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ANNUAL REPORT 2016

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All significant events up to February 24, 2017, are reflected in this report.

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.

A line worker installing the MILE intelligent maintenance system on a distribution line in the Laurentides region.

"We clearly identified the behaviors expected of managers and employees according to our values, mission and strategic priorities. In a nutshell, our target culture will be based on **teamwork**, **agility**, and **openness** to new ideas and growth opportunities. To achieve **results** we can all be **proud** of, we must bank on our **skills** and always make **customers the focus of our decisions**."

A green resource

over

99%

from renewables

Generating capacity

36,908 MW

from 86 generating stations
operated by Hydro-Québec

Net income

$**2,861**M

in 2016

Capital investments

$**3,460**M

in Québec in 2016

Workforce

19,552

permanent and temporary employees

Electricity sales

202.0 TWh

including 32.7 TWh in exports

Residential rate

7.23¢/kWh

the lowest in North America

Purchases of goods and services

$**2,772**M

in Québec in 2016

Message from the Chairman of the Board

First, Hydro-Québec's management team deserves wholehearted congratulations for its solid leadership, which is reflected in the year's excellent financial results with net income of over $2.8 billion. The company also reaped the rewards of efforts made throughout the year to provide services that are up to customers' expectations; in fact, customer satisfaction averaged 91%, compared with 82% in 2015. Another achievement worthy of note: Hydro-Québec stood by its commitment that rate increases would not outpace forecast inflation.

Michael D. Penner
Chairman of the Board

For the Board of Directors, too, 2016 was a year of intense activity marked by decisions of great importance on major issues. Considerable work went into the adoption of the *Strategic Plan 2016–2020*, as Board members played an essential role in a rethinking of the company's strategies that will guide its actions in the coming years. The Board also conducted an evaluation of its own performance.

The Board's composition changed during the year, with the departure of three of its members —Jacques Leblanc, Gilbert Charland and Éric Forest—and the arrival of three new members— Anne-Marie Croteau, Marie-Josée Morency and Robert Keating. Nine of the 16 members of Hydro-Québec's Board of Directors now are women. This high level of female representation is more than just symbolic: it is an example to be emulated.

A presentation on the development of new growth avenues and the principles that will guide future investments outside Québec confirmed to Board members that the company had put in place all the necessary mechanisms to achieve one of the objectives stated in the *Strategic Plan 2016–2020*, namely to double its revenue by 2030 so as to increase profits. The Board plays a part in reaching this goal by supporting the President and Chief Executive Officer and his management team in the steps they take to promote the company's international growth.

During the year, we paid particularly close attention to the activities of the Information Technologies Committee formed in fall 2015. One of this committee's tasks was to monitor the overhaul of IT services, a process begun by the company in 2015, as well as cybersecurity reinforcement and the performance indicators of the Vice-présidence – Technologies de l'information et des communications.

In late 2016, following a number of severe accidents on Hydro-Québec's jobsites, the Board struck a special committee charged with examining the company's health and safety practices and recommending any changes required to ensure that the most stringent standards are applied in this regard. The committee has retained the services of an outside firm to assist in this process.

In its continued endeavor to adopt governance best practices, the Board decided to adopt fixed compensation for Hydro-Québec's internal auditor. To help establish an organizational environment that promotes the internal auditor's independence and objectivity—two basic principles that are essential to the performance of his duties—we decided that, effective January 1, 2016, he would no longer be covered by the variable compensation policy.

On September 27, we launched the 40th Hydro-Québec Centraide campaign. The first campaign, in 1976, involved the company's Montréal employees. Two years later, it was extended to all employees throughout Québec. As co-chair of the 2016 campaign, I am very proud of the record amount we raised during the year. The $5,708,883 will go to support organizations working to improve the quality of life of people in difficulty.

Message from the President and Chief Executive Officer

When I joined Hydro-Québec, I made a commitment to improve the company's image and see that it regained its place as a source of pride for all Quebecers. To achieve this goal, we made customers the focus of our decisions and enhanced the performance of our customer relations centres. The efforts we made to better meet customer expectations are beginning to yield results, as evidenced by an overall satisfaction index of 91% in 2016, up from 82% in 2015.

Éric Martel
President and
Chief Executive Officer

In the area of customer services, we can be proud of the 58% reduction in average call wait time and the 33% reduction in the number of complaints. In addition, the proportion of calls answered in less than 210 seconds rose from 62% in 2015 to 90% in 2016, well beyond the target of 80% set a year ago.

As regards communications with customers, we adopted a digital strategy that provided support for our initiatives and enabled us to explain our activities, business environment, challenges and contribution to the Québec economy more effectively. By opting for a personable communications approach emphasizing such means as the Web, and social media in particular, we were able to promote direct, rapid exchanges with our customers.

Our investments in energy efficiency from 2003 to 2015 are generating energy savings of 8.8 TWh—equivalent to the consumption of 500,000 households. Clearly, our customers are making energy efficiency an increasingly important part of their electricity use habits. This trend is growing steadily and will have a definite impact on demand in the coming years; in fact, the savings achieved by our customers will allow us to sell more energy on markets outside Québec.

Some of our customers are expressing more and more interest in alternative energy sources like photovoltaic solar. Use of this energy source will also affect residential demand growth. At the same time, by freeing up kilowatthours that we can market beyond our borders, it could very well open up attractive business opportunities.

New trends are emerging in the residential sector, where digital technologies such as smart meters, remote control and automation will eventually transform electricity use habits and consumption management. Tomorrow's power system will feature growing feed-in from residential customers due to greater availability of grid-interactive technologies. More than ever, we must support the emergence of these technologies and capitalize on them.

Our energies are also focused on continuing to boost our productivity. To this end, we've set targets for reducing operating expenses throughout the company.

The performance and engagement of our employees play a large part in giving Hydro-Québec a vitality that will make it a model on many different levels. I thank them for their daily contribution to our success.

I'm also grateful to the members of the Board of Directors for their diligence in examining the various files submitted to them, and in particular for all the work they put toward the adoption of the *Strategic Plan 2016–2020*.

For 2016, net income was

$2,861M

Contribution of more than

$4 billion

to the Québec government's revenue for 2016

Our Management Team

To become a leader in customer service, ensure sales growth and provide a stimulating work environment for its employees, Hydro-Québec relies on a management team with the skills to handle the many issues lying ahead. With this in mind, we welcomed some new individuals with new expertise in recent months. Together, we are striving to develop a long-lasting relationship of trust with our customers, bring our practices in line with our values and motivate our employees.

Front row: Éric Martel, President and Chief Executive Officer; Réal Laporte, President, Hydro-Québec Innovation, équipement et services partagés and President and Chief Executive Officer, Société d'énergie de la Baie James; Stella Leney, Vice President – Corporate Affairs and Secretary General; Élise Proulx, Vice President – Communications and Government Affairs; Richard Cacchione, President, Hydro-Québec Production. *Back row:* Johanne Duhaime, Vice President – Information and Communications Technologies; David Murray, President, Hydro-Québec Distribution; Lise Croteau, Executive Vice President and Chief Financial Officer; Jean-Hugues Lafleur, Vice President – Financing, Treasury and Pension Fund; Bruno Gingras, Vice President – Human Resources; Marc Boucher, President, Hydro-Québec TransÉnergie; Michel Ménard, Vice President – Corporate Transformation, Health and Safety; Steve Demers, Vice President – Business Development.

OUR CUSTOMERS

Serving customers is central to our business of providing electricity. Enhancing the performance of our customer relations centres is always a top priority. That's why we've extended our business hours, expanded our online self-service options, made our services more accessible and continued our efforts to reduce service connection lead times. We've also made a commitment that our rate increases will not outpace inflation. Our objective is to become a benchmark in customer service.

Improved services

We achieved a major milestone during the year: since June 25, just in time for the busy moving season, our customer relations centres have been open weekday evenings and weekends so we can serve our customers better. For the first time, they were also open from nine to five on July 1, Canada Day. Our customer service representatives answered 3,758 calls that day and have handled an average of 4,000 calls every weekend since the new schedule took effect.

All this was made possible thanks to our employees, who embraced the new practice with conviction, and the receptiveness of our union partners. Our ways of doing things had to change. Specifically, we had to adjust work schedules to the call pattern, as some of the traffic shifted to the new business hours. Some employees already on the job switched to new schedules—including evenings and weekends—drawn up in conjunction with the union.

Moreover, people can now ask to have a customer service representative call them at a time that suits them, during the day, evening or weekend. They can make the appointment by phone or on the Hydro-Québec Web site.

More effective support

Setting up first-level support for customer service representatives in 2016 reduced the number of customer callbacks. Representatives now have access to support while they are talking to customers. In more complex cases, a more experienced person can take over. We're also simplifying work procedures to provide better service to our customers by resolving issues on the first call.

Adaptable training

We established new career opportunities to offer customer service representatives an environment that fosters each person's professional fulfillment and improved performance. All representatives receive training that covers basic competencies. When they've mastered those, they can acquire additional skills that give them access to other duties or promotions. All our training programs were revamped accordingly.

Greater use of online services

We launched a pilot project to encourage residential customers to make their change of address themselves online. In that way, they avoid the $20 file administration charge or $50 new file charge. There were a total of over 173,000 online self-service transactions between April 11 and September 30, 2016, up from about 97,000 for the same period the previous year—a remarkable 78% increase. Greater use of online options reduced the volume of calls to the customer relations centres, the number of transactions on the interactive voice response system and the number of address changes mailed in.

NEW FOCUS ON MOBILE ACCESS

With a view to improving the customer experience, Hydro-Québec is continuing to develop Web and mobile access so that customers can manage their accounts and track their requests themselves. This means diversifying our offerings and improving the performance of self-service options for both computer browsers and mobile devices. We have optimized pathways through the self-service platform, adding FAQs and clarifying certain steps, for example, to make the transactions easier.

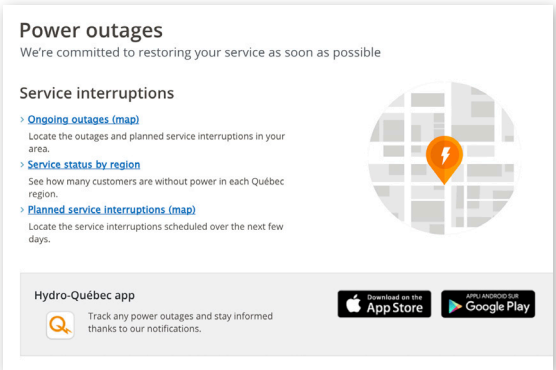
Since December 2016, customers have been able to report power failures from their computers or mobile devices. Planned service interruptions have been added to the outage information map, making it easy to see when work is going to be done in a given neighborhood.

Customers and their master electricians can now track the progress of work requests (new service connection, pole relocation, etc.) on our Web site. The Track a Request option lists the actions to be done and displays the anticipated date of each, as well as any change in the date.

We are exploiting the capabilities of next-generation meters to help customers manage their power use better. Thanks to these meters, customers can view their daily energy use online, whereas before they could only see monthly and yearly totals. Results may be displayed in kilowatthours or dollars.

To better support customers with financial problems, Hydro-Québec has added medium-term (three- to six-month) payment arrangements as a self-service option, in addition to short-term arrangements, which were introduced in June 2015. In 2016, 29,106 short- or medium-term payment arrangements were made through this service. We also added a new section to the Web site explaining the various solutions available to customers having trouble paying their bills.

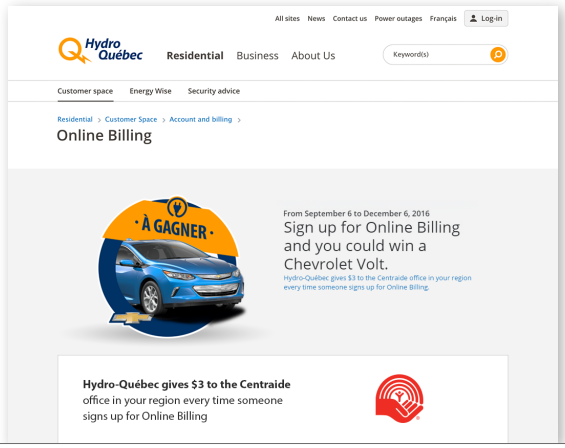
In addition, customers who are moving can obtain the estimated amount of their annual bill, the amount of their highest bill in the past year and the amount of their installment if they are signed up for the Equalized Payments Plan. They can also ask for an estimate of the annual electricity consumption at a place they plan to move into.



ONLINE BILLING IN THE SPOTLIGHT

From September 6 to December 6, 2016, Hydro-Québec ran a campaign urging customers to sign up for Online Billing. For each of the 92,245 customers who did, Hydro-Québec donated $3 to Centraide in their region, for a total donation of $276,735. Plus, one customer won a Chevrolet Volt in a random draw from among existing and new users of the service. In addition to cutting down on paper, the service offers customers a number of advantages. They are notified by e-mail as soon as a bill is ready. They can also sign up for e-mail reminders to avoid missing the due date. Bills are archived for two years and can be viewed anytime.

At year end, 1,019,620 of our customers had opted for Online Billing, which means more than 9.8 million fewer bills printed each year. Less paper and less mail are significantly better for the environment.



Replacing medium-voltage lines in a residential neighborhood.

Our performance barometer

2016 **91%** 2015 **82%**

Overall public satisfaction index

In 2016, 91% of customers said they were "very satisfied" or "quite satisfied" with Hydro-Québec. That reflects efforts to meet customer expectations better by enhancing our services and improving our ways of communicating.

2016 **87** 2015 **205**

Average call wait time (seconds) – residential customers

Average call wait time improved greatly in 2016. It was 58% shorter than the previous year, reflecting our efficiency gains in this area.

2016 **90%** 2015 **62%**

Call service level

The proportion of calls answered in less than 210 seconds rose from 62% in 2015 to 90% in 2016, exceeding the target of 80% set a year ago.

2016 **3,838** 2015 **5,762**

Number of complaints

There were 33% fewer complaints in 2016, indicating improvement in interactions with customers.

2016 **90%** 2015 **83%**

Simple service connections

This rate indicates the percentage of simple service connections completed within 10 business days. It was 90% in 2016, much better than the previous year.

2016 **92%** 2015 **55%**

Multiple-party service connections

This rate indicates cases in which technical services involving multiple parties were provided on schedule. The significant improvement in 2016 is attributable to the establishment of the customer technical services centre.

IMPACT OF INCREASE REQUESTED FOR 2017 ON HOMES HEATED WITH ELECTRICITY

Apartment	Small house	Midsize house	Large house
$0.43/month	$2.36/month	$3.84/month	$5.11/month

Undeniable advantage

Thanks to hydropower, electricity rates are still very low in Québec, compared with the rest of North America. They help households balance their budgets and offer all Québec businesses a strong competitive edge.

To maintain this advantage, Hydro-Québec has made a commitment to keep rate increases in the coming years lower than or equal to inflation. That's why we need to contain our operating costs and keep improving productivity.

The Régie de l'énergie approved an electricity rate increase of 0.7%—a third of the forecast inflation rate— as of April 1, 2016, for all residential customers and most business customers. We are applying for a 1.6% increase as of April 1, 2017, for the same customer segments, in part so that we can finance the investments needed to ensure the long-term operability of transmission lines and substations.

Smart maintenance

We're continuing to roll out the MILE intelligent power line maintenance system, which monitors line condition in real time. The system is able to locate several types of line faults—such as those caused by tree branches, contact with animals or equipment failure—with a high degree of precision. At year end, the system was being used on 27 lines serving some 41,000 customers, mostly in the Laurentides and Montérégie regions.

The information provided by MILE helps our engineers and technicians respond to customer complaints, optimize grid protection and plan the most appropriate repairs. If, for example, a ski resort experiences repeated power failures while making artificial snow, MILE can determine that a defective insulator on the line crossing the mountain is responsible.

Overhauled conditions of service

As part of our major efforts to improve customer services, our *Conditions of Service* were completely overhauled and the new version was filed with the Régie de l'énergie in the wake of focus groups involving 13 organizations. Our goal was to simplify the conditions governing relations with customers, in particular so that they need contact us only once to make a request, whether by phone or, increasingly, online. This will free up our representatives to deal with more complex situations. We also proposed a simplified pricing structure for work requested by customers, which should reduce lead times.

New coordinating centre

In April 2016, we opened a coordinating centre for customer technical services to improve communications with customers requesting new connections or other work. The centre handles requests from intake to completion and can set a personalized, reliable date for work to be done. It not only processes requests more quickly, but also maintains contact with customers and their master electricians throughout the entire process and provides access to more information online.

Streamlined bill

We're reviewing the way information is presented on electricity bills to make it easier to understand. To this end, we consulted customers, service representatives and consumer associations by means of surveys, meetings and focus groups during the year.

EFFICIENT HABITS

Hydro-Québec has seen its customers become more energy-efficient as they change their electricity use habits. This trend is confirmed by the 10-year demand forecasts: average yearly growth of only 0.4% in energy needs and 0.6% in capacity needs is anticipated for the period covered by the Electricity Supply Plan 2017–2026.

We are continuing our energy efficiency efforts, which are compounded by customers' new energy-saving habits along with the impact of efficient products.

Winter 2015–2016 saw customers maintaining a trend prompted by recent harsh winters with their higher heating costs, as those who had changed their habits lowered their thermostats by an average of 2.6°C.

LED bulbs and CFLs have penetrated the market quickly, as demonstrated by the fact that more than 39 million have been installed in the past three years.

New constructions are better insulated and up to 20% more energy-efficient.

Restoring service after a December snowstorm.

Tomorrow's off-grid systems

By 2020, Hydro-Québec will have issued a request for proposals for each of its off-grid systems with a view to cutting energy supply costs. Those systems, currently using diesel generators, will be completely or partially converted to renewable energy sources, taking into account the requirements of both local communities and Hydro-Québec.

We had already begun the process in 2015 with an RFP for 6 MW of wind energy in Îles-de-la-Madeleine. In fall 2016, we issued an RFP for power generated from forest biomass to supply the community of Obedjiwan. This will reduce dependency on diesel and cut GHG emissions, while at the same time promoting projects that will have economic spinoffs.

We also continued our campaigns to raise awareness among customers of off-grid systems, particularly in Îles-de-la-Madeleine, Basse-Côte-Nord, Haute-Mauricie, Schefferville and Nunavik, encouraging them to conserve electricity in winter and during peak periods. A survey confirmed that the campaign objectives had been met: more than two thirds of respondents had changed their habits and were using electricity more wisely in cold weather.

RATE FOR CHARGING STATIONS

With transportation electrification in view, Hydro-Québec has proposed a special experimental rate for public fast-charge stations, one that is better suited to their low power use. The new rate, BR, will be the subject of a five-year pilot project that will enable us to track the rollout of charging stations in Québec, document this new use of electricity and maintain rate flexibility over the next few years.

Single point of access

Hydro-Québec continued to work with the Bureau de l'efficacité et de l'innovation énergétiques (BEIE) on an energy efficiency package designed for low-income households and offered through a single point of access. Our pilot project includes measures like caulking; installing electronic thermostats, LED bulbs and water- and energy-saving products; replacing inefficient refrigerators; and raising awareness about energy-saving behaviors.

LOWEST RATES IN NORTH AMERICA

Hydro-Québec rates for residential customers have been the lowest in North America since 2009. As at April 1, 2016, a Québec customer with a monthly consumption of 1,000 kWh paid 7.23¢/kWh. By way of comparison, residential customers in Toronto paid 17.81¢/kWh—more than twice as much.

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

SUSTAINED COMMITMENT

The Electric Circuit added 220 charging stations in the past year, bringing the total to 794. The network of fast-charge stations now extends across Québec, mainly along Highway 20 between Montréal and the Bas-Saint-Laurent region, and on the roads encircling Gaspésie. There were 66 fast chargers by the end of 2016, up from 29 a year earlier.

To better meet members' needs, Electric Circuit partners may now offer charging by the hour at their regular 240-V stations. For the first time, the Electric Circuit will venture outside Québec, extending the network on four major roadways in northeastern Ontario into Ottawa and as far as Prescott, by way of Cornwall.

One of the Electric Circuit's plans for the future is to open an electric vehicle super charging station with several fast chargers. Hydro-Québec will also be working with the Québec government to set up a network of multifuel service stations (electricity, gasoline, hydrogen, propane, natural gas and biofuels).

Hydro-Québec is committed to supporting the development of an electric mass-transit infrastructure. We are working on the Réseau électrique métropolitain, a light rail system proposed by CDPQ Infra, as well as the Cité Mobilité Montréal project, which involves the purchase of electric buses and is overseen by the Société de transport de Montréal.

Montréal hosted the 29th International Electric Vehicle Symposium (EVS29) in June 2016—a sign of a dynamic movement toward electric transportation in Québec.

Electric Circuit

794 public **charging stations** (including 66 fast-charge stations)

Serving **16 administrative regions**

181 partners

11,458 members

Power demand

Based on the success of the pilot project to reduce power demand in winter 2015–2016, we launched a new offer on April 1 that applies to commercial and institutional buildings, as well as to small- and medium-power industrial facilities. It offers financial compensation to customers who curb their power demand during peak periods. This demand response initiative attracted a great deal of interest right from the start. With 280 projects signed up, it could shave up to 130 MW off the peak in winter 2016–2017.

Improved competitiveness

An electricity management system (EMS) ensures methodical management of energy use. This can help industrial companies strengthen their competitive position through savings and improved work procedures. Customers eligible under the EMS component of our Industrial Systems Program receive financial assistance for implementing an EMS. For instance, Waterville TG and Domtar-Windsor, two companies that took part in 2016, reduced their electricity use without investing in their existing production machinery or compromising on product quality.

Economic Development Rate

In the years to come, Hydro-Québec will have more energy available than will be needed in Québec. So that society as a whole benefits from this positive balance, in 2015 we introduced the Economic Development Rate, which initially offers 20% off the going rate. Energy-intensive capital projects in high-growth sectors are targeted. About a dozen customers, primarily data centres, have taken out service contracts at this rate.

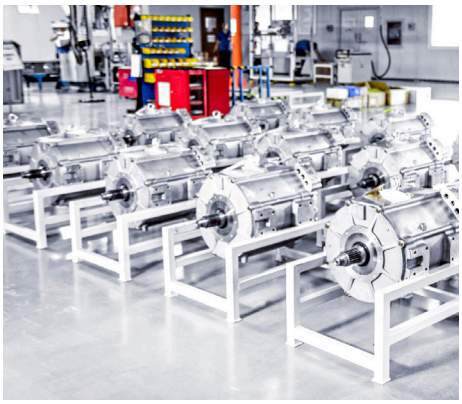
Agreement for concerted use

An agreement was signed with the Union des municipalités du Québec and the Fédération québécoise des municipalités on the coordinated use of municipal public rights-of-way. The efficiency gains will benefit the entire population.

In October 2016, Hydro-Québec was honored for its contribution to the industry when it received an award for being the electric utility providing the most emergency assistance in the previous 12 months from among more than 200 companies in eastern North America. The North Atlantic Mutual Assistance Group (NAMAG) noted that more than 200 Hydro-Québec line crew members had been mobilized to lend a hand to their coworkers in Long Island, NY, in January, and then Long Island again and New Jersey in September.

