Derivative instruments which are not designated as hedges, but which nonetheless provide an economic hedge for at-risk opposite positions, also reduce the volatility of results. The sensitivity of results is thus limited to net exposure to unhedged risks.

| | | | | | **2015** |
|---|---|---|---|---|---|
| | Losses (gains) on derivatives designated as fair value hedges | Losses (gains) on derivatives designated as cash flow hedges | | | Losses (gains) on derivatives not designated as hedges |
| | Recognized in results | Effective portion recognized in Other comprehensive income | Ineffective portion recognized in results | Effective portion reclassified from Other comprehensive income to results | Recognized in results |
| Contracts – Currency risk | – | (1,637) | 2[a] | (1,273)[a] | (584) |
| Contracts – Currency risk and interest rate risk | (14) | – | – | – | – |
| Contracts – Interest rate risk | (57) | (1) | – | 3[b] | 7 |
| Contracts – Price risk | – | (377) | (3)[c] | (325)[c] | (40) |
| | **(71)**[d] | **(2,015)** | **(1)** | **(1,595)** | **(617)**[e] |
| Impact of hedged items on results | **73** | | **–** | **1,595** | **607** |

| | | | | | 2014 |
|---|---|---|---|---|---|
| | Losses (gains) on derivatives designated as fair value hedges | Losses (gains) on derivatives designated as cash flow hedges | | | Losses (gains) on derivatives not designated as hedges |
| | Recognized in results | Effective portion recognized in Other comprehensive income | Ineffective portion recognized in results | Effective portion reclassified from Other comprehensive income to results | Recognized in results |
| Contracts – Currency risk | – | (745) | 3[a] | (728)[a] | (215) |
| Contracts – Currency risk and interest rate risk | (1) | – | – | – | – |
| Contracts – Interest rate risk | (254) | 1 | – | 12[b] | – |
| Contracts – Price risk | – | (185) | (4)[c] | 175[c] | (12) |
| | (255)[d] | (929) | (1) | (541) | (227)[e] |
| Impact of hedged items on results | 241 | | – | 541 | 242 |

a) The impact on results of currency risk hedging transactions is recognized in the line item affected by the hedged item. Therefore, $106 million was recognized in Revenue in 2015 [$(136) million in 2014], and $(1,377) million in Financial expenses [$(589) million in 2014].

b) The impact on results of interest rate risk hedging transactions is recognized in the line item affected by the hedged item. Therefore, $3 million was recognized in Financial expenses ($12 million in 2014).

c) The impact on results of transactions to hedge energy and aluminum price risk is recognized in the line item affected by the hedged item. Therefore, $(328) million was recognized in Revenue ($166 million in 2014); no amount was recognized in Electricity and fuel purchases ($5 million in 2014).

d) The impact on results of fair value risk hedging transactions, including the ineffective portion, which amounts to $2 million [$(14) million in 2014], is recognized in the line item affected by the hedged item, namely Financial expenses.

e) These instruments are essentially related to integrated risk management transactions. The impact of these instruments on results is recognized in the line item affected by the managed risk. Therefore, $4 million was recognized in Revenue in 2015 [$(8) million in 2014], $(20) million in Electricity and fuel purchases [$(3) million in 2014] and $(601) million in Financial expenses [$(216) million in 2014].

In 2015, Hydro-Québec reclassified a net gain of $3 million from Accumulated other comprehensive income to results after discontinuing some cash flow hedges (net loss of $11 million in 2014).

As at December 31, 2015, the net amount of gains presented in Accumulated other comprehensive income that would be reclassified to results in the next 12 months was estimated at $103 million ($115 million as at December 31, 2014).

As at December 31, 2015 and 2014, the maximum period during which Hydro-Québec hedged its exposure to the variability of cash flows related to anticipated transactions was three years.

### FAIR VALUE OF OTHER FINANCIAL INSTRUMENTS

Fair value measurements for other financial instruments are Level 2 measurements. Fair value is obtained by discounting future cash flows, based on rates observed on the balance sheet date for similar instruments traded on capital markets.

The fair value of cash equivalents, receivables – accounts receivable, other receivables and financial liabilities approximates their carrying amount because of the short-term nature of these financial instruments, except for the items presented in the table below:

| | **2015** | | 2014 | |
|---|---|---|---|---|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| Long-term debt[a] | **45,672** | **62,106** | 44,485 | 60,569 |
| Perpetual debt | **311** | **237** | 267 | 217 |

a) Including the short-term portion.

## NOTE 16 // Equity

### SHARE CAPITAL

The authorized share capital consists of 50,000,000 shares with a par value of $100 each, of which 43,741,090 shares were issued and paid up as at December 31, 2015 and 2014.

### RETAINED EARNINGS

Under the *Hydro-Québec Act*, the dividends to be paid by Hydro-Québec are declared once a year by the Québec government, which also determines the terms and conditions of payment. For a given year, the dividend cannot exceed the distributable surplus, equal to 75% of net income. This calculation is based on the consolidated financial statements. However, in respect of a given year, no dividend may be declared in an amount that would have the effect of reducing the capitalization rate to less than 25% at the end of the year. All or a portion of the distributable surplus that has not been subject to a dividend declaration may no longer be distributed to the shareholder as a dividend.

For 2015, the dividend is $2,360 million ($2,535 million for 2014).

### ACCUMULATED OTHER COMPREHENSIVE INCOME

| | | | **2015** |
|---|---|---|---|
| | Cash flow hedges | Employee future benefits | Accumulated other comprehensive income |
| Balance, beginning of year | (187) | (1,985) | **(2,172)** |
| Other comprehensive income before reclassifications | 2,015 | 64 | **2,079** |
| Amounts reclassified to results | (1,595) | 243 | **(1,352)** |
| Other comprehensive income | 420 | 307[a] | **727** |
| Balance, end of year | 233 | (1,678) | **(1,445)** |

| | | | 2014 |
|---|---|---|---|
| | Cash flow hedges | Employee future benefits | Accumulated other comprehensive income |
| Balance, beginning of year | (575) | (1,514) | (2,089) |
| Other comprehensive income before reclassifications | 929 | (696) | 233 |
| Amounts reclassified to results | (541) | 225 | (316) |
| Other comprehensive income | 388 | (471)[a] | (83) |
| Balance, end of year | (187) | (1,985) | (2,172) |

a) Other comprehensive income includes the change in the employee future benefit regulatory asset, which totaled $(385) million in 2015 ($1,312 million in 2014).

## NOTE 17 // Supplementary Cash Flow Information

| | 2015 | 2014 |
|---|---|---|
| **Change in non-cash working capital items** | | |
| Accounts receivable and other receivables | **(14)** | 268 |
| Materials, fuel and supplies | **(13)** | (7) |
| Accounts payable and accrued liabilities | **(35)** | (174) |
| Accrued interest | **(36)** | (19) |
| | **(98)** | 68 |
| **Investing activities not affecting cash** | | |
| Increase in property, plant and equipment | **91** | 247 |
| **Interest paid** | **2,178** | 2,097 |

## NOTE 18 // Employee Future Benefits

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

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

All Hydro-Québec's plans are defined benefit plans. The projected benefit obligations of these plans, valued by independent actuaries, and their assets, at fair value, are valued as at December 31 of each year. The most recent actuarial valuation of the Pension Plan for funding purposes was as at December 31, 2014, at which date the plan was funded at 122.1%. The next valuation must be as at December 31, 2015.

### CHANGES IN PROJECTED BENEFIT OBLIGATIONS AND IN PLAN ASSETS, AT FAIR VALUE

| | Pension Plan | | Other plans | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| **Projected benefit obligations** | | | | |
| Balance, beginning of year | **22,275** | 18,628 | **1,339** | 1,125 |
| Current service cost | **441** | 344 | **44** | 42 |
| Employee contributions | **148** | 131 | **–** | – |
| Benefit payments and refunds | **(927)** | (869) | **(71)** | (61) |
| Interest on obligations | **880** | 879 | **53** | 53 |
| Actuarial loss | **309** | 3,162 | **43** | 184 |
| Plan amendments | **–** | – | **12** | (4) |
| Balance, end of year | **23,126** | 22,275 | **1,420** | 1,339 |
| **Plan assets, at fair value** | | | | |
| Balance, beginning of year | **20,778** | 18,732 | **76** | 72 |
| Actual return on plan assets[a] | **2,019** | 2,521 | **2** | 3 |
| Employee contributions | **148** | 131 | **–** | – |
| Contributions by Hydro-Québec | **225** | 263 | **13** | 13 |
| Benefit payments and refunds | **(927)** | (869) | **(19)** | (12) |
| Balance, end of year | **22,243** | 20,778 | **72** | 76 |
| **Funded status – Plan deficits** | **883** | 1,497 | **1,348** | 1,263 |
| Presented as: | | | | |
| Accounts payable and accrued liabilities | **–** | – | **57** | 55 |
| Other liabilities | **883** | 1,497 | **1,291** | 1,208 |

a) Administrative and management expenses billed to the Pension Plan by Hydro-Québec amounted to $16 million in 2015 ($15 million in 2014).

As at December 31, 2015, accumulated benefit obligations under the Pension Plan totaled $21,681 million ($20,905 million as at December 31, 2014). Unlike projected benefit obligations, accumulated benefit obligations do not take into account the salary escalation rate assumption.

## PENSION PLAN ASSETS

Investments and their associated risks are managed in accordance with the Hydro-Québec Pension Fund Investment Management Policy (the Investment Policy), which is approved every year by the Board of Directors. These risks include market risk, credit risk and liquidity risk. The Investment Policy provides for diversification of benchmark portfolio securities in order to maximize the expected return within an acceptable risk interval that takes into account the volatility of the Pension Plan's surplus or deficit. Additional frameworks define the approval process for each type of transaction and establish rules governing the active management of the different portfolios as well as credit risk management. Compliance with the Investment Policy and the additional frameworks is monitored on a regular basis. The Investment Policy allows the use of derivative instruments such as forward contracts, options and swaps.

The target allocation of Pension Plan investments, as established by the Investment Policy in effect as at December 31, 2015, was as follows:

| % | Target allocation |
|---|---|
| Fixed-income securities | 38 |
| Equities | 47 |
| Alternative investments[a] | 15 |
| | 100 |

a) Alternative investments include real estate investments, private equity investments and commercial mortgages.

The fair value of Pension Plan investments as at December 31, according to the fair value hierarchy and based on the type of securities, was as follows:

| | | | | **2015** | | | | 2014 |
|---|---|---|---|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total | Level 1 | Level 2 | Level 3 | Total |
| Short-term investments[a] | – | 213 | – | **213** | – | 142 | – | 142 |
| Bonds[a, b] | 593 | 6,908 | – | **7,501** | 1,212 | 6,665 | – | 7,877 |
| Listed shares | 9,695 | – | – | **9,695** | 9,001 | – | – | 9,001 |
| Real estate investments[c] | 349 | – | 2,474 | **2,823** | 341 | – | 2,121 | 2,462 |
| Commercial mortgages[a] | – | 76 | – | **76** | – | 78 | – | 78 |
| Private equity investments[d] | – | – | 234 | **234** | – | – | 87 | 87 |
| Hedge funds[e] | 361 | 1,155 | – | **1,516** | 443 | 816 | – | 1,259 |
| Derivatives[f] | (11) | 24 | – | **13** | (11) | 35 | – | 24 |
| | 10,987 | 8,376 | 2,708 | **22,071** | 10,986 | 7,736 | 2,208 | 20,930 |
| Other[g] | | | | **206** | | | | 166 |
| | | | | **22,277**[h] | | | | 21,096[h] |

a) The fair value of Level 2 short-term investments, bonds and commercial mortgages is essentially measured by discounting net future cash flows, based on the current market rate of return.

b) Pension Plan assets include securities issued by Hydro-Québec, as well as by the Québec government and some of its agencies, for a total of $1,137 million ($1,124 million in 2014).

c) The fair value of Level 3 real estate investments is measured by independent appraisers. The main method used to determine the fair value of these investments is discounting future cash flows. This method is based on observable and unobservable inputs, in particular the discount rate and future cash flows.

d) The fair value of private equity investments is measured by various techniques including future cash flow discounting or using data such as capitalization multiples or the price of recent comparable transactions.

e) Hedge funds are measured at the values provided by the fund managers, which are determined on the basis of the fair value of the underlying investments or of the net asset value.

f) Level 2 derivatives are measured using the market closing prices of the underlying products or by discounting net future cash flows.

g) "Other" includes cash, as well as interest and dividends receivable.

h) The fair value of investments does not take into account the net amount of payables and receivables, which is a payable of $34 million ($318 million in 2014).