OUR GROWTH AVENUES

The new avenues we're following—in our export markets, for investments beyond our borders or in marketing our technologies—are key to achieving our goal of doubling our revenue by 2030 and increasing our net income. Boosting the capacity of our generating fleet is another promising growth avenue. Through all our initiatives in the coming years, we'll be able to make a greater contribution to Québec's prosperity.



Our Business Positioning

Future growth depends on new long-term export contracts and on investments in generation and transmission assets outside Québec.

Participating in the energy transition

The Paris Agreement on climate change, which came into effect in 2016, reaffirmed the signatories' commitment to transition to energy sources with lower greenhouse gas emissions. Hydro-Québec is the largest producer of clean energy in North America. We want to play a part in this global transition by marketing our renewable electricity and technological innovations, but also by contributing our technical expertise and know-how in power system operation.

The team in charge of growth outside Québec works within the Vice-présidence – Développement des affaires, a unit that calls on all of the company's resources in fulfilling its mission.

Agreements for reducing GHG emissions

Hydro-Québec has long partnered with electricity service providers in the U.S. Northeast. We already export large volumes of renewable energy to their markets and we've demonstrated that we can do more to ensure that they have a reliable power system with a small carbon footprint. The agreements we reach with our partners offer them the additional benefit of stable long-term prices.

We are consequently making major efforts to negotiate new long-term contracts for electricity sales to neighboring systems, where ambitious emission reduction targets have been set.

In fall 2016, for example, we signed an agreement with Ontario's Independent Electricity System Operator (IESO), which notably provides for the sale of 2 TWh a year to Ontario from 2017 to 2023. This will reduce GHG emissions from natural gas power plants.

Having participated in a request for proposals from three New England states, we're now preparing our response to an RFP to be launched by Massachusetts in 2017.

The Massachusetts RFP will follow on the summer 2016 enactment of a clean energy bill that recognizes the important role of hydropower in the supply mix. This legislation is historic as it authorizes the purchase of significant quantities of hydropower and the associated transmission needed to deliver it to customers—a first in that state. With this new law, Massachusetts is better positioned to meet its 2020 GHG emission reduction requirement under the *Global Warming Solutions Act*. What's more, it establishes a foundation from which the entire New England region can collaborate to transition to a cost-effective clean energy future.

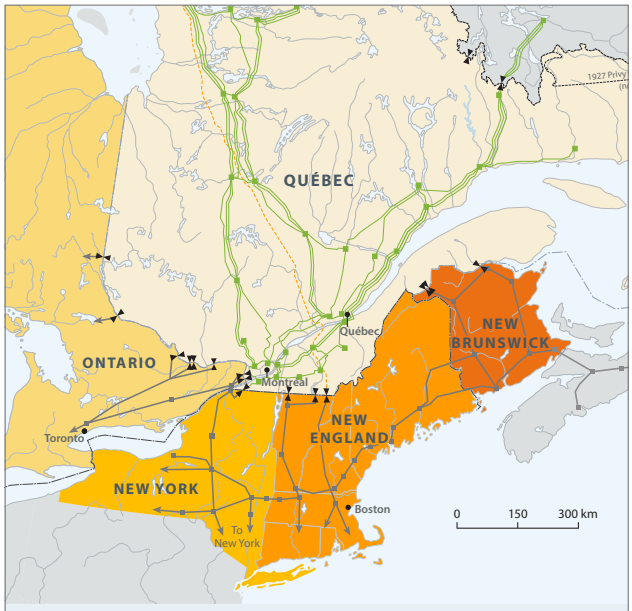
In addition, we're talking with New York authorities, who want to see 50% of the state's energy needs met by renewables by 2030. New York City would like to have all its administrative buildings supplied with 100% renewable energy.

We're also contributing to an initiative by the Massachusetts Institute of Technology (MIT), Ouranos and HEC Montréal, aimed at developing a modeling tool for climate change research, and in particular for studying the future use of renewables in New England.

Changing domestic demand

The Electricity Supply Plan 2017–2026 filed with the Régie de l'énergie in November 2016 anticipates average annual growth of 0.4% in energy needs starting in 2017. This modest growth rate is partly due to the effects of changing consumer habits and more efficient home appliances.

As a result, an average of 11.3 TWh will be available each year for the next 10 years. To turn this situation to our advantage, in May 2016 we announced an aggressive campaign to attract data centres, which are known for their high energy usage. By locating in Québec, they could count on a reliable supply of clean power from renewable sources,

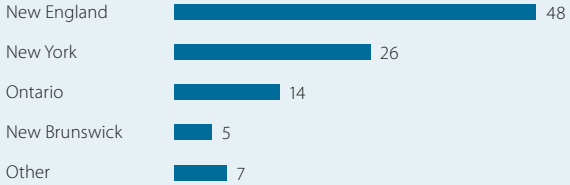


CONTRIBUTION BY OUR EXPORTS

Our export markets generated profits of $803 million in 2016, or 28% of the company's net income. This was a record year for export volume, which totaled 32.6 TWh.

SALES OUTSIDE QUÉBEC IN 2016

%



very competitive electricity rates, a climate that does not require large power draws for cooling, more than 25 million square feet of available real estate in strategic locations, support services that can help them get their projects up and running quickly, and expertise in energy efficiency.

By taking tangible steps to increase sales in Québec, we're ensuring that we'll be able to fulfill our commitment that rate increases will not outpace inflation.

Purchases of assets and stakes

We can also contribute to the energy transition by purchasing assets or stakes in companies involved in hydroelectric generation and power transmission, two fields at the core of our reputation and expertise.

We advocate a partnering approach. Hydro-Québec is a long-term strategic ally that offers its partners cutting-edge expertise and innovative technologies. What sets us apart is that we are not just an investor, but also an experienced operator.

In 2016, we focused mainly on the Americas and Europe. In the current dynamic market, we looked at opportunities that are potential fits for our investment criteria.

A PARTNER OF CHOICE

France's transmission provider, RTE, is a partner of choice for Hydro-Québec. Long-time allies, each operating a vast power transmission system, we've decided to strengthen our cooperation, which is based on a shared culture of public service. In November 2016, we signed a memorandum of understanding (MOU) on a strategic partnership that will allow us to work together to meet the technological challenges posed by the energy transition in Europe and North America.

Under the MOU, we'll join forces to identify opportunities to purchase strategic transmission system assets, either jointly or separately, as well as to create common structures for commercializing innovative solutions developed by our R&D teams. We'll also pool our know-how in occupational safety and other areas.

Éric Martel, President and Chief Executive Officer of Hydro-Québec, and François Brottes, Chairman of the RTE Management Board, after signing the memorandum of understanding.

We took steps to acquire a stake in the largest high-voltage transmission system in Europe, the Réseau de transport d'électricité (RTE), owned by Électricité de France (EDF). Although the deal fell through, it paved the way for a strategic partnership between Hydro-Québec and RTE.

AN INVESTMENT IN THE FUTURE

To maintain the reliability of our deliveries to New England, we invested in the direct-current (DC) link between Radisson substation (photo) and Sandy Pond substation in spring 2016. The work was carried out so efficiently that we were able to complete the job two weeks ahead of schedule and resume exports earlier than expected.

The Radisson–Nicolet–Des Cantons line, inaugurated in the early 1990s, is a 450-kV DC line running from the La Grande complex, in the Baie-James region, with an extension south of the border to Sandy Pond substation, just outside Boston. Its construction was made possible by a partnership between Hydro-Québec and New England utilities.

The Radisson–Sandy Pond line is over 1,500 km long and has the largest transfer capacity of all the interconnections between Québec and New England. Since this major infrastructure went into operation, it has carried more than 100 billion kWh of electricity to our southern neighbors.

Innovation: An Engine for Growth and Performance

More than ever before, Hydro-Québec will remain at the forefront of electricity-related innovation thanks to the work, scientific excellence and solid expertise of its research institute, the Institut de recherche d'Hydro-Québec (IREQ).

A changing environment

The power industry is facing a wave of major changes. In addition to integrating renewable energy sources, making room for decentralized generation and turning to large-scale energy storage, we must learn to make optimal use of big data by applying leading-edge digital technologies for the benefit of our customers.

IREQ has determined which of its innovation avenues will be essential to the company's performance over the next decade. In 2016, four pilot projects were launched, each in a different field of innovation: advanced algorithmics for power system optimization; digital simulation of equipment and facilities; equipment diagnostics and prognostics; and grid-interactive technologies for customer empowerment.

INNOVATION AND PERFORMANCE

According to the ranking published last November by Re$earch Infosource, Hydro-Québec came in 24th out of Canada's top 100 corporate R&D spenders—a move upward from the spot we held at 29th in 2014. Within the Canadian power industry, however, we rank first thanks to IREQ, our world-class research centre and a true technological leader in multiple fields related to power systems and renewable energy. One of the areas studied by IREQ's researchers is the use of drones to inspect transmission and distribution lines (photo). With its 1,100 patents and the creative potential of its 500 employees, IREQ plays a leading role in innovation for Hydro-Québec and all of Québec. Its contributions will enable us to implement leading-edge technological solutions to support our activities, expand our markets and raise our visibility on the world scene.

The future of storage

A testament to the quality of its work on battery materials, IREQ has partnered with some of the industry's leading players, including Sony (Japan), Arkema (France), BASF (Germany) and the U.S. Department of Energy. To date, IREQ has granted 30 active licences and acquired 848 patents related to various types of materials.

Technologies Esstalion, a joint venture of Hydro-Québec and Sony, has developed a large-scale energy storage system that can provide 2.4 MWh, twice as much as the previous generation. A prototype will be tested in 2017 at IREQ and then connected to a feeder line at Hemmingford substation, in the Montérégie region.

In 2016, research on electrolytes and batteries got under way at a laboratory jointly run by Hydro-Québec subsidiary SCE France and Arkema at Chemstart'up, a business service centre for chemical companies in Lacq, France. The laboratory's work has led to two European patent applications.

Future energy needs

More than 99% of the electricity we generate is from renewables, and we intend to remain a green power producer. Nevertheless, we need to think about ways to eventually enhance our resource portfolio so that we can meet our customers' future energy requirements. IREQ could provide very useful input to help us make clear choices about new sources of renewable energy. Any choice we make will have to further our aims of maintaining the lowest residential rates in North America and recovering our investment rapidly.

Predictive maintenance

Rigorous asset management and maintenance are essential for ensuring service continuity and optimal system performance and reliability. However, because maintenance work directly impacts the company's operations and results, our teams are developing methods and technological solutions to reduce the frequency and duration of maintenance work, make it more transparent to operations, prolong the useful life of equipment and facilities and determine the phenomena likely to affect power system equipment and reliability. Today, it's no longer enough to know the condition of equipment and facilities. We need to optimize our maintenance strategies through the use of prognostics, a predictive approach and decision support tools.

One of our research teams has developed a method for assessing power transformer aging. We can now determine the remaining service life of the solid insulation material in transformers without opening them or removing them from the grid. This has already yielded concrete results in a number of Hydro-Québec TransÉnergie facilities and has attracted the attention of several power industry companies and research groups. The innovation is completely in line with our predictive maintenance approach for transformers.

It will contribute to shorter maintenance outages and increased equipment availability, thus improving service continuity.

Consumption management

Thanks to our tool for determining and classifying demand profiles, we presented 19 industrial customers with data on their power demand. Following the success of this pilot project, the offer was extended to 600 industrial companies in fall 2016.

Optimized steel for turbine runners

In February 2016, subsequent to IREQ's extensive studies on the type of steel to use in turbine runners, Les Cèdres generating station received the first turbine runner made of high-tensile carbon steel, manufactured by Voith. This is the first hollow-blade runner used at Hydro-Québec. IREQ also equipped the runner with measuring instruments to track its behavior.

SUCCESSFUL UPGRADE

We were able to capitalize on IREQ's solid expertise in power system simulation when we replaced the control and protection systems in a key transmission facility, the multiterminal direct-current system (MTDCS), which includes a 450-kV DC line connecting Radisson substation in the Baie-James region and Sandy Pond substation near Boston. IREQ used its Hypersim power system simulator to validate the new digital systems, carrying out some 1,000 tests. As a result, exports resumed two weeks ahead of schedule, limiting the impact of the shutdown required to install the new systems. The MTDCS enables cross-border power transmission to New England and carries a significant portion of Hydro-Québec's exports.

A sales and marketing partnership

CGI, an IT solutions provider with an international presence, will be taking over sales and marketing of the MILE system developed at IREQ. MILE locates transient faults on distribution lines and determines their probable cause. We use it for preventive maintenance on our grid, and have also been able to resolve disturbances very quickly, improving our service quality. The transfer of technology has already begun under an agreement signed in 2016, and a number of electric utilities outside Québec have expressed an interest.

A RECOGNIZED CONTRIBUTION TO SUSTAINABLE TRANSPORTATION

Through its subsidiary TM4, Hydro-Québec is contributing to the development of plug-in electric vehicles. TM4 is currently ramping up production of its electric and hybrid powertrains and commercializing these technologies on major world markets.

In 2016, TM4 won a contract to provide air supply motors and inverters for the FCveloCity–HD fuel cell module developed by Ballard Power Systems of Canada. Designed for use in hydrogen-powered vehicles, this module requires a high-precision air flow. The TM4 MOTIVE motor series was selected for its quality, high power density and tried-and-tested reliability.

Prestolite E-Propulsion Systems (PEPS), a joint venture of TM4 and Prestolite Electric Beijing, received ISO/TS 16949:2009 certification for the design and manufacture of electric powertrains. Using TM4 technology under licence, PEPS develops, manufactures and markets electric and hybrid motors for the Chinese market. The certification confirms that the company meets the highest quality standards in the automotive industry. Through PEPS, TM4 sold 900 electric powertrains in 2015 and 5,000 in 2016. A significant increase in sales is also anticipated in 2017.

TM4's SUMO™ motor system was used in the MD9 electriCITY, a new platform for electric buses unveiled by TEMSA, a Turkish manufacturer of buses, coaches and light trucks.

Increasing Capacity to Supply Our Customers

In the coming years, we'll add 1,140 MW to our hydroelectric generating capacity in the Plan Nord area and commission new transmission facilities.

Romaine complex

Construction continued on hydropower facilities in the Minganie region. Romaine-2 and Romaine-1 generating stations having come onstream in 2014 and 2015, our teams concentrated their efforts on Romaine-3 (395 MW) and Romaine-4 (245 MW). Work involved construction of Romaine-3 substation, the line connecting it to Romaine-4 substation and the line between Romaine-4 and Montagnais substation, with a view to connecting the two generating stations to the grid.

After concreting was completed on Romaine-3, we began assembling the generating units and installing the mechanical, electrical and architectural components. The gates for the spillway and temporary bypass were installed. The Romaine-3 switchyard has been in place since fall 2016, and the plant is slated to go into commercial operation in 2017.

At Romaine-4 (245 MW), we awarded contracts for the generating units, temporary bypass gates, dam and penstock linings. The main activities carried out at the site were the building of access roads and land clearing for the permanent structures. Excavation began on the temporary bypass and the generating station. The facility will deliver its first megawatts in 2020.

LABOR AND SPINOFFS

In 2016, 48% of the 1,611 workers on the job at the Romaine complex came from Côte-Nord municipalities (767 workers) and 9% were Innu (147 workers). Significant amounts of capital continued to be invested in the Côte-Nord region, in procurement of goods and services, salaries and contributions to the different funds laid out under agreements with local communities. As a result of construction expenditure, including regional subcontracts, going to Côte-Nord companies since the start of the project, Hydro-Québec has become a leading economic player in the region.

Romaine-3 generating station is scheduled to start commercial operation in 2017.

Generating station rehabilitation

In 2016, we allocated $344 million to refitting and refurbishing generating stations and structures, including major projects at Robert-Bourassa, Beauharnois, Rapides-des-Quinze and La Gabelle. When we rehabilitate generating stations, we increase their installed capacity or output whenever possible.

Chamouchouane–Bout-de-l'Île project

This project calls for the construction of a 735-kV line running more than 400 km from Chamouchouane substation, in the Saguenay–Lac-Saint-Jean region, to 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. The line route has undergone a number of changes in response to concerns expressed by the community. Work on the Chamouchouane–Bout-de-l'Île project continued in 2016 and will pick up speed in early 2017, with a view to commissioning by the end of 2018. The project meets the need for improved reliability on the main transmission system and will reinforce supply to the Montréal region. The new line will also reduce transmission losses and increase operating flexibility for the main 735-kV system.

A new transmission line

We will soon be building a 120-kV transmission line to connect Grand-Brûlé substation, in Mont-Tremblant, to an existing 120-kV line running between Saint-Sauveur and Sainte-Agathe-des-Monts substations. This project will have a positive impact on the reliability of the transmission system as well as on its ability to meet short- and long-term needs in the Laurentides region.

OUR COMMUNICATIONS

We favor a personable communications approach based on authenticity and attentive listening. We're also modernizing by adopting a digital strategy that allows direct, rapid exchanges with our customers, wherever they are. Social media, a mobile app and an enhanced Web experience are all means that we use to explain our activities, business environment, challenges and contribution to the Québec economy. In addition, we launched a large-scale information and advertising campaign designed to encourage dialogue with our customers.

Customer Twitter account:
Direct contact with our customers

LinkedIn:
CEO's page with the latest news on the company and its priorities

Corporate Twitter account:
Set up three years ago

Power Outages app:
Available for iOS and Android, and winner of the "IT Favorite" prize awarded at the OCTAS gala

New Web home page and Residential section:
Greater access to customer services

Facebook:
Official page since July 2016

To provide better information on our programs, actions and the many different challenges we face, we've opted for more direct communication with our customers. With this in mind, we launched a large-scale information and advertising campaign—our first in eight years—which ran from January 12 to the end of February. Its theme, *Welcome to Hydro-Québec*, underscored the company's openness to its customers, who were invited to find out more about their electricity supplier. The campaign continued in the fall.

Having made our services more accessible, we banked on this information campaign to achieve our goal of encouraging dialogue with customers, especially through social media. The campaign was an opportunity for people to learn more about the company and for us to shine a spotlight on some Hydro-Québec employees.

Phase 1 of the *Welcome to Hydro-Québec* advertising campaign aimed primarily to inform our customers, strengthen our ties with them and generate a sense of pride among our employees and Quebecers in general. Customers were invited to ask questions about the company on the **welcome.hydroquebec.com** Web site, where they can view short videos that expand on the information in the ads. Between January 11 and March 30, the site had 137,711 visits. The videos were viewed 211,156 times, and we responded online to 2,091 questions on topics such as customer services, dual-energy systems, address changes, next-generation meters, energy efficiency, electricity rates and wind power.

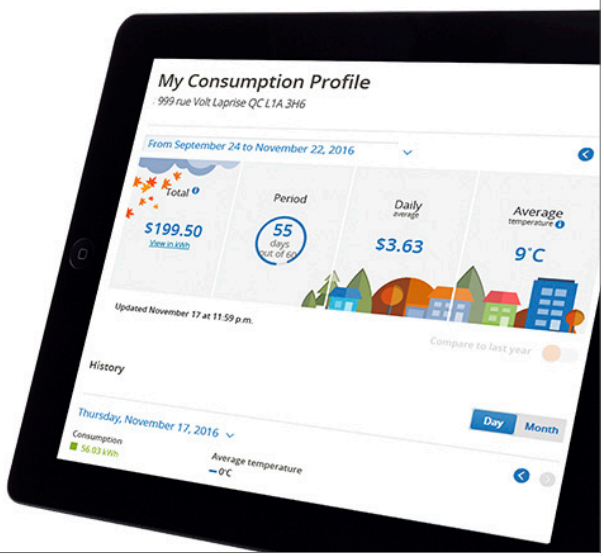
In view of the success of phase 1, last fall we launched phase 2, intended to continue our dialogue with customers by increasing our presence across all our social media platforms. To achieve this, we produced a new TV commercial, two Web videos, and online and print ads, as well as buying advertising space in various other Québec media. The new content revolved around the theme of innovation—one of the growth avenues presented in the *Strategic Plan 2016–2020* unveiled in June—and specifically about working with international partners to develop the battery materials of the future. Exchanges with customers were extended to Facebook, LinkedIn, Twitter and YouTube.

Employees were our ambassadors during the *Welcome to Hydro-Québec* advertising campaign, designed to strengthen our ties with customers.

Updated content

The overhaul of the ENERGY WISE Web site gave us the opportunity to update its content and provide customers with better information and more effective guidance. It contains practical, inexpensive ideas for saving electricity, information on energy-efficient products, and tools for managing

Our new newsletter was launched a little over a year ago, in fall 2015. Written in a current, lively and engaging style, it has an informal tone designed to foster closer ties with our customers. It covers subjects people should find useful and refers them to the Web site as often as possible: tips for saving electricity, quick access to services that simplify their account management, and practical examples of how to reduce their electricity consumption. Topics in the fall 2016 newsletter included the new My Consumption Profile tool, The Right Moves, planned service interruptions, three-element water heaters, LED bulbs, online callback scheduling, and TM4.



consumption. Customers are invited to visit the site at various key moments for them. Hydro-Québec would like to see ENERGY WISE become an indispensable energy efficiency benchmark.

Facility tours

Our guided facility tours enable the public to become better acquainted with Hydro-Québec's facilities, their history and the technological innovations they feature. In 2016, the 14 sites open to the public drew 134,687 visitors, an 8% increase over 2015. That means tens of thousands of people discovering what the company's mission and strategic objectives represent in concrete terms. The tours provide an appreciation of the benefits of hydropower and the expertise and know-how of Hydro-Québec's employees. The tour guides also talk about the company's environmental performance and integration of the structures into their surroundings. These contacts with the public have two other important functions: they contribute to the development of regional recreation and tourism, and they spark young people's interest in science by explaining things in layperson's language.

During the summer, we inaugurated the entirely renovated interpretation centre at Manic-5 generating station and Daniel-Johnson dam. These facilities, which receive more than 6,000 visitors every year, are a remarkable showcase for Hydro-Québec. The new museum exhibit measures up to the reputation enjoyed by the world-renowned Manic-5 development.

We continued *The Right Moves* campaign, which encourages customers to adopt simple daily actions that make a big difference, individually and collectively. **The Right Moves** site offers an energy efficiency test that customers can take, and 20 or so info-capsules on electricity-saving habits. It even includes a section showing the collective impact of these small changes.

Social media, mobile app, Web site, self-service options available online and through our interactive voice response system—these are some of the tools that help us communicate better with customers on an ongoing basis. Our *Welcome to Hydro-Québec* advertising campaign further enabled us to generate a sense of pride among our employees and Quebecers in general.

TO BAIE-JAMES IN JUST A FEW SECONDS

Hydro-Québec is continuing to forge closer ties with customers by making one of its developments at Baie-James accessible to everyone. The company has produced a 360° video offering the public its first chance for a virtual tour of the world's largest underground hydropower plant, Robert-Bourassa generating station. It's a fitting way to celebrate the 45th anniversary of breaking ground on the Project of the Century: the La Grande hydroelectric complex. At 17,418 megawatts, the combined capacity of its powerhouses—still on the cutting edge of technology—makes it the largest generating complex in North America. This video lets people zip up to Baie-James in just a few seconds and discover a slice of Québec history. The 360° virtual reality technology conveys the immense scale of this imposing facility.

Our Commitments at Home and Abroad

Hydro-Québec supports a host of community activities throughout Québec, including community-interest projects funded by the Integrated Enhancement Program 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.