A reconciliation of the opening and closing balances of Level 3 investments is presented in the table below:

| | | | **2015** | | | 2014 |
|---|---|---|---|---|---|---|
| | Real estate investments | Private equity investments | Total | Real estate investments | Private equity investments | Total |
| Balance, beginning of year | 2,121 | 87 | **2,208** | 1,941 | – | 1,941 |
| Unrealized net gains | 68 | 50 | **118** | 33 | 15 | 48 |
| Realized net gains | 28 | 2 | **30** | – | – | – |
| Acquisitions and disposals | 257 | 95 | **352** | 147 | 72 | 219 |
| Balance, end of year | 2,474 | 234 | **2,708** | 2,121 | 87 | 2,208 |

In 2015 and 2014, there was no reclassification between Level 3 and Levels 1 and 2.

## OTHER PLAN ASSETS

Other plan assets as at December 31, 2015, were composed of bonds issued by Hydro-Québec for a total of $67 million ($69 million as at December 31, 2014), as well as cash amounting to $5 million ($7 million as at December 31, 2014). Bonds are classified at Level 2 in the fair value hierarchy.

## PLAN COSTS

### NET COST COMPONENTS RECOGNIZED FOR THE YEAR

| | Pension Plan | | Other plans | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| Current service cost | **441** | 345 | **44** | 42 |
| Interest on obligations | **880** | 879 | **53** | 53 |
| Expected return on plan assets | **(1,302)** | (1,189) | **(3)** | (3) |
| Amortization of net actuarial loss | **291** | 181 | **25** | 11 |
| Amortization of past service costs (credits) | **29** | 37 | **(1)** | (5) |
| Actuarial (gain) loss on long-term disability salary insurance plan | **–** | – | **(4)** | 2 |
| **Net cost recognized for the year** | **339** | 253 | **114** | 100 |

### COMPONENTS OF OTHER COMPREHENSIVE INCOME FOR THE YEAR

| | Pension Plan | | Other plans | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| Actuarial (gain) loss | **(408)** | 1,829 | **48** | 182 |
| Past service costs (credits) | **–** | – | **12** | (4) |
| Amortization of net actuarial loss | **(291)** | (181) | **(25)** | (11) |
| Amortization of past service (costs) credits | **(29)** | (37) | **1** | 5 |
| Total (increase) decrease in Other comprehensive income | **(728)** | 1,611 | **36** | 172 |
| Less | | | | |
| (Decrease) increase in the employee future benefit regulatory asset | **(397)** | 1,189 | **12** | 123 |
| **Net (increase) decrease in Other comprehensive income** | **(331)** | 422 | **24** | 49 |

### COMPONENTS OF ACCUMULATED OTHER COMPREHENSIVE INCOME

| | Pension Plan | | Other plans | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| Unamortized net actuarial loss | **4,110** | 4,809 | **421** | 398 |
| Unamortized past service costs (credits) | **59** | 88 | **(35)** | (48) |
| Aggregate of amounts recognized in Accumulated other comprehensive income | **4,169** | 4,897 | **386** | 350 |
| Less | | | | |
| Employee future benefit regulatory asset | **2,630** | 3,027 | **247** | 235 |
| **Net amount recognized in Accumulated other comprehensive income** | **1,539** | 1,870 | **139** | 115 |

For 2016, the amortization of the net actuarial loss and the past service costs (credits) in the net cost recognized for the year should amount to $247 million and $16 million, respectively, for the Pension Plan, and to $26 million and $(6) million, respectively, for the other plans.

## SIGNIFICANT ACTUARIAL ASSUMPTIONS

The following actuarial assumptions, used to determine the projected benefit obligations and net cost recognized, result from a weighted average:

| | Pension Plan | | Other plans | |
|---|---|---|---|---|
| % | **2015** | 2014 | **2015** | 2014 |
| **Projected benefit obligations** | | | | |
| Rate at end of year | | | | |
| Discount rate | **3.89** | 3.98 | **3.89** | 3.98 |
| Salary escalation rate[a] | **3.21** | 3.23 | **–** | – |
| **Net cost recognized** | | | | |
| Rate at end of prior year | | | | |
| Discount rate | **3.98** | 4.77 | **3.98** | 4.77 |
| Expected long-term rate of return on plan assets[b] | **6.75** | 6.75 | **3.33** | 3.73 |
| Salary escalation rate[a] | **3.23** | 3.31 | **–** | – |
| Active employees' average remaining years of service | **13** | 12 | **12** | 12 |

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

b) The expected long-term rate of return on the Pension Plan assets is the average of the expected long-term return on the various asset classes, weighted according to their respective target weightings, plus a rebalancing, diversification and active management premium, minus expected management and administration fees.

As at December 31, 2015, health care costs were based on an annual growth rate of 5.50% for 2016. According to the assumption used, this rate will then decrease to a final rate of 4.90% in 2030. A change of 1% in this annual growth rate would have had the following impact in 2015 and 2014:

| | 1% increase | | 1% decrease | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| Impact on current service cost and interest cost on projected benefit obligations for the year | **9** | 8 | **(7)** | (5) |
| Impact on projected benefit obligations at end of year | **110** | 98 | **(85)** | (77) |

### BENEFITS TO BE PAID IN NEXT 10 YEARS

| | Pension Plan | Other plans |
|---|---|---|
| 2016 | 957 | 68 |
| 2017 | 1,003 | 70 |
| 2018 | 1,049 | 74 |
| 2019 | 1,096 | 77 |
| 2020 | 1,145 | 80 |
| 2021–2025 | 6,460 | 441 |

In 2016, Hydro-Québec expects to make contributions of $282 million and $18 million, respectively, to the Pension Plan and other plans.

## NOTE 19 // Commitments and Contingencies

### COMMITMENTS

*Electricity purchases*

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

As at December 31, 2015, Hydro-Québec was also committed under contracts to purchase electricity from other power producers. Based on the renewal clauses, the terms of these contracts extend through 2052. Hydro-Québec had also undertaken to purchase power transmission rights.

On the basis of all these commitments, Hydro-Québec expects to make the following payments over the coming years:

| | |
|---|---|
| 2016 | 1,646 |
| 2017 | 1,802 |
| 2018 | 1,913 |
| 2019 | 2,064 |
| 2020 | 2,074 |
| 2021 and thereafter | 32,542 |

*Investments*

Hydro-Québec expects to invest approximately $3.9 billion in property, plant and equipment and intangible assets in 2016.

### CONTINGENCIES

*Guarantees*

In accordance with the terms and conditions of certain debt securities issued outside Canada, Hydro-Québec has undertaken to increase the amount of interest paid to non-residents in the event of changes to Canadian tax legislation governing the taxation of non-residents' income. Hydro-Québec cannot estimate the maximum amount it might have to pay under such circumstances. Should an amount become payable, Hydro-Québec has the option of redeeming most of the securities in question. As at December 31, 2015, the amortized cost of the long-term debts concerned was $5,903 million.

*Litigation*

In the normal course of its development and operating activities, Hydro-Québec is sometimes party to claims and legal proceedings. Management is of the opinion that an adequate provision has been made for these legal actions. Consequently, it does not foresee any significant adverse effect of such contingent liabilities on Hydro-Québec's consolidated operating results or financial position.

Among other ongoing actions, some Aboriginal communities have instituted proceedings against the governments of Canada and Québec, as well as against Hydro-Québec, based on demands concerning their ancestral rights. In particular, the Innus of Uashat mak Mani-Utenam are demanding $1.5 billion in damages resulting from various operations carried out on land they claim as their own. Hydro-Québec is challenging the legitimacy of these claims.

Moreover, in June 2009, the Innus of Uashat mak Mani-Utenam served notice that they had filed for an injunction to suspend work at the Romaine complex jobsite, and in May 2010, an application was added for an interlocutory injunction to suspend work on the related tie lines. In March 2015, a proposed out-of-court settlement for the injunction proceedings was accepted by a vast majority of the applicants. A motion was filed in November 2015 to have the courts declare as inadmissible the injunctions being brought by dissident claimants. This motion has been taken under advisement.

As well, in November 2006, the Innus of Pessamit reactivated a case instituted in 1998 aimed at obtaining, among other things, the recognition of ancestral rights related to Québec lands on which certain hydroelectric generating facilities belonging to the Manic-Outardes complex are located. The Innus of Pessamit are claiming $500 million. Hydro-Québec is challenging the legitimacy of this claim. In July 2015, the Superior Court granted a motion in which the Innus of Pessamit requested that proceedings be suspended until the end of January 2017 so that they could pursue discussions with the Québec government.

## **NOTE 20** // Segmented Information

Hydro-Québec carries on its activities in the four reportable business segments defined below. The non-reportable business segments and other activities are grouped together under Corporate and Other Activities for reporting purposes.

**Generation:** Hydro-Québec Production operates and develops Hydro-Québec's generating facilities. It provides Hydro-Québec Distribution with an annual base volume of up to 165 TWh of heritage pool electricity, and can participate in that division's calls for tenders in a context of free market competition. In addition, it sells electricity and engages in arbitrage transactions on external markets.

**Transmission:** Hydro-Québec TransÉnergie operates and develops Hydro-Québec's power transmission system. It markets system capacity and manages power flows throughout Québec.

**Distribution:** Hydro-Québec Distribution operates and develops Hydro-Québec's distribution system and ensures the supply of electricity to the Québec market. It also engages in activities related to selling electricity in Québec, delivering customer services and promoting energy efficiency.

**Construction:** Hydro-Québec Équipement et services partagés and Société d'énergie de la Baie James (SEBJ) design, build and refurbish generating and transmission facilities, mainly for Hydro-Québec Production and Hydro-Québec TransÉnergie. Hydro-Québec Équipement et services partagés is responsible for projects throughout Québec, except in the territory governed by the *James Bay and Northern Québec Agreement* (JBNQA). SEBJ builds generating facilities in the territory governed by the JBNQA (north of the 49th parallel) and may also carry out certain projects elsewhere in Québec or outside the province.

**Corporate and Other Activities:** The corporate units help the divisions achieve their business objectives. They include the Groupe – Développement de l'entreprise, planification stratégique et innovation, Groupe – Direction financière et contrôle, Vice-présidence – Affaires corporatives et secrétariat général, Vice-présidence – Financement, trésorerie et caisse de retraite, Vice-présidence – Ressources humaines and Vice-présidence – Technologies de l'information et des communications, as well as the Direction principale – Centre de services partagés, which reports to Hydro-Québec Équipement et services partagés. The Centre de services partagés brings together internal company-wide shared services, including procurement of goods and services, real estate management, vehicle fleet management, materials management, as well as management of food, accommodation and air transportation services.

The amounts presented for each segment are based on the financial information used to prepare the consolidated financial statements. The accounting policies used to calculate these amounts are as described in Note 1, Significant Accounting Policies, and Note 3, Regulation.

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

Intersegment products and services are measured at full cost, which includes all costs directly associated with product or service delivery.

Most of Hydro-Québec's revenue is from Québec, and substantially all its property, plant and equipment are related to its Québec operations. In 2015, revenue from outside Québec amounted to $1,825 million, with $1,458 million originating from the United States ($1,736 million and $1,389 million, respectively, in 2014).