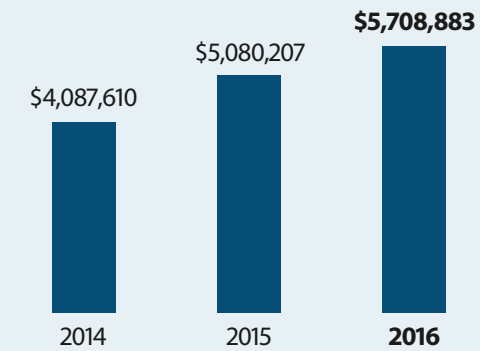
Support for municipalities and regions

Through our Integrated Enhancement Program (IEP), communities that host new transmission lines or substations receive funding equal to 1% of the initially authorized value of the project. This funding is intended for local or regional initiatives related to municipal, community or recreational infrastructure, community development or the environment.

In 2016, the IEP supported 25 initiatives, for a total of $3 million. These included providing the city of Repentigny, in Lanaudière, with more than $95,000 to build an outdoor skating rink and a basketball court as part of the 120-kV Pierre-Le Gardeur–Saint-Sulpice line project.

The Fondation Hydro-Québec pour l'environnement, for its part, allocated $971,480 to various Québec organizations, thereby contributing to 18 initiatives in nine regions of Québec for the protection and enhancement of natural areas and education about local environmental issues. For example, the $125,000 it provided to the Conseil régional de l'environnement de la Côte-Nord (CRECN) will allow that regional board to restore the west bank of the mouth of the Rivière Moisie, which is very popular with vacationers and tourists, and oversee its use. At a total cost of $275,000, the project is intended to restore plant cover on the sand spit, limit the circulation of off-road vehicles, and reduce trampling of the vegetation and disruption to wildlife. For more information on the Foundation's activities, go to: **www.hydroquebec.com/fondation-environnement/en**.

THE HYDRO-QUÉBEC EMPLOYEES' AND PENSIONERS' CENTRAIDE CAMPAIGN RAISED $5,708,883 IN 2016.



Our sustainability efforts between now and 2020

Our *Sustainable Development Action Plan 2015–2020*, adopted in July 2015, contains the main measures underlying Hydro-Québec's contribution to Québec's *Government Sustainable Development Strategy 2015–2020*, its 2011–2016 strategy to ensure the occupancy and vitality of territories and its *Agenda 21 for Culture*. A detailed account of our performance with respect to the Action Plan is presented in the *Sustainability Report 2016*. For more information on Hydro-Québec's sustainable development efforts, go to: **www.hydroquebec.com/sustainable-development**.

Our donations and sponsorships

Beyond supplying reliable energy at affordable prices, Hydro-Québec is committed to contributing to Québec society and culture. We're active in community assistance, education and health, and are also pleased to support cultural, environmental, socioeconomic, scientific and sports events. Once again, a wide range of organizations benefited from our donations and sponsorships in 2016. They include the Québec Aboriginal Science and Engineering Association, the Marie-Vincent Foundation, Université du Québec à Chicoutimi, Défi sportif AlterGo, Journées de la culture in all of Québec's regions, and Hôtel-Dieu de Lévis. Altogether, nearly 650 organizations received $17.6 million. For more information, go to: **www.hydroquebec.com/donations-sponsorships**.

AN EVENT TO PROMOTE SUSTAINABLE ELECTRICITY

On May 29 and 30, 2017, Hydro-Québec will host the 26th Global Sustainable Electricity Partnership (GSEP) Summit in Montréal, focusing on the theme "Electricity as a Tool for Carbon Footprint Reduction." For two days, this major event will bring together executives from some of the world's most active electric utilities. The GSEP is a non-profit organization founded in 1992 in the wake of the Earth Summit in Rio. Its mission is to play a leading role in the global debates on key electricity industry issues and, in particular, to promote the development of sustainable energy through knowledge-transfer projects for developing countries.

OUR PRODUCTIVITY

Improving our productivity is an absolute imperative. The levers we've identified to this end are the optimal use of information and communication technologies (ICTs) and the performance and engagement of our employees— ICTs because they improve the company's overall performance; and human resources because they have a key impact on our current and future success. We'll also be modifying our goods and services procurement practices to promote value creation and making targeted energy purchases.

Information and Communication Technologies

At Hydro-Québec, ICTs are the very core of power system operations and service continuity. They enable process optimization and automation, improve the company's overall performance, and provide the information systems and telecommunication services used by our employees.

In 2016, in line with our efforts to increase efficiency and achieve productivity gains, we implemented a plan to reduce operating expenses. Savings were achieved through growth absorption, spending reduction and the renegotiation of contracts with suppliers.

Serving our mission

Hydro-Québec relies on an extensive and robust private telecommunications network to manage, monitor and operate its facilities. In 2016, we carried out work to connect several new facilities, including the Romaine-3 development, Adamsville substation and the future Judith-Jasmin substation. We continued modernizing microwave links that are strategic to the power system, such as Jarry–Grand-Brûlé, Edmunston–Rivière-du-Loup and Chicoutimi–Jacques-Cartier. Rollout of the IP/MPLS backbone proceeded, along with the migration of services onto that network. Ultimately, we're moving toward a single, reliable and powerful IP network infrastructure that will meet all the company's data communication needs.

Target architecture

In order to align all system components and informational resources with our business strategies, we defined a target ICT architecture to be implemented over the next five years. This approach will help us simplify our processes and reduce the number of technological platforms and applications. More specifically, we want to create value for Hydro-Québec's divisions by working closely with them to select the most appropriate and cost-effective technologies. Security is also a major consideration, as the power system must be protected under all circumstances.

A team of ITC specialists is piloting the project to develop SIGMa-P, an integrated maintenance management system for generating equipment.

A new IT centre

We have a new primary IT centre in Drummondville, designed according to industry best practices. It will be synchronized in real time with the Montréal IT centre to guarantee the security and continuity of operations at all times. Energy consumption in this strategic facility will be optimized through an innovative free-cooling system. The new centre will run its first applications in spring 2017.

New corporate communication tools

Communication and collaboration tools help our employees work better. They ensure continuous exchanges, reduce travel—along with the associated time lost and greenhouse gases emitted—and increase efficiency in daily activities.

Through our IP telephony network, we implemented a communication system that allows employees to access telephone services from their computers, share their screens with several colleagues, and use a number of other features to simplify the management of their communications. And in early 2017, we rolled out a company-wide webcasting service capable of handling large-scale videoconferencing. Among other benefits, this latest addition to Hydro-Québec's communication and dissemination toolkit will bring Senior Management closer to employees.

Exchanges with customers

We're progressively modernizing the technologies we use to interact with our customers. Already in 2016, customers could access online self-service options from their smart phones. Through secure information management, these tools allow customers to track their consumption history, check their account balance, change their monthly payment under the Equalized Payments Plan (EPP) and even make a payment arrangement.

In addition, we're constantly improving our power outage information service. Available on computer browsers and a mobile app, the service gives details such as outage location, number of customers affected and service restoration time. It also sends notices of planned outages.

Enhancing cybersecurity

We're continuing efforts to protect our facilities, our data and the content of our customer files. This involves making individual employees aware of the right reflexes and instilling a security culture in all sensitive areas.

We implemented a number of technical solutions and services for heightened security of access to our systems and networks, including a centre for the continuous monitoring of malicious behavior directed at our systems and information. We also bolstered the security of our external perimeter and set up an integrated system for stricter management of electronic access privileges.

Our Human Resources

Only through employee performance and engagement can we reach our strategic objectives and be better positioned to meet the challenges lying ahead. By developing a corporate culture focused on pride and results, we're laying the foundations for a company with a never-ending supply of drive and vitality.

Evolving our corporate culture

The *Strategic Plan 2016–2020* clearly sets out our intention to build a unifying culture focused on pride and results. To determine the strengths of our current culture and the changes required, we looked at best practices, held consultations with employees, managers and union representatives, and organized strategic brainstorming workshops with Senior Management. In this way, we clearly identified the behaviors expected of managers and employees according to our values, mission and strategic priorities. In a nutshell, our target culture will be based on **teamwork**, **agility** and **openness** to new ideas and growth opportunities. To achieve **results** we can all be **proud** of, we must bank on our **skills** and always make **customers the focus of our decisions**.

To help us move toward this target culture, we developed an action plan that includes measures for grooming leaders, improving our talent management practices and standardizing our management processes. These initiatives will be rolled out as of 2017, ensuring that Management and employees are fully engaged in our cultural transformation process.

Employee engagement

Employee engagement directly contributes to Hydro-Québec's performance and productivity. Engaged employees collaborate, find solutions, outperform, innovate and participate in change. Every year, Hydro-Québec conducts the *Écoute du personnel* survey, which assesses employee investment in the company's future. In 2016, over 15,000 employees responded, a 76% participation rate. The survey results help managers target the measures most likely to promote employee engagement. In 2016, we devoted 2.7% of total payroll to developing our human resources. Leadership succession needs were determined at all levels of the organization and the succession management tool was implemented in all units.

PROCUREMENT AND PURCHASES

Along with the optimal use of ICTs and employee performance and engagement, we'll be banking on two additional levers to improve productivity: adjusting our goods and services procurement practices to create more value, and launching calls for tenders to purchase new energy supplies only when the total quantity of energy available in a given year dips below the threshold of 2% of total needs.

Renewal of essential know-how

After assessing the skill development needs of our employees, we developed critical knowledge maps for key positions. We plan to step up our use of technological resources to deploy innovative learning solutions, such as performance support tools and on-the-job training strategies based on job profiles.

Corporate security

To improve our security posture, we standardized our practices in terms of both physical security and cybersecurity. An integrated, company-wide process has been applied to corporate security governance. The next step is to promote this approach to our workforce as a whole.

Workplace health and safety

Initiatives for preventing absenteeism, illness and workplace accidents must be implemented by managers, who are in charge of motivating employees to look after their personal health and safety and that of others. Efforts were made to promote and generalize measures and behaviors that contribute to ensuring worker health and safety.

The work we began in 2016 to group together all prevention activities will simplify the standardization of practices and the development of a health and safety culture. Finally, to support the company's growth efforts, we incorporated needs related to our new avenues of development into our HR service offering.

The success of our interactive training tools

We designed an interactive application that helps contractors working in generating stations and substations to learn the requirements of the *Work Safety Code*. In 2016, "Operation: Zero Blackout" caught the attention of the Brandon Hall Group, the American organization that hands out the Human Capital Management Excellence Awards. As a result, Hydro-Québec and its partner Ellicom received a bronze medal in the category "Best Use of Games and Simulations for Learning." Zero Blackout also garnered an Award of Excellence and a Best of the Best award from The Institute for Performance and Learning.

Comparative analysis of overall compensation

Under the 2016–2017 rate filing, the Régie de l'énergie requested a comparative analysis of the overall compensation of employees in companies similar to Hydro-Québec. The analysis, carried out by a consulting firm, looked at some 40 companies operating in Québec and a few large Canadian hydroelectricity distributors. The findings showed that, generally, the overall compensation of Hydro-Québec's employees is well positioned relative to the market.

Key data in human resources

At the end of 2016, we had 35,015 LinkedIn subscribers receiving company news and information about job openings. In total, 147 permanent employees and 1,487 temporary employees were hired in 2016.

Management's Discussion and Analysis

This Management's Discussion and Analysis should be read in conjunction with the consolidated financial statements of Hydro-Québec and the notes thereto. The financial information and tabular amounts presented herein are expressed in Canadian dollars, unless otherwise indicated. 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.

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 24, 2017, the date of approval of this Annual Report by Hydro-Québec's Board of Directors.

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2016 at a Glance

Hydro-Québec's net income remained high in 2016, at $2,861 million, even as temperatures returned to near normal on the Québec market after two years marked by very cold winters. The company was able to capitalize on its commercial and operational expertise to export a record volume of electricity, which mitigated the impact of lower prices on energy markets. As a result, Hydro-Québec will once again be able to pay a dividend of more than $2 billion to its shareholder, the Québec government. For 2016, the dividend amounts to $2,146 million.

EXPORTS REACH A HISTORIC HIGH

Net electricity exports rose by 3.3 TWh compared to 2015, reaching a historic high of 32.6 TWh and contributing $803 million to net income. This is a 1.8-TWh increase over the previous record, set in 2013, made possible by the smooth operation of generating and transmission facilities, in particular, as well as high runoff and favorable weather conditions. These factors, combined with the skillful development and deployment of the sales strategy, enabled the company to take advantage of business opportunities on external markets. The record volume of exports is all the more remarkable given the unavailability of a major power transmission link between Québec and New England in April and May 2016 due to scheduled maintenance.

Finally, because of the high runoff in 2016, Hydro-Québec ended the year with record reservoir storage of 138.2 TWh.

MAJOR INVESTMENTS THROUGHOUT QUÉBEC

Hydro-Québec's investment program totaled $3,460 million in 2016, mainly because of the continuation of major projects in the generation and transmission segments.

The largest project under way was still the construction and connection of the Romaine hydroelectric complex in the Côte-Nord region. This complex, consisting of four reservoir generating stations, will have a total installed capacity of 1,550 MW, of which 910 MW is already in operation. A new milestone was reached in September with the completion of the dam at Romaine-3 (395 MW), slated for commissioning in 2017. Romaine-1 generating station (270 MW) came onstream at the end of 2015, allowing Hydro-Québec to tap this new source of power during peak consumption periods in winter 2015–2016.

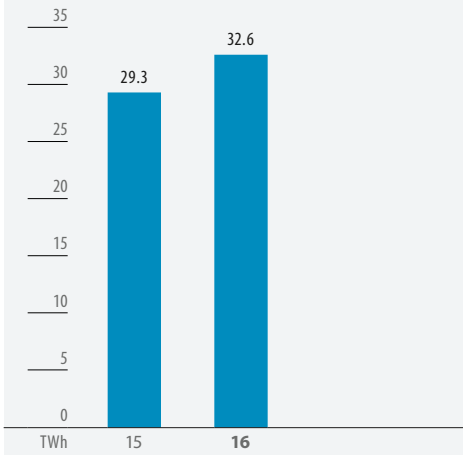
Work also went forward on the 735-kV Chamouchouane–Bout-de-l'Île project, which has two main components: first, construction of 735/120/25-kV Judith-Jasmin substation in Lanaudière; and, second, deployment of a 735-kV line extending more than 400 km between Chamouchouane substation, in the Saguenay–Lac-Saint-Jean region, and Judith-Jasmin substation, as well as the relocation of a short segment of an existing 735-kV line to Bout-de-l'Île substation, in Montréal. After clearing began in fall 2015, the project continued in 2016 with the launch of construction at Judith-Jasmin substation, among other things. Work will be stepped up in 2017 in view of a 2018 start-up.

A MAJOR CONTRIBUTION TO THE QUÉBEC GOVERNMENT'S REVENUE

For a fourth consecutive year, Hydro-Québec's contribution to the revenue of its sole shareholder, the Québec government, has exceeded the $4-billion mark. This amount includes the company's net income of $2,861 million, $667 million in water-power royalties, $284 million in public utilities tax and $218 million in guarantee fees related to debt securities. This contribution, combined with economic spin-offs from the company's operations in all four corners of the province, will benefit all Quebecers.

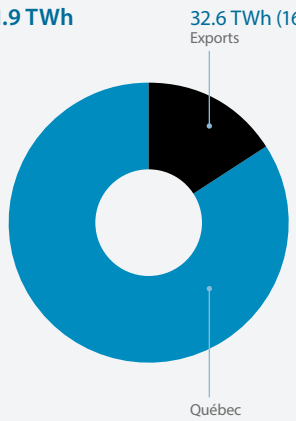
In 2016, net exports accounted for 16% of sales volume, but generated 28% of the company's net income.

Net Electricity Exports



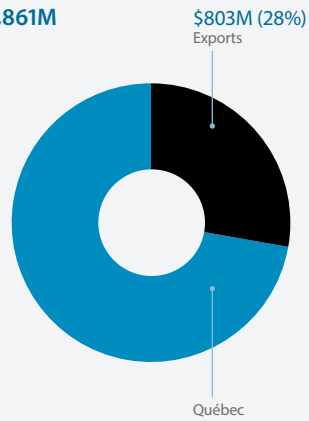
Net Electricity Sales in 2016

201.9 TWh

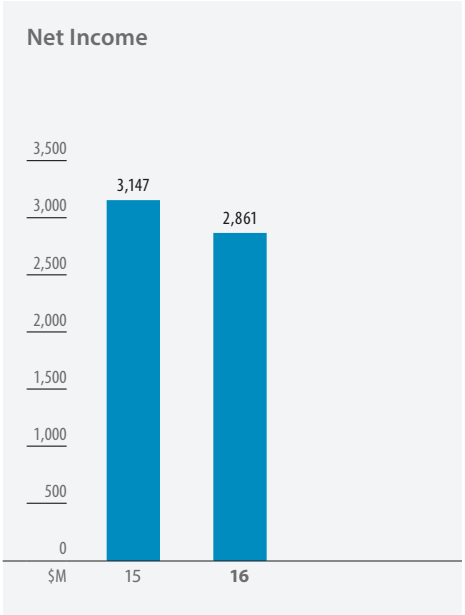


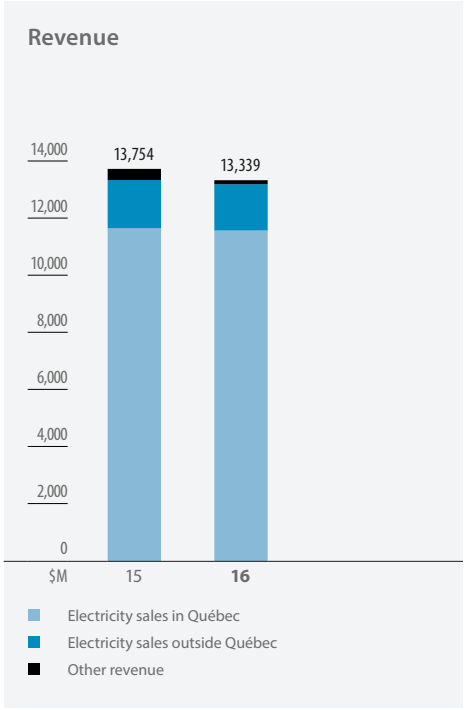
Net Income in 2016

$2,861M



Consolidated Results





NET INCOME

In 2016, Hydro-Québec posted net income of $2,861 million, compared to $3,147 million in 2015. Hydro-Québec Production's net electricity exports decreased by $77 million because of lower prices on energy markets, the impact of which was offset by a volume increase of 3.3 TWh, bringing net exports to a historic high of 32.6 TWh. On the Québec market, the return to near-normal temperatures in 2016 led to a $63-million decrease in supplies provided by Hydro-Québec Production to Hydro-Québec Distribution. Finally, financial expenses increased by $83 million, essentially on account of the foreign currency effect on working capital denominated in U.S. dollars.

REVENUE

Revenue totaled $13,339 million, compared to $13,754 million in 2015. Revenue from electricity sales decreased by $163 million to $13,199 million. Sales in Québec generated $11,573 million, or $89 million less than the $11,662 million recorded in 2015. On markets outside Québec, revenue from electricity sales was $1,626 million, a decrease of $74 million. Other revenue amounted to $140 million, compared to $392 million in 2015.

The $89-million decrease in electricity sales in Québec resulted mainly from temperature variances, which led to a 2.9-TWh ($241-million) drop in volume. In 2015, first-quarter temperatures were, on average, 5°C lower than normal, resulting in additional sales of 4.3 TWh or $338 million; conversely, fourth-quarter temperatures were exceptionally mild, resulting in a 1.7-TWh or $130-million decrease in sales. In 2016, however, temperatures were closer to normal. This factor therefore had a $17-million negative impact in 2016, compared to a $224-million positive impact in 2015. The negative impact of temperature variances was mitigated by the April 1, 2015 and 2016 rate adjustments, which led to a $141-million increase in revenue. These rate adjustments, made to permit cost of service recovery, were approved by the Régie de l'énergie.

Revenue from electricity sales on markets outside Québec amounted to $1,626 million, compared to $1,700 million in 2015. This $74-million decrease was primarily due to lower prices on energy markets. The volume increase, combined with the positive impact of the company's risk management strategy, limited the impact of the decrease in prices.

Other revenue decreased by $252 million to $140 million in 2016, mainly because of the change in the net amounts that Hydro-Québec is entitled to receive from customers or is required to pay to them, principally in connection with revenue variances related to climate conditions and variances in supply costs for electricity in excess of the heritage pool.

EXPENDITURE

Total expenditure was $7,946 million in 2016, compared to $8,158 million in 2015.

Operating expenses amounted to $2,438 million, an $89-million decrease from the $2,527 million recorded in 2015. Strict management and tight control of expenses made it possible to absorb the increase in costs related to inflation, salary indexing and growth in operating assets. It should also be noted that Hydro-Québec's workforce numbered 19,552 at year end, the lowest in the past 40 years.

Electricity and fuel purchases totaled $1,866 million, a $72-million decrease compared to $1,938 million in 2015. This change is essentially due to a $60-million reduction in Hydro-Québec Distribution's electricity purchases from third parties. On the one hand, short-term market purchases decreased by $93 million given that, in 2015, the division had to purchase large quantities of energy on the markets to meet ad hoc requirements resulting from the very cold winter temperatures. On the other hand, wind power purchases increased by $34 million, partly due to the commissioning of new wind farms and wind project phases.

Depreciation and amortization expense amounted to $2,597 million, a $116-million decrease compared to 2015. The amortization expense related to regulatory assets and liabilities declined by $177 million, mainly because of deferred charges related to the changeover to U.S. generally accepted accounting principles, which were recognized in 2015 and amortized in 2016 under the terms approved by the Régie de l'énergie. Furthermore, the depreciation of property, plant and equipment increased by $49 million, partly because of the commissioning of the two units at Romaine-1 generating station at the end of 2015.

Taxes were $1,045 million, compared to $980 million in 2015. The increase is due to three main factors: the recognition of a $15-million contribution payable to the Québec government under the *Act to establish the Northern Plan Fund*; a $13-million increase in water-power royalties on account of higher output and the indexing of the applicable rate; and a $16-million rise in the public utilities tax resulting from an increase in the tax base, itself due to growth in the net value of taxable assets.

Financial expenses totaled $2,532 million in 2016, compared to $2,449 million the previous year. This increase is essentially due to the foreign currency effect on working capital denominated in U.S. dollars. The marked depreciation of the Canadian dollar in 2015 had resulted in the recognition of a significant exchange gain.

	2016	2015
OPERATIONS AND DIVIDEND ($M)		
Revenue	**13,339**	13,754
Operating income	**5,393**	5,596
Net income	**2,861**	3,147
Dividend	**2,146**	2,360
BALANCE SHEETS ($M)		
Total assets	**75,167**	75,199
Property, plant and equipment	**62,691**	61,558
Long-term debt, including current portion and perpetual debt	**45,909**	45,983
Equity	**19,704**	19,475
FINANCIAL RATIOS		
Return on equity from continuing operations (%)[a]	**13.1**	14.9
Capitalization (%)[b]	**30.5**	30.1
Profit margin (%)[c]	**21.4**	22.9
Interest coverage[d]	**2.16**	2.20
Self-financing (%)[e]	**58.8**	82.8

a) 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 2016 and 2015, the denominator amounted to $21,842 million and $21,091 million, respectively. Hydro-Québec did not record any amount with respect to discontinued operations in 2016 or 2015, such that net income corresponds to income from continuing operations.

b) 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.

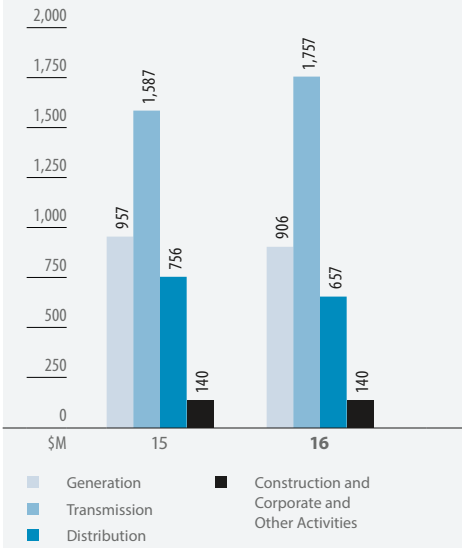
c) Net income divided by revenue.

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

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.

Cash and Capital Management

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



OPERATING ACTIVITIES

Cash flows from operating activities totaled $5.5 billion in 2016, compared to $6.2 billion in 2015. These funds were used to pay the dividend for 2015 and to finance a large portion of the investment program, among other things.

INVESTING ACTIVITIES

In 2016, Hydro-Québec invested $3.5 billion in property, plant and equipment and intangible assets, compared to $3.4 billion in 2015. Of the total, $1.5 billion was invested in development projects and $2.0 billion in maintaining or improving the quality of assets.

Hydro-Québec Production's investments totaled $906 million. A large portion of this amount, $562 million, was devoted to development activities, mainly ongoing construction of the Romaine hydroelectric complex. The amounts allocated to ongoing asset maintenance and improvement totaled $344 million. Work included refurbishment at Robert-Bourassa, Beauharnois and Rapides-des-Quinze generating stations.

Capital spending at Hydro-Québec TransÉnergie totaled $1,757 million. Of this amount, $618 million was used to connect new hydroelectric and wind power facilities to the grid and increase transmission capacity. Construction projects included Romaine-3 substation, the line connecting it to Romaine-4 substation and the line extending from Romaine-4 substation to Montagnais substation. The division also continued work on the 735-kV Chamouchouane–Bout-de-l'Île project. Another $1,139 million was allocated to enhancing transmission asset reliability and sustainment, which mainly involved replacing equipment and modernizing facilities. In particular, the division allocated $114 million to the replacement of PK type circuit breakers.

Hydro-Québec Distribution invested $657 million, mainly to handle its growing customer base, ensure the long-term operability of the distribution system and enhance service quality.

Hydro-Québec Innovation, 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.

FINANCING ACTIVITIES

In 2016, Hydro-Québec's financing activities raised $2.0 billion on the Canadian capital market.

In May, the company issued $1.0 billion in fixed-rate medium-term notes, at a cost of 1.1%. In August, it issued variable-rate notes for a total amount of $1.0 billion. These two series of notes will mature in 2019.

The proceeds were used to support part of the investment program and to refinance maturing debt.

SOURCES OF FINANCING

Type of financing	Amount authorized by the Board of Directors	Market	Outstanding as at December 31, 2016
Operating credit lines	C$ or US$1,000 million[a]		C$3.1 million
Credit facility[b]	US$2,000 million[c]		–
Commercial paper[b]	US$3,500 million or equivalent in C$	United States or Canada	C$7.4 million
Medium-term notes[b]	US$3,000 million or equivalent in other currencies C$20,000 million or equivalent in US$	United States Canada	US$340 million[d] C$14,204 million[d]

a) Of this amount, available balances of US$200 million and $232 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

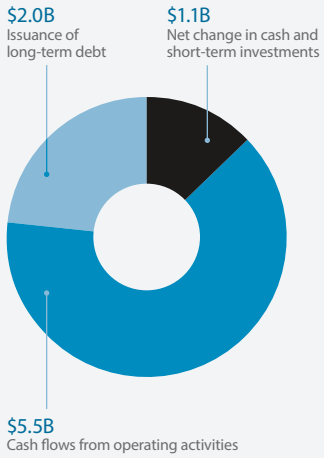
	2016			2015		
	Commercial paper	Long-term debt	Outlook/ Trend	Commercial paper	Long-term debt	Outlook/ Trend
U.S. agencies						
Moody's	**P-1**	**Aa2**	**Stable**	P-1	Aa2	Stable
Standard & Poor's	**A-1+**	**A+**	**N/A**[a]	A-1+	A+	N/A[a]
Fitch Ratings	**F1+**	**AA–**	**Stable**	F1+	AA–	Negative
Canadian 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, the outlook it has given the Québec government, Hydro-Québec's shareholder and guarantor, went from "stable" to "positive" in 2016.

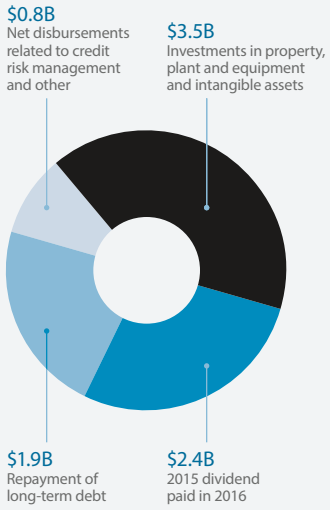
DIVIDEND AND CAPITALIZATION

The dividend payable to the Québec government for 2016 is $2,146 million. Once this dividend is factored in, the capitalization rate was 30.5% as at December 31, 2016.

Sources of Funds in 2016



Uses of Funds in 2016

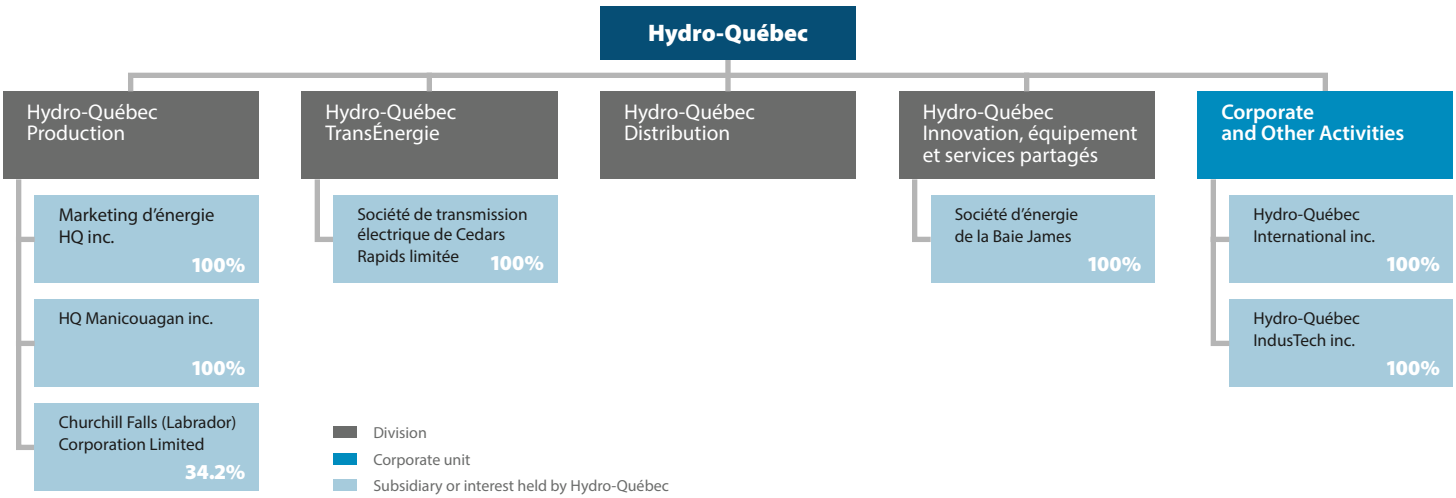


Segmented Results

OPERATING SEGMENTS

As in 2015, Hydro-Québec had four operating segments in 2016, 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:



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, provides customer services and promotes energy efficiency.

CONSTRUCTION

Hydro-Québec Innovation, 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:

						2016
Segmented financial information ($M)	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Hydro-Québec
Revenue[a]	**6,482**	**3,215**	**11,514**	**2,225**	**1,746**	**13,339**
Net income	**1,870**	**561**	**342**	**1**	**87**	**2,861**
Total assets	**32,773**	**21,476**	**13,546**	**59**	**7,501**	**75,167**

						2015
Segmented financial information ($M)	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Hydro-Québec
Revenue[a]	6,624	3,308	11,834	2,098	1,714	13,754
Net income	2,130	559	364	–	94	3,147
Total assets	33,108	20,944	13,425	58	7,829	75,199

a) Segment data include revenue from both external and intersegment customers as presented in Note 20 to the consolidated financial statements, whereas Hydro-Québec's revenue figure reflects the intersegment eliminations and adjustments presented in that same note.

Note: Some of the prior year's data have been reclassified to conform to the presentation adopted in the current year.

Generation

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 62 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 $1,870 million in 2016, compared to $2,130 million in 2015. Net electricity sales to Hydro-Québec Distribution totaled $4,820 million, a $63-million decrease primarily due to a reduction in peak supplies, which were greater in 2015 on account of the harsh winter. Net electricity exports totaled $1,568 million, or $77 million less than the $1,645 million recorded a year earlier, mainly because of lower prices on energy markets, the impact of which was mitigated by growth in export volume. Taxes and financial expenses increased by $56 million and $76 million, respectively.

ELECTRICITY SALES IN QUÉBEC

SALES TO HYDRO-QUÉBEC DISTRIBUTION

The total volume of electricity sales to Hydro-Québec Distribution was 159.1 TWh in 2016, compared to 160.8 TWh in 2015. Revenue from these sales decreased by $63 million from the $4,883 million posted in 2015, mainly as a result of temperatures, which deviated significantly from normal seasonal values in 2015. More specifically, the harsh winter conditions in the first quarter of 2015 led to an increase in peak supplies that was only partly offset by the lower sales resulting from the mild temperatures recorded in the fourth quarter. Since 2016 temperatures were, on average, closer to normal, the volume of electricity sales to Hydro-Québec Distribution decreased by 1.7 TWh compared to 2015.

ELECTRICITY SALES OUTSIDE QUÉBEC

Electricity sales outside Québec amounted to $1,626 million, compared to $1,700 million the previous year.

Net electricity exports, which factor in short-term electricity purchases, totaled $1,568 million for 32.6 TWh, a $77-million decrease compared to $1,645 million for 29.3 TWh in 2015. Export volume reached a record high in 2016, which is all the more remarkable given the unavailability of a major power transmission link between Québec and New England in April and May 2016 due to scheduled maintenance. The 3.3-TWh volume increase, combined with the positive impact of the company's risk management strategy, limited the impact of the lower prices on energy markets.

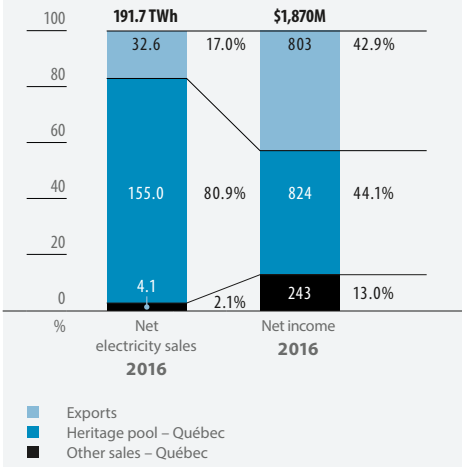
As at December 31, 2016, reservoir storage again stood at a historic level, namely 138.2 TWh, compared to 126.9 TWh a year earlier. This increase was mainly attributable to natural water inflows that were 13.6 TWh higher than normal in 2016. The energy reserve fully meets the criteria set for management of risks related to the security of the energy supply.

DEPRECIATION AND AMORTIZATION

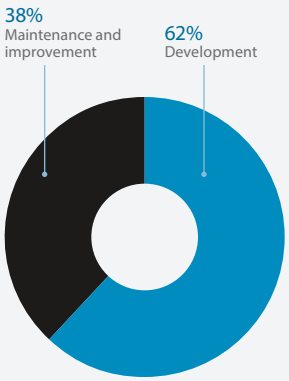
Depreciation and amortization expense totaled $775 million in 2016, compared to $766 million in 2015. This increase partly results from the commissioning of the two units at Romaine-1 generating station at the end of 2015.

2016 AT A GLANCE	
Revenue	**$6.5B**
Net income	**$1,870M**
Contribution of net exports to net income	**$803M**
Customers (% of revenue from electricity sales)	
Hydro-Québec Distribution	**74%**
Other	**26%**
Sales volume	
Hydro-Québec Distribution	**159.1 TWh**
Other	**32.7 TWh**
Property, plant and equipment as at December 31 (including work in progress)	**$30.9B**
Investments in property, plant and equipment and intangible assets	**$906M**
Reservoir storage as at December 31	**138.2 TWh**

Net Electricity Sales and Net Income of Hydro-Québec Production, by Market



Breakdown of 2016 Investments by Hydro-Québec Production



TAXES

Taxes were $848 million in 2016, compared to $792 million in 2015. Among other things, the increase is due to a $15-million contribution payable to the Québec government under the *Act to establish the Northern Plan Fund* and a $13-million increase in water-power royalties on account of higher output and the indexing of the applicable rate.

FINANCIAL EXPENSES

Financial expenses totaled $1,205 million in 2016, compared to $1,129 million in 2015. This increase is essentially due to the foreign currency effect on working capital denominated in U.S. dollars. The marked depreciation of the Canadian dollar in 2015 had resulted in the recognition of a significant exchange gain.

INVESTING ACTIVITIES

Investments in property, plant and equipment and intangible assets totaled $906 million in 2016. Of this amount, $562 million went toward development activities, mainly the continued construction of the Romaine hydroelectric complex.

Hydro-Québec Production also invested $344 million in asset sustainment and optimization. Work included refurbishment at Robert-Bourassa, Beauharnois and Rapides-des-Quinze generating stations.

Transmission

Hydro-Québec TransÉnergie operates and develops Hydro-Québec's power transmission system, one of 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 CASES

For 2016, the revenue authorized by the Régie de l'énergie for transmission rate-setting purposes totaled $3,113 million, namely $2,744 million for native-load transmission and $369 million for short- and long-term point-to-point transmission services. These amounts represent decreases of $58 million and $9 million, respectively, compared to 2015.

For 2017, Hydro-Québec TransÉnergie filed an application with the Régie de l'énergie requesting revenue of $3,306 million, namely $2,910 million for native-load transmission and $396 million for short- and long-term point-to-point transmission services. The Régie's decision regarding this application is expected in the first quarter of 2017.

OPERATING RESULTS

Hydro-Québec TransÉnergie's net income was $561 million in 2016, comparable to the $559 million recorded in 2015. The decrease in revenue from native-load transmission service was offset by a reduction in the amortization expense related to regulatory assets and liabilities, determined in accordance with the terms approved by the Régie de l'énergie.

INVESTING ACTIVITIES

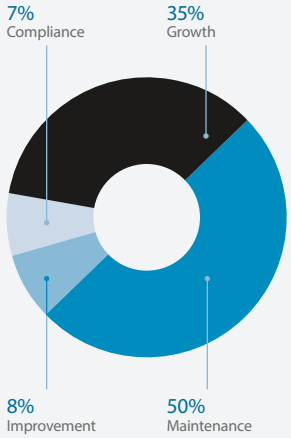
In 2016, Hydro-Québec TransÉnergie invested $1,757 million in property, plant and equipment and intangible assets, namely $618 million for growth projects and $1,139 million for asset sustainment and reliability projects. The purpose of growth projects is to connect new hydroelectric facilities and wind farms to the grid or to increase transmission capacity in response to higher load demand or new customer requests. 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 2016 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 $189 million to build Romaine-3 substation, the line connecting it to Romaine-4 substation and the line extending from Romaine-4 substation to Montagnais substation. The division also continued to integrate the output from wind farms built in response to the calls for tenders issued by Hydro-Québec Distribution, as well as from the Mesgi'g Ugju's'n wind farm, for a total investment of $141 million. In addition, it allocated $177 million to the construction of a line and the relocation of a short segment of an existing line as part 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 $114 million in the replacement of PK circuit breakers. At the end of this project, in 2017, it will have replaced 280 breakers at 34 transmission substations. The division also allocated $66 million (including the project's growth component) to rebuilding De Lorimier substation and the related tap lines.

2016 AT A GLANCE	
Revenue	$3.2B
Net income	$561M
Customers (% of revenue)	
Hydro-Québec Distribution *(native-load transmission service)*	85%
Hydro-Québec Production and other North American wholesalers *(point-to-point transmission service)*	12%
Other	3%
Property, plant and equipment as at December 31 (including work in progress)	$21.3B
Investments in property, plant and equipment and intangible assets	$1,757M

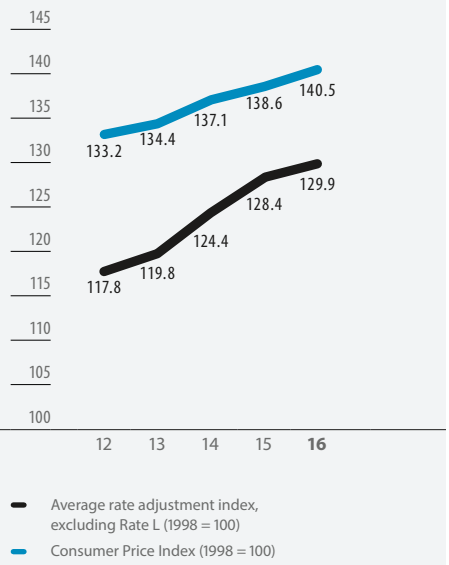
Breakdown of 2016 Investments by Hydro-Québec TransÉnergie



Distribution

2016 AT A GLANCE	
Revenue	$11.5B
Net income	$342M
Market segments (% of revenue from electricity sales)	
Residential	45%
Commercial, institutional and small industrial	33%
Large industrial	20%
Other	2%
Property, plant and equipment as at December 31 (including work in progress)	$9.8B
Investments in property, plant and equipment and intangible assets	$657M
Rate increase effective April 1, 2016 (excluding Rate L, which remained unchanged)	0.7%

Average Rate Adjustment Index and Consumer Price Index



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 2016, the Régie de l'énergie authorized an average increase of 0.7% in all Hydro-Québec electricity rates except the large-power industrial rate (Rate L), which remained unchanged. 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. The new rates went into effect on April 1, 2016.

In July, Hydro-Québec Distribution filed an application with the Régie for a 1.6% rate adjustment for all customers except those at Rate L, for which the requested adjustment was 1.1%. The new rates would take effect on April 1, 2017. The main reasons for the 1.6% adjustment are the investments needed for transmission asset sustainment, higher electricity supply costs and lower-than-anticipated growth in demand for electricity. Other factors, such as a return to near-normal temperatures in winter 2015–2016 and the decrease in the cost of basic service, partly due to productivity gains, limited the increase requested.

The cumulative average rate adjustment index for 1998 to 2016 is 129.9, while the Consumer Price Index for the same period is 140.5.

The Régie de l'énergie's ruling on the rate application is expected in March 2017.

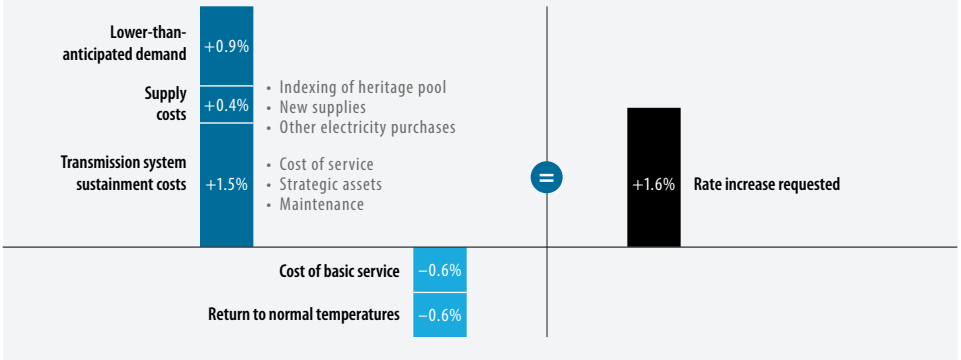
SUPPLYING THE QUÉBEC MARKET

Hydro-Québec Distribution depends on various sources to supply the Québec market, mainly 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 could not be met otherwise, the division relied on a framework agreement with Hydro-Québec Production that covered the period from January 1, 2014, to December 31, 2016, and was approved by the Régie in December 2013. In September 2016, the Régie approved the renewal of this agreement for the period from January 1, 2017, to December 31, 2019.

In November 2016, Hydro-Québec Distribution filed its Electricity Supply Plan 2017–2026 with the Régie de l'énergie. The plan anticipates average yearly growth of 0.4% in energy needs and 0.6% in capacity needs over the next 10 years.

Finally, Hydro-Québec Distribution is continuing its efforts to promote energy efficiency. Among other things, it is developing an integrated offer based on an educational approach that encourages customers to make lasting changes in their habits. In addition, the division constantly adjusts its programs according to market needs and the company's requirements, and ensures that its initiatives are in line with those of its various partners.

2017–2018 Rate Adjustment Application



OPERATING RESULTS

Hydro-Québec Distribution recorded net income of $342 million in 2016, compared to $364 million in 2015, a decrease of $22 million. Revenue from electricity sales decreased by $89 million, mainly because of a volume reduction that was essentially due to temperature variances, and the impact of which was mitigated by the April 1, 2015 and 2016 rate adjustments. In addition, the change in the net amounts that Hydro-Québec is entitled to receive from customers or is required to pay to them, particularly in connection with variances in supply costs for electricity in excess of the heritage pool and revenue variances related to climate conditions, had a negative impact of $215 million on other revenue. Electricity purchases, the related transmission costs and fuel purchases decreased by $198 million. This is because supplies purchased from Hydro-Québec Production and from third parties decreased by $63 million and $60 million, respectively, while transmission costs incurred with Hydro-Québec TransÉnergie declined by $48 million. Depreciation and amortization expense decreased by $27 million.