The following tables contain information related to results, assets and investing activities by segment:

| | | | | | | | **2015** |
|---|---|---|---|---|---|---|---|
| | Generation | Transmission | Distribution | Construction | Corporate and Other Activities | Intersegment eliminations and adjustments | Total |
| Revenue | | | | | | | |
| External customers | 1,833 | 120 | 11,752 | – | 49 | – | **13,754** |
| Intersegment customers | 4,791 | 3,188 | 82 | 2,098 | 1,634 | (11,793) | **–** |
| Depreciation and amortization | 766 | 1,033 | 806 | 4 | 104 | – | **2,713** |
| Financial expenses | 1,129 | 827 | 471 | – | 29 | (7) | **2,449** |
| Net income | 2,130 | 558 | 364 | – | 95 | – | **3,147** |
| Total assets | 33,108 | 20,944 | 13,425 | 58 | 7,829 | (165) | **75,199** |
| Investments in property, plant and equipment and intangible assets affecting cash | 957 | 1,587 | 756 | 1 | 139 | – | **3,440** |

| | | | | | | | 2014 |
|---|---|---|---|---|---|---|---|
| | Generation | Transmission | Distribution | Construction | Corporate and Other Activities | Intersegment eliminations and adjustments | Total |
| Revenue | | | | | | | |
| External customers | 1,758 | 130 | 11,695 | – | 69 | – | 13,652 |
| Intersegment customers | 5,008 | 3,122 | 82 | 2,281 | 1,629 | (12,122) | – |
| Depreciation and amortization | 716 | 1,032 | 746 | 3 | 96 | – | 2,593 |
| Financial expenses | 1,138 | 794 | 463 | – | 35 | (5) | 2,425 |
| Net income | 2,301 | 560 | 343 | – | 121 | – | 3,325 |
| Total assets | 32,500 | 20,323 | 13,695 | 65 | 6,696 | (171) | 73,108 |
| Investments in property, plant and equipment and intangible assets affecting cash | 1,204 | 1,623 | 825 | 11 | 152 | – | 3,815 |

# **NOTE 21** // First-Time Application of U.S. GAAP

Hydro-Québec's consolidated financial statements have been prepared in accordance with U.S. GAAP since January 1, 2015. Prior to that date, they were prepared in accordance with Canadian GAAP.

The tables and notes below describe the impact of the transition from Canadian GAAP to U.S. GAAP.

## RECONCILIATION OF NET INCOME

| | Notes | Year ended December 31, 2014 |
|---|---|---|
| Net income in accordance with Canadian GAAP | | 3,380 |
| Adjustments | | |
| Employee future benefits | *a* | 34 |
| Regulatory assets and liabilities | *b* | (77) |
| Other adjustments | *e* | (12) |
| | | (55) |
| Net income in accordance with U.S. GAAP | | 3,325 |

## RECONCILIATION OF COMPREHENSIVE INCOME

| | Notes | Year ended December 31, 2014 |
|---|---|---|
| Comprehensive income in accordance with Canadian GAAP | | 3,759 |
| Adjustments | | |
| Net income | | (55) |
| Employee future benefits | *a* | (471) |
| Other adjustments | *e* | 9 |
| | | (517) |
| Comprehensive income in accordance with U.S. GAAP | | 3,242 |

## RECONCILIATION OF EQUITY

| | Notes | As at January 1, 2014 | As at December 31, 2014 |
|---|---|---|---|
| Retained earnings in accordance with Canadian GAAP | | 15,568 | 16,413 |
| Adjustments | | | |
| Employee future benefits | *a* | (462) | (428) |
| Regulatory assets and liabilities | *b* | (273) | (350) |
| Other adjustments | *e* | 136 | 124 |
| | | (599) | (654) |
| Retained earnings in accordance with U.S. GAAP | | 14,969 | 15,759 |

| | Notes | As at January 1, 2014 | As at December 31, 2014 |
|---|---|---|---|
| Accumulated other comprehensive income in accordance with Canadian GAAP | | (548) | (169) |
| Adjustments | | | |
| Employee future benefits | *a* | (1,514) | (1,985) |
| Other adjustments | *e* | (27) | (18) |
| | | (1,541) | (2,003) |
| Accumulated other comprehensive income in accordance with U.S. GAAP | | (2,089) | (2,172) |

## CONSOLIDATED BALANCE SHEETS

| As at January 1, 2014 | Notes | Canadian GAAP | Adjustments | U.S. GAAP |
|---|---|---|---|---|
| **ASSETS** | | | | |
| **Current assets** | | | | |
| Cash and cash equivalents | *c, d* | 1,695 | (262) | 1,433 |
| Short-term investments | | 1,689 | – | 1,689 |
| Accounts receivable and other receivables | *c, d, e* | 2,177 | 232 | 2,409 |
| Derivative instruments | *c, d, e* | 883 | (807) | 76 |
| Regulatory assets | | 1 | – | 1 |
| Materials, fuel and supplies | *d* | 194 | (2) | 192 |
| | | 6,639 | (839) | 5,800 |
| Property, plant and equipment | *d, e* | 59,077 | (308) | 58,769 |
| Intangible assets | *b, d, e* | 2,323 | (1,278) | 1,045 |
| Investments | *d, e* | 146 | 717 | 863 |
| Derivative instruments | *c, e* | 659 | (641) | 18 |
| Regulatory assets | *a, b* | 8 | 2,939 | 2,947 |
| Other assets | *a, d* | 4,258 | (3,786) | 472 |
| | | 73,110 | (3,196) | 69,914 |
| **LIABILITIES** | | | | |
| **Current liabilities** | | | | |
| Borrowings | | 23 | – | 23 |
| Accounts payable and accrued liabilities | *a, d* | 2,229 | 49 | 2,278 |
| Dividend payable | | 2,207 | – | 2,207 |
| Accrued interest | | 890 | – | 890 |
| Asset retirement obligations | *d* | 118 | (1) | 117 |
| Derivative instruments | *c, d* | 576 | (317) | 259 |
| Current portion of long-term debt | *d* | 1,157 | (11) | 1,146 |
| | | 7,200 | (280) | 6,920 |
| Long-term debt | *e* | 43,067 | 7 | 43,074 |
| Asset retirement obligations | | 834 | – | 834 |
| Derivative instruments | *c* | 1,295 | (1,144) | 151 |
| Regulatory liabilities | *b* | – | 273 | 273 |
| Other liabilities | *a, e* | 1,067 | 88 | 1,155 |
| Perpetual debt | | 253 | – | 253 |
| | | 53,716 | (1,056) | 52,660 |
| **EQUITY** | | | | |
| Share capital | | 4,374 | – | 4,374 |
| Retained earnings | *a, b, e* | 15,568 | (599) | 14,969 |
| Accumulated other comprehensive income | *a, e* | (548) | (1,541) | (2,089) |
| | | 19,394 | (2,140) | 17,254 |
| | | 73,110 | (3,196) | 69,914 |

## CONSOLIDATED BALANCE SHEETS

| As at December 31, 2014 | Notes | Canadian GAAP | Adjustments | U.S. GAAP |
|---|---|---|---|---|
| **ASSETS** | | | | |
| **Current assets** | | | | |
| Cash and cash equivalents | *d* | 1,275 | (4) | 1,271 |
| Short-term investments | | 1,664 | – | 1,664 |
| Accounts receivable and other receivables | *d, e* | 2,184 | (13) | 2,171 |
| Derivative instruments | *c, e* | 507 | (335) | 172 |
| Regulatory assets | | 182 | – | 182 |
| Materials, fuel and supplies | *d* | 201 | (2) | 199 |
| | | 6,013 | (354) | 5,659 |
| Property, plant and equipment | *d, e* | 60,713 | (300) | 60,413 |
| Intangible assets | *b, d, e* | 2,278 | (1,216) | 1,062 |
| Investments | *d, e* | 151 | 712 | 863 |
| Derivative instruments | *c, e* | 1,047 | (956) | 91 |
| Regulatory assets | *a, b* | 372 | 4,187 | 4,559 |
| Other assets | *a* | 4,316 | (3,855) | 461 |
| | | 74,890 | (1,782) | 73,108 |
| **LIABILITIES** | | | | |
| **Current liabilities** | | | | |
| Borrowings | *c* | 126 | (103) | 23 |
| Accounts payable and accrued liabilities | *a, c* | 2,099 | 158 | 2,257 |
| Dividend payable | | 2,535 | – | 2,535 |
| Accrued interest | | 907 | – | 907 |
| Asset retirement obligations | | 79 | – | 79 |
| Derivative instruments | *c* | 896 | (737) | 159 |
| Current portion of long-term debt | | 906 | – | 906 |
| | | 7,548 | (682) | 6,866 |
| Long-term debt | *e* | 43,571 | 8 | 43,579 |
| Asset retirement obligations | | 804 | – | 804 |
| Derivative instruments | *c* | 623 | (563) | 60 |
| Regulatory liabilities | *b* | – | 350 | 350 |
| Other liabilities | *a, e* | 1,459 | 1,762 | 3,221 |
| Perpetual debt | | 267 | – | 267 |
| | | 54,272 | 875 | 55,147 |
| **EQUITY** | | | | |
| Share capital | | 4,374 | – | 4,374 |
| Retained earnings | *a, b, e* | 16,413 | (654) | 15,759 |
| Accumulated other comprehensive income | *a, e* | (169) | (2,003) | (2,172) |
| | | 20,618 | (2,657) | 17,961 |
| | | 74,890 | (1,782) | 73,108 |

## ADJUSTMENTS

*a) Employee future benefits*

In accordance with Canadian GAAP, Hydro-Québec recognized accrued benefit assets and liabilities in Other assets and Other liabilities on the balance sheet, namely the cumulative difference between accrued benefit costs recognized and the contributions that it was making to the various plans.

Under U.S. GAAP, Hydro-Québec recognizes the funded status of plans on the balance sheet, namely the difference between the fair value of their respective assets and the value of projected benefit obligations. Consequently, on the date of transition to U.S. GAAP, the unamortized net actuarial losses and unamortized past service costs (credits) under the Pension Plan and other post-retirement benefits were recognized in Accumulated other comprehensive income, while the actuarial gain related to post-employment benefits was recognized in Retained earnings. Hydro-Québec also recognizes a regulatory asset against components of Accumulated other comprehensive income related to rate-regulated activities to take into account the expected recovery of these amounts in setting future rates.

As at January 1, 2014, these adjustments resulted in a $1,950-million increase in regulatory assets ($3,262 million as at December 31, 2014), a $3,782-million decrease in employee future benefit assets presented in Other assets ($3,855 million as at December 31, 2014), a $54-million increase in accounts payable and accrued liabilities ($55 million as at December 31, 2014), a $90-million increase in employee future benefit liabilities presented in Other liabilities ($1,765 million as at December 31, 2014), a $462-million decrease in retained earnings ($428 million as at December 31, 2014) and a $1,514-million decrease in accumulated other comprehensive income ($1,985 million as at December 31, 2014).

For 2014, these adjustments resulted in a $34-million increase in net income and a $471-million decrease in other comprehensive income.

*b) Regulatory assets and liabilities*

In accordance with Canadian GAAP, development costs were capitalized when they met capitalization criteria. Under U.S. GAAP, these costs cannot be capitalized and must be expensed in the period in which they are incurred. However, the Régie authorized the recognition as regulatory assets of certain development costs related to rate-regulated activities, including the costs of implementing the EEP.

This adjustment led to a $989-million decrease in intangible assets as at January 1, 2014 ($925 million as at December 31, 2014) and a corresponding increase in regulatory assets.

Prior to July 10, 2015, the useful life of property, plant and equipment was limited to 50 years for rate-setting purposes. Since then, this limit no longer applies, provided that the weighted average useful life of all property, plant and equipment of the Transmission Provider, on the one hand, and of the Distributor, on the other hand, does not exceed 50 years. The differences in the depreciation expense resulting from the application of useful lives limited to 50 years for rate-setting purposes until July 9, 2015, were accounted for as regulatory liabilities. This adjustment led to a $229-million increase in regulatory liabilities as at January 1, 2014, and a corresponding decrease in retained earnings. For 2014, it resulted in an $88-million decrease in net income, a corresponding decrease in retained earnings and a corresponding increase in regulatory liabilities.

The unamortized balance, as at July 10, 2015, of past service costs under the Pension Plan that has already been recovered in the rates and will be reflected in the results of future years was accounted for as a regulatory liability. This adjustment led to a $44-million increase in regulatory liabilities as at January 1, 2014, and a corresponding decrease in retained earnings. For 2014, it resulted in an $11-million increase in net income, a corresponding increase in retained earnings and a corresponding decrease in regulatory liabilities.

Moreover, in accordance with Canadian GAAP, the straight-line method of depreciation was adopted prospectively on January 1, 2010, for property, plant and equipment related to rate-regulated activities, replacing the sinking fund method for regulatory accounting purposes. Since the sinking fund method is not acceptable under U.S. GAAP, the cumulative variance between the amounts calculated under the two methods as at January 1, 2010, was measured and amounted to approximately $3.4 billion. Because the variance is taken into account in the depreciation and amortization expense for purposes of setting rates for the Transmission Provider and the Distributor, this amount constitutes a regulatory asset which was charged against the accumulated depreciation balance for property, plant and equipment.

*c) Derivative instruments*

In accordance with Canadian GAAP, set-off was compulsory if the entity had an unconditional and legally enforceable right of set-off and intended to proceed with a net settlement. Under U.S. GAAP, the legally enforceable right does not need to be unconditional. In addition, in the event derivative instruments are subject to an enforceable master netting arrangement, the intent to proceed with a net settlement is not a required criterion.

As at January 1, 2014, this adjustment led to an $816-million decrease in derivative instruments classified under Current assets ($342 million as at December 31, 2014), a $642-million decrease in derivatives classified under Long-term assets ($958 million as at December 31, 2014), a $314-million decrease in derivatives classified under Current liabilities ($737 million as at December 31, 2014), and a $1,144-million decrease in derivatives classified under Long-term liabilities ($563 million as at December 31, 2014).

In addition, margin calls on derivative instruments may result in amounts received from or paid to clearing agents, based on the fair value of the instruments concerned. Previously, the offsetting item for the amounts received was presented in Borrowings under Current liabilities on the balance sheet (nil as at January 1, 2014, and $103 million as at December 31, 2014), while the offsetting item for the amounts paid was presented in Cash and cash equivalents, under Current assets on the balance sheet ($248 million as at January 1, 2014, and nil as at December 31, 2014). The amounts are now presented respectively in Accounts payable and accrued liabilities and in Accounts receivable and other receivables.

*d) Joint ventures*

In accordance with Canadian GAAP, interests in joint ventures were accounted for using the proportionate consolidation method. Under U.S. GAAP, such interests must be accounted for using the equity method. The adjustment as at January 1, 2014, and December 31, 2014, consists in reclassifying joint venture assets and liabilities to Investments, and in reclassifying the revenue and expenses thereof to Revenue.

*e) Other adjustments*

Other adjustments are related to various items that are not individually or collectively material.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

The transition from Canadian GAAP to U.S. GAAP has not had any significant impact on the totals presented as operating, investing and financing activities in the consolidated statements of cash flows.

# Five-Year Review

## CONSOLIDATED FINANCIAL INFORMATION

| $M | **2015** | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| **OPERATIONS** | | | | | |
| **Revenue** | **13,754** | 13,652 | 12,878 | 12,134 | 12,250 |
| **Expenditure** | | | | | |
| Operations | **2,527** | 2,366 | 2,460 | 2,375 | 2,417 |
| Electricity and fuel purchases | **1,938** | 1,968 | 1,568 | 1,183 | 1,154 |
| Depreciation and amortization | **2,713** | 2,593 | 2,483 | 2,405 | 2,603 |
| Taxes | **980** | 975 | 1,000 | 997 | 864 |
| | **8,158** | 7,902 | 7,511 | 6,960 | 7,038 |
| **Operating income** | **5,596** | 5,750 | 5,367 | 5,174 | 5,212 |
| Financial expenses | **2,449** | 2,425 | 2,429 | 2,438 | 2,526 |
| **Income from continuing operations** | **3,147** | 3,325 | 2,938 | 2,736 | 2,686 |
| **Income (loss) from discontinued operations**[a] | **–** | – | 4 | (1,876) | (75) |
| **Net income** | **3,147** | 3,325 | 2,942 | 860 | 2,611 |
| **DIVIDEND** | **2,360** | 2,535 | 2,207 | 645 | 1,958 |
| **BALANCE SHEET SUMMARY** | | | | | |
| Total assets | **75,199** | 73,108 | 73,110 | 70,508 | 69,594 |
| Long-term debt, including current portion and perpetual debt | **45,983** | 44,752 | 44,477 | 43,524 | 42,050 |
| Equity | **19,475** | 17,961 | 19,394 | 18,982 | 18,834 |
| **INVESTMENTS FOR CONTINUING OPERATIONS AFFECTING CASH** | | | | | |
| Property, plant and equipment and intangible assets | **3,440** | 3,815 | 4,335[b] | 3,932[b] | 3,814[b] |
| **FINANCIAL RATIOS** | | | | | |
| Interest coverage[c] | **2.20** | 2.23 | 2.09 | 2.02 | 1.97 |
| Return on equity from continuing operations (%)[d] | **14.9** | 16.1 | 14.6 | 14.6 | 15.5 |
| Profit margin from continuing operations (%)[e] | **22.9** | 24.4 | 22.8 | 22.5 | 21.9 |
| Capitalization (%)[f] | **30.1** | 28.9 | 30.5 | 30.6 | 31.4 |
| Self-financing (%)[g] | **82.8** | 56.4 | 68.3 | 55.4 | 48.7 |

a) The discontinued operations are related to the 2012 decision to abandon the project to refurbish Gentilly-2 nuclear generating station and to terminate nuclear power operations.

b) Including the Energy Efficiency Plan.

c) Sum of operating income and net investment income divided by interest on debt securities.

d) Income from continuing operations divided by average equity less average accumulated income (loss) from discontinued operations for the current year and prior years and average accumulated other comprehensive income. For the period from 2011 to 2015, average equity less average accumulated income (loss) from discontinued operations for the current year and prior years and average accumulated other comprehensive income amounted to $17,319 million, $18,729 million, $20,141 million, $20,602 million and $21,091 million, respectively.

e) Income from continuing operations divided by revenue.

f) Equity divided by the sum of equity, long-term debt, current portion of long-term debt, perpetual debt, borrowings and derivative instrument liabilities, less derivative instrument assets and sinking fund.

g) Cash flows from operating activities less dividend paid, divided by the sum of cash flows from investing activities, excluding net disposal or acquisition of short-term investments, and repayment of long-term debt.

Note: The data for 2015 and 2014 are presented according to U.S. GAAP, while the data for prior years are presented according to Canadian GAAP, as published in the *Annual Report 2014*.

## OPERATING STATISTICS

| | **2015** | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| GWh | | | | | |
| **Electricity sales**[a] | | | | | |
| In Québec, by segment | | | | | |
| Residential | **66,558** | 68,074 | 65,983 | 61,956 | 62,402 |
| Commercial, institutional and small industrial | **45,335** | 45,189 | 44,620 | 43,775 | 43,683 |
| Large industrial | **54,200** | 55,738 | 56,855 | 56,875 | 58,210 |
| Other | **5,170** | 5,222 | 5,818 | 5,795 | 5,671 |
| | **171,263** | 174,223 | 173,276 | 168,401 | 169,966 |
| Outside Québec | | | | | |
| Canada/U.S. | **29,864** | 26,624 | 32,208 | 28,089 | 23,680 |
| Total electricity sales | **201,127** | 200,847 | 205,484 | 196,490 | 193,646 |
| $M | | | | | |
| **Revenue from electricity sales**[a] | | | | | |
| In Québec, by segment | | | | | |
| Residential | **5,222** | 5,162 | 4,825 | 4,452 | 4,508 |
| Commercial, institutional and small industrial | **3,774** | 3,657 | 3,504 | 3,370 | 3,377 |
| Large industrial | **2,350** | 2,389 | 2,439 | 2,317 | 2,533 |
| Other | **316** | 308 | 317 | 303 | 302 |
| | **11,662** | 11,516 | 11,085 | 10,442 | 10,720 |
| Outside Québec | | | | | |
| Canada/U.S. | **1,700** | 1,629 | 1,525 | 1,194 | 1,252 |
| Total revenue from electricity sales | **13,362** | 13,145 | 12,610 | 11,636 | 11,972 |
| As at December 31 | | | | | |
| **Number of customer accounts** | | | | | |
| In Québec, by segment | | | | | |
| Residential | **3,890,956** | 3,857,782 | 3,821,012 | 3,777,196 | 3,731,047 |
| Commercial, institutional and small industrial | **319,294** | 317,671 | 316,585 | 314,895 | 313,468 |
| Large industrial | **181** | 183 | 186 | 188 | 189 |
| Other | **4,290** | 4,214 | 4,207 | 3,988 | 4,004 |
| Total customer accounts | **4,214,721** | 4,179,850 | 4,141,990 | 4,096,267 | 4,048,708 |

a) Data related to continuing operations.

| | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| MW | | | | | |
| **Installed capacity** | | | | | |
| Hydroelectric | **36,370** | 36,100 | 35,364 | 35,125 | 35,285 |
| Nuclear[a] | **–** | – | – | – | 675 |
| Thermal | **542** | 543 | 704 | 704 | 1,011 |
| Total installed capacity | **36,912**[b] | 36,643 | 36,068 | 35,829 | 36,971 |
| GWh | | | | | |
| **Total energy requirements**[c] | **222,172** | 222,045 | 226,576 | 221,004 | 214,764 |
| MW | | | | | |
| **Peak power demand in Québec**[d] | **37,349** | 38,743 | 39,031 | 38,797 | 35,481 |
| km | | | | | |
| **Lines (overhead and underground)** | | | | | |
| Transmission | **34,272**[e] | 34,187 | 33,885 | 33,911 | 33,902 |
| Distribution[f] | **116,258** | 115,583 | 114,843 | 114,649 | 113,525 |
| Total lines (overhead and underground) | **150,530** | 149,770 | 148,728 | 148,560 | 147,427 |

a) Gentilly-2 generating station ceased to operate on December 28, 2012.

b) In addition to the generating capacity of its own facilities, Hydro-Québec has access to almost all the output from Churchill Falls generating station (5,428 MW) under a contract with Churchill Falls (Labrador) Corporation Limited that will remain in effect until 2041. It also purchases all the output from 36 wind farms (3,260 MW) and 5 small hydropower plants (65 MW) and almost all the output from 7 biomass and 3 biogas cogeneration plants (257 MW) operated by independent power producers. Moreover, 1,062 MW are available under long-term contracts with other suppliers.

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

d) The 2015 figure was valid on February 19, 2016. The values indicated correspond to the needs for the winter beginning in December, including interruptible power. The peak for a given period is based on measurements at fixed intervals. The 2015–2016 winter peak was 37,349 MW and occurred on February 15, 2016, at 7:00 a.m. However, the system load momentarily reached 37,650 MW at 7:14 a.m.

e) 34,000 km of lines operated by Hydro-Québec TransÉnergie and 272 km by Hydro-Québec Distribution.

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

## OTHER INFORMATION

| | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| % | | | | | |
| **Average rate increase (decrease) from January 1 to December 31** | **3.2**[a] | 3.8[a] | 1.7 | (0.4) | (0.2) |
| As at December 31 | | | | | |
| **Salaried employees**[b] | **19,381** | 19,505 | 19,692 | 21,032 | 21,977 |
| **Total number of employees**[b] | | | | | |
| Permanent | **17,475** | 17,793 | 17,861 | 18,926 | 19,415 |
| Temporary | **2,319** | 2,250 | 2,382 | 2,670 | 3,086 |
| | **19,794** | 20,043 | 20,243 | 21,596 | 22,501 |
| Women (%) | **29.0** | 29.4 | 30.0 | 30.6 | 31.1 |

a) Excluding Rate L.

b) Excluding employees of subsidiaries and joint ventures.

# Consolidated Results by Quarter

| | | | | | 2015 |
|---|---|---|---|---|---|
| $M | 1st quarter | 2nd quarter | 3rd quarter | 4th quarter | 12-month period |
| **Revenue** | 4,618 | 2,920 | 2,804 | 3,412 | **13,754** |
| **Expenditure** | | | | | |
| Operations | 628 | 631 | 601 | 667 | **2,527** |
| Electricity and fuel purchases | 645 | 418 | 398 | 477 | **1,938** |
| Depreciation and amortization | 650 | 658 | 674 | 731 | **2,713** |
| Taxes | 301 | 229 | 202 | 248 | **980** |
| | 2,224 | 1,936 | 1,875 | 2,123 | **8,158** |
| **Operating income** | 2,394 | 984 | 929 | 1,289 | **5,596** |
| Financial expenses | 604 | 641 | 590 | 614 | **2,449** |
| **Net income** | 1,790 | 343 | 339 | 675 | **3,147** |

| | | | | | 2014 |
|---|---|---|---|---|---|
| $M | 1st quarter | 2nd quarter | 3rd quarter | 4th quarter | 12-month period |
| **Revenue** | 4,631 | 2,868 | 2,664 | 3,489 | 13,652 |
| **Expenditure** | | | | | |
| Operations | 596 | 558 | 533 | 679 | 2,366 |
| Electricity and fuel purchases | 768 | 364 | 349 | 487 | 1,968 |
| Depreciation and amortization | 628 | 636 | 631 | 698 | 2,593 |
| Taxes | 282 | 227 | 228 | 238 | 975 |
| | 2,274 | 1,785 | 1,741 | 2,102 | 7,902 |
| **Operating income** | 2,357 | 1,083 | 923 | 1,387 | 5,750 |
| Financial expenses | 604 | 620 | 594 | 607 | 2,425 |
| **Net income** | 1,753 | 463 | 329 | 780 | 3,325 |

# Corporate Administration


**90**

Board of Directors

**92**

Activity Report of the Board of Directors and Board Committees

**95**

Governance

Hydro-Québec's Board of Directors. Absent: Jacques Leblanc and Gilbert Charland.