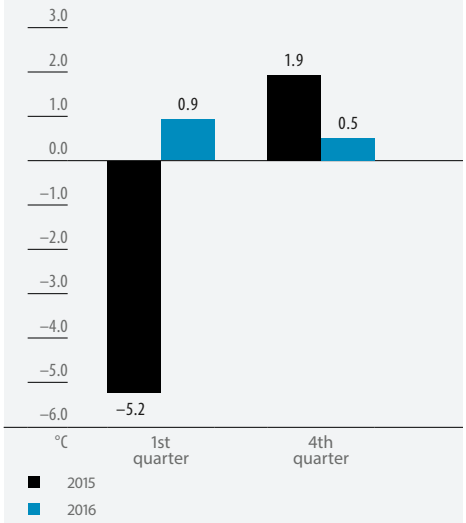
ELECTRICITY SALES IN QUÉBEC BY SEGMENT

	Sales volume			Sales revenue		
	2016	2016–2015 change		**2016**	2016–2015 change	
Market segment	TWh	TWh	%	$M	$M	%
Residential	**65.1**	(1.5)	(2.3)	**5,155**	(67)	(1.3)
Commercial, institutional and small industrial	**45.5**	0.2	0.4	**3,842**	68	1.8
Large industrial	**53.6**	(0.6)	(1.1)	**2,265**	(85)	(3.6)
Other	**5.1**	(0.1)	(1.9)	**311**	(5)	(1.6)
Total	**169.3**	(2.0)	(1.2)	**11,573**	(89)	(0.8)

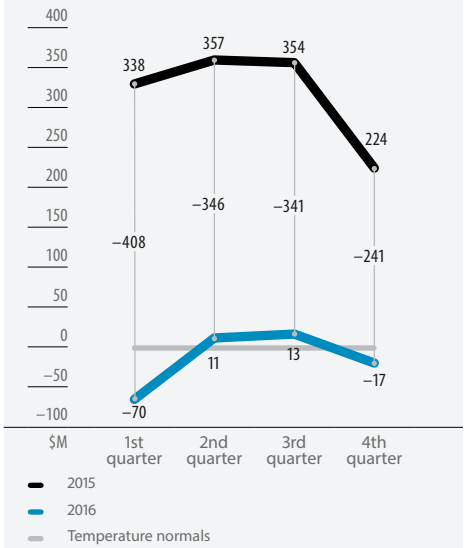
FACTORS IN THE 2016–2015 CHANGE IN SALES BY SEGMENT

	Volume effects							Price effects			**Total**
	Baseload demand		Temperatures		February 29		**Total**	Rate adjustments	Other	**Total**	
Market segment	TWh	$M	TWh	$M	TWh	$M	$M	$M	$M	$M	$M
Residential	0.6	50	(2.4)	(206)	0.3	22	**(134)**	74	(7)	**67**	**(67)**
Commercial, institutional and small industrial	0.4	40	(0.4)	(31)	0.2	12	**21**	49	(2)	**47**	**68**
Large industrial	(0.7)	(50)	–	–	0.1	6	**(44)**	13	(54)	**(41)**	**(85)**
Other	–	(3)	(0.1)	(4)	–	1	**(6)**	5	(4)	**1**	**(5)**
Total	0.3	37	(2.9)	(241)	0.6	41	**(163)**	141	(67)	**74**	**(89)**

Variances from Temperature Normals – Montréal



Cumulative Impact of Temperatures Compared to Normals



ELECTRICITY SALES IN QUÉBEC

Revenue from electricity sales totaled $11,573 million, an $89-million decrease from 2015 that was essentially due to temperatures, the impact of which was mitigated by the April 1, 2015 and 2016 rate adjustments.

Sales volume totaled 169.3 TWh, compared to 171.3 TWh in 2015, a decrease of 2.0 TWh. In 2015, first-quarter temperatures were, on average, 5°C lower than normal, resulting in additional sales of 4.3 TWh; conversely, fourth-quarter temperatures were exceptionally mild, resulting in a 1.7-TWh decrease in sales. In 2016, however, temperatures were closer to normal. This factor therefore had a $17-million negative impact in 2016, compared to a $224-million positive impact in 2015. The negative impact of temperatures was mitigated by additional sales of 0.6 TWh on February 29, since 2016 was a leap year.

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 $215 million in 2016. This negative change mainly results from variances in supply costs for electricity in excess of the heritage pool and revenue variances related to climate conditions.

Variances in supply costs for electricity in excess of the heritage pool led to the recognition of $29 million payable to customers in 2016, compared to $120 million receivable from them in 2015. This $149-million difference is due to the fact that supply costs incurred in winter 2016 were lower than the previous year on account of milder temperatures.

The near-normal temperatures in 2016 also had an impact on revenue variances related to climate conditions, which correspond to differences between Hydro-Québec Distribution's actual transmission and distribution revenue and the revenue forecasts established on the basis of climate normals for rate filing purposes. These variances led to the recognition of $11 million receivable from customers in 2016, compared to an amount payable of $115 million in 2015.

In addition, the amortization of variances from previous years had a negative impact of $223 million in 2016, compared to $26 million in 2015. The $197-million difference is mainly attributable to the amortization of variances in supply costs for electricity in excess of the heritage pool, given the very cold temperatures in the winters of 2013–2014 and 2014–2015. This expenditure was factored into the rate adjustment that took effect on April 1, 2016, as approved by the Régie de l'énergie.

ELECTRICITY PURCHASES, TRANSMISSION COSTS AND FUEL PURCHASES

Electricity purchases, the related transmission costs and fuel purchases decreased by $198 million compared to 2015. Supplies from Hydro-Québec Production were $63 million lower, mainly due to temperatures, while third-party supplies decreased by $60 million, primarily on account of a $93-million reduction in short-term market purchases. In 2015, the division had to purchase large quantities of energy on the markets to meet ad hoc requirements resulting from the very cold winter temperatures. The reduction in short-term purchases was mitigated, however, by a $34-million increase in wind power purchases, partly due to the commissioning of eight new wind farms or wind project phases at the end of 2015 and during 2016. Finally, transmission costs incurred with Hydro-Québec TransÉnergie decreased by $48 million.

DEPRECIATION AND AMORTIZATION

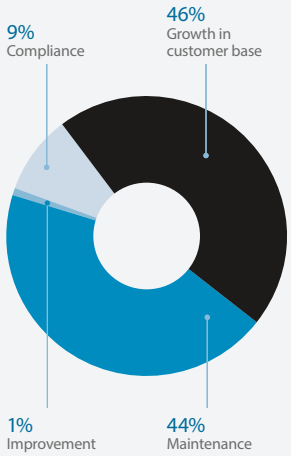
Depreciation and amortization expense amounted to $779 million, a $27-million decrease from $806 million the previous year, essentially because of a reduction in the amounts recognized for asset retirement given that, in 2015, the massive rollout of next-generation meters had resulted in a large number of assets being retired.

INVESTING ACTIVITIES

In 2016, Hydro-Québec Distribution's investments in property, plant and equipment and intangible assets totaled $657 million.

Of this amount, $305 million was allocated to the growth of the Québec customer base, including $171 million for new customer connections. The division also invested $291 million in asset sustainment, of which $62 million went toward completing the rollout of the advanced metering infrastructure.

Breakdown of 2016 Investments by Hydro-Québec Distribution



Construction

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

Hydro-Québec Innovation, 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 Innovation, équipement et services partagés and SEBJ 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

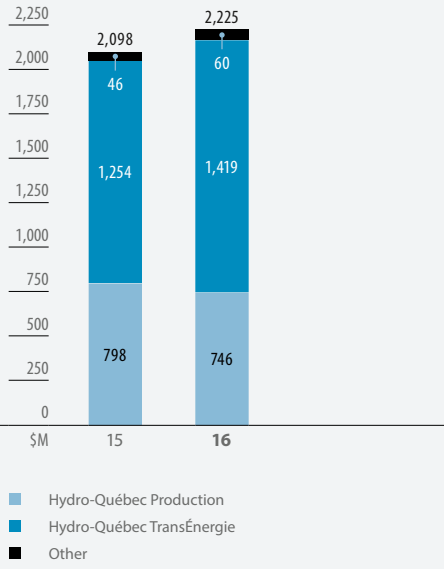
Hydro-Québec Innovation, équipement et services partagés and SEBJ carried out activities amounting to a total of $2,225 million in 2016, compared to $2,098 million the previous year. The high volume is attributable to several large-scale projects. Work done for Hydro-Québec Production totaled $746 million, compared to $798 million in 2015, while work done for Hydro-Québec TransÉnergie totaled $1,419 million, compared to $1,254 million.

MAIN PROJECTS

In the area of power generation, Hydro-Québec Innovation, équipement et services partagés continued construction of the Romaine hydroelectric complex and refurbishment of the structures at Beauharnois, Les Cèdres and La Gabelle generating stations. In addition, the division finished overhauling generating units at Robert-Bourassa, Rapides-des-Quinze, Rapide-2 and Rapide-7. For Hydro-Québec TransÉnergie, ongoing mandates included the connection of the Romaine complex and construction of several substations. The 735-kV Chamouchouane–Bout-de-l'Île project, launched in 2015, moved ahead as well. Work in progress also included reconstruction of De Lorimier substation and deployment of related lines, as well as various projects stemming from continued investment in asset reliability and sustainment, particularly the replacement of PK circuit breakers. Finally, the division worked on upgrading various facilities in the main transmission system while pursuing other projects to increase transmission system capacity.

2016 AT A GLANCE	
Volume of activity	$2.2B
Main customers	
Hydro-Québec Production	34%
Hydro-Québec TransÉnergie	64%

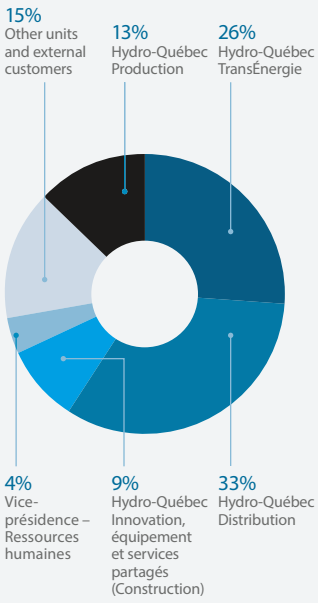
Breakdown of Construction Segment Activities



1. The operations of the Direction principale – Institut de recherche d'Hydro-Québec, Direction principale – Centre de services partagés and Direction principale – Approvisionnement stratégique are included under Corporate and Other Activities.

Corporate and Other Activities

Breakdown of 2016 Revenue: Vice-présidence – Technologies de l'information et des communications



As at December 31, 2016, the Corporate and Other Activities heading included all corporate activities, as well as the Vice-présidence – Technologies de l'information et des communications, Vice-présidence – Développement des affaires, acquisitions et stratégies, Direction principale – Gestion des filiales, Direction principale – Institut de recherche d'Hydro-Québec, Direction principale – Centre de services partagés and Direction principale – Approvisionnement stratégique.

RESULTS

Corporate and Other Activities recorded net income of $87 million in 2016, comparable to the 2015 figure.

CORPORATE ACTIVITIES

As at December 31, 2016, corporate activities consisted of the Groupe – Direction financière et contrôle, Vice-présidence – Affaires corporatives et secrétariat général, Vice-présidence – Financement, trésorerie et caisse de retraite and 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 and public affairs, as well as relations with governments, communities and partner organizations. It is also responsible for services and expertise related to legal affairs, ethics and sustainable development. 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 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 2016, the pension fund's rate of return was 5.9% in a low-interest-rate environment. Over the past 10 years, it has posted an average annual return of 6.9%, placing it in the first decile of Canadian pension funds of comparable size. As at December 31, 2015, the date of the most recent actuarial valuation, the pension plan showed a funding surplus of $5.1 billion, which means that the assets held on that date were sufficient to cover future pension costs as well as the stabilization provision established under the requirements of the *Act to amend the Supplemental Pension Plans Act mainly with respect to the funding of defined benefit pension plans*. The pension plan's funding ratio was 129.5% at that time.

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, facilities, and information and communication technologies.

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

The mandate of the Vice-présidence – Technologies de l'information et des communications is to design, build, deploy, operate and maintain the company's information and telecommunications networks, systems, applications and infrastructure. With this in mind, it continues to implement an integrated vision with respect to governance, architecture, development, operations and cybersecurity. It offers the divisions and corporate units technology solutions designed to support the operation of the power system and to increase their productivity and efficiency, thereby contributing to the company's overall performance.

In 2016, this unit posted revenue of $666 million, compared to $627 million in 2015.

INVESTING ACTIVITIES

In 2016, the investments made by the Vice-présidence – Technologies de l'information et des communications totaled $103 million and were allocated to maintaining asset quality.

VICE-PRÉSIDENCE – DÉVELOPPEMENT DES AFFAIRES, ACQUISITIONS ET STRATÉGIES

The mandate of the Vice-présidence – Développement des affaires, acquisitions et stratégies is to prospect for business opportunities and act on them so that Hydro-Québec can not only increase its operating revenue and income from markets outside Québec, but also play a leading role in the global energy transition, in accordance with the strategies laid out in the *Strategic Plan 2016–2020*. In concrete terms, the unit is constantly on the lookout for potential international investments in the form of assets, stakes or long-term partnerships that will leverage the company's expertise in power generation and transmission. In addition, it is actively involved in marketing Hydro-Québec's technological innovations and developing the company's export markets by highlighting the benefits of Québec hydropower.

DIRECTION PRINCIPALE – GESTION DES FILIALES

The Direction principale – Gestion des filiales coordinates the activities and development of the technology subsidiaries reporting to the first-tier subsidiary Hydro-Québec IndusTech, including TM4, Technologies Esstalion and MIR Innovation, in such a way as to maximize their contribution to Hydro-Québec's growth objectives. It also commercializes the company's innovations in collaboration with the Vice-présidence – Développement des affaires, acquisitions et stratégies. In addition, it supports innovation related to transportation electrification and guides the deployment and expansion of the Electric Circuit in Québec and Ontario.

DIRECTION PRINCIPALE – INSTITUT DE RECHERCHE D'HYDRO-QUÉBEC

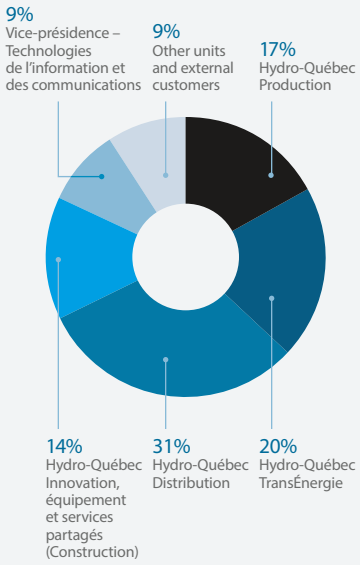
The Direction principale – Institut de recherche d'Hydro-Québec, which is part of Hydro-Québec Innovation, équipement et services partagés, develops and adapts leading-edge technology solutions according to the company's business requirements and objectives. It provides technical assistance to the divisions and carries out innovation projects to support their operations and ensure Hydro-Québec's long-term development.

DIRECTION PRINCIPALE – CENTRE DE SERVICES PARTAGÉS AND DIRECTION PRINCIPALE – APPROVISIONNEMENT STRATÉGIQUE

The Direction principale – Centre de services partagés and Direction principale – Approvisionnement stratégique are also part of Hydro-Québec Innovation, équipement et services partagés. The Direction principale – Centre de services partagés offers services pertaining to real estate management and materials management, as well as transportation and other specialized services, in order to contribute to the company's performance. The Direction principale – Approvisionnement stratégique provides procurement guidelines, products and services to the entire company, in line with best practices.

The revenue of these two units totaled $485 million in 2016, compared to $490 million in 2015.

Breakdown of 2016 Revenue: Direction principale – Centre de services partagés and Direction principale – Approvisionnement stratégique



SUBSEQUENT ORGANIZATIONAL ADJUSTMENTS

Following a restructuring that took effect in January 2017, Hydro-Québec now has two new top-level corporate units:

- Vice-présidence – Communications et affaires gouvernementales, tasked with continuing to implement the company's proactive communication strategy;
- Vice-présidence – Transformation, santé et sécurité, responsible for spearheading efforts to transform the corporate culture and improve performance, as well as overseeing occupational health and safety.

In addition, the Direction principale – Gestion des filiales is now part of the Vice-présidence – Développement des affaires, acquisitions et stratégies, which was renamed Vice-présidence – Développement des affaires. For its part, the Vice-présidence – Affaires corporatives et secrétariat général continues to provide support to the Board of Directors and remains in charge of services related to sustainable development and legal affairs.

Outlook

As indicated in its *Strategic Plan 2016–2020*, Hydro-Québec is targeting net income of approximately $2.6 billion for the year ending December 31, 2017.

The company plans to invest on the order of $4 billion in 2017, most of which will be allocated to the operations of Hydro-Québec TransÉnergie ($2.2 billion) and Hydro-Québec Production ($1.1 billion). Almost 60% 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 division plans to bring Romaine-3 generating station onstream in 2017 and Romaine-4 in 2020. At the same time, it will continue investing to ensure the long-term operability of its facilities and optimize their output. For instance, refurbishment is under way at Robert-Bourassa, Beauharnois and Carillon generating stations.

Hydro-Québec TransÉnergie will devote a large part of its investments to erecting transmission lines, in particular the line connecting Chamouchouane substation to Judith-Jasmin substation as part of the 735-kV Chamouchouane–Bout-de-l'Île project and the 120-kV Grand-Brûlé–Saint-Sauveur supply line. In addition, it will continue connecting wind farms built in response to Hydro-Québec Distribution's calls for tenders, working on Judith-Jasmin substation and connecting the Romaine complex as part of the project to expand the transmission system in the Minganie region. The division will also continue to invest in upgrading and modernizing its facilities to ensure the reliability and long-term operability of its transmission assets and enhance service quality. An example of the latter is the ongoing work to replace 280 PK circuit breakers.

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. Its growth projects include connecting Judith-Jasmin substation to the distribution system.

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 identify and assess its main risks and then develop and apply mitigation measures to ensure that residual risks are at a level acceptable to Hydro-Québec. The divisions and corporate units report monthly 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.

INTEGRATED BUSINESS RISK MANAGEMENT PROCESS

	Annually	Monthly
	Business Plan	
Divisions and corporate units	• Identification of each division's or corporate unit's risks and validation by the manager reporting to the President and Chief Executive Officer • Development or updating of the division's or corporate unit's portfolio of residual business risks	Report on follow-up of each division's or corporate unit's portfolio of residual business risks
Corporate Management[a]	Review of the company's consolidated portfolio of residual business risks, risk map and probability of attaining projected net income	Review of the consolidated monthly report on follow-up of the company's portfolio of residual business risks
Board of Directors	**Audit Committee** Analysis of the company's integrated process for managing 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** Review of the company's consolidated portfolio of residual business risks, risk map and probability of attaining projected net income	

a) Acting as the risk management committee with the President and Chief Executive Officer as 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 the company's 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 indicators related to financial and energy transactions, recommends strategies and applies controls aimed at reducing risk.

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 mainly on the use of derivative financial instruments. 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 an entity will encounter difficulty in meeting obligations associated with 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 position of its counterparties. In addition, the company generally does business with counterparties that have a high credit rating. It also enters into credit agreements to keep the market value of the main portfolios of derivative instruments below a predetermined threshold.

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 an annual base volume of up to 165 TWh of heritage pool electricity 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. It therefore 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 on markets outside Québec, and is mitigated by ongoing monitoring of trends in 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.

Hydro-Québec Production is also exposed to the risk of 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 (NERC) and the Northeast Power Coordinating Council, as well as measures to maintain and improve its 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 provide adequate transmission capacity to supply Hydro-Québec Distribution and other customers while also ensuring transmission system security and reliability. To do so, the division relies, among other things, on a transmission asset management model and on a process for optimal management of annual peak load.

DISTRIBUTION

The continuity of power distribution is the main risk to which Hydro-Québec Distribution is exposed. To maintain power quality, the division makes ongoing investments in its system to modernize and automate it and enhance its security. It also relies on 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. 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 Innovation, équipement et services partagés must constantly 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 lead times, 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, where new legislative and regulatory measures may have an impact on workflows and on Hydro-Québec's ability to do business 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 Innovation, 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 lead times, among other things. It also monitors key price and activity indicators 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, two new trade agreements—the *Trade and Cooperation Agreement Between Ontario and Québec*, whose Public Procurement chapter took effect on September 1, 2016, and the *Canada-European Union Comprehensive Economic and Trade Agreement*, which will take effect in September 2017—will affect the company's procurement processes, particularly regarding security, confidentiality of information and the way requirements are defined.

CORPORATE AND OTHER ACTIVITIES

SAFETY AND SECURITY

The safety of individuals (employees, suppliers and the public) and the security of the company's assets, including information and communication technologies (ICT), are key concerns for Hydro-Québec. That is why the company has set up a multidisciplinary team of experts who continuously monitor its facilities, anticipate and analyze threats, maintain a close watch on related risks, regularly assess the mitigation measures in place and deploy new strategies based on changes in the social and business environment as well as emerging trends in security. Hydro-Québec's security model is based on anticipation, detection, dissuasion, intervention and restoration. It is also rooted in an integrated security culture that relies on cooperation and awareness on the part of the company's managers, employees and internal and external partners. The NERC audit performed in October 2016 confirmed that the company's practices fully meet the regulatory requirements of the North American electricity sector.

Protection of information, ICT and intellectual property is a major issue. In 2016, Hydro-Québec set up a centre for continuous monitoring of malicious behavior directed at the power system as well as corporate systems and information.

In December 2016, following the fourth accidental death in seven years at the Romaine jobsite, the Board of Directors created a special committee to assess safety measures at Hydro-Québec jobsites and ensure that the highest safety standards are maintained. The special Board committee hired ERM, a world leader in workplace health and safety and management of related risks, to evaluate the company's practices in this area.

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 business units' emergency response plans and activities with the aim of strengthening and improving coordination of the efforts of all internal and external responders, including public authorities.

BUSINESS DEVELOPMENT AND INVESTMENT OUTSIDE QUÉBEC

In keeping with the strategies set out in the *Strategic Plan 2016–2020*, Hydro-Québec has undertaken to expand its operations on markets outside Québec with a view to enhancing its profitability. The growth avenues it is exploring involve developing its export markets, commercializing its technological innovations and building partnerships, making acquisitions or acquiring interests outside the province. To successfully implement its international expansion projects, the company adopted a business opportunity analysis process that will enable it to identify the related risks and manage them proactively.

ENVIRONMENT

Environmental protection and conservation are also among Hydro-Québec's main priorities. 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.