# Board of Directors

## Michael D. Penner

President and Chief Executive Officer, Peds Chaussettes et Cie

*Appointment: October 8, 2014*

*Term: May 14, 2018*

*Status: Independent director*

With a Bachelor of Arts degree from McGill University and a Juris Doctor of Law degree from Hofstra University in New York, Michael D. Penner is President and Chief Executive Officer of Peds Chaussettes, a garment manufacturing company. Based in Montréal, Peds Chaussettes has established sourcing, production and distribution facilities around the world.
Mr. Penner has sat on the boards of numerous not-for-profit organizations and serves on the board of the Global Sustainable Electricity Partnership. He is a member of the New York State Bar.

## Éric Martel

President and Chief Executive Officer, Hydro-Québec

*Appointment: July 6, 2015*

*Term: July 6, 2020*

*Status: Non-independent director*

Éric Martel holds a Bachelor's degree in electrical engineering from Université Laval and is a member of the Ordre des ingénieurs du Québec. Before joining Hydro-Québec in July 2015, he held a number of management positions at Bombardier from 2002 to 2015, including those of President, Bombardier Business Aircraft, and President, Customer Services and Specialized and Amphibious Aircraft. Mr. Martel has also worked for several high-profile international companies such as Pratt & Whitney, Rolls Royce, Procter & Gamble and Kraft Foods. He has been actively involved with Centraide of Greater Montréal since the late 1990s.

## Geneviève Bich

Vice President, Human Resources, Metro inc.

*Appointment: September 9, 2015*

*Term: September 9, 2019*

*Status: Independent director*

Geneviève Bich graduated from McGill University with a Bachelor's in psychology and from Université de Montréal with a Bachelor of Law degree. She is a member of the Barreau du Québec and the Ordre des conseillers en ressources humaines agréés du Québec. From 1991 to 2008, she held various management positions at Bell Canada, including Vice-President, Human Resources and Labour Relations. Before joining Metro in 2013, Ms. Bich worked at Groupe Dynamite and Aimia. She sits on the board of Collège de Bois-de-Boulogne.

## Anik Brochu

Director, Human Resources, Groupe T.A.P.

*Appointment: September 13, 2006*

*Term: November 30, 2015*[1]

*Status: Independent director*

Anik Brochu holds a law degree from the University of Ottawa and is a member of the Barreau du Québec. After serving as General Manager of the Chambre de commerce de Val-d'Or from 1997 to 2008, she was a lawyer with Cain Lamarre Casgrain Wells from 2008 to 2010, and continues to provide consulting services to that firm. In 2011, she joined Groupe T.A.P. as Director of Human Resources.

## Carl Cassista

President, Technologies Axion

*Appointment: September 26, 2007*

*Term: December 17, 2018*

*Status: Independent director*

A graduate of Université Laval and member of the Ordre des ingénieurs du Québec, Carl Cassista has worked in electrical engineering with Technologies Axion since 1982. He has served as president of Axion since 1994 and has piloted the company's expansion in North America and Europe. Mr. Cassista has also sat on the boards of numerous economic development organizations.

## Gilbert Charland

Deputy Minister of Energy and Natural Resources

*Appointment: January 5, 2015*

*Term: February 19, 2017*

*Status: Non-independent director*

With a Bachelor's degree in history from the Université du Québec à Trois-Rivières as well as a Master's and a PhD in political science from Université Laval, Gilbert Charland has held many senior positions in various departments of the Québec government. He was Deputy Minister of Higher Education, Research and Science, then Deputy Minister of Sustainable Development, the Environment and the Fight Against Climate Change, before being appointed Deputy Minister of Energy and Natural Resources.

## Michelle Cormier

Operating Partner, Wynnchurch Capital (Canada) Ltd.

*Appointment: November 4, 2009*

*Term: December 17, 2018*

*Status: Independent director*

With a Bachelor of Business Administration from Bishop's University and a Graduate Diploma in Public Accountancy from McGill, Michelle Cormier is a member of the Ordre des comptables professionnels agréés du Québec (CPA, CA) and has certification from the Collège des administrateurs de sociétés. Over the course of her career, she has held senior positions with Alcan Aluminium, Entreprises Repap and TNG Corporation. Ms. Cormier serves on the boards of Industries Dorel, Industries Moreau, Profab and the Orchestre Métropolitain.

## Laurent Ferreira

Executive Vice-President and Managing Director, Derivatives and Equities, Banque Nationale du Canada

*Appointment: December 17, 2014*

*Term: December 17, 2018*

*Status: Independent director*

Laurent Ferreira holds a Bachelor's degree in economics from the Université du Québec à Montréal and an MSc in administration with a specialization in finance from HEC Montréal. Mr. Ferreira was formerly an Associate – Investment Banking – Marketing and Derivatives at the U.S. firm Bankers Trust. In 1998, he joined Banque Nationale du Canada.
He sits on the boards of various not-for-profit organizations.

## Éric Forest

Mayor, Rimouski

*Appointment: December 17, 2014*

*Term: December 17, 2018*

*Status: Non-independent director*

After earning a Bachelor's degree in recreation and leisure studies from the Université du Québec à Trois-Rivières, Éric Forest served as General Director of the Office du tourisme et des congrès de Rimouski. From 1986 to 1995, he was General Manager and then Vice-President of Sales at the Boulevard Chevrolet automotive dealership, before being named General Manager of the Rimouski Oceanic hockey club, a position he held from 1995 to 2005. Mayor of the city of Rimouski since 2005, Mr. Forest was President of the Union des municipalités du Québec from 2010 to 2014.

1. When their term expires, directors remain in office until replaced or reappointed.

### Hélène V. Gagnon

Vice President, Public Affairs and Global Communications, CAE Inc.

*Appointment: April 22, 2015*

*Term: April 22, 2019*

*Status: Independent director*

A graduate of McGill University in both civil law and common law, Hélène V. Gagnon also has a Master's degree in public administration and public policy from the London School of Economics. She is a member of the Barreau du Québec and holds accreditation from the Canadian Public Relations Society. Prior to her appointment at CAE in 2015, Ms. Gagnon worked at Bombardier Aéronautique, most recently as Vice President, Public Affairs, Communications and Corporate Social Responsibility. She chairs the board of directors of Aéro Montréal and sits on the board of Aéroports de Montréal.

### Suzanne Gouin

Corporate Director

*Appointment: September 26, 2007*

*Term: November 30, 2015*[1]

*Status: Independent director*

Suzanne Gouin has a Bachelor's degree in political science from Concordia University, where she also pursued graduate courses in media studies. She completed an MBA at the University of Western Ontario and has earned certification from the Institute of Corporate Directors. She has held several management positions in media companies, including that of President and Chief Executive Officer of TV5 Québec Canada from 2002 to 2015. Ms. Gouin sits on the board of the Bell Fund.

### Isabelle Hudon

Executive Chair, Québec and Senior Vice-President, Client Solutions, Financière Sun Life

*Appointment: November 30, 2011*

*Term: November 30, 2015*[1]

*Status: Independent director*

After pursuing a career in communications, Isabelle Hudon was President and Chief Executive Officer of the Board of Trade of Metropolitan Montreal and President of the advertising agency Marketel/McCann-Erickson. In 2010, she joined Financière Sun Life, where she has served as Executive Chair, Québec and Senior Vice-President, Client Solutions since 2014. In 2015, Ms. Hudon completed the Rotman School of Management's Financial Literacy Program. She sits on the board of the Canada Council for the Arts.

### Jacques Leblanc

President, Gestion Jacques Leblanc

*Appointment: April 7, 2004*

*Term: November 30, 2014*[1]

*Status: Independent director*

A graduate of Université Laval in administration, Jacques Leblanc is a chartered professional accountant and a Fellow of the Ordre des comptables professionnels agréés du Québec. He has also received certification from the Collège des administrateurs de sociétés. Mr. Leblanc was a partner in the firm of Leblanc Bourque Arsenault for 25 years.

### Yvon Marcoux

Corporate Director

*Appointment: December 17, 2014*

*Term: December 17, 2018*

*Status: Independent director*

Yvon Marcoux holds a licentiate in law from Université Laval and a Master of Laws from the University of Toronto, and is a member of the Barreau du Québec. He has held senior management positions at Québec's Conseil du trésor and Ministère des Affaires municipales, as well as at Banque Nationale, Banque Laurentienne and Provigo, and was Chairman, President and Chief Executive Officer of the Société générale de financement du Québec. He has sat in the Québec National Assembly, where he was Transport Minister from 2003 to 2005, then Justice Minister from 2005 to 2007.

### Paul Stinis

Senior Vice-President and Treasurer, BCE Inc.

*Appointment: April 22, 2015*

*Term: November 29, 2015*[1]

*Status: Independent director*

With a Bachelor's in mining engineering from McGill University and an MBA from Concordia University, Paul Stinis began his career as an engineer in the oil and gas industry. He has held various management positions at two major banks, and was Vice-President, Finance and Treasurer at Bell Canada International. In 2003, he joined BCE, where he has held the positions of Vice-President and Assistant Treasurer and, since 2009, Senior Vice-President and Treasurer.

### Marie-Anne Tawil

President and Chief Executive Officer, Les Investissements Iron Hill Inc.

*Appointment: December 7, 2005*

*Term: November 30, 2015*[1]

*Status: Independent director*

With a Licentiate in Civil Law and a Bachelor of Common Law from the University of Ottawa, and an MBA from Concordia University, Marie-Anne Tawil is a member of the Barreau du Québec and has earned certification from the Institute of Corporate Directors. She began her career by practising law and was the Legal Counsel and Secretary of Québecor. Since 2000, she has been President and Chief Executive Officer of Les Investissements Iron Hill. Ms. Tawil sits on the boards of Centraide of Greater Montréal, Stornoway Diamond Corp., Dundee Precious Metals Inc. and Fondation Montréal inc., and is on the Governance Committee of ONE DROP.

## DIRECTORS' COMPENSATION AND BENEFITS IN 2015[a, b]

| | Base compensation[c] | Meeting fees[c] | Taxable benefits[d] |
|---|---|---|---|
| **Geneviève Bich** | $5,487 | $3,000 | $1,720 |
| **Anik Brochu** | $18,245 | $12,399 | $175 |
| **Carl Cassista** | $23,947 | $23,075 | $5,952 |
| **Michelle Cormier** | $19,916 | $17,089 | $6,553 |
| **Laurent Ferreira** | $18,802 | $8,979 | $175 |
| **Éric Forest** | - | - | $6,134 |
| **Hélène V. Gagnon** | $12,522 | $5,142 | - |
| **Suzanne Gouin** | $22,276 | $19,223 | $750 |
| **Isabelle Hudon** | $19,916 | $10,685 | $175 |
| **Jacques Leblanc** | $22,276 | $26,047 | $4,779 |
| **Yvon Marcoux** | $20,362 | $7,751 | $259 |
| **Michael D. Penner**[e] | $62,783 | $35,466 | $7,978 |
| **Paul Stinis** | $14,193 | $10,284 | - |
| **Marie-Anne Tawil** | $18,245 | $16,668 | $5,952 |

a) Compensation set by the government under Order-in-Council No. 610-2006 of June 28, 2006.

b) By law, non-independent directors—Éric Martel, Gilbert Charland and Éric Forest—receive no compensation or meeting fees as members of Hydro-Québec's Board of Directors.

c) Includes indexing from April 1, 2015.

d) Insurance and health assessments paid by Hydro-Québec.

e) Under Order-in-Council No. 877-2014, Michael D. Penner receives an annual base compensation of $55,550, plus a meeting fee of $857 for each Board or committee meeting attended, and a $5,716 yearly supplement as Chair of the Governance and Ethics Committee and of the Information Technologies Committee.

1. When their term expires, directors remain in office until replaced or reappointed.

# Activity Report of the Board of Directors and Board Committees

Hydro-Québec is proud to support the visual arts in Québec. Some pieces from our collection are displayed in high-traffic areas so that they can be enjoyed by as many people as possible.

Nicolas Lachance, *B.13*, 2013, acrylic lacquer, sized canvas on Masonite. © Nicolas Lachance

## BOARD OF DIRECTORS

Chaired by Michael D. Penner, the Board of Directors met 12 times in 2015, while its committees held 38 meetings over the same period. The Board approved numerous capital projects in power generation, transmission and distribution, including Phase I of the program to replace series compensation control and protection systems at several substations, as well as construction of the new Saint-Jean substation and its connection to the distribution system. The Board also authorized capital projects for optimizing the data processing centres and closely monitored the installation of next-generation meters as part of the rollout of the advanced metering infrastructure. In addition, the Board members took part in developing Hydro-Québec's *Strategic Plan 2016–2020*.

In the course of its recurring deliberations, the Board examined the company's objectives and approved its quarterly and annual financial results, as well as the financial statements of the Hydro-Québec pension plan. It reviewed the progress of the company's main capital projects and examined the consolidated residual business risk portfolio. It also approved the company's Business Plan.

### EXECUTIVE (A)

The Executive Committee, chaired by Michael D. Penner, did not hold any meetings in 2015.

### GOVERNANCE AND ETHICS (B)

In 2015, the Governance and Ethics Committee, chaired by Michael D. Penner, met four times. It examined Hydro-Québec's *Annual Report 2014*, the annual report on induction and ongoing training programs for Board members, and the annual reviews of several company policies. It submitted recommendations to the Board for the establishment of the Information Technologies Committee, the appointment of directors to different Board committees, and the appointment of the most senior officer of each of Hydro-Québec's wholly owned subsidiaries as well as the directors and external auditors of its first-tier wholly owned subsidiaries. In addition, the Committee undertook the review of the process for evaluating the operation of the Board of Directors.

### AUDIT (C)

The Audit Committee, chaired by Michelle Cormier, held seven meetings in 2015. As part of its recurring deliberations, it examined the quarterly and annual financial statements of Hydro-Québec and its pension plan, and the annual financial statements of Société d'énergie de la Baie James. It also reviewed the company's annual control plan. It monitored the independence of the independent auditors and met with them in order to plan the annual audit and receive its results. The Committee recommended that the Board approve the financial year's audit plans and engagement letters for the company and its pension plan. It examined the internal audit results and reports regarding control and optimization of the company's operations and resources as well as management of the related risks. It also studied the management of Hydro-Québec Distribution's accounts receivable and the work of the Auditor General of Québec concerning the optimization of Hydro-Québec's resources. Moreover, it examined the company's 2016 internal audit plan and recommended its approval by the Board. In addition, it monitored the changeover to U.S. GAAP, effective January 1, 2015.

### HUMAN RESOURCES (D)

In 2015, the Human Resources Committee, chaired by Carl Cassista, held 13 meetings, including a joint meeting with the Finance Committee to examine Hydro-Québec's Business Plan, executives' performance objectives and the consolidated portfolio of residual business risks. The Committee conducted the selection process for Hydro-Québec's President and Chief Executive Officer and evaluated the extent to which the company had met its annual performance objectives. The Committee also examined the overall compensation of Hydro-Québec's employees, executives and President and Chief Executive Officer, and of the employees and executives of its wholly owned subsidiaries, and recommended approval by the Board. In addition, it closely monitored the business risks related to human resources. Lastly, it studied the 2014 report of activities of the Corporate Ombudsman.

### ENVIRONMENT AND PUBLIC AFFAIRS (E)

Chaired by Isabelle Hudon, the Environment and Public Affairs Committee met five times in 2015. Among other topics, it studied the results of the President and Chief Executive Officer's annual environmental management review as well as the semi-annual reports on environmental compliance. It recommended that the Board approve the granting of donations and sponsorships. The Committee also examined the annual results with respect to the company's communication activities and related performance indicators. It reviewed the results of the university research chairs program and the annual activity reports of the Fondation Hydro-Québec pour l'environnement and of the liaison committees established by the company with the Union des producteurs agricoles and the Fédération québécoise des municipalités. The Committee commented on the Hydro-Québec Sustainability Report and met with the report's auditor. It also contributed to the 2015–2018 communication plan and the advertising campaign launched in early 2016.

### FINANCE (F)

The Finance Committee, chaired by Paul Stinis, held four meetings in 2015, including a joint meeting with the Human Resources Committee for the purpose of analyzing the company's Business Plan, objectives and consolidated portfolio of business risks. It examined various annual programs and files of a financial nature before recommending their approval by the Board: borrowings, guarantees, financial risk management, swaps, sinking fund management, derivatives and underlying products. In addition, it recommended Board approval of the updating of risk management programs for Hydro-Québec Production's sales and trading activities and Hydro-Québec Distribution's procurement activities, and of credit limits for each counterparty for each of the company's functions concerned. It also followed up on the company's major capital projects.

### PENSION PLAN FINANCIAL MANAGEMENT (G)

In 2015, the Pension Plan Financial Management Committee, chaired by Yvon Marcoux, met three times. It examined the annual actuarial valuation for pension plan funding and solvency purposes, amendments to the Pension Fund Investment Management Policy and the annual pension fund management and pension plan administration budgets, and recommended their approval by the Board. It also recommended that the Board approve the reappointment of the actuary for the next annual valuation, and it evaluated the performance and structure of the pension fund portfolio and the performance of specialized portfolio managers. Lastly, it closely monitored changes in the pension plan's financial position.

### INFORMATION TECHNOLOGIES (H)

The Information Technologies Committee, formed in 2015 and chaired by Michael D. Penner, held two meetings. It focused particular efforts on managing IT and telecommunications at Hydro-Québec with regard to several factors: costs, operations, security issues, governance structure and projects in progress. In addition, the Committee members completed Université Laval's training program on governance for IT investments.

## DIRECTOR ATTENDANCE AT MEETINGS OF THE BOARD OF DIRECTORS AND BOARD COMMITTEES IN 2015*

| DIRECTORS | Notes | Board | A | B | C | D | E | F | G | H |
|---|---|---|---|---|---|---|---|---|---|---|
| **Number of meetings** | | **12** | | **4** | **7** | **13** | **5** | **4** | **3** | **2** |
| **Michael D. Penner** A B C D E F G H | | 12 | | 4 | 7 | 13 | 5 | 4 | 3 | 2 |
| **Éric Martel** A E F G H | 1 | 6 | | 2 | 3 | 3 | 2 | 2 | 1 | 2 |
| **Geneviève Bich** D | 2 | 4 | | | | 2 | | | | |
| **Anik Brochu** D E | 3 | 11 | | | | 3 | 5 | | | |
| **Carl Cassista** B D H | 4 | 10 | | 1 | 5 | 13 | | | | 2 |
| **Gilbert Charland** | 5 | 11 | | | | | | | | |
| **Michelle Cormier** A C F | 6 | 10 | | | 7 | | | 4 | 2 | |
| **Laurent Ferreira** C H | | 10 | | | 2 | | | | | 2 |
| **Éric Forest** G | | 11 | | | | | | | | |
| **Hélène V. Gagnon** E | 7 | 7 | | | | | 2 | | | |
| **Suzanne Gouin** A D E | | 11 | | | | 11 | 5 | | | |
| **Isabelle Hudon** B E | | 10 | | 1 | | | 5 | | | |
| **Jacques Leblanc** B C | 8 | 10 | | 3 | 5 | 10 | | 2 | 2 | |
| **Yvon Marcoux** B F G | | 11 | | 1 | | | | 2 | 1 | |
| **Paul Stinis** A F G | 9 | 9 | | | 3 | | | 3 | 2 | |
| **Marie-Anne Tawil** B C H | | 12 | | 4 | 7 | | | | | 2 |

* The composition of Board committees was reviewed on September 11, 2015. Some directors were appointed as members or chairs of certain committees as of that date, which is why they did not attend all of the meetings held during the year.

**Committees of the Board of Directors**

A Executive
B Corporate Governance and Ethics
C Audit
D Human Resources
E Environment and Public Affairs
F Finance
G Pension Plan Financial Management
H Information Technologies

**Notes**

1. Éric Martel was appointed effective July 6, 2015. He attends the meetings of the Governance and Ethics, Audit and Human Resources committees as a guest.
2. Geneviève Bich was appointed effective September 9, 2015.
3. Anik Brochu participated as a substitute member in the Human Resource Committee meeting held on September 10, 2015.
4. Carl Cassista's term as a member of the Audit Committee ended on September 11, 2015.
5. Gilbert Charland was appointed effective January 5, 2015.
6. Michelle Cormier participated as a substitute member in the Finance Committee meetings held on March 25 and June 18, 2015, and in the Pension Plan Financial Management Committee meetings held on March 25 and May 21, 2015.
7. Hélène V. Gagnon was appointed effective April 22, 2015.
8. Jacques Leblanc participated as a substitute member in the Human Resources Committee meetings held on February 19, March 2, March 19, March 26, April 10, April 21, April 22, May 7, May 21 and June 18, 2015, in the Pension Plan Financial Management Committee meetings held on March 25 and May 21, 2015, and in the Finance Committee meetings held on March 25 and June 18, 2015.
9. Paul Stinis was appointed effective April 22, 2015. He participated as a substitute member in the Audit Committee meetings held on May 21 and June 18, 2015, in the Pension Plan Financial Management Committee meeting held on May 21, 2015, and in the Finance Committee meeting held on June 18, 2015. He also participated in the Audit Committee meeting held on September 10, 2015, as a guest.

# Governance

Hydro-Québec's Board of Directors complies with the requirements of the *Hydro-Québec Act* with regard to governance. It also follows the Canadian Securities Administrators' guidelines applicable to state-owned enterprises, even though it is not legally bound to do so because Hydro-Québec is not publicly traded in Canada.

## INDEPENDENCE

With the exception of Éric Martel, President and Chief Executive Officer, Gilbert Charland, Deputy Minister of Energy and Natural Resources, and Éric Forest, Mayor of Rimouski, the members of the Board are independent directors, meaning that they have no direct or indirect relations or interests—financial, commercial, professional or philanthropic in nature, for example—that could affect the quality of their decision-making with regard to the interests of the company.

## RULES OF ETHICS

The Board is responsible for compliance with the rules set out in the *Code of Ethics and Rules of Professional Conduct for Directors, Executives and Controllers of Hydro-Québec*, which are based primarily on the *Regulation respecting the ethics and professional conduct of public office holders*. The Code is available at www.hydroquebec.com/about-hydro-quebec/who-are-we/corporate-governance/policies-code-conduct.html.

## COMPENSATION AND BENEFITS PAID TO DIRECTORS

Compensation for all independent directors is set out in Order-in-Council No. 610-2006 and is indexed periodically by the government. Compensation consists of a basic annual retainer of $18,291 plus a meeting fee of $857 for each Board or committee meeting. A yearly supplement of $5,716 is paid to the chairs of Board committees. Under Order-in-Council No. 877-2014, the Chairman of the Board receives annual compensation of $55,550 and earns the same compensation as the independent directors for participating in meetings of the Board and its committees as well as for chairing a committee. Board members are also entitled to reimbursement of travel expenses incurred in the performance of their duties.

## DIRECTOR INDUCTION AND TRAINING PROGRAM

When Board members are first appointed, they receive training on their roles and responsibilities, the nature and business context of Hydro-Québec's principal activities, and the company's legal and regulatory context. The director induction and training program also includes presentations on major issues and projects, as well as tours of company facilities.

In 2015, the Board members received some 20 hours of corporate governance training from the Collège des administrateurs de sociétés. They visited Hydro-Québec's research institute (IREQ) and the laboratories of its joint venture Technologies Esstalion. They also took part in meetings with Management during the development of the *Strategic Plan 2016–2020*.