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 2016 and 2015 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 24, 2017

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, 2016 and 2015, 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, 2016 and 2015, 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, for the year ended December 31, 2016, these principles have been applied on a basis consistent with 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 24, 2017

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 In millions of Canadian dollars	Notes	2016	2015
Revenue		**13,339**	13,754
Expenditure			
Operations		**2,438**	2,527
Electricity and fuel purchases		**1,866**	1,938
Depreciation and amortization	4	**2,597**	2,713
Taxes	5	**1,045**	980
		7,946	8,158
Operating income		**5,393**	5,596
Financial expenses	6	**2,532**	2,449
Net income		**2,861**	3,147

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years ended December 31 In millions of Canadian dollars	Notes	2016	2015
Net income		**2,861**	3,147
Other comprehensive income			
Change in deferred (losses) gains on items designated as cash flow hedges	15	**(251)**	2,015
Reclassification to results of deferred gains on items designated as cash flow hedges	15	**(117)**	(1,595)
Actuarial (losses) gains and past service costs for employee future benefits	18	**(234)**	64
Reclassification to results of net actuarial losses and past service costs (credits) for employee future benefits	18	**113**	243
Translation differences in financial statements of foreign operations		**3**	–
		(486)	727
Comprehensive income		**2,375**	3,874

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

CONSOLIDATED BALANCE SHEETS

As at December 31 In millions of Canadian dollars	Notes	2016	2015
ASSETS			
Current assets			
Cash and cash equivalents		**1,243**	2,648
Short-term investments		**2,184**	1,895
Accounts receivable and other receivables	15	**2,049**	2,242
Derivative instruments	15	**100**	274
Regulatory assets	3	**123**	122
Materials, fuel and supplies		**219**	212
		5,918	7,393
Property, plant and equipment	7	**62,691**	61,558
Intangible assets	8	**938**	1,014
Investments	9	**884**	859
Derivative instruments	15	**284**	128
Regulatory assets	3	**4,237**	3,939
Other assets	10	**215**	308
		75,167	75,199
LIABILITIES			
Current liabilities			
Borrowings		**7**	9
Accounts payable and accrued liabilities		**2,199**	2,278
Dividend payable	16	**2,146**	2,360
Accrued interest		**894**	913
Asset retirement obligations	11	**86**	85
Derivative instruments	15	**152**	299
Regulatory liabilities	3	**–**	49
Current portion of long-term debt	12	**1,398**	2,059
		6,882	8,052
Long-term debt	12	**44,218**	43,613
Asset retirement obligations	11	**774**	780
Derivative instruments	15	**13**	5
Regulatory liabilities	3	**381**	392
Other liabilities	13	**2,902**	2,571
Perpetual debt	14	**293**	311
		55,463	55,724
EQUITY	16		
Share capital		**4,374**	4,374
Retained earnings		**17,261**	16,546
Accumulated other comprehensive income		**(1,931)**	(1,445)
		19,704	19,475
		75,167	75,199
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 In millions of Canadian dollars	Note	Share capital	Retained earnings	Accumulated other comprehensive income	Total equity
Balance as at January 1, 2016		**4,374**	**16,546**	**(1,445)**	**19,475**
Net income		**–**	**2,861**	**–**	**2,861**
Other comprehensive income	16	**–**	**–**	**(486)**	**(486)**
Dividend	16	**–**	**(2,146)**	**–**	**(2,146)**
Balance as at December 31, 2016		**4,374**	**17,261**	**(1,931)**	**19,704**
Balance as at January 1, 2015		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

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31 In millions of Canadian dollars	Notes	2016	2015
Operating activities			
Net income		**2,861**	3,147
Adjustments to determine net cash flows from operating activities			
Depreciation and amortization	4	**2,597**	2,713
Amortization of premiums, discounts and issue expenses related to debt securities		**173**	159
(Deficit) excess of net cost recognized with respect to amounts paid for employee future benefits		**(146)**	161
Other		**299**	209
Regulatory assets and liabilities		**(301)**	(56)
Change in non-cash working capital items	17	**21**	(98)
		5,504	6,235
Investing activities			
Additions to property, plant and equipment		**(3,363)**	(3,340)
Additions to intangible assets		**(97)**	(100)
Net acquisition of short-term investments		**(272)**	(218)
Other		**39**	14
		(3,693)	(3,644)
Financing activities			
Issuance of long-term debt		**2,011**	13
Repayment of long-term debt		**(1,927)**	(1,044)
Cash receipts arising from credit risk management	15	**10,312**	8,220
Cash payments arising from credit risk management	15	**(11,093)**	(6,397)
Net change in borrowings		**(6)**	(19)
Dividend paid		**(2,360)**	(2,535)
Other		**(137)**	486
		(3,200)	(1,276)
Foreign currency effect on cash and cash equivalents		**(16)**	62
Net change in cash and cash equivalents		**(1,405)**	1,377
Cash and cash equivalents, beginning of year		**2,648**	1,271
Cash and cash equivalents, end of year		**1,243**	2,648
Supplementary cash flow information	17		

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

Years ended December 31, 2016 and 2015

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).

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

Management has reviewed events occurring until February 24, 2017, 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; fair value measurements of financial instruments; the useful life of property, plant and equipment and intangible assets for calculating the depreciation and amortization expense, as well as cash flows, the expected timing of payments, and the discount rates used to determine asset retirement obligations and employee future benefit liabilities. These rates are based on economic and actuarial assumptions. Actual results could differ from those estimates and such differences could be significant.

For 2016, Hydro-Québec changed some accounting estimates for calculating the recognized net cost of employee future benefits. The changes are described in Note 18, Employee Future Benefits.

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 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 issue expenses 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, net of cash received or paid under collateral exchange agreements, 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 hedging 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. Gains and losses previously accumulated 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	40–120 years
Thermal generation	15–50 years
Transmission substations and lines	30–85 years
Distribution substations and lines	25–70 years
Other property, plant and equipment	5–50 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 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	3–10 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:

- Discount rates used are based on the interest rate curve on the measurement date, namely December 31, of high-quality Canadian corporate bonds and take into account the amount and different payment maturity dates of the projected benefit obligations for each plan.
- 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

RECENT CHANGES

HEDGE ACCOUNTING

On January 1, 2016, Hydro-Québec early adopted Accounting Standards Update (ASU) 2016-05, *Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships*, as issued by the Financial Accounting Standards Board (FASB). This ASU states that hedge accounting may continue to apply to a derivative that has been designated as a hedging instrument if this derivative is novated to a new counterparty, as long as all the other applicable conditions continue to be met. It was applied prospectively and has not had any impact on Hydro-Québec's consolidated financial statements.

INTANGIBLE ASSETS

On January 1, 2016, Hydro-Québec adopted ASU 2015-05, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*, as issued by the FASB. This ASU clarifies the circumstances in which a cloud computing arrangement includes an internal-use software licence. It was applied prospectively and has not had any impact on Hydro-Québec's consolidated financial statements.

CONSOLIDATION

On January 1, 2016, Hydro-Québec adopted ASU 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*, as issued by the FASB. This ASU amends the guidance on the analysis to be performed by a reporting entity in order to determine if it must consolidate certain types of legal entities. It was applied on a modified retrospective basis and has not had any impact on Hydro-Québec's consolidated financial statements.

STATEMENT OF OPERATIONS

On January 1, 2016, Hydro-Québec adopted ASU 2015-01, *Income Statement—Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*, as issued by the FASB. It was applied prospectively and has not had any impact on Hydro-Québec's consolidated financial statements.

STANDARDS ISSUED BUT NOT YET EFFECTIVE

STATEMENT OF CASH FLOWS

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. This ASU clarifies how certain items are presented and classified in the statement of cash flows. It will apply on a full retrospective basis to interim and annual financial statements for annual periods beginning on or after January 1, 2018, and should not have any significant impact on Hydro-Québec's consolidated financial statements.

INVESTMENTS

In March 2016, the FASB issued ASU 2016-07, *Investments—Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting*. This ASU simplifies the application of the equity method of accounting in the case where a reporting entity increases its level of investment in another entity or its degree of influence over such an entity. The ASU applies prospectively to transactions as of January 1, 2017. Hydro-Québec is currently examining the impact of this ASU on its consolidated financial statements.

LEASES

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This ASU provides guidance on lease definition, recognition and presentation and requires the recognition of assets and liabilities by lessees for all operating and finance leases with a term of more than 12 months. It will apply on a modified retrospective basis to interim and annual financial statements for annual periods beginning on or after January 1, 2019. Hydro-Québec is currently examining the impact of this ASU on its consolidated financial statements.

FINANCIAL INSTRUMENTS

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This ASU provides guidance on the recognition and measurement of financial assets and financial liabilities. It will be applied on a modified retrospective basis to interim and annual financial statements for annual periods beginning on or after January 1, 2018, and should not have any significant impact on Hydro-Québec's consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This ASU provides new guidance on the impairment of financial assets that are not accounted for at fair value through net income. It will be applied on a modified retrospective basis to the consolidated financial statements for annual periods beginning on or after January 1, 2020. Hydro-Québec is currently examining the impact of this ASU on its consolidated financial statements, but does not intend early adoption.

REVENUE

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU 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 issued ASU 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, which defers the effective date of this guidance by one year.

In March 2016, the FASB issued ASU 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*. This ASU clarifies the guidance used to determine if an entity is acting on its own behalf or as an intermediary.

In April 2016, the FASB issued ASU 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*. This ASU clarifies guidance on identifying performance obligations and the licensing of intellectual property rights.

In May 2016, the FASB issued ASU 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*. This ASU clarifies the guidance on assessing collectibility, on noncash considerations and on completed contracts on the date of initial application.

These ASUs will apply on a full or modified retrospective basis to consolidated financial statements for annual periods beginning on or after January 1, 2018. Hydro-Québec is currently examining their impact on its consolidated financial statements, but does not intend early adoption.

Note 3 Regulation

RATES

TRANSMISSION

Hydro-Québec's power transmission rates for 2016 and 2015 were determined in Régie decisions D-2016-046 and D-2015-031, effective January 1, 2016, and January 1, 2015, respectively. The authorized return on the rate base was set at 6.85% in 2016 and 6.97% in 2015, assuming a capitalization with 30% equity.

DISTRIBUTION

Hydro-Québec's electricity rates for the rate years beginning on April 1, 2016, and April 1, 2015, respectively, were determined in decisions D-2016-047 and D-2015-033, in which the Régie authorized increases of 0.70% and 2.86% for all rates except Rate L, which remained unchanged in 2016, but for which an increase of 2.49% was authorized in 2015. The authorized return on the rate base was set at 6.95% in 2016 and 7.08% in 2015, assuming a capitalization with 35% equity.

CHANGEOVER TO U.S. GAAP

In decisions D-2015-189 and D-2016-003, 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 related to the recognition of certain development expenses and some costs associated with the Energy Efficiency Plan (EEP) as regulatory assets. They also concerned 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.

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 they are included in the rate base and 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 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, according to 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-2016-105 of July 5, 2016, the Régie revoked decisions D-2015-179 and D-2016-069, in which it had approved an agreement regarding use of the generating station during peak demand periods.

COSTS RELATED TO THE PROJECT INVOLVING THE REPLACEMENT OF PK TYPE CIRCUIT BREAKERS

The eligible expenses incurred as of April 11, 2016, as part of the project involving the replacement of PK type circuit breakers are recognized in a separate account, for which the disposition method has not yet been established. These expenses bear interest at the rates prescribed by the Régie. This accounting practice was authorized by the Régie in decisions D-2016-077 and D-2016-174, which relate to Hydro-Québec's power transmission activities.

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	**2016**	2015
Costs related to the EEP	2017–2026	**684**	800
Costs related to the de-icing system at Lévis substation	2017–2047	**5**	6
Costs related to a suspension agreement	2017–2020	**482**	356
Costs related to the project involving the replacement of PK type circuit breakers	To be determined	**51**	–
Development costs	2017–2021	**16**	17
Employee future benefits	As of 2017	**3,122**	2,877
Other	–	**–**	5
		4,360	4,061
Short-term regulatory assets		**123**	122
Long-term regulatory assets		**4,237**	3,939

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, were recognized in separate accounts in 2015 and amortized in 2016. The amounts recognized in these accounts bore interest at the rates prescribed by the Régie. The changes concerned 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 had been authorized by the Régie in decisions D-2015-189, D-2016-003, D-2016-029 and D-2016-033, which relate 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	**2016**	2015
Deferred expense accounts related to the changeover to U.S. GAAP	–	**–**	49
Depreciation of property, plant and equipment	2017–2115	**361**	366
Past service costs under the Pension Plan	2017–2022	**20**	26
		381	441
Short-term regulatory liabilities		**–**	49
Long-term regulatory liabilities		**381**	392

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. Set using methods approved by the Régie, these rates 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 2016 and 2015.

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

	Note	**2016**	2015
Variances in supply costs for electricity in excess of the heritage pool		**(20)**	368
Revenue variances related to climate conditions		**176**	32
Variances in pension cost		**(45)**	(8)
Variances in the expense related to the activities of the Bureau de l'efficacité et de l'innovation énergétiques		**19**	8
Other		**32**	17
		162	417
Presented as follows:			
Accounts receivable and other receivables		**29**	215
Other assets	10	**133**	226
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

	2016	2015
Property, plant and equipment	**2,209**	2,160
Intangible assets[a]	**178**	164
Regulatory assets and liabilities	**120**	297
Retirement of capital assets	**90**	92
	2,597	2,713

a) For the period from 2017 to 2021, amortization of intangible assets that have already been recognized should be as follows: $171 million in 2017, $100 million in 2018, $70 million in 2019, $42 million in 2020 and $22 million in 2021.

Note 5 Taxes

	2016	2015
Water-power royalties[a]	**673**	660
Public utilities tax[b]	**284**	268
Municipal, school and other taxes[c]	**88**	52
	1,045	980

a) Water-power royalties payable to the Québec government totaled $667 million in 2016 ($654 million in 2015), including a balance due of $68 million as at December 31, 2016 ($3 million as at December 31, 2015).

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

c) Including two amounts payable to the Québec government in 2016, namely $36 million under the *Act Respecting Energy Efficiency and Innovation* ($32 million in 2015), of which no balance was outstanding as at December 31, 2016 ($7 million as at December 31, 2015), and $15 million under the *Act to establish the Northern Plan Fund* (nil in 2015), which was outstanding as at December 31, 2016.

Note 6 Financial Expenses

	2016	2015
Interest on debt securities	**2,510**	2,552
Net exchange loss (gain)	**32**	(69)
Guarantee fees related to debt securities[a]	**218**	205
	2,760	2,688
Less		
Capitalized financial expenses	**194**	211
Net investment income	**34**	28
	228	239
	2,532	2,449

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

Note 7 Property, Plant and Equipment

	2016			
	In service	Accumulated depreciation	Under construction	Net carrying amount
Generation				
Hydraulic	45,744	17,438	2,271	**30,577**
Thermal	393	377	–	**16**
Other	792	470	8	**330**
	46,929	18,285	2,279	**30,923**
Transmission				
Substations and lines	30,052	11,637	1,749	**20,164**
Other	2,562	1,500	95	**1,157**
	32,614	13,137	1,844	**21,321**
Distribution				
Substations and lines	14,224	6,499	359	**8,084**
Other	3,432	1,768	101	**1,765**
	17,656	8,267	460	**9,849**
Construction	42	23	1	**20**
Corporate and Other Activities	1,307	817	88	**578**
	98,548[a]	40,529[a]	4,672	**62,691**

	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

a) As at December 31, 2016, the cost and accumulated depreciation of property, plant and equipment in service under capital leases amounted to $885 million and $163 million, respectively ($699 million and $127 million as at December 31, 2015).

Note 8 Intangible Assets

	2016			2015		
	Cost	Accumulated amortization	Net carrying amount	Cost	Accumulated amortization	Net carrying amount
Subject to amortization						
Software and licences	1,897	1,421	**476**	1,849	1,277	572
Patents	26	17	**9**	25	14	11
	1,923	1,438	**485**	1,874	1,291	583
Not subject to amortization						
Servitudes			**442**			426
Rights			**11**			5
			453			431
			938			1,014

Additions corresponding to internally developed software totaled $81 million in 2016 ($91 million in 2015).

Note 9 Investments

	2016	2015
At equity		
Churchill Falls (Labrador) Corporation Limited (34.2%)	**249**	231
Société en commandite Hydroélectrique Manicouagan (60.0%)[a]	**613**	621
	862	852
Other	**22**	7
	884	859

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 $262 million (respectively, $282 million and $273 million in 2015).

In 2016, electricity purchases from Churchill Falls (Labrador) Corporation Limited [CF(L)Co] and Société en commandite Hydroélectrique Manicouagan totaled $103 million and $81 million, respectively ($110 million and $81 million in 2015).

Note 10 Other Assets

	2016	2015
Government reimbursement for the 1998 ice storm[a]	**66**	66
Receivables[b]	**133**	226
Other	**16**	16
	215	308

a) In accordance with the terms and conditions in effect since January 1, 2013, the Québec government will pay the full amount of the reimbursement no later than October 15, 2019. In the meantime, it pays annual interest calculated at the Bankers' Acceptance Rate for a 12-month term.

b) These receivables are related to variances between the actual amount of certain specific items and the amount provided in rate filings for these items.

Note 11 Asset Retirement Obligations

Liabilities arising from asset retirement obligations relate to the costs of dismantling the Gentilly-2 facilities, the removal of spent nuclear fuel resulting from their 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:

				2016
	Dismantling of Gentilly-2 facilities[a]	Removal of spent nuclear fuel[a]	Dismantling of other assets	Total
Balance, beginning of year	464	255	146	**865**
Liabilities incurred	–	–	1	**1**
Accretion expense	25	15	4	**44**
Liabilities settled	(37)	(3)	(7)	**(47)**
Revision of estimated cash flows and expected timing of payments	16	(19)	–	**(3)**
Balance, end of year	468	248	144	**860**
Less				
Current portion	44	6	36	**86**
	424	242	108	**774**

				2015
	Dismantling of Gentilly-2 facilities[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

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 the Gentilly-2 facilities and the removal of spent nuclear fuel.

The following table presents the discount rates used to determine the carrying amount of the asset retirement obligations, which correspond to the credit-adjusted risk-free rates:

%	Dismantling of Gentilly-2 facilities	Removal of spent nuclear fuel	Dismantling of other assets
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 0.8 and 4.6

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, 2016, the investments held in the Hydro-Québec trust fund were composed of debt securities issued by Hydro-Québec, the fair value of which totaled $161 million ($153 million as at December 31, 2015).

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 purposes of managing currency risk related to long-term debt were taken into account in determining the percentages of debt by currency at the time of repayment.

	2016				2015			
			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	%	%
Canadian dollars[a, b]	36,232	**36,232**	**80**	**100**	33,953	33,953	75	100
U.S. dollars	6,701	**9,000**	**20**	**–**	8,098	11,212	25	–
Other currencies								
Euros	–	**–**	**–**	**–**	60	91	–	–
Yen	1,000	**12**	**–**	**–**	1,000	12	–	–
		45,244	**100**	**100**		45,268	100	100
Plus								
Adjustment for fair value hedged risk		**372**				404		
		45,616				45,672		
Less								
Current portion		**1,398**				2,059		
		44,218				43,613		

a) Including non-interest-bearing debts other than bonds and medium-term notes whose discounted value was $1,466 million as at December 31, 2016 ($1,345 million as at December 31, 2015).
b) Certain debts carry sinking fund requirements. An amount of $729 million ($701 million as at December 31, 2015) 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:

2017	1,398
2018	1,167
2019	3,144
2020	2,471
2021	2,381

INTEREST RATES

The following table presents 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, 2016, the variable rate portion of the bonds and notes totaled 15.2% (14.5% as at December 31, 2015).

%				**2016**	2015
Maturity	Canadian dollars	U.S. dollars	Other currencies	Weighted average	Weighted average
1–5 years	6.81	8.45	1.46	**7.09**	6.32
6–10 years	8.82	8.38	–	**8.53**	8.84
11–15 years	3.34	9.85	–	**7.61**	9.66
16–20 years	5.59	–	–	**5.59**	5.21
21–25 years	5.11	–	–	**5.11**	5.11
26–30 years	4.89	–	–	**4.89**	4.89
31–35 years	4.47	–	–	**4.47**	4.47
36–40 years	3.98	–	–	**3.98**	3.98
41–45 years	6.53	–	–	**6.53**	6.53
Weighted average	5.03	9.17	1.46	**5.35**	5.39

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 2021. Any related 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 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, 2016, the available balances on these lines of credit were US$200 million and $232 million in Canadian or U.S. dollars (US$200 million and $247 million in Canadian or U.S. dollars as at December 31, 2015).

Note 13 Other Liabilities

	Note	**2016**	2015
Employee future benefit liabilities	18	**2,395**	2,174
Accounts payable		**507**	397
		2,902	2,571

Accounts payable include a $359-million financial liability ($239 million as at December 31, 2015) related to an agreement regarding the temporary suspension of deliveries from a generating station, which was approved by the Régie in May 2014. The current portion, presented under Accounts payable and accrued liabilities, totaled $123 million as at December 31, 2016 ($117 million as at December 31, 2015). This financial liability, including the current portion, represents a discounted amount of $482 million ($356 million as at December 31, 2015) and contained an outstanding amount, payable in U.S. dollars, of $32 million (US$24 million) as at December 31, 2016 ($22 million, or US$16 million, as at December 31, 2015). As at December 31, 2016, the effective rate of this liability was 1.22% (1.56% as at December 31, 2015).

Note 14 Perpetual Debt

Perpetual notes in the amount of $293 million (US$218 million) as at December 31, 2016, and of $311 million (US$225 million) as at December 31, 2015, bear interest at LIBOR, plus 0.0625%, as calculated semiannually. As at December 31, 2016 and 2015, the rates applicable to the perpetual notes were 1.3% and 0.6%, respectively.

The perpetual notes are redeemable at Hydro-Québec's option. In 2016, portions totaling $10 million (US$7 million) were repurchased on the secondary market and then canceled ($6 million, or US$5 million, in 2015). Forward contracts 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 and reduce their overall impact on results.

MANAGEMENT OF LONG-TERM RISK

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

	2016[a]	2015[a]
Forward contracts		
U.S. dollars	**1,223**	2,230
Swaps		
Canadian dollars	**(7,969)**	(9,400)
U.S. dollars	**5,730**	6,042
Other currencies		
Euros	**–**	61
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 in currency sales contracts as at December 31, 2016, was US$1,175 million (US$1,129 million as at December 31, 2015).

Interest rate risk – Hydro-Québec uses forward rate agreements and interest rate swaps 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, 2016, totaled 19.9 TWh (20.0 TWh as at December 31, 2015), natural gas futures for which open positions as at December 31, 2016, totaled 0.5 million MMBtu (no open position as at December 31, 2015), petroleum product swaps for which open positions as at December 31, 2016, totaled 2.6 million litres (8.5 million litres as at December 31, 2015), as well as aluminum swaps for which open positions as at December 31, 2016, totaled 254,050 tonnes (no open position as at December 31, 2015).

LIQUIDITY RISK

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with 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, 2016, $43,491 million in long-term debt, perpetual debt and borrowings, net of the sinking fund, was guaranteed by the Québec government ($43,672 million as at December 31, 2015).

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 of the related assets presented 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, 2016, substantially all counterparties dealing with Hydro-Québec had a credit rating of A or higher, 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 $119 million ($115 million as at December 31, 2015), of which $32 million ($30 million as at December 31, 2015) is recognized in Accounts payable and accrued liabilities and $87 million ($85 million as at December 31, 2015) 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:

	2016	2015
Accounts receivable[a]	**1,684**	1,626
Other receivables[b]	**365**	616
	2,049[c]	2,242[c]

a) Including unbilled electricity deliveries, which totaled $1,206 million as at December 31, 2016 ($1,093 million as at December 31, 2015).
b) Including a $104-million financial guarantee ($189 million in 2015) covering certain derivative instruments held at year end.
c) Including US$159 million (US$229 million in 2015) translated at the exchange rate in effect at the balance sheet date.

The allowance for doubtful accounts receivable amounted to $250 million as at December 31, 2016 ($273 million as at December 31, 2015).