## DEINTEGRATION

In 1997, Hydro-Québec implemented an organizational structure that allows some units to work independently from one another while remaining part of the same company. This is the principle of deintegration, or unbundling. The operations of these units are subject to set rules of conduct and ethics. The Distributor's electricity procurement process is governed by the *Code of Ethics on Conducting Calls for Tenders*, which ensures that the tendering process is conducted fairly for all electricity suppliers. The *Code de conduite du Distributeur* (Distributor Code of Conduct) applies to transactions between the Distributor and the Generator for procurement not subject to the tendering process. It also governs dealings between the Distributor and its affiliates, with the aim of preventing affiliates' business operations from being financed, in whole or in part, by electrical service customers. The *Code of Ethics on Conducting Calls for Tenders* is available for consultation at www.hydroquebec.com/distribution/en/marchequebecois/documentation.html and the *Code de conduite du Distributeur* (in French only) can be consulted at www.hydroquebec.com/publications/fr/politiques-codes-ethique-conduite/.

Hydro-Québec TransÉnergie is subject to the *Transmission Provider Code of Conduct*, which governs relations between the Transmission Provider and its affiliates, and is intended to prevent any form of preferential treatment or cross-subsidization.

Lastly, the *Reliability Coordinator Code of Conduct* is intended to ensure that the reliability of the transmission system remains the Reliability Coordinator's top priority and to prevent any form of preferential treatment in favor of other branches of the Transmission Provider, its affiliates or other system users.

The application of each of these codes is the subject of an annual accountability report to the Régie de l'énergie.

## INTERNAL CONTROL SYSTEM

Hydro-Québec's Management maintains an internal control system that is based on the internationally recognized framework developed by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. The objective of this system is to provide reasonable assurance that financial information is relevant and reliable, and that Hydro-Québec's assets are appropriately recorded and safeguarded. The system includes a business risk management process and the development of an annual internal control plan that requires the involvement of all divisions and corporate units. Internal auditing helps to determine whether the internal control system is sufficient and effective, and to assess the company's policies and directives. It includes a performance audit to ensure the efficiency, effectiveness and cost-effectiveness of the company's activities.

## COMPENSATION AND BENEFITS PAID TO THE COMPANY'S FIVE MOST HIGHLY COMPENSATED OFFICERS AS AT DECEMBER 31, 2015

| | Base salary as at December 31 | Incentive compensation[a] | Perquisites used[b] | Taxable benefits | | | |
|---|---|---|---|---|---|---|---|
| | | | | Automobile | | | Life insurance and health insurance |
| | | | | Nature of benefit | Allowance | Usage and parking | |
| **Éric Martel**<br>President and Chief Executive Officer, Hydro-Québec | $483,357[c] | – | – | Executive vehicle | – | – | $3,761 |
| **André Boulanger**<br>President, Hydro-Québec TransÉnergie | $405,613 | $119,298 | $2,389 | Car allowance or provision of a vehicle, plus parking | $15,655 | $7,532 | $10,304 |
| **Richard Cacchione**<br>President, Hydro-Québec Production | $403,911 | $118,798 | $5,000 | | – | $13,829 | $9,492 |
| **Daniel Richard**<br>President, Hydro-Québec Distribution | $393,085 | $106,002 | $3,365 | | $15,655 | $4,317 | $27,075 |
| **Réal Laporte**<br>President, Hydro-Québec Équipement et services partagés<br>President and Chief Executive Officer, Société d'énergie de la Baie James[d] | $390,213 | $114,118 | $890 | | – | $14,045 | $8,393 |
| | **Pension Plan and Supplementary Benefits Program** | | | | | | |
| | **Basic Hydro-Québec Pension Plan (HQPP)**<br>- Usual contribution under the plan<br>- Pension calculated on the basis of average salary for the best five years<br>- Credit of 2.25% per contribution year<br>- Recognition of 66.67% of the maximum incentive compensation as pensionable earnings for purposes of the HQPP, up to a maximum of 20% of salary<br>**Supplementary Benefits Program**<br>- Contribution assumed by Hydro-Québec<br>- Additional benefits to offset the tax limits under the HQPP (lifting of ceiling on the permitted maximum amount)<br>- Payment of benefits according to the same terms as those applicable under the HQPP<br>*Other provisions applicable to the President and Chief Executive Officer of Hydro-Québec*<br>- Pension calculated on the basis of average salary for the best three years (less pension payable under the HQPP)<br>- Credit of 4% per contribution year (less pension credit under the HQPP)<br>- Recognition of 100% of the maximum incentive compensation as pensionable earnings (less portion recognized for purposes of the HQPP) | | | | | | |

a) Incentive compensation paid in 2015. The performance threshold set by the Québec government, i.e., a net income of $3,050 million for the period from April 1, 2014, to March 31, 2015, was attained. As for incentive compensation linked to the 2015 targets, it will be paid in 2016 on attainment of the performance threshold set by the Québec government, i.e., a net income of $2,750 million (based on U.S. GAAP) for the period from April 1, 2015, to March 31, 2016. Under Québec government measures to achieve a return to a balanced budget in 2015–2016, Hydro-Québec was required to maintain its payroll for 2014 and 2015 at the 2013 level. Hydro-Québec complied with these measures.

b) Taxable benefits related to financial and estate planning, sports clubs and professional dues.

c) After taking office on July 6, Éric Martel was paid a salary of $232,383 in 2015.

d) Réal Laporte does not receive any separate compensation as President and Chief Executive Officer, Société d'énergie de la Baie James.

## COMPENSATION AND BENEFITS PAID TO THE ONLY OFFICER COMPENSATED BY A WHOLLY OWNED SUBSIDIARY AS AT DECEMBER 31, 2015

| | Base salary as at December 31 | Incentive compensation | Perquisites | Benefits |
|---|---|---|---|---|
| **Sophie Paquette**[a] | $119,859 | – | – | Hydro-Québec pension plan and group insurance plan |

a) Because Sophie Paquette was appointed on December 21, 2015, no salary, incentive compensation or perquisites were paid in 2015.

## AUDITORS' FEES AND INDEPENDENCE

KPMG LLP, Ernst & Young LLP and the Auditor General of Québec are Hydro-Québec's independent auditors for 2015. The professional fees billed by KPMG LLP and by Ernst & Young LLP in 2015 for services other than auditing and certification amounted to 4.8% of the total $5.7 million in fees billed.

Hydro-Québec uses various mechanisms to enable the Audit Committee to ensure that independent auditors remain independent, including a process whereby any assignment that could be given to them is analyzed beforehand. With respect to the office of the Auditor General of Québec, no professional service assignment may be given to it because it serves the National Assembly exclusively.

## ACCESS TO DOCUMENTS AND PROTECTION OF PERSONAL INFORMATION

Hydro-Québec does its utmost to maintain the confidentiality of its employees', customers' and suppliers' personal information, in accordance with the *Act Respecting Access to Documents Held by Public Bodies and the Protection of Personal information*, while respecting the public's right to information. To facilitate access to documents whose publication is prescribed by the *Regulation respecting the distribution of information and the protection of personal information*, Hydro-Québec publishes them on its Web site www.hydroquebec.com/publications/en. In addition, the site provides information about the right to information and the protection of personal information, including instructions for requesting access to a document. The company's key official publications are also available on the site.

As of 2015, the *Regulation respecting the distribution of information and the protection of personal information* prescribes the publication of other information on the Hydro-Québec Web site, such as training costs, registration fees for conferences and congresses, and advertising, telecommunications, employee travel and space rental expenses, broken down quarterly.

In 2015, Hydro-Québec received 406 requests for access to information, of which 321 were granted in full or in part and 61 were turned down. Most of the request denials were motivated by protection of third-party personal information or by commercial, strategic or security concerns that prevented disclosure of the document. As for the 24 remaining requests, either Hydro-Québec was unable to fulfill them, for instance because it did not have the document, or the request was withdrawn. Twenty-seven Hydro-Québec responses were the subject of requests for review by the Commission d'accès à l'information (CAI), and none required any specific accommodation measures for persons with disabilities. A total of 369 information requests were processed within the prescribed timeframe, while 37 required more than 30 days.

Finally, two complaints against Hydro-Québec were filed with the CAI. In both cases, Hydro-Québec responded to the CAI diligently and took corrective action where necessary.

## ETHICS

Hydro-Québec attaches great importance to ethics in all aspects of its activities. As a government-owned corporation, Hydro-Québec must demonstrate exemplary probity, and it can do so only with the consistent support of its employees, who must meet the highest standards with respect to ethics and irreproachable conduct. Loyalty, integrity, respect, discretion and fairness are fundamental values reflecting Hydro-Québec's social commitment to its customers and the community. Ethical rules resulting from these values are set out in the *Code of Ethics and Rules of Professional Conduct for Directors, Executives and Controllers of Hydro-Québec* and in the employees' Code of Conduct. The latter document, which is available (in French only) at www.hydroquebec.com/publications/en, has a twofold purpose: facilitate the understanding of the ethical precepts set out in the policy Our Management and approved by the Board of Directors, and help all employees fulfill their duties in accordance with Hydro-Québec's values.

## LANGUAGE GUIDELINES

In 2015, Hydro-Québec adopted an update of the directive on the application of the *Charter of the French Language*, in accordance with the 2011 governmental policy regarding the use and quality of the French language in the public administration. A reference guide to the directive was distributed to all of the company's employees. In addition, various French proficiency courses were offered to employees, who also have access to a vast energy-related terminology database as well as to a terminology assistance service.

## SUSTAINABLE DEVELOPMENT

The Sustainability Report discusses the company's main sustainable development initiatives, the progress made in this area and the company's sustainable energy choices. The report is based on the Global Reporting Initiative Guidelines. It is published at www.hydroquebec.com/sustainable-development, where additional information is provided on the company's performance with regard to sustainable development.

**Sustainable Development Action Plan 2015–2020 //** Hydro-Québec published its *Sustainable Development Action Plan 2015–2020* in July 2015. This is one way we contribute to the implementation of Québec's *Government Sustainable Development Strategy*, its strategy to ensure the occupancy and vitality of territories and its *Agenda 21 for Culture*. A formal accounting of the company's performance with respect to the Action Plan is presented in the *Sustainability Report 2015*.

| | Action | | Indicator | Results as at December 31, 2015 |
|---|---|---|---|---|
| 1 | Build hydropower projects | OVT | Cumulative capacity made available by the Romaine complex | 910 MW |
| 2 | Increase the capacity of existing hydroelectric generating stations | OVT | Cumulative gains in additional available peak capacity | 36 MW |
| 3 | Continue energy efficiency initiatives | | New annual energy savings | 570 GWh |
| | | | Number of initiatives per market | 16 initiatives/ 3 markets |
| 4 | Continue efforts in the field of transportation electrification | | Number of Electric Circuit charging stations in service and number of regions served | 577 charging stations/ 16 regions |
| | | OVT | Partnership agreements for R&D and commercialization of leading-edge technologies | 8 agreements |
| | | | Number of patents held | 511 patents |
| 5 | Publicize the knowledge acquired through Hydro-Québec environmental studies | C | Number of documents published on the Web | 3 documents published |
| 6 | Continue to protect and enhance the company's built, technological and intangible heritage | C OVT | Number of measures carried out by 2020 | 1 measure |
| 7 | Strengthen environmentally responsible management practices | | Annual GHG emissions from the light-vehicle fleet | 25,322 t $CO_2$ eq. |
| | | OVT | Number of videoconferences held annually | 9,065 videoconferences |
| | | | Percentage of company printers that are print-release enabled | 7.6% |
| 8 | Continue measures that take into account and protect biodiversity and ecosystem services | OVT | Number of innovative measures implemented annually to take into account and protect biodiversity and ecosystem services | 7 measures |
| 9 | Optimize the application of sustainability principles to projects and activities | | Number of projects or activities analyzed each year | 1 project |
| 10 | Promote the integration and favorable reception of Hydro-Québec's system equipment | OVT | Percentage of MRCs that have received the information program | 0% |
| 11 | Integrate the life cycle approach into our innovation efforts | | Number of projects to which sustainability and eco-innovation principles have been applied | 1 project |
| 12 | Keep updating current knowledge on the life cycle assessment of electricity distributed in Québec | | Number of updates of inventory data on the life cycle of Québec's electricity mix per year | 1 update |

OVT Action related to the implementation of the strategy to ensure the occupancy and vitality of territories.

C Action related to the implementation of *Québec's Agenda 21 for Culture*.