FAIR VALUE

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:

				2016
	Derivatives designated as fair value hedges	Derivatives designated as cash flow hedges	Derivatives not designated as hedges[a]	Gross amounts of derivatives recognized[b]
Assets				
Contracts – Currency risk	–	1,217	94	**1,311**
Contracts – Currency risk and interest rate risk	1	–	–	**1**
Contracts – Interest rate risk	540	–	–	**540**
Contracts – Price risk	–	54	57	**111**
	541	1,271	151	**1,963**
Liabilities				
Contracts – Currency risk	–	(152)	(1,028)	**(1,180)**
Contracts – Currency risk and interest rate risk	–	–	–	**–**
Contracts – Interest rate risk	–	(2)	(3)	**(5)**
Contracts – Price risk	–	(48)	(16)	**(64)**
	–	(202)	(1,047)	**(1,249)**
Total	541	1,069	(896)	**714**

				2015
	Derivatives designated as fair value hedges	Derivatives designated as cash flow hedges	Derivatives not designated as hedges[a]	Gross amounts of derivatives recognized[b]
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)	98

a) These derivative instruments are mainly traded as part of Hydro-Québec's risk management. As at December 31, 2016, $(1,023) million was in consideration of amounts received or disbursed [$(2,331) million as at December 31, 2015] 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) 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 the spot rates, forward rates or forward 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 impact of offsetting derivative instruments is presented in the table below:

	2016				2015			
	Gross amounts of derivatives recognized	Gross amounts offset[a]	Cash (received) paid as collateral[b]	Net amounts presented on the balance sheet	Gross amounts of derivatives recognized	Gross amounts offset[a]	Cash (received) paid as collateral[b]	Net amounts presented on the balance sheet
Assets								
Current	223	(110)	(13)	**100**	452	(178)	–	274
Long-term	1,740	(974)	(482)	**284**	2,264	(2,136)	–	128
	1,963	(1,084)	(495)	**384**	2,716	(2,314)	–	402
Liabilities								
Current	(1,091)	939	–	**(152)**	(2,550)	2,251	–	(299)
Long-term	(158)	145	–	**(13)**	(68)	63	–	(5)
	(1,249)	1,084	–	**(165)**	(2,618)	2,314	–	(304)
Total	714	–	(495)	**219**	98	–	–	98

a) The gross amounts of derivatives 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.

b) Cash amounts offset are amounts received or paid under collateral exchange agreements signed in compliance with ISDA guidelines.

Moreover, although certain derivatives cannot be offset for lack of enforceable master netting arrangements, margin calls may result in amounts received from or paid to clearing agents, based on the fair value of the instruments concerned. As at December 31, 2016, $27 million receivable from clearing agents in consideration of net cash payments was included in Accounts receivable and other receivables, under Current assets on the balance sheet (nil as at December 31, 2015). In addition, $16 million payable to clearing agents in consideration of net cash receipts was included in Accounts payable and accrued liabilities, under Current liabilities on the balance sheet ($316 million as at December 31, 2015).

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.

	2016				
	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	–	428	(1)[a]	272[a]	133
Contracts – Currency risk and interest rate risk	–	–	–	–	–
Contracts – Interest rate risk	32	–	–	3[b]	1
Contracts – Price risk	–	(177)	(4)[c]	(392)[c]	(47)
	32[d]	**251**	**(5)**	**(117)**	**87**[e]
Impact of hedged items on results	**(32)**			**117**	**(126)**

	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

a) In 2016, $13 million was recognized in Revenue ($106 million in 2015), and $258 million in Financial expenses [$(1,377) million in 2015].

b) In 2016 and 2015, $3 million was recognized in Financial expenses.

c) In 2016, $(396) million was recognized in Revenue [$(328) million in 2015].

d) This amount, including any ineffective portion, which was nil in 2016 ($2 million in 2015), was recognized in 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, in 2016, $(49) million was recognized in Revenue ($4 million in 2015), $(16) million in Electricity and fuel purchases [$(20) million in 2015] and $152 million in Financial expenses [$(601) million in 2015].

In 2016, Hydro-Québec did not reclassify any amounts from Accumulated other comprehensive income to results after having discontinued cash flow hedges (net gain of $3 million in 2015).

As at December 31, 2016, 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 $17 million ($103 million as at December 31, 2015).

As at December 31, 2016, the maximum period during which Hydro-Québec hedged its exposure to the variability of cash flows related to anticipated transactions was two years (three years in 2015).

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 in the case of the items presented in the table below:

	2016		2015	
	Carrying amount	Fair value	Carrying amount	Fair value
Long-term debt[a]	**45,616**	**60,931**	45,672	62,106
Perpetual debt	**293**	**217**	311	237

a) Including the current 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, 2016 and 2015.

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 2016, the dividend is $2,146 million ($2,360 million for 2015).

ACCUMULATED OTHER COMPREHENSIVE INCOME

				2016
	Cash flow hedges	Employee future benefits	Translation differences	Accumulated other comprehensive income
Balance, beginning of year	233	(1,678)	–	**(1,445)**
Other comprehensive income before reclassifications	(251)	(234)	3	**(482)**
Amounts reclassified to results	(117)	113	–	**(4)**
Other comprehensive income	(368)	(121)[a]	3	**(486)**
Balance, end of year	(135)	(1,799)	3	**(1,931)**

				2015
	Cash flow hedges	Employee future benefits	Translation differences	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)

a) Other comprehensive income includes the change in the employee future benefit regulatory asset, which totaled $245 million in 2016 [$(385) million in 2015].

Note 17 Supplementary Cash Flow Information

	2016	2015
Change in non-cash working capital items		
Accounts receivable and other receivables	**182**	(14)
Materials, fuel and supplies	**(6)**	(13)
Accounts payable and accrued liabilities	**(96)**	(35)
Accrued interest	**(59)**	(36)
	21	(98)
Investing activities not affecting cash		
Increase in property, plant and equipment	**173**	91
Interest paid	**2,112**	2,178

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, 2015, at which date the plan was funded at 129.5%. The next valuation must be as at December 31, 2016.

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

	Pension Plan		Other plans	
	2016	2015	**2016**	2015
Projected benefit obligations				
Balance, beginning of year	**23,126**	22,275	**1,420**	1,339
Current service cost	**424**	441	**45**	44
Employee contributions	**163**	148	**–**	–
Benefit payments and refunds	**(970)**	(927)	**(67)**	(71)
Interest on obligations	**766**	880	**48**	53
Actuarial loss	**494**	309	**25**	43
Plan amendments	**–**	–	**–**	12
Balance, end of year	**24,003**	23,126	**1,471**	1,420
Plan assets, at fair value				
Balance, beginning of year	**22,243**	20,778	**72**	76
Actual return on plan assets[a]	**1,195**	2,019	**5**	2
Employee contributions	**163**	148	**–**	–
Contributions by Hydro-Québec	**304**	225	**18**	13
Benefit payments and refunds	**(970)**	(927)	**(12)**	(19)
Balance, end of year	**22,935**	22,243	**83**	72
Funded status – Plan deficits	**1,068**	883	**1,388**	1,348
Presented as:				
Accounts payable and accrued liabilities	**–**	–	**61**	57
Other liabilities	**1,068**	883	**1,327**	1,291

a) Administrative and management expenses billed to the Pension Plan by Hydro-Québec amounted to $15 million in 2016 ($16 million in 2015).

As at December 31, 2016, accumulated benefit obligations under the Pension Plan totaled $22,531 million ($21,681 million as at December 31, 2015). 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, 2016, 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:

				2016				2015
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Short-term investments[a]	–	234	–	**234**	–	213	–	213
Bonds[a, b]	1,038	7,671	–	**8,709**	593	6,908	–	7,501
Listed shares	9,129	–	–	**9,129**	9,695	–	–	9,695
Real estate investments[c]	183	–	2,703	**2,886**	349	–	2,474	2,823
Commercial mortgages[a]	–	72	–	**72**	–	76	–	76
Private equity investments[d]	–	–	360	**360**	–	–	234	234
Hedge funds[e]	445	976	–	**1,421**	361	1,155	–	1,516
Derivatives[f]	(12)	(17)	–	**(29)**	(11)	24	–	13
	10,783	8,936	3,063	**22,782**	10,987	8,376	2,708	22,071
Other[g]				**182**				206
				22,964[h]				22,277[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 $1,142 million ($1,137 million in 2015).

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 earnings 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 $29 million ($34 million in 2015).

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

	2016			2015		
	Real estate investments	Private equity investments	Total	Real estate investments	Private equity investments	Total
Balance, beginning of year	2,474	234	**2,708**	2,121	87	2,208
Unrealized net gains	15	11	**26**	68	50	118
Realized net gains	6	3	**9**	28	2	30
Acquisitions and disposals	208	112	**320**	257	95	352
Balance, end of year	2,703	360	**3,063**	2,474	234	2,708

In 2016 and 2015, there was no reclassification between Level 3 and Levels 1 and 2.

OTHER PLAN ASSETS

Other plan assets as at December 31, 2016, were composed of bonds issued by Hydro-Québec for a total of $70 million ($67 million as at December 31, 2015), as well as cash amounting to $13 million ($5 million as at December 31, 2015). Bonds are classified at Level 2 in the fair value hierarchy.

PLAN COSTS

NET COST COMPONENTS RECOGNIZED FOR THE YEAR

	Pension Plan		Other plans	
	2016	2015	**2016**	2015
Current service cost	**424**	441	**45**	44
Interest on obligations	**766**	880	**48**	53
Expected return on plan assets	**(1,337)**	(1,302)	**(3)**	(3)
Amortization of net actuarial loss	**247**	291	**26**	25
Amortization of past service costs (credits)	**16**	29	**(5)**	(1)
Actuarial loss (gain) on long-term disability salary insurance plan	**–**	–	**9**	(4)
Net cost recognized for the year	**116**	339	**120**	114

Since January 1, 2016, Hydro-Québec has been using a more precise method to estimate the current service cost and interest on its employee future benefit plan obligations. These costs were previously estimated by applying an average weighted discount rate based on the interest rate curve used to measure employee future benefit obligations at the beginning of the year. Under the new method, separate discount rates based on the interest rate curve are used to reflect the various payment maturity dates of the projected benefits.

In addition, the assumption regarding the expected long-term rate of return on Pension Plan assets was revised downward for 2016.

These changes in accounting estimates have been applied prospectively. For 2016, they resulted in a decrease of $92 million in the recognized net cost of employee future benefits.

COMPONENTS OF OTHER COMPREHENSIVE INCOME FOR THE YEAR

	Pension Plan		Other plans	
	2016	2015	**2016**	2015
Actuarial loss (gain)	**636**	(408)	**14**	48
Past service costs	**–**	–	**–**	12
Amortization of net actuarial loss	**(247)**	(291)	**(26)**	(25)
Amortization of past service (costs) credits	**(16)**	(29)	**5**	1
Total decrease (increase) in Other comprehensive income	**373**	(728)	**(7)**	36
Less				
Increase (decrease) in the employee future benefit regulatory asset	**249**	(397)	**(4)**	12
Net decrease (increase) in Other comprehensive income	**124**	(331)	**(3)**	24

COMPONENTS OF ACCUMULATED OTHER COMPREHENSIVE INCOME

	Pension Plan		Other plans	
	2016	2015	**2016**	2015
Unamortized net actuarial loss	**4,499**	4,110	**409**	421
Unamortized past service costs (credits)	**43**	59	**(30)**	(35)
Aggregate of amounts recognized in Accumulated other comprehensive income	**4,542**	4,169	**379**	386
Less				
Employee future benefit regulatory asset	**2,879**	2,630	**243**	247
Net amount recognized in Accumulated other comprehensive income	**1,663**	1,539	**136**	139

For 2017, the amortization of the net actuarial loss and the past service costs (credits) in the net cost recognized for the year should amount to $222 million and $11 million, respectively, for the Pension Plan, and to $26 million and $(5) million, respectively, for the other plans.

SIGNIFICANT ACTUARIAL ASSUMPTIONS

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

	Pension Plan		Other plans	
	2016	2015	**2016**	2015
Projected benefit obligations				
Rate at end of year (%)				
Discount rate – Projected benefits	**3.83**	3.89	**3.84**	3.89
Salary escalation rate[a]	**3.14**	3.21	**–**	–
Net cost recognized				
Rate at end of prior year (%)				
Discount rate – Current service cost	**4.00**	3.98	**4.00**	3.98
Discount rate – Interest on obligations	**3.34**	3.98	**3.41**	3.98
Expected long-term rate of return on plan assets[b]	**6.50**	6.75	**3.95**	3.33
Salary escalation rate[a]	**3.21**	3.23	**–**	–
Active employees' average remaining years of service	**13**	13	**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, net of expected management and administrative fees.

As at December 31, 2016, health care costs were based on an annual growth rate of 4.00% for 2017. According to the assumption used, this rate will increase on a linear basis to reach 6.50% in 2021 and subsequently decrease to a final rate of 4.50% in 2036. A change of 1% in this annual growth rate would have had the following impact in 2016 and 2015:

	1% increase		1% decrease	
	2016	2015	**2016**	2015
Impact on current service cost and interest cost on projected benefit obligations for the year	**9**	9	**(8)**	(7)
Impact on projected benefit obligations at end of year	**99**	110	**(78)**	(85)

BENEFITS TO BE PAID IN NEXT 10 YEARS

	Pension Plan	Other plans
2017	1,000	68
2018	1,045	70
2019	1,092	72
2020	1,140	74
2021	1,188	76
2022–2026	6,660	420

In 2017, Hydro-Québec expects to make contributions of $280 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 was automatically renewed for a further 25 years in accordance with the contract provisions. 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, 2016, 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:

2017	1,717
2018	1,906
2019	1,956
2020	1,965
2021	2,094
2022 and thereafter	30,214

INVESTMENTS

As part of its development projects and activities aimed at maintaining or improving the quality of its assets, Hydro-Québec plans to invest approximately $3.5 billion in property, plant and equipment and intangible assets per year in Québec over the 2017–2021 period.

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, 2016, the amortized cost of the long-term debts concerned was $4,389 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.

In June 2009, the Innus of Uashat mak Mani-Utenam filed for an injunction with the Superior Court of Québec 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. In November 2015, the Attorney General of Québec filed a motion to have the courts declare as inadmissible the injunctions being brought by dissident claimants. The Superior Court granted this motion in its ruling of February 23, 2016. The dissident claimants appealed the decision, but their appeal was improperly initiated. Given that they did not correct the error within the stipulated six months, the ruling of February 2016 is considered final.

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 Innovation, 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 Innovation, 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 – Direction financière et contrôle, Vice-présidence – Affaires corporatives et secrétariat général, Vice-présidence – Financement, trésorerie et caisse de retraite, Vice-présidence – Ressources humaines, Vice-présidence – Technologies de l'information et des communications, Vice-présidence – Développement des affaires, acquisitions et stratégies, Direction principale – Gestion des filiales as well as three units that report to Hydro-Québec Innovation, équipement et services partagés, namely the Direction principale – Centre de services partagés, Direction principale – Approvisionnement stratégique and Direction principale – Institut de recherche d'Hydro-Québec.

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 2016, revenue from outside Québec amounted to $1,771 million, with $1,456 million originating from the United States ($1,825 million and $1,458 million, respectively, in 2015).

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

							2016
	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Intersegment eliminations and adjustments	Total
Revenue							
External customers	1,766	75	11,434	3	61	–	**13,339**
Intersegment customers	4,716	3,140	80	2,222	1,685	(11,843)	**–**
Depreciation and amortization	775	917	779	4	122	–	**2,597**
Financial expenses	1,205	839	460	–	33	(5)	**2,532**
Net income	1,870	561	342	1	87	–	**2,861**
Total assets	32,773	21,476	13,546	59	7,501	(188)	**75,167**
Investments in property, plant and equipment and intangible assets affecting cash	906	1,757	657	8	132	–	**3,460**

							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	1,665	(11,824)	–
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	559	364	–	94	–	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

Note 21 Comparative Information

Some of the prior year's data have been reclassified to conform to the presentation adopted in the current year.

Five-Year Review

CONSOLIDATED FINANCIAL INFORMATION

$M	**2016**	2015	2014	2013	2012
OPERATIONS					
Revenue	**13,339**	13,754	13,652	12,878	12,134
Expenditure					
Operations	**2,438**	2,527	2,366	2,460	2,375
Electricity and fuel purchases	**1,866**	1,938	1,968	1,568	1,183
Depreciation and amortization	**2,597**	2,713	2,593	2,483	2,405
Taxes	**1,045**	980	975	1,000	997
	7,946	8,158	7,902	7,511	6,960
Operating income	**5,393**	5,596	5,750	5,367	5,174
Financial expenses	**2,532**	2,449	2,425	2,429	2,438
Income from continuing operations	**2,861**	3,147	3,325	2,938	2,736
Income (loss) from discontinued operations[a]	**–**	–	–	4	(1,876)
Net income	**2,861**	3,147	3,325	2,942	860
DIVIDEND	**2,146**	2,360	2,535	2,207	645
BALANCE SHEET SUMMARY					
Total assets	**75,167**	75,199	73,108	73,110	70,508
Long-term debt, including current portion and perpetual debt	**45,909**	45,983	44,752	44,477	43,524
Equity	**19,704**	19,475	17,961	19,394	18,982
INVESTMENTS FOR CONTINUING OPERATIONS AFFECTING CASH					
Property, plant and equipment and intangible assets	**3,460**	3,440	3,815	4,335[b]	3,932[b]
FINANCIAL RATIOS					
Return on equity from continuing operations (%)[c]	**13.1**	14.9	16.1	14.6	14.6
Capitalization (%)[d]	**30.5**	30.1	28.9	30.5	30.6
Profit margin from continuing operations (%)[e]	**21.4**	22.9	24.4	22.8	22.5
Interest coverage[f]	**2.16**	2.20	2.23	2.09	2.02
Self-financing (%)[g]	**58.8**	82.8	56.4	68.3	55.4

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) 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 2012 to 2016, the denominator amounted to $18,729 million, $20,141 million, $20,602 million, $21,091 million and $21,842 million, respectively.

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) Income from continuing operations divided by revenue.

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

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 2016 to 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

	2016	2015	2014	2013	2012
GWh					
Electricity sales[a]					
In Québec, by segment					
Residential	**65,065**	66,558	68,074	65,983	61,956
Commercial, institutional and small industrial	**45,483**	45,335	45,189	44,620	43,775
Large industrial	**53,635**	54,200	55,738	56,855	56,875
Other	**5,062**	5,170	5,222	5,818	5,795
	169,245	171,263	174,223	173,276	168,401
Outside Québec					
Canada/U.S.	**32,744**	29,864	26,624	32,208	28,089
Total electricity sales	**201,989**	201,127	200,847	205,484	196,490
$M					
Revenue from electricity sales[a]					
In Québec, by segment					
Residential	**5,155**	5,222	5,162	4,825	4,452
Commercial, institutional and small industrial	**3,842**	3,774	3,657	3,504	3,370
Large industrial	**2,265**	2,350	2,389	2,439	2,317
Other	**311**	316	308	317	303
	11,573	11,662	11,516	11,085	10,442
Outside Québec					
Canada/U.S.	**1,626**	1,700	1,629	1,525	1,194
Total revenue from electricity sales	**13,199**	13,362	13,145	12,610	11,636
As at December 31					
Number of customer accounts					
In Québec, by segment					
Residential	**3,924,992**	3,890,956	3,857,782	3,821,012	3,777,196
Commercial, institutional and small industrial	**314,816**	319,294	317,671	316,585	314,895
Large industrial	**183**	181	183	186	188
Other	**4,550**	4,290	4,214	4,207	3,988
Total customer accounts	**4,244,541**	4,214,721	4,179,850	4,141,990	4,096,267

a) Data related to continuing operations.

OPERATING STATISTICS (CONTINUED)

	2016	2015	2014	2013	2012
MW					
Installed capacity					
Hydroelectric	**36,366**	36,370	36,100	35,364	35,125
Thermal	**542**	542	543	704	704
Total installed capacity	**36,908**[a]	36,912	36,643	36,068	35,829
GWh					
Total energy requirements[b]	**223,143**	222,172	222,045	226,576	221,004
MW					
Peak power demand in Québec[c]	**36,005**	37,349	38,743	39,031	38,797
km					
Lines (overhead and underground)					
Transmission	**34,292**[d]	34,272	34,187	33,885	33,911
Distribution	**116,794**	116,258	115,583	114,843	114,649
Total lines (overhead and underground)	**151,086**	150,530	149,770	148,728	148,560

a) 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 39 wind farms (3,508 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, 1,056 MW are available under long-term contracts with other suppliers.

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

c) The 2016 figure was valid on February 24, 2017. 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 2016–2017 winter peak was 36,005 MW and occurred on January 9, 2017, at 8:00 a.m. However, the system load momentarily reached 36,350 MW at 7:33 a.m.

d) 34,020 km of lines operated by Hydro-Québec TransÉnergie and 272 km by Hydro-Québec Distribution.

OTHER INFORMATION

	2016	2015	2014	2013	2012
%					
Average rate increase (decrease) from January 1 to December 31	**1.2**[a]	3.2[a]	3.8[a]	1.7	(0.4)
As at December 31					
Total number of employees[b]					
Permanent	**17,282**	17,475	17,793	17,861	18,926
Temporary	**2,270**	2,319	2,250	2,382	2,670
	19,552	19,794	20,043	20,243	21,596
Women (%)	**28.7**	29.0	29.4	30.0	30.6

a) Excluding Rate L.

b) Excluding employees of subsidiaries and joint ventures.

Consolidated Results by Quarter

					2016
$M	1st quarter	2nd quarter	3rd quarter	4th quarter	12-month period
Revenue	4,302	2,815	2,740	3,482	**13,339**
Expenditure					
Operations	589	593	544	712	**2,438**
Electricity and fuel purchases	562	422	402	480	**1,866**
Depreciation and amortization	625	628	633	711	**2,597**
Taxes	289	240	239	277	**1,045**
	2,065	1,883	1,818	2,180	**7,946**
Operating income	2,237	932	922	1,302	**5,393**
Financial expenses	653	626	616	637	**2,532**
Net income	1,584	306	306	665	**2,861**

					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

Board of Directors

For the Board of Directors, 2016 was a year of intense activity marked by decisions of great importance on major issues. Considerable work went into the adoption of the ***Strategic Plan 2016–2020***, as Board members played an essential role in a rethinking of the company's strategies that will guide its actions in the coming years.

Michael D. Penner
Chairman of the Board

Left to right: Laurent Ferreira, Isabelle Hudon, Suzanne Gouin, Robert Keating, Michael D. Penner, Marie-Josée Morency, Geneviève Bich, Éric Martel, Marie-Anne Tawil, Michelle Cormier, Carl Cassista, Hélène V. Gagnon, Yvon Marcoux. *Absent:* Anik Brochu, Anne-Marie Croteau, Paul Stinis.

Michael D. Penner

Chairman of the Board,
Hydro-Québec

Appointment: October 8, 2014

Term: May 14, 2018

Status: Independent director

A graduate of McGill University and Hofstra University in New York, and a member of the bar association for the State of New York, where he practised law, Michael D. Penner has sat on numerous boards and is involved in international governance-related events and organizations such as COP 21 and the Global Sustainable Electricity Partnership. He is also working with the new owners of Peds Chaussettes, a company he sold in 2016 after turning it into a world leader in the textile industry. Mr. Penner is active in a variety of social causes, in particular as co-chair of Hydro-Québec's Centraide campaign.

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 President of the Avions d'affaires and Services à la clientèle divisions. Mr. Martel has also worked for several high-profile international companies such as Pratt & Whitney, Rolls Royce, Procter & Gamble and Kraft Foods. He serves on the board of the Global Sustainable Electricity Partnership. 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 as Vice-President, Human Resources, Ms. Bich worked at Groupe Dynamite and Aimia. She sits on the board of Collège de Bois-de-Boulogne.