# Assessment of Hydro-Québec's Efficiency and Performance

## BACKGROUND

Under the *Hydro-Québec Act*, the company has implemented an assessment process in which it compares itself against other companies in the power industry and reports every three years on the results obtained. The following table shows the results of the second assessment performed by the company, based on indicators drawn from our latest Strategic Plan. The reference period varies, depending on the availability of data for each indicator, but in all cases, the information covers three years.

Certain indicators were not compared, since there were no common benchmarking metrics. However, the results of the assessment were examined by recognized independent organizations.

## RESULTS

Although the companies in the reference group all belong to the power industry, the comparability of the indicators is limited by large differences in business conditions, such as the size of territory served, the regulatory framework and the age of assets. It should also be noted that cost indicators expressed in U.S. dollars are sensitive to exchange rate fluctuations.

### RESULTS OF 2015 ASSESSMENT

| **INDICATORS COVERED IN THREE-YEAR BENCHMARKING** | | | | |
|---|---|---|---|---|
| COST INDICATORS | Hydro-Québec's results *Average results* | | | Comments |
| Transmission substations (US$/MVA)[a] *(Benchmarked by PA Consulting Group)* | **2013** | **2012** | **2011** | The exceptional size of our system means more equipment relative to the reference group and thus higher operating and maintenance expenses. |
| | 2,418 | 2,342 | 2,233 | |
| | *1,104* | *925* | *1,138* | |
| Transmission lines (US$/circuit-mile)[a] *(Benchmarked by PA Consulting Group)* | **2013** | **2012** | **2011** | In view of the relatively high percentage of high-voltage lines in our system, a given load can be transmitted over a smaller number of lines relative to the reference group, yielding substantial maintenance savings. |
| | 1,808 | 1,967 | 2,408 | |
| | *12,405* | *8,509* | *6,547* | |
| Distribution system (US$/customer account)[b] *(Benchmarked by First Quartile Consulting)* | **2014** | **2013** | **2012** | The significant improvement in these two indicators in 2014, both in absolute value and relative to the reference group, is largely attributable to our efficiency efforts. |
| | 83 | 103 | 103 | |
| | *85* | *90* | *83* | |
| Customer operations (US$/customer account)[b] *(Benchmarked by First Quartile Consulting)* | **2014** | **2013** | **2012** | |
| | 55 | 67 | 61 | |
| | *52* | *54* | *49* | |
| SERVICE RELIABILITY INDICATORS | Hydro-Québec's results *Average results* | | | Comments |
| Service interruptions (minutes)[c] *(Benchmarked by First Quartile Consulting)* | **2014** | **2013** | **2012** | The 2014 system average interruption index was one of our best performances in the last decade. However, our performance remains below that of the reference group due to the vastness of the territory we serve. |
| | 143 | 165 | 162 | |
| | *90* | *112* | *95* | |

| **OTHER INDICATORS** | Hydro-Québec's results | | | Comments |
|---|---|---|---|---|
| Average cost of generation (C¢/kWh) *(Benchmarking of certain cost components by Electric Utility Cost Group)* | **2014** | **2013** | **2012** | The average cost of generation remained relatively stable from 2012 to 2014, as a result of tight cost control. |
| | 2.0 | 2.0 | 2.1 | |
| Overall customer satisfaction (out of 10) *(Indicator verified by Bureau de normalisation du Québec)* | **2015** | **2014** | **2013** | This indicator has been down slightly in recent years. To improve it, we'll focus on improving certain aspects of our service and communications. |
| | 7.27 | 7.46 | 7.48 | |
| Cumulative total energy savings (TWh) | **2015** | **2014** | **2013** | Cumulative energy savings achieved under the Energy Efficiency Plan over the life of the Plan, namely from 2003 to 2015, exceeded the original target by 10%. |
| | 8.8 | 8.2 | 7.7 | |
| Atmospheric emissions of vehicle fleet ($t CO_2$ eq.) *(2015 figure verified by Bureau de normalisation du Québec)* | **2015** | **2014** | **2013** | An increase in the distances travelled in 2015 led to slightly higher GHG emissions from our vehicle fleet. Emissions have nevertheless decreased by 12.5% since the 2005 introduction of a series of reduction measures. |
| | 53,000 | 51,074 | 52,349 | |

a) Operating and maintenance expenses, based on the exchange rate for the year in question.

b) Operating expenses, based on the exchange rate for the year in question.

c) System average interruption duration per customer per year.

# Our generating, transmission and distribution facilities

## GENERATION INSTALLED CAPACITY IN MW

### HYDROELECTRIC GENERATING STATIONS — 36,370 MW

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Robert-Bourassa | 5,616 | Sainte-Marguerite-3 | 882 | Laforge-2 | 319 | Rapides-des-Îles | 176 |
| La Grande-4 | 2,779 | Laforge-1 | 878 | Trenche | 302 | Chelsea | 152 |
| La Grande-3 | 2,417 | Bersimis-2 | 869 | La Tuque | 294 | Sarcelle | 150 |
| La Grande-2-A | 2,106 | Outardes-4 | 785 | Romaine-1 | 270 | La Gabelle | 131 |
| Beauharnois | 1,853 | Eastmain-1-A | 768 | Beaumont | 270 | Première-Chute | 131 |
| Manic-5 | 1,596 | Carillon | 753 | McCormick | 235 | Les Cèdres | 113 |
| La Grande-1 | 1,436 | Romaine-2 | 640 | Rocher-de-Grand-Mère | 230 | Rapides-Farmer | 104 |
| René-Lévesque | 1,326 | Toulnustouc | 526 | Paugan | 226 | Rapides-des-Quinze | 103 |
| Jean-Lesage | 1,229 | Outardes-2 | 523 | Rapide-Blanc | 204 | Other (19 generating stations rated less than 100 MW) | 798 |
| Bersimis-1 | 1,178 | Eastmain-1 | 480 | Shawinigan-2 | 200 | | |
| Manic-5-PA | 1,064 | Brisay | 469 | Shawinigan-3 | 194 | | |
| Outardes-3 | 1,026 | Péribonka | 385 | Manic-1 | 184 | | |

### THERMAL — 542 MW

| | |
|---|---|
| Bécancour (gas turbine) | 411 |
| Other (23 diesel plants on off-grid systems) | 131 |

### HYDROELECTRIC GENERATING STATIONS UNDER CONSTRUCTION — 640 MW

| | |
|---|---|
| Romaine-3 | 395 |
| Romaine-4 | 245 |

### INSTALLED CAPACITY OF HYDRO-QUÉBEC'S GENERATING FLEET — 36,912 MW

| | |
|---|---|
| Hydroelectric (63)[a] | **36,370** |
| Thermal (24)[b] | **542** |

a) 62 operated by Hydro-Québec Production and 1 by Hydro-Québec Distribution.
b) 1 operated by Hydro-Québec Production and 23 by Hydro-Québec Distribution.

### OTHER SOURCES OF SUPPLY — 10,072 MW

| | |
|---|---|
| Churchill Falls generating station [Churchill Falls (Labrador) Corporation Limited][a] | **5,428** |
| 36 wind farms operated by independent power producers[b] | **3,260** |
| 7 biomass and 3 biogas cogeneration plants operated by independent power producers[c] | **257** |
| 5 small hydropower plants operated by independent power producers[b] | **65** |
| Other suppliers[d] | **1,062** |

a) Hydro-Québec has access to almost all the output until 2041.
b) Hydro-Québec purchases all the output.
c) Hydro-Québec purchases almost all the output.
d) Hydro-Québec has access to the output of these suppliers.

## TRANSMISSION

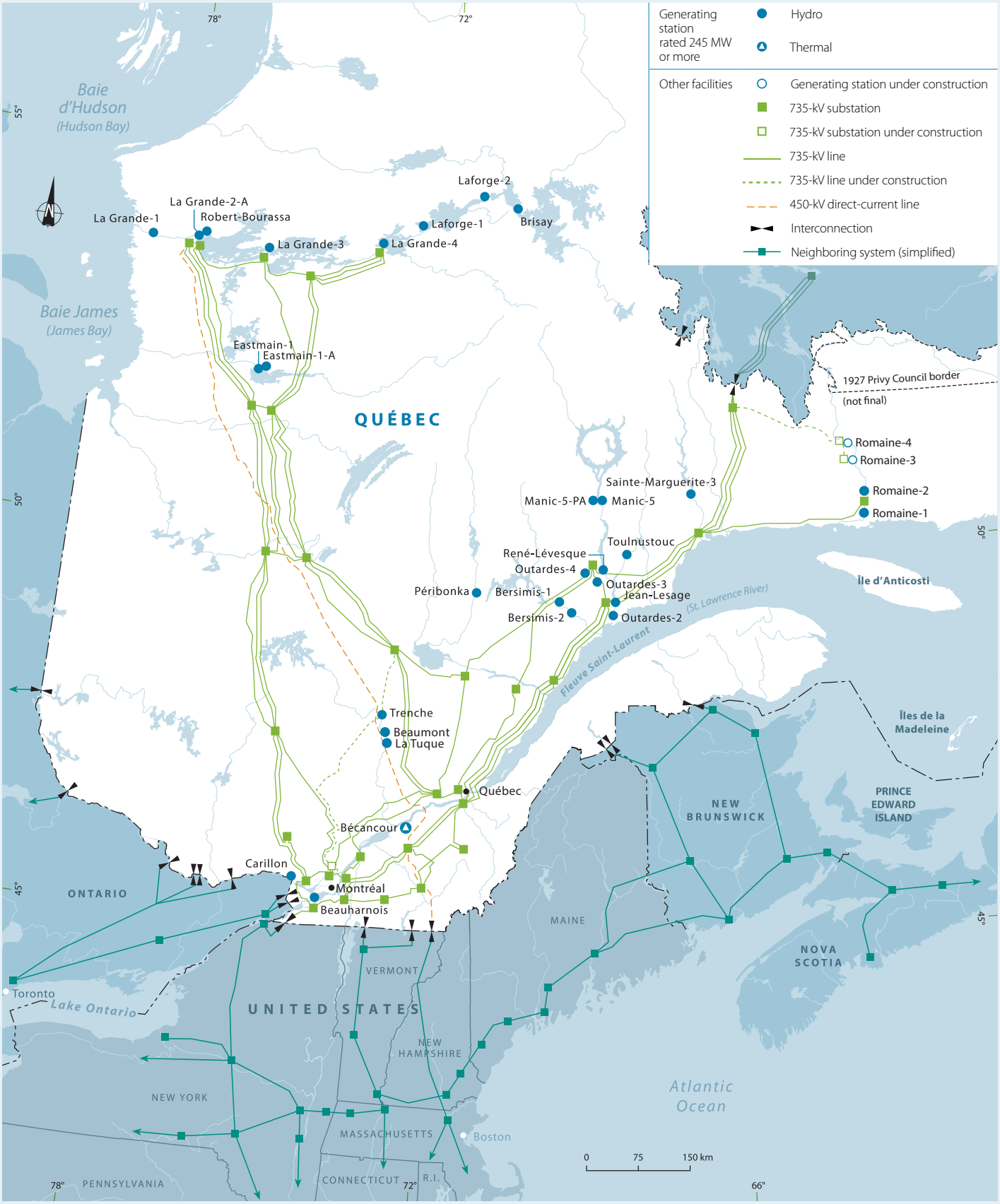
| Voltage | Lines (km) | Substations (number) |
|---|---|---|
| 765 and 735 kV | 11,719[a] | 40 |
| 450 kV DC | 1,218 | 2 |
| 315 kV | 5,456 | 75 |
| 230 kV | 3,236[b] | 54 |
| 161 kV | 2,140 | 43 |
| 120 kV | 6,948 | 217 |
| 69 kV or less | 3,555[c] | 102[d] |
| **Total** | **34,272** | **533** |

a) Including 289 km of 735-kV lines operated at 315 kV.
b) Including 33 km of 230-kV lines operated at 120 kV.
c) 3,283 km of lines operated by Hydro-Québec TransÉnergie and 272 km by Hydro-Québec Distribution.
d) 91 substations operated by Hydro-Québec TransÉnergie and 11 by Hydro-Québec Distribution.

## DISTRIBUTION

| Voltage | Lines (km) |
|---|---|
| 34 kV | 740 |
| 25 kV | 110,501 |
| 12 kV | 4,772 |
| 4 kV or less | 245 |
| **Total** | **116,258** |

# Our major facilities



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

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The French version shall prevail.

*Ce document est également diffusé en français.*

Hydro Québec