Anik Brochu

Director, Special Projects,
Groupe T.A.P.

Appointment: September 13, 2006

Term: July 6, 2020

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. In 2011, she joined Groupe T.A.P., where she now holds the position of Director, Special Projects. She sits on the board of the Centre de musique et de danse de Val-d'Or.

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 at 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.

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 Cascades, Industries Dorel, Uni-Sélect and Champion Iron.

Anne-Marie Croteau

Associate Dean, Professional Graduate Programs and External Relations, and Professor, Supply Chain and Business Technology Management, John Molson School of Business, Concordia University

Appointment: July 6, 2016

Term: July 6, 2020

Status: Independent director

Anne-Marie Croteau holds a Bachelor's degree in Actuarial Mathematics from Concordia University, a Bachelor of Business Administration and a Master's in Management Information Systems from HEC Montréal, and a PhD in administration from Université Laval. She joined Concordia University in 1997 and has been pursuing a two-pronged career there, in administration and in teaching business technology management. She is certified by the Collège des administrateurs de sociétés and serves on the boards of the Institute for Governance of Public and Private Organizations and the Société de l'assurance automobile du Québec.

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 Université du Québec à Montréal and a Master's in Management Science 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.

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. Ms. Gagnon has been Vice President, Public Affairs and Global Communications at CAE since 2015 and has held similar positions at Bombardier Aéronautique, Bombardier Transport and Noranda. 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: July 6, 2020

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 boards of the Bell Fund, the Foundation of Greater Montreal and Montreal Digital Spring.

Isabelle Hudon

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

Appointment: November 30, 2011

Term: July 6, 2020

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. She sits on the board of the Canada Council for the Arts and is the co-founder of L'Effet A, an initiative to promote women's professional involvement.

Robert Keating

Deputy Minister of Energy and Natural Resources

Appointment: November 9, 2016

Term: February 19, 2017[1]

Status: Non-independent director

After earning a Bachelor's degree in social science (economics), Robert Keating pursued graduate studies in economics at Université Laval. He has held numerous management positions in various Québec government departments, including those of Québec Delegate General in Tokyo and New York, and Assistant Deputy Minister for Bilateral Affairs in the Ministère des Relations internationales. Prior to his appointment as Deputy Minister of Energy and Natural Resources, Mr. Keating was a member of the board and President and CEO of La Financière agricole du Québec.

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, which has named him a *Lawyer Emeritus*. 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 and 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, then Justice Minister and Attorney General.

Marie-Josée Morency

Executive Director, Chambre de commerce et d'industrie Saguenay-Le Fjord

Appointment: July 6, 2016

Term: July 6, 2020

Status: Independent director

After completing a Bachelor's in communications at Université Laval, Marie-Josée Morency began her career in 1993 as an entrepreneur. She has been active in the business world for more than 20 years and is involved in her community as a member of several committees and boards and a supporter of various causes. She has worked in communications in the Saguenay region for Cystic Fibrosis Québec, the Association provinciale des constructeurs d'habitations du Québec and Promotion Saguenay. She has been Executive Director, Chambre de commerce et d'industrie Saguenay-Le Fjord since 2010.

Paul Stinis

Senior Vice-President and Treasurer, BCE Inc.

Appointment: April 22, 2015

Term: July 6, 2020

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 held the positions of Vice-President and Assistant Treasurer before being named Senior Vice-President and Treasurer in 2009.

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, Dundee Precious Metals and Kruger, and is on the Governance Committee of ONE DROP.

Directors' Compensation and Benefits in 2016[a,b]

	Base compensation	Meeting fees	Taxable benefits[c]
Geneviève Bich	$18,291	$17,997	$6,106
Anik Brochu	$18,291	$19,711	$135
Carl Cassista	$24,007	$23,139	$6,106
Michelle Cormier	$24,007	$20,140	$6,597
Anne-Marie Croteau	$8,653	$4,285	$112
Laurent Ferreira	$18,291	$15,426	$135
Hélène V. Gagnon	$18,291	$14,569	$135
Suzanne Gouin	$18,291	$21,425	$2,566
Isabelle Hudon	$24,007	$14,998	$135
Yvon Marcoux	$24,007	$20,521	$216
Marie-Josée Morency	$8,653	$4,285	$2,912
Michael D. Penner[d]	$66,982	$44,993	$7,572
Paul Stinis	$24,007	$16,712	$135
Marie-Anne Tawil	$18,291	$17,997	$6,106

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 and Robert Keating—receive no compensation or meeting fees as members of Hydro-Québec's Board of Directors.

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

d) 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 of our premises, where they can be enjoyed by as many people as possible. Karen Tam, *Pâté chinois/Mash-Up,* 2008, cutout paper. © Karen Tam.

Board of Directors

Chaired by Michael D. Penner, the Board of Directors met 11 times in 2016, while its committees held 43 meetings over the same period. The Board approved Hydro-Québec's *Strategic Plan 2016–2020* and closely monitored the company's growth projects in collaboration with Management. It approved numerous capital projects in power generation, transmission and distribution, including the replacement of PK circuit breakers, reinforcement of the main transmission system—and specifically of the regional grid in the Gaspésie region so that three wind farms selected under Hydro-Québec Distribution's tender call A/O 2013-01 can be brought onto the grid—as well as construction of 120/25-kV Gracefield substation and tap line. The Board also authorized capital projects to replace the data storage infrastructure and approved the formation, composition and mandate of the Special Committee on Workplace Health and Safety and a new policy on the reliability of the power system. 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 and organizational changes, in addition to the appointment of senior managers reporting to the President and Chief Executive Officer.

EXECUTIVE (A)

The Executive Committee, chaired by Michael D. Penner, did not hold any meetings in 2016.

GOVERNANCE AND ETHICS (B)

In 2016, the Governance and Ethics Committee, chaired by Michael D. Penner, met five times. It examined Hydro-Québec's *Annual Report 2015*, 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 approval of the *Strategic Plan 2016–2020*, updating of the mandates of certain Board committees, and 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. The Committee also oversaw the Board performance evaluation and provided follow-up by giving presentations on the risk management process and the management succession process. In addition, the Committee organized governance training sessions to be offered to the directors in early 2017. The Chairman of the Board met with each of the directors individually to assess their performance, in accordance with section 4.0.5 of the *Hydro-Québec Act*.

AUDIT (C)

The Audit Committee, chaired by Michelle Cormier, held six meetings in 2016. 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 and followed up on 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 conducted an evaluation of the independent auditors. 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 reviewed the management of Hydro-Québec Distribution's accounts receivable and the performance audit of Hydro-Québec conducted by the Auditor General of Québec. Moreover, it examined the company's 2017 internal audit plan and recommended its approval by the Board.

HUMAN RESOURCES (D)

In 2016, the Human Resources Committee, chaired by Carl Cassista, held 10 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 coordinated the evaluation of Hydro-Québec's President and Chief Executive Officer and monitored the management succession process. It also evaluated the extent to which the company had met its annual performance objectives. The Committee further reviewed 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. Finally, the Committee studied the 2015 report of activities of the Corporate Ombudsman and reports on the corporate policies on human resources and security.

ENVIRONMENT AND PUBLIC AFFAIRS (E)

Chaired by Isabelle Hudon, the Environment and Public Affairs Committee met five times in 2016. Among other topics, it studied the results of the President and Chief Executive Officer's annual environmental management review and the semiannual reports on environmental compliance, and recommended that the Board approve the corporate program for assessing environmental compliance. The Committee further recommended that the Board approve the granting of donations and sponsorships, and that the related corporate policy be updated. It examined the annual results with respect to the company's communication activities and related performance indicators. It also 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 Hydro-Québec's *Sustainability Report 2015* and met with the report's auditor. In addition, it monitored the company's communication plan and advertising campaign.

FINANCE (F)

The Finance Committee, chaired by Paul Stinis, held six meetings in 2016, including a joint meeting with the Human Resources Committee for the purpose of analyzing the company's Business Plan, objectives and consolidated portfolio of residual 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 wholesaling and trading activities and Hydro-Québec Distribution's procurement activities, and of credit limits for each counterparty for each of the functions concerned. It also followed up on the company's major capital projects.

PENSION PLAN FINANCIAL MANAGEMENT (G)

In 2016, the Pension Plan Financial Management Committee, chaired by Yvon Marcoux, met four 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 further recommended that the Board approve the reappointment of the actuary for the next annual valuation. In addition, the Committee studied the 2016 control plan for Hydro-Québec's pension plan and evaluated the performance and structure of the pension fund portfolio and the performance of specialized portfolio managers. It received a detailed presentation on the private equity investments and alternative investments held in the pension fund portfolio. It also reviewed the measures introduced following publication of regulations under the *Act to amend the Supplemental Pension Plans Act mainly with respect to the funding of defined benefit pension plans*. Lastly, the Committee monitored the process implemented this past year for evaluating the carbon footprint of Hydro-Québec's pension fund portfolio, as well as changes in the pension plan's financial position.

INFORMATION TECHNOLOGIES (H)

Chaired by Michael D. Penner, the Information Technologies Committee met four times in 2016. The Committee closely monitored the project launched in 2015 to overhaul IT services, as well as the performance indicators of the Vice-présidence – Technologies de l'information et des communications. The Committee recommended that the Board approve phase 2 of the program to ensure the long-term operability of analog microwave links and the project to replace the data storage infrastructure. In addition, it monitored issues related to cybersecurity and examined reports on the application of the policy on information technologies.

SPECIAL COMMITTEE ON WORKPLACE HEALTH AND SAFETY (I)

The Special Committee on Workplace Health and Safety, formed in December 2016 and co-chaired by Éric Martel and Yvon Marcoux, held three meetings. It defined the Committee's mandate in order to submit it to the Board for approval and selected the firm that will analyze the company's workplace health and safety practices.

Director attendance at meetings of the Board of Directors and Board committees in 2016

DIRECTOR	Notes	Board	A	B	C	D	E	F	G	H	I
Number of meetings		**11**		**5**	**6**	**10**	**5**	**6**	**4**	**4**	**3**
Michael D. Penner A B C D E F G H I		11		5	6	10	5	6	4	4	3
Éric Martel A E F G H I	1	11		4	5	8	5	5	2	4	3
Geneviève Bich D I		10				9					3
Anik Brochu D E I		9				8	4				3
Carl Cassista B D H		10		4		10				4	
Michelle Cormier A C F I		10			6			6			3
Anne-Marie Croteau	2	6									
Laurent Ferreira C H		10			6					3	
Hélène V. Gagnon E I		10					5				3
Suzanne Gouin A D E	3	11				9	5		1		
Isabelle Hudon B E		9		4			5				
Robert Keating	4	2									
Yvon Marcoux B F G I	5	11		4				6	4	1	3
Marie-Josée Morency	2	6									
Paul Stinis A F G		10						6	4		
Marie-Anne Tawil B C H		10		4	5					3	

Committees of the Board of Directors

A Executive
B Governance and Ethics
C Audit
D Human Resources
E Environment and Public Affairs
F Finance
G Pension Plan Financial Management
H Information Technologies
I Special Committee on Workplace Health and Safety

Notes

1. Éric Martel attends meetings of the Governance and Ethics, Audit and Human Resources committees as a guest.
2. Anne-Marie Croteau and Marie-Josée Morency were appointed effective July 6, 2016.
3. Suzanne Gouin participated as a substitute member in the meeting of the Pension Plan Financial Management Committee held on December 15, 2016.
4. Robert Keating was appointed effective November 9, 2016.
5. Yvon Marcoux participated as a substitute member in the meeting of the Information Technologies Committee held on April 14, 2016.

Governance

Hydro-Québec's Board of Directors complies with the requirements of the *Hydro-Québec Act* with regard to governance. In particular, it ensures that appropriate controls are in place and are the subject of periodic reporting.

Independence

With the exception of Éric Martel, President and Chief Executive Officer, and Robert Keating, Deputy Minister of Energy and Natural Resources, 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/board-directors.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 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. New directors also receive training providing them with a solid grasp of the basic notions of electricity, as well as tours of the system control centre and the energy trading floor.

As part of the regular Board meetings in 2016, members were given presentations on such topics as the company's integrated business risk management process, management of reservoir storage, electricity markets and Hydro-Québec's insurance portfolio. Board members also had an opportunity to attend a detailed presentation on the company's new growth avenues.

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 electricity 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. This document is available (in French only) at **www.hydroquebec.com/publications/fr/politiques-codes-ethique-conduite/**.

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, whose financial information component 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 guidelines. 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, 2016

	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 President and Chief Executive Officer, Hydro-Québec	$517,675	$119,450	$2,529	Executive vehicle	–	–	$7,609
Réal Laporte President, Hydro-Québec Innovation, équipement et services partagés President and Chief Executive Officer, Société d'énergie de la Baie James[c]	$425,000	$115,854	$822	Car allowance or provision of a vehicle, plus parking	–	$13,653	$7,964
Richard Cacchione President, Hydro-Québec Production	$411,990	$121,012	$5,000		–	$13,548	$9,240
David Murray President, Hydro-Québec Distribution	$400,000	$18,240	$3,339		$12,092	$3,640	$7,068
Marc Boucher President, Hydro-Québec TransÉnergie	$400,000	–	–		$8,908	$2,517	$3,694
	Basic Hydro-Québec Pension Plan (HQPP) - Usual contribution under the plan - Pension calculated on the basis of average salary for the best five years - Credit of 2.25% per contribution year - 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 **Supplementary Benefits Program** - Contribution assumed by Hydro-Québec - Additional benefits to offset the tax limits under the HQPP (lifting of ceiling on the permitted maximum amount) - Payment of benefits according to the same terms as those applicable under the HQPP **Other provisions applicable to the President and Chief Executive Officer of Hydro-Québec** - Pension calculated on the basis of average salary for the best three years (less pension payable under the HQPP) - Credit of 4% per contribution year (less pension credit under the HQPP) - Recognition of 100% of the maximum incentive compensation as pensionable earnings (less portion recognized for purposes of the HQPP)						

a) Incentive compensation paid in 2016. The performance threshold set by the Québec government under the *Act mainly to implement certain provisions of the Budget Speech of 4 June 2014 and return to a balanced budget in 2015–2016*, i.e., net income in accordance with U.S. GAAP of $2,750 million for the period from April 1, 2015 to March 31, 2016, was attained. Under those same provisions, Hydro-Québec was required to maintain its 2015 payroll at the 2013 level. Hydro-Québec complied with that provision. As for incentive compensation linked to 2016 targets, given the Québec government's return to a balanced budget in 2015–2016 and the subsequent termination of the provisions, it will be paid in 2017 upon attainment of the financial target set by Hydro-Québec.

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

c) 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, 2016

	Base salary as at December 31	Incentive compensation[a]	Perquisites[b]	Benefits
Sophie Paquette General Manager, Société de transmission électrique Cedars Rapids limitée	$122,256	$17,818	$2,100	Hydro-Québec pension plan and group insurance plans

a) Incentive compensation paid in 2016. The performance threshold set by the Québec government under the *Act mainly to implement certain provisions of the Budget Speech of 4 June 2014 and return to a balanced budget in 2015–2016*, i.e., net income in accordance with U.S. GAAP of $2,750 million for the period from April 1, 2015 to March 31, 2016, was attained. Under those same provisions, Hydro-Québec was required to maintain its 2015 payroll at the 2013 level. Hydro-Québec complied with that provision. As for incentive compensation linked to 2016 targets, given the Québec government's return to a balanced budget in 2015–2016 and the subsequent termination of the provisions, it will be paid in 2017 upon attainment of the financial target set by Hydro-Québec.

b) Taxable benefits related to financial and estate planning, sports clubs and monthly transit passes.

Auditors' fees and independence

KPMG LLP, Ernst & Young LLP and the Auditor General of Québec are Hydro-Québec's independent auditors for 2016. The professional fees billed by KPMG LLP and by Ernst & Young LLP in 2016 for services other than auditing and certification amounted to 4.2% of the total $5.1 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. No professional service assignment may be given to the Auditor General of Québec, since that office serves the National Assembly exclusively.

Access to documents and protection of personal information

Hydro-Québec does its utmost to maintain the confidentiality of its customers', employees' 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.

In 2016, Hydro-Québec received 413 requests for access to information, of which 154 were granted in full, 144 were granted in part and 67 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 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-eight Hydro-Québec responses were the subject of requests for review by the Commission d'accès à l'information, and none required any specific accommodation measures for persons with disabilities. The average request processing time was 20 days.

Employees were reminded of the principles involved in access to documents and protection of personal information through various communications and training sessions, as well as in connection with specific cases.

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 ethical principles reflecting Hydro-Québec's social commitment to its customers and the community. Ethical rules resulting from these principles 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/fr/politiques-codes-ethique-conduite**, has two aims: facilitate the understanding of the fundamental principles set out in the policy on management, which was approved by the Board of Directors, and help all employees fulfill their duties with integrity and loyalty, in accordance with Hydro-Québec's ethical principles.

Language guidelines

In 2016, Hydro-Québec maintained its efforts to ensure the quality of French in its internal and external communications. Various proficiency courses were offered to employees, who also have access to a vast energy-related terminology database. They are also periodically reminded of the company's language policy. An intranet site devoted to the language guidelines applicable to Hydro-Québec includes a number of tools to facilitate their day-to-day application.

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 2016*.

	Action		Indicator	Results as at December 31, 2016
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	42 MW[a]
3	Continue energy efficiency initiatives		New annual energy savings	534 GWh[a]
4	Continue efforts in the field of transportation electrification		Number of Electric Circuit charging stations in service and number of regions served	794 charging stations[a]/ 16 regions
		OVT	R&D partnership agreements	5 agreements[a]
			Number of patents held	572 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	2 measures
7	Strengthen environmentally responsible management practices		Annual GHG emissions from the light-vehicle fleet	22,852 t CO_2eq.[a]
		OVT	Number of videoconferences held annually	9,101 videoconferences[a]
			Percentage of company printers that are print-release enabled	13%[a]
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[a]
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	2%[a]
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

a) Preliminary data. The final figure will be published in the *Sustainability Report 2016*.

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*.

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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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This is a translation of the original French text.
The French version shall prevail.

Ce document est également diffusé en français.

Our Generating, Transmission and Distribution Facilities

GENERATION INSTALLED CAPACITY IN MW

HYDROELECTRIC GENERATING STATIONS — 36,366 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	1,876	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 (18 generating stations rated less than 100 MW)	771
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 — 36,908 MW

Hydroelectric (62)[a]	**36,366**
Thermal (24)[b]	**542**

a) 61 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 — 10,314 MW

Churchill Falls generating station [Churchill Falls (Labrador) Corporation Limited][a]	**5,428**
39 wind farms operated by independent power producers[b]	**3,508**
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]	**1,056**

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

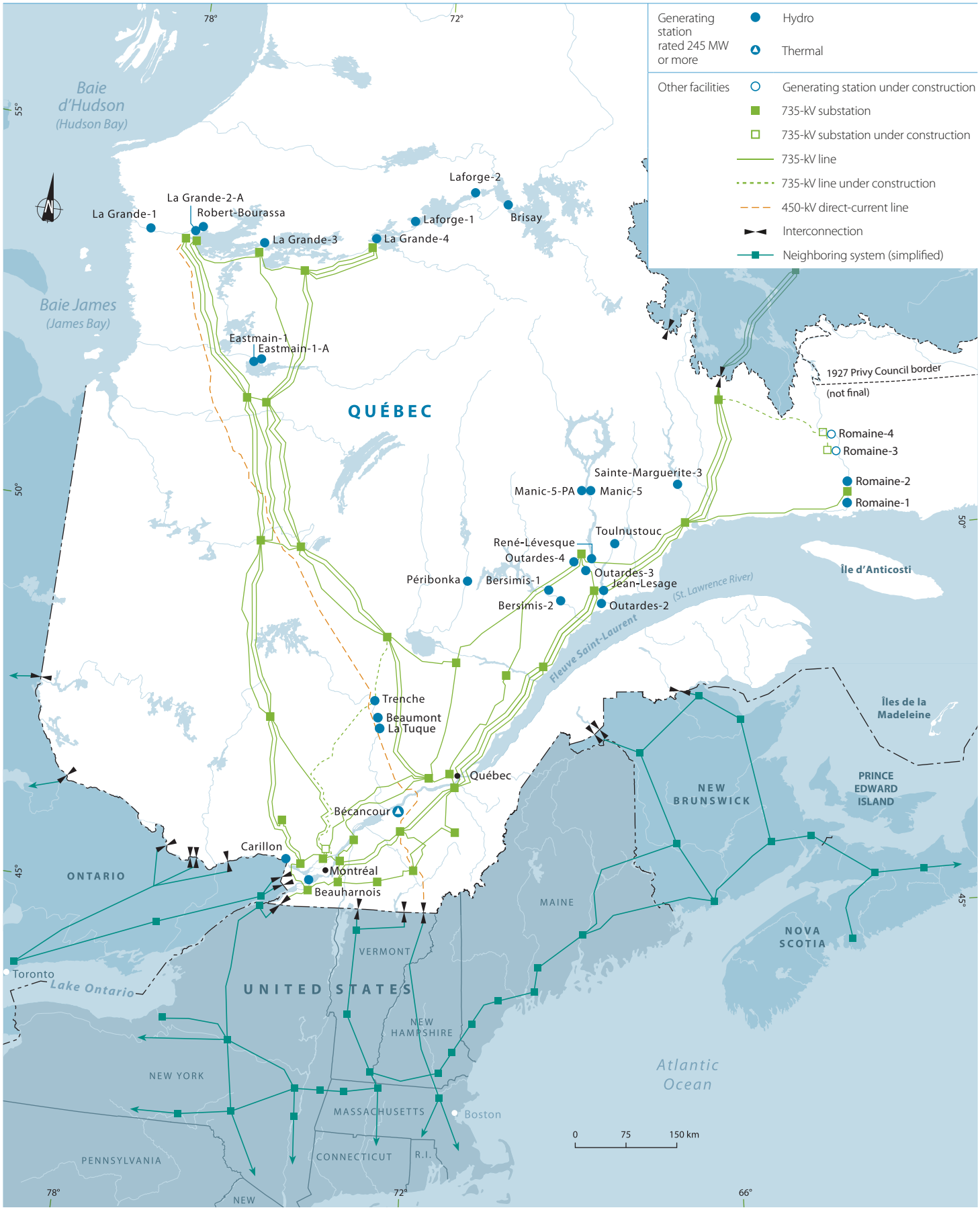
Voltage	Lines (km)	Substations (number)
765 and 735 kV	11,691[a]	40
450 kV DC	1,218	2
315 kV	5,484	77
230 kV	3,259[b]	54
161 kV	2,140	43
120 kV	6,957	219
69 kV or less	3,543[c]	101[d]
Total	**34,292**	**536**

a) Including 261 km of 735-kV lines operated at 315 kV.
b) Including 33 km of 230-kV lines operated at 120 kV.
c) 3,271 km of lines operated by Hydro-Québec TransÉnergie and 272 km by Hydro-Québec Distribution.
d) 90 substations operated by Hydro-Québec TransÉnergie and 11 by Hydro-Québec Distribution.

DISTRIBUTION

Voltage	Lines (km)
34 kV	744
25 kV	111,111
12 kV	4,674
4 kV or less	265
Total	**116,794**

Our Major Facilities



